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Background Paper: Historical Foundations of the Corporation and Literature Review of Relevant Themes

Daniel King et Richard Janda

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Richard Janda est professeur agrégé à la faculté de droit de l'Université McGill. Il enseigne le droit des sociétés, le droit administratif, le droit de la concurrence, le contrôle gouvernemental des affaires et la réglementation du transport aérien. Ancien clerc auprès des juges Le Dain et Cory de la Cour suprême du Canada, il a aussi été directeur du Centre d'études des industries réglementées à l'Université McGill. Actuellement, ses principaux domaines de recherche sont : la base légale de la responsabilité sociale des entreprises nationales et mondiales et le cadre réglementaire applicable aux biens publics nationaux et mondiaux. Outre cette contribution académique, il a travaillé pour l'OMC, l'OACI, l'OCDE, la Banque mondiale, pour de nombreuses agences publiques canadiennes et dans divers pays en développement.

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Background Paper: Historical Foundations of the Corporation and Literature Review of Relevant Themes

Par *Daniel King et Richard Janda*

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École des sciences de la gestion
Université du Québec à Montréal
Case postale 8888, Succursale Centre-ville
Montréal (Québec) H3C 3P8 Canada
http://www.crsdd.uqam.ca

Avant-propos

Ce cahier de recherche a été réalisé dans le projet *La responsabilité sociale : une redéfinition de l'entreprise comme institution sociale* financé par le programme Initiative de développement de la recherche du CRSH. Ce projet vise à développer une problématisation de la responsabilité sociale comme symptôme d'une redéfinition fondamentale de l'entreprise comme institution sociale des sociétés modernes avancées. Cela suppose de mettre en commun une perspective sociale mais aussi juridique, historique et managériale de l'entreprise comme objet de recherche. On vise ainsi à mettre au jour les déterminants de l'entreprise comme résultat d'un compromis social institutionnalisé, afin d'envisager l'issue des contestations dont elle fait l'objet actuellement.

Les contestations sociales participent à redéfinir la dimension institutionnelle de l'entreprise en présidant à de nouvelles règles qui en modifient à la fois les contours et la logique interne ; or, c'est une dynamique dont ne rend pas compte le courant de la responsabilité sociale qui met l'accent sur les réponses organisationnelles offertes à ces contestations. De telles redéfinitions institutionnelles se sont articulées autour de différents enjeux au cours de l'histoire, à tel point qu'à chaque période correspond une forme dominante d'entreprise comme l'ont illustré des auteurs tels que Eells et Walton (1961), Chandler (1977), Harris (2000) ou McLean (2004). Aujourd'hui, les contestations sociales qui pourraient présider à des refondations institutionnelles de l'entreprise se déclinent principalement sur deux fronts : la crise écologique dans sa matérialité et de par les transformations symboliques qu'elle induit quant à la conception du développement et du progrès d'une part, et la cohésion sociale qui, avec la fin du fordisme, semble incertaine même en période de vigueur économique d'autre part. En se basant notamment sur les transformations institutionnelles que l'entreprise a connues en regard des contestations marquant d'autres époques, et en explorant les réponses institutionnelles qui se font progressivement jour à

l'heure actuelle à travers le monde, le projet de recherche vise à clarifier comment les contestations d'aujourd'hui pourraient reconfigurer l'entreprise comme institution sociale.

La série de cahiers issus de ce projet étudient la constitution de l'entreprise à travers l'histoire ainsi que l'analyse de six mutations institutionnelles passées et actuelles. *CG.*

Résumé

The purpose of this background paper is twofold. The first is to outline in broad brushstrokes certain milestones in the history of the corporation, emphasizing transformations in its social function over time. If the purpose of our project is to explore possible trajectories for the transformation of the corporation in the future, it is helpful to have in mind the transformations it has already gone through. Whereas one should necessarily be cautious about attributing a self-standing history, apart from other factors, to a single form of social relations, there can nevertheless be useful lessons drawn from observing shifts in the purpose, economic function, and governance structure of the corporation. By analogy, one can point to useful histories of the family, the church or the state. We divide the history of the corporation somewhat arbitrarily into six periods, with emphasis upon recent developments: Roman law, precursors to the modern company in Medieval and Renaissance Italy, the first companies in the age of exploration, the industrial revolution, the deployment of the corporation for nation-building in the United States, the externalization of production into the 60s, and the globalization of capital and technology since the 80s.

The second part of this background paper provides a few snapshots of key texts tracing the transformations of the corporation identified in our project proposal, with the not so hidden agenda of adding a consideration of changes in the fiduciary concept.

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1. Part 1: A brief history of the corporation

A. The Enterprise in Roman Law

Whereas forms of incorporation arose in India centuries before the emergence of such entities in Rome,[1] it was Republican Rome that spawned many of the features of the modern corporation.[2] There were two kinds of enterprise: the *collegium* and the *societas*.[3] Burdick likens the *collegium* to a guild for tradesmen or people with common interests. Malmendier calls the *collegium* a form of "corporation," but suggests that it was limited to public and social functions. Burdick also emphasizes that they were not originally created to benefit private interests – they were solely concerned with the public interest.[4] Indeed a *collegium* had no proprietary capacity, nor did it have any rights or liabilities in its own name.[5]

The lines between public and private interest blurred as Republican Rome's wealthy became heavily involved in tax-collecting. The state's minimal bureaucracy was unable to collect taxes. It contracted tax-collecting and other public services – building or public works or providing armaments – to private entrepreneurs.[6] To pursue these ambitious objectives,

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[1] Khanna, Vikramaditya S. The Economic History of Organizational Entities in Ancient India. SSRN U. Michigan Working paper available at

[2] Janda, Kerr and Pitts, *Corporate Social Responsibility: A Legal Analysis*, (Toronto: Lexis-Nexis 2010) at 52.

[3] Malmendier, Ulrike, *Societas*, p.1. http://www.econ.berkeley.edu/~ulrike/Papers/Societas_Article_v3.pdf

[4] Burdick, William Livesey. *The Principles of Roman law and their relation to modern law,* (New York: Lawyer's Cooperative, 1938) p. 284. See also Perrott, D.L. "Changes in Attitude to Limited Liability: the European Experience" in Ohrnial, T. (ed.) *Limited Liability and the Corporation* (London: Croom Helm, 1982) at 81.

[5] Burdick, William Livesey. *The Principles of Roman law and their relation to modern law* at 281.

[6] Malmendier, Ulrike. "Law and Finance 'at the Origin'" 47 J. of Econ. Lit. (2009) 1076 at 1088.

entrepreneurs required legal devices capable of organizing large scale businesses – and they could not use the *collegium,* as it was solely for the public interest. This is when the *societas* emerged.

The *societates* were divided into ordinary *societates* and *societates publicanorum.* The *societas publicanorum* is comparable to the modern corporation inasmuch as its existence continued despite the departure of some of its leaders and it could issue tradable, limited liability shares.[7] One or more of the leadership could bind the firm, facilitating transactions.[8] The Digests indicate that it could also obtain rights and obligations from others such as property ownership or the right to sue.[9] Its investors were known as *publicani* because they were investing public purposes, albeit seeking a return. The regular *societas* is more analogous to the modern partnership. Formation was simple: the requirements were consent, and a specific purpose, which could be anything provided it was not illegal.[10] *Societates* could be time-limited, or perpetual.[11] Partners could not limit their liability – there was no legal personality.[12] Should a partner leave, dissolution was unavoidable.[13]

As the Roman Republic declined, so did the *societates*. Tax collection and other public services were centralized.[14] Hansmann et al. point out that there are a variety of explanations for the decline of the *societates.* Ultimately, they argue that the

[7] *Ibid.*
[8] *Ibid.*
[9] Digests. 47, 2, 31 cited in *ibid.* at 1089..
[10] *Ibid.* at 1088.
[11] *Ibid.*
[12] Burdick, William Livesey. *The Principles of Roman law and their relation to modern law,* p. 281.
[13] Malmendier, Ulrike. *Law and Finance "at the Origin"*, p. 12.
[14] Hansmann et al. *Law and the Rise of the Firm,* p. 25. http://www.usc.edu/schools/college/crcc/private/ierc/Law_and_the_Rise_of_the_Firm.pdf

nail in the coffin was the reign of the Emperor Commodus, in which private property was seized and the Empire's resources were devoted to wars.[15] The state's seizure of production meant that individuals were discouraged from organizing together for commercial purposes. For Hansmann et al., the important story underlying the development of the corporation concerns shifting costs and benefits of what they call "affirmative asset partitioning" or "entity shielding" – that is, the capacity of "the owners of a firm to reserve its assets for the firm's creditors, and, correlatively, to shield those assets from the owners' personal creditors."[16] Their hypothesis is that although the *societas publicanorum* achieved entity shielding, the costs of extending such a function across the economy to private undertakings were too high because Roman law had not yet achieved adequate protection against debtor opportunism – something that could be addressed, on the contrary where the state was the debtor.

B. Italian Innovations

Commercial activity in Dark Ages Europe was limited, as was the demand for sophisticated legal tools to facilitate commercial activity. Braudel writes that the next great legal development in the history of the Western enterprise occurred in Venice, starting in the 9th century.[17] Sea trade merchants wanted to diminish the risk of long voyages. They often adopted the model of the Muslim *muqarada*, a mechanism for investors to pool their capital.[18] In their more complex medieval forms, notably the *commenda*, these partnerships financed multiple voyages and included numerous foreign partners.[19] Hansmann et al. emphasize that the "the hull of the ship … acted as a resilient firm boundary that

[15] *Ibid.* at 25-6.
[16] *Ibid.* at 1.
[17] Braudel, Fernand. *Civilization and Capitalism, 15th-18th Century.* Vol. II: *The Wheels of Commerce*, p. 434.
[18] Micklethwait, John and Wooldridge, Adrian. *The Company: A Short History of a Revolutionary Idea*, p. 6-7.
[19] *Ibid.* at 7.

reduced the costs of both limited liability and liquidation protection, making the *commenda* uniquely configured to realize the benefits of strong asset partitioning in the medieval period."[20]

The 12th century saw the rise of the *compagnia.* The original *compagnia* were family firms in which all partners were jointly liable for all of their assets. Debtors' prisons beckoned for those who failed to pay debts, so it was advisable to join only partnerships with trusted family members. Hansmann et al. suggest that mutual agency was the key evolution from the Roman *societas* to the Italian *compagnia* rendering that form more useful to larger firms operating on an increased scale.[21]

Compagnia partners increasingly sought to expand their capital base by attracting non-family partners.[22] It was difficult to replicate the trust between family members, so it was essential to find other ways to inspire investor confidence. Double-entry bookkeeping, introduced in the 14th century, accomplished this goal, as well as ensuring that all money was accounted for in transactions between a *compagnia's* international offices.[23] The Medicis' banks, themselves partnerships, expanded rapidly in the 14th century. Just as was the case with the *compagnia,* their banks prioritized diversification.[24] One major defaulting debtor could destroy competitors' banks, but because each of their branches constituted a separate partnership, founded on contracts with different terms and separate asset pools, their banks prospered and made a substantial impact on European

[20] Hansmann et al. *Law and the Rise of the Firm,* p. 36. http://www.usc.edu/schools/college/crcc/private/ierc/Law_and_the_Rise_of_the_Firm.pdf

[21] Mitchell, W. *An Essay on the Early of the Law Merchant*, p. 132-3, cited in Hansmann et al. *Law and the Rise of the Firm,* p. 28.

[22] Micklethwait, John and Wooldridge, Adrian. *The Company: A Short History of a Revolutionary Idea*, p. 8.

[23] *Ibid.*

[24] Ferguson, Niall. *The Ascent of Money,* p. 44.

commerce[25] They obtained a monopoly on the Papacy's business, the wool trade and textile colouring.[26] Never before had capital be deployed as widely and as flexibly.

Northern European entrepreneurs took advantage of local bank branches and their own versions of the Italian *compagnia.*[27] Medieval jurists, interested in Roman and Canonical texts, explored the possibility of corporate personhood.[28] Originally conceived as an all-purpose, rather than purely business-related tool, corporate personhood enabled a range of different associations of people to be treated as groups. Universities, towns and religious organizations took advantage of corporate personhood to bequeath land and other valuables to subsequent generations. The Church's accumulation of wealth and power was of particular concern to the royal authorities – and this tension between sources of authority and accumulated wealth became a key factor in the development of the chartered company.

C. The Chartered Company

Medieval society's independent associations grew in power and influence, and that they could do so under the protection of immortality worried monarchs around Europe, who saw their accumulated wealth as a challenge to their authority.[29] According to Micklethwait and Woolridge, the chartered company became a way to balance those concerns against the useful functions provided by associations. It enabled the state to circumscribe the boundaries of company activity, usually by granting a monopoly and then selling shares in the venture.

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[25] *Ibid.* at 44-5. See also De Roover, Raymond, *The Rise and Decline of the Medici Bank 1397-1494* (1963).
[26] Micklethwait, John and Wooldridge, Adrian. *The Company: A Short History of a Revolutionary Idea*, p. 9.
[27] *Ibid.* at 12.
[28] *Ibid.*
[29] *Ibid.* at 13.

The Age of Exploration featured the development of chartered companies in Europe. Conflating the state with the private company, not unlike the modern privately traded Chinese state enterprise, Monarchs often maintained a direct and supervening stake.[30] These companies were empowered to obtain the resources of newly discovered continents. To achieve this objective, they drew on old and new legal mechanisms.

The two older legal mechanisms were share purchases and limited liability. Beginning in the 13th century, shares in some enterprises such as mines, could be purchased.[31] True stock exchanges, where shares could be purchased on an open market, were an innovation of the 16th and 17th centuries. Financing long, dangerous colonial voyages was a difficult matter, and selling small shares in the entire venture improved access to capital. Limited liability bolstered investor confidence by reducing risk. Investors in the Dutch East India Company, and other early charter companies, were typically given a share of the cargo haul at the end of a voyage.[32] Each asset liquidation process at the end of a voyage was time-consuming, so the Dutch Estates General voted to grant an infinite lifespan to their East India Company so as to avoid liquidation. The British soon followed suit.[33] The tension between preserving a company's capital base and satisfying investors' desire to maintain the liquidity of their investment produced the compromise that investors could no longer withdraw at will, but could sell their shares without the consent of other shareholders.[34]

Chartered companies served the purposes of European governments, but fell into disfavour due to scandal and

[30] *Ibid.* at 17.
[31] *Ibid.* at 18.
[32] Hansmann et al. *Law and the Rise of the Firm.* p. 37. http://www.usc.edu/schools/college/crcc/private/ierc/Law_and_the_Rise_of_the_Firm.pdf
[33] *Ibid.*
[34] *Ibid.*

significant transaction costs. After the South Sea Bubble crisis severely diminished investor confidence, the UK Parliament adopted the *Bubble Act* of 1720, which rendered illegal and void any body corporate not operating pursuant to the specific provisions of a royal charter. This produced the time-consuming and frustrating process of seeking a separate act of Parliament granting a charter for each new corporation, which in turn led to capital choosing other business organizations. One innovation was to create unincorporated companies by superimposing the trust on the partnership, since the former offered full liquidation protection from personal creditors.[35]

D. The Corporation in the Industrial Revolution

In 1844, Parliament passed the *Joint Stock Companies Registration and Regulation Act*, the first general incorporation statute – separately adopted charters were no longer required.[36] The United States soon followed suit. How did we get from the *Bubble Act* to the general incorporation statute, in 120 years?

The literature suggests three key reasons for the general incorporation movement. First, the popularity of ideas of economic liberty was rapidly increasing, particularly given Adam Smith's immensely successful *Inquiry into the Wealth of Nations* – although Smith was himself a notable antagonist of the rise of the corporation as against the partnership (which was less susceptible, in his view, to opportunistic behavior). Second, the expansion of the British Empire was intimately connected with the rise of incorporation, since an increasingly wide array of ventures was launched to exploit its vast resources. Third, the chartering process was deeply flawed, and its critics successfully spotlighted its problems. Impatient to exploit potential opportunities, businessmen condemned the inefficiency with

[35] *Ibid.* at 43.
[36] (7 & 8 Vict. c.110)

which parliament granted incorporation.[37] Those who were unfriendly with influential politicians raged against the favoritism of the process.[38] The Board of Trade's report produced strong evidence of nepotism, while advocating what would later become the key planks of the 1844 statute.

Incorporation was to be a two stage process. Interim status would be granted quickly, becoming full status once capital requirements were met. Though incorporation was still granted by statute, it was understood that provided the paperwork was completed, anyone could incorporate. Ultimately, the 1844 statute gave way to full-fledged general incorporation statutes in the U.K. and the United States by the end of the 19th century. A key feature of the general incorporation statute was that it did not create a legal distinction between the widely-held highly capitalized corporation and the closely-held corporation or modestly capitalized corporation.

The same was not true in continental Europe, which also removed many restrictions on incorporation but channeled investors to more specific forms, such as the AG, GmbH and KGaA in Germany or the SA, Sarl and SCA in France.[39] It is arguable that the preservation of a range of forms of corporate personality in Continental Europe has corresponded to an orientation of the large corporation toward blockholding. For the purposes of our project, it will be important to bear in mind the

[37] Hurst, J.W. *The Legitimacy of the Business Corporation in the Law of the United States*, p. 34.
[38] Micklethwait, John and Wooldridge, Adrian. *The Company: A Short History of a Revolutionary Idea*, p. 47-8.
[39] Perrott, D.L. "Changes in Attitude to Limited Liability: the European Experience" in Ohrnial, T. (ed.) *Limited Liability and the Corporation* (1982) 81 at 102-104.

distinction between “insider” and “outsider” governance systems that persist even with the rise of the multinational corporation.[40]

E. The Corporation’s Role in Building America

Alfred Chandler called the railroads the “first modern business enterprises.”[41] No other transportation system operated common carriers. A common carrier is a company that transports goods on behalf of another company or person with the imprimatur and loose supervision of a regulatory body. Other transportation bodies, like the canals, were public. But the railroads and the sophisticated technology necessary for their functioning required a massive injection of capital – and shippers were generally distrustful of government.

The railroads featured the emergence of the separation between ownership and control.[42] The immense complexity of the task of managing a railroad and the associated corporate structure was far beyond the ability of investors. They hired specialized managers, uniquely equipped to handle the immense challenge.48 With complexity came the growth of an administrative hierarchy – with different rungs on the ladder associated with different aspects of the enterprise; specialization begat specialization. The more complicated the business became, the easier it was for owners to cede additional responsibilities to the increasingly busy management team.[43]

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[40] See Bratton and McCahery, “Comparative Corporate Governance and the Theory of the Firm” as well as Maher, M and Andersson, T. “Corporate Governance: Effects on Firm Performance and Economic Growth” (OECD, 1999).

[41] Chandler, Alfred. *The Visible Hand: The Managerial Revolution in American Business,* p. 81.

[42] *Ibid.*

[43] This theme is most famously discussed in Berle, A.A. and Means, G.C., *The Modern Corporation and Private Property* (1932).

The 1870s saw managers adopt what Chandler calls the "consolidation strategy."[44] Worried about competitors, managers overbuilt the network. By 1900, the consolidated railroad systems were the world's largest business enterprises.[45] They could grow far beyond the size of other industries because they had relatively easy access to capital from outside their home regions.[46] Novel legal techniques strengthened the hand of managers of private enterprise. State legislatures, starting with New Jersey, modified incorporation statutes to enable companies to hold stock in other, out of state companies. This was partly a response to the growing use of antitrust law against trusts, an alternative business form that grouped multiple entities under the control of a trustee. Subsequently, the New Jersey holding company emerged, allowing a number of different enterprises to be operated through a holding company.[47] Holding companies, along with mergers and acquisitions, were soon to become crucial legal weapons in the arsenal of the professional manager.

F. Multinational Production in the 60s

The United States remained better able than any other economy rapidly and effectively to exploit new technologies. The disparity between it and other world powers only increased through the two World Wars, where every other major power's economy and infrastructure was devastated. With its technological edge, the US economy required increasingly sophisticated regulatory and legal tools. Robert Clark's "Four Stages of Capitalism" describes the way in which these tools have been applied to watershed moments in the history of American finance.[48] His first stage includes the rise of the US "robber barons" and the flourishing of

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[44] Chandler, Alfred. *The Visible Hand: The Managerial Revolution in American Business,* p. 87.
[45] *Ibid.* at 88.
[46] *Ibid.*
[47] *Ibid.* at 319-20.
[48] Clark, Robert. "Review: The Four Stages of Capitalism: Reflections on Investment Management Treatises", *94 Harvard L. Rev.* 561 (1981).

the enterprise with the aid of the general incorporation statute at the end of the 19th century.[49] The second stage, arising in the first two decades of the 20th century, witnessed the widespread rise of the professional manager – the phenomenon that started with the railroads of the 19th century.[50] The third stage, which corresponds to the sixties, is when the institutional investor rose to prominence.[51] Writing in 1981, Clark predicted a "fourth stage" of capitalism that would involve an even greater dispersion of ownership and concentration of control because of the further spread or "democratization" of investment accomplished through pension funds and the correspondingly greater control left in the hands of managers. Whereas the second stage split ownership and control, Clark writes that the third stage split ownership into capital supplying and investment, and the fourth stage would split capital supply into savings planning and benefit.[52]

The dispersion of ownership and concentration of control traced by Clark facilitated greater accumulations of capital and its projection into foreign markets. The "multinational corporation" – a term coined in 1960 by David Lilienthal, was not the first example of international business ventures, as indeed this brief history documents.[53] Nevertheless the ability of the multinational corporation to take its domestic rules of incorporation abroad began to dis-embed it from any specific jurisdiction and become more clearly its own legal order.[54]

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[49] *Ibid.* at 563.
[50] *Ibid.*
[51] *Ibid.* at 564.
[52] *Ibid.*
[53] On the origins of the MNC, see Muchlinski, Peter, *Multinational Enterprises and the Law* 2d ed. (Oxford: Oxford U. Press 2007) at 12 ff. See also Pauly, L. and Reich S., "Multinational structures and multinational corporate behaviour: enduring differences in the age of globalization" (1996) 51 *International Organization*1.
[54] See Romano, Roberta *The Genius of American Corporate Law* (1993) [on the way in which U.S. corporate law has become a market for

G. The Rise of the Polycorporate Enterprise

Antunes documents that the multinational corporation – a single entity operating in a number of countries – was only the first stage in the globalization of the corporation.[55] By the 1990s, what he called the "polycorporate enterprise" and what has also been called the "network enterprise"[56] by Castells has come to occupy a significant share of the world's economy. Japan and other parts of Asia had long been dominated by corporate groups. But as a global phenomenon, corporate groups operating through a complex set of holding companies, subsidiaries and alliances made up of tens of thousands of global linkages have become dominant economic actors. One can no longer, therefore, speak of transforming the corporation as a singular entity but must instead turn attention to the corporation's capacity itself to generate economic entities.

corporate law as a product and which this creates a competitive advantage for US firms] and Teubner, G. "Corporate Fiduciary Duties and their Beneficiaries – A Functional Approach to the Legal Institutionalization of Corporate Law " in Hopt, K.J. and Teubner, G. (eds.) *Corporate Governance and Directors' Liabilities – Legal, Economic and Sociological Analyses on Corporate Social Responsibility* (1985) 149 [emphasizing the challenge of re-embedding the multinational corporation posed for CSR]. Of course, the idea of embedded capitalism has its origin in Karl Polanyi's *The Great Transformation: The Political and Economic Origins of Our Time* (1946).

[55] Antunes, J. *The Corporate Group as an Economic and Legal Phenomenon* (1994)

[56] Castells, M. *The Rise of the Network Society* (1996)

Part 2: A selective literature review touching on key project themes

A. Fiduciary Duties

A theme running through the historical discussion is the changing significance of public purposes for the corporation. As the corporation shifts to a networked and international form, its capacity to have marked impacts on global public goods and its displacement of formal public actors have become all the more evident. Yet other-regarding fiduciary duties remain at the heart anglo-american corporate law and provide a legal basis for inquiring into the ongoing public purposes of the corporation.. Directors and senior officers of a corporation are after all fiduciaries. In *Bristol & West Building Society v. Mothew*, Lord Millett defined a fiduciary as follows: "A fiduciary is someone who has undertaken to act for and on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence."[57] Fiduciary duties thus have prima facie potential to constrain and orient corporate behaviour, even in a post-Fordist context characterized by the widespread availability of non-public interest incorporation.

Tamar Frankel's work explores the origin and future of fiduciary obligations.[58] Drawing on Sir Henry Maine's trope, "from status to contract," she suggests that contemporary social interdependency has pushed us from contract to fiduciary relations as the prevalent form of legal relationship. Each is entrusted to act in the interests of others within the confines of accepted roles and responsibilities. The corporation could thus be conceived as the site of targeted other-regarding behaviour.

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[57] *Bristol & West Building Society v. Mothew*. [1998] Ch 1 at 16.

[58] Frankel, Tamar. *Fiduciary Law.* in California Law Review, no. 3 (1983), p. 798.

Such a conception is of course far from attracting a consensus, notably in the law and economics literature, which is dominated by the "nexus of contracts" view of the corporation.[59] Thus, for example, Easterbrook and Fischel view fiduciary duties as the legal completion of incomplete contractual terms – read into the contract so as to allow smooth transactions and assigned so as to protect shareholders, who have the best incentives to make optimal investment and management decisions.[60] Macey takes a similar approach focusing on the capacity of other stakeholders to enter into more specific forms of contractual protection.[61] Hart's economic analysis of the advantages and disadvantages of a broad fiduciary duty suggests that a broad, mandatory rule will have greater disadvantages than advantages because it is difficult to come up with a standard rule that will be effective for all corporate settings.[62] Romano goes even further, criticizing the idea that there are substantial economic benefits to broad fiduciary duties.[63]

Other authors dispute the notion that a corporation can be conceived as a nexus of contracts. Stephen Bottomley argues that contract law is at best an inadequate basis for thinking about corporate law. He prefers constitutional law, largely because the corporation is best viewed as a constituted social organization

[59] Jensen, Michael and William Meckling,, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" Journal of Financial Economics (JFE), Vol. 3, No. 4, 1976 .

[60] Easterbrook, Frank H. and Fischel, Daniel R. *The Economic Structure of Corporate Law* (Cambridge: Harvard U. Press, 1976) at 90 ff.

[61] Macey, Jonathan R. "Fiduciary Duties As Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective,," 84 Cornell L. Rev 1266 (1999) at 1281.

[62] Hart, Oliver. An Economist's View of Fiduciary Duty, University of Toronto Law Journal 43 (1993) 299 at 313.

[63] Romano, Roberta. Comment on Easterbrook and Fischel, "Contract and Fiduciary Duty", Journal of Law and Economics Vol. 36 (1993) at 447-451.

rather than as a meeting of minds in a transaction.[64] On a constitutional approach, fiduciary duties are owed to the entity itself rather than to individual "contracting parties". Valsan and Yahya, writing from a corporate finance perspective, argue that managers should focus their efforts on projects with the highest expected value and so fiduciary duties should he owed to the corporation as a whole – as all stakeholders would want the firm to do this, anyway.[65] Freeman also challenges the nexus of contracts view, arguing that 20th century American law has increasingly empowered various non-shareholder stakeholders to demand reasonable treatment from corporations under the aegis of fiduciary duties.[66] He also argues for a fiduciary duty owed to a wide range of stakeholders on economic grounds: if the nexus of contracts view holds, governments are strictly limited in their efforts to regulate externalities, moral hazards and monopoly power. Without that regulation, management will have a tough time acting even in the interests of shareholders.69 Gunther Teubner argues that fiduciary duties have proceduralized the governance of corporations to the point of making corporate social responsibility part of that process and the means through which corporations can be integrated into their social environment.[67]

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[64] Bottomley, Stephen, 'The Birds, the Beasts and the Bat: Developing a Constitutionalist Theory of Corporate Regulation', 27 Federal L. Rev. 243-264. (1999). See also Bottomley,, Stephen *The Constitutional Corporation* London: Ashagate, 207).

[65] Valsan, Remus D. and Yahya, Moin A. *Shareholders, Creditors, and Directors' Fiduciary Duties: A Law and Finance Approach,* abstract.

[66] R. Edward Freeman, "Stakeholder Theory of the Modern Corporation," in Ethical Issues in Business: A Philosophical Approach, Thomas Donaldson and Patricia H. Werhane, eds. (6th ed., 1999) at 247.

[67] Teubner, Gunther, "Corporate Fiduciary Duties and their Beneficiaries: A Functional Approach to the Legal Institutionalization of Corporate Responsibility" in Hopt, Klaus J and Teubner, Gunther. *Corporate Governance and Directors' Liabilities: Legal, Economic and*

B. Internalization of Environmental and other Externalities

The attempt to use fiduciary duties to underpin corporate social responsibility ultimately turns on seeking to have those duties constrain what Joel Bakan has called "the externalizing machine" that is the corporation.[68] The internalization of environmental costs is a classic debate in economics, involving two of the field's most renowned scholars. Arthur Pigou proposed government measures, such as taxes and subsidies, aimed at controlling externalities, such as environmental harms.[69] He acknowledged the existence of market failures: in which market actors acting only in response to price signals would fail to coordinate decision-making so as to avoid externalities. Carbon taxes and the creation of pollution markets are examples of Pigovian measures.[70]

In contrast, Ronald Coase envisioned \situations in which parties could and would bargain toward compensatory payments so that each would bear all the costs of their actions. Coase's approach assumes a well-organized property rights system and, in the presence of significant transaction costs, the identification of liability rules that would align with bargains that would be achieved in their absence.[71]

Herbert Hovenkamp's study of the work of Pigou and Coase suggests that in fact Pigou anticipated Coase's emphasis on

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Sociological Analyses on Corporate Social Responsibility (Berlin: de Gruyter: 1985) at 149.

[68] Bakan, Joel, *The Corporation: The Pathological Pursuit of Power and Profit* (New York: Free Press, 2004).

[69] Pigou, A. C. *The Economics of Welfare*. (London: Macmillan, 1920).

[70] For a description and evaluation of Pigovian policies, see Baumol, William J. "On Taxation and the Control of Externalities" 62 Amer. Econ. Rev. 307 (1972).

[71] Coase, Ronald H. " 'The Problem of Social Cost" (1960) 3 Journal of Law and Economics 1-44.

transaction costs tby insisting that it is often costly to change the way in which resources are allocated and that costs may be so high as to prevent an otherwise desired bargain from taking place.[72] Imperfect information is often a major reason for prohibitively high transaction costs. People often lack information about the value of a resource in a particular context or exactly how it might be deployed in a different context.[73] Disclosure rules can play a significant role in reducing these kinds of transaction costs and in doing so, they can play a major role in altering the corporation's cost/benefit decision-making calculation.

Dorwelier and Yakhou describe some of the corporate decisions impacted by environmental accounting: pricing, controlling overhead, disclosure of environmental information of interest to affected communities.[74] Hecht describes how environmental accounting works in practice.[75] Reorienting corporate accounting practices can be done through government imposition, voluntary means, or by some means that falls between the two extremes on the spectrum of coercion. Many of the possibilities are described in the UN Report on Environmental Management Accounting.[76] Gray, Bebbington and Walters have written about the levels of corporate willingness to adopt environmental

[72] Hovenkamp, Herbert. "The Coase Theorem and Arthur Cecil Pigou" 51 Arizona L. Rev. 633 (2009).
[73] Singh, Nirvikar. *Transaction Costs, Information Technology and Development*. http://escholarship.org/uc/item/1460z68n
[74] Dorwelier, Vernon P. and Yakhou, Mehenna. *Environmental Accounting: An Essential Component of Business Strategy*.
[75] Hecht, Joy E. *Environmental Accounting: Where We Are Now, Where We Are Heading.* http://www.rff.org/rff/Documents/RFF-Resources-135-enviroaccount.pdf
[76] *Environmental Management Accounting Procedures and Principles* http://www.un.org/esa/sustdev/publications/proceduresandprinciples.pdf

accounting standards, and the degree to which the adoption of the standard has altered behaviour.[77]

C. The Changing Role of the Shareholder

Fiduciary duties do not generally apply to shareholders, who are protected behind a veil of limited liability. However, there is the beginning of a discussion in the literature as to whether the role of shareholders is changing to encompass some dimension of social responsibility. Martel and Martel well describe the conventional view of the relationship between the shareholder and the corporation: a shareholder's obligations vis-à-vis the corporation are limited by the terms of the concrete arrangement with the enterprise.[78] Yet there are some alternatives to this view. Klonoski argues that shareholders have a moral responsibility to monitor and perhaps even challenge immoral corporate behaviour.[79] Klonoski seeks to ground that responsibility in an expanded conception of property according to which property is relational and carries with it obligations as well as rights.

In a different vein, Russell Sparkes explores shareholders' potential to impact corporate decisionmaking through ethical investing.[80] The work of Michelson, Wailes, van der Laan and Frost questions the motivations of some actors who opt for so-called "ethical" investment options.[81] Their research suggests that many people invest in `both socially responsible funds and

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[77] Bebbington, Jan, Gray, Rob and Walters, Diane. *Accounting for the Environment, Part 2,* p. 31-4.

[78] Martel, Maurice et Paul Martel. *La société par actions au Québec*, *Les aspects juridiques*, (Montréal: Wilson & Lafleur, 2011) vol. I, p. 1-7.

[79] Klonoski, Richard J. "The Moral Responsibilities of Stockholders. Journal of Business Ethics" (1986) 5 (5):385 - 390.

[80] Sparkes, Russell. *Ethical Investment: Whose Ethics, Which Investment?,* abstract. http://www3.interscience.wiley.com/journal/118994482/abstract

[81] Frost, Geoff et al, *Ethical Investment Process and Outcomes,* p.2. http://www.pensionsatwork.ca/english/pdfs/scholarly_works/sw_edition3/MicWaiLaaFro.pdf,

conventional or even companies with socially irresponsible records. This suggests that well-performing ethical funds attract ethical and conventional investors, and that the distinction between ethical and conventional investors may not be clear cut.

D. The Public- Private Distinction

A last related theme concerns the interplay of public-private ownership and governance structures with social responsibility. While corporations with a public ownership stake arguably have greater de facto obligations to public stakeholders, Norman and Heath argue that it is be difficult to institutionalize corporate social responsibility obligations even for such enterprises.[82] They look at the example of state-owned enterprises in the 60s and 70s as firms that had similar governance challenges to private enterprises attempting to introduce CSR norms. Their conclusion is that state-owned enterprises with public interest mandates not only failed to make profits but also failed to advance the public interest. These lessons may prove important with the growing role and influence of Chinese corporations and their increasingly ambitious corporate social responsibility undertakings.[83]

Co-determination, particularly in the German context remains an alternative stakeholder-engaged governance structure at least as concerns workers. Despite the challenges it has faced, Walther Muller-Jentsch argues that it continues to be an important institution in German industrial relations and argues for

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[82] Heath, Joseph and Norman, Wayne. *Stakeholder Theory, Corporate Governance and Public Management: What can the history of state-run enterprises teach us in the post-Enron era?* p. 10. http://www.creum.umontreal.ca/IMG/pdf/Heath_Norman_final_preproof.pdf

[83] See Sarkis, Joseph and Zhu, Qinghua, “Winds of Change: Corporate Social Responsibility in China” Ivey Business Journal (2011) available at http://www.iveybusinessjournal.com/topics/social-responsibility/winds-of-change-corporate-social-responsibility-in-china.

its continuation.[84] Indeed, Rinne and Zimmermann have attributed Germany's relative success in weathering the most recent financial downturn as attributable in large part to a coordinated government-worker-employer labour market strategy.[85]

[84] Jentsch-Muller, Walther. *Industrial Democracy: Historical Development and Current Challenges,* p. 13. http://www.management-revue.org/papers/mrev_4_08_Mueller-Jentsch.pdf.

[85] Rinne, Ulf and Zimmermann, Klaus F. "Another Economic Miracle? The German Labor Market and the Great Recession" IZA DP No. 6250 (2011) available at http://ftp.iza.org/dp6250.pdf.