



Shareholder Primacy: The Main Barrier to Sustainable Companies

The Sustainable Companies Project

The [Sustainable Companies Project](#) commenced in 2010 and has involved a team of more than 40 legal scholars mapping the law in 26 jurisdictions across the globe. This document summarises the company law analysis based on that mapping and on further extensive research into the barriers and possibilities company law provides for sustainable companies, conducted by the head of the project, Professor Beate Sjøfjell, together with Professors Andrew Johnston and David Millon, and research assistant Linn Anker-Sørensen. Our focus, like that of the project, is on the environmental dimension of sustainability, with climate change as our case in point.¹

A Great Unexplored Potential

Our analysis shows that there is great unexplored potential within current company law regimes for companies to shift away from the path of business as usual and onto a path towards sustainability. In the mainstream corporate governance debate it is often said that the purpose of companies is the maximisation of shareholder value. As a matter of law, this is incorrect, particularly if we are referring to society's purpose with the companies as an institution. Profit for shareholders is but one function of companies, and even where, exceptionally, company law turns this function into the primary goal by requiring directors to prioritise the shareholder interest, it is still understood that this is as a means to the end of increasing society's welfare.

Shareholders *could* use their power and influence to demand a shift away from business as usual. Many jurisdictions give broad powers to the general meeting which would allow them to alter the business of the company from unsustainable to sustainable. However, as the research in the project under the leadership of Professor Benjamin Richardson has shown, socially responsible investment is likely to remain a small, niche sector of the financial economy, unable to greatly to influence the environmental practices of companies, at least in the absence of legal reforms. Conversely, the general influence of shareholders tends to be an uncritical push for profit-maximisation (the shareholder primacy drive, which we return to below).

Company law across many jurisdictions gives boards of directors - and by extension the management - perhaps surprising latitude to steer companies' business towards greater sustainability. No system of company law insists that boards should focus only on shareholder value. In some jurisdictions, environmental sustainability has begun to make inroads into the duties of the board. All jurisdictions expect boards to ensure their companies comply with environmental law, and allow boards to go beyond the requirements of environmental law to internalise environmental externalities, at least as far as they can articulate a business case argument for this. Some jurisdictions go further and allow companies to protect the environment beyond the scope of the business case. The business judgement rule adopted in most jurisdictions broadens this discretion considerably.

¹ For a summary of the research into accounting and auditing law, see under news on the project website: <http://www.jus.uio.no/ifp/english/research/projects/sustainable-companies/>



The Social Norm of Shareholder Primacy

While no company law system requires directors to pursue shareholder profit maximisation at all costs, the social norm of shareholder primacy provides incentives and pressures to do just this. Our analysis shows that, while company law does erect some barriers to the pursuit of sustainability, these are trivial compared with the social norm of shareholder primacy. This norm springs out of the historically contingent focus of company law on the position of shareholders (albeit one that varies across jurisdictions). Shareholder primacy has been allowed to develop because the law contains neither an explicit statement of what the societal purpose of companies is, nor of what the interests of the company are.

The influence of shareholder primacy means that there has been little exploration of how far boards, the strategy-setting, supervisory organ of companies, are legally permitted to go in shifting towards sustainable business. Boards frequently do not even choose the environmentally friendly, low carbon option where there is an arguable business case, let alone challenge the outer boundaries of the rules by pursuing sustainability where the profitability of a particular decision may be challenged. The practice of companies in the aggregate is therefore detrimental both to those affected by climate change and environmental degradation (who, to date, have been primarily located in developing countries) and to future generations, whose ability to fulfil their own needs is in peril. 'Business as usual' is detrimental to any shareholder with more than a very short-term perspective on their investment, including institutional investors such as pension funds and sovereign wealth funds. At the individual company level shareholder primacy has negative implications for the long-term prospects of the firm itself.

In the context of corporate groups, shareholder primacy is even more prominent, with the parent company's control of the group going way beyond the scope of company law combined with very limited possibilities for holding the parent company liable for subsidiaries' environmental transgressions.

A Way Forward

While company law gives those who control companies ample scope to take account of sustainability, company law has also allowed the social imperative of shareholder primacy to develop to the point that it constitutes the main barrier to more sustainable companies. This has occurred because of what the law regulates and what it does not. It is here that we have tentatively identified a way forward. Since the key problem is a lack of regulatory clarity with regard to society's purpose in allowing companies to operate, and to the interests of the company, setting these key issues straight in a principle-based manner could be the start for a shift in a sustainable direction. The competence and duties of the board would need to be revised to reflect the redefined purpose of the company, with the concept of the interests of the company codified in a modern and inclusive manner. The board's duty to pursue profit within the overarching framework of sustainability would require the imposition of a binding legal obligation to establish risk management and due diligence systems that identify and mitigate the environmental and climate impacts of the company's activities.

Shareholder primacy has become deeply entrenched through market pressure, necessitating legal reform. Competitive advantage must be given to companies that contribute to sustainable development and taken away



from those which do not. Reform of core company law, both at the level of broad principle, and at the level of its more detailed structure, is a prerequisite to achieving sustainable companies. If done thoughtfully, it holds out the prospect of making more effective the external regulation of companies while allowing each company to realise its potential and contribute in its own creative and independent way to the mitigation of climate change and to broader environmental sustainability.

Oslo, 31 January 2014

[Beate Sjøfjell](#), Professor dr. juris, Faculty of Law, University of Oslo

[Andrew Johnston](#), Professor, School of Law, University of Sheffield

Linn Anker-Sørensen, Research Assistant, Faculty of Law, University of Oslo

[David Millon](#), Professor, School of Law, Washington and Lee University