CORPORATE AND CATHOLIC?

A CRITIQUE OF CORPORATE LAW BASED ON THE PRINCIPLES OF CATHOLIC SOCIAL TEACHING

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Ad majorem Dei gloriam

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INTRODUCTION

The current economic crisis has prompted a renewed appetite for an ethically based economic system. In March 2009, Gordon Brown, Prime Minister of the United Kingdom, called for a "financial system [...] founded on the very same values that are at the heart of the best of our family lives".[1] On the same occasion, Kevin Rudd, Prime Minister of Australia, described the challenge facing governments in rebuilding the economic system as one of "getting the balance right; affirming the right to individual enterprise while reaffirming our responsibility to the common good".[2] The Roman Catholic Church is in a unique position to contribute to the formulation of such an ethical economic system. It is one of the largest and oldest institutions on earth[3] and, particularly in the last 200 years, has developed a significant body of teaching devoted to articulating principles on which to pursue "a more humane and humanizing" economic system.[4]

Within this body of thought, known collectively as Catholic Social Teaching (CST), the Roman Catholic Church proposes the fundamental principle that "man ought to be the source, the focus and the aim of all economic and social life".[5] This has implications at all levels of economic activity, from regulation at an international level to the impact on local communities, and it touches on concerns as diverse as a just wage,[6] conservation of the environment,[7] employment relations,[8] and the effects of unemployment.[9]

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[1] Gordon Brown, "Speech and Q&A at St Paul's Cathedral", given on 31 March, 2009. Official transcripts of this event are available at http://www.number10.gov.uk/Page18858, the official site of the Prime Minister's Office.

[2] Kevin Rudd, "Speech and Q&A at St Paul's Cathedral", given on 31 March, 2009. Rudd also argued that "government should balance the market to ensure that both individual liberty and the common good are enhanced".

[3] According to the 2009 edition of the Pontifical Year Book, there were approximately 1.15 billion Catholics worldwide at the end of 2007 (the latest date with data available). See, "Church Growing With World Population" (2009) *Zenit* <http://zenit.org/article-25244?l=english> at 1 October 2009. The Catholic population of New Zealand in 2006, according to the 2006 Census Data, was approximately 508, 000 out of a total population of approximately 4.14 million. See, "Quick Stats About Culture and Identity" (Statistics New Zealand, 2006).

[4] Pope Benedict XVI, Encyclical letter *Caritas in Veritate*, 29 June 2009, at §9.

[5] Ibid., at §25. Many of the encyclical passages quoted herein were not translated from Latin to English in "inclusive" or "gender-neutral" language. Rather than be distracted by what might be considered a sexist application of the word "man" in these quotations, the reader should attempt to digest and interpret this language as it was originally intended. At the time most encyclicals were written and translated, "man" was considered gender-neutral.

[6] See Pontifical Council For Justice And Peace (PCFJAP), *Compendium of the Social Doctrine of the Church*, (Washington: USCCB Publications, 2007) at §302.

[7] For a New Zealand example, see Anna Sussmilch, Mary Betz and Leesa Roy (eds), *Renew the Face of the Earth: Environmental Justice* (2006) and Martin de Jong and Lisa Beech, *Founded on Rock: Putting into*

This study applies the principles of CST to a particular area within the economic system; the modern business corporation.[10] While they are entities created by the law, frequently the law proves inadequate in regulating their activity to protect the common good. This study asks whether the principles of CST could be implemented in New Zealand to better reflect the common good.

The ability of New Zealand law to regulate domestic companies can be complicated by globalisation and trans-national corporations. They dominate the international economic sphere, at times with incomes rivalling that of whole states, compromising the ability of states and domestic law to regulate them. Trans-national corporations are not the focus of this study, but their existence and ability to resist domestic pressure provides a back-drop for the domestic focus of this study, particularly as some of them are also domestic employers.

Chapter One of this dissertation outlines the basic principles of Catholic Social Teaching, before drawing out the implications of these for corporate law. This focuses on two principles: the pre-eminence of the worker and the common good of the community, which both repudiate the exclusive pursuit of profit as the purpose of a business. It also outlines the limitations of reform as understood within the Catholic tradition.

Chapter Two examines the theory behind corporate law that have led to the modern business corporation. It then examines how this is reflected in current New Zealand company law, assessing the degree to which this reflects or frustrates the principles set out in Chapter One. The underlying question is whether New Zealand law keeps "man [as] the source, the focus and the aim of all economic and social life"[11] or put some other goal in this place.

Finding a number of disparities between the current regime of company law and the principles of CST, Chapter Three then examines three different justifications for excluding the common good from corporate law: shareholder ownership, market regulation, and the

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Practice Catholic Teaching on Land and the Environment, (Wellington: Caritas Aotearoa New Zealand, 2007), both authorised by the New Zealand Bishops Conference.

[8] For New Zealand examples, see New Zealand Catholic Bishops Conference, *Statement on Industrial Relations*, May 1981 and New Zealand Catholic Bishops Conference, *Employment Contracts Legislation: A Catholic Response*, April 1991; both reprinted in Chris Orsman and Peter Zwart (eds), *Church in the World: Statements on Social Issues 1979-1997* (1997), 39-42.

[9] For a New Zealand example, see New Zealand Catholic Bishops Conference, *Statement on Employment*, 11 September 1980; reprinted in Orsman, *Church in the World*, 27.

[10] The words "company" and "corporation" will be used inter-changeably in this dissertation as New Zealand law makes no distinction between the two terms.

[11] Pope Benedict XVI, *Caritas*, at §25.

public/private distinction. The discipline of Critical Legal Studies offers a number of insights into corporate theory that expose certain problems in the justification for current systems.

Having questioned the validity of these objections, Chapters Four and Five analyse two alternative approaches to implementing the principles of CST within corporate law. Chapter Four examines how the Stakeholder Theory could be incorporated into New Zealand law, and whether this would better protect the common good. It then examines Co-determination structures from overseas as a possible avenue of giving greater priority to employees. Chapter Five examines co-operative companies to see whether they better align with the principles of CST. It examines both the theoretical basis for co-operatives – which is fundamentally different that other companies – and the current framework that exists in New Zealand law. This chapter coincides with the recent call in CST for "hybrid forms of commercial behaviour, [...] types of economic initiative which, without rejecting profit, aim at a higher goal than the mere logic of exchange of equivalents, of profit as an end in itself".[12]

The options highlighted in these last two chapters are drawn from overseas jurisdictions. Consequently, they reveal that New Zealand is lagging behind many other countries in incorporating concerns for the common good into law, but also provide practical options for New Zealand to implement the principles of CST to produce a "more humane and humanizing" economic system.[13]

[12] Ibid., at §35.
[13] Ibid., at §9.

CHAPTER ONE: CATHOLIC SOCIAL TEACHING

A. AN OVERVIEW OF CATHOLIC SOCIAL TEACHING

Catholic Social Teaching has frequently been described as the "best kept secret" of the Roman Catholic Church.[14] It is a body of documents and teaching that has developed as Catholic beliefs have been applied to social, political, and economic problems confronting the world.[15] These documents include Papal encyclical letters, Church Council documents, and letters from national bishop conferences.[16] While it has its origins in a specific theological worldview, it is directed to "all persons of good will, including those of any or no religion. It presupposes only that its addressees are interested in building a just and peaceful society on earth".[17] While CST is addressed to all people, some may question the relevance of a Catholic (or any religious) perspective on a "secular" matter such as the economy. This objection is not of primary concern in this dissertation, nor will the overall coherency of CST be examined;[18] instead, the focus is on implementing the principles. If the results are compelling, they should stand on their own ground independent of the religious (or otherwise) background of the reader.[19]

The foundational principle of CST is the dignity of the human person. This recognition requires any system to be ordered so that it serves the good of the people involved in it, and never undermine them. CST "judge[s] any economic system by what it does for and to people

[14] John L Jr Allen, "Economic encyclical expands on church's 'best-kept secret'", *National Catholic Reporter*, 7 July 2009.

[15] For a detailed outline of the historical development of CST, from its popularly recognised beginnings in Pope Leo XIII's *Rerum Novarum*, published in 1891, see PCFJAP, *Compendium*, (Washington: USCCB Publications, 2007) at 31-47.

[16] Within the Roman Catholic Church, encyclical letters are written by Popes and have the second highest level of authority, behind only Apostolic Constitutions. Consequently, these teachings have significant gravitas within Catholicism. Church Council documents, in particular those from Vatican II (1962 – 1965), also have significant authority as they are issued by Popes in concert with the bishops of the world. Statements from bishops conferences have less authority but are frequently more context-specific.

[17] Avery Cardinal Dulles, "Catholic Social Teaching and American Legal Practice" (2002) 30 *Fordham Urban Law Journal* 277 at 279.

[18] For an in-depth analysis of Catholic Social Teaching, see Kenneth R. Himes and Lisa Sowle Cahill (eds), *Modern Catholic Social Teaching: Commentaries and Interpretations* (Washington, DC: Georgetown University Press, 2005), and for a more critical appraisal, see Charles Curran, *Catholic Social Teaching, 1891-Present: A Historical, Theological, and Ethical Analysis* (Washington, DC: Georgetown University Press, 2002).

[19] For further discussion of the debate over the role of religious contributions to public issues, see Denise Meyerson, "Why religion belongs in the private sphere, not the public square" in Peter Crane, Carolyn Evans and Zoe Robinson (eds), *Law and Religion in Theoretical and Historical Context* (Cambridge: Cambridge University Press, 2008) and the sources referred to within her treatment of the subject.

and by how it permits all to participate in it. The economy should serve people, not the other way around".[20]

Building directly upon the dignity of the human person are three other "permanent" principles: the common good, subsidiarity, and solidarity.[21] The *common good* (CG) is broadly defined as "the sum total of social conditions which allow people, either as groups or as individuals, to reach their fulfilment".[22] In CST, the state bears particular responsibility for attaining the CG, with the "specific duty to harmonize the different sectoral interests with the requirements of justice".[23] However, there is also a responsibility on all people to work towards attaining this goal.[24] If "any section of the population is in fact excluded from participation in the life of the community, even at a minimal level, then that is a contradiction to the concept of the [CG] and calls for rectification".[25]

Subsidiarity holds that the people or groups most directly affected by a decision or policy should play a key role in making these decisions. It is therefore, wrong "to assign to a greater and higher association what lesser and subordinate organizations can do".[26] Subsidiarity aims to prevent abuses or exploitation by "higher-level social authority"; its characteristic implication of is participation, which CST extends to "the world of work and economic activity".[27]

Finally, s*olidarity* highlights the "intrinsic social nature of the human person [and] awareness of the bond of interdependence between individuals and peoples".[28] These principles function together and "must be appreciated in their unity, interrelatedness and articulation".[29]

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[20] United States Conference of Catholic Bishops, Pastoral letter *Economic Justice for All: Catholic Social Teaching and the U.S. Economy*, 13 November 1986, at §13.

[21] These three, together with the principle of human dignity, are characterised as "permanent principles". By this, they are understood as having permanence in time and universality in meaning, as opposed to the concrete application of these principles that can differ from time and place. These four principles are presented as "the primary and fundamental parameters of reference for interpreting and evaluating social phenomena"; PCFJAP, *Compendium*, at §161.

[22] Second Vatican Ecumenical Council, Pastoral Constitution *Gaudium et Spes*, 7 December 1965, at §26; reprinted in Walter M Abbott and Joseph Gallagher (eds), *The Documents of Vatican II* (1966). For a secular discussion of the common good, see John Finnis, "Community, Communities, and Common Good" in *Natural Law and Natural Rights* (Oxford: Clarendon Press, 1980). Alternatively, for an ecumenical New Zealand perspective on the common good, see Ruth Smithies and Helen Wilson (eds), *Making Choices: Social Justice For Our Times* (1993).

[23] PCFJAP, *Compendium*, at §169.

[24] Ibid., at §167.

[25] Catholic Bishops' Conference of England and Wales (CBCEW), *The Common Good and the Catholic Church's Social Teaching*, 1996, at §70.

[26] Pope Pius XI, Encyclical letter *Quadragesimo Anno*, 15 May 1931, at §79.

[27] PCFJAP, *Compendium*, at §189.

[28] Ibid., at §192.

B. THE PRIORITY OF WORK

In relating CST to corporations, two papal encyclicals are of particular importance. The first is *Laborem Exercens*, written by Pope John Paul II in 1981.[30] It articulates the Catholic vision of the value of work. The second is *Caritas in Veritate*, written by Pope Benedict XVI in 2009.[31] It addresses the phenomenon of globalisation and applies CST to the current global economic recession.

In *Laborem Excercens,* work is defined inclusively, extending to "any activity by man, whether manual or intellectual, whatever its nature or circumstances".[32] Work is understood as encompassing two senses: the objective and the subjective. The objective sense of work is the product of labour. It includes physical products, such as those from manufacturing, as well as the product of more intellectual labour. It "constitutes the contingent aspect of human activity, which constantly varies in its expressions according to the changing technological, cultural, social and political considerations".[33] The subjective sense of work is its effect on the person, contributing to his or her development. It "gives work its particular dignity, which does not allow that it be considered a simple commodity or an impersonal element of the apparatus for productivity".[34] According to CST, the subjective element must take priority over the objective; if the inverse occurs, then "work activity and the very technology employed become more important than the person himself and at the same time are transformed into enemies of his dignity".[35] Because of this danger,[36]

> the church considers it to be its task always to call attention to the dignity and rights of those who work, to condemn situations in which that dignity and those rights are violated, and to help guide [...] changes so as to ensure authentic progress by man and society.

For CST, "disorder in the order of [work] is the principal cause of the injustices in society, the structures of oppression, and the alienation inflicted on people".[37] Consequently, large companies, as one of the primary employers in this country, play a pivotal role in determining the justice or injustice present in society. "Never has their role been so decisive with regard to

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[29] Ibid., at §162.
[30] Pope John Paul II, Encyclical letter *Laborem Exercens,* 14 September 1981.
[31] Pope Benedict XVI, *Caritas.*
[32] Pope John Paul II, *Laborem*, at §1.
[33]PCFJAP, *Compendium*, at §270.
[34] Ibid., at §271.
[35] Ibid.
[36] Pope John Paul II, *Laborem*, at §1.
[37] Gregory Baum, *The Priority of Labor*, (Ransey, N.J.: Paulist Press, 1982) at 10.

the authentic integral development of humanity in solidarity".[38] If they are to be consistent with the principles of CST, they must ensure the dignity of the worker is preserved and maintained. This is "to be a goal of the firm equivalent to those economic objectives of growth, maximum profit, and increased market share and stock value".[39]

C. The Common Good

This proposal may be interpreted by many as threatening the profit motivation of economic activity. It is indisputable that producing profit is an essential part of any business operation, and CST does not deny this. Profit is typically the major criterion of success for a business; it is "the regulator of the life of a business".[40] CST, however, does not accept this as the sole purpose of economic activity. It provides a wider definition of the purpose of business enterprise:[41]

> The purpose of a business firm is not simply to make a profit, but is to be found in its very existence as a *community of persons* who in various ways are endeavouring to satisfy their basic needs, and who form a particular group at the service of the whole of society.

Consequently, the profit motive is placed within a wider context. In CST, "other human and moral factors must also be considered which, in the long term, are at least equally important for the life of a business".[42] Beyond its ethical basis, there is some economic support for businesses pursuing wider objectives. A study by Collins and Porras on "visionary companies" found that the most successful were those that "pursue a cluster of objectives, of which making profits is only one".[43]

CST has some particular concerns about single-minded pursuit of profit. As Pope Benedict XVI recently described it:[44]

> Profit is useful if it serves as a means towards an end that provides a sense both of how to produce it and how to make good use of it. Once profit becomes the exclusive

[38] PCFJAP, *Compendium*, at §342.
[39] Michael A Zigarelli, "Catholic Social Teaching and the employment relationship: A model for managing human resources in accordance with Vatican doctrine" (1993) 12 *Journal of Business Ethics* 75 at 76.
[40] Pope John Paul II, Encyclical letter *Centesimus Annus*, 1 May 1991, at 35.
[41] Ibid.
[42] Ibid.
[43] James C Collins and Jerry I Porras, *Built to Last*, (New York: HarperCollins, 1994) at 8. For more on this situation, see Andrew V Abela, "Profit and More: Catholic Social Teaching and the Purpose of the Firm" (2001) 31 *Journal of Business Ethics* 107, which ties the findings of Collins and Porras with the wider purpose of the firm as proposed by Pope John Paul II in *Centesimus Annus.*
[44] Pope Benedict XVI, *Caritas*, at §21.

> goal, if it is produced by improper means and without the common good as its ultimate end, it risks destroying wealth and creating poverty.

This quotation ties profit back into the Catholic concept of the CG. Pursuit of the CG extends to consideration of "the workers, the suppliers, the clients, the suppliers of various elements of production, the community of reference".[45] The principles of CST require companies to consider these other groups when formulating their business strategies.

As an important point of clarification, the Catholic conception of the CG is not a utilitarian vision, aiming for the greatest net good. "Institutions exist for people and individuals may not be harmed in order that others may prosper or that 'the system' may work".[46] Instead, CST strikes a balance between individualism and collectivism.

These two major principles, the priority of the worker and the pursuit of the CG, form the backbone of this dissertation's examination of the modern business corporation. It needs to be understood, however, that "the Church does not have technical solutions to offer".[47] The goal of these principles is not to dictate one particular system or another, but rather to stimulate humane economic forms. These principles will need to be continually applied to contemporary circumstances. Any number of systems and structures, differing in time and place, could be compatible with these guiding principles so long as they respect and uphold human dignity.

D. The Effects of Globalisation

An additional consideration affecting the CG is the phenomenon of globalisation. While individual states may try to promote the CG within their own jurisdictions, the "increasing mobility both of financial capital and means of production, material and immaterial",[48] allows trans-national corporations to move to less regulated environments. This enables them to avoid considerations of the CG that may affect their profit-margins, and also creates competition between states to attract foreign business through favourable fiscal regimes and

[45] Ibid., at §40.
[46] Ruth Smithies, "Catholic Social Teaching: A Rich Heritage" in Jonathan Boston and Alan Cameron (eds), *Voices for Justice: Church, Law and State in New Zealand* (Palmerston North: Dunmore Press, 1994) at 159.
[47] Second Vatican Ecumenical Council, *Gaudium et Spes*, at §36.
[48] Pope Benedict XVI, *Caritas*, §24.

deregulation of the labour market.[49] As a consequence, protecting the CG also requires co-ordinated international regulation. CST teaches that:[50]

> [T]he governance of globalisation must be marked by subsidiarity, articulated into several layers and involving different levels that can work together. Globalisation certainly requires authority, insofar as it poses the problem of a global common good that needs to be pursued. This authority, however, must be organised in a subsidiary and stratified way, if it is not to infringe upon freedom and if it is to yield positive effects in practice.

This international governance is an essential backdrop for effective domestic protection of the CG. Consideration of how to effectively achieve this is beyond the scope of this dissertation, but it provides a necessary context for the domestic situation that will be discussed.[51]

E. Limitations of Reform

The Catholic Church strongly endorses structural reform as a means of facilitating the CG. In his encyclical letter *Centisimus Annus,* Pope John Paul II taught that there is an obligation to remove the "specific structures of sin which impede the full realization of those who are in any way oppressed by them".[52] These "structures of sin" are considered to fall into two categories: "on the one hand, the all-consuming desire for profit, and on the other, the thirst for power, with the intention of imposing one's will upon others".[53] These institutionalised forms of oppression are targeted by CST.

Structural reform, however, will not be sufficient on its own to produce and protect the CG. Within CST, injustice is not simply produced by "some vague entity or anonymous collectivity such as the situation, the system, society, structures or institutions".[54] The unjust effects of what the Catholic Church calls "structures of sin" are "always connected to concrete acts of the individuals who commit them, consolidate them and make it difficult to remove them".[55] The two are related, with individual decisions consolidating unjust structures,[56] while established structures can legitimate or normalise these unjust personal

[49] John Farrar, *Corporate Governance: Theories, Principles and Practice*, 3rd ed (Melbourne: Oxford University Press, 2008) at 15.
[50] Pope Benedict XVI, *Caritas*, §53.
[51] For further discussion on how international regulation of trans-national corporations is required to protect the CG, see Pope Benedict XVI, *Caritas*; Farrar, *Corporate Governance*, chapters 37 and 38; and David C Korten, *When Corporations Rule the World* (London: Earthscan Publications Ltd, 1995).
[52] Pope John Paul II, *Centesimus*, at §38.
[53] PCFJAP, *Compendium*, at §119.
[54] Pope John Paul II, Apostolic Exhortation *Reconciliatio et Paenitentia*, 2 December 1984, at §16.
[55] PCFJAP, *Compendium*, at §119.
[56] Ibid.

decision. As a consequence, alongside structural reform, CST recognises the need for "a social ethos in which people become committed to [the common good]".[57]

Structural reform can itself contribute to the creation of this social ethos. As the law "establishes norms for social behaviour, it has a pedagogical function",[58] and has "an essential place in the maintenance of a healthy social order".[59] Given this two-fold understanding within CST, structural reform has a vital role, but does not stand alone. Producing and protecting the CG requires reform of structures, but it also requires commitment from the individuals involved within the economic system.

[57] Dulles, "Catholic Social Teaching", at 280.
[58] Ibid.
[59] Ibid.

CHAPTER TWO: CORPORATE STRUCTURE

A. COMPANY STRUCTURE

Economic activity is organised in a variety of legally recognised forms. Companies, with which this study is concerned, are distinct from other business forms, such as sole-traders and partnerships, in that in law, they are regarded as a separate legal person. This provides "legal recognition to bodies of persons, associated together, as distinctive holders of rights under a collective name, with distinct legal consequences".[60] In New Zealand, this status is conferred through registration under the Companies Act 1993.[61] The effect of this incorporation is that companies are able to own assets,[62] including their own shares,[63] they can sue or be sued in their own right,[64] they can outlast their founders, and shareholders are given the protection of limited liability.[65] Limited liability allows shareholders to invest in companies, gaining the ability to receive dividends and share in the company's profits, while being immune from liability to creditors. This relationship ensures companies are capable of attracting capital while minimising the risks to the shareholders. In this manner, companies have become effective wealth producing entities; as a consequence, there are over 500,000 companies registered in New Zealand.[66]

Practically, there are a number of factors that distinguish larger companies from smaller ones. These differences are important, at least for the purposes of this study, in the larger the company, the greater capacity it has to affect the CG. The traditional business mode was typically a single-unit enterprise; handling a single economic function, it typically operated in a single geographical location, and was owned by an individual or a small number of owners.[67] This is still the most common form in New Zealand, and most other Western

[60] Farrar, *Corporate Governance* at 21.
[61] Companies Act 1993, ss 14 and 15. For the origins of the common law doctrine of separate legal personality, see *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL).
[62] Companies Act, s 16.
[63] Companies Act, s 59. This is allowed provided that it is not prohibited by the company's constitution.
[64] Companies Act, s 16.
[65] Companies Act, s 97.
[66] According to the New Zealand Companies Office, "New Zealand Companies Office Profile 2008-2009" (Ministry of Economic Development, 2009), there were 506,300 registered companies in New Zealand as at 30 June 2008.
[67] Alfred D Jr Chandler, *The Visible Hand: The Managerial Revolution in American Business*, (Cambridge, MA: Harvard University Press, 1977) at 7.

countries.[68] Large companies, or corporations, differ from this. They integrate numerous different economic units, carrying on a diverse range of economic activities, and operate in different geographic locations. These activities are integrated into a much larger economic structure with vertical and horizontal integration of the activities.[69]

This necessitated the creation of a distinct class of professional directors and managers with specialist skills. Their role is to monitor and coordinate the work of the various units under their control. "The existence of a managerial hierarchy is a defining characteristic of the modern business enterprise".[70] The introduction of a managerial class was accompanied by a distancing of ownership and control. Ownership of the corporation could be spread through shares, with a significantly broader base of owners.[71] "The typical result was that in the very large corporations, the nominal owners were a large group of absentee shareholders, who had little to do with the actual running of the business, while the people with the real control over the productive assets of the corporation were not the hired specialist managers".[72] In New Zealand, publically listed companies are only a small fraction of total businesses, but due to their size, they have a disproportionate influence on the economy.[73]

Traditionally, the divide between owner-shareholders and non-owner managers created an "agency problem". How could the shareholders ensure the managers acted in such a way as to further shareholder interests and not their own? One approach was the development of fiduciary duties owed by directors to shareholders.[74] This view of the company, as a form of agency relationship, was replaced by a "nexus of contracts" conception. In this arrangement, everyone involved in a corporation has bargained through contract for their rights:[75]

> If parties dislike the terms of the 'contract' between themselves and the company, they can leave. Not only can shareholders sell their shares, but employees can quit,

[68] Statistics New Zealand, "Employment size groups for enterprises-(ANZSIC 06)" (Statistics New Zealand, 2009), of the 320,000 companies above the economic significance criteria on Statistics New Zealand's Business Frame, 120,000 had less than 10 employees.
[69] Chandler, *The Visible Hand*, at 3.
[70] Ibid., at 7.
[71] Farrar, *Corporate Governance* at 12.
[72] Michael Robertson, "Property and Ideology" (1995) 8 *Canadian Journal of Law and Jurisprudence* 275 at 286. See also, David Millon, "Theories of the Corporation" [1990] *Duke Law Journal* 201 at 214.
[73] As of September 2009, there were 327 listed organizations on the NZSX, NZAX, and NZDX. This is a tiny fraction of the 320,000 companies registered with the Companies Office. Statistics New Zealand, "Employment size groups".
[74] Farrar, *Corporate Governance* at 13.
[75] Kent Greenfield, *The Failure of Corporate Law*, (Chicago: University of Chicago Press, Ltd, 2006) at 14. See also, David Millon, *New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law* (1993) 50 *Washington and Lee Law Review* 1373 at 1378-1379.

> managers can find a different company to manage, suppliers can sell their goods elsewhere, creditors can sell their bonds.

This view of a "nexus of contracts" also affirmed the primacy for shareholders. They "contracted" with the managers to increase their share value and to achieve maximum profits. The "contract" is not to understood in the legal sense – frequently no such contract exists between the parties involved, such as between shareholder and director – but as an individual exchange relationship.[76] This conception has led to the prevailing understanding of the corporation, succulently laid out by Kent Greenfield:[77]

> Corporations are voluntary, private, contractual entities; they have broad powers to make money in whatever ways and in whatever locations they see fit; and the primary legal obligation of management is towards shareholders, and shareholders alone. Most important, the law still operates around the premise that corporations have broad powers but only a limited role: they are entities that have as their primary objective the making of money, and not much else is expected or required of them.

For reasons made clear in Chapter One, this primary focus on shareholders does not correspond to the principles of CST. Instead, it can create a single-minded focus on profit-maximisation for these absentee shareholders, at the expense of employees and other affected groups. While these general characteristics of company structure just discussed – distinct legal entity, limited liability, and professional managers – exist in New Zealand law, this study now turns to the particular legal framework that governs corporate governance and activity.

B. The Companies Act 1993

In New Zealand law, companies are governed by the Companies Act 1993, which provides the mechanism for recognition of companies, the duties and obligations of directors, shareholders' rights, and other default rules. The long title of the Act sets out that, among other goals, it aims to "reaffirm the value of the company as a means of achieving economic and social benefits".[78] While recognising the social benefits of the company could reflect a wider appreciation of the purpose of business firms as found in CST, the statue is based on "somewhat conservative ideas of [the company's] role in society"[79] giving it a more limited role. The long title later mentions "providing protection for shareholders and creditors against

[76] Farrar, *Corporate Governance* at 40.
[77] Greenfield, *Failure* at 125.
[78] Companies Act, long title.
[79] Farrar, *Corporate Governance*, at 490.

the abuse of management power", reflecting a narrower group of interests than CST is concerned to protect.

In New Zealand law, the primary organ for managing companies is the Board of Directors. As set out in s 128, the "business and affairs of a company must be managed by, or under the direct supervision of, the board of a company".[80] If the principle of the CG is to be reflected in the practice of companies, it must be implemented at the level of the directors. They are the most significant actors in determining the direction of the company and, consequently, its effect on the CG:[81]

> It is the function of directors to determine the corporate objectives and strategies and ensure that the management implement those policies, to determine the extent and priority of the company's investment in new ventures having regard to the resources available and the risks involved, [and] to ensure that the company is well managed. [...] The directors provide the company with its direction, and act as a check on management to ensure that the direction is adhered to and pursued.

The Companies Act creates a number of duties that directors are required to abide by in ss 131 - 138 of the Companies Act. Most important with regards to the common good is s 131, which requires a director to "act in good faith and in what the director believes to be the best interests of the company".[82] On its face, this wording appears opposed to the shareholder primacy and profit maximisation just discussed as a standard feature of corporate theory. The duty here is owed to the *company*, not to the shareholder.[83] Furthermore, the duty appears to be subjective, with a standard of the director's belief. Consequently, it could appear that s 131 is open to considerations of the common good beyond just the interests of the shareholders, however, the statute provides little guidance beyond this.

According to the common law, interprets this duty as applying primarily to creditors of the company. In *Sojourner & Anor v Robb*, the High Court held that in situations of insolvency, "the best interests of the company include the obligation to discharge those obligations before rewarding the shareholders".[84] The interests of the employees, however, are not included in the ambit of this duty, although s 132 makes some provision for them. It allows directors "to

[80] Companies Act, s 97.
[81] *Dairy Containers Ltd v NZI Bank Ltd* [1995] 2 NZLR 8, 79-80 (CA).
[82] Companies Act, s 131(1).
[83] There are some exceptions to this, where directors do owe duties to shareholders. In *Coleman v Myers* [1977] 2 NZLR 225 (CA), the Court of Appeal recognised a duty owed by directors to shareholders not to make "deliberate or careless statements" in regard to share value. However, this duty owed to shareholders has little application to the CG, so will not be discussed further.
[84] *Sojourner & Anor v Robb* [2006] 3 NZLR 808, (HC) at [102]. This decision was upheld by the Court of Appeal in *Sojourner v Robb* [2008] 1 NZLR 751.

make provision for the benefit of employees [...] in connection with the company ceasing to carry on the whole or part of its business".[85]

What, then, is meant by the term "in the best interests of the company"? The wording of the statute suggests a subjective test, which could be a statutory acknowledgement of the business judgment rule.[86] In some jurisdictions, the business judgment rule enables courts to recognise the inherent risk involved in business enterprise; consequently, the courts will not second-guess business judgments taken by directors in good faith. There is reference to this idea in the long title of the Act, which includes as one of its goals, "to encourage efficient and responsible management of companies by allowing directors a wide discretion in matters of business judgment".[87] If it was an acknowledgement of this idea, it could allow some discretion for individual directors to take account of the CG, provided they believe that it will also be in the best interests of the company. Some companies choose to do so, joining organisations such as The New Zealand Business Council for Sustainable Development, which requires them to file sustainability reports and take other measures to consider the wider impact of their activity on communities.[88] These steps, however, are solely voluntary, and directors that choose to implement them could be challenged through various mechanisms.

While this could be possible on the bare words of the statute, later case law has added an objective gloss to this test. The High Court in *Sojourner v Robb* held that s131:[89]

> is an amalgam of objective standards as to how people of business might be expected to act, coupled with a subjective criterion as to whether the directors have done what they honestly believe to be right. The standard does not allow a director to discharge the duty by acting with a belief that what he is doing is in the best interest of the company, if that belief rests on a wholly inappropriate appreciation as to the interests of the company.

This objective gloss to the test limits the ability of directors to have recourse to considerations of the CG in making their decision-making.

Furthermore, despite the Companies Act not strictly giving shareholders priority, there is evidence to suggest this may be what occurs in practice. Dr Ivor Francis carried out an

[85] Companies Act, s 132.
[86] Farrar, *Corporate Governance*, at 147.
[87] Companies Act, long title.
[88] See, *Sustainable Development Reporting: Executive Summary* (The New Zealand Business Council for Sustainable Development) <http://www.nzbcsd.org.nz/sdr/content.asp?id=33>.
[89] *Robb v Sojourner* [2006] 3 NZLR 808, [102].

intriguing study comparing the attitudes of Australian, American and Japanese directors towards their duties. The study asked directors to rank in priority a number of different concerns including the company, the shareholders, employees, the community, and the future. The study showed 74 per cent of Australian directors ranked shareholders as their first priority, well ahead of the company as the second highest consideration. Australia's company law is similar to New Zealand's in that directors owe their duties to the company, not to the shareholder. Unfortunately, similar New Zealand statistics were not available, but given the similarities in both law and culture, it is likely that similar attitudes exist here. Consequently, while a duty to maximise profit to the shareholder is not required *de jure,* it does appear to be the *de facto* position.[90]

Section 131 of the Companies Act also makes provision for directors to consider the interests of holding companies. If the company is a wholly-owned subsidiary, the directors are entitled to "act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company".[91] In the case of subsidiary companies that are not wholly owned by a holding company, the director may also act in the best interests of the holding company provided that the constitution allows it, and they have the agreement of the shareholders of the subsidiary company.[92] Where the requirements of this provision are met, it allows the directors to disregard the local situation of the company in the interests of the holding company which may be quite removed from the local situation.

Another factor in the Companies Act pertinent to the CG is the ability of shareholders to challenge decisions made by directors. Section 109 provides shareholders with the power to review management decisions, and they also have the capacity to alter company constitutions, in this manner protecting their own interests. Shareholders also have the ability to appoint and remove directors; while this is a blunt accountability mechanism, it provides some leverage for shareholders to pressure directors to place their interests first. In contrast, employees and most other stakeholders lack equivalent mechanisms, and so there is no mechanisms to encourage directors to consider the CG.

[90] Ivor Francis, *Future Direction - The Power of the Competition Board*, (Melbourne: FT Pitman Publishing, 1997). See also, Farrar, *Corporate Governance*, at 35.
[91] Companies Act, s 131(2).
[92] Companies Act, s 131(3).

C. Other Regimes

Looking beyond the perimeters of the Companies Act, some recognition of the CG can be found elsewhere in New Zealand. The Securities Commission, which is primarily concerned with issuers of securities, produced a Handbook for Directors, Executives, and Advisers with a number of "Principles for Corporate Governance". These included the principle that "the board should respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose".[93] Expanding on this principle, the Securities Commission encouraged developing clear policies on the relationships with key stakeholders, and regular assessment of compliance with these policies. The Commission also discussed the relevance of these guidelines to directors' duties:[94]

> Company law requires directors to act in the best interests of the company (subject to certain exceptions). However, advancing the interests of other stakeholders, such as employees and customers, will often further the interests of an entity and its shareholders. There is a trend for listed companies to report on how they have affected their stakeholders.

This principle reflects the CST concern for the wider CG by encouraging companies to consider stakeholders; however, these principles are not legally binding. There is also some overlap with the rules for the New Zealand Stock Exchange. For instance, NZX Listing Rule 10.5.3(h), requires listed companies to file annual reports which include "a statement of any corporate governance policies, practices and processes, adopted or followed by the Issuer",[95] but these are focused more on accurate reporting to shareholders and the market, than on promoting wider responsibility.

D. A Contemporary Example

Up to this point, analysis has been theoretical, examining the law as it currently is, without any practical case studies. Consequently, there can be some difficulty in seeing its practical implications. The well-publicised case of Dominion Breweries (DB) and the Monteiths Brewery, provides a practical insight into the operation of New Zealand company law. DB, a national brewery based in Auckland, purchased the Monteiths Brewery, located in Greymouth. In 2001, DB chose to transfer production of Monteiths from Greymouth to its Waitemata Brewery in Auckland; as a consequence, the 15 Greymouth employees were made

[93] Securities Commission, *Corporate Governance in New Zealand: Principles and Guidelines: A Handbook for Directors, Executives, and Advisors*, (Wellington: Securities Commission, 2004) at 24.
[94] Ibid., at 25.
[95] NZX Listing Rule 10.5.3(h).

redundant. The move "was 'just' an economically rational decision on the part of DB",[96] with the company holding that "the cost of sustaining production at the West Coast Brewery was no longer viable".[97]

This was not the situation of a company in financial difficulty, having to make tough decisions in order to ensure its future viability. Instead, the Monteiths brand had become too successful; the Greymouth facility had been running at full capacity to meet demand. Consequently, the decision to close the Greymouth plant was solely a profit maximisation decision, ignoring the connection between Monteiths and the Greymouth community since 1868. According to law, DB was perfectly within its rights to make this decision. Its directors believed moving the plant to Auckland would increase profits and be in "the best interests of the company".

This might be an acceptable situation for some; not, however for CST. For the Greymouth community, it would detrimentally affect the CG, which to reiterate, is "the sum total of social conditions which allow people, either as groups or as individuals, to reach their fulfilment".[98] Pursuing increased profits at the expense of the Greymouth community is almost a paradigm example of the warning given by Pope Benedict XVI: "Once profit becomes the exclusive goal, if it is produced by improper means and without the common good as its ultimate end, it risks destroying wealth and creating poverty".[99] Finally, economic calculation justifying the redundancy of those workers would prioritise the objective sense of work over the subjective.

In this particular instance, the final outcome of the Greymouth Brewery was altered by sustained public outcry. A consumer boycott of DB products and outlets was organised by former West-Coasters, and gained popularity around parts of New Zealand. The situation became the "catalyst for an extensive discussion concerning the intersection of 'good' business practice, community and globalisation".[100] Finally, in response to the public pressure

[96] Sara Walton, Shayne Grice and Bevan Catley, "The Monteith's Affair: Bitter to the Loyal End?" (2003) 9 *Journal of the Australian and New Zealand Academy of Management* 69 at 69.
[97] "DB responds to calls to keep West Coast brewery open", (Dominion Breweries, 2001).
[98] Second Vatican Ecumenical Council, *Gaudium et Spes*, at §26; reprinted in Abbott and Gallagher (eds), *The Documents of Vatican II*.
[99] Pope Benedict XVI, *Caritas*, at §21.
[100] Walton, Grice and Catley, "The Monteith's Affair: Bitter to the Loyal End?" at 69.

(and a 20c drop in share price),[101] DB changed its mind: "We have listened to people's concerns [...] We have decided to keep it open".[102]

Despite the happy ending for the Greymouth community, this example illustrates a blind spot in current New Zealand company law with regard to CST's conception of the CG. The move would have amounted to an abandonment of the community that had created the successful business in the first place.[103] CST argues that the CG requires "due consideration for the way in which the [profit] was generated and the harm to individuals that will result if it is not used where it was produced".[104] Other examples of profit maximisation decisions, frequently resulting in profit being geographically removed from the economic enterprise itself, abound. For instance, in 2008, ANZ National sent 500 call centre jobs from New Zealand to India, despite making NZ$1 billion that year. Similarly, Fisher & Paykel laid off 430 New Zealand workers, in order to relocate production to Mexico.[105] From a New Zealand perspective, these examples reflect a rejection of the CG.

E. Preliminary Conclusions

Having considered the duties outlined by the Companies Act and what this produces in practice, two conclusions can be drawn. Firstly, New Zealand has technically not adopted a duty of shareholder profit maximisation. As directors primarily owe their duties to the company, there is some room to consider interests other than just shareholders; however, this is judged objectively, so it must align with how "people of business might be expected to act".[106] Some evidence suggests, however, that most directors rank shareholders as their highest priority. It is also clear, however, that the CG need not be considered. While there are certain reporting procedures in place for companies listed on the NZX, explicit consideration of wider community interests is solely voluntary. Community stakeholders also lack enforcement mechanisms, while shareholders are able to challenge director's decisions. Therefore, this current situation poorly reflects the principles of CST. For the principles of CST to be effectively implemented, restructuring and reform of company law should occur to give greater priority for stakeholders and the CG.

[101] Paul Madgwick and Elinore Wellwood, "A Toast for the Coast", *The Press*, 28 March 2001, 1.
[102] "DB responds", (Dominion Breweries).
[103] For further discussion on this issue, see Joseph Singer, "The Reliance Interest in Property" (1988) 40 *Stanford Law Review* 611.
[104] Pope Benedict XVI, *Caritas*, at §40.
[105] Green Party, "A rough day for Kiwi workers", *infonews.co.nz*, 17 April 2008.
[106] [2006] 3 NZLR 808, [102].

CHAPTER THREE: OBJECTIONS TO THE COMMON GOOD

There are a number of arguments commonly used to justify the status quo and exclude reform aimed at achieving the CG. The prevailing understanding of the corporation, as discussed earlier, makes recourse to the CG appear illegitimate for companies. Before examining possible reforms in Chapters Four and Five, these arguments need to be addressed. One way of achieving this is to reveal ways in which the assumptions about corporations are false or mask harmful realities. Three such arguments will be examined. Firstly, the claim that shareholder ownership excludes consideration of non-owner groups; secondly, the claim that the CG is best achieved through market mechanisms not government regulation; and finally, examining the background homogenisation of private property that justifies the status quo.

A. OBJECTION ONE: SHAREHOLDER OWNERSHIP

A major objection to taking the CG into consideration in the operation of companies is the conception that the company is owned by shareholders, and that any consideration of the CG that adversely affects their interests is an illegitimate use of company property.[107] "If the state were to broaden a corporation's responsibilities beyond the shareholder-owners, it would extract the owners' private resources for public purposes".[108] After all, it is argued, shareholders contribute the capital and hire the management. At its most extreme, some commentators, most notably Milton Friedman, argue that any reduction of profits of distribution of corporate profits to the wider community is a form of theft, stealing profits from the shareholders.[109] Even though New Zealand does not recognise a strict duty owed by directors to shareholders, this concept is still influential, and is reflected in shareholders' ability to challenge company distributions.

What is it that entitles shareholders to receive the profits of a company? It is not sufficient simply to say that shareholders "own" the firm. This needs to be based on a principled foundation. Operating in the background of these ideas is the paradigm of "the individual property owner who works his own asset, or the entrepreneur who sees a market opening and moves to fill it".[110] Such individuals sacrifice, risk, and work at the development of their

[107] For the historical origins of this idea, see Millon, "Theories" at 223.
[108] Greenfield, *Failure* at 43.
[109] Millon, "Theories" at 227.
[110] Robertson, "Property" at 284.

product or enterprise; therefore, they were entitled to the rewards. This nexus of risk and control is still largely reflected in small businesses, which form the majority of New Zealand enterprises, and the paradigm of the entrepreneur has a significant role in the New Zealand ethos. Large modern companies, however, depart significantly from this paradigm. Risk and control no longer converge in one group. The introduction of professional managers has resulted in control of the operation moving away from shareholders, with all the important decisions being made by the Board of Directors. The owners, the shareholders, ostensibly have some control as exercised through annual meetings, shareholder resolutions, and the ability to appoint and remove directors. However, this right is of diminishing importance as the number of shareholders in each corporation increases. The ability of shareholders to express their opinions becomes almost non-existent, with only a symbolic or political role akin to writing to a Member of Parliament.

The effect of this is that the bundle of rights typically corresponding to property ownership has been split between the managerial class and the shareholder. This separation is increased when the secondary institutions are taken into consideration. Various smaller institutions, such as mutual funds and superannuation schemes, own a portfolio of shares in companies and then distribute the dividends from a diversified group of companies. This has the effect of further distancing shareholders from the corporations they ostensibly own. Consequently, the shareholder becomes a type of passive beneficiary, far removed from the paradigm of ownership.

Finally, apart from at start-up, large companies do not rely on investor-supplied capital, but rather function on retained earnings. Transactions on the secondary stock market do not directly affect the company's assets. Consequently, the prevalence of the entrepreneur paradigm means the law is "failing to pay attention to the fact that, although they continue to exist, a new and more important business form has supplanted them – a business form which might need to be fundamentally rethought in terms of property rights and duties".[111]

Another argument for excluding concerns of the CG in company law is that shareholders are the sole residual claimant. This conception sees the company as a nexus of contracts, of which the primary contract is between the shareholder and the director. On this nexus view, the only intention of the company must be that of the contractual parties, namely the shareholder. It is only the shareholder that contracts to be residual claimants for the firm.

[111] Ibid. at 286.

That is, when all contractual obligations have been met, only the shareholders have contracted to receive surplus profit.

However, what is the basis for their claim to the residual? On a nexus approach, there must be a contract between the shareholders and the directors for it; however, no contract exists. This leads to claims of an 'implied contract' yet there is no reason to restrict such an implied contract to shareholders. They could be extended to many other stakeholder groups who benefit when the company succeeds. Shareholders also lack the ability to declare dividends, and so are reliant on the directors to release them. However, it is at the directors' discretion to determine a company's profits. This can be affected by raising the wages of their employees or providing annual bonuses. Equally, directors can choose to make donations to philanthropic causes, such as local schools, community groups or charities. They can even choose to retain the earnings as future investment.

All of these choices are made independent of the shareholders, and determine the profit available for dividends. As such, both workers and other groups can also make a claim to be residual claimants of the company. As a result, "there is little reason or justification for assuming that all profits should automatically accrue to shareholders. Put differently, shareholders – not having created the entire enterprise – are no longer the sole residuary legatees".[112]

B. Objection Two: Market Regulation

Another argument against systematic consideration of the CG in company law is that as a private entity, "the public interest should be protected, if at all, by pressure applied on corporations from the outside, rather than by changing the nature of corporate governance inside the firm".[113] This pressure was to be applied through market mechanisms, seen as the most efficient way of regulating this activity.[114] This concept held that "markets were self-regulating, that governments' regulation of such markets was interference and that the unrestrained pursuit of self-interest was not only morally legitimate but, equally, to be morally encouraged".[115] According to this understanding, when the CG was detrimentally

[112] Adolph A Berle and Gardiner C Means, *The Modern Corporation and Private Property*, Revised ed (New York: Harcourt, Brace & World, 1968) at xvi.
[113] Greenfield, *Failure*, at 30.
[114] Millon, "Theories" at 230.
[115] Rudd, "Speech and Q&A at St Paul's Cathedral".

affected, market pressure would cause companies to respond. External pressure would be sufficient to protect the CG.

This can certainly be effective, as DB's experience with Monteiths illustrates. A more recent New Zealand example of effective application of market pressure is that of Cadburys Ltd. As opposed to employee redundancies, this example concerns the company's environmental impact. Cadburys changed their manufacturing processes to include palm oil; palm oil plantations have led to deforestation and so, it was argued, contributed to climate change. This action drew enough public concern that a boycott was organised in 2009. In response to this public pressure, Cadburys reverted to its former techniques.[116]

These two examples illustrate how market pressure can be successfully created through public concern for the CG, causing companies to modify their practices to conform. The effectiveness of the market is recognised in CST, which teaches that in certain circumstances, "it would appear that ... the free market is the most efficient instrument for utilizing resources and effectively responding to needs".[117] However, CST also recognises the market's limitations, holding that "it is the task of the State to provide for the defence and preservation of common goods [...] which cannot be safeguarded simply by market forces. [...] There are important human needs which escape [the market's] logic".[118]

Indeed, the logic of the market requires a number of factors to be present before pressure can be effectively applied to companies in order to protect the CG. It requires:[119]

(1) that the persons who are going to withdraw patronage know *the fact* that they are being "injured" (where injury refers to a whole range of possible grievances);
(2) that they know *where* to apply pressure of some sort;
(3) that they are in a *position* to apply pressure of some sort; and
(4) that their pressure will be *translated* into warranted changes in the institution's behaviour.

It is frequently the case that all these factors are not present. There are a number of situations where the person who is to apply market pressure is unaware of the injury being done to them or to the CG. This can occur due to simple ignorance of the facts, or as yet undiscovered detrimental effects. Christopher Stone uses the example of the dangers of smoking to the

[116] Michael Fox, "Cadbury stops using palm oil in chocolate", *Stuff.co.nz*, 17 September 2009.
[117] Pope John Paul II, *Centesimus*, at §34. This quotation specifically referred to the operation of the market at "the level of individual nations and of international relations".
[118] Ibid., at §40. See also, CBCEW, *The Common Good*, 1996, at §74.
[119] Christopher Stone, "Why the Market Can't Do It" in *Where the Law Ends: The Social Control of Corporate Behaviour* (New York: Herper & Row, 1975) at 89.

health of the consumer, where the connection with cancer was not clearly established for a long time. Consequently, an individual could not shift their patronage to non-filter cigarettes. Alternatively, ignorance of the harm could also be due deliberate concealment by companies. Smoking again provides an example, where cigarette companies disputed and challenged findings of its harmful effects in an effort to slow reform and regulation.[120]

Even where the detrimental effect to the CG is known, pressure needs to be applied to the correct place. In the examples of DB and Cadburys, there was an identifiable product, and an identifiable target company with which to apply pressure. This is possible with companies that focus on a single or small number of activities. However, as discussed in Part A of this chapter, a characteristic of many large modern companies is the integration of numerous different economic units into a larger entity. This can be accompanied by complex network of subsidiary companies that make it difficult to identify the correct place to apply pressure.

The diversification of large companies can also confuse the issue. For instance, since the 1970s, there has been a campaign to boycott Nestlé S.A. products over concerns that their promotion of milk powder in developing countries contributes to infant mortality.[121] However, since 2005, Nestlé has also sold a Fairtrade blend of coffee. As a consequence, consumers concerned with one aspect of its practice yet supportive of another aspect are unable to effectively apply pressure to the corporation. This example also illustrates that companies are not passive entities affected by the market. They act to resist public pressure or deflect it through other public relations initiatives.[122]

Even if these first two factors are met, there is a third difficulty in relying on market pressure to protect the CG. In order for pressure to be applied, there must be some interface between the company and the individual concerned over its activity. While this will be the situation for "a worker who is a member of a union recognised by the corporation, and for the person who is directly a consumer of the corporation's products or services",[123] for many other concerned parties, there will be no connection with the company. This frequently occurs if the company to be pressured is not a producer of consumer goods. Alternatively, if an employee wants to apply pressure, they may risk their own livelihood.

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[120] Ibid.
[121] Joanna Moorhead, "Milking It", *The Guardian*, 15 May 2007.
[122] Martin Hickman, "Nestlé defies boycotters and 'ethical shoppers' by launching its own Fair Trade coffee brand", *The Independent*, 7 October 2005; John Vidal, "Nestlé launch of Fairtrade coffee divides company's critics", *The Guardian*, October 7 2005.
[123] Stone, "Why the Market Can't Do It" at 90.

A final factor required to effectively use the market mechanism to protect the CG is that companies need to translate the pressure into the correct change. However, companies also have the option of shifting their market, or even ignoring the pressure, as illustrated by the attempted boycott of Nestlé that continues after 30 years.

Consequently, while there are certain situations where market pressure can effectively translate into change of corporate practice, this is not always the case. It requires adequate consumer knowledge and action, as well as a correct response from the target company. This being the case, the market is frequently an ineffective and inefficient method to promote and protect the CG. The limitations of this approach suggest more direct regulation is required to adequately protect the CG.

C. Objection Three: Corporations as Private Entities

A third argument that insulates companies from concerns of the CG is their categorisation as solely private entities. This has been described by some commentators as "the abidingly crucial issue in corporate legal theory".[124] This categorisation means corporate law "narrowly focuses on the rights and responsibilities contained within the 'contract' between management and shareholders".[125] These categorisations are useful ways of understanding the law and are frequently so engrained that they appear natural or inevitable. "These basic organising categories and paradigms structure the ways we apprehend important parts of social reality, and because they operate at such a basic and fundamental level, their influence may escape notice".[126] This makes it more difficult to recognise the positive effects that changes in the law could produce.[127] Bringing these assumptions to light allows them to be assessed and questioned. If their effect is detrimental to society, they should then be modified for more optimal outcomes.

In discussing this idea, Greenfield identifies two different ways corporations have been understood as private. The former model was of the corporation as defined by agency relationships, with fiduciary duties establishing the obligations of managers. More recently, corporations have been seen as a nexus-of-contracts, created through a multitude of private contractual relationships.[128] This is an even stronger private view of the corporation, causing

[124] Millon, "Theories" at 202.
[125] Greenfield, *Failure*, at 29.
[126] Robertson, "Property" at 276.
[127] Greenfield, *Failure*, at 29.
[128] Ibid., at 30.

some scholars to argue that the issue of corporate governance is "not one of public policy but of contract law".[129]According to this view, the only considerations that should be taken into account are those bargained for by the various parties involved in the company.

Under both understandings, the corporation is a solely private construction, and consequently, it is "incapable of having social or moral obligations much in the same way that inanimate objects are incapable of having these obligations".[130] Advocates of this position argue "corporate governance is a matter of private agreement rather than public law".[131]

Generally, in Western liberal societies, private property is understood as sacrosanct and superior to other arrangements. Some of the advantages thought to be associated with private property are that (1) it ensures people are rewarded for their own work as they gain the benefits from their own private property;[132] (2) this creates incentives to work hard; therefore, increasing efficiency and productivity;[133] and (3) private property guarantees personal freedom and autonomy in that when people own private property, they are less susceptible to external pressures or coercion.[134] Because these advantages are thought to derive from private property, "state generated restraints on the private property owner, although justified in a limited range of cases, should generally be looked on with suspicion. Private property in general means that the state stays out and owners make the decisions".[135]

When corporations are understood as private property, all these ideas are active in the background when considering how and when they should be regulated. The difficulty is that while these ideas are a good fit to certain types of property, they are a less suitable fit for the larger corporations. However, these ideas are still seen to apply generally due to a homogenisation of private property, which is where fundamentally different types of property are treated alike. Currently, there is insufficient distinction drawn between very different types of private property.

One example of this homogenisation is the application of the New Zealand Bill of Rights Act 1990. The Bill of Rights Act "is an affirmation of fundamental human rights for all persons in New Zealand, reflecting rights and freedoms long established in the Anglo-New Zealand

[129] Daniel R Fischel, "The Corporate Governance Movement" (1982) 35 *Vanderbilt Law Review* 1259 at 1273.
[130] Ibid.
[131] Greenfield, *Failure*, at 31.
[132] Paddy Ireland, "Property and Contract in Contemporary Corporate Theory" (2003) 23 *Legal Studies* 453 at 503.
[133] Robertson, "Property" at 278.
[134] Ireland, "Contemporary Corporate Theory" at 503.
[135] Robertson, "Property" at 278.

tradition".[136] However, these rights and freedoms are also given to legal persons, through the operation of s 29, which states that: [137]

> Except where the provisions of this Bill of Rights otherwise provide, the provisions of this Bill of Rights apply, so far as practicable, for the benefit of all legal persons as well as for the benefit of all natural persons.

Consequently, companies, as legal persons, receive many of the same rights to limit government interference as natural persons receive.[138] While, the original rationale of Bill of Rights was to protect individuals from the coercive power of the state; now, however, corporations may "invoke these rights to free themselves from government regulation, ultimately to the detriment of the vulnerable".[139] In New Zealand, legal persons have invoked protection of the Bill of Rights Act with regard to freedom of expression,[140] the right to justice,[141] and unreasonable search and seizure.[142] This is still the situation, even though "the State [now] finds itself having to address the limitations to its sovereignty imposed by the new context of international trade and finance, which is characterized by increasing mobility both of financial capital and means of production, material and immaterial. This new context has altered the political power of States".[143]

When it comes to corporations, an important aspect that is ignored or overlooked by this homogenisation is power. While "all private property involves power over others, the extent of power over others, and its significance, varies depending upon the type of private property involved".[144] The current New Zealand framework treats companies of all sizes the same, regardless of the different levels of power they hold over the public. This is reflected in the Companies Act, which abolished the distinction between private and public companies, and

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[136] Paul Rishworth et al, *The New Zealand Bill of Rights*, (Melbourne: Oxford University Press, 2003) at 1.
[137] New Zealand's approach differs from that of a number of other jurisdictions. For instance, neither the Constitution of the United States or the Canadian Charter of Rights and Freedoms extends the protection of rights to corporations; instead, case law has incrementally extended certain rights to corporations in certain circumstances. New Zealand chose instead to legislate on this issue, rather than leave it to the judiciary. Rishworth et al, *New Zealand Bill of Rights*, at 110.
[138] No provisions of the Bill of Rights Act specifically exclude legal persons; however, ss 12, 18(2) and 18(4) implicitly do so by requiring citizenship as a prerequisite. See, Andrew Butler and Petra Butler, *The New Zealand Bill of Rights Act: A Commentary*, (Wellington: LexisNexis, 2005) at 110.
[139] Rishworth et al, *New Zealand Bill of Rights*, at 109. See also, Joel Bakan et al, "Developments in Constitutional Law: The 1993-1994 Term" (1995) 6 *Supreme Court Law Review* 67.
[140] *Living Word Distributors v Human Rights Action Group Inc (Wellington)* [2000] 3 NZLR 570 (CA).
[141] *P J Moore v Putaruru District Court* [2000] 1 NZLR 729 (HC).
[142] *TranzRail v Commerce Commission* [2002] 3 NZLR 780 (CA).
[143] Pope Benedict XVI, *Caritas*, at §24.
[144] Robertson, "Property" at 279. See also, Millon, "Theories" at 226-227.

applies equally to companies with one shareholder to those with hundreds.[145] Likewise, directors of both have the same duties and obligations to the company and to the shareholders.

CST has long recognised the potential for coercive power over the public, and is concerned to minimise the harmful effects of this power. For this reason, in 1931 Pope Pius XI wrote that "certain kinds of property, [...] carry with them a dominating power so great that they cannot without danger to the general welfare be entrusted to private individuals".[146] This danger is heightened when power differences are ignored, as when private property is homogenised. Corporations are able to shelter behind property rights developed for earlier forms of property.

This homogenisation can operate ideologically. Ideology is here understood in the critical sense of "ideas that vindicate or disguise class interest".[147] In the context examined here, the homogenisation operates to benefit shareholders at the expense of those affected by corporate power: the employees and community. Even though corporations produce "an unequal distribution of wealth, status, and power, as well as reduced opportunities for autonomy and self-development",[148] this is justified based on their private property classification.

An alternative to this homogenisation is to recognise that larger companies differ not just in degree, but in kind from smaller companies. When their activities provide significant power over the public, they have ceased being a solely private entity; while not outright public, they are quasi-public entities. Being quasi-public entities, they should be more accountable to those they have power over.

This appreciation that "private" companies can owe "public" obligations has some support from the common law doctrine of "prime necessity". This doctrine held that a "monopoly supplier of an essential commodity is under an obligation to supply and to supply at a reasonable price".[149] The doctrine originally arose in Britain and was applied to public

[145] Farrar, *Corporate Governance*, at 16. Compare this with the United Kingdom Companies Act 2006, which provides definitions for both public and private companies, with differing requirements for each throughout the Act.
[146] Pope Pius XI, *Quadragesimo*, at §114.
[147] Robertson, "Property" at 275.
[148] Ibid.
[149] Rex J Ahdar, "Battles in New Zealand's Deregulated Telecommunications Industry" (1995) 23 *Australian Business Law Review* 77 at 112.

utilities such as water, gas, and electricity companies.[150] At the time, these were supplied by private companies which had virtual monopolies in these areas. While continuing to operate as private enterprises, they became subject to duties to the public, in effect breaking down a strict distinction between public and private entities.

This doctrine was later inherited by the New Zealand common law;[151] however, it has not developed significantly in New Zealand, as public utilities have been established and run primarily by the State. As a consequence, they have been under statutory duties to supply their services,[152] rendering the common law doctrine less important at the time.[153] This situation has changed drastically in New Zealand since the mid 1980s, with the corporatisation and privatisation of many public entities. As a consequence, the provision of these services is no longer under statutory duties to supply without discrimination or at a reasonable price. Rather than establishing regulatory agencies to monitor these industries, New Zealand has trusted in the Commerce Act and the Commerce Commission to ensure "active but fair competition".[154]

This light regulatory stance taken by New Zealand has been taken further than many other Western countries, skipping over intermediary regulatory bodies such as those adopted by Australia and the United Kingdom.[155] However, this rapid privatisation has meant that although control of these utilities has shifted from public to private ownership, consumers are still as captive to these suppliers as they were when the State had a monopoly on them, but with less protection. This privatisation has pressured the traditional New Zealand stance that "public utilities should be universally available to all at a fair and reasonable price".[156] Many have argued that "these changes favour business at the expense of residential consumers".[157] As a consequence of this deregulation and the concern over unfair treatment, the doctrine of prime necessity may have renewed applicability. The Court of Appeal in *Vector Ltd v Transpower New Zealand Ltd* has unequivocally recognised the existence of the doctrine in New Zealand law.[158]

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[150] Michael Taggart, "Public Utilities and Public Law" in P A Joseph (ed), *Essays on the Constitution* (Wellington: Brooker's, 1995) at 254.
[151] *Vector Ltd v Transpower New Zealand Ltd* [1999] 3 NZLR 646, [34] – [51].
[152] Taggart, "Public Utilities" at 256.
[153] See [1999] 3 NZLR 646, [47] for the few New Zealand cases that have discussed the doctrine.
[154] Taggart, "Public Utilities" at 255.
[155] Ahdar, "Battles in New Zealand" at 77; Taggart, "Public Utilities" at 256.
[156] Taggart, "Public Utilities" at 257.
[157] Ibid.
[158] [1999] 3 NZLR 646, Thomas J at [69].

The prime necessity doctrine provides one example of how the public private distinction can be broken down. It is also particularly consistent with CST, in that in recognising the necessity of certain services, it places a public interest – or as CST would call it, the "dignity of the human person" – ahead of economic interest. Consequently, the doctrine of prime necessity keeps "man [as] the source, the focus and the aim of all economic and social life".[159]

However, despite its recognition in *Vector Ltd*, the doctrine has had limited application. In that case, it was held that operation of the Commerce Act excluded the doctrine on the facts, but Thomas J recognised that "there is scope for the doctrine of prime necessity to develop in relation to state-owned enterprises as well as private enterprises, including privatised industries".[160] The doctrine "is essentially directed at curbing the exploitation or abuse of monopoly power. A supplier enjoying a practical monopoly in supplying an essential service (or product) is vested with that power".[161]

Furthermore, the fundamental principle underlying the doctrine is questions the validity of excluding regulation or the common good simply based on private ownership. "[O]wnership is not ultimately important; rather it is the importance of the activity to the public that demands regulatory control".[162] This principle could be applied to a wider context than just public utilities, to all "private" companies that wield significant power over the public. Recognition of this factor allows for the application of public law and the recognition of duties to the CG. There are a range of options that this recognition could lead to, from moderate to more radical changes. Moderate changes to corporate structure will be discussed in Chapter Four, while more radical changes will be discussed in Chapter Five.

[159] Pope Benedict XVI, *Caritas*, at §25.
[160] [1999] 3 NZLR 646, Thomas J at [75].
[161] Ibid., at [77].
[162] Taggart, "Public Utilities" at 262.

CHAPTER FOUR: REFORMS

A. ACHIEVING THE COMMON GOOD

In CST, consideration of the CG is one of "the primary and fundamental parameters of reference for interpreting and evaluating social phenomena".[163] Currently in New Zealand, there is no requirement for companies to take the CG into account, and there has been little debate on this topic. One commentator even claimed that "New Zealand is beginning to lag behind" developments in other countries on this issue.[164] While certain altruistic directors may choose to take the CG into account, this is currently entirely voluntary.[165] Resistance to mandating such requirements comes from different avenues, with three already discussed, and their rationale questioned. This chapter now examines how the principle of the CG could be better reflected in corporate practice, including an examination of some techniques used internationally.

Corporations would better achieve the CG if they were accountable to wider groups in society than just the shareholders. It has already been shown that shareholders' claim to all the ownership rights is based on an older model that does not correspond to the modern reality.[166] Having thus questioned their claim to exclusive rights to consideration by directors, there is room for wider stakeholders to be considered by the corporation. This concept is widely known as the stakeholder theory. It recognises various groups that are involved in the corporation and gives them different rights and recognition. A particular subset within this stakeholders is the employees. There are particular ways to give employees greater rights and involvement within the corporate structure, such as those known as the Co-determination system practiced in Germany and some other European countries.

In this chapter, both these approaches will be examined to determine whether they would aid in realising the principles of CST – namely the CG and the priority of the worker – and how they could practically be implemented. CST already acknowledges a role for wider

[163] PCFJAP, *Compendium*, at §161.
[164] Farrar, *Corporate Governance*, at 490.
[165] The New Zealand Business Council for Sustainable Development is an example of an organization that pursues corporate social responsibility. Companies can voluntarily join this organization, fulfilling various criteria for acceptance. Perhaps the most notable member of this organization has been Dick Hubbard's cereal producer Hubbards Foods. See for instance, their *Sustainability Report: Nourishing the Nation 2007* <http://www.hubbards.co.nz/tbl.php>.
[166] Berle and Means, *The Modern Corporation*, at xvi.

consideration of stakeholders. There is concern that businesses "are almost exclusively answerable to their investors, thereby limiting their social value".[167] This is compounded by internationalisation of corporations and the out-sourcing of production: [168]

> that can weaken the company's sense of responsibility towards the stakeholders – namely the workers, the suppliers, the consumers, the natural environment and broader society – in favour of the shareholders, who are not tied to a specific geographical area and who therefore enjoy extraordinary mobility.

B. The Stakeholder Theory

While the traditional goal of a corporation was the maximisation of profit, the stakeholder theory has arisen from an understanding that the "modern corporation by its nature creates interdependencies with a variety of groups with whom the corporation has a legitimate concern, such as employees, customers, suppliers and members of the communities in which the corporation operates".[169] Recognising these connections, the stakeholder theory tries to broaden accountability beyond just shareholders to other concerned groups. Each of these groups can be identified as having a particular stake in the corporation:[170]

> In the case of employees it is an input of human capital particularly of long-term employees who have worked to consolidate specialist skills attributable to the company to assist with maintaining a successful business. The stake of suppliers is that they derive income from goods supplied to the company. The stake of owners is principally economic in the sense that they are relying on their shares in the company to produce a profit. The stake of the community is the need for a clean environment and boost to the economy through the provision of jobs and production of goods. Finally, the stake of creditors is that the business continues to perform well to ensure that the debts owed to the creditor are satisfied.

Versions of the stakeholder theory have been applied elsewhere in the United States, as well as in Germany[171] and Japan.[172] At this stage, however, it has not been introduced to New Zealand law. The stakeholder theory, with its consideration of wider groups in society, is compatible with CST, both in reflecting the CG and the principle of solidarity, which to reiterate, recognises "the bond of interdependence between individuals and peoples".[173] Not

[167] Pope Benedict XVI, *Caritas*, at §40.
[168] Ibid.
[169] Andrea Corfield, "The Stakeholder Theory and its Future in Australian Corporate Governance: A Preliminary Analysis" (1998) 10 *Bond Law Review* 213 at 213.
[170] Ibid., at 214.
[171] Ibid., at 213.
[172] Farrar, *Corporate Governance*, at 23.
[173] PCFJAP, *Compendium*, at §192.

only will the stakeholder theory better reflect the principles of CST than shareholder maximisation, it is actually in the long term interests of the corporation itself. On a broad level, all businesses are affected by the health of the economy, as illustrated by the recent recession. "It, therefore, makes good economic sense to strive for economic stability to support business for the long run".[174] Concern for various groups beyond just shareholders aids the creation of this stability. For this reason, some economists argue the stakeholder theory is better in the long term for corporations.[175]

The implementation of the stakeholder theory requires a change in how corporations are viewed. Margaret Blair, an economist from the United States, argues that the corporation should be understood as "a governance structure whose social role is to administer the resources and investments made by all the firms' stakeholders".[176] As discussed earlier, this requires a shift beyond the exclusive ownership model of shareholders to a broader and more inclusive understanding. For Blair, shareholders occupy a position of residual claimants rather than owners. Attributing "ownership" to a body like a corporation requires asking "which parties in the corporate enterprise are contributing what resources and which ones are bearing what risks".[177] Ownership is therefore not given solely to those that contribute capital, but in different extents to all that contribute to the corporation.

One way of implementing the stakeholder theory into New Zealand law would be to amend the Companies Act 1993. New Zealand could follow the example of many states in the U.S. which provide a general extension of what is relevant for a Director to consider. A typical example is the Pennsylvanian Stakeholder Statue, which provides that:[178]

> Directors, in considering the best interests of the company, are permitted to consider the effects of any action upon all groups affected by such action, including shareholders, employees, suppliers, customers, creditors of the corporation and communities in which offices or other establishments of the corporation are located.

This approach is a permissive one, allowing directors to consider different groups without their decision being ultra vires. It is not, however, mandatory, and so while clarifying their

[174] Corfield, "Stakeholder Theory" at 215.
[175] Margaret M Blair, *Ownership and Control: Rethinking Corporation Governance for the Twenty-First Century* (Washington, DC: Brookings Institution Press, 1995).
[176] Ibid., at 1.
[177] Margaret M Blair, *Wealth Creation and Wealth Sharing: A Colloquium on Corporate Governance and Investments in Human Capital* (Washington, DC: Brookings Institution Press, 1996), 7. Cited in Corfield, "Stakeholder Theory" at 216.
[178] 15 PA Cons Stat Ann 1715-1716 (sup 1992). Cited in Corfield, "Stakeholder Theory" at 214.

discretion, it remains at the level of personal choice.[179] In practice, these statutes have frequently been utilised in the context of preventing corporate takeovers, particularly where the takeover would result in asset stripping – the company's assets being split up and sold individually for profit.[180] In these circumstances, despite shareholders being offered a higher price than the market, directors have been able to block the hostile takeover by appealing to wider interests of the community.[181]

There are some exceptions to the permissive statutes, in particular in the state of Connecticut. It requires that a director "*shall* consider, in determining what he reasonably believes to be the best interests of the corporation [...] the interests of the corporation's employees, customers, creditors and suppliers".[182] It is the latter wording that is more consistent with CST, making consideration of stakeholder interests mandatory. Even with these statutes, however, Singer argues that corporations are still seen as being owned by shareholders, and consequently, "in any contest between shareholders and workers the shareholders will prevail. This means that the interests of workers count only so long as they are consistent with shareholder interests".[183]

The United Kingdom has recently adopted new companies legislation that provides another example New Zealand could draw from. It is even more specific in requiring directors consider wider groups than shareholders, outlining six matters that directors must consider. Section 172 of the Companies Act 2006 (UK) provides that:[184]

> A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
>
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment,
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
> (f) the need to act fairly as between members of the company.

[179] Joseph William Singer, *Entitlement: The Paradoxes of Property*, (Yale: Yale University Press, 2000) at 201.
[180] Millon, "Theories" at 234.
[181] Ibid., at 251-261. See also, Millon, *New Directions in Corporate Law* at 1375.
[182] Conn. Stat. Ann, §33-756. Cited in Singer, *Entitlement*, at 201, footnote 24. Emphasis added.
[183] Singer, *Entitlement*, at 202.
[184] Companies Act 2006 (UK), s 172.

This statute provides for balanced consideration of a number of stakeholder groups, and exemplifies the wider considerations of the CG advocated by the principles of CST.

C. A Contemporary Example

What might this stakeholder theory look like in practice? Joseph Singer, in his book *Entitlement: The Paradoxes of Property,* draws attention to the evocative example of Aaron Feuerstein, the owner of a textile company in Lawrence, Massachusetts.[185] In 1995, three of the nine buildings in his company burned down. Feuerstein decided to rebuild the factories, and in addition to this, he made a number of remarkable promises: he would pay his workers their wages for the next month, as well as their expected Christmas bonus, and promised to try and re-employ all of his workers if possible. None of these promises were required of him by law. Legally, Feuerstein was only required to consider his own interests, but instead he chose to consider a wider group of people: his employees and his community. Feuerstein based this decision on an appreciation of relationship between his company and the wider community:[186]

> I have a responsibility to the worker, both blue-collar and white-collar. I have an equal responsibility to the community. It would have been unconscionable to put 3,000 people on the streets and deliver a deathblow to the cities of Lawrence and Methuen. Maybe on paper our company is worthless to Wall Street, but I can tell you it's worth more.

This situation stands in stark contrast to the experience of Monteiths Brewery in Greymouth, discussed earlier. Both companies played an important role in the local economies, yet in one, the motivation to produce more profit saw Dominion Breweries opt to relocate the factory, disregarding any relationship built up with the community stakeholders who had made Monteiths the successful company that attracted their attention in the first place. In the other example, Feuerstein recognised the interdependence between the factory he owned and the workers and community involved in it. Feuerstein opted for the CG, rather than immediate concerns of profit. His practice conformed to the CST understanding that the purpose of a business firm:[187]

> is not simply to make a profit, but is to be found in its very existence as a *community of persons* who in various ways are endeavouring to satisfy their basic needs, and who form a particular group at the service of the whole of society.

[185] Singer, *Entitlement*, at 197.
[186] Michael Ryan, "They Call Their Boss a Hero", *Parade Magazine*, 8 September 1996, at 4.
[187] Pope John Paul II, *Centesimus*, at 35.

D. Co-determination Models

The stakeholder theory, in holding companies more accountable to community stakeholders, aligns with the perspective of CST in regards to fostering the CG. Of the various possible stakeholders, one in particular is of concern to CST: the employees. Currently in New Zealand, there is no provision or power for employees to participate in corporate decision-making, nor to influence the direction of the firm. Such an institutional ability would go some way to preventing the disinheriting of employees that can occur under the current law, as exemplified by the attempted closure of the long-standing Monteiths Brewery. The emphasis on employees in CST has already been discussed in Chapter One, both as an aspect of the principle of the CG, and that of subsidiarity. What now needs to be examined are various models that may be more compatible with CST than current company law.

Currently in New Zealand law, Boards of Directors are elected solely by shareholders. As they are only held accountable to this one group, their concerns will be understandably directed to those with the power to remove them. Providing a mechanism to increase directors' accountability to stakeholders would alter this. One way of achieving this is through "co-determination" systems, providing a supervisory board with employee representation. Two different forms of co-determination that developed in Germany will be discussed here.

Co-determination models evolved in Germany, and have been a particularly influential European model.[188] While they are only required for specific types of companies, they appear consistent with the principles of CST; they achieve "the consideration and manifestation of stakeholder interest within the corporate decision-making process".[189] These models may provide a workable scheme for New Zealand. The success of German companies operating with co-determination for the last 30 years shows how "two apparently conflicting goals might be achieved at the same time: enhanced economic performance of corporations and the integration of employees into the corporate decision-making process".[190]

The German system has two forms of co-determination, one more strenuous than the other. The lesser form does not strictly involve employees in any decision making capacity, but it

[188] Stephen Copp, "A Christian Vision for Corporate Governance" in Paul R Beaumont (ed), *Christian Perspectives on Law Reform* (London: Paternoster Press, 1998) at 116.
[189] Florian Schwarz, "The German Co-Determination System: A model for introducing corporate social responsibility requirements into Australian Law? Part 1" (2008) 23 *Journal of International Banking Law and Regulation* 125 at 126.
[190] Ibid., at 128.

does require consultation with employee representatives through "work councils". This consultation occurs both during and after the corporate decision making process, and includes matters such as "payment, working hours, holidays, hiring and firing, safety at work, etc".[191]

Work councils can negotiate with employers, and employees are granted some ability to determine how decisions are to be implemented. This lesser form does not significantly change corporate structure, and so places less onerous requirements on companies. Under German legislation, the threshold for work councils is five employees; however, there is no requirement for a council if the employees are not interested. In 2005, there were around 105,000 work councils in Germany.[192] The work council model differs from current New Zealand employment law. For instance, while employers are expected to consult with employees over redundancies, it is not required in all situations and is only with regard to how to implement the redundancy, not whether it will occur in the first place.[193]

The more substantive co-determination model in Germany involves a two-tier board structure, which separates executive directors from non-executive directors, with the latter hierarchically superior to the Board of Directors. Originally, the supervisory board only represented shareholders, but it now includes both shareholders and employees in a ratio determined by the size of the company.[194] For companies that have 500 employees, this upper board is composed of 33 per cent employee representatives. The remaining positions are filled by those elected at the company's annual general meeting. As in New Zealand, voting rights at annual general meetings are determined by share ownership, thus retaining for shareholders a role in overseeing the corporation.

For corporations with at least 2,000 employees, the employee representation increases to 50 per cent on the supervisory board. In the case of a tied vote, the chairperson of the board can cast an extra vote. As the chairperson of the supervisory board is nominated by the shareholders, the "shareholder representatives will always dominate the [supervisory board] even if the employees are entitled to occupy half of the seats".[195] These two ratios correctly draw a distinction between companies of different sizes, recognising the difference in power this represents.

[191] Giles Proctor and Lilian Miles, *Corporate Governance*, (London: Cavendish Publishing, 2002) at 92.
[192] Schwarz, "German Co-Determination, Part 1" at footnote 51.
[193] *Aoraki Corporation Ltd v McGavin* [1998] 3 NZLR 276 (CA) at 294
[194] Proctor and Miles, *Corporate Governance*, at 91.
[195] Florian Schwarz, "The German Co-Determination System: A model for introducing corporate social responsibility requirements into Australian law? Part 2" (2008) 23 *Journal of International Banking Law and Regulation* 190 at 192.

What outcomes can the co-determination system produce that protects the dignity of the worker beyond participation in decision making? Examples include reductions in hours across the work force rather than layoffs of some few members.[196]

In giving weight to employee concerns, a major question is whether this may result in overall detriment to the company. The German co-determination system may also introduce inefficiency into the system. In order to properly assess this, it is essential to know precisely the roles of the supervisory board, and the main Board of Directors. "Only if the supervisory board is not paralysed by employee representation the codetermination model may contribute to the economic success of a corporation".[197]

If the German model as it stands, with the same thresholds, were to be applied in New Zealand, full co-determination would affect a small number of companies. According to the Statistics New Zealand website, in 2008, out of 470,000 business enterprises there were approximately 2,200 businesses with over 100 employees. However, these accounted for approximately 920,000 employees out of a total of 1,900,000 across businesses of all sizes.[198] Consequently, introducing this form of co-determination at a 100 employee threshold would affect a small number of total businesses, but those with the greatest public impact. This could have significant consequences. For instance, the decision of Fisher & Paykel in 2008 to close down a Dunedin plant and shift the manufacturing to Mexico resulted in the lay-off of 430 workers.[199]

In conclusion, the German co-determination system specifically, and the stakeholder theory more generally, would serve to bring corporate practice more in line with the principles of CST. The co-determination system provides a forum for employees to influence the direction of the corporation, and so safeguard their dignity. Being forced to consider employee's interests moves the focus of the corporation away from solely profit maximisation, encouraging a more people focused system. That shareholders retain the majority on the supervisory board, however, should prevent the corporation being crippled. However, as the interests of shareholders and employees will frequently align, this should be less of a problem than might be expected.

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[196] Philip J Chemielewski, "Workers' Participation in the United States: Catholic Social Teaching and Democratic Theory" (1997) 55 *Review of Social Economy* 487 at 496.
[197] Schwarz, "German Co-Determination, Part 2" at 199.
[198] Statistics New Zealand, "Employment size groups". Statistics New Zealand does not further differentiate beyond businesses with over 100 employees. These statistics only include business enterprises over a certain threshold.
[199] Green Party, "Rough day".

CHAPTER FIVE: ALTERNATIVE STRUCTURES

A. ALTERNATIVE STRUCTURES

These techniques of streamlining the management of corporations, or providing institution protection for employees will only go so far towards achieving the goals of CST. It may be that instead of tweaking the model of the corporation, there are other options available that are more compatible with CST. This is because, as the previous sections have outlined, many of the reasons why corporations fail to live up to CST are due to deeply imbedded assumptions as to how and why they should function. It is not merely a case of making superficial changes. Instead, these principles must permeate from the very foundation of the corporate form. Hence, challenging the ownership claims of shareholders, the solely private understanding of the corporation, or profit maximisation as the single goal.

"Perhaps at one time it was conceivable that first the creation of wealth could be entrusted to the economy, and then the task of distributing it could be assigned to politics";[200] however, given the internationalisation of corporations, even if it was once possible, it is now very difficult for politics alone to effectively carry out this task. An alternative to trying to reform these structure may then be to re-imagine ways in which "the canons of justice [are] respected from the outset, as the economic process unfolds, and not just afterwards or incidentally".[201]

B. CO-OPERATIVE COMPANIES

An alternative to the predominant corporate form that is worth considering is co-operatives. These function on a different set of principles to that of private corporations. "By contrast, co-operative ownership confers control over enterprises on a group of members who work in the enterprise, live in the community in which the enterprise is located, and who decide matters democratically on the egalitarian basis of one person one vote".[202] Each of these characteristics requires further explanation, but they offer a different paradigm of economic enterprise that may have more affinity to the principles of CST.

[200] Pope Benedict XVI, *Caritas*, at §37.
[201] Ibid.
[202] Michael Robertson, "Reconceiving Private Property" (1997) 24 *Journal of Law and Society* 465 at 477.

There are a number of different types of co-operatives. These are consumer, producer, purchasing, and worker co-operatives:[203]

> Purchasing and shared services cooperatives are owned and governed by independent business owners that come together to enhance their purchasing power, lowering their costs and improving their competitiveness and ability to provide quality services and products.
>
> Producer cooperatives are owned by people who produce similar types of products – farmers who grow crops, raise cattle or milk cows, or by craft workers and artisans.
>
> Consumer cooperatives are owned by the people who buy the goods or use the services of the cooperative. Consumer co-ops may sell consumer goods such as farm supplies or food, or provide housing, or electricity.
>
> Worker cooperatives are owned and governed by the employees of the business. They operate in all sectors of the economy providing workers with both employment and ownership opportunities.

While all types of co-operative models have particular appeal to CST, worker co-operatives are particular attractive.

In traditional co-operatives, ownership shares cannot be bought or sold in ordinary markets or in private transactions. Instead, "purchase of a share is legally tied to admission to membership in a 'political community' (the firm), which is in turn tied to performance of the functional role of working in the firm".[204] Because ownership is fundamentally connected with participation in the enterprise, it prevents the problem of absentee shareholders that divert profit far from where it was generated. In this manner, it avoids "the harm to individuals that will result if [profit] is not used where it was produced".[205] The inability to trade shares also prevents intense wealth concentration and assures a more egalitarian division of profits within the enterprise.[206] This characteristic of universal worker ownership radically implements a principle articulated by Pope John Paul II, that "on the basis of his work each person is fully entitled to consider himself a part-owner of the great workbench at which he is working with everyone else".[207]

A second key feature of co-operative ownership is that all members of the firm are given equal voting and governance rights, regardless of the value of their share. This direct

[203] New Zealand Cooperatives Association, *Types of Cooperatives*, < http://nz.coop/types-of-cooperatives/>.
[204] Karl Klare, "Legal Theory and Democratic Reconstruction: Reflections on 1989" (1991) 25 *University of British Colombia Law Review* 69 at 87.
[205] Pope Benedict XVI, *Caritas*, at §40.
[206] Klare, "Legal Theory" at 87.
[207] Pope John Paul II, *Laborem*, at §14.

involvement by those participating in the enterprise avoids another problem caused by the current arrangement of companies. When shareholders are absentee owners, consideration of their interests can result in workers being treated as mere economic units, such that they can be laid off if it will result in increased profits for the absentee shareholders. Within co-operatives, because governance is shared by all involved in the enterprise, it is easier to keep "man [as] the source, the focus and the aim of all economic and social life".[208]

This structure also "extends democratic decision making beyond the political realm where it has been corralled by the liberal public/private distinction and into the economic lives of people too".[209] This is in accord with CST, in particular with the principle of subsidiarity explained in Chapter One. To reiterate, subsidiarity holds that the people or groups most directly affected by a decision or policy should play a key role in making these decisions.[210] Whereas current company law provides no role for employees in the decision-making of directors, in the co-operative model, it is to the workers that the directors are accountable.

The democratic self-management involved in this structure does not, of course, require that workers are involved in every decision. They can elect representatives and managers from within their body to run and direct the enterprise. However, these managers are accountable to the workers themselves, in contrast to the current system within companies, where the managers are directly accountable only to shareholders through their voting rights. This places the worker at the very centre of the business enterprise, thereby limiting the capacity of the co-operative to treat workers as "a simple commodity or an impersonal element of the apparatus for productivity".[211]

Another significant difference between the co-operative model and the current company model is the equitable allocation of earnings. In the current company structure, profits are allocated to shareholders based on their capital investment; the more share, the higher the proportion of profits. For worker co-operatives, earnings are instead allocated relative to the contribution of labour.[212]

[208] Pope Benedict XVI, *Caritas*, at §25.
[209] Robertson, "Reconceiving Property" at 481.
[210] PCFJAP, *Compendium*, at §189.
[211] Ibid., at §271.
[212] David P Ellerman, *The Democratic Corporation*, (Beijing: Xinhua Publishing House, 1997) at 443.

C. The Co-operative Companies Act 1996

Co-operative companies exist in current New Zealand law, with five of New Zealand's largest twenty companies by turnover operating as co-operatives, increasing to eight of the largest thirty companies.[213] They are governed by a combination of the Co-operative Companies Act 1996 and the Companies Act 1993. The Co-operative Companies Act modifies the regime of the Companies Act to be suitable for co-operative activity,[214] but leaves the directors duties intact. It recognises three forms of co-operative activity; supplying or providing the shareholders of the company with goods or services, processing or marketing goods or services supplied or provided by its shareholders, and entering into any other commercial transaction with the shareholders of the company.[215]

It provides a middle ground between the "pure" co-operative model discussed above and the shareholder model of regular companies in that for it to qualify as a co-operative company "not less than 60 per cent of the voting rights are held by transacting shareholders".[216] "Transacting shareholders" are defined as those who supply or provide goods or services to the company, purchase or acquire goods or services from the company, or enter into other commercial transactions with the company.[217] The remaining 40 per cent can be held by non-transacting shareholders, providing a means for co-operative companies to generate capital.

Difficulties in raising capital have led two large New Zealand co-operatives, Fonterra and Silver Fern Farms, to pursue a hybrid co-operative structure.[218] Silver Fern Farms has chosen to pursue a mixed co-operative/shareholder model, in which 60 per cent control will remain with the "supplier shareholders", and 40 per cent will be offered on the tradable stock exchange. It was argued that while "retaining the core principle of farmer control", this measure would allow for injection of new capital.[219]

These restructuring measures were voted on only by transacting shareholders, as required by the Co-operative Companies Act,[220] restricting voting to those with a close and immediate connection with the company. In this manner, the decisions on restructuring are made by

[213] Neal Wallace, "Co-ops: Force to be Reckoned With", *Otago Daily Times*, 9 May 2009.
[214] Co-operative Companies Act 1996, long title.
[215] Co-operative Companies Act, s 2. These also extend to services provided to a holding company of the company.
[216] Co-operative Companies Act, s 2.
[217] Co-operative Companies Act, s 4(1)(a) - (d).
[218] Neal Wallace, "Co-operatives in need of more owner buy-in", *Otago Daily Times*, 28 July 2009.
[219] Neal Wallace, "40% of shares could be publically listed: SFF", *Otago Daily Times*, 2 July 2009.
[220] Co-operative Companies Act, s 33.

those most affected. The close connection between transacting shareholders and the governance of the co-operative provides for more flexibility in how it is managed. There is no longer a conflict between profit maximisation for shareholders and supporting those that work in the co-operative.

D. A Contemporary Example

This flexibility is illustrated by Ravensdown Fertilizer. Functioning on the co-operative model, Ravensdown is owned by the farmers that purchase fertilizer from it. During the financial downturn, market fertilizer prices rocketed; Ravensdown, however, was able to sell its fertilizer below cost to its farmer/owners in order to protect them from the worst effects of the economic crisis.[221]

In a standard corporation, this practice would be problematic. Directors would be caught in a conflict between the interests of their shareholders, wanting to maintain the profitability of the company and protect their dividends – and so resisting any sales under cost – and the interests of their long-term consumers. While it could be argued that it was in the long-term best interests of the company for its consumers to remain afloat, and therefore this short-term reduction of profits be acceptable, there is an inherent tension between these different interests. With no statutory authority allowing consideration of other stakeholders, the profit motive would force the company to take a harsher line. The co-operative model, however, allowed Ravensdown to ensure that "man [remained] the source, the focus and the aim of all economic and social life".[222]

The price decrease was coincided with a cut in profits for farmers from Fonterra. Sources for Ravensdown described the situation as similar to the mid-1980s. Then a cut in subsidies "led to a spike in fertiliser use, from which some farms took up to five years to recover".[223]

E. Conclusions

Co-operatives provide a more democratic structure from the outset, and ensure that the participants involved remain central to the enterprise. They look beyond maximising shareholder profits, and focus on long-term stability for those involved within the process. In

[221] Neal Wallace, "Ravensdown lifts shareholder return", *Otago Daily Times*, 29 July 2009.
[222] Pope Benedict XVI, *Caritas*, at §25.
[223] Simon Hartley, "Fertiliser company slashes prices", *Otago Daily Times*, 30 January 2009.

New Zealand, co-operative companies have proven very effective.[224] They ensure that the "canons of justice [are] respected from the outset, as the economic process unfolds, and not just afterwards or incidentally".[225] Consequently, the use of co-operative structures should be encouraged in New Zealand as an economic form that more effectively implements the principles of CST than standard company law.

[224] Kevin Wilson, "A Financial Commentary on New Zealand Rural Co-operatives" in *Rural Report* (National Bank, March 2009), 1.
[225] Pope Benedict XVI, *Caritas*, at §37.

CONCLUSION

The principles of Catholic Social Teaching are aimed at producing "a more humane and humanizing" economic system,[226] built on the fundamental principle of the dignity of the human person. From this foundation, CST has articulated a number of principles aimed at keeping "man [as] the source, the focus and the aim of all economic and social life".[227] This study has focused on two particular aspects of CST as they relate to New Zealand company law: consideration of the common good, and the priority of workers.

Current New Zealand law poorly reflects these concerns. The Companies Act 1993 presents a conservative role for companies in society. While directors owe duties to the company, not directly to shareholders, the practical effect differs little from traditional theories of shareholder primacy. As a consequence, considerations of the common good need not be considered in corporate decision-making. This legal regime was reflected in the example of the treatment of Monteiths Brewery in Greymouth.

Nonetheless, the current regime is premised on a number of different arguments for why the common good should be excluded. Three of these arguments have been examined – shareholder ownership, the operation of the market, and the public/private distinction – and their contemporary rationale questioned. While the rights gained from being a shareholder once reflected a closer relationship between ownership and control, they poorly reflect the current arrangement of absentee owners and professional managers. While still a vital contributor, they can no longer claim to be the sole residual beneficiaries. The operation of the market is at times an effective mechanism to protect the common good, but it is only effective when four factors are present. These requirements render the market frequently incapable of protecting and promoting the common good. Finally, the public/private distinction ignores the power over the public that large companies have, undermining the arguments for excluding state regulation. The prime necessity doctrine provides a specific example where private ownership is not the deciding factor in determining regulation.

Following this, a number of proposals have been examined that will more closely reflect the principles of CST. The stakeholder theory closely aligns with the Catholic understanding of

[226] Pope Benedict XVI, *Caritas*, at §9.
[227] Pope Benedict XVI, *Caritas*, at §25.

the common good. Examples from the United States and, particularly, the United Kingdom suggest changes to the Companies Act that would reflect this theory. Not only do these other jurisdictions better promote the common good, they also show that New Zealand is "beginning to lag behind" many other Western countries.[228] The model of co-determination practiced in Germany provides another model for protecting a particular group of stakeholders – the employees. Work councils provide a less intrusive mechanism for protecting employees, while the supervisory boards serve as a stronger mechanism to ensure the priority of the worker as advocated by CST. Finally, co-operative structures have been examined as an economic form that ensure that the "canons of justice [are] respected from the outset".[229] Encouraging co-operatives would provide a more alternative method of promoting and protecting the common good.

While "the Church does not have technical solutions to offer",[230] this examination of successful models from other countries provides practical direction for how New Zealand's company law can better reflect the principles of Catholic Social Teaching.

[228] Farrar, *Corporate Governance*, at 490.
[229] Pope Benedict XVI, *Caritas*, at §37.
[230] Second Vatican Ecumenical Council, *Gaudium et Spes*, at §36.

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