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The Social Responsibility of Companies

BY LORD WEDDERBURN OF CHARLTON*

[*The debate surrounding the issue of corporate responsibility to the community as a whole, as opposed to a responsibility to shareholders alone with a sole pursuit of profit-maximisation, has been ongoing throughout Britain and the United States for many years. In his speech delivered at the University of Melbourne, on 17th September, 1984, Lord Wedderburn contrasts the more conservative attitude of the judiciary in Britain where the altruism of company directors is more constrained by the doctrine of* ultra vires, *with the more liberal judicial attitudes in the United States, embodying the doctrine of 'fairness' to determine the duty of directors to shareholders and the community, and provides criticism of this approach. Lord Wedderburn also examines moves in Europe towards 'Industrial Democracy' in which corporate responsibility is exercised in favour of workers.*]

Social Responsibility and Profit Maximisation

'The social responsibility of business is to increase its profits.'[1] With those trenchant words an American Professor of Economics, who is somewhat fashionable today in certain circles in Britain, settled all the issues that fall within the compass of my title. Indeed, Professor Friedman has described any deviation from that single-minded pursuit of profit-maximisation by the admission of some other social responsibility as 'fundamentally subversive', as 'pure unadulterated socialism', something which could 'thoroughly undermine the very foundations of our free society.' Businessmen subjected to 'a social responsibility other than making maximum profits for stockholders' cannot know, he says, what interests to serve, and society would not tolerate public functions of taxation and expenditure being exercised by persons 'chosen for their posts by strictly private groups.'[2]

In similar vein, the chief ideologue behind the current drive towards deregulation, 'privatisation' and 'marketisation' in Britain has demanded that company directors remain 'trustees for the shareholders and for their benefit'; then 'their hands are largely tied', whereas, if management of a big enterprise is entitled, or worse obliged, to consider 'the public or the social interest, to support good causes and generally act for the public interest', its power becomes 'uncontrollable' in a

* Cassel Professor of Commercial Law, University of London.

[1] Milton Friedman in Steiner, G. and Steiner, J. (eds), *Issues in Business and Society* (2nd ed. 1977) 168. This is not the place to consider in detail the gloss put upon 'maximisation' of profits by some economists who, under the influence of the Berle and Means thesis (*infra* n. 14, p. 6), have elaborated theories of 'satisficing' profits: *e.g.* Marris, R., *The Economic Theory of Managerial Capitalism* (1964) and *The Corporate Economy* (1971). Nor would it alter the major arguments addressed below. For convincing criticism of the gloss, see Aaronovitch, S. and Sawyer, M., *Big Business* (1975) and Herman, E. S., *Corporate Control; Corporate Power* (1981) ch. 3, especially 111-12 nn. 104-13.

[2] Friedman, M., *Capitalism and Freedom* (1962) 133 and *An Economist's Protest* (1972) 177.

private enterprise — and that will inevitably lead to 'increasing public control' by government.[3]

But this is not exactly how even our traditional company laws see the problem. Apart from wider social obligations, they contain even technical rules based on social morality. For one thing, they restrain the controllers of companies from making profits in particular ways that might be supported on economic grounds, even if the company also profits. Our laws lean against 'insider dealing', for example, which the English legislature has at last made into a criminal offence, albeit one so defined that the Act is more likely to be 'a fertile source of examination questions' than of convictions.[4] Although adherents of the Friedman or 'purist' school insist that insider dealing is a proper method of rewarding entrepreneurial skill,[5] the company law found in common law countries, such as Australia, Britain and the United States, attempts to restrain it, largely on the basis (in so far as a basis is ever made explicit) of ethical considerations.

As Professor Loss has said of the stock market: '[If] you're going to run a casino, let's have an honest casino'; and as Professor Cary retorted to Manne: 'Do modern concepts of morality fade under the cold light of economic analysis?'[6] Or, as the now famous law student said of it: 'I don't care; it's just not right.'[7]

My aim today, then, is to inquire into the modern state of play on the question of corporate social responsibility, primarily by reference to British law and practice, partly because that is the system most familiar to me, partly because that law has exported many leading features to other common law systems in the Commonwealth and the United States, and partly because the British debate on the issue remains so undeveloped. Indeed, it is curious that in Britain, even in the post-war period when nationalisation and privatisation of companies have been tides flowing and ebbing with the changing fortunes of political parties in government, there has never been a great debate in Britain equivalent to that of the 1930's across the Atlantic.

[3] Hayek, F., *Law Legislation and Liberty* (1982) vol. iii, 82. Hayek agrees that the only proper job of government is to protect the market: Von Mises, L., *Human Action* (1949) 239.

[4] Companies Act 1980 (Eng.) Part V, so described by Gower, L. C. B., *Modern Company Law* (4th ed. 1979, *Supplement* 1981) 636-8. See, too, Rider, B., *Insider Trading* (1983); Rider, B. and Ffrench, H., *The Regulation of Insider Trading* (1979). 'As all those closely connected with the stock market know, insider dealing goes on and on a large scale. It is certainly greater than the minnows sacrificed so far': *The Times* (London), 7 January 1984. It is remarkable that the British legislature, which until 1980 persisted in using disclosure as a sanction against insider dealing, as early as 1967 made criminal the particular form of director's 'put' and 'call' options: Companies Act 1967 (Eng.) ss 25, 30.

[5] Manne, H. G., *Insider Trading and the Stock Market* (1966). See too Manne, H. G. (ed.), *Economic Policy and the Regulation of Corporate Securities* (1968) 11-16.

[6] See Loss, L. (ed.), *Multinational Approaches — Corporate Insiders* (1976) 70; and Cary, W. L., *Cases and Materials on Corporations* (5th ed. 1980) 727. On experience in the United Kingdom and United States on insider dealing laws, see Branson, D., (1982) *Journal of Business Law* 342, 413, 536; and on justifications for the American approach Scott, K., 'Insider Trading: Rule 10b-5' (1980) 9 *Journal of Legal Studies* 801; Haft, A., 'The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation' (1982) 80 *Michigan Law Review* 1051. But doubt remains among adherents to free market forces: see Herman, E. S., 'Equity Funding, Inside Information and the Regulators' (1973) 21 *U.C.L.A. Law Review* 1; Wu, H., 'An Economist Looks at Section 16, Securities Exchange Act, 1934' (1968) 68 *Columbia Law Review* 260; and the debate summarised in Loss, L., *Fundamentals of Securities Regulation* (1983) 34-8, 604-9.

[7] A healthy reaction in Loss's view: see Loss, L., 'The Fiduciary Concept as Applied to Trading by Corporate 'Insiders' in the United States' (1970) 33 *Modern Law Review* 34, 37; and on France, Tunc, A., 'The Reform of French Insider Trading Law' (1983) 4 *Company Law* 205.

Between 1931 and 1942, Professors Berle and Dodd did battle in the American law reviews on the issue: 'For Whom are Corporate Managers Trustees?'[8] This debate was greatly affected by the growing acknowledgment that the large modern corporation had brought into being controllers in management who were (as it was put) 'divorced' from the owners (the shareholders). This analysis, first offered in its modern form by Berle and Means,[9] led them to suggest that the new concentrations of corporate power in the giant corporations must now 'serve not alone the owners or the control, but all society',[10] and led Berle later to concede that Dodd's argument was the better, that management powers were now held in trust for the entire community.[11] In its simplistic form, the 'divorce' between ownership and control in corporations has not stood the test of further research.[12] But the substance of the debate remains with us.

Indeed, modern management frequently declares itself a trustee for employees, consumers and stockholders and may even affirm 'a social responsibility to a wide variety of societal segments which have a stake in the continued health of [the] corporation.'[13]

When this same debate resurfaced, however, in America after the war in 1959, it was noticeable that the British contribution was invariably on the issue of social responsibility injected through public or co-operative *ownership*, while the American authors (for whom this was not a major issue in the absence of any serious socialist political or union movement) returned to the question that vexed Dodd and Berle, some arguing for a clear acceptance of profit maximization, others that 'shareholder democracy' should be replaced by new institutional arrangements accommodating various social interests, including employees.[14]

Shareholder Control and The Company's Interests

It is particularly odd that parallel discussion on corporate responsibility in Britain has been sparse. Modern commerce, industry and services are largely conducted

[8] Berle, A., 'Corporate Powers as Powers in Trust' (1931) 44 *Harvard Law Review* 1049, and 'For Whom *are* Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1365; Dodd, E. M., 'For Whom *are* Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145, and 'Is Effective Enforcement of the Fiduciary Duties of Corporate Trustees Practicable?' (1934) 2 *University of Chicago Law Review* 194. See Weiner, J., 'The Berle-Dodd Dialogue on the Concept of the Corporation' (1964) 64 *Columbia Law Review* 1458.

[9] Berle, A., and Means, G., *The Modern Corporation and Private Property* (2nd ed. 1967), especially ch. V.

[10] *Ibid.* 312. See too Dodd, E. M., 'For Whom *are* Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145, 1148: 'a social service as well as a profit-making function.'

[11] Berle, A., *The 20th Century Capitalist Revolution* (1955).

[12] See the important study by Herman, E. S., *Corporate Control, Corporate Power* (1981), which illustrates that effective 'control' and 'ownership' are not easily divided in today's large corporations. See too Nyman, R. and Silberman, A., 'The Ownership and Control of Industry' (1978) *Oxford Economic Papers*; and Aaronovitch, S. and Smith, R., *The Political Economy of British Capitalism* (1981) 239-50. For an earlier, pungent critique of Berle's theses, see Beed, C. S., 'The Separation of Ownership from Control' (1966) 1 *Journal of Economic Studies* 29.

[13] See this somewhat verbose formulation in Tenth Article of the Certificate of Incorporation of Control Data Corporation, adopted in 1978 (but as part of an effort to fend off tender offers): see Cary, W. L., *Cases and Materials on Corporations* (5th ed. 1980) 221.

[14] Mason, E. (ed.), *The Corporation in Modern Society* (1959) respectively Crosland, A., ch. 13 (Britain); Rostow, E., ch. 3(profit maximization); and Chayes, A., ch. 2 (replacement of shareholder democracy). See *infra* nn. 27 *et seq.*, p. 8.

through legal instruments which provide the most extensive legal privilege ever known to our societies. I refer, of course, to incorporation with limited liability. The availability of this status by mere registration at a companies' registry was still regarded as shocking in England little more than 100 years ago, though our civil law neighbours had long made use of the *societé en commandite*.[15] A gentleman in an English partnership was fully liable for its debts. Lord Mounteagle of Brandon predicted that limited liability would encourage 'excessive and reckless enterprise and open the door to dishonesty and fraud'; the *Law Times* said in 1858 that this legislative 'Rogues' Charter' had already given rise weekly to 'some new rascality, perpetrated under the protection of a law which sets at defiance every rule of right and every principle of morality';[16] and the Manchester Chamber of Commerce declared the law 'subversive of that high moral responsibility which has hitherto distinguished our Partnership Laws.'[17]

Today such sentiments may seem antique and absurd; incorporation with limited liability is a crucial element in the process of investment and production. But are they more absurd than the legal weapons with which English judges must wrestle with the social issues presented by transnational entities clothed in layers of corporate veils? Recently the Court of Appeal faced three giant multinational oil companies (based in the United States, France and Japan) in a joint venture, sole shareholders of two companies, one registered in Liberia for tax reasons, the other in England as a service company.[18] The giants wound up the Liberian company after its directors had carried out their precepts. The liquidation ruined its creditors to the alleged tune of £113 million. The three oil companies made no offer to discharge the liabilities. The liquidator sued the service company, its own directors, and the giant shareholders for alleged negligence, in an attempt to 'get at' the oil companies. Only if there was a cause of action, though, against the directors and giant shareholders (all of whom were out of the jurisdiction) could they be added to the action. No such cause of action, the majority decided, could exist here. Each corporation was a separate entity on the principle of *Salomon v. Salomon Co. Ltd.*[19] The three giants were shareholders not responsible beyond their limited liability (only $1 million out of $25 million capital of the Liberian company had been paid in cash). The plaintiff Liberian corporation could act 'like a fool' if it chose, within the general law; and 'it was for the shareholders to decide whether the plaintiff should act foolishly.'[20] The directors could not be liable for negligence when their actions were required or approved by all the shareholders. Such approval did not raise the question (as the dissenting judgment found) of shareholders' ability to deprive a company of its cause of action against the directors, for no such cause of action had ever crystallised. The shareholders'

[15] Cooke, C., *Corporation, Trust and Company* (1950) 44-7; Levy, A., *Private Corporations and Their Control* (1950) ch. 1.
[16] See respectively *The Law Times* (London), 21 June 1856 and 25 March 1858.
[17] See Cooke, *op. cit.* 156.
[18] *Multinational Gas and Petrochemical Co. v. Multinational Gas and Petrochemical Services Ltd* [1983] 3 W.L.R. 492.
[19] [1897] A.C. 22.
[20] *Per* Lawton L.J. [1983] 3 W.L.R. 501.

unanimous decisions were the decisions of the company; it was their company and their acts were *its* acts.[20A]

The *Salomon* decision was indeed of 'vital importance' to our company law;[21] but whether or not one shares the view that it was a 'calamitous decision',[22] it would surely have surprised the Law Lords in 1897 (and certainly have shocked the *Law Times* in 1858) to learn that the principles laid down to govern the modest boot business of Aaron Salomon, his wife, their five sons and one daughter, were to be applied without modification to the joint venture companies formed by three giant, transnational, oil corporations and to their right to refuse to pay for the massive losses caused to creditors by their direct instructions as shareholders to the Liberian company's directors. Dr. Hadden has recently illustrated the urgent need to reconsider the English principles governing parent and subsidiary companies.[23] But as our law stands: 'How can poor old *Salomon* be expected to cope with *Multinational Gas*?'[24]

British Company Law

The paradox of British company law — some would say its strength — in the last decade has been its essentially unchanging character despite a mass of new legislation.[25] Even when a universally respected adviser reports that, if proposals to legislate on investor protection are not urgently implemented, 'further serious scandals undermining public and international confidence are in my view inevitable',[26] and at a time when the structures of the City of London are undergoing volcanic changes through the internationalisation of its capital market, when the broker-jobber system is giving rise to financial 'hyper-markets', conglomerate 'boutiques' and to banking-securities mergers, giving rise 'to potential conflicts of interest on a much bigger scale than have been present in the past',[27] the response of government has been to promise a White Paper this year and to 'hope' to

[20A] But where directors and shareholders who completely control the company appropriate its assets 'dishonestly', they are guilty of theft, because there is no consent by the company to the taking: *Re Attorney-General's Reference* (No. 2, 1982) [1984] 2 All E.R. 216.

[21] Afterman, A., and Baxt, R., *Cases and Materials on Corporations and Associations* (3rd ed. 1980) 142.

[22] Kahn-Freund, O., 'Some Reflections on Company Law Reform' (1944) 7 *Modern Law Review* 54. On the debts of companies in groups, see the *Cork Report on Insolvency Law and Practice* (1982) Cmnd 8558, paras 1939-52; Schmitthoff, C., 'Should precedents be binding?' (1982) *Journal of Business Law* 290; Wooldridge, F., *Groups of Companies; Law and Practice in Britain, France and Germany* (1981).

[23] See his pioneering study, Hadden, T., *The Control of Corporate Groups* (1983) and his *Company Law and Capitalism* (2nd ed. 1977) chs 4 and 9.

[24] Wedderburn, K. W., 'Multinationals and the Antiquities of Company Law' (1984) 47 *Modern Law Review* 87, 92.

[25] Notably the Companies Acts (Eng.) 1976, 1980 and 1981, comprising 254 sections and 11 Schedules.

[26] Gower, L. C. B., *Review of Investor Protection* (1984) Cmnd 9125 para. 12.02.

[27] *Financial Times* London, 16 July and 29 May 1984, and see 15 August 1984, on the merger of Warburg, merchant bank, with jobbers Ackroyd and Smithers, stockbrokers Rowe and Pitman, and gilt specialists, Mullens, bringing a conglomerate worth more than £350 million under the control of Warburg's parent Mercury Securities. On link-ups between such institutions involving 'hundreds of millions of pounds' and conflicts created in this 'revolution', see *Financial Times* (London) 16 and 19 May and 4 June 1984. But the British institutions face international, especially American, groups which dispose of much larger capital: *Financial Times* (London), 6 June 1984 where it is stated that the Bank of England found in one recent City merger 'no fewer than 13 potential conflicts of interest.'

introduce legislation by 1986, but legislation firmly based upon 'self-regulation' in the City.[28] We are even now to have no Securities or Companies Commission.

The truth is that the absence of any profound reconsideration of the structure and responsibilities of companies and their controllers has made fundamental issues as alien to conventional debate as they were two decades ago, even though the same period has seen a 'huge growth' in commercial fraud.[29] Indeed, it is at the end of this same period that we find demands being made for relaxation of traditional controls, even for a restriction of the basic mechanisms and levels of disclosure by companies — which has been from 1844 the main price of incorporation — on the ground of 'cost-effectiveness' — *i.e.* 'the cost to commerce as a whole.'[30] Social cost is increasingly elbowed out by the accountant's bottom line; and it remains unfashionable to ask:

> What are the modern . . . conditions on which private capital in a mixed economy can be allowed the privilege of incorporation with limited liability?[31]

Yet that is surely still the crucial question for our company law.

The legal practitioner operates a system of company principles still firmly fixed in shareholder-democracy. The shares owned by the incorporators or 'members' (a status legally defined by the ancient semantics of partnership to which the debenture holder, however important he may be to the corporate well-being, can never aspire) are rights of property which can be used by the owners (at least in general, as against class, meetings) in their own interests, even to the extent of validating breaches of duty to the company committted by them in other capacities — and to do so by ordinary majority.[32] Their proprietary rights permit them to do acts as shareholders which if done by them as directors would be a contempt of court.[33] Directors may owe an over-riding fiduciary duty to act *bona fide* in what they consider is 'in the interests of the company and not for any collateral purpose';[34] but the company's interests are still measured primarily by the judiciary, not in terms of different constituencies of persons, but as represented by the interests 'of

[28] Tebbit, N., Secretary of State for Trade and Industry, England, *Parliamentary Debates*, House of Commons, 16 July 1984, 49; *The Times* (London), 17 July 1984. The Stock Exchange issued its own 'White Paper' on the new system of share trading on 19 July 1984.

[29] Levi, M., 'The Incidence and Control of Commercial Credit Fraud' (1980) 1 *Company Law* 219 (especially on long-firm fraud); more generally, see Hadden, T., 'Fraud in the City: Enforcing the Rules.' (1980) 1 *Company Law* 9; and on 'self-regulation' see Hurst, T., 'Self-Regulation Versus Legal Regulation' (1984) 5 *Company Law* 161. At p. 170: 'some movement towards a greater degree of legal regulation' is inevitable in view of the internationalization of the City and the changes by which it takes on 'more and more the characteristics of Wall Street.'

[30] Sealy, L., 'The "Disclosure" Philosophy and Company Law Reform' (1981) 2 *Company Law* 51; and his more general study 'A Company Law for Tomorrow's World' (1981) 2 *Company Law* 195.

[31] Wedderburn, K. W., *Company Law Reform* (1965) 19.

[32] *Pender v. Lushington* (1877) 6 Ch. D. 70; *North-west Transportation v. Beatty* (1887) 12 A.C. 589; *Grant v. U.K. Switchback Rlwy* (1888) 40 Ch. D. 135; *Bamford v. Bamford* [1970] Ch. 212. Despite efforts to amend them, these principles remain: see *Prudential Assurance Ltd v. Newman Industries Ltd* (No. 2) [1980] 2 All E.R. 841; [1982] Ch. 204; Wedderburn, K. W., 'Derivative Actions and Foss v. Harbottle' (1981) 44 *Modern Law Review* 202; Davies, P., (1980) *Journal of Business Law* 415. Gregory, R., 'What *is* the Rule in Foss v. Harbottle?' (1982) 45 *Modern Law Review* 584; Sealy L., (1982) 41 *Cambridge Law Journal* 247; Boyle, A., 'The Prudential, the Court of Appeal and Foss v. Harbottle' (1981) 2 *The Company Lawyer* 264.

[33] *Northern Counties Securities v. Jackson and Steeple Ltd* [1974] 1 W.L.R. 1133.

[34] *Per* Lord Greene M.R. *Re Smith and Fawcett Ltd* [1942] Ch. 304, 306.

present and future members of the company', balancing 'a long term view against short term interests of the present members.'[35]

This is the legal structure of profit maximization; and the same philosophy seems still to be alive in Australia:

> The shareholders are not trustees for one another and, unlike directors, they occupy no fiduciary position and are under no fiduciary duties. They vote in respect of their shares which are property . . . to be enjoyed and exercised for the owner's personal advantage . . . The 'company as a whole' is a corporate entity consisting of all the shareholders.[36]

Once it is acknowledged that the proprietorship of the shareholders is linked to the concept of profit maximisation — and through it to such traditional company law concepts as maintenance of capital — there is nothing illogical, as some have thought, in permitting directors of a subsidiary company normally to consider that company's interests by reference to the group as a whole,[37] for it is the modern rule rather than the exception that shareholders now depend on the success of the group as a whole to further their own interests.

Recent legislative provisions have made it clear that the Westminster Parliament sees the need to intervene specifically if shareholders are to be barred from voting in their own interests.[38] On the other hand, in 1948 it specifically underpinned the shareholder-democracy model by enacting that a majority of members have the power to remove any or all of the directors.[39] When Lord Diplock hinted that the 'interests of the company' could sometimes include interests of the creditors, it was a rather daring innovation.[40] But if directors consider interests of others (employees, for example), no matter how important they are to the life of the company, in priority to those of shareholders, they act wrongfully.[41] Our Parliament required them in 1980 to have regard now to 'the interests of the company's employees in general as well as the interests of its members'; but when it expressly permitted them to donate funds to employees, or former employees of the company or its subsidiary, 'on the cessation or transfer of the undertaking', it found it necessary to declare: '(2) The power conferred . . . to make any such provision may be exercised notwithstanding that its exercise is not in the best interests of the company.'[42]

[35] E. Milner Holland, *Report of Investigation into Savoy Hotel Ltd* (1954) 16; long accepted as an authoritative statement, see Gower, L. C. B., *Modern Company Law* (4th ed. 1979, *Supplement* 1981) 577-8 and 'Corporate Control: The Battle for the Berkeley' (1955) 68 *Harvard Law Review* 1176.

[36] *Per* Dixon J. *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457, 504, 512. For a rare suggestion of a different approach to the corporate 'interests' see Oliver J. in *Re Halt Garage Ltd* [1982] 3 All E.R. 1016, 1035.

[37] *Charterbridge Corporation Ltd v. Lloyd's Bank Ltd* [1970] Ch. 62, 74. Directors must not, of course, consider the interests of other companies in the group ahead of the interests of their own company: *Walker v. Wimborne* (1976) 137 C.L.R. 1.

[38] See Companies Act 1981 (Eng.) ss 47(9), 55(7). (Member barred from voting for resolution for purchase of his shares by company, or for payment out of capital in private company. But he may vote his other shares, not being purchased, on a poll.)

[39] Companies Act 1948 (Eng.) s. 184.

[40] *Lonrho Ltd v. Shell Ltd* [1980] 1 W.L.R. 627, 634. See Boyle, A. and Birds, J., *Company Law* (1983) 575, who restrict consideration of creditors' interests to insolvency situations, citing *Walker v. Wimborne* (1976) 137 C.L.R. 1.

[41] *Parke v. Daily News* [1962] Ch. 927.

[42] Respectively in Companies Act 1980 (Eng.) s. 46(1), ss 74(1)(2). Section 46(2) insists that the directors' duty is still owed to the company alone, in an apparent effort to exclude derivative actions by an employee-shareholder. Section 74 deems the company to have capacity to make payments, thereby

That is to say — not in the interests of the shareholders on a long term view; or not in the interests of profit maximisation.[43] To make this clear, the legislature felt obliged to require the approval of the shareholders in general meeting (or through such other machinery as is provided in their company's constitution) and to specify that payments may be made only out of profits available for dividend.[44] The payments are still 'a matter of shareholder discretion and not employee entitlement.'[45]

The Businessman and Responsibility

The businessman would say, however, that this is a rather academic view. First, the directors of large companies know as well as company law committees of inquiry 'the illusory nature of the control theoretically exercised by shareholders over directors', accentuated as it is by 'the dispersion of capital' among small shareholders and, more important the recent growth of investment and unit trusts, and other institutional shareholding.[46] Institutional shareholding has increased more rapidly in Britain than elsewhere, certainly in the United States. Private investors owned 59 per cent of shares in major listed companies in 1963, but only 37 per cent in 1975; and by 1980 institutional shareholding accounted for over half the total, and is still rising.[47] So too, the rate of capital concentration in Britain has been phenomenally high.[48] These developments have left the controllers of large companies with massive economic and social power, which has become integrated into a transnational economic order. In Britain, the institutional shareholders have not, until relatively recently at least, played an active role in determining policies of boards of directors, but the declining private investor has long had inadequate power effectively to challenge the board in all but the small company.[49]

side-stepping problems of *ultra vires*. See the problem discussed in the context of take-overs, Lofthouse, S., 'Competition Policies as Take-Over Defences' (1984) *Journal of Business Law* 320, 323-9.

[43] *Cf.* Prentice, D., *Companies Act 1980* (1980) ch. 17. Birds concluded that s. 46 is 'window-dressing': 'Making Directors do their Duties' (1980) 1 *The Company Lawyer* 67, 73. Compare the less credible prediction of Pennington that the section is likely in practice to 'figure mainly as a device for them to justify decisions which are not calculated to benefit members of the company': Pennington, R., *The Companies Acts 1980 and 1981: A Practitioners' Manual* (1983) 242. But he agrees (at p. 243) that s. 74(2) means that directors are there permitted to act otherwise than in the best interests of the *members* as a whole.

[44] Companies Act 1980 (Eng.) s. 74(3)(6)(a). As to payment in a winding up, see s. 74(6)(b).

[45] Prentice, D., 'A Company and Its Employees' (1981) 10 *Industrial Law Journal* 1, 9. The payments are separate from the sums a company has, since the Redundancy Payments Act 1965 (Eng.), been legally obliged to pay to employees dismissed by reason of 'redundancy' (now Employment Protection (Consolidation) Act 1978 (Eng.) ss 81-120.)

[46] See *'Cohen' Committee Report on Company Law Amendment* (1945) Cmnd 6659, paras 7, 124; *'Jenkins' Committee Report on Company Law*, (1962) Cmnd 1749, para. 105.

[47] England Central Statistical Office, *Studies in Official Statistics No. 34* (1979); Johnson, A., *The City Take-Over Code* (1980) 120; *'Wilson' Report on Financial Institutions* (1980) Cmnd 7937, para. 250 ff. and Appendix 3, paras 3.327 ff.; *'Diamond' Commission Report on Distribution of Income and Wealth No. 2* (1975) Cmnd 6172, ch. 2. The Stock Exchange gave the figure for 'individual' share ownership as 35 *per cent* in 1983: *Stock Exchange Year-Book* (1983-84) 924. See too the figures quoted by Farrar, J. and Russell, M., 'The Impact of Institutional Investment on Company Law' (1984) 5 *The Company Lawyer* 107.

[48] Hart, P. and Clarke, R., *Concentration in British Industry 1933-1975 (1980);* Hannah, L. and Kay, J., *Concentration in Modern Industry* (1977); Aaronovitch, S. and Smith, R., *op. cit.* 265-74.

[49] See Midgley, K., *Companies and Their Shareholders* (1975); Pickering, M., 'Shareholders Voting Rights and Company Control' (1965) 81 *Law Quarterly Review* 248; Afterman, A., *Company*

It is not surprising that directors have long seen themselves as owing duties not exclusively to their shareholders. In 1960, the editor of the *Investor's Chronicle* (no radical journal) described three 'co-equal interests' which he saw must be served: shareholders, employees and customers.[50] In the middle of the last War, a group of 120 businessmen issued a statement affirming a 'three-fold public responsibility' for 'Industry':— to consumers, employees and investors; and then overall 'to the well-being of the nation as a whole.'[51] Today, the General Principles of the City Code on Take-overs and Mergers tell directors that there are 'limitations' on their exercise of the duty to act in the interest of shareholders; and even that:

> It is the shareholders' interests taken as a whole, *together with* those of employees and creditors, which should be considered.[52]

But if corporate responsibility is defined by reference to these wider constituencies, and even more widely to the community at large, what is the place of profit maximisation? The only major attempt by British business to state its position was made in 1973 by the Confederation of British Industry.[53] It recognised responsibilities of the company, to members, creditors, customers, employees *and* to 'society at large.' This gave rise to the famous formula:

> A company should behave like a good citizen in business.

The law defines many, but not all, obligations, it said; a good citizen must also take on obligations based upon 'an informed and ethical judgment.'

This standard was used in 'Codes of Business Practice' adopted by several large companies;[54] one in four had such a code in 1983.[55] But the Confederation of Business Industry was equally adamant that the 'profit motive' remained the mainspring of the system. Profit 'should be regarded as the principal yardstick by

Direction & Controllers, their duties to the company & the shareholders (1970) ch.1, section B; Rubner, A., *The Ensnared Shareholder* (1965). On the modifications of the concepts of 'ownership' and 'control' in face of institutional shareholding: King, M., *Public Policy and The Corporation* (1977), whose conclusions accord well with Herman, E. S., *Corporate Control, Corporate Power* (1981). The National Association of Pension Funds chairman has recently said that 'if the institutions get too involved in the detail' of company management 'difficult points' arise; and, although institutional investors take a closer interest if profits tumble, it remains 'rare' for them to use their muscle: *Financial Times* (London), 3 July 1984.

[50] Wincott, H., *Minutes of Evidence to 'Jenkins' Company Law Committee* (Day 1, September 23, 1960) 9; a company forgetting this 'will be failing in its duty'.

[51] *A National Policy for Industry* (1942), in that order.

[52] Council for the Securities Industry, *City Code on Takeover and Mergers* (1981) General Principle 11; emphasis supplied.

[53] Confederation of British Industry, *The Responsibilities of the British Public Company*, (1973), 7, 23.

[54] For example the Turner and Newall Ltd Code, 1974. On the corporation as a 'good citizen' see Mundheim, B., 'A Comment on the Social Responsibilities of Life Insurance Companies as Investors' (1975) 61 *Virginia Law Review* 1247, 1260 where he tries to set guidelines for the definition of profit-maximising activities (relatively direct for the benefit of the corporation) and for the limits of expenditure which does not advance the business. See too Kripke, H., 'The SEC, Corporate Governance and the Real Issues' (1981) 36 *Business Law* 173, 184-5; and Brudney, V., 'The Independent Director-Heavenly City or Potemkin Village' (1982) 95 *Harvard Law Review* 597, 639-56.

[55] International Management, *Survey on Ethics and Business* (1983) (as quoted in *Observer* (London), 13 March 1983). For an early statement by a businessman, see Goyder, G., *The Responsible Company* (1961); see also Fogarty, M., *Company and Corporation — One Law?* (1965) Ch.6 and his *Company Responsibility and Participation — A New Agenda* (1975).

which to judge the success or failure of a company.' Shareholders are 'the owners of the business', but they must exercise their responsibility 'more fully' and cannot disown the company's responsibilities to the community.

This valiant attempt to enjoy one's cake but not eat it (or, at least, not eat it all) neither solves the problem nor does it bring business practice into any clearer relationship to the law. In one sense, it represents the partial incorporation by British business of Berle's later belief that the modern corporation would develop a 'conscience' to guide its response to public opinion through its controlling managers.[56] 'The modern corporation is a soulful corporation.'[57] But there is considerable evidence to suggest that management of the big enterprise responds more frequently by trying to *alter* public opinion rather than to follow it.[58] Moreover, any system of company *law* constructed on such a basis would leave the directors effectively free from control, at any rate unless they were both crooked and careless, deprived of the guideline of profit for shareholders, but given an 'ambiguous amalgam' for their 'trusteeship', without 'any logical framework to guide and legitimate management.'[59] The maxim 'Be a good citizen in business' is little more use as a guide to action than the concept: 'What is good for the country is good for General Motors'; or *vice versa*. Management of even moderate intelligence can use it to do most of what it wishes to do.

Even so, corporate 'altruism' is widely recognised as part of modern life — an indispensable part for many universities. It cannot be denied that the determination of U.S. Steel to clean up Pittsburgh, or Shell's policy to 'Protect the Countryside', have bestowed advantage on the community. Moreover, even though they have not met with great success, radical social action campaigns conducted through proxy circulars (in the attempt to stop Dow Chemicals in America, for instance, producing napalm) or for 'ethical investment' (including campaigns on 'Infant Formula' milk, Third World markets, or South African investment) all testify to the widespread belief that the corporate soul can be captured by justice and conscience.[60]

That companies *do* intervene in social affairs is indisputable. In Britain, in the 1950's industrial companies re-equipped the scientific laboratories of the 'public' (*i.e.* private) schools to the tune of some £3 million to stave off competition from State (*i.e.* public) schools; and companies have regularly made donations to funds

[56] Berle, A., *The Twentieth Century Capitalist Revolution* (1955); *Power Without Property* (1959); and see his *Power* (1969). In *The Modern Corporation and Private Property* (1932) 356, Berle and Means spoke of a 'neutral technocracy' operating according to 'public policy rather than private cupidity'.

[57] Kaysen, C., 'The Social Significance of the Modern Corporation' (1957) *American Economic Review* 314. See too Hamilton, W., *The Politics of Industry* (1957) 138, 166 on the business 'conscience' that would serve all interests through the best available 'series of compromises.'

[58] See the crisp response to Berle by Herman, E. S., *Corporate Control, Corporate Power* (1981) 258-60, and *infra* n. 82, p. 17.

[59] Respectively Rostow, *op. cit.* 71; Vagts, D., 'Reforming the Modern Corporation: Perspectives from the German' (1966) 80 *Harvard Law Review* 23, 48. So too, the discussion and sources in the invaluable article by Brudney, *op. cit.* 640-4.

[60] See on these developments Herman, E. S., *Corporate Control, Corporate Power* (1981) 260-277; McKie, J. (ed.), *Social Responsibility and the Business Predicament* (1974) 54-63. On the Dow Campaign see *Medical Committee for Human Rights v. SEC* 432 F. 2d. 659 (1970); 401 U.S. 973 (1970); and 404 U.S. 403 (1972).

concerned with education, research, social welfare and public amenities.[61] Corporate giving, though, is smaller than in the United States. Spending on community projects there accounts regularly for more than 2.0 *per cent* of pre-tax profits, whereas the latest figures for Britain show that (in an estimated total of £132.5 million) only two companies currently give more than 1.0 *per cent* of such profits; only 39 of the top 1,000 give more than £200,000 annually, and most corporate-giving remains 'random', 'haphazard', even an 'afterthought.'[61A] There is evidence that, through such organisations as 'Business in the Community' and 'Action Resource Centre', corporate support is, at this time of massive unemployment, switching, in the words of one oil executive, 'from church bells to job creation.'[62] Corporate largesse is an important American institution,[63] though it is necessary to look more at the practice than at generous statements by top management, because such policies are not always translatable into action in the face of profit-oriented elements in a firm's own control system.[64]

Where, then, does such philanthropy fit in to the theories of the pundits? And what does a company law system based upon profit-maximisation have to say about it?

Political-Economic Theory

Writers of various persuasions have shown a remarkable ability to accommodate corporate philanthropy into their systems. Even supporters of the 'purist' Friedman school do so largely by denying that the businessmen know what they are doing, or do what they profess to be doing. Corporate social activities are 'engaged in for good business reasons and merely claimed as corporate altruism.'

> The social forces that create personal incentives to use discretionary funds for public purposes are often the same as those forces that create real business costs in the form of unfavourable publicity.[65]

'Social' expenditure, on pollution or minority groups, it is said, becomes 'necessary' for corporations, making them less vulnerable to the incursions of 'ethical investors.'[66] Others, more ready to put aside the profit motive, nevertheless insist that community or philanthropic service will 'produce long-term benefit

[61] See Shenfield, B., *Company Boards* (1971) ch. 4; and *Company Giving* (1969). On the fund for public schools: Labour Party, *Industry and Society* (1957) 52.

[61A] Directory of Social Change, *A Guide to Company Giving* (1984) 1-2, 4-5: this total includes donations, sponsorship, advertising (to help charities), joint promotions and secondments of staff; but not 'gifts in kind' ('very substantial') or separate trusts. The tax treatment (at pp. 7-10) is less favourable than in America. The oil companies have a poor record: (at p. 5).

[62] *Financial Times* (London), 9 August 1984: 'Industry and commerce increasingly operate by consent of the community . . . We are interdependent and must contribute to the quality of life'.

[63] See Herman, E. S., *Corporate Control, Corporate Power* (1981) 256-7; Blumberg, P., 'Corporate Responsibility and the Social Crisis' (1970) 50 *Boston University Law Review* 155.

[64] Rumelt, R., *Strategy, Structure and Economic Performance* (1974) 158. See too Ackerman, R. and Bauer, R., *Corporate Social Responsiveness, The Modern Dilemma* (1976); Ashen, M. (ed.), *Managing The Socially Responsible Corporation* (1974).

[65] Manne, H., 'The Limits and Rationale of Corporate Altruism' (1973) 59 *Virginia Law Review* 708, 722.

[66] Manne, H. and Wallich, H., *The Modern Corporation and Social Responsibility* (1972) 4-6, 37-40, 71-4, where similar conclusions are reached from different viewpoints. See too Simon, J., Powers, C. and Gunnerman, J., *The Ethical Investor* (1971); and *Natural Resources Defense Council Inc. v. SEC* 389 F. Supp. 689, 700 (1974).

for the firm and its stockholders.'[67] Even radical economists sometimes commend the 'highmindedness' and 'patriotism' of a manager who seeks a good name for his company, even if it smacks of hypocrisy: 'hypocrisy — the homage which vice pays to virtue — is much to be preferred to cynicism.'[68]

These last sometimes derive sustenance from unlikely sources. Frequently, for example, one finds reference to Marx's thesis that, in later development of capital, 'a conventional degree of prodigality . . . becomes a business necessity';[69] and these so-called 'expenses of representation' are used to accommodate both 'conspicuous waste' and 'philanthropy.'[70] From a very different point of view, corporate altruism is found to be 'essential' for a capitalist system with diversified investment.[71]

These different rationalisations, however, fudge the issue. This 'social' expenditure so explained becomes no more than 'seed corn', sown in the surrounding ground with a long-term view of profit, scattered because: 'The best place to do business is in a happy, healthy community.'[72] Whereas any European worker to whom such programmes provide a job today will be gratefully uninterested in the ideology behind it, these various statements do no more than describe the process of social activity as *part* of (or even essential to) corporate profit maximisation, not distinct from it. There is little for Milton Friedman to object to in that — if it is really true. It amounts to little more than a tactical judgment as to the way to conduct business for profit in modern society.[73]

But, in truth, those who accept the profit-imperative find, when they examine the detail, that they can give their support only to a much narrower range of community activity for corporations, limited mainly to voluntary disclosures and forbearances for which the corporation can detect a clear 'signal' from the current social consensus.[74] The scale of corporate social activity, while it may not wholly contradict the corporate quest for profit, does appear to be inadequately explained *in toto* simply as an indirect quest for advantage. We find that

> all — except the most devout free market economists — embrace the notion of *some* social responsibility in the sense of incurring uncompensable costs for socially desirable but not legally mandated, action.[75]

This fact has led to strange partnerships among different philosophies on political economy. The 'managerialists' have, as we have seen, often relied upon

[67] McKie, J. (ed.), *op. cit.* 14.
[68] Robinson, J., *Economic Philosophy* (1962) 135.
[69] Marx, K., *Capital* (1946) Vol. I, 605.
[70] Baran, P. and Sweezy, P., *Monopoly Capital* (1966) 44.
[71] Wallich, H. and McGowan, J., in Baumol, W., Likert, R., Wallich, H. and McGowan, J., *A New Rationale for Corporate Social Policy* (1971).
[72] *Financial Times* (London), 9 August 1984, quoting respectively executives of Citibank and Levi Strauss (U.K.) Northern Europe (subsidiary of the American multinational which, modelling its programme of community affairs on the parent, has set up a separate company, homing in on 'social issues' in order to 'try to take our activities away from pure P.R.').
[73] See Friedman, M., 'Corporate Power, Government by Private Groups, and the Law' (1957) 57 *Columbia Law Review* 155, 161-2: Baumol, *et. al., op. cit.* 207.
[74] See the remarkable appraisal by Engel, D., 'An Approach to Corporate Social Responsibility' (1979) 32 *Stanford Law Review* 1, though by what osmosis the signal is relayed is not made clear. Of course, in the deeper recession and higher unemployment in Europe of the 1980's, stronger and wider 'signals' might be received.
[75] Brudney, *op. cit.* 604-5.

the tendency of the new controllers to cultivate a corporate social 'conscience', divorced from the cupidity of the 'owners'; but this prediction has not been clearly substantiated.[76] A very different school points to a more profound passage in Marx, where he responds to the (then new) joint stock company by appearing to predict an internal 'socialisation' of capital in a manner not vastly different from that of Berle. Resting on a social mode of production and presupposing concentration, it

> assumes the form of social capital, as distinct from private capital, and its undertakings assume the form of social undertakings, as distinct from private undertakings. It is the abolition of capital as private property within the framework of capitalist production.

And in an equally famous phrase: 'This is the abolition of the capitalist mode of production within the capitalist mode of production itself.'[77] Although this concept of the transmutation of the 'private' capitalist, ('dissociated from the management' in Keynes' phrase, who also spoke of business 'socializing' itself)[78] 'socialisation from within', nevertheless it was visionary,[79] and has become arguably at odds with the socio-legal form of corporate capital which actually developed.

> The joint stock company did not alter [the place of profit in capitalism], it neither represents a sign of the dissolution of capitalist relations of production nor the advent of 'social responsibility' in commodity production.[80]

Marx after all never attempted to investigate what would have been 'a hypothetical system characterized by the prevalence of large-scale enterprise and monopoly', which had not by his time developed, because he anticipated the end of capitalism long before such potentialities were realised.[81]

In other words, none of the philosophies which have predicted an automatic socialisation of corporate life have been justified by the social facts of recent decades. Whereas the internal planning of giant corporations has become 'in effect *social* planning', the prime exercise of social control has become the task, not of a

[76] See *supra* nn. 12, 56 *et. seq.* Berle's corporate conscience 'is a vague composite of public relations, actions responsive to public opinion or to pressures or threats by government, and the long-run interest of managers in system survival': Herman, E. S., *Corporate Control, Corporate Power* (1981) 258. A more authoritarian version was inherent in Burnham, J., *The Managerial Revolution* (1941).

[77] Marx, K., *Capital* (1984) Vol. III 427, 429. (Criticism of Marx sometimes overlooks the fact that the joint-stock company as we know it scarcely existed at the time of his work. The uneasiness of Engels on this point is apparent in his editorial note at pp. 428-9.) Few modern Marxists rely upon this passage for more than a prediction that the capitalist unit would become the 'social' company rather than the 'private' investor: see Aaronovitch, S. and Smith, R., *op. cit.* 244.

[78] Keynes, J. M., *Essays in Persuasion* (1931) 314. For a simple equation between the Marxist analysis of finance capital and the 'divorce' of ownership from control in companies see Cole, G. D. H., *What Marx Really Meant*(1934) 115-25.

[79] See Kamenka's fascinating *The Ethical Foundations of Marxism* (1962) especially 9, 156-60.

[80] Hirst, P., *On Law and Ideology* (1979) 135-6.; see too ch. 5 generally, including his complementary assessment of Renner, K., *The Institutions of Private Law and Their Social Functions* (1949); and Cutler, A., Hindess, B., Hurst, P. and Hussain, A., *Marx's Capital and Capitalism Today* (1977). Marx's concept lay at the root of Renner's notion that 'private property . . . (is) transformed into a public utility, though it has not become public property' and the process of collectivisation of capital to the point 'where it is ripe for transfer into communal ownership' (Renner, *op. cit.* 119, 286).

[81] Baran, P. and Sweezy, P., *op. cit.* 4-5. Their attempt to remedy this gap did not make use of internal 'socialisation'. On the contrary, 'the real capitalist today is not the individual businessman but the corporation . . . an institutionalization of the capitalist function' of which the 'heart and core' is still accumulation: (at p. 43-4).

conscience stricken technocracy, but of government.[82] No new and comprehensive ethic of business seems likely to be born by determined historical forces, springing fully armed like Athena from the head of our ageing economic order.

Company Law: Anglo-American Contrasts

It is clear, too, that none of the common law systems of law has incorporated any overarching theory of social responsibility. The legal problem tends to emerge first in respect of corporate gifts, at any rate where the company relies upon some implied power, or inherent capacity, to enable it lawfully to give money to good causes.[83] In this field, the waning doctrine of the *ultra vires* principle has played a leading role. None of our systems seems to have reached the point where it will tolerate commercial management acting in a totally 'altruistic' manner.[84] But the courts in America after 1953 demonstrated that the test of what is of implicit benefit to the corporation could be used to validate even gifts, reasonable in quantum,[85] which brought to the corporation no more direct benefit than a strengthening of faith in the private enterprise system among those who might be 'not entirely satisfied with our present social and economic system.'[86] English courts have never gone quite so far. Their ears still echo to the precept:

> There shall be no cakes and ale except such as are required for the benefit of the company.[87]

In that 'not very philanthropic garb' alone is charity allowed to sit at the British directors' table, when the company seeks to justify an implicit power to give under the *ultra vires* doctrine. The belief that this might justify *any* kind of charitable donation 'to preserve goodwill' for the company must be tempered now by the reflection that the directors' knuckles will be sharply rapped by the judges if their altruism can be shown to have overlooked the primary interests of the shareholders.[88] Moreover, where expenditure is to shareholders themselves, the gift may be doubly bad if it infringes the prohibition on the unauthorised return of capital.[89] Of course in most systems, statute has intervened to give either a general

[82] Braverman, H., *Labor and Monopoly Capital* (1974) 268-9. But on the influence of corporations *on* government, see Herman, E. S., *Corporate Control, Corporate Power* (1981) 5; and see, on the power of business over the social environment: Miliband, R., *The State in Capitalist Society* (1969) 147-55, 210-18; and on 'whose consensus?': Nettl, P., 'Consensus or Elite Domination: The Case of Business' (1965) 13 *Political Studies* 22-44. See too *supra* n. 58.

[83] Where there is an express power to give money, English law now imposes no further test as to 'benefit to the company': *Re Horsley and Weight Ltd [1982] Ch. 442; Wedderburn K. W.*, 'Ultra Vires in Modern Company Law' (1983) 46 *Modern Law Review* 204.

[84] See Engel, *op. cit.* 16; *Dodge v. Ford Motor Co.* 204 Mich. 459 (1919): though presumably English law would accept this if it were an express object, *supra* n. 82. But see *Re Introductions Ltd* [1970] Ch. 199, 209.

[85] The basis of much corporate giving in Britain: *Evans v. Brunner Mond and Co. Ltd* [1921] 1 Ch. 359.

[86] *Theodora Holding Corp. v. Henderson* 257 A 2d. 398, 406 (Del. Ch. 1969). See the critical decision in *A. P. Smith v. Barlow* 13 N.J. 145 (1953); 346 US 861 (1953). The quantum of what is 'reasonable' is of course related in American law to the tax relief available for philanthropic gifts.

[87] *Per* Bowen L.J. *Hutton v. West Cork Railway Co.* (1883) 23 Ch. D. 654, 673.

[88] Compare the unduly wide propositions in the *'Jenkins' Report* (1962) Cmnd 1749 para 52. with *Parke v. Daily News Ltd. [1962] Ch. 927* and Companies Act 1980 (Eng.) ss 46 and 74, *supra* nn. 42, 43.

[89] For a modern illustration, see *Re Halt Garage (1964) Ltd* [1982] 3 All E.R. 1016; Wedderburn, K. W., 'Ultra Vires in Modern Company Law' (1983) 46 *Modern Law Review* 204. See, in America, *Adams v. Smith* 275 Ala. 142 (1963).

capacity to act as a human person may act, or at least to make donations for charitable or other social purposes,[90] or, at any rate, to make donations 'for patriotic or for charitable purposes'.[91]

But why do we allow this? The explanations seems to be that society now insists that the investor who puts in his money for profit with limited liability must accept that his directors must have power to give part or all of it away for socially approved purposes.[92] It is surely a fault of fashionable liberalism that it has made us forget the functions which the *ultra vires* doctrine was meant to play in protecting shareholders, creditors *and* society in such connection. If legal technique cannot maintain the adequacy of that doctrine for the task, it should not be jettisoned; it should be replaced by something else.

Systems other than English company law have moved away from what are often regarded as the unduly rigid and technical rules that dominate it.

> In the United States, judge-made law has been both more generous in scope and more readily available, giant steps in procedure far outstripping those of the halting, tradition-bound English judges.[93]

At first sight, various jurisdictions in the United States have indeed so far 'liberalised' American corporation laws as to distinguish them sharply from the more conservative British system. This arises partly from the very existence of the SEC and its all pervading regulation, not least the omni-present Rule 10-b5 which (while it has not created an overriding Federal duty of 'fairness')[94] is part of that corpus of Federal law which possesses such far-reaching influence.[95] So too, contrary to normal English principles, majority controlling stockholders are frequently placed under fiduciary obligations to the minority;[96] and courts have extended the concept of corporate property in 'opportunities' by relying upon the debate about social responsibility.[97] And if majority stockholders owe a duty 'at

[90] See Engel, *op. cit.* 14-15; Cary, W. L., *Cases and Materials on Corporations* (5th ed. 1980) 45-8. For the acceptance of expenditure which benefits a healthy society (and thereby the company) see: *Schwartz v. Romnes* 495 F. 2d. 844 (1974); *Masili v. Pacific Gas & Electric Co.* 51 Cal. App. 3rd. 313 (1975).

[91] Uniform Companies Act 1981 (Cth.) s. 19. (now s. 67 and Schedule 2 of the Companies Code 1981). In Britain, European Communities Act 1972 (Eng.) s. 9 has little impact; but elsewhere, statute has relieved directors of the bonds of *ultra vires* altogether: *e.g.* Business Corporations Act 1975 (Canada) ss 15-18. But why should directors be enabled to make valid dispositions of assets to whom they choose by a law that gives 'the company the rights, powers and privileges of a natural person' (s. 15)?

[92] See the careful proposals made in Professor Gower's *Final Report on the Company Law of Ghana* (1961) where in draft cl. 24 and commentary he argued for retention of the limitation on gifts to those which benefitted the company, even though the company had the powers of a natural person for furtherance of its objects: 40-2.

[93] Hornstein, G., 'The Shareholder's Derivative Suit in the United States' (1967) *Journal of Business Law* 282, 288. On the English derivative action see now *Wallersteiner v. Moir (No. 2)* [1975] Q.B. 373; *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 W.L.R. 2; *Prudential Assurance Co. Ltd v. Newman Industries Ltd* [1982] Ch. 204 (*supra* n. 32).

[94] *Sante Fe Industries Inc. v. Green* 430 U.S. 462 (1977); see too *Goldberg v. Meridor* 567 F. 2d. 209 (1977); *Panter v. Marshall Field and Co.* 646 F. 2d. 271 (1981).

[95] See the remarkable discussion in Loss, L., *Fundamentals of Securities Regulation* (1983) ch. 9.

[96] *Perlman v. Feldmann* 219 F. 2d. 173 (1955), cert. den. 349 U.S. 952; *Honigman v. Green Giant Co.* 208 F. Sup. 754 (1961), cert. den. 372 U.S. 941; *Jones v. Ahmanson.* 1 Cal. 3d. 93 (1969); *Sinclair Oil v. Levien* 280 A. 2d. 717 (1971); *Roland Int. Corpn v. Najjar* 407 A 2d. 1032 (1979); *Perl v. I.U. International Corpn* 61 Hawaii 622 (1980); see Cary, *op. cit.* 1541-52.

[97] *Diamond v. Oreamuno* 287 NYS 2d. 300, 303 (1968); affirmed 24 NY 2d. 494, 500 (1969); citing Israels, C., 'A New Look at Corporate Directorship' (1968) 24 *BusinessLaw* 727 and Schotland, R., 'Unsafe at Any Price: A Reply to Manne, Insider Trading & the Stock Market' (1967) 53 *Virginia*

least [to] act fairly to the minority interests and the majority cannot avoid that duty merely because the action taken is legally authorised',[98] the bottom falls out of the power of shareholder-owners to validate or ratify all breaches of duty owed to the company, short of misappropriation of corporate assets or bad faith (as English law seems to permit), allowing the courts to measure liability by reference to 'fairness', a standard that can be set flexibly by the circumstances of the type of corporation involved.[99] Moreover, their looser application of principles governing capacities of the corporation permits American courts to acquiesce in payments made partly by reason of the corporation's perceived responsibilities to its local community.[1]

It is especially in the development of 'fairness' as a test to overcome 'technical' rules of substantive law that the American courts are said to be superior to the 'tradition-bound' English judges. (Their alleged superiority in procedural development has far more to do with the legal system as a whole than with company law).[2] It is true too that in these areas a strong thread of policy aims to deter 'unethical behaviour' by the controllers of companies.[3] But it may be questioned whether the standard of 'fairness', often looser than the more 'technical' English fiduciary duty, has been successful, for example, in dealing with corrupt or questionable payments (ranging from political pay-offs to bribery and 'slush' funds) of recent years in America, even though boards there contain far more 'independent', non-executive directors than British boards of directors.[4] Indeed, such independent directors, (often put on the board to guard some special social interest or minority group) are found to have only a modest effect on corporate response to community needs.[5] On the other hand, they have been used paradoxically, and even accepted by the courts, as a vehicle, not for controlling,

Law Review 1425. But contrast *Schein v. Chasen* 313 So. 2d. 739 (1975); *Freeman v. Decio* 584 F. 2d. 186 (1978). On ratification and directors' breach of duty by acquiring a corporate opportunity, see however the very divergent tendencies in the case law of different jurisdictions: Cary, *op. cit.* 590-613, 630-7, 931-4; Brudney, V. and Clark, R., 'A New Look at Corporate Opportunities' (1981) 94 *Harvard Law Review* 997.

[98] *Burt v. Burt Boiler Works Inc.* 360 So 2d. 327, 331 (1978).

[99] *Boss v. Boss* 200 A. 2d. 231 (1964); *Irwin v. Pre-Stressed Structures* 420 S.W. 2d. 491, 495 (1967). Sometimes unanimous assent is required to ratify directors 'waste' or gift of assets: *Saxe v. Brady* 40 Del. Ch. 474 (1962); *Schreiber v. Bryan* 396 A. 2d. 512 (1978). *Cf. Sladen v. Rowse* 347 A. 2d. 409 (1975); and *Lash v. Lash Furniture Co.* 296 A. 2d. 207 (1972).

[1] *Kelly v. Bell* 266 A. 2d. 878 (1970). But see Engel, *op. cit.* 16.

[2] The contingency fee system is more important than the absence of *Foss v. Harbottle* (1843) 2 Hare 461; 67 E.R. 189: Loss, L., *Securities Regulation* (2nd ed. 1961) Vol. III.

[3] See Coffee, J., 'Beyond the Shut-Eyed Sentry: Towards a Theoretical View of Corporate Misconduct' (1977) 63 *Virginia Law Review* 1099; Andrews, W., 'Can the Best Corporations be Made Moral' (May-June 1973) *Harvard Business Review* 57. Coffee would replace the shareholder-based fiduciary ideology with a board-based system of accountability.

[4] See Coffee, *op. cit.* 1118-1278; Brudney, *op.cit.* 636-647; Herman E. S., *Corporate Control, Corporate Power* (1981) 280-5. On non-executive directors, see Mace, M., *Directors — Myths and Realities* (1971) and his up-date in (1979) 32 *Rutgers Law Review* 293; Herman, *op. cit.* 31-8; and in Britain: Brookes, C., *Boards of Directors in British Industry* (1979) 36-9; *'Bullock' Report on Industrial Democracy* (1977) Cmnd 6706; Corporate Consulting, *The Non-Executive Director in the U.K.* (1980).

[5] See the authoritative survey in Brudney, *op. cit.* 607-27; 639-59. On the socialisation of independent directors into 'group think', see International Management, *Survey on Ethics and Business* (1983). See too on these matters the sources cited by Cary, W. L., *Cases and Materials on Corporations* (5th ed. 1980) 214-19, especially Solomon L., 'Restructuring the Corporate Board of Directors: Fond Hope-Faint Promise?' (1978) 76 *Michigan Law Review* 581.

but for exculpating active members of the board, replacing the 'business judgment' of a general meeting with that of the directors' 'independent' cronies, sometimes forming special 'litigation committees' to determine the fate of action against executives.[6] In fact, American judges appear to interfere with management today little more, or arguably even less, than they did twenty years ago.[7] Even in the 1960's, commentators were asking despairingly whether directors were now 'trustees' for anyone.[8] In general the mixture of permissive State legislation and loose tests of 'fairness' has only created 'considerable uncertainty' about managers' duties.[9]

The contrast with Britain suggests that there are reasons for its different condition other than the 'tradition-bound' character of the judiciary — though many English judges fully deserve that description. In certain ways, a determination not to stray far from the traditional base of shareholders' democracy for all its technicalities may even betray an instinct for the real issue. The rare cases, for example, in which English courts have subjected majority shareholders to general fiduciary duties,[10] are regarded, by friend and foe alike, as 'wrong.'[11] The reason, surely, is not merely tradition. It is that: 'It is not the business of the court to manage the affairs of the company. That is for the shareholders and the directors.'[12] That is why majority rule by shareholders is adhered to in Britain as the base; that is the reason for denying minority shareholders a right of action (except where there is bad faith or misappropriation)[13] under the 'Rule in *Foss v. Harbottle*' the

[6] *Burks v. Lasker* 441 U.S. 471, 485 (1979); *Auerbach v. Bennett* 47 NY 2d. 619 (1979); *Lewis v. Anderson* 615 F 2d. 778 (1979), *certiorari* denied 449 U.S. 869 (1980). The point is not answered merely by the court's adding its own test of reasonableness; *Zapata Corpn v. Maldonado* 430 A. 2d. 779 (1981). On the dangers to deriviative actions, see Coffee, J. and Schwarz, D., 'The survival of the derivative suit: An Evaluation and a Proposal for Legislative Reform' (1981) 81 *Columbia Law Review* 261; Payson, A., Goldman, T. and Inskip, R., 'After *Maldonado* — The Role of the Special Litigation Committee' (1982) 37 *Business Law* 1199; but contrast Beyer, D., 'Business Judgment: Dismissal of Suits by Board Litigation Committees' (1982) 35 *Vanderbilt Law Review* 235.

[7] See Brudney, *op. cit.*; Bishop, W., 'New Problems in Indemnifying and Insuring Directors' (1972) *Duke Law Journal* 1153, and his earlier study in (1968) 77 *Yale Law Journal* 1078. On state statutes, see: Pinto, A.R., and Bulbulia , A. 'Statutory Responses to Interested Directors' Transactions; A Watering Down of Statutory Standards' (1977) 53 *Notre Dame Law Review* 201.

[8] Marsh, H., 'Are Directors Trustees?' (1966) 22 *Business Lawyer* 35; Israels, C., 'Are Corporate Powers Still Held in Trust?' 64 *Columbia Law Review* 1446.

[9] Cary, W. L., *Cases and Materials on Corporations* (5th ed. 1980) 606 on the statutes; *cf. Fliegler v. Lawrence* 361 A. 2d. 218 (1976).

[10] That is, otherwise than under statutory provisions for, *e.g.*, a just and equitable winding-up (see *Ebrahimi v. Westbourne Galleries* [1973] A.C. 360) or an alteration of articles. The attempt in Gower, L. C. B., *Modern Company Law* (4th ed. 1979, *Supplement* 1981) 616-30, to create such an objective duty is unconvincing, even in respect of such alterations, in the light of the cases.

[11] The best example is *Clemens v. Clemens Bros Ltd* [1976] 2 All E.R. 268; Joffe, V., 'Majority Rule Undermined?' (1977) 40 *Modern Law Review* 71; Prentice, D. D., 'Restraints on the exercise of Majority Shareholder Power' (1976) 92 *Law Quarterly Review* 502.; Sealy, L. S., 'Company Law, Protection of Minority Shareholders' (1976) 35 *Cambridge Law Journal* 235 and see the discussions of the *Prudential Assurance* decisions *supra* n. 32. For the problems caused in limiting the majority shareholders' right to control corporate litigation (either by reason of articles giving directors power to manage or of some over-riding doctrine of equity) see Gower, L. C. B., *Modern Company Law* (4th ed. 1979, *supplement* 1981) 147-8; Wedderburn, K. W., 'Control of Corporate Litigation' (1976) 39 *Modern Law Review*327; and now *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 W.L.R. 2. But the doubtful English law is not necessarily inferior to American principles which hand the matter over to the 'business judgment' of litigation committees of 'independent' directors, *supra* n. 5, p. 5.

[12] *Per* Scrutton L.J. *Shuttleworth v. Cox Bros & Co. (Maidenhead) Ltd* [1927] 2K.B. 9, 23.

[13] *Cook v. Deeks*[1916] 1 A.C. 554; *Daniels v. Daniels* [1978] Ch. 406; and the *Prudential Assurance* decision, *supra* n. 32.; see too *supra* n. 93.

boundaries of which 'lie along the boundaries of majority rule.'[14] It is necessary to 'draw a line' beyond which the courts, and indeed lawyers, should 'not venture in the determination of what are essentially managerial decisions.'[15]

The concept of 'majority-shareholder-rule' is not just a procedural appendix to the law. It is central to its structure, whether or not shareholders can 'control' directors in reality. It is worth, by way of further example, noting its relationship to 'oppression' of the minority shareholder and to fiduciary duties.

English courts have always been cautious in interpreting even the right to a remedy given expressly by Parliament to a minority shareholder on the ground of 'oppression' or 'unfair prejudice.'[16] Indeed, there are no major reported instances of judges intervening in favour of the minority without some evidence of acts or omissions in themselves wrongful.[17] But there are instances of firm rejection by our judges of cases built, not upon something 'burdensome, harsh or wrongful', but upon allegations that management has been 'unwise, inefficient and careless' in performing its duties.[18] The critical issue — not perhaps always retained in mind in the American discussions — is whether the court will give a remedy which intervenes in cases of mere *mismanagement* — 'superimposing the will of the court on the controlling shareholders and directors on matters of commercial policy and judgment.'[19] Will it force the board, for example, (as in the United States) to pay a dividend or change its line of business?[20] To the extent that such a remedy *is* provided, there is more logic in extending *locus standi* to a wider range, outside the shareholders, to directors, creditors, or others.[21] But then, after that, why not employees, consumers or public agencies? Perhaps English judges know that their training (to put it mildly) fits them little for these general judgments, whereas across the Atlantic, law school graduates pride themselves (not always justifiably) upon their grasp of all aspects of society's problems.

[14] Wedderburn, K. W., 'Shareholders Rights and The Rule in *Foss v. Harbottle*' [1957] *Cambridge Law Journal* 194, 198; *Foss v. Harbottle* (1843) 2 Hare 461; 67 E.R. 189.

[15] Rider, B., 'Amiable Lunatics and the Rule in *Foss v. Harbottle*' [1978] *Cambridge Law Journal* 270, 287.

[16] Respectively, Companies Act 1948 (Eng.) s. 210 and Companies Act 1980 (Eng.) s. 75. The latter's extension to 'unfairly prejudicial acts' does not seem likely to make judges more venturesome: see *Re A Company* [1983] Ch. 178; Wedderburn, K. W., 'Companies, Courts and Management' (1983) 46 *Modern Law Review* 643; Birds, J., 'What Constitutes Unfair Prejudice?' (1983) 4 *The Company Lawyer* 78

[17] As in *Re H. R. Harmer Ltd* [1959] 1 W.L.R. 62; *Scottish Co-operative Wholesale Society Ltd v. Meyer* [1959] A.C. 324. In the former a remedy was given even though the enterprise was making a big profit.

[18] *Re Five Minute Car Wash Service Ltd* [1966] 1 All E.R. 242, 247, *per* Buckley J; (1966) 29 *Modern Law Review* 321, 324-7 (where the alleged loss was £250,000); and see the significant reversal on appeal in *Re Jermyn Street Turkish Baths Ltd* [1971] 1 W.L.R. 1042; Rajak, H., 'The oppression of Minority Shareholders' (1972) 35 *Modern Law Review* 156.

[19] Hadden, T., *Company Law and Capitalism* (2nd ed. 1977) 270.

[20] Compare *Re A Company supra* n. 16, p. 21 with American tendencies in *Eisenberg v. Flying Tiger Line Inc.* 451 F. 2d. 267 (1971) (order against merger plan); *Knapp v. Bankers' Securities Corpn* 230 F. 2d. 717 (1956) (order to pay dividend).

[21] See Business Corporations Act 1975 (Canada) s. 234 (opression, unfair prejudice or unfair disregard of interests; for security holder, creditor, director or officer), and the enthusiastic account by Beck, S., *Corporate Law in the 80's* (1982) 312-20. It is notable that none of the cases cited rests on mismanagement as such, rather than 'unfairness', though the latter can be almost as great an engine of social policy. The words 'equitable rights of members' can mean everything or nothing: *Johnston v. West Fraser Timber Ltd* (1981) 29 B.C.L.R. 379, (1982) 133 D.L.R. (3d.) 77.

Even so, a major jurisdiction to intervene within corporate management policy, and to provide a remedy for investors (and others?) for 'unfair mismanagement', must rank ultimately as a power to enforce the social policies of the judiciary upon the company (whether the company be public or private) including, indirectly or directly, a policy on profit-maximisation, as *custodes morum reipublicae*. Such matters undoubtedly concern the 'proprietary rights' of those concerned.[22] It is not obvious that courts are necessarily the right instruments for such policy-making, rather than (say) a Companies Commission or corporate Ombudsman, who could be the subject of accountability and democratic control in the way he elaborated the policies. Since the retirement of Lord Denning, we have learned to doubt whether the judges do always know best.

Management of Fiduciaries

Much of current commentary on the British law concerning directors' duties is concerned to persuade us, often with great ingenuity, to jettison all the so-called 'technical' rules and turn the matter over to a judicial determination of what is 'fair'.[23] The fiduciary duties which history has bequeathed to the company director apply principles more strict than most people's concept of 'fairness' for commercial men. If he profits secretly from his position, when his interest and his duty conflict, the director is liable to account for his profit, even if it was honestly made and even if his company has suffered no harm as such or could not have enjoyed the advantage which he utilised.[24] Some have said that this is unfair and would attach liability only when there has been dishonesty or 'unjust enrichment'.[25] That would be a move towards a lower line of duty. Of course, the director may obtain 'absolution of his sins' by full disclosure and validation (approval in advance or ratification in arrears) from the shareholders' meeting,[26] *unless* the breach is unratifiable (which largely appears to mean a breach involving bad faith or misappropriation of 'money, property or advantages' belonging to the company).[27]

[22] A ground on which 'oppression' sections were once held in Quebec to be *ultra vires* the Parliament of Canada, though the decision was reversed on appeal: *Montel v. Groupe de Consultants PGL Inc.* (1981) 128 D.L.R. (3d.) 609; (1982) 142 D.L.R. (3d.) 659.

[23] For some of the most persuasive arguments in this general direction, see Beck, S., 'The Quickening of Fiduciary Obligation' (1975) 53 *Canadian Bar Review* 771. and his parallel 'The Shareholders' Derivative Action' (1974) 52 *Canadian Bar Review* 159. But see his *Studies in Canadian Company Law* (1973) vol. ii, 199-201 where he does not advocate the jettisoning of all the strict duties. See, too, Prentice, D., 'Directors' Fiduciary Duties: The Corporate Opportunity Doctrine' (1972) 50 *Canadian Bar Review* 623; Braithwaite, W., 'Unjust Enrichment and Directors' Duties' (1978) *Canadian Business Law Journal* 210.

[24] *Industrial Development Consultants Ltd v. Cooley* [1972] 1 W.L.R. 443; *Regal (Hastings) Ltd v. Gulliver* [1942] 1 All E.R. 378; [1967] 2 A.C. 134 n. On the fiduciary duties see Gower, L. C. B., *Modern Company Law* (4th ed. 1979, *Supplement* 1981) chs 24 and 26; Boyle and Birds, *op. cit.* chs 20 and 21. See the inclination of Laskin J. to loosen, in part, but, in part, to extend the fiduciary duties: *Canadian Aero Services v. O'Malley* (1973) 40 D.L.R. (3d.) 371.

[25] See Jones, G., 'Unjust Enrichment and the Fiduciary's Duty of Loyalty' (1968) 84 *Law Quarterly Review* 472 (the Americanism 'duty of loyalty' being a significant choice).

[26] *Bamford v. Bamford* [1970] Ch. 212, 238 *per* Harman L.J.

[27] *Burland v. Earle* [1902] A.C. 83, 93*per* Lord Davey; *Cf. Cook v. Deeks* [1916] 1 A.C. 554. On the vexed issue of where precisely to draw the line of unratifiable breach of duty, see the different accounts by Gower, L. C. B., *Modern Company Law* (4th ed. 1979, *Supplement* 1981) ch. 24; Beck, *S., Studies in Canadian Company Law* (1973) vol. ii, 232-8; Wedderburn, K. W., 'Shareholders' Rights and the Rule in Foss v. Harbottle' [1958] *Cambridge Law Journal* 93, 99-106. The precise boundary does not affect the present argument, unless it is left at the discretion of the court *via* 'unjust

If the duties were swallowed up by some conglomerate duty of 'fairness' between director and company, the possibility of defining a line between ratifiable and unratifiable breaches of duty would become almost impossible.[28]

The desire to lighten the apparent burden of strict fiduciary duties imposed by English law upon directors — including, it is often forgotten, the duties of a constructive trustee in respect of corporate property[29] — is often associated with a recognition that directors of a commercial company and trustees are, indeed, very different animals. The 'economic function' of trustees is dissimilar to that of management:

> Trustees do not maximize profit in the context of the competitive market. They do not concern themselves with innovation in products . . . Most important, trustees need not fear that beneficiaries may sell their interest to entrepreneurs who will install new trustees.[30]

How (broadly) true. Yet English courts were not unaware of such differences just in the period when they applied trustee-like duties to directors. They knew they were 'commercial men, managing a trading concern for the benefit of themselves and all the other shareholders.'[31] But they still drew upon the stricter duties by which to guage directors' liabilities, rooted in *Keech v. Sandford*,[32] though these duties are now better seen as duties of 'fiduciaries' — a word which solves little and only directs one to 'further inquiry'.[33] But it must never be forgotten that the orginal application of 'trust principles' to directors was made in cases of corporations created by charter or letters patent, a century, in fact, before the language was used about directors of a deed of settlement company.[34]

These were the corporations which *had* a place in public, as much as in private, law. They carried with them the requirements imposed by the Crown, and even from earlier times the tang of monopoly.[35] In Maitland's words:

> And now let me once more repeat that the connection between Trust and Corporation is very ancient.[36]

enrichment'. Whatever that boundary is, it appears to define also the area within which the English 'derivative action' is permissible. A 'dishonest appropriation' of assets by those who have complete control of the company is theft: *Attorney-General's Reference* (no. 2 of 1982) [1984] 2 All E.R. 216.

[28] See Beck, S., *Studies in Canadian Company Law* (1973) vol. ii, 236 n. 184 on the American law: 'not clear on what constitutes a non-ratifiable act'; see also *supra* n. 97.

[29] *Steen v. Law* [1964] A.C. 287; *Selangor United Rubber Estates v. Cradock* (no. 3) [1968] 1 W.L.R. 1555; *Wallersteiner v. Moir* [1974] 3 All E.R. 217; *Korak Rubber Ltd v. Burden* (No. 2) [1972] 1 All E.R. 1210; *International Sales and Agencies Ltd v. Marcus* [1982] 3 All E.R. 551.

[30] Winter, R., *Government and The Corporation* (1978) 33.

[31] *In Re Forest of Dean Coal Mining Co.* (1878) 10 Ch. D. 450, 452. See, too, the treatment of directors when they have to deal with different classes of shareholders: *Mills v. Mills* (1938) 60 C.L.R. 150. On the danger of using such phrases as '*quasi*-trustees' to describe ordinary fiduciary duties: see *In Re City Equitable Fire Insurance Co. Ltd* [1925] Ch. 407, 426.

[32] (1726) Sel. Cas. t. King 61; 25 E.R. 223. On the historical development see Sealy, L., 'The Director as Trustee' (1967) *Cambridge Law Journal* 83; Beck, S., *Studies in Canadian Company Law* (1973) vol. ii, 199-207.

[33] *Per* Frankfurter J., *Securities & Exchange Commission v. Chenery Corpn* 318 U.S. 80, 85 (1943).

[34] See Sealy, L., 'The Director as Trustee' (1967) *Cambridge Law Journal* 83, 84-6; *Charitable Corporation v. Sutton* (1742) 2 Atk. 400; 26 E.R. 642; *Benson v. Heathorn* (1842) 1 Y. & C. Ch. Cas. 326; 62 E.R. 909.

[35] See Cooke, *op. cit.* 40-60; *The Case of Monopolies* (1612) Noy 173; 77 E.R. 1260; Statute of Monopolies 1623; Gower, L. C. B., *Modern Company Law* (4th ed. 1979, *Supplement* 1981) 22-7.

[36] Maitland, F., 'Trust and Corporation' in Hazeltine, H., Lapsley, G., and Winfield, P. (eds), *Selected Essays* (1936) 214.

It is clear that none of the modern writers on legal sociology or economics and law, is able to determine from theory whether the duties of British directors *ought* to remain as strict as they are.[37] The issue is not whether trustees are 'like' directors but:

> Whether the rationale of the fiduciary principle has relevance to the corporate director given the management role the director now plays, the legal and factual distribution of corporate power between the director and the shareholder, and the functional and procedural reality behind that distribution of power.[38]

In other words, the standard is in the last resort a value judgment, a condition or ethical standard which society must determine in its apportionment of responsibilities. That very fact accentuates the tension inherent in the ordinary fiduciary duty itself. It is imposed in private law, but with a *public* function. It is the vehicle of a social purpose. Indeed, public law proper has recently taken new note of its potentialities.[39]

But there is a further twist in the skein. This mixed, private and public function is largely at the mercy of private beneficiaries. By ratification after full disclosure they — and only they — may cure the breach of duty where it is ratifiable. The duty to observe a proper business ethic can be largely nullified by a private group of 'owners' or 'members' whom it suits to permit inferior conduct. Questionable business conduct can, this far at least, be made moral by the engine of shareholder democracy. And even if they do not release the duty, the ill-gotten gain may go to hands which appear no more meritorious than the directors whom the law has found to be in breach of duty, as in the *Regal* case itself. Despite all these problems, however, foreign systems which have no experience of the fiduciary concept feel that there is a 'serious lacuna' in their law.[40] Why? The reason is surely this: the fiduciary duty is the main instrument which the Chancellor's courts bequeathed to today's judges by which to mark out certain basic social responsibilities of management. Its obscurities and technicalities, and the problems posed by the doctrine of ratification, put it in need of repair. But in any reform, the social values at its core must be examined and protected by those who wish to sustain its standards, not least at a time when they are challenged afresh by rapidly changing financial markets and dealings, from 'questionable' corporate payments to the internationalization of the City of London. Will the legal conditions placed upon incorporation and limited liability continue to impose — and to impose effectively — an ethic founded upon public standards which forbids management to place itself in a position where its interests conflict with its perceived duties?

[37] See, for example, Bishop, W. and Prentice, D., 'Some Legal and Economic Aspects of Fiduciary Remuneration' (1983) 46 *Modern Law Review* 289; McLean, A. J., 'The Theoretical Basis of the Trustee's Duty of Loyalty' (1969) 7 *Alberta Law Review* 218.

[38] Beck, S., *Studies in Canadian Company Law* (1973) vol. ii, 206, who here argues for an extension of the duties, in regard to interlocking directorates.

[39] *Bromley LBC v. GLC* [1983] 1 A.C. 768 (fiduciary duty of council to ratepayers). But sometimes it is oddly excluded as not belonging to public law: *Swain v. Law Society* [1983] 1 A.C. 598. On the analogy between local authorities and 'trustees' see Wade, H. W. R., *Administrative Law* (5th ed. 1982) 378-380.

[40] See Tunc, A., 'A French Lawyer looks at British Company Law' (1982) 45 *Modern Law Review* 1, 13.

Social Perspectives on Company Law

Professor Gower once said that company law received inadequate parliamentary time because it is not a 'sexy subject'. The entry of the United Kingdom into the European Economic Community seems to have cured that defect; for under the impetus of regular Directives from Brussels, British law now receives a regular stream of new law,[41] and every Bill introduced to put an E.E.C. Directive into effect acquires its own plethora of clauses on passing through Parliament which have nothing to do with the E.E.C. demands. There is therefore more opportunity in Britain now for company law reforms.[42] Yet it seems unlikely that structural reform will be undertaken, or even that fundamental questions will be allowed to emerge from the morass of soggy verbiage that passes for legislative debate upon most Companies Bills.

One of the reasons for that is, again, usefully approached through a brief comparison with the United States. There, those who feel that corporation laws need revision, and especially those who do not accept the dominance of profit maximisation, or who find the 'race for the bottom' by State Codes unpalatable (most eager to reduce the obligations for business corporations in order to profit from their custom),[43] have put forward a vast literature for reform of the structure of corporation law. Recently, attention has concentrated on the board, on promoting the place of the 'independent' directors, with audit and nominating committees.[44] Research suggests that such reforms have altered little.[45] These changes, together with ingenious proposals for 'special public directors' appointed by government in certain circumstances (violations of the law, for example)[46] or for a more general intrusion of government appointed directors to act as surveillance of the executives,[47] may have overlooked Crosland's perceptive remark:

> government nominees on a private board must either 'go native' or remain suspect.[48]

[41] In addition to the Acts of 1980 and 1981, (responding to the Second and Fourth Directives) see also the Stock Exchange (Listing) Regulations 1984, S.I. 716, which adopted the desperate expedient of printing as Schedules two Directives *verbatim* (79/279 and 80/390) without making wholly clear which parts of the existing law were affected or repealed!

[42] But a consolidation of the legislation is being prepared — a vast exercise — and it is to be hoped that this can be accomplished before new reforms occur. See too Dept of Trade, *Proposals for Revision of Tables A to E and Schedule 1 to the Companies Act 1980* (1983). (Now Companies Act 1985)

[43] See the classic article: Cary, W. L., 'Federalism and Corporate Law: Reflections upon Delaware' (1974) 83 *Yale Law Journal* 663. See too Cary, W. L., *Cases and Materials on Corporations* (5th ed. 1980) 5-14; and Hurst, J., *The Legitimacy of the Business Corporation in the United States* (1970). For an invaluable background to the discussion, see Eisenberg, M., *The Structure of the Corporation: A Legal Analysis* (1976).

[44] Committee on Corporate Law, 'Overview Committees of the Board of Directors' (1979) 34 *Business Lawyer* 1837; Neal, A. C., *Business Power and Public Policy* (1981); Eisenberg, M., 'The Legal Roles of Shareholders and Management in Modern Corporate Decision-Making' (1969) 57 *California Law Review* and *supra* nn. 5-7 p. 19-20.

[45] See Brudney, *op. cit.*; Solomon, *loc. cit.*

[46] Stone, C., *Where the Law Ends: The Social Control of Corporate Behaviour* (1976), which might be acceptable even to 'purists': Winter, R., *Government and The Corporation* (1978) 57. See too Stone, C., 'The Place of Enterprise Liability in the Control of Corporate Conduct' (1980) 90 *Yale Law Journal* 1.

[47] Stone's more radical proposal, *ibid.* See Herman's doubts in the light of such appointments under various Acts (*op. cit.* 289-92), and Cary's rather peremptory rejection (*op. cit.* 224).

[48] Crosland, C. A. R., *The Future of Socialism* (1956) 358. *Cf.* Shwartz, D., 'Governmentally Appointed Directors in a Private Corporation — The Communications Satellite Act of 1962' (1965) 79 *Harvard Law Review* 350, 362-3.

The effect of 'group-think' upon those added to the board is very powerful.

Even more radical plans have been put forward. Ralph Nader and his associates propose dividing the corporation into nine constituencies, under federal laws, each group electing a director with special responsibility, representing:- employees, consumers, the environment, shareholders, law-enforcement, marketing, finance, planning and research, and management.[49] Such proposals are not difficult to criticize from a conventional standpoint;[50] but even if conventional disbelief is suspended, one discovers that, apart from appeals to 'decency' or 'reasonableness', the authors have not been able to construct an index of priorities which avoids management's own version of the public interest being what is actually put into practice, thereby increasing rather than diminishing the directors' discretion. [51]

It would be wrong to suggest that similar proposals for new corporate constituencies have not been made in Britain, nor have they found a better way to overcome the same difficulties, not least because proposals for a 'social audit' have so far failed to produce any clear guidance on priorities.[52] Some produced constitutional mazes of extraordinary complexity.[53] But they formed, and form, part of a debate very different from the American, and it is of importance to recognize the distinctions because they are relevant to another feature of the nature, and practicabilities, of a debate on corporate social responsibilities.

'Industrial Democracy'

A glance at the literature illustrates that, while employees take their place as one of many proposed constituent groups in the United States, they play a dominant role in the British, and indeed the European, debates. It is no accident that there a large number of suggestions in the last three decades which have aimed to turn the company into one type or other of workers' co-operative.[54] Each debate naturally acquires the marks of its culture. French proposals for new corporate constituencies can accommodate substantial room for a State inspector, who would be alien to Americans.[55] But throughout Europe the last thirty years have seen this topic dominated by demands for 'industrial democracy'. That is to say, the legitimacy of management and shareholders was challenged primarily in the name of *workers'* interests and on a platform which frequently challenged too the very social and

[49] Nader, R., Green, M. and Seligman, J., *Taming the Giant Corporation* (1976); and Nader, R., *et. al.* in Steiner and Steiner (eds), *op. cit.* 22.

[50] See Conard, A., 'Reflections on Public Interest Directors' (1977) 75 *Michigan Law Review* 941

[51] See McKie (ed.), *op. cit.* 76; Winter, R., *op. cit.* 50.

[52] See for example, Goyder, G., *The Responsible Company* (1961); Fogarty, M., *Company and Corporation — One Law?* (1965); *Company Responsibility and Participation — A New Agenda* (1967); and *Wider Business Objectives: American Thinking and Experience* (1966) (on the ethically qualified businessman); Derrick, P., *The Company and The Community* (1964); Derrick, P. and Phipps, J. (eds), *Co-ownership, Co-operation and Control* (1969). Compare Robertson, D., *The Control of Industry* (1930); and see Social Science Research Council, *Report of Advisory Panel on the Social Responsibilities of Business* (1976) on 'social audits'.

[53] See, for example, Ross, N., *The Democratic Firm* (1964).

[54] See Allan, D., *Socialising The Company* (1974); Boswell, J., *Can Labour Master the Private Sector?* (1968); Blum, F. J., *Work and Community; The Scott Bader Commonwealth* (1968). See too Elliott, J., *Conflict or Cooperation?: The Growth of Industrial Democracy* (1978) Ch. 13; Brannen, P., *Authority and Participation in Industry* (1983) especially ch. 8.

[55] See Bloch-Lainé, M., *Pour Une Réforme de l'Entreprise* (1963).

economic system in which the company operates. In the United States, though, even the most radical critic had no quarrel with Milton Friedman on one point: he advanced his proposals in order that 'the competitive enterprise system can be made to work equitably and efficiently', and his plan is 'the precise opposite of Socialism.'[56]

This is not, however, to suggest that European criticism of existing corporate arrangements are restricted to socialists. Many other philosophies have been represented in the wide variety of programmes put forward for 'industrial democracy',[57] and even in some of those adopted.[58] Proposals for wide-ranging worker-representation within the large corporate structure made by the Commission of the E.E.C. are certainly not classifiable as socialist.[59] What *is* important, however, is that the entire debate in Western Europe, from the 'wage earner funds' in Sweden, through the employee members of the (different) 'supervisory boards' of companies in Holland and Germany, to the French *comité d'entreprise* and (very different) German Works Council, to the flirtation of the British TUC and Government with some of these forms of 'industrial democracy' between 1974 and 1979,[60] one issue is paramount: the relationship of corporate responsibility to the workforce, and a change in that relationship *in order* to complement political and social change in society more broadly.

It must be added that the perspective of industrial democracy is, at times, specifically useful to the analysis of corporate institutions. It focuses the mind upon the reality of social power behind the theoretical formulae. Thus, the concept that extended institutional shareholding by pension funds necessarily extends economic 'democracy', because the beneficiaries behind the trusts are the workers employed by the companies concerned, is exploded as soon as it is demonstrated that these funds are operated by technical advisers largely in the same way as any other unit of finance capital — indeed, by law, operated on the principles normally governing 'trustees'.[61]

[56] Nader, R., *et. al. Taming the Giant Corporation* (1976) 262.

[57] See the Liberal Party, *Co-Partnership at Work* (1968); Fogarty, M., *Company Responsibility and Participation* (1975) and other works cited *supra* n. 52, p. 26.

[58] Notably in Germany in structures of co-determination: on the history see Spiro, H., *The Politics of German Co-Determination* (1958); and see the useful accounts in Schregle, J., 'Co-determination in the Federal Republic of Germany: a Comparative View' (1978) 117 *International Labor Review* 81; and Batstone, E. and Davies, P., *Industrial Democracy: European Experience* (1976).

[59] On the thinking of the European Commission, see E.C.O.S., *Employee Participation and Company Structure* (1975) and on opposition of the U.K. Government to the latest proposals: Dept of Employment and Dept of Trade and Industry, *Draft European Communities Directive (etc.) — A Consultative Document* (1983), which also expresses hostility to the draft E.E.C. 'Vredeling' Directive, as amended, which aims to give workers and their unions rights to information and consultation which are effective in *groups* of companies operating in the E.E.C. including those whose parent company is located outside the member States.

[60] See T.U.C. , *Industrial Democracy* (1977); the subsequent *'Bullock' Report on Industrial Democracy* (1977) Cmnd 6706.; the White Paper *Industrial Democracy* (1978) Cmnd 7231.; and the account in Elliott, *op. cit.* Characteristic of the debates in Britain, see Kahn-Freund, O., 'Industrial Democracy' (1977) 6 *Industrial Law Journal* 65; Davies, P., and Wedderburn, K. W., 'The Land of Industrial Democracy' (1977) 6 *Industrial Law Journal* 197.

[61] See Minns, R., *Pension Funds and British Capitalism* (1980) who largely destroys the myths in Drucker, P., *The Unseen Revolution: How Pension Fund Socialism Came to America* (1976) at any rate in the British context. Pension fund trustees must obey ordinary trust doctrines and invest at the best profit for their beneficiaries, not pursue 'an investment policy intended to assist the industry that the pensioners have left, or their union': *per* Megarry V.C. *Cowan v. Scargill* [1984] 3 W.L.R. 501, 516-17. Pension funds are said now to own 'nearly 30% of all quoted shares': *Sunday Times* (London), 20 May 1984.

It is impossible to survey here the vast literature and rich experience now available in Europe on this front.[62] What is essential is to spotlight the context in which a debate on social responsibility is taking place. When a British statute introduced an obligation on directors to consider the interests of employees 'as well as the interests of its members',[63] it inevitably formed part of the wider debate on 'industrial democracy'. In the United States that would not have been the case. So too, when (as now does happen from time to time) union officials or employee representatives are invited to become members of an American board of directors, the event has few, if any, implications concerning control of the corporation.[64] In *any* Western European country, it would immediately form part of the 'industrial democracy' debate (even today when some of those zealous for reform are less confident about the role of worker-directors presiding over redundancies in companies reeling under the gales of the economic recession). In great measure — though not entirely — these differences spring from the deep divide that separates American labour unions which do not, and almost all Western European trade unions which do, wish to change the social system within which they live.

Having in mind the very special environment of conciliation and arbitration within which Australian labour relations have developed since 1904 and the beginnings of industrialisation here, I am naturally led to speculate about the nature of the ripples which might be spread in your particular pond if such pebbles were cast into it. Are proposals on employee participation confined to corporate governance within its present system (as in the United States), or do they reach out to one or other form of 'industrial democracy' — or, perhaps, to a third, and different, debate? For there is no natural monopoly on the agenda for these matters in Europe or the United States.

A Concluding Dimension

That is not a question which can be answered here. But it does prompt one reflection and one last inquiry. The reflection is that issues of corporate social responsibility properly take their significance and their very meaning, not from abstract considerations about shareholders' democracy, but from the culture and language of particular social relations. Each society, each governmental machinery, each system of production and exchange, faces those issues in its own

62 The present author explores further certain themes of industrial democracy, and the transnational issues, in relation to corporate responsibility in 'The Legal Development of Corporate Responsibility' in Hopt, K. and Teubner, G. (eds), *Corporate Governance and Directors' Liability: Legal, Economic and Sociological Analyses of Corporate Social Responsibility* (forthcoming).

63 Companies Act 1980 (Eng.) s. 46, discussed *supra* n. 42. p. 10.

64 The entry to the Chrysler board of Mr. Fraser, President of the Automobile Workers, is well-known, and caused some perplexity among American lawyers (see Abramowitz, B., (1980) 34 *South Western Law Journal* 963; Forst, B., (1982)7 *Journal of Corporation Law* 421). But, although such experiments are exceptional and confined to corporations in distressed circumstances (Merrifield, L., 'Worker Participation in Decisions Within Undertakings' *International Society of Labour Law and Social Security, General Report Theme I* (1982/3), they are not as isolated as is often believed. See, for example, the two seats on the board accepted by the union (plus a 25 *per cent* equity holding) as part of a settlement with Eastern Air Lines, together with wage reductions of 18 to 22 *per cent*, a rescue package on which Wall Street had 'reservations': *Financial Times* (London), 13 December 1983.

peculiar setting and its own values. There is therefore no universal plan or gospel for corporate governance, only the conditions which each society sees fit to place upon the granting of incorporation with limited liability.

What the American perspective has done is to reveal one aspect which is of value to us all, the fact that:

> the modern super-corporations . . . wield immense, virtually unchecked power. Some say they are private governments whose decisions affect the lives of us all.

Such enterprises, it is said, must be expected to rise above '"the morals of the market place" which exalts a single-minded myopic determination to maximise profits.'[65]

What the European debate has done is demonstrate the way in which specific social responses to those private organs of government are in great measure moulded by the varying character of the collective organizations of workpeople which have come into existence in industrial society in an attempt to amend the unequal bargaining power of the individual employee, faced with the conflict of interest with the employer who purchases his labour power.

The final question is set within a paradox. Each of us must find our own way. But none of our societies now *can* stand alone. Each is part of an economic order which is rapidly being internationalized. Each faces transnational enterprises, multinational groups of companies, and world-wide capital markets which easily transcend frontiers and escape the legal jurisdictions of nation states. History threatens to reduce national governments:

> to the status of parish councils in dealing with the large corporations which will span the world.[66]

As Professor Herman writes:

> These corporations have helped create enormous wealth, but in the process they have broken down traditional community links and brought forth new problems whose solutions require protective and control mechanisms — private and governmental, local, national and international — that do not now exist.[67]

How are we to define, still less enforce, the obligations of transnational corporate management? To whom and for what ends are *they* trustees? How will we — or the global businessmen themselves — identify the 'good citizen' in *international* business?

If there is great obscurity in our national systems of company law on the issue of corporate responsibility, how can we expect lawyers to contribute to the emergent

[65] *Per* Justice Douglas (dissenting), *SEC v. Medical Committee for Human Rights* 404 U.S. 403, 409-10 (1972). Berle and Means had predicted that the corporations would rival the power of the State as a dominant form of social organisation: *The Modern Corporation and Private Property* (1932) 313, a conclusion supported by Herman, E. S., *Corporate Control, Corporate Power* (1981) 50 years later; but see his pessimistic conclusions: 'The hope for the future must be that a series of survivable small shocks or minor catastrophes will occur, leading to the emergence of new ideologies, values and institutional arrangements, that will strengthen the powers of small groups and nations to protect themselves and to cope with the lack of international authority . . . [but] a bleaker forecast is plausible' (at p. 301).

[66] Benn, A. W., Minister of Technology, *Parliamentary Debates*, House of Commons, 27 November 1968, 491.

[67] Herman, E. S., *Corporate Control, Corporate Power* (1981) 301; see, too, his comments on the new 'dangers inherent in a world of slowing growth, intensifying internal conflict, and increasing economic interdependence without effective international economic or political authority' (at p. 300).

codes of conduct (from the Organisation for Economic Co-operation and Development and the United Nations, for example) which have begun to confront the international problems? Company lawyers are now under a double obligation to re-examine business and its accountability in their own national company laws. Only when we have clarified our objectives and our methods at that level can we hope to make a meaningful contribution to the questions of transnational obligation, made daily more acute by the contradictions of world poverty amidst plenty and hourly more urgent by growing concentrations of economic and social power amidst the crises of inflation, unemployment and recession, and the increasingly debilitated state of our traditional machineries for corporate accountability. Seen in that context, the range of our approach to social responsibility of companies must accommodate an imagination more searching than that found in the simple definitions of Professor Friedman.