THE POSSIBLE IMPACTS OF “ENLIGHTENED SHAREHOLDER VALUE” ON CORPORATIONS’ ENVIRONMENTAL PERFORMANCE

by

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This paper argues that “enlightened shareholder value” (“ESV”) offers a “third way” between the shareholder primacy and stakeholder theories of the corporation; one that maintains the creation of shareholder value as the corporation’s primary function, but requires directors to take into account the environmental impact of the corporations’ operations. ESV requires directors to “have regard to”, among other things, “the impact of the company’s operations on…the environment.” The obligation to “have regard to” should be interpreted as a procedural duty requiring directors to inform themselves as to the environmental impact of the corporation’s operations, which may in itself cause directors to reallocate corporate resources to environmental protection. ESV may also improve corporations’ environmental disclosure and impact social norms of corporate behaviour with respect to the environment. Any negative impact of ESV on present shareholder returns is justified by the obligation to avoid imposing foreseeable severe or irreparable environmental harm on future generations.
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What are companies for? The primary goal is to make a profit for their shareholders, certainly. But the days when that was the whole answer are long gone.¹

I. Introduction

Given the corporation’s place as the primary vehicle of economic activity and the profound effect of this activity on the environment, it is necessary to explore how corporations might be better induced to take into account the environmental impact of their operations. The “enlightened shareholder value” approach (“ESV”), recently codified in the United Kingdom,² is one possible way of doing so. ESV requires directors, in fulfilling their duty to run the company in the best interests of the shareholders, to “have regard to” several factors, including “the impact of the company’s operations on…the environment.” This paper will argue that the obligation to “have regard to” should be interpreted as a procedural duty on directors to inform themselves as to the environmental impact of the corporation’s operations. Although focusing on procedure may attract the criticism that ESV will merely add to the costs of corporate decision-making without sufficient corresponding improvements in corporate environmental performance, a duty to gather and review information on environmental impacts may in itself cause directors to reallocate corporate resources to environmental protection. ESV may also improve environmental disclosure and have an important impact on social norms of corporate behaviour with respect to the environment. Any negative impact of ESV on present shareholder returns is justified by the duty on present generations to avoid imposing foreseeable severe or irreparable environmental harm on future generations. Such a duty is necessary to ensure that economic

² Companies Act 2006 (U.K.), 2006, c. 46, s. 172 [Companies Act].
growth in the present does not come at the expense of future generations by failing to take into account the future costs of present economic activity. This paper will argue that ESV offers a “third way” between the shareholder primacy and stakeholder theories of the corporation; one that maintains the creation of shareholder value as the corporation’s primary function, but helps to ensure that this value is not generated at the cost of severe or irreparable environmental harm on future generations.

This is not an argument that ESV is a substitute for government regulation of the environment. Government regulations are necessary to set minimum requirements, and it is ultimately up to the public to determine whether an environmental harm is so undesirable that it should be prohibited outright. And clearly the most serious environmental problems that future generations will face, such as climate change, will not be resolved by the actions of corporate officials alone. As will be argued below, however, ESV may help to support government regulation by requiring corporations to become fully informed of the environmental impacts of their operations and by encouraging directors to be more proactive in improving their companies’ environmental performance even in unregulated areas.

The paper will proceed as follows. Part II will set out the theoretical framework for the rest of the paper. This framework seeks to re-conceptualize traditional welfare analysis in order to take into account the environmental impact on future generations of decisions made in the present. Part III describes ESV as set out in the U.K. legislation, and briefly discusses the current approach to fiduciary duties of directors in Canada and the U.S. Part IV summarizes the two traditional approaches to directors’ fiduciary duty, namely shareholder primacy and stakeholder theory, and explains how ESV is a “third way” between the two. Part V makes the argument that, to be workable in practice, ESV should be
interpreted as a procedural duty to be informed of the corporation’s environmental impacts, and explains what this means and how it may impact directors’ decision-making. Part VI will review three ways that ESV could have a positive impact on corporations’ environmental performance. First, by requiring corporations to gather information on the environmental impacts of the corporation’s operations, these impacts will become harder to ignore. ESV may also encourage the implementation of environmental management systems, which may improve corporations’ environmental performance. Second, disclosure of environmental information complements and is complemented by ESV by reinforcing the reputational harm to corporations of ignoring environmental impacts. Third, ESV may help to shape new social norms of corporate conduct with respect to the environment. Part VII examines whether, even if ESV can have a positive impact on the environment, it is appropriate for corporate directors to set limits on their own profit-making activities, or whether this is better left to government. Part VIII provides a preliminary cost-benefit analysis of the expected impact of ESV on the corporation, and concludes that the benefits both to the corporation and to the environment should outweigh the increased costs to the corporation in having to gather and analyze this additional information. Although beyond the scope of this paper, Part VIII also outlines the cost-benefit analysis that would be required to determine whether the net gains of ESV would outweigh the net gains of relying on other methods of controlling pollution. Part IX concludes.
II. Theoretical Framework: Re-conceptualizing Welfare to Include Intergenerational Equity

The currently dominant theory of the corporation holds that the corporation’s proper and sole end is the maximization of shareholder value. The theory is often defended on the ground that maximizing shareholder value is the best way to maximize social welfare. This argument is based on the theory that individuals acting in their own rational self-interest will, subconsciously, act in the interests of all; this is the invisible hand of the free market. Rational self-interest is defined as maximizing individual well-being or “utility” at the lowest cost or causing the least harm. Social welfare is defined as the aggregation of individual utility.

The assumption that people act in their own rational self-interest implies that when parties voluntarily enter a contract, the terms of the contract must represent the maximization of the utility of all parties – otherwise they would not have entered into the bargain. In other words, the bargain is assumed to be “Pareto superior”, meaning that at least one party is made better off and no party is made worse off. This is the normative argument behind freedom of contract. The problem, of course, is that most bargains impose “externalities” or costs on third parties who did not consent to and do not necessarily benefit from the bargain. Where these costs are not “internalized” or borne by the parties to the contract, the result is

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3 Commonly referred to as “shareholder primacy theory” and discussed in more detail in Part IV, below.
7 See Trebilcock, ibid.
8 Posner, supra note 6 at 13; Trebilcock, ibid. at 58.
overproduction of externalities, such as pollution – “the classic negative externality.”

Government intervention in private bargaining may be justified to limit these externalities.

The Kaldor-Hicks theory of efficiency attempts to take externalities into account. A bargain will be Kaldor-Hicks efficient when the benefits to the “winners” would sufficiently outweigh the costs imposed on the “losers” that the winners could, hypothetically, compensate the losers and still come out in the black. The question raised by the Kaldor-Hicks definition of efficiency is who is included in the calculation? Or, to put it another way, what is the relevant time frame? In the environmental context, there can be significant time lags between cause and effect: the negative environmental impacts of current economic activity may only be experienced by distant generations we will never encounter. If these costs to future generations outweigh the benefits of present economic activity, then the value generated may represent a transfer of wealth from the future to the present, rather than the efficient use of resources to maximize social welfare. Does this require that the costs to future generations of these long-term impacts be included in a Kaldor-Hicks cost-benefit analysis? The principle of intergenerational equity would say yes.


10 Trebilcock, supra note 5 at 58-60. Trebilcock at 247 specifically acknowledges that limits on freedom of contract may be justified to solve the “tragedy of the commons”. See also Revesz & Stavins, ibid. at 506-07.

11 Posner, supra note 6 at 13; and Trebilcock, ibid. at 58.

12 Revesz & Stavins, supra note 9 at 505; Trebilcock, ibid. at 7. The bargain is not Pareto superior unless the third parties are in fact compensated: Posner, ibid. at 13.


14 The harm caused by increased pollution from economic activity “all too often” outweighs the increase in profits to the firm: Aseem Prakash & Matthew Potoski, The Voluntary Environmentalists (New York: Cambridge University Press, 2006) at 1.
Intergenerational equity is a central part of the principle of “sustainable development”, most commonly defined as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs.” The result of modern technological and scientific advancements is that the economic activity of present generations is much more likely to interfere with future states of the world than the economic activity of past generations. At the same time, present generations are also better able to predict the future consequences of our economic activity. Climate change is only the most obvious example of a severe and potentially irreparable future consequence. This ability both to impose externalities on distant generations and to foresee the serious consequences of imposing those externalities means that these costs can and should be taken into account in present-day decision-making. The duty owed to future generations by present generations is therefore limited by current knowledge of the foreseeable consequences of present actions. Furthermore, as in the case of the common law tort duty, is not a duty of absolute risk avoidance, but one of taking “a serious deliberative approach to managing...serious environmental risks”.

In the past, it might have been safe to assume that the benefits to future generations of present economic growth would outweigh the costs. Although future generations will arguably still benefit from present economic growth, through technological advancements,
for example, the continuing “unconstrained consumption of non-renewable resources” – such as oil\textsuperscript{19} – and “still hardly constrained” greenhouse gas (“GHG”) emissions, the costs of which will be borne almost exclusively by distant future generations, undermines the assumption that the gains to future generations from economic growth in the present will outweigh the costs; that is, the assumption that future generations will always be better off than the present ones.\textsuperscript{20}

Although the use of the word “equity” might be seen as invoking ideas of “fairness”, this is not necessarily an argument that in making policy decisions about defining the fiduciary duty of directors, welfare concerns should be tempered by fairness concerns,\textsuperscript{21} especially given the metaphysical and other difficulties in suggesting that future generations have “rights”.\textsuperscript{22} Rather, it may be argued that taking into account the costs to future generations of present economic activity is necessary to ensure that present economic activity is truly welfare-enhancing in the Kaldor-Hicks sense in the long-term.\textsuperscript{23}

\textsuperscript{19} As Suzumara & Tadenuma, \textit{supra} note 13 at 324, note “petroleum plays such a crucial role in all aspects of human life that the styles of food, clothes and shelter, and convenience and opportunity to travel [of future generations] would all differ immensely depending on” whether or not this generation decides to impose restrictions on its use.

\textsuperscript{20} Christopher Lumer, “Principles of generational justice” in Tremmel, \textit{supra} note 16 at 46-47. See also Michael Wallack, “Justice between generations: the limits of procedural justice” in Tremmel, \textit{ibid.} at 89 and 99. Although addressing the issue is beyond the scope of this paper, intergenerational equity may raise distributional issues regarding present generations in less-developed parts of the world.

\textsuperscript{21} See Louis Kaplow & Steven Shavell, \textit{Fairness versus Welfare} (Cambridge, MA: Harvard University Press, 2002). Kaplow & Shavell argue that concern for “fairness” should play no independent role in policy analysis on the ground that giving independent weight to fairness without regard for the consequences for social welfare runs the risk of making everybody worse off. Rather, the sole criterion for public policy should be the maximization of individual utility, defined broadly as everything that enhances an individual’s well-being. Obviously, such a controversial thesis spawned plenty of academic discussion. For responses to Kaplow & Shavell’s thesis, see, e.g., Richard H. Fallon, Jr., “Should We All Be Welfare Economists?” (2003) 101 Mich. L. Rev. 979; and Michael B. Dorff, “Why Welfare Depends on Fairness: A Reply to Kaplow and Shavell” (2002) 75 S. Cal. L. Rev. 847.

\textsuperscript{22} See, e.g., Wilfred Beckerman, “The impossibility of a theory of intergenerational justice” in Tremmel, \textit{supra} note 16. For a response to Beckerman, see Wallack, \textit{supra} note 20 at 100-102.

“harm to future generations represents a type of externality, which, if it is to be dealt with, must be internalized by putting appropriate values on future damages and factoring those costs into present day decision-making.”\textsuperscript{24} Avoiding severe or irreparable long-term environmental harm may require “shifting today’s investments from consumption to the lowering of resource consumption, the reduction of GHG emissions and so on”,\textsuperscript{25} which will, of course, increase the costs borne by present generations. The increase in present costs is justified in order to ensure that present generations are not engaging in an inefficient amount of environmentally-harmful economic activity because the full environmental costs of this activity are not being taken into account in the present. Although perhaps not the optimal means of doing so,\textsuperscript{26} requiring directors to “have regard to” the environmental impacts of the corporation’s operations is one way of attempting to take into account the future costs of present economic activity. A “fine-grained” cost-benefit analysis of future environmental harm versus present economic growth may not be possible,\textsuperscript{27} but a general principle that calls for limiting severe long-term or irreversible environmental harm\textsuperscript{28} may be welfare-enhancing in more cases than strict adherence to shareholder primacy.

In maximizing shareholder value, therefore, directors must at least be aware of the present and future environmental impacts of the corporation’s operations. Again, the additional costs to the internal functioning of the corporation of gathering information on

\begin{footnotesize}
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  \item\textsuperscript{24} Bodansky, Brunnée & Hey, \textit{supra} note 15 at 14. See also Prakash & Potoski, \textit{supra} note 14 at 1.
  \item\textsuperscript{25} Lumer, \textit{supra} note 20 at 47.
  \item\textsuperscript{26} The full internalization of the costs of environmental harm through government regulation or taxes may be a more efficient solution, although, as argued below, environmental issues will always arise that cannot be regulated \textit{ex ante}.
  \item\textsuperscript{27} Gardiner, \textit{supra} note 23 at 158-59, discussing climate change.
  \item\textsuperscript{28} Wallack, \textit{supra} note 20 at 97-98 suggests a “Minimum Irreversible Harm Principle” which would require present generations to limit irreversible harm to the “shortest feasible time” and “smallest feasible loci”. Gardiner, \textit{ibid.} at 164 suggests a “global core precautionary principle” which is less informationally demanding than cost-benefit analysis: all that would need to be known is that the effects of a given activity would be severe.
\end{itemize}
\end{footnotesize}
environmental impacts and to the profits that might otherwise have been made are justified by the duty to avoid imposing the costs of severe or irreparable environmental harm on to future generations. This requires an adjustment to the dominant theory of shareholder primacy to allow directors to make decisions in the interest of avoiding future environmental impacts, even if these decisions have a negative effect on shareholder returns in the present. ²⁹ It is arguable, however, that ESV will also have economic benefits. The costs and benefits of ESV to the corporation are discussed further in Part VIII, below.

It is possible that eventually the demands of intergenerational equity and of shareholders will converge.³⁰ A small but significant number of shareholders are already taking into account the external long-term impacts of their investments, as evidenced by the growing number³¹ of socially responsible investors.³² Many more investors, however,

²⁹ Ian Lee, “Efficiency and Ethics in the Debate about Shareholder Primacy” (2006) 31 Del. J. of Corp. L. 533 at 578 argues that managers should be able to deviate from profit maximization where it “would severely impair or destroy important interests of third parties lacking in economic or political power.” Clearly, future generations may be said to fall into this category.

³⁰ The fact that citizens in many parts of the world, including Canada, are likely to increasingly rely on private personal investment for their retirement savings means that shareholders will increasingly reflect society in general. To the extent that the creation of corporate wealth negatively impacts the environment in the present, “shareholders”, as members of the general public, are affected: Einer Elhauge, “Sacrificing Corporate Profits in the Public Interest” (2005) 80 N.Y.U. L. Rev. 733 at 793.


³² Benjamin J. Richardson, “Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?” (2007) 22 B.F.L.R. 145 at 147 notes that there is no “authoritative” definition of SRI, but he
continue to base their investment decisions on expected return alone. Pressure from SRI investors may not be enough, therefore, to improve corporate environmental performance sufficiently to avoid imposing severe or irreparable environmental harm on future generations.

The next section describes the current state of the law on the fiduciary duty of corporate directors in the U.K., Canada and the United States, beginning with ESV as it has been codified in the U.K.

III. The Current Legal Status of ESV: U.K., Canada and the U.S.


In October 2007, the U.K. Companies Act 2006 came into force, requiring directors, in fulfilling their duty “to promote the success of the company for the benefit of its [shareholders] as a whole,” to “have regard to” a non-exhaustive list of other factors, including “the impact of the company’s operations on…the environment”. 33 The committee recommending this approach to directors’ fiduciary duty referred to it as “enlightened shareholder value” (“ESV”). 34 Section 170(1) provides that the duty under s. 172 is owed to the company. Only shareholders, not any of the constituencies to which the company must

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33 Supra note 2, s. 172(1)(d). The legislation uses “members” – the U.K. term for shareholders. The ESV approach was not entirely new: the predecessor to s. 172, s. 309(1) of the Companies Act 1985, stipulated that “The matters to which directors are to have regard in the performance of their functions include the interests of the company’s employees in general, as well as the interests of its members.” See J. E. Parkinson, Corporate Power and Responsibility: Issues in the Theory of Company Law (Oxford: Clarendon Press, 1993) at 82.

“have regard”, may apply to the court to bring a derivative claim on behalf of the company for breach of the fiduciary duty.\textsuperscript{35}

Justice Arden, a member of the Steering Group, has described this requirement as a duty “to genuinely take the relevant matters into account” in order to reconnect “the corporate vehicle with the society in which it operates.”\textsuperscript{36} Although shareholder value is still the object of the corporation, this object is not to be pursued at all costs, but, as the legislation expressly states, with regard to its impact on, among other things, the environment.\textsuperscript{37} The weight to be given to the factors in any particular business decision is left to the judgement of the directors.\textsuperscript{38} ESV nevertheless dictates that in the event of conflicting interests, those of the shareholders should prevail.\textsuperscript{39}

The express purpose of ESV is to encourage directors to focus on long-term value\textsuperscript{40} by “reminding” directors of the “best practice” of taking the long view and looking to the effects of a decision on the corporation’s relationships with its other stakeholders.\textsuperscript{41} ESV attempts to address the concern that “pressures from shareholders, or managerial perceptions of such pressures,” to come up with short-term gains means sacrificing “long-term investment in value-creating” relationships.\textsuperscript{42} At the same time, the Steering Group was reluctant to alter the objects of the corporation, given its past success:

\textsuperscript{35} Companies Act, supra note 2, Part 11, Ch. 1.
\textsuperscript{37} This approach could also be described as “constraint-based” corporate responsibility, which requires directors to take “steps to avoid damage to non-shareholder interests”: see Parkinson, supra note 33 at 277.
\textsuperscript{38} Arden, supra note 36 at 167.
\textsuperscript{39} Steering Group, supra note 34 at 38-39.
\textsuperscript{40} The first factor in the list is “the likely consequences of any decision in the long term”: Companies Act, supra note 2, s. 172(a).
\textsuperscript{41} Arden, supra note 36 at 170. See also Williams & Conley, supra note 1 at 25.
\textsuperscript{42} Steering Group, supra note 34 at 36 and 41-42. See also Arden, ibid. at 165; William W. Bratton, “Enron and the Dark Side of Shareholder Value” (2002) 76 Tul. L. Rev. 1275; and Parkinson, supra note 33 at 155. For a
...the limited company form has proved over the last 150 years an outstandingly successful means for organizing productive activity, deploying and protecting investment and allocating risk. It is critically important that that success should be preserved, and indeed enhanced, in the modern context.\textsuperscript{43}

In the opinion of the Steering Group, however, the corporation could continue to thrive while at the same time responding to a wider range of interests and minimizing the negative impacts of economic activity.\textsuperscript{44}

The Steering Group envisaged that ESV would be coupled with enhanced disclosure obligations regarding its social and environmental performance, which would hopefully increase the reputational costs to corporations of poor social and environmental performance and thereby make responding to these interests in the best interests of the shareholders.\textsuperscript{45} To this end, s. 417(5)(b)(i) of the \textit{Companies Act} requires the directors’ report of a publicly-traded company to include information about environmental matters, including the impact of the company's business on the environment.

ESV is not without its critics: some suggest that it is merely shareholder primacy dressed up in socially responsible clothing.\textsuperscript{46} This paper argues that ESV is distinguishable from, but not inconsistent with, shareholder primacy as traditionally understood, and that ESV may improve the environmental performance of corporations. This paper also goes beyond the U.K. legislation, however, in suggesting that the principle of intergenerational


\textsuperscript{44} Steering Group, \textit{ibid.} at 10, 36. Interestingly, the Steering Group expressly stated that the goal of corporate law should be to “maximize wealth and welfare as a whole” but not to decide how that wealth should be allocated based on “fairness”. See discussion of the “fairness v. welfare” debate, \textit{supra} note 21 and accompanying text.

\textsuperscript{45} \textit{Ibid.} at 51. See discussion of ESV and disclosure in section VLB, below.

\textsuperscript{46} See Keay, \textit{supra} note 4 at 604, 609.
equity may require sacrifices to shareholder value in order to maximize aggregate social welfare in the long-term.47

B. The Canadian Position: Best Interests of “the Corporation”

The fiduciary duty of directors and officers in Canada is currently formulated as a duty to “act honestly and in good faith with a view to the best interests of the corporation”.48 The Supreme Court of Canada has held that the “best interests of the corporation” is not to be equated with “the best interests of the shareholders”, or any other particular constituency of the corporation. In determining the corporation’s best interests, however, “it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.”49

In the recent BCE decision,50 the Court confirmed its earlier decision in Peoples,51 and attempted to elaborate further on the content of the fiduciary duty.52 The Court stated that the corporation’s best interests are “not confined to short-term profit or share value”; rather, directors should look to the long-term,53 and in “acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on corporate

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47 See Part II, above.
49 Peoples Department Stores Inc. (Trustee of) v. Wise, [2004] 3 S.C.R. 461 at para. 42 [Peoples]. It could be argued that in holding that the duty of directors is to the “corporation”, the Court is taking a “team production theory” approach to corporate law: see Blair & Stout, supra note 43 discussed in Part IV.B.1, below.
50 BCE Inc. v. 1976 Debentureholders, 2008 SCC 69 [BCE].
51 Ibid. at para. 40.
52 Ibid. at paras. 37, 81.
53 Ibid. at para. 38.
stakeholders." The Court explained that this was what the duty required of directors acting in the best interests of the corporation viewed as a good corporate citizen. Similarly, in another part of the decision, the Court stated that acting in the corporation’s best interests means “having regard to all relevant considerations, including, but not confined to, the need to treat affected stakeholders in a fair manner, commensurate with the corporation’s duties as a responsible citizen.”

Although it is possible that the Court was simply expressing the view that corporate profits are better protected in the long-run when directors take into account the impacts of their decisions beyond the immediate impact on the bottom-line, the use of language such as “good corporate citizen” and “responsible citizen” would seem to invoke some kind of moral or social obligation on directors to have concern for the external impacts of their decisions independent of the protection of profitability in the long-term. It may be that, similar to the U.K. government’s aim in establishing ESV, that the Court was trying to articulate a “best practices” view of the fiduciary duty, including greater emphasis on long-term profitability and consideration of the impacts of board decisions on the corporation’s various constituencies. Going back to the Court’s earlier decision in Peoples, confirmed in BCE, these constituencies include the environment.

In addition to the duty of directors under Canadian corporate law, directors can be held personally liable for environmental offences under both federal and provincial environmental statutes. Some of these statutes also impose a duty on directors to take “all

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54 Ibid. at para. 66 [emphasis added]. See also ibid. at para. 81.
55 Ibid. [emphasis added].
56 Ibid. at para. 82 [emphasis added].
57 Canadian Environmental Protection Act, 1999, S.C. 1999, c. 33, s. 280(1) [CEPA]. Fisheries Act, R.S. 1985, c. F-14, s. 78.2
58 See, e.g., Ontario’s Environmental Protection Act, R.S.O. 1990, c. E.19, s. 194(2) [EPA]. See also Ontario Water Resources Act, R.S.O. 1990, c. O.40, s. 116(2) [OWRA].
reasonable care” to prevent environmental offences\textsuperscript{59} and at least one also includes a general prohibition on harming the environment.\textsuperscript{60} Canadian environmental law could be interpreted, therefore, as imposing a duty on directors to take all reasonable care to avoid environmental harm – arguably a more stringent responsibility than the duty imposed by ESV to “have regard to” the environment. It is difficult to say exactly what the duty entails, however, since there are very few cases involving director liability under environmental statutes. In the leading Ontario case, the only non-managerial director charged was acquitted on the grounds that he seldom visited the site in question, was unaware of the environmental concern and had properly delegated responsibility to an on-site manager.\textsuperscript{61} The duty to take all reasonable care under Canadian environmental legislation is compared with the duty to have regard to the environment under ESV in Part V, below.

\textbf{C. The U.S. Position: Shareholder Primacy, But…}

The American Law Institute’s Principles of Corporate Governance state that “a corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.”\textsuperscript{62} This objective is qualified, however, not only by an obligation “to act within the boundaries set by law”, but also by permission, although no obligation, to “take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business” and to “devote a reasonable

\begin{footnotesize}
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\item \textsuperscript{59} \textit{CEPA}, \textit{supra} note 57, s. 280.1(1); \textit{EPA}, \textit{ibid.}, s. 194(1); and \textit{OWRA}, \textit{ibid.}, s. 116(1). Under the \textit{EPA}, s. 194(2.1) and the \textit{OWRA}, s. 116(2.1), the onus is on the directors to prove that all reasonable care was taken in the circumstances.
\item \textsuperscript{60} Under \textit{EPA}, \textit{ibid.}, s. 194(1.1), directors may be held liable for the discharge of a contaminant that “causes or is likely to cause an adverse effect”.
\item \textsuperscript{61} \textit{R. v. Bata Industries Ltd. and Thomas Bata et al.} (1992), 7 C.E.L.R. (N.S.) 245 at 364 [\textit{Bata Industries}].
\item \textsuperscript{62} Sec. 2.01(a): Jesse H. Choper, John C. Coffee, Jr. & Ronald J. Gilson, \textit{Cases and Materials on Corporations}, 6\textsuperscript{th} ed. (New York: Aspen Publishers, 2004) at 38.
\end{itemize}
\end{footnotesize}
amount of resources to public welfare, humanitarian, educational and philanthropic purposes.” 63 This approach has been described as an “intermediate position” between “[h]ard-boiled proponents of profit maximization”, on the one hand, and “[p]roponents of a broader definition of corporate social responsibility”, on the other. 64 By limiting “ethical considerations” to those “reasonably regarded as appropriate to the responsible conduct of business”, the principles arguably require no more than the market already expects, and thereby creates little uncertainty. 65

In the wake of the leveraged buy-out craze of the 1980s, several U.S. states enacted “constituency statutes” 66 permitting, but not requiring, directors to take into account the interests of other stakeholders or “constituencies” of the corporation. 67 The former SEC Commissioner who helped draft the first constituency statute for Pennsylvania explained that the purpose of such statutes was to ensure that directors could act in the best interests of the corporation and that the corporation’s bests interests meant “enhancing its ability to produce wealth indefinitely”. 68 These statutes have been criticized, however, as doing little more than allowing management to serve their own best interests by resisting takeover bids. 69

63 Sec. 2.01(b): ibid.
64 Ibid. at 40.
65 Ibid.
66 Ibid. at 41, putting the number of states with such statutes at twenty-nine.
67 The exception is the Connecticut statute, which states that managers “shall” consider non-shareholder interests: see Elhauge, supra note 30 at 769.
68 Steven M. H. Wallman quoted in Margaret Blair, “Whose Interests Should Corporations Serve?” in Max B.E. Clarkson, ed., The corporation and its stakeholders: classic and contemporary readings (Toronto: University of Toronto Press, 1998) at 56.
Delaware, arguably the most important state when it comes to corporate law,\(^{70}\) has not enacted a constituency statute. In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,\(^{71}\) the Delaware Supreme Court held that outside of an auction, in which case the directors’ sole obligation is to obtain the highest possible bid, the directors may take other constituencies’ interests into account “provided there are rationally related benefits accruing to the stockholders.”\(^{72}\) In other words, Delaware courts have never held that management can, or ought to, prefer the interests of other constituents to those of shareholders.\(^{73}\)

U.S. federal environmental statutes do not contain express provisions for liability of directors and officers, but U.S. courts have imposed liability nonetheless; in particular, with respect to hazardous waste.\(^{74}\) Liability has been limited, however, to situations in which directors had authority over and direct involvement in the company’s waste handling practices.\(^{75}\) U.S. law does impose some obligations on corporations to have regard to their environmental impacts. For example, under the *Clean Air Act*, companies that use high volumes of chemicals must implement, and continually review and update, “a multi-step management practice” to assess the risk of accidents, develop procedures to reduce that risk and “ensure that procedures are carried out in practice.”\(^{76}\)

It is probably safe to say, therefore, that generally speaking U.S. law still reflects the shareholder primacy theory of the corporation. The arguments for and against shareholder

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\(^{70}\) Elhauge, *ibid.* at 738 describes Delaware as “the eight-hundred-pound gorilla of corporate law”.

\(^{71}\) 506 A.2d 173 (Del. 1986) [*Revlon*].

\(^{72}\) *Ibid.* at 182.

\(^{73}\) Macey & Miller, *supra* note 69 at 414-415.


\(^{75}\) *Ibid.* at 2-14 to 2-14.1.

primacy and its principal opponent, stakeholder theory, are discussed in the next section.

ESV is then suggested as a possible “third way” between these two approaches.

IV. ESV as a “Third Way” Between Shareholder Primacy and Stakeholder Theories of the Corporation

A. Shareholder Primacy

1. The Argument in Favour of Shareholder Primacy

In essence, the shareholder primacy principle holds that the sole duty of corporate directors is to maximize shareholder value.\textsuperscript{77} This is corporate law as private law.\textsuperscript{78} The welfare or efficiency argument in favour of shareholder primacy\textsuperscript{79} is that because shareholders, unlike the firm’s other stakeholders, share in any profits, they have the greatest incentive to ensure that profits are maximized.\textsuperscript{80} This will in turn benefit the firm’s other stakeholders, because maximizing profits should increase the corporation’s wealth, allowing it, for example, to expand and hire more employees.\textsuperscript{81} Ensuring that the corporation’s directors fulfill this goal through contractual terms would be nearly impossible, given the innumerable ways that they could deviate from it. Corporate law attempts to solve this

\textsuperscript{77} See, generally, Milton Friedman, “The Social Responsibility of Business Is to Increase Its Profits” in Beauchamp & Bowie, supra note 5.
\textsuperscript{79} Friedman, supra note 77 at 51 argues that in addition to welfare considerations, shareholders have a “right” to the profits as the “owners” of the firm. As Blair, supra note 68 at 59 points out, however, this argument is circular: shareholders are not “owners” in the traditional sense, but equity investors. The question is what rights should attach to this kind of ownership. See also Bainbridge, ibid. at 564-65; and Jeffrey G. MacIntosh, “The End of Corporate Existence: Should Boards Act as Mediating Hierarchs?” (2002) The Corporation in the 21st Century: Papers presented at the Queen’s Annual Business Law Symposium at 63 [MacIntosh, “The End of Corporate Existence”].
\textsuperscript{80} See, e.g., MacIntosh, “The End of Corporate Existence”, ibid. at 66, arguing that fixed claimants, such as employees, will be more risk-averse than shareholders, and would make choices that would maximize their chances of realizing on their claims, rather than maximizing value. As will be argued below, however, the fact that shareholders gain on the upside, but bear limited liability on the down-side may create an inefficient “incentive to risk”: see infra notes 90 and 91 and accompanying text.
\textsuperscript{81} Lee, “Efficiency and Ethics”, supra note 29 at 538, footnote 7. See also Blair & Stout, supra note 43 at 313, who argue that this justifies granting voting rights only to shareholders.
problem by imposing on the directors a fiduciary duty to run the company in the best interests of the shareholders. Focusing management on maximizing shareholder value reduces decision-making costs and managerial discretion, as well as the costs of monitoring management to ensure that they are fulfilling their mandate. Extending the duty to other stakeholders would reduce social welfare by requiring management to balance other stakeholders’ interests against shareholders’ interest in maximizing profits. Besides, these groups, being fixed rather than residual claimants, can more easily protect their interests through express contractual terms. The existence of negative externalities is not a reason to deviate from shareholder primacy, since, it is argued, the wealth generated by the corporation would be reduced, thereby diminishing aggregate welfare.

2. The Argument against Shareholder Primacy

Even if managerial focus on maximizing shareholder value is, in general, the most efficient means of increasing aggregate social wealth, this does not mean that “unconstrained profit maximization” is necessarily “conducive to the public interest.” Profit maximization at the expense of all other interests or values may reduce aggregate social welfare by failing to take competing preferences into account. For example, there might exist a widely held

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84 Lee, “Efficiency and Ethics”, *supra* note 29 at 537.
85 The counter-argument is that a) this is not true as an empirical statement and b) that shareholders are in fact better able to protect their interests than other stakeholders by diversifying their investments: Keay, *supra* note 4 at 585-86.
86 Lee, “Efficiency and Ethics”, *supra* note 29 at 539. As Maclntosh, “The End of Corporate Existence”, *supra* note 79 at 68 puts it, the fact that the shareholder primacy rule will not result in the maximization of social welfare in all cases does not mean that it is not the best rule in the sense of maximizing social welfare in most cases. But see the argument in Part II that a rule requiring directors to have regard to the environment may be welfare-enhancing in a greater number of cases than the shareholder primacy rule.
87 Parkinson, *supra* note 33 at 41-42.
preference for protecting small town main streets from big box retailers, even if this preference is not wealth-maximizing.

Shareholder primacy is also criticized for disregarding ethical considerations. Although shareholder primacy is justified on the basis that it is necessary to ensure that managers fulfill their function to maximize profits, it is not necessarily the case that all management decisions that do not seek to maximize profits for the corporation seek to line the pockets of managers. Lee criticizes shareholder primacy for failing to distinguish between instances in which directors indulge in their own personal preferences and those in which ethical considerations constrain profit-maximizing behaviour.88 Williams argues that ethical considerations are “a more persuasive ethical lens through which to evaluate corporate action”, rather than shareholder wealth maximization alone; the latter may explain but not necessarily justify corporate actions that may otherwise be considered ethically problematic by society at large.89

Another potential problem with shareholder primacy is that it may result in excessively risky decisions, because a fiduciary duty owed only to shareholders, who share in any upside but whose downside is limited to their investment, may create an “incentive to risk”.90 For example, the limited liability of shareholders may lead to over-investment in “unusually hazardous industries.”91 Shareholders, therefore, may fail to temper managers’ “cognitive bias, which underweights downside risk and overweights…the probability of

89 Cynthia Williams, “Corporate Compliance with the Law in the Era of Efficiency” (1998) 76 N.C. L. Rev. 1265 at 1382-83. Williams gives the example of tobacco marketing aimed at young people.
90 Oliver Hart, “An Economist’s View of Fiduciary Duty” (1992) 43 U.T.L.J. 299 at 305; and Macey & Miller, supra note 69 at 409. See also Choper, Coffee & Gilson, supra note 62 at 48, discussing Chancellor Allen’s footnote in Credit Lyonnais Bank Netherlands N.V. v. Pathe Communications Corp.
91 Parkinson, supra note 33 at 362.
upside gain”, a bias that is “inseparable from shareholder value maximization”. Shareholder primacy may also result in a focus on short-term earnings, and in fact sacrifice shareholder value in the long-term. Finally, increases in shareholders’ earnings may be obtained by merely transferring wealth to shareholders from other stakeholders, to whom a fiduciary duty is not owed, rather than generating new wealth. This means that shareholder primacy may not, in fact, result in increased aggregate social welfare in the long-term.

Even advocates of shareholder primacy will admit that the application of the principle will not necessarily lead to increased aggregate welfare if all of the costs of a given transaction are not internalized by the parties. In the labour context, a decision to close a plant visits potential costs on the community – such as increases in domestic violence and alcohol abuse – which the corporation does not bear and therefore are not taken into account by corporate decision-makers. On the other hand, the potential benefits of closing the plant – the expansion of a plant in another community, for instance – also have to be taken into account. Weighing all of the potential costs and benefits to the firm’s other constituencies may, however, eventually devolve into a general welfare analysis, for which directors may not be qualified.

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92 Bratton, supra note 42 at 1331.
93 Keay, supra note 4 at 585. Further discussion is found in Part VIII, below.
94 Macey & Miller, supra note 69 at 409; and MacIntosh, “Efficient Fiduciary Law”, supra note 69 at 426.
95 Easterbrook & Fischel, supra note 82 at 25.
97 Hart, supra note 90 at 310.
98 Ibid. at 311.
100 See Part VII below.
B. Stakeholder Theory

1. The Argument in Favour of Stakeholder Theory

Stakeholder theory holds that the end or object of the corporation should include not just the best interests of shareholders, but also other stakeholders or constituencies of the corporation. This is corporate law as public law.\(^{101}\) Stakeholders are defined generally as “those persons or interests that have a stake, something to gain or lose as a result of [the corporation’s] activities,”\(^ {102}\) and include, in addition to shareholders, suppliers, customers, employees and the community.\(^ {103}\) Management’s role, then, is to balance the competing claims of the firm’s various stakeholders.\(^ {104}\)

The stakeholder approach is usually supported by both deontological and utilitarian arguments: there is a moral obligation to treat all stakeholders as “ends in themselves”; and treating stakeholders as ends in themselves will ensure that they are more willing to make firm-specific investments in the corporation.\(^ {105}\) In other words, taking the interests of other stakeholders into account will generate more wealth for the corporation than focusing on maximizing shareholder value alone. This last point is taken up by Blair and Stout in their “team production theory” of the corporation,\(^ {106}\) which has generated a number of responses from shareholder primacy theorists\(^ {107}\) and other critics.\(^ {108}\) Blair and Stout suggest that the

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\(^{101}\) Bainbridge, supra note 78 at 549. This theory has its historical roots in E. Merrick Dodd’s article “For Whom Are Corporate Managers Trustees?” in Clarkson, supra note 68.

\(^{102}\) Clarkson, ibid. at 2. See also R. Edward Freeman, “A Stakeholder Theory of the Modern Corporation” in Beauchamp & Bowie, supra note 5 at 58: stakeholders can be defined narrowly as those groups “vital to the survival and success of the corporation”, or widely as any group that is affected by or can affect the corporation.

\(^{103}\) Freeman, ibid. at 56.

\(^{104}\) Ibid. at 60-61.

\(^{105}\) Ibid. at 59-60. It seems difficult, however, to separate treating stakeholders as ends in themselves from treating them with respect in order to ensure the corporation’s success in the long-run. See also Steering Group, supra note 34 at 38, 42-43 regarding the utilitarian argument for pluralism.

\(^{106}\) Blair & Stout, supra note 43.

\(^{107}\) See, e.g., Bainbridge, supra note 78; and MacIntosh, “The End of Corporate Existence”, supra note 79.
problem that corporate law seeks to solve is that of ensuring that each group of team members – employees, creditors, shareholders, etc. – is willing to make the necessary inputs given that the output – corporate profits – cannot be differentiated based on inputs and therefore cannot be distributed to the team members on this basis. Similar to the argument for shareholder primacy theory, Blair and Stout argue that this problem cannot be completely resolved contractually. The role of directors under this theory, therefore, is to “mediate” the competing demands of the team members in the best interests of the team’s project – that is, the corporation. Although Blair and Stout distinguish their approach from stakeholder theory on the ground that directors are “beholden” only to the corporation itself, it is similar in holding that the end of the corporation is not simply to generate value for the shareholders, but for all of the corporation’s team members or stakeholders.

2. The Argument against Stakeholder Theory

A major criticism of stakeholder theory, and one that arguably applies equally to team production theory, is that it allows directors to justify any decision as having been in the best interests of some constituency, making them unaccountable to anybody. “a manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither,” turning the fiduciary duty from a deterrence against self-dealing or shirking into a “shield that prevents investors from controlling [their] conduct.” This is especially the case where management is permitted, but not required, to take other stakeholders’ interests into account. The result is that directors fail to ensure

109 Blair & Stout, supra note 43 at 254.
110 Hart, supra note 90 at 303.
111 Easterbrook & Fischel, supra note 82 at 38.
112 Ibid. at 93.
113 Macey & Miller, supra note 69 at 410.
that managers are maximizing profits and, so the critique goes, therefore also fail to maximize social welfare.

But the scope of managerial discretion is also a problem for shareholder primacy. Although shareholder primacy may be seen as setting a clearer objective for directors to pursue, it is still up to them to determine the course of action that will achieve this objective, and which course of action will maximize shareholder value will rarely be obvious. It is not clear, therefore, that a fiduciary duty owed exclusively to shareholders provides significantly greater control over directors’ conduct.114

The difficulty in determining what course of action will in fact maximize shareholder value has naturally resulted in the courts’ long-standing reluctance to interfere with “business judgements”, except in cases of gross incompetence or obvious self-dealing.115 Although the business judgement rule is probably “efficient” in the sense that shareholder value is better protected by leaving business decisions in the hands of professional managers rather than the courts,116 the upshot of the rule is that “as a practical matter, the rights being taken away from shareholders by [U.S.] other constituency statutes were not rights that provided much in the way of concrete benefits for shareholders in the first place.”117 The ultimate enforcement mechanism of the fiduciary duty may not be the courts but the market for corporate

114 Ibid. at 404; and Parkinson, supra note 33 at 93. See also Lee, “Citizenship”, supra note 88 at 25, making the same point regarding “the best interests of the corporation”.
115 Adolph A. Berle and Gardiner C. Means. The Modern Corporation and Private Property, revised ed., (New York: Harcourt, Brace & World, Inc., 1968) at 296; Blair & Stout, supra note 43 at 299; Easterbrook & Fischel, supra note 82 at 2 and 99. The Supreme Court of Canada held in Peoples, supra note 49 at para. 46 that “any honest and good faith attempt to redress the corporation’s financial problems…will not qualify as a breach of the statutory fiduciary duty.”
116 Easterbrook & Fischel, ibid. at 98-100; and Elhauge, supra note 30 at 776-77.
117 Becht, Bolton & Röell, supra note 83 at 847; and Macey & Miller, supra note 69 at 403. See also BCE, supra note 50 at para. 41.
control,\textsuperscript{118} which is why the law should be cautious in providing directors with the means to resist takeovers.\textsuperscript{119}

The other main argument against broadening the fiduciary duty to encompass other constituents of the corporation is that loyalty is a finite good: the more people or groups to whom the duty is owed, the lesser its value to any one person or group.\textsuperscript{120} Although it is possible that there is some “organizational slack” in many corporations, providing room to meet other, even competing demands, while still generating the same level of profits,\textsuperscript{121} there is still the risk that this approach will mean distracting management with political battles at the expense of economic growth.\textsuperscript{122}

\textbf{C. ESV: A Third (and Better) Way?}

ESV is an attempt to strike a middle path between the certainty of shareholder primacy, on the one hand, and the sensitivity to external impacts of stakeholder theory, on the other. ESV, as enacted in the U.K., maintains directors’ focus on generating shareholder value, creating a clear rule to resolve conflicting interests. The generation of shareholder value is qualified, however, by the requirement to have regard for the long-term external impacts of this value creation. ESV is properly understood, therefore, as a limit on the maximization of shareholder value, rather than as altering the end of the corporation. The imposition of such a limit is not inconsistent with shareholder primacy theory. As even one

\textsuperscript{118} Bainbridge, \textit{supra} note 78 at 570; Easterbrook & Fischel, \textit{supra} note 82 at 96-97; and Steering Group, \textit{supra} note 34 at 34.

\textsuperscript{119} Becht, Bolton & Röell, \textit{supra} note 83 at 873 note that the market for corporate control in the U.S. has “essentially collapsed”, whereas the U.K. has retained an active market.

\textsuperscript{120} Hart, \textit{supra} note 90 at 303; Macey & Miller, \textit{supra} note 69 at 401-02; and MacIntosh, “The End of Corporate Existence”, \textit{supra} note 79 at 71.

\textsuperscript{121} Elhauge, \textit{supra} note 30 at 805-06; Prakash & Potoski, \textit{supra} note 14 at 188; and Parkinson, \textit{supra} note 33 at 67.

\textsuperscript{122} Steering Group, \textit{supra} note 34 at 44. Similarly, Lee, “Efficiency and Ethics”, \textit{supra} note 29 at 543 notes that the implication of Blair & Stout’s team production theory is that team members will spend their time trying to influence the board’s allocation of profits rather than producing wealth.
of the most ardent defenders of shareholder primacy has acknowledged, the duty to “make as much money as possible” is qualified by “conform[ity] to the basic rules of the society, both those embodied in law and those embodied in ethical custom.” The express qualification of the duty to maximize shareholder value by “having regard to” the impacts of profit maximization on the environment can be viewed as a new “basic rule of society” as enacted through the legislative process. The rule implies that profits to shareholders should not be generated at the expense of long-term severe and irreparable environmental harm. If the public, through legislation, has decided to bestow corporate directors with this discretion, then “corporate social responsibility” in this form cannot be criticized as undemocratic.

ESV, then, seeks to balance the essentially private nature of modern corporations against the public impacts of their operations by acknowledging the corporation’s primary economic function, but at the same time requiring directors to consider the direct external impacts of profit maximization. This approach is not incompatible with shareholder primacy, since, as noted above, managers must maximize shareholder value within the bounds of the socially accepted rules of the game. Although some argue that these “rules” should be limited to express requirements found in laws and regulations currently in force, this would always leave a gap where there either is no law or the law itself is unethical. Playing within these rules should, in most cases, coincide with shareholders’ best interests, since “it is usually in one’s interest to act morally.” ESV merely codifies a rule that many already

123 Friedman, supra note 77 at 51.
124 Friedman criticizes corporate social responsibility as undemocratic because it encourages corporate directors to adopt preferences that are not reflected in legislation enacted by government: ibid. at 53.
125 John J. Donahue, “Does Greater Managerial Freedom to Sacrifice Profits Lead to Higher Social Welfare?” in Hay, Stavins & Vietor, supra note 9 at 84, citing U.S. law in the 1800s regarding slavery as an example.
126 Beauchamp & Bowie, supra note 5 at 3. Blair & Stout, supra note 43 at 304-05 argue that the team production theory of the corporation also suggests that shareholders’ long-term interests should be interpreted
considered necessary to corporations’ continued legitimacy in the community.\(^{127}\) The fact that it is contained in legislation indicates societal consensus in the U.K. that economic growth should be kept within the boundaries of environmental sustainability.\(^{128}\) In addition, ESV, by creating a mandatory rule, ensures that corporations that already take into account the negative impacts of their operations and mitigate accordingly are not at a competitive disadvantage to those that do not.\(^{129}\)

**V. ESV In Practice: A Duty To Be Informed**

One of the harshest criticisms of ESV is that it is “contentless” in the sense that it does not provide any direction as to when or to what degree management should or may deviate from shareholder wealth maximization.\(^{130}\) It is also relevant to consider how a court is to review a board’s decision for conformity with ESV. This section will argue that ESV should be interpreted as a duty on directors to be informed of the impacts of the corporation’s operations on the environment. Such an approach might be referred to as a “management-based strategy”, one that “call[s] upon firms to invest in the production of information about the environmental risks they create, about alternatives to reduce or mitigate those risks, and about procedures for continued monitoring and information collection.”\(^{131}\) Directors’ decisions should be guided by the duty to avoid causing severe or irreparable environmental harm to future generations, but the substantive outcomes of directors’ decisions should

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\(^{128}\) There may be a similar shift in the fiduciary duty of pension fund trustees from interpreting “best interests” of the beneficiaries as “sole interests” to including collateral benefits to, e.g., the environment, so long as no conflict arises: Richardson, *supra* note 32 at 160-61.

\(^{129}\) Stiglitz, *supra* note 23 at 199.

\(^{130}\) MacIntosh, “Efficient Fiduciary Law”, *supra* note 69 at 444.

\(^{131}\) Coglianese, *supra* note 76 at 62.
continue to be protected by the business judgement rule, in order to provide stability and
certainty to business decisions and to minimize the costs of ESV. This approach focuses
directors’ attention on avoiding direct negative impacts, rather than requiring directors to have a general concern for the general well-being of the corporation’s stakeholders, as stakeholder theory might demand.

The fact that this interpretation of ESV leaves much to the discretion of management is no different from a fiduciary duty to the shareholders or to the corporation: neither produces a particular substantive outcome in any given case. The business judgement rule is necessary to prevent courts from simply substituting their view on the best course of action to maximize shareholder value and avoiding negative external impacts for that of management’s. Enforcement of the duty must focus, therefore, on the decision-making process.\(^\text{132}\) A process-oriented approach is already used in other areas of corporate law. For example, self-interested transactions may be approved by a court when they have been approved by “independent monitors”, such as disinterested directors or a shareholder vote.\(^\text{133}\) The requirements for application of the business judgement rule also emphasize process, namely that the decision was informed and made in good faith or with an honest belief.\(^\text{134}\)

\(^\text{132}\) As is currently the case: see, e.g., *BCE*, *supra* note 50 at para. 26, noting that the trial judge took into account the independence of the directors, “that the arrangement was the culmination of a robust strategic review and auction process”, and the assistance provided to the Board by “leading legal and financial advisors”.

\(^\text{133}\) Easterbrook & Fischel, *supra* note 82 at 104-05. See also *BCE*, *ibid.* at para. 152: in determining whether an arrangement has met the test for court approval under s. 192 of the *CBCA*, the court may “consider the repute of the directors and advisors”; and “whether the plan has been approved by a special committee of independent directors”.

\(^\text{134}\) Regarding the law in the U.S., see *Revlon*, *supra* note 71 at 180. See also Bainbridge, *supra* note 78 at 562; and Blair & Stout, *supra* note 43 at 300. Regarding the law in Canada, see *Maple Leaf Foods Inc. v. Schneider Corp.* (1998) 42 O.R. (3d) 177 (C.A.) at paras. 33-34. Weiler J.’s reasons in *Maple Leaf* also emphasize the importance of process in cases of suspected conflict of interest between the board and the shareholders: “the real questions are whether Committee was independent and whether the process undertaken by the Special Committee was in the best interests of Schneider and its shareholders in the circumstances.” At para. 39 [emphasis added]. See also *UPM-Kymmene Corp. v. UPM-Kymene Miramichi Inc.* (2004), 250 D.L.R. (4th) 526 at para. 7.
In order for a court to hold that a board of directors had complied with the duty to “have regard to” environmental impacts under ESV, it would have to find that they had been provided with and reviewed adequate information on the environmental impacts of the decision at issue. The additional burden imposed on directors by ESV is, therefore, an informational one. Although this may seem a rather weak interpretation of the duty to “have regard to”, once directors are informed of the environmental impacts of the corporation’s operations, they may have a hard time ignoring them. Directors may, as a result of complying with ESV, decide to re-allocate firm resources to environmental protection. Ensuring that information on environmental impacts is taken into account by those with the ultimate decision-making power over the corporation’s activities should also help to move environmental impacts from the periphery of business concerns, or solely the concern of a specialized employee or department, closer to the centre of long-term and strategic business planning. There is some empirical evidence that this sort of management-based approach “can result in environmental gains.” The potential positive impacts of ESV on corporate environmental performance are discussed in more detail in Part VI, below, but calling directors’ attention to environmental issues should help to internalize the costs of monitoring compliance with existing environmental regulations and help to fill the gaps in those regulations.

135 Thomas Gehring, “Treaty-Making and Treaty Evolution” in Bodansky, Brunnée & Hey, supra note 15 at 484. For further discussion of the impact of a duty to gather information on the firm’s environmental impacts, see Part VI.A, below.
136 Ashford & Caldart, supra note 9 at 396; and Parkinson, supra note 33 at 368.
137 See Coglianese, supra note 76 at 66, citing a 40% drop in insurance claims in the chemical industry after the introduction of the Clean Air Act regulation and describing, at 67-68, a study showing that “the presence of a management-based regulation in a facility’s state was associated with about a 30 percent decrease in toxic air emissions – over and above what otherwise would have occurred in the absence of the management-based law.”
138 Ibid. at 69, citing the self-reported responses to a recent survey which revealed that the use of regulations that target management decision-making “correlates with reported improvements in unregulated aspects of
ESV is similar to, but distinguishable from, the duty of directors under Canadian law to take all reasonable care to avoid adverse environmental effects. Although both should improve compliance with existing regulations, the Canadian environmental law duty may not cover the environmental impacts of a corporation’s operations that will not themselves have an adverse effect on their own, but will have a cumulative adverse effect when combined with the environmental impacts of other corporations.139 The duty under Canadian environmental law, therefore, may not cover long-term cumulative environmental impacts such as climate change.140 Although enforcement by penal sanctions141 may make the Canadian approach more appealing, the deterrence value of the sanction is limited to environmental effects that will occur and be discovered within the director’s lifetime, whereas the effects of climate change likely will not be felt for another 50-100 years. Furthermore, a duty to take all reasonable care to avoid an adverse effect may be interpreted by directors as a requirement to meet a certain threshold of harm avoidance, whereas the positive formulation of the duty under ESV may better encourage directors to take responsibility for improving their corporation’s environmental performance on an ongoing

139 The qualifier in s. 194(1.1) of the *EPA*, *supra* note 58 “likely to cause” may also limit the application of the duty to take all reasonable care to avoiding immediate or imminent environmental harm only, since the farther out in time an environmental harm is predicted to occur, the less “likely” it may be to occur.


141 *CEPA*, *supra* note 57, s. 272(2); *EPA*, *supra* note 58, s. 187; and *OWRA*, *supra* note 58, ss. 108 and 109.
basis. The advantage of including a duty to have regard to environmental impacts as part of the fiduciary duty under corporate law, rather than under environmental legislation, is that it may signal to directors that environmental considerations should be integrated into the corporation’s long-term financial and strategic planning, rather than merely an added-on, stand-alone cost of operations. On the other hand, the duty under Canadian environmental law sets a minimum standard of care expected of directors, whereas ESV leaves much more to their discretion. For this reason, it might be undesirable to replace the duty under Canadian environmental legislation with ESV. If added to the fiduciary duty of directors under Canadian corporate law, however, ESV might further improve Canadian corporations’ environmental performance. In particular, since whether or not “all reasonable care” has been taken is usually judged against industry standards, ESV could help to raise the standard against which directors are judged under environmental legislation.

Some scholars have criticized the emphasis on process in the law on corporate governance as requiring directors merely to “go through the motions of making considered business judgements.” There may be a risk that ESV will become an exercise in ticking a box after a perfunctory review. But, as one process critic has acknowledged, apart from examining a board’s decision-making process, it is impossible for a court to inquire into the

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142 Cass R. Sunstein, “Social Norms and Social Roles” (1996) 96 Colum. L. Rev. 903 at 942-44 describes empirical studies finding that people demanded much higher amounts to allow environmental destruction than they were willing to pay to prevent it. Sunstein suggests that the difference is the shame attached to the greater sense of moral responsibility assigned to allowing the harm versus preventing it. ESV may be able to capitalize on the shame attached to allowing, versus preventing, environmental harm by making directors feel a greater sense of responsibility for the environmental impacts caused by the corporation’s operations. As Sunstein, ibid. at 944 notes, “[p]eople want to avoid or minimize the feeling that they have been morally culpable for producing the loss of an environmental amenity.”

143 Bata Industries, supra note 61 at 362-63. The industry standard will prevail except where circumstances dictate the need for a higher level of care: Estrin, supra note 74 at 4-32.5.

144 Bratton, supra note 42 at 1334.
“degree of attention and quality of judgement actually brought to bear” and the alternative of “strict scrutiny” of the substance of business judgements is undesirable.145

Another serious challenge to ESV is the argument that it removes the “determinate metric for assessing options” provided by shareholder primacy.146 The argument is that by including other factors that directors must consider in making decisions, ESV introduces the possibility of conflicts of interest between shareholder value and, for example, avoiding impacts on the environment. The wording of the U.K. provision makes clear, however, that the directors’ overriding duty is still to “to promote the success of the company for the benefit of its members as a whole”, and so does provide some guidance for resolving conflicts, although this paper argues that directors’ decisions that appear to sacrifice short-term shareholder value in order to mitigate or avoid severe or irreparable environmental harm should not be challengeable. Furthermore, shareholder disagreement on decisions regarding avoidance of environmental impacts is not dissimilar to disagreement on the corporation’s business strategy. One means of avoiding disagreement may be for the board to publish a clear policy on its own ESV strategy,147 including which specific environmental impacts are considered in board decisions – climate change, endangered species, biodiversity, etc. – and the process by which the board goes about comparing these impacts to expected shareholder gains. This may also help to alleviate concerns that the additional leeway provided to directors by ESV may make shareholders less willing to invest.148 By requiring directors to focus on long-term value, however, the result of ESV may in fact be

145 Ibid. at 1334, 1338.
146 Bainbridge, supra note 78 at 581.
147 See Richardson, supra note 32 at 166, arguing that if pension fund trustees keep beneficiaries informed of their SRI policies, it is unlikely that beneficiaries could hold them liable for breach of their fiduciary duty.
148 Bainbridge, supra note 78 at 582.
the reduction of conflicts between shareholder value and stakeholders’ interests where ongoing commitment and support from stakeholders is required for ongoing profitability.\textsuperscript{149}

Finally, it may be argued that ESV is meaningless since there is no real way of enforcing it. The U.K. legislation allows only shareholders to bring derivative claims\textsuperscript{150} and they are unlikely to bring claims for directors’ failure to “have regard to” the environment unless shareholder value is significantly negatively affected. Even if a claim were to be brought, subject to following an adequate decision-making process, the weight directors assign to environmental impacts in making any particular decision is within their discretion and, in general, will be protected by the business judgement rule. Given the deference by North American courts to directors’ decisions under the business judgement rule, however, even when the central issue is maximization of shareholder value and the potential conflict of interest of the directors,\textsuperscript{151} a fiduciary duty understood simply as a duty to maximize corporate profits is not a right that is clearly enforceable. As stated above, under current Canadian and U.S. law, shareholders are unlikely to succeed in an action against the directors for breach of fiduciary duty absent gross incompetence or obvious self-dealing.\textsuperscript{152} It follows that although the enforceability problem is a difficult one for ESV, it is not, perhaps, the most relevant. Furthermore, ESV may have an impact on directors’ behaviour beyond the threat of direct enforcement, through its potential impact on social norms.\textsuperscript{153} The potential

\textsuperscript{149} Beauchamp & Bowie, supra note 5 at 47: as a “practical matter”, managers may only be able to generate profits if they treat employees and customers well.

\textsuperscript{150} Companies Act, supra note 2, Part 11, Ch. 1. In Canada, an application to bring a derivative action may be brought by a registered or beneficial shareholder, a director or officer of a corporation, the “Director” or any other “proper person”: see CBCA, supra note 48 ss. 238 and 239.

\textsuperscript{151} See Maple Leaf, supra note 134.


\textsuperscript{153} See Part VI.C, below.
positive impacts of ESV on corporations’ environmental performance are elaborated on in the next section.

VI. The Potential Positive Impact of ESV on the Environment

A. The Power of Information – Internal: ESV and Environmental Management Systems

The problem of imperfect information is one of the main types of market failure. Economic theory assumes that “vigorous competition among profit-maximizing firms, vying for the business of informed customers, will result in the most efficient allocation of society’s limited resources.” Imperfect information, however, “can prevent the efficient allocation of resources by making it impossible for economic agents to act in their own self-interest.” This may especially be the case with environmental harm given the often significant lag time between cause and effect, which means that the harm is not immediately obvious. A legal duty on directors to be informed about the environmental impacts of their corporation’s operations may help to make the information available to them “less imperfect” by revealing potential environmental harm that may previously have gone undiscovered until the damage had been done.

Once better information on the environmental impacts of the corporation’s operations is in directors’ possession, it is at least arguable that they will choose to re-allocate corporate

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154 Portney, supra note 9 at 109. See also Ashford & Caldart, supra note 9 at 135; and Kaplow & Shavell, supra note 21 at 455.
155 Portney, ibid.
156 Ibid. at 110. See also Ngo Van Long, “Toward a Just Savings Principle” in Roemer & Suzumura, supra note 13 at 297, noting the distinction made by economists between the “correct” price and the market price. This difference will arise where, for example, the market price of a forest fails to reflect “its contribution to biodiversity”; ibid.
157 Supra note 13 and accompanying text.
resources to environmental protection. Writing in the international context, Gehring argues that information on environmental problems and the available solutions

is difficult...to ignore. ... Hence, even actors intending exclusively to maximize their own utility might be inclined to change their preferences if they learn about additional implications of an environmental problem. ... And a defensive strategy...cannot be justified by lack of suitable substitutes...once [it has been] revealed that such substitutes exist.¹⁵⁸

Improving the information provided to directors may also counter the problem of cognitive bias against incurring present costs for future benefits.¹⁵⁹ This very human shortcoming was noted by Garrett Hardin in his seminal article “The Tragedy of the Commons”:

...natural selection favors the forces of psychological denial. The individual benefits as an individual from his ability to deny the truth even though society as a whole, of which he is a part, suffers.¹⁶⁰

A legal requirement that directors inform themselves of the environmental impacts of the corporation’s operations can help counter the “forces of denial” by not allowing directors to remain blissfully ignorant. In other words,

...by directing the board to consider the [environment] it might expand the cognitive basis of decision-making and so might on occasion lead to a superior accommodation of [environmental] interests within the traditional framework of shareholder supremacy.¹⁶¹

That is, if environmental impacts are considered early in the decision-making process, it is possible that even if the board ultimately decides to proceed, greater measures will be taken to prevent or to mitigate the impact. Considering environmental impacts in the initial design

¹⁵⁸ Gehring, supra note 135 at 484-85.
¹⁵⁹ Birnbacher, supra note 16 at 34.
¹⁶⁰ Garrett Hardin, “The Tragedy of the Commons” (1968) 162 Science 1243 at 1244.
of products and choice of raw materials, for example, rather than as an afterthought when end-of-pipe controls may be the only option.\(^{162}\) could have significant environmental benefits, since a focus on end-of-pipe reductions can result in “media substitution” – simply moving the pollution from one point source to another, with no real gains to environment quality.\(^{163}\)

Where the information provided to directors in compliance with the duty under ESV reveals environmental problems, the background threat of tort or regulatory liability should lead corporate directors to instruct that action be taken to address the problem.\(^{164}\) Since ESV is a legal obligation, corporations do not have the option, as they would with a voluntary program, of not engaging in information-gathering in an attempt to avoid future liability.\(^{165}\)

One specific impact on corporate behaviour that ESV might have is to encourage more widespread use of “environmental management systems” (“EMS”).\(^{166}\) An EMS is a way for firms to develop, institutionalize and achieve their own environmental goals,\(^{167}\) allowing management to generate their own performance targets based on an understanding of the firm or facility’s specific environmental impact and to implement the lowest cost

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\(^{162}\) Ashford & Caldart, supra note 9 at 971-72.

\(^{163}\) Prakash & Potoski, supra note 14 at 7. This is one of the problems with command-and-control regulation: see Part VII.B, below.

\(^{164}\) Coglianese, supra note 76 at 64-65. As discussed above, under Canadian environmental law, directors and officers have a duty to take all reasonable care to comply with regulatory requirements. With respect to tort liability, see United Canadian Malt Ltd. v. Outboard Marine Corp., (2000), 48 O.R. (3d) 352, in which Nordheimer J. stated as follows: “In my view, the allegation that individual directors knew of the existence of an environmental problem such as is alleged to have existed here and did nothing to alert the plaintiff of the risk posed to the plaintiffs operation, such that the plaintiff was subsequently harmed, is sufficient on the surface to found a reasonable cause of action against those individual directors.”

\(^{165}\) Coglianaese, ibid. at 65.

\(^{166}\) Ontario courts will ask whether a pollution prevention program was put in place in determining directors’ liability under the EPA: Bata Industries, supra note 61 at 362.

\(^{167}\) Ashford & Caldart, supra note 9 at 937; Coglianese, supra note 76 at 56; Prakash & Potoski, supra note 14 at 89; and Wood & Johnson, supra note 140 at 2.
improvements. A fully developed EMS should integrate environmental management with the corporation’s strategic business plan and establish regular communication between top management and personnel. These aspects of EMS are very similar to the goals of ESV, namely ensuring that information about external impacts makes its way up the corporate food-chain and is integrated into directors’ decision-making, thereby better connecting the corporation with the community and the environment in which it operates. Furthermore, like the process-based articulation of ESV presented in this paper, EMS is “predicated on the belief that if appropriate processes and management systems are in place, desired outcomes will follow.” Although implementation of an EMS does not require the firm to adopt any specific substantive targets, there is some evidence that implementation of an EMS does improve a firm’s environmental performance. There are also emerging international standards for what such a system should involve, and standards such as the ISO 14001 have started to be added to domestic environmental regulation.

ESV and EMS may also improve compliance with existing regulations. The ISO standard requires firms to “strive to comply” with government regulations. One empirical study indicates that U.S. firms that have an ISO 14001 certified EMS spend less time out of

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168 Ashford & Caldart, ibid. at 938.
169 Prakash & Potoski, supra note 14 at 90-91.
170 See supra note 36 and accompanying text.
171 Prakash & Potoski, supra note 14 at 89.
172 Ibid. at 3, 148 and 166, reporting results of their study that U.S. firms with an ISO 14001 EMS in place experienced lower toxic emissions than those without, controlling for other possible causes. The difference was not large, but was “statistically significant”.
173 For a detailed analysis of the ISO 14001 standard and its possible impact on corporations’ environmental performance, see Prakash & Potoski, supra note 14.
174 See, e.g., Ontario Environmental Penalties, O. Reg. 222/07, s. 17, which allows for a deduction of 5% from the amount of an environmental penalty if the company had an ISO-certified EMS in place at the time of the incident. Ontario law also requires certain facilities to have in place a “spill prevention and contingency plan”: see Spill Prevention and Contingency Plan, O. Reg. 224/07. U.S. government prosecutors also have an established practice of leniency to firms with an EMS: see Coglianese, supra note 76 at 57.
175 Prakash & Potoski, supra note 14 at 89.
compliance. EMS may also help to trigger internal environmental protection norms in employees by making them aware of instances of non-compliance and improvements in performance. A duty to be informed of the firm’s environmental impacts may also mean that the costs of ensuring compliance are internalized by the corporation, reducing the need for, and by extension the cost of, government enforcement of regulations.

**B. The Power of Information – External: ESV and Disclosure**

As noted above, the U.K. *Companies Act* now requires that public companies’ director’s reports include reporting on environmental issues, although only “to the extent necessary for an understanding of the development, performance or position of the company’s business”. Canadian securities law also requires disclosure on the “effects of environmental protection” on capital expenditures, earnings and the competitive position of the company, where such effects are “material” in the sense that they would affect a “reasonable investor’s” decision to buy, sell or hold the company’s shares. Canadian public companies are also required to disclose environmental policies that are considered “fundamental” to their operations, environmental risks, and trends or risks likely to

176 Ibid. at 166.
178 Prakash & Potoski, *supra* note 14 at 7, noting that the enforcement-intensive nature of traditional “command-and-control regulation” means that compliance has suffered from reductions in government budgets.
179 Section 417(5)(b)(i): see Part III.A, above.
180 National Instrument 51-102, *Continuous Disclosure Obligations*, Form 51-102F2, s. 5.1(1)(k) [NI 51-102].
181 NI 51-102, Form 51-102F2, Part 1 (e) and Form 51-102F1, Part 1 (f). The “reasonable investor” is to be understood as an “economic being”: *In the Matter of YBM Magnex International Inc.*, (2003) 26 OSCB 5285 at para. 91.
182 NI 51-102, Form 51-102F2, s. 5.1(4).
183 NI 51-102, Form 51-102F2, s. 5.2.
affect their financial statements in the future.\textsuperscript{184} U.S. securities law contains similar disclosure requirements.\textsuperscript{185}

ESV is both complemented by and complements this mandatory disclosure and environmental disclosure made under voluntary standards, such as the Global Reporting Initiative.\textsuperscript{186} First, ESV is complemented by disclosure by informing investors and consumers about a corporation’s production methods which might otherwise be invisible to them absent a significant effect on share or product price.\textsuperscript{187} Disclosure also helps third parties monitor corporations for their contributions to “large group externality problems” like climate change, where the sheer number of sources makes it difficult to pinpoint contributors.\textsuperscript{188} To the extent that corporations disclose actual environmental performance “indicators”,\textsuperscript{189} disclosure should also help to ensure that ESV does in fact result in substantive improvements to corporations’ environmental performance, and does not become an empty procedural exercise. Finally, ESV is complemented by disclosure because disclosure increases the possibility of the corporation suffering harm to its reputation from causing negative environmental impacts, thereby backing up the legal requirement to “have regard to” with market pressure.\textsuperscript{190}

\begin{itemize}
  \item \textsuperscript{184} NI 51-102, Form 51-102F1, Part 1 (a).
  \item \textsuperscript{185} Perez, \textit{supra} note 161 at 12-13.
  \item \textsuperscript{186} The Global Reporting Initiative (GRI) was created in 1997 by Ceres in partnership with the U.N. Environment Program. The GRI publishes guidelines for companies to follow in making environmental and social disclosure. The idea is to come to a consensus on an international disclosure standard, thereby facilitating comparison between companies. See www.globalreporting.org.
  \item \textsuperscript{187} Parkinson, \textit{supra} note 33 at 15.
  \item \textsuperscript{189} Global Reporting Initiative, “Making the Connection” at 5, available at <http://www.globalreporting.org/NR/rdonlyres/A72A4645-B6FA-40B5-A1EE-A64E6f0CFBB2/0/260607_COP_MTC.PDF> (last accessed June 24, 2009).
  \item \textsuperscript{190} Perez, \textit{supra} note 161 at 27; and Revesz & Stavins, \textit{supra} note 9 at 548, although they note that the evidence is mixed.
\end{itemize}
ESV, in turn, complements disclosure by signalling that corporations ought to be concerned with their environmental impacts, and that investors and consumers ought to hold accountable those corporations that fail to fulfil this obligation. This reinforces the reputational risk corporations face for failing to have regard to the environment. After all, “[h]arm to a firm’s reputation...arises only in the case of conduct widely judged to be inappropriate and therefore worthy of censure.” A legal requirement to have regard to environmental impacts signals a societal consensus that this represents good corporate behaviour, and a failure to do so is “worthy of censure.” Greater disclosure on environmental performance may also help to flesh out the content of corporate environmental responsibility generally and to future generations by facilitating the “cognitive conditions” for an “informed and richer discussion about how to evaluate” the sustainability of current corporate conduct. In other words, greater disclosure on corporations’ environmental performance may help to determine the content of the duty owed to future generations to avoid severe or irreparable harm, discussed in Part II, above.

ESV may also broaden the type of information that is considered relevant to assess the company’s long-term performance beyond current accounting standards. Current disclosure standards require reporting on environmental matters only when there is an expectation that future revenues will be affected. The problem with this approach is that given the difficulties in valuing environmental harm, “environmental reporting is not likely

191 See, e.g., Richard McAdams & Eric B. Rasmusen, “Norms and the Law” in Polinsky & Shavell, supra note 9 at 1589 regarding law’s potential impact on social norms, discussed in Part V.C, below.
192 Klare, supra note 96 at 395.
193 Perez, supra note 161 at 20.
194 Ibid. at 7.
195 Ibid. at 11. See also Canadian securities disclosure requirements, supra notes 180-84 and accompanying text.
to generate the proper signals to the market.” Specifically, costs or harm that is not expected to arise for a number of generations is not going to be taken into account. By requiring that data on environmental performance be gathered and by indicating that such data is relevant to the corporation’s long-term performance, ESV may help to improve environmental disclosure by expanding the current understanding of “material” information.

The question for regulators is whether disclosure on environmental matters should be mandatory or voluntary. Mandatory disclosure has the advantage of ensuring that all corporations make disclosure, but it can become “boilerplate” and uninformative. Voluntary disclosure has the advantage of being more flexible and responsive to the types of information readers actually want to have. But notwithstanding the increasing number of companies voluntarily disclosing information on social and environmental issues, take-up of voluntary reporting standards has been low. ESV may prompt more directors to voluntarily disclose environmental information not only because they now have a legal obligation to gather the data necessary to meet the reporting requirements of voluntary standards such as the GRI, but also to inform shareholders as to how the corporation is addressing its environmental impacts and thereby avoid allegations that they are either failing to comply with requirements under ESV or taking advantage of their discretion under ESV for their own gain. Changes in social norms of corporate behaviour, discussed in the next

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196 Ibid. at 14.
197 Williams & Conley, supra note 1 at 36.
198 The Global Reporting Initiative, for example, collaborates with business, civil society, labour and “other professional institutions” in coming up with the information required to meet its disclosure standard: see Global Reporting Initiative, “Making the Connection” at 5, available at <http://www.globalreporting.org/NR/rdonlyres/A72A4645-B6FA-40B5-A1EE-A64E6F0CFBB2/0/260607_COP_MTC.PDF> (last accessed June 24, 2009).
199 Williams & Conley, supra note 1 at 41, note that almost 50% of the “Global 250” are issuing sustainability reports.
200 Perez, supra note 161 at 25.
section, may also help to improve take-up rates of voluntary reporting standards like the GRI.  

C. Impact of ESV on Social Norms of Corporate Behaviour

Social norms are “maxims that people want to obey because the maxims have been inculcated in them or are inborn.” Social norms are also defined as “behavioural regularities followed by individuals” frequently grounded in some sort of normative basis. Social norms are enforced by feelings of guilt or shame for violating the norm or of pride for complying with it. These feelings of guilt, shame or pride can be understood as a “tax” or a “subsidy” attached to behaviour; in this way, social norms can be seen as imposing a “cost” on behaviour that violates the norm. Social norms may also be enforced through self-imposed “commitments”, which limit an individual’s options even aside from internal feelings of guilt or pride or external impacts on reputation. Social norms can be internalized by a private organization as well as an individual; these are referred to as “organizational norms”. The instrumental value of social norms is that they promote behaviour that, in most cases, is welfare-enhancing for the individual and society in the long-term, even though there may be specific instances where the immediate benefits of violating

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201 Ibid. at 24.
202 Kaplow & Shavell, supra note 21 at 10.
203 Green, supra note 188 at 413-14. See also McAdams & Rasmusen, supra note 191 at 1576. Social norms can be contrasted with social “conventions”, such as in which hand to hold a fork, which have no normative basis: McAdams & Rasmusen, ibid. at 1576.
204 McAdams & Rasmusen, ibid. at 1579; Sunstein, supra note 142 at 915; and Vandenbergh, supra note 177 at 67-68, 70.
205 Sunstein, ibid. at 939.
206 Ibid. at 945.
208 McAdams & Rasmusen, supra note 191 at 1576.
The power of social norms may, therefore, explain patterns of behaviour that go against what economists would otherwise expect of “rational” individuals, because the internal and external sanctions attached to violations of social norms – that is, feelings of guilt or shame – influence how individuals define their own best interests. Social norms therefore may help to solve collective action problems by inducing people to do things that they otherwise would have little economic incentive to do, such as recycling.

The relationship between law and social norms is one of interdependence. On the one hand, law derives much of its authority from its congruence with social norms. Furthermore, a law backed by strong social norms lowers monitoring costs, because social norms, being internally enforced, are enforced by the party best-informed about its conduct. On the other hand, laws are sometimes needed to reinforce a social norm when norms may not be perfectly complied with or may not be universally held within a society. Law can also influence social norms, by, for example, “chang[ing] perceptions of what incurs disapproval.” This is closely related to the “expressive function of law”: “by saying what people should do, even if there is no penalty, the law tries to shift or maintain tastes” and to educate society’s members regarding its norms. In other words, the function

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\text{209 Blair & Stout, supra note 43 at 318; Green, supra note 188 at 413-14; Kaplow & Shavell, supra note 21 at 10; and Sunstein, supra note 142 at 916. Of course, this is not to suggest that there are no examples of social norms that are not welfare-enhancing: Sunstein, ibid. at 914-15.}
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\text{210 Sunstein, ibid. at 909.}
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\text{211 Ibid. at 918.}
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\text{212 Lee, “Efficiency and Ethics”, supra note 29 at 564.}
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\text{213 Elhauge, supra note 30 at 754. See also Green, supra note 188 at 423.}
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\text{214 McAdams & Rasmusen, supra note 191 at 1590. Law may, for example, “increase an individual decision-maker’s perceptions of the existence of a consensus regarding a norm.”: Vandenbergh, supra note 177 at 75.}
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\text{215 See, generally, Sunstein, supra note 142.}
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\text{216 McAdams & Rasmusen, supra note 191 at 1589.}
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\text{217 Sunstein, supra note 142 at 953.}
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\text{218 McAdams & Rasmusen, supra note 191 at 1590.}
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of law is not only to enforce social norms or other rules through a system of punishment for breach of those rules, but also “to create and perpetuate norms”\textsuperscript{219} via their expression in law.

In addition to law’s impact to shape social norms, there exist powerful social norms regarding the law itself; that is, “[p]eople often feel obliged to obey laws…from the very fact that they are laws, rather than from any other motivation.”\textsuperscript{220} This obligation is independent from the potential material sanction for violating the law. The role of law in helping to shape social norms and the social norm of obedience to the law are particularly relevant to ESV given the acknowledged difficulties of enforcing it.\textsuperscript{221} At least “one empirical study suggests that the existence of a strongly held internal norm of law compliance is very influential in determining the behavioral intent of potential decision-makers regarding corporate environmental compliance”.\textsuperscript{222}

In the environmental context, changing social norms or values can be seen as an alternative to assigning property rights or imposing regulations or taxes as a means of changing behaviour in order to solve the problem of negative externalities.\textsuperscript{223} This may not be as far-fetched an approach as it might initially sound: one interpretation of survey evidence of environmental concern is that “everyone has a latent ‘environmental protection’ norm” that just needs to be “activated” for individuals to take action to protect the environment.\textsuperscript{224} The theory of norm activation holds that norms are activated when individuals are made aware of the consequences of their actions and of their responsibility

\textsuperscript{219} \\textit{Ibid.} at 1590.
\textsuperscript{220} McAdams & Rasmusen, \textit{supra} note 191 at 1591. See Vandenbergh, \textit{supra} note 177 at 81-88 for a detailed discussion of the norm of law compliance.
\textsuperscript{221} \textit{Supra} note 150 and accompanying text.
\textsuperscript{222} Vandenbergh, \textit{supra} note 177 at 77.
\textsuperscript{223} Green, \textit{supra} note 188 at 413.
\textsuperscript{224} \textit{Ibid.} at 414-15.
for them. ESV could therefore activate directors’ latent environmental protection norm by requiring directors to be informed of the environmental impacts of the corporation’s operations and imposing a responsibility on directors to limit these impacts. ESV may also remind directors of the environmental protection norm, thereby “mak[ing] the norm more salient during the…decision-making process.” Such reminders are important where norms are “fragile” and therefore more likely to be “crowded out” by monetary incentives.

ESV might also encourage corporations to work with governments in encouraging social norms of environmental protection. Last year, the City of Toronto proposed a by-law requiring retailers to charge a 5 cent tax on plastic bags. Loblaws – a prominent Canadian grocery store chain – started charging its customers for plastic bags six months before the bylaw came into effect. It also started selling inexpensive reusable bags at each cash register. Within weeks, the distinctive black canvas bags could be spotted all over the city, and more and more Loblaws customers were bringing their own bags. In fact, Loblaws reported a 75% drop in plastic bag consumption and, as a result, implemented the 5 cent charge in the rest of its Canadian stores. Such a dramatic decrease is difficult to explain as a result of a small 5 cent financial penalty alone. Rather, the change in behaviour would seem to be better explained by a combination of the expressive function of the bylaw in signalling

225 Vandenbergh, supra note 177 at 73-74, suggesting that enforcement actions could activate norms where they include an explanation of the consequences of the non-compliant act.
226 Ibid. at 74. There is at least one study showing that an environmental protection norm influenced managers’ environmental decision-making: ibid. at 96.
227 McAdams & Rasmussen, supra note 191 at 1596-97. See also Green, supra note 203188 at 415.
228 CBC News, “Loblaws starts charging for plastic bags”, January 12, 2009, http://www.cbc.ca/canada/toronto/story/2009/01/12/loblaws-bags.html, last accessed August 5, 2009. Some writers on corporate social responsibility argue that one of the most important things corporations could do is to refrain from involvement in law-making, or limit themselves to playing only a supportive role, thereby better ensuring that legal requirements maximize social welfare: Orts, supra note 18 at 194; David J. Vogel, “Opportunities for and Limitations of Corporate Environmentalism” in Hay, Stavins & Vietor, supra note 9 at 199.
social disapproval for the use of plastic bags, and the leadership role taken by a major Canadian corporation in supporting the City’s effort.

That corporate law and corporate law theory can have an impact on how corporate managers and directors behave in practice may be evidenced by the behaviour of Enron’s executives and those of the other corporations that made accounting scandal headlines earlier this decade. One analysis of Enron’s monumental collapse suggests that its managers had internalized “the contemporary shareholder value maximization norm” of the eighties and nineties, making them less risk-averse in contrast with their earlier counterparts who sought to make corporations “bigger and safer” in the long-term, rather than focusing on raising the current stock price. Proponents of shareholder primacy have defended it on the ground that it provides a social norm against managers lining their own pockets, but others respond that this goal could be achieved without the negative side-effects by a narrower norm against self-dealing. Shareholder expectations may also be shaped by law or the perception of what the law requires. A revision to the legislative articulation of the fiduciary duty of directors as well as a revised understanding of that duty may shift corporate culture away from a focus on short-term value maximization to generation of long-term value that does not impose severe or irreparable environmental harm on future generations.

230 Bratton, supra note 42 at 1358-60. In Bratton’s opinion, Enron was unique only in crossing the line to fraud. Posner, supra note 6 at 451 also notes the increase in corporate fraud in the nineties and attributes it to attempts by officers to delay the collapse of stock prices. Regarding internalization of the shareholder primacy norm, see also Bainbridge, supra note 78 at 576, 582.
231 Bainbridge, ibid. at 581.
232 Elhauge, supra note 30 at 813-14; and Lee, “Citizenship”, supra note 88 at 23.
233 Elhauge, ibid. at 788.
234 See further discussion in Part VIII, below.
VII. Directors’ Competence to Assess Long-Term Environmental Costs

A. Do Corporate Directors Exercise Decision-Making Power?

A preliminary question to address before examining directors’ competence to weigh long-term environmental costs and benefits against present day value to shareholders, as ESV requires them to do, is whether corporate directors in fact exercise “decision-making power” or whether they simply respond to the demands of the market. The case for ESV rests on the assumption that directors are not entirely controlled by market forces (including things such as the demands of institutional investors or insurers), but, rather, do make choices that impact the public interest.

In a “perfect” market, directors would not exercise any real decision-making power, but simply respond to market forces. Under these circumstances, a firm would be unable to voluntarily internalize environmental costs without losing its competitiveness as against other firms not taking on this additional cost. Of course, in a “perfect” market, all environmental costs would be fully internalized in market prices. “Perfect” markets are, however, a mere economic fiction. Although some markets might nevertheless be very competitive, thereby circumscribing directors’ choices, they are likely imperfect enough to leave directors with enough choice in exercising their function of managing the corporation that they can be said to exercise “decision-making power”. The concentration of wealth in the corporation over the course of the 20th and 21st centuries means that the use of corporate

235 Parkinson, supra note 33 at 10.
236 Reinhardt, supra note 127 at 158.
237 Stiglitz, supra note 23 at 29: “information is always imperfect and markets are always incomplete.”
238 Lee, “Citizenship”, supra note 88 at 20; and Parkinson, supra note 33 at 10. But see Mark J. Roe, “On Sacrificing Profits in the Public Interest” in Hay, Stavins & Vietor, supra note 9 at 89 and 95, arguing that the “twin pressures of heightened product market competition and the acceleration of technological change” as a result of globalization have severely limited management’s ability to “look beyond profit maximization.”
resources has significant impacts on various external economic interests, including those of workers and consumers, in addition to the environment. There is room, then, for the law to shape how these decisions ought to be made.

In addition to market imperfections, some argue that the corporate form itself grants directors and managers significant decision-making power. Although the “nexus of contract” theory of the corporation, having assigned to the corporation the minimal role of common contracting party, would reject the idea that directors exercise any significant amount of power, Berle and Means argued back in the 1930s that the separation of ownership from control inherent in the corporate business form, coupled with the dilution of each individual shareholder’s interest, left management with a significant amount of power over substantial resources. The only check on management’s use of its power was the occasional need to re-tap the capital markets for funds. Approximately sixty years later, Blair and Stout make a similar argument, that “[a]s the ultimate decision-making body within the firm, [the directors] are not subject to direct control or supervision by anyone, including the firm’s shareholders.” Furthermore, they suggest that decisions regarding the allocation of corporate wealth are driven not only by market forces but also by “political forces.” Directors, therefore, are able to exercise substantial discretion in decision-making. Even if one does not subscribe to Blair and Stout’s team production theory of the corporation, it is

239 Berle & Means, supra note 115 at 309-10.
240 Easterbrook and Fischel, supra note 82 argue that the corporation is nothing more than a nominal common contracting party for shareholders, employees and other stakeholders. The purpose of the fiduciary duty, therefore, is to fill a gap in the contract with shareholders.
242 Berle & Means, supra note 115 at 309-10.
243 Ibid. at 247.
244 Blair & Stout, supra note 43 at 290. See also Bainbridge, supra note 78 at 555: the “defining characteristic of a firm is the existence of a central decisionmaker vested with the power of fiat”. Bainbridge, ibid. at 572-73 also argues that directors’ decision-making power is the corporate form’s “chief economic virtue” and that granting shareholders greater oversight is actually contrary to maximizing shareholder value.
245 Blair & Stout, ibid. at 325 [emphasis in original].
arguable that under corporate law, significant decision-making power is assigned to the board, and that subject to the constraints of an imperfect market, directors have discretion in exercising this decision-making power unconstrained by any contractual obligations to shareholders, employees, customers or any other constituency. This discretion is clearly reflected in the business judgement rule, discussed above, under which courts give substantial deference to directors’ decisions.

Assuming, therefore, that directors do exercise some not insignificant amount of decision-making power, it must still be determined whether directors are in the best position to make decisions regarding possible limits on profit maximization, or whether this is better left to government and markets.

**B. Are Corporate Directors Competent to Weigh Environmental Costs Against Economic Benefits in Exercising Their Decision-Making Power?**

Part of the pressure on corporations to be more “socially responsible” is, paradoxically, the public’s faith in the effectiveness of corporations in contrast to governments. But is this faith well-placed? The argument that corporate officials have no role to play in setting limits on profit maximization is made by critics from both the right and the left. This critique is essentially that corporate officials are both ill-equipped to balance competing public interests and unaccountable for the balance they strike. Government, on

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247 Assuming they are not dominated by managers, which may frequently be the case: Lee, “Efficiency and Ethics”, supra note 29 at 543.
249 See, e.g., from the left, Joel Bakan, The Corporation: the Pathological Pursuit of Profit and Power (New York: Free Press, 2004) at 161; and, from the right, Friedman, supra note 77 at 52.
250 See Friedman, ibid. at 52; Macey & Miller, supra note 69 at 422; MacIntosh, “Efficient Fiduciary Law”, supra note 69 at 443; and Parkinson, supra note 33 at 307.
the other hand, according to this view, is both better positioned to make trade-offs\textsuperscript{251} and
directly accountable to voters for those decisions. MacIntosh argues, for example, that if it
were left up to industry to determine the right “production/pollution mix”, it may not choose
the mix that maximizes social welfare; that is, it may overvalue the environment over jobs or
vice versa.\textsuperscript{252} Furthermore, the “blunt instrument” of the fiduciary duty of directors may not
be able to “assure that specific social ills will be addressed by the boards of the specific
corporations that are creating the problematic externalities.”\textsuperscript{253} Leaving it to government to
legislate the right mix through regulated limits on emissions is, therefore, according to these
critics, the preferable option.

With respect to the issue of environmental impact specifically, the problem with
leaving it to government is that government is not necessarily in a better position than
directors to understand the environmental impacts of the corporation’s operations and how to
eliminate or minimize them at the lowest cost. Although government can demand
information on, for example, production processes, use of hazardous substances and quantity
of emissions, it does not necessarily follow that government officials will be better able than
corporate officials to understand and assess information on environmental harm and the
possible methods of controlling it, and gathering and evaluating this information can place an
incredible strain on public resources.\textsuperscript{254} This applies to both regulations mandating the use of
particular pollution control technology and regulations setting emission limits.\textsuperscript{255} In addition,
regulation may stifle pollution control innovation, since once the standard is set, there is no

\textsuperscript{251} MacIntosh, “Efficient Fiduciary Law”, \textit{ibid.} at 442-43.
\textsuperscript{252} \textit{Ibid.} at 443. See also Roe, \textit{supra} note 238 at 96, noting that management’s vision of the public interest may
not match the public’s or the expert’s cost-benefit analysis.
\textsuperscript{253} Bainbridge, \textit{supra} note 78 at 591.
\textsuperscript{254} Neil Gunningham, \textit{Smart Regulation: designing environmental policy} (New York: Oxford University Press,
1998) at 44; and Posner, \textit{supra} note 6 at 396.
\textsuperscript{255} Posner, \textit{ibid.}
incentive to develop a means of further reducing pollution, unless this new method will also save money.\footnote{Ibid.} 

There is also a positive argument that corporate directors should play a role in setting limits on their own profit-making on the ground that, in a liberal-democratic society, “[a]utonomy in an enterprise is a valued condition”.\footnote{Wood & Johnson, supra note 140 at 32. See Vandenberghe, supra note 177 at 99-102 for a detailed discussion of the norm of autonomy.} The notion of leaving directors with a certain amount of autonomy to respond to the direct impacts of the corporation’s activities is arguably consistent with the “deliberative” structure of the board of directors, which can legally make decisions only as a group.\footnote{See Lee, “Efficiency and Ethics”, supra note 29 at 582-83.} Although the primary focus of the corporation is profit maximization, ESV suggests that there should also be some “space for deliberation” about the corporation’s external impacts.\footnote{Ibid. at 583; and Lee, “Sen’s Concept of Commitment”, supra note 207 at 126.} With respect to directors’ ability to weigh public policy concerns, directors of certain Crown corporations are required to do this by statute.\footnote{For example, the Canadian Mortgage and Housing Corporation is required to carry out the purpose of the National Housing Act, which “is to promote housing affordability and choice,…to protect the availability of adequate funding for housing at low cost, and generally to contribute to the well-being of the housing sector in the national economy.”; see National Housing Act, R.S., 1985, c. N-11, s. 3 and Canadian Mortgage and Housing Corporation Act, R.S., 1985, c. C-7, s. 17.} Although it is possible that these directors are appointed for their particular expertise in the relevant policy area, this indicates at least a belief on the part of the legislative body delegating this responsibility that it is legitimate to require corporate directors to make decisions to further public policy.

To the extent that ESV emphasizes the oversight role of the board of directors over management, it may attract the general criticism that boards have proven to be ineffective in
Posner argues that boards, like shareholders and consumers, are dependent on management for information and devote only a small amount of time to their duties as directors. Furthermore, the ability of directors to further non-shareholder interests is limited by the fact that directors are elected by shareholders. Others, however, suggest that “a firm’s leadership may be what really makes the difference” to a firm’s environmental performance, but question “how public policy could define, let alone foster” the necessary kind of leadership. As argued above, ESV could have an impact on the social norms that guide the conduct of directors, causing them to internalize an “environmental ethic” and therefore to select managers who share this ethic. A duty to “have regard to” environmental impacts may also make directors feel a greater responsibility for these impacts leading them to drive managers and employees to come up with ways to lessen the environmental impact of their economic activities.

Notwithstanding the concerns about competence and effectiveness, the nature of the most pressing environmental problems of today may demand the direct participation of industry in the solutions, rather than relying on traditional “command-and-control” government regulation. Even where legal sanctions are optimal, there will be gaps, because “the underinclusion cannot be eliminated without increasing the overinclusion of

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261 Becht, Bolton & Röell, supra note 83 at 833.
262 Posner, supra note 6 at 451-52. In Posner’s opinion, the primary role of the board is to pick the CEO and intervene in the event of a crisis.
263 MacIntosh, “The End of Corporate Existence”, supra note 79 at 60, 71.
264 Coglianese, supra note 76 at 70. See also Vandenbergh, supra note 177 at 97, regarding the potential influence of “one player with causative responsibility or with a powerful preventative capability” takes a socially responsible position, others will be reluctant to oppose and will follow suit [citation omitted].
265 ESV could, therefore, alter the view that directors might not be “naturally sympathetic” to environmental issues: see MacIntosh, “The End of Corporate Existence”, supra note 79 at 70, discussing employees.
266 Wood & Johnson, supra note 140 at 15.
desirable conduct” under the prohibition.267 This may be especially true for environmental regulation, where hard and fast prohibitions on conduct are more difficult to come by, because environmental harm is a necessary by-product of desirable economic activity.268

The nature of government regulations is that they address a particular problem and apply equally to all facilities of a certain type. This means, however, that government regulation is generally not tailored to a specific facility. Although attempts have been made to regulate on an individual facility basis, these attempts can result in back-logs and leave in place outdated standards.269 Corporate officials, on the other hand, can assess the cumulative impact of the corporation’s operations, rather than having to focus on each identifiable environmental issue separately. They may be better placed, therefore, to determine where the greatest improvements at the lowest cost can be achieved.

There is also evidence that as “[t]he regulatory system keeps adding more and more rules, and increasingly specific controls…its progress in protecting the environment seems to be slowing down.”270 Some argue that the first wave of environmental regulation in the 1970s “successfully harvested the low-hanging fruit”, and that the high compliance costs of subsequent layers of regulations outweigh the benefits.271 Increasingly complicated

267 Elhauge, supra note 30 at 740. See also Donahue, supra note 125 at 84, agreeing with Elhauge that legislators will never be able to “get the law so precisely right that individual corporate managers would be unable to enhance social welfare by going beyond the demands of law at times.”; and Portney, supra note 9 at 119: “no one would argue that every serious threat to consumers, workers, or the environment has been addressed, even in the western industrial democracies where regulation is pervasive.”


270 Ashford & Caldart, supra note 9 at 973.

271 Prakash & Potoski, supra note 14 at 6. For a review of the history of environmental regulation, see Gunningham, supra note 254 at 5-8.
regulations may also undermine the social norm of law compliance if managers otherwise motivated to comply lack the capacity to do so. It may in fact be the case that regulation has reached the limits of its technical capacity. As the Steering Group observed, “there are limits to what [legislation] can achieve. It is slow to be introduced and adjusted, relies on minimum rather than aspirational standards and cannot adjust to specific circumstances.” Furthermore, the technology changes faster than the standards can be set, and building incentives for continual improvement into the regulatory system may be beyond the capacity of government agencies. Slow reaction times and limited information may be partly the results of a lack of government resources, making it necessary to figure out a way of harnessing private resources to the task of environmental protection. For these reasons, “[r]egulators and policy analysts increasingly recognize that firms’ internal management is an important ingredient in combating the nation’s environmental problems.” ESV is one way of affecting firms’ internal management by imposing an obligation to be informed of the corporation’s environmental impacts, which may lead to the discovery of currently

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272 See supra note [x] and surrounding text.
273 Vandenbergh, supra note 177 at 83 and 104.
274 Gunningham, supra note 254 at 7; Wood & Johnson, supra note 140 at 14.
275 Steering Group, supra note 34 at 49.
276 Ashford & Caldart, supra note 9 at 974.
277 Gunningham, supra note 254 at 10. Prakash & Potoski, supra note 14 at 7, footnote 6, note that governments are prone to enacting strict laws, in order to reap the political gains from appearing to be “tough on polluters”, but then failing to provide the necessary budget to enforce them. See also Portney, supra note 9 at 119, noting that “[r]egulatory agencies often are given or take on much more work than they have resources to deal with.” Coglianese, supra note 76 at 54. This is also evident in the increasing calls for the implementation of so-called “smart regulation” that “aims” to “stimulate self-reflection and self-correction by regulated actors in line with public goals, rather than dictating the details of permissible behaviour.”: see Wood & Johnson, supra note 140 at 15. ESV would seem to fall in line with this way of thinking, since a duty to “have regard to” the environmental impacts of a corporation’s operations should trigger, at minimum, self-reflection and will, hopefully, result in greater self-directed measures to ensure that economic growth conforms to growing public concern for the state of the natural environment. EMS, the implementation of which ESV may encourage, are also considered part of smart regulation: see Wood & Johnson, ibid.
unregulated environmental impacts and will hopefully prompt firms to take action to mitigate or even eliminate those impacts, even though doing so is not legally required.\textsuperscript{279}

In addition to the challenges posed by the nature of environmental problems are the challenges to domestic governments in regulating multinational corporations (MNCs), specifically operations in developing countries, which may lack the capacity to impose even the most basic environmental standards of the developed countries where most MNCs are headquartered. Where corporations are “part of the fabric of the community” they may take more moral responsibility for their actions and “do the right thing” even when not compelled to by law and doing so may have a negative effect on short-term profits.\textsuperscript{280} This sense of “moral responsibility is weakened”, however, with respect to a corporation’s foreign operations. To the extent that this is true, ESV may help to counter this tendency, since ESV requires directors to have regard to environmental impacts even where the “environment” is in another country.\textsuperscript{281}

Finally, requiring corporate directors to have regard to the environmental impacts of the corporations’ operations is even more important with respect to the environment than other stakeholder groups because, unlike shareholders, employees, creditors or customers, the environment can neither consent to risks nor “exit” if it is not satisfied with the corporation’s environmental performance. The environment is dependent on human beings to look out for its best interests. Although it may seem obvious, this basic fact highlights the reason that traditional “nexus of contract” and shareholder primacy theories of the

\textsuperscript{279} See Part VI.A, above.
\textsuperscript{280} Stiglitz, \textit{supra} note 23 at 196.
\textsuperscript{281} Ashford \& Caldart, \textit{supra} note 9 at 933. Portney, \textit{supra} note 9 at 120 notes that applying the same environmental standards at all plant locations should be efficient for the firm, since it can be done at little additional cost.
corporation seem to fail to address environmental issues. Unfortunately, human beings have done an inadequate job to date of looking out for the environment. A legal obligation on directors to have regard to the environmental impacts of the corporation’s operations may help to ensure that the external environmental costs of the bargains struck between corporations and its various stakeholders do not go unaccounted for.

This is not to suggest that determining the future environmental costs of a given economic activity is going to be easy, but the fact that something is difficult does not mean that it should not be attempted, and the principle of intergenerational equity demands that future costs be taken into account. Monetary estimates need not necessarily be precise: where an economic action is going to or is likely to result in severe or irreparable harm to a significant portion of the natural environment, forgoing the activity is arguably more likely to maximize social welfare than going ahead in the hopes that the economic gains will outweigh the environmental costs. The creation of the St. Lawrence Seaway, which celebrated its 50th anniversary this year, is one example of an environmentally devastating investment that did not result in the expected economic returns.

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282 Part of the reason is that these theories are part of the same theoretical lineage as the Coase theorem, which holds that private parties will bargain for the socially optimal outcome. As Revesz & Stavins, supra note 9 at 502, point out, however, the theorem may not hold where there are transaction costs, wealth or income effects of the bargain, a public good is involved or third party effects. It is, therefore, rare that private bargains will fully internalize environmental costs. Perhaps even more fundamentally, protecting the environment through a Coasean bargain where there is no “use” value at stake requires an individual or group to bargain on the environment’s behalf, and be willing to pay for the non-use benefit.

283 Posner, supra note 6 at 403. Bergkamp, supra note 15 at 408 argues that sustainable development entails a “utilitarian assessment of the value of activities or opportunities, but the data required to conduct such an assessment cannot be obtained.” This is a major problem for utilitarianism in general: Beauchamp & Bowie, supra note 5 at 21.

284 Gardiner, supra note 23 at 150 notes that the ability of present generations to impose costs on future generations provides an incentive to “cheat” future generations and that the theoretical difficulties of doing cost-benefit analysis far into the future provide a “good cover” for this moral corruption.

oil sands may prove to be another example where the expected economic gains fail to outweigh the tremendous environmental costs.

The principle of intergenerational equity also explains why it cannot be left to the market to fill in the inevitable gaps in government regulation. A moral obligation to take into account the cost to future generations of present economic growth and consumption means that the prevention of severe or irreparable environmental harm cannot be left to consumer choice. Consumers are likely to share the natural human “psychological tendency to devalue future utility (‘time preference’) and to ‘discount’ future benefits and harm relative to present benefit and harm”. Individuals may also make different decisions as consumers than they would as citizens. Even if consumers could be counted on to make choices that take harm to future generations into account, consumers and investors are at an informational disadvantage to the corporation with respect to the environmental impacts of their products and production processes. Although improved environmental disclosure may help to bridge the gap, consumers and investors are likely to remain at an informational disadvantage to corporate directors, thus necessitating a duty on the latter to have regard for environmental impacts notwithstanding the market impact of doing so.

Having established that directors do exercise some amount of decision-making power, that they are arguably competent to take environmental concerns into account in

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286 For some of the limits on the ability of consumers to impact production decisions of corporations, see, e.g., Jacoby at 199, supra note 248; and Parkinson, supra note 33 at 13-14.
287 Birnbacher, supra note 16 at 34. Posner, supra note 6 at 17 refers to this phenomenon of weighing present benefits and costs more heavily than future ones to an irrational extent as “hyperbolic discounting”. Or, as Gardiner, supra note 23 at 149 puts it, each generation has an incentive to oversupply “front-loaded” goods (benefits now, costs later) and undersupply “back-loaded” goods (costs now, benefits later), which means that the cumulative effect over time means that the situation is worse the farther in the future one projects. The potential seriousness of these cumulative effects provides a moral reason for limiting the impact of “generation-relative preferences”.
288 Sunstein, supra note 142 at 959.
making decisions and that the nature of today’s environmental problems coupled with the shortcomings of government regulation creates a need for them to do so, the next section provides a preliminary outline of the costs and benefits of ESV to the corporation itself.

VIII. Cost-Benefit Analysis of the Impact of ESV on the Corporation

This section will examine whether the potential benefits of ESV are likely to outweigh its potential costs to directors’ decision-making and corporate profitability. A full cost-benefit analysis of ESV would also require examining whether ESV is the best method of improving corporations’ environmental performance. Although the position taken in this paper is that ESV should *compliment* other government initiatives, it is possible that ESV may result in a reduced emphasis on government regulation. For example, corporate managers may support the argument that they are competent to make decisions in the public interest in order to avoid more stringent government regulation. On the other hand, ESV may be able to achieve the same level of environmental quality at a lower cost than government regulation. In other words, in order to fully assess the desirability of ESV, it would be necessary to determine whether the potential net gains from ESV outweigh the potential net gains of relying on other more traditional methods of controlling environmental

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289 As Vandenbergh, *supra* note 177 at 141 notes, cooperation and deterrence strategies of enforcement should not be regarded as mutually exclusive.
291 Vogel, *supra* note 228 at 200.
292 “A regulatory policy that targets social norms may well be the cheapest and most effective strategy available to a government seeking to discourage risky behaviour.”: Sunstein, *supra* note 142 at 908.
harm. Unfortunately, a rigorous analysis of this question is beyond the scope of this paper and will have to be left for future discussion.

Even if ESV does not increase aggregate social welfare over what it would be without ESV, the distribution of benefits may be altered in favour of third parties, including future generations, negatively impacted by corporations’ activities. In other words, ESV may help to redistribute to the “losers” in the Kaldor-Hicks efficiency evaluation the gains made to the “winners” at the losers’ expense. In this sense, ESV might be viewed as a “winner’s tax” or, perhaps more accurately, a tax on present generations in the form of foregone economic benefits in order to ensure that sufficient natural resources are left for the future.

Turning to the costs of ESV to the corporation, there is no doubt that ESV entails additional costs in the form of foregone economic benefits from reallocating corporate resources to gathering and analyzing information on environmental and other external impacts and refocused management attention on whether and how to address these impacts. Even though ESV maintains maximization of shareholder value as the corporation’s end, ESV does not permit a single-minded focus on this end, and therefore is likely to result in increased costs of board decision-making. Although the goal of ESV is to avoid economic activity that causes severe or irreparable environmental harm such that the economic gains are unlikely to exceed the environmental costs and therefore should result in more “efficient” use of natural resources, leaving these decisions to directors may undermine

294 Portney, supra note 9 at 123; and Revesz & Stavins, supra note 9 at 511-12. Of course, it is to be expected that, to the extent possible, corporations will pass on any increased costs of complying with ESV to their customers. Although this is another cost to be taken into account in the cost-benefit analysis of ESV, it may also have environmental benefits in the form of reduced consumption, particularly of those products with the most severe environmental impacts.
the market’s ability to put resources to their most valued use. Furthermore, as argued above, ESV is rightly conceived as a limit on the creation of shareholder value and, therefore, may mean lower economic growth – and possibly fewer jobs – than has been seen in the past. The “opportunity cost” of ESV may, therefore, affect not just shareholders but also stakeholders, including employees, consumers or the local community. But economic growth is not by definition welfare-enhancing: there are costs both to voluntary participants in the corporation and to third parties that the corporation is not forced to internalize by government regulation.

ESV may, however, also have economic benefits to the corporation. Of course, if ESV could be said to always be in shareholders’ best interests, it would be undertaken by most corporations without the need for legislation. Even assuming that ESV will not always improve profitability, however, it is possible that re-focusing directors on the long-term will result in less market volatility. Concerns that directors and managers will expend too much time and energy on the negative external impacts of the corporation’s operations and not enough on generating wealth should be addressed by market constraints, such as the market for corporate control, which, while not eliminating the decision-making power of directors, do limit it.

Turning to the potential economic benefits of ESV to the corporation, first, ESV may shift directors’ focus back to the generation of long-term wealth rather than short-term stock

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296 Posner, supra note 6 at 9. Of course, part of the reason for ESV in the first place is that the market has not proven itself to be very good at valuing environmental costs or resources: see infra note 308.
297 Portney, supra note 9 at 128.
298 Posner, supra note 6 at 85; and Reinhardt, supra note 127 at 157.
299 Lee, “Efficiency and Ethics”, supra note 29 at 570.
300 See Richardson, supra note 32 at 186: “[g]rowth of financial markets has been closely associated with more volatile, speculative and short-term investment”.
301 Elhauge, supra note 30 at 840.
market gains. One of the main objectives of ESV is to ensure that the long-term value of the corporation’s relationships with its other constituencies is not unduly discounted in the pursuit of short-term earnings.\textsuperscript{302} It may be the case that corporations that take responsibility for their external impacts will become better run companies in general, perhaps because the information required to be gathered under ESV will lead to a greater understanding of the corporation’s operations.\textsuperscript{303} That a change in the law is required to ensure that directors and managers take the long-term view would seem to be evidenced by the recent examples of stock market bubbles built on short-term paper earnings, not increases in fundamental value.\textsuperscript{304} As mentioned above, Bratton persuasively argues that Enron’s spectacular collapse in 2001 can be explained, at least in part, by the shareholder value maximization norm and its narrow focus on stock price.\textsuperscript{305} More recently, some commentators have suggested that a focus by managers and investors on short-term stock price increases is the “overarching cause” of the current economic downturn.\textsuperscript{306} Although the “efficient market hypothesis” holds that the stock price should reflect projections of future earnings and thereby correspond to a corporation’s “true” value, it would appear, given recent stock market bubbles, that in practice, markets might be “selective” in what public information about a company they

\textsuperscript{302} Steering Group, supra note 34 at 43; and supra note 41.

\textsuperscript{303} See Richardson, supra note 32 at 167, noting, in the context of SRI and pension funds, that the research required by SRI can lead to a better understanding of the company, which could result in better selection of companies to invest in and, therefore, better financial returns. In the same way, a duty on directors to be informed of the environmental impacts of a corporation should lead to a better understanding of how the corporation works.

\textsuperscript{304} The “dot-com” bubble of the late nineties and the recently burst housing bubble are two such examples.

\textsuperscript{305} \textit{Supra} note 230 and accompanying text. See also Becht, Bolton & Röell, \textit{supra} note 83 at 872: In Anglo-American markets, “managers tend to be obsessed with quarterly performance measures and have an excessively short-termist perspective.” On the other hand, some commentators ask whether increasing managerial discretion might increase corruption: Donahue, \textit{supra} note 125 at 84-85.

assimilate. More generally, the short-term nature of the stock market, with its emphasis on quarterly earnings, may prevent corporations from incurring present costs in exchange for benefits that will accrue over a longer period of time, given the tendency of markets to “undervalu[e] ecological properties, and discoun[t] future environmental costs and benefits.” ESV may have economic benefits, therefore, by countering the incentive created by the stock market to focus on short-term profits over long-term value.

Second, although the evidence is much debated, it is at least possible that improving environmental performance can reduce a corporation’s costs of production. For instance, to the extent that ESV encourages directors to take preventive measures to reduce or eliminate harmful environmental impacts, such as emission of toxic substances, it may also reduce or eliminate reliance on expensive “end-of-pipe” treatments to comply with regulatory emission limits. Contrary to the “institutionalized assumptions that environmental compliance is always a cost to be minimized”, reducing pollution can result in previously unrealized cost savings for which managers have not been trained to look. Corporations may not voluntarily incur the costs of searching for these savings, because they may underestimate the probability of finding savings that will outweigh the search costs.

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308 Richardson, supra note 32 at 186.

309 See, e.g., several of the essays and comments in Hay, Stavins & Vietor, supra note 9. On the one hand, Esty, supra note 293 (at 140-41) and Vogel, supra note 228 (at 197-98), argue that there is evidence that cost savings can be found. On the other hand, Donahue, supra note 125 (at 78-79) suggests that this evidence is weak at best. See also Elhauge, supra note 30 at 744-45, suggesting that managers are unlikely to miss profit-maximizing opportunities. The evidence regarding the existence of a link between financial performance and corporate social responsibility is also rather weak: see Portney, supra note 9 at 113-14.

310 See Ashford & Caldert, supra note 9 at 968 on the “evolution” of approaches to pollution control from end-of-pipe treatments to systemic changes and sustainable development.

311 Prakash & Potoski, supra note 14 at 48. See also Revész & Stavins, supra note 9 at 512.

312 Coglianese, supra note 76 at 63-64. Coglianese refers to this as “rational ignorance”: “Since firms have naturally not yet found their unidentified costs savings, they may well view their expected net benefits of doing so as being quite small”.
Strict regulatory limits is one incentive, but an expectation or social norm, reinforced by ESV, that managers take responsibility for environmental impacts may also lead managers to look for “win-win situations” in which they can both improve environmental performance and reduce costs. As one commentator argues, if firms decide to make a serious effort to improve their environmental performance, they will find cost-effective ways of doing so.314 There may also be a certain amount of “slack” in corporations’ current environmental management practices in which environmental performance can be improved without affecting profits315 and the flexibility of ESV, like that of many voluntary initiatives, means that individual corporations or even facilities can target the area in which the most gains can be made at the lowest cost, potentially lowering resistance to making these changes.316 ESV may also improve a corporation’s competitive advantage in the long-term where it results in improved efficiencies that do not rely on the ability to externalize the costs of environmental harm – “an inherently unstable basis for competitive advantage.”317 Finally, detection of future environmental problems may have a positive impact on long-term shareholder value where these problems are prevented, thereby avoiding expensive remediation costs.318

In addition to the potential economic benefits, ESV should increase efficiency by helping to ensure that the environmental externalities of corporations’ economic activities are taken into account. Costs cannot be internalized if they are unknown. Absent a legal obligation on corporations to gather information on environmental impacts, many environmental problems – and their solutions – may remain undiscovered. To the extent that

313 See discussion of the potential impact of ESV on social norms of corporate behaviour in Part VI.C, above.
314 Vogel, supra note 228 at 198.
315 Supra note 121 and accompanying text.
316 Ashford & Caldart, supra note 9 at 927-28.
317 Esty, supra note 293 at 139.
318 Estrin, supra note 74 at 4-89.
some costs remain externalized, there may be a misallocation of resources to environmentally inefficient industries, which would prove unprofitable if the environmental costs were fully accounted for. Relying solely on government regulation is likely to leave some costs unaccounted for, since it is “virtually inevitable” that regulation will fail to internalize the full cost of environmental harm. To allow these environmental costs to remain externalized may result in a transfer of wealth from future generations to the present.

The importance of internalizing the environmental costs to future generations is particularly acute with respect to the issue of climate change, because the persistence of greenhouse gases in the atmosphere means that “future generations will experience much of the impact of current emissions.” Without taking into account the costs that will be imposed on future generations from this impact, corporations are undoubtedly producing inefficient quantities of emissions; that is, the future environmental costs of present economic activity outweigh the present benefits to shareholders and consumers, in the form of greater profits and lower prices, respectively. As explained in Part II, above, our increasing capacity both to have a causal effect on the environmental health of distant future generations and to foresee these effects means that present generations have a duty to avoid severe or irreparable environmental harm, even where this means sacrificing economic growth in the present. Requiring directors to have regard to the environmental impacts of the corporations’ operations may lead to a reallocation of corporate resources to environmental protection, which is more likely to maximize social welfare when the welfare of future generations is taken into account than maximizing shareholder value without regard to environmental externalities.

319 Parkinson, *supra* note 33 at 312.
320 Green, *supra* note 188 at 413.
IX. Conclusion

The great problems of contemporary society, such as environmental pollution, waste disposal...are most likely to be solved by combining the organizational discipline of the action-oriented business corporation with the legal and taxing powers of government.\(^{321}\)

The question is how best to harness that “organizational discipline” to improve corporate environmental performance. This paper has attempted to demonstrate how ESV could contribute to this goal by ensuring that corporate directors are fully informed of the environmental impacts of corporations’ operations. Although there may currently be some obligation to gather this information under existing environmental laws, it may be limited to impacts for which the corporation can be held fully responsible, rather than impacts that are benign in isolation, but cumulatively may cause severe or irreparable environmental harm in the future. By requiring that corporate directors be more fully informed of the environmental harm caused by the corporation’s operations, ESV may result in directors reallocating corporate resources to improve environmental protection. This reallocation of resources may in turn lead to the discovery of changes to production methods that can reduce both emissions and costs. ESV may also reinforce the reputational harm of poor environmental performance. Finally, ESV may result in a new social norm of corporate behaviour that corporate officials should be taking greater responsibility for preventing environmental harm, not simply complying with regulations. Any negative effect of ESV on economic growth and shareholder value in the present is justified by the duty to avoid imposing the costs of foreseeable severe or irreparable harm on future generations.

ESV is unlikely to prove effective enough in improving corporations’ environmental quality, however, to replace government regulation, taxes and market mechanisms. More

\(^{321}\) Jacoby, \textit{supra} note 248 at 69.
research is required to determine whether the overall social gains of adding ESV to the “regulatory mix” are likely to outweigh the costs, or whether social welfare is better maximized by relying solely on government to set environmental standards. The arguments put forward in this paper in favour of ESV suggest that further research on its costs and benefits is a worthwhile endeavour.
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