Why Can't Stakeholder Theory Save the Planet and What Can Corporate Law Do Instead?

Seniha Irem Akin*

Abstract

In the midst of a multidimensional crisis with economic, social and environmental aspects, corporations have become aware that the reality of our day necessitates that they must play a dual role both for their businesses and for the general public. A primary reason for the change in this perception is the alarming state of the environment and especially the potentially irreversible effects of the climate crisis. As a living and evolving entity within society, companies now take on the public duty to address the mounting concerns about the environment and adopt environmentally sustainable corporate strategies. While doing this, many of them refer to the stakeholder theory. Almost forty years ago, the stakeholder theory was introduced by Freeman as a management concept. Including environmental sustainability within the scope of the stakeholder theory is, therefore, a fairly new approach and raises the following question: Is the stakeholder theory the best tool to integrate environmental sustainability into corporate activity? This article will aim to demonstrate why the answer to this question should be 'no'. Adding to this, it will then discuss how legal reform in the area of corporate law focusing on the key concepts of corporate interest and directors' duties should be done instead.

Keywords: stakeholder theory, corporate environmental sustainability, corporate reform, corporate interest, board of directors.

1 Introduction

There is now a mutual understanding between different parties, scholars, lawmakers and businesspeople that attributing the limited role of profit maximisation is an underestimation of corporations' potential. Currently, we live in a world where corporations are expected to have a dual role both for their shareholders and for non-shareholder stakeholders. This change in the perception was triggered by the harsh criticism against the way corporations operate in the modern day as capitalism has reached its 'inflection point'.[1] Multinational corporations have started to be seen as 'behemoths'[2] or 'money monsters'.[3] In line with this, the role of corporations within society has also changed and the idea of revisiting the business as usual has evolved.[4]

In the United States, one exciting private initiative came from the Business Roundtable (BRT), which includes influential CEOs of companies such as Apple, Amazon, and JP Morgan. In 2019, through their Statement on Purpose of Corporation they 'redefined' their purpose and declared that they are making a 'fundamental commitment to all of our stakeholders'.[5] This was a radical shift when it is considered that the same body, in its statement back in 1997, set forth that 'the Business Roundtable wishes to emphasize that the principal objective of a business enterprise is to generate economic returns to its owners'.[6] It can be seen from this old statement that, apart from the explicit preference for financial gains over other purposes a business can pursue, shareholders were perceived as the 'owners' of the businesses. Nevertheless, the new statement in 2019 shows that the view of BRT has changed dramatically throughout those twenty-five years. In a similar vein, as another internationally influential institution, the World Economic Forum (WEF) also embraced a view in favour of a broader range of stakeholders by stating that

> the purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders but all its stakeholders – employees, customers, suppliers, local communities and society at large.[7]

* Seniha Irem Akin is PhD researcher at the Erasmus University Rotterdam, the Netherlands.

1 M. Lipton, 'It's Time to Adopt the New Paradigm', *Harvard Law School Forum on Corporate Governance* (2019) https://corpgov.law.harvard.edu/2019/02/11/its-time-to-adopt-the-new-paradigm/ (last visited 9 October 2022).

2 L. Davoudi, C. McKenna & R. Olegario, 'The Historical Role of the Corporation in Society', *6 Journal of the British Academy* 17 (2018).

3 C. Mayer, *Prosperity: Better Business Makes the Greater Good* (2018), at 229.

4 This term is used to refer to the business model established under the influence of the shareholder primacy approach.

5 www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans (last visited 4 January 2023).

6 www.ralphgomory.com/wp-content/uploads/2018/05/Business-Roundtable-1997.pdf (last visited 4 January 2023).

7 www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/ (last visited 4 January 2023).

doi: 10.5553/ELR.000228

One of the primary reasons for this shift is the soaring expectations the society has from the private sector to take an active role in combating environmental challenges, climate change being the most serious one.[8] The achievement of global far-reaching environmental goals (such as limiting global warming to 1.5 °C by the 2030 deadline) requires the active participation of the private actors. On the one hand, corporations have a transformative role to play in the green transition as they constitute a significant part of the economy through the production of goods, provision of services and employment generation. The desired transitions to make consumption and production habits more environmentally sustainable, therefore, necessitates their full involvement. On the other hand, private corporations, especially the ones in the fossil fuel industry, are significant contributors to the environmental challenges of today, and most specifically, anthropogenic climate change.[9] For this reason, corporations now feel the responsibility to adopt environmentally sustainable strategies as a part of their business policy. As a recourse, they often reach the stakeholder theory. However, such a construction creates subtle problems.

Almost forty years ago, the stakeholder theory was introduced by Freeman as a management concept to find a balance between the conflicting interests of shareholders and non-shareholder corporate constituencies. The main focus group of stakeholders was employees and customers.[10] Including environmental sustainability within the scope of the stakeholder theory is, therefore, a fairly new approach and raises the following question: Is the stakeholder theory the best tool to integrate environmental sustainability into corporate activity? This article will aim to demonstrate why the answer to this question should be 'no' and why we need a structural legal reform in corporate law instead.

2 Clarification of the Meaning of Stakeholder Theory

Before presenting a critique of the stakeholder theory and its suitability for achieving corporate environmental sustainability, a point of clarification should be made regarding its meaning with reference to in this article. Stakeholderism can be described in two different ways: (i) as stakeholder-oriented corporate law systems and (ii) as a strategic management concept. This article will refer to the latter.

The first category of stakeholderism refers to jurisdictions that have stakeholder-friendly corporate law systems, such as Germany and the Netherlands. In these jurisdictions, consideration of different stakeholder groups, especially employees, has been a long tradition that precedes the managerial stakeholder theory. For instance, in both Germany and the Netherlands, employee representation at the board level has been a living tradition.[11] For this reason, they are often considered as a 'stakeholder society'.[12] What makes a legal territory stakeholder society is not related to the managerial stakeholder theory. Rather, it is because these jurisdictions have adopted corporate law systems which are *designed* to promote stakeholder interests.

These corporate law systems favouring a stakeholder society are completely different from the second version of stakeholderism which is a 'genre of management theory'.[13] Stakeholder theory was introduced by Freeman in 1984 as a management tool.[14] This is fairly different from the first understanding of stakeholderism which refers to corporate law systems that have established stakeholder societies. Stakeholder theory does not define the whole identity of the corporate law system, it merely refers to a managerial concept. Thus, a comparison between these two versions of stakeholderism can advance a faulty dichotomous view. For this reason, this article will not handle these concepts through a comparative analysis. Rather, it will raise criticism against using the managerial stakeholder theory in achieving stakeholder societies. It will contribute to the state of the art by discussing why a total reliance on stakeholder theory, as a management concept, will fail in creating sustainable societies. These sections will be complemented by providing argumentation on the need for corporate law reform to make the necessary changes in corporate behaviour and construct a legal system that can favour environmental sustainability.

3 Problem I: The Identification of the Environment as a Stakeholder

Under the stakeholder theory, the first step is to define the scope of the stakeholders. Up to this day, there has

8 WEF's 2021 Global Risks Perception Survey reports that five out of the ten most serious global risks over the next decade are environmental risks with the first three being climate action failure, extreme weather and biodiversity loss respectively.

9 According to the Carbon Majors Report, 70% of all anthropogenic GHG emissions are caused by the fossil fuel industry and its products. In a similar vein, in its Sixth Assessment Report, the UN Intergovernmental Panel on Climate Change (IPCC) highlights that the biggest contributor to global net anthropogenic emissions is the CO2 from the fossil fuel industry (CO2-FFI).

10 B. Sjåfjell and J.T. Mähönen, 'Corporate Purpose and the Misleading Shareholder vs Stakeholder Dichotomy', 43 *University of Oslo Faculty of Law Legal Studies Research Paper Series* 1, at 11 (2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4039565 (last visited 8 December 2022).

11 For instance, under the 1976 Codetermination Act (*Mitbestimmungsgesetz*) of Germany, companies which have over 2,000 employees are required to have half of their supervisory board directors from representatives of workers.

12 G.M.M. Gelauff and C. den Broeder, *Governance of Stakeholder Relationships: The German and Dutch Experience* (1996).

13 B. Parmar, R.E. Freeman, J.S. Harrison & A.C. Purnell, 'Stakeholder Theory: The State of the Art', 4 *The Academy of Management Annals* 403, at 408 (2010).

14 R.E. Freeman, *Strategic Management: A Stakeholder Approach* (1984).

doi: 10.5553/ELR.000228

not been a unified definition for the term stakeholder. Opinions on the scope of stakeholders are generally categorised into two types as narrow and broad.[15] To start with, Freeman's original definition falls under the broader type of definitions since he defines stakeholders as 'any group or individual who can affect or is affected by the achievement of the organization's objectives'.[16] In fact, his definition was later criticised for being 'the broadest definition in the literature'.[17] This is because the notion 'can affect or is affected' annihilates any requirement for a contract, transaction or even a reciprocal relationship.[18] Under the broad definitions, stakeholders can vary from shareholders to the general public.

There are also definitions for the stakeholder theory that aim to narrow the scope by introducing different criteria for the attribution of the stakeholder title. These definitions generally identify stakeholders based on whether the relevant group takes a risk, often a financial one, due to business activity.[19] This approach is also more in line with the etymological roots of the word stakeholder as 'stake' represents the risk-bearing nature of this concept.[20] In line with this, narrow definitions define a stakeholder as 'an individual or group that asserts to have one or more of the stakes in a business'[21] or more specifically, they make entitlement for the stakeholder status conditional upon putting 'some economic value at risk'.[22]

From the perspective of the environmental interests, broad and narrow definitions can have both advantages and disadvantages. Broad definitions are inherently more beneficial for the larger group of stakeholders as they cover even those who do not have direct ties with the corporation. Nevertheless, since broader definitions require almost no distinctive feature for the identification of stakeholders, they can put too many different stakeholder interests on the management's plate at the same time. This will mean that each stakeholder's interest needs to be considered with a larger number of interests. In addition to this, the lack of a special focus can cause managers to pay scant attention to the stakeholder interests they are asked to safeguard and promote.[23] This can impair the managers' vision, leaving each stakeholder group worse off. Such an approach will also lower the chance of the environmental interests being upheld during management's decision-making process.

Narrow definitions, on the other hand, are more advantageous for the management as they limit their attention to a smaller group. This seems more workable from the management's perspective since it is harder to consider different stakeholders and their varying interests at the same time due to the 'practical reality of limited resources, time, attention, and limited patience of managers'.[24] In addition, the preferred group of stakeholders will also benefit from narrow definitions since they can now be selected amongst a smaller number of stakeholders. Nevertheless, a narrow approach may not be favourable for the environmental interests as they are located at the outermost layer of a corporation's external relationships. The chances of the environmental interests being considered within the scope of the stakeholder theory are, therefore, low if narrow definitions are adopted.

As to the more philosophical question of *whether* the environment, by itself, can be deemed as a stakeholder, there are also different views. One of the clearest examples of an affirmative answer to this question is given by Starik.[25] He criticises the fact that the notion of stakeholder has been limited to natural human beings. Indeed, as he raises the question, stakeholders have generally been described as 'individuals or groups' which is a phrase that indicates human nature. Conversely, Starik believes that the environment is a stakeholder in itself, and its protection is required for its own interests. Contrary to his views, a bigger majority of scholars fiercely argue over the stakeholder status of the environment. The most straightforward argument here is the non-anthropocentric nature of the environment, unlike other stakeholders.[26] Under this view, the environment cannot pursue its own interests and will require other stakeholders for its protection. Building upon this, Orts and Strudler argue that the protection of the environment should be due to its 'moral and aesthetic importance' and 'not because of its interests or needs'.[27] Their opposition primarily focuses on the ethical aspects of attributing stakeholder status to the environment as they believe that balancing economic interests and environmental interests will be 'morally repugnant'.[28] In their view, the management should consider environmental interests due to moral reasons and should not address them under the stakeholder theory which they call 'an unnecessary and unworkable theory'.[29]

Similarly, according to Phillips and Reichart, the environment cannot be regarded as a stakeholder on its own and for its own interests. According to their view, a corporation will have an obligation to protect the environment, not for the sake of the environment itself, but for

15 D. Windsor, 'Stakeholder Management in Multinational Enterprises', 3 *Proceedings of the International Association for Business and Society* 241 (1992).
16 Freeman, above n. 14, at 46.
17 R.K. Mitchell, B.R. Agle & D.J. Wood, 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts', 22 *The Academy of Management Review* 853 (1997).
18 *Ibid*., at 856.
19 E.W. Orts and A. Strudler, 'The Ethical and Environmental Limits of Stakeholder Theory', 12 *Business Ethics Quarterly* 215 (2002), at 218.
20 *Ibid*.
21 A.B. Carroll and A.K. Buchholtz, *Business & Society: Ethics and Stakeholder Management* (2009).
22 K.E. Goodpaster, 'Business Ethics and Stakeholder Analysis', 1 *Business Ethics Quarterly* 53, at 54 (1991).
23 J. Tirole, 'Corporate Governance', 69 *Econometrica* 1, at 27 (2001).
24 Mitchell et al., above n. 17, at 857.
25 M. Starik, 'Should Trees Have Managerial Standing? Toward Stakeholder Status for Non-Human Nature', 14 *Journal of Business Ethics* 207 (1995).
26 O.M. David, 'The Impact of Environmental Law on Corporate Governance: International and Comparative Perspectives', 12 *European Journal of International Law* 685, at 689 (2001).
27 Orts and Strudler, above n. 19, at 223.
28 *Ibid*., at 225.
29 *Ibid*., at 227.

doi: 10.5553/ELR.000228

the interests of the legitimate stakeholders such as local communities, who have environmental interests.[30] Regarding this point, they also make a similar argument with Orts and Strudler and state that even when legitimate stakeholders do not press demands on the corporation for safeguarding their environmental interests, these interests will still be relevant since the management will then have a 'moral obligation' to take them into consideration. This argumentation, however, is still problematic since it now leaves the consideration of environmental interests fully to the management's moral values.

As can be understood, there is not, and probably will not be, a consensus regarding the identification of the environment as a stakeholder. In case the environment is not considered as a stakeholder, then the focus will turn either to other stakeholders who will pursue the interests of the environment or to the management which will consider environmental interests due to moral and ethical reasons. Under the first scenario, where environmental interests are left to the 'legitimate' stakeholders, these interests will be considered by the management only if these stakeholders have a demand to do so. Under the second scenario, the consideration of environmental interests will be left purely to the management's subjective discretion. The first step of the stakeholder theory, therefore, causes impracticalities under each of these scenarios. Nevertheless, even if this step is neglected, the subtle problems inherent in the stakeholder theory remain during the management of stakeholder interests. The next section will elaborate on the more practical issues relating to the application of the stakeholder theory by the management in pursuing environmental sustainability.

4 Problem II: Management of Stakeholder Interests

The previous section aimed at demonstrating how the identification of the relevant stakeholders can lead to managerial inefficiencies regarding the proper consideration of environmental interests and the environment. However, there are even more compelling reasons that make the stakeholder theory an inapplicable tool for the integration of environmental sustainability into corporate practice.

The stakeholder theory does not end with the identification of stakeholders. A proper application of the stakeholder theory requires more than that. Stakeholder management will come only after determining the scope of stakeholders and relevant stakeholder interests. While coming to a decision, the management has to consider the various interests of these stakeholders and find an optimal balance between them. Stakeholder interests can be 'multiple and not always entirely congruent'.[31] This may lead to some trade-offs. In other words, while managing these interests, the management will have to favour some stakeholder interests over others. The task of management here can be regarded as 'to mediate'[32] between the divergent interests of different stakeholders. In an ideal world, the aim should be to cause minimal damage to the unpreferred group of stakeholders while making sure that the chosen group of stakeholders is adequately satisfied. However, the act of balancing stakeholder interests can be problematic in two ways: (i) power inequality between shareholders and other stakeholders and (ii) lack of guidance the stakeholder theory can offer.

4.1 Power Inequality between Shareholders and Other Stakeholders

First, the initial problem occurs due to the power inequality between shareholders and other stakeholders. Ever since Berle and Means introduced the notion of separation of control and ownership in the early twentieth century, mechanisms impacting management's behaviour was constructed in a way that would improve shareholder value.[33] This was further strengthened with the introduction of the agency theory.[34] To prevent managerial opportunism arising from the lack of involvement of shareholders in the daily management of the modern company, corporate law has been focusing on aligning managers' interests with the interests of the shareholders. Since shareholders bear the residual risk of the company, they are considered as the vulnerable group. To protect 'passive investors who placed their economic interests in the hands of professional managers',[35] executives' incentives are tied to the interests of the shareholders. As a result, financial benefits, such as stock compensations or bonuses, are linked to the economic performance of the corporation which heavily relies on financial criteria and ultimately, the share price. Through this, the aim is to blur the line between the management and the shareholders and to, as the cliché goes, 'make employees think and act like owners'. However, the current design of compensation schemes produces little alignment with the interests of non-shareholder stakeholders. Since the interests of the management often go in the same direction as shareholders, there is a very little chance that other stakeholder interests will be considered carefully. This is because, under the conventional design of the compensation schemes, executives know that they can enjoy direct economic benefits deriving from the increased share-

30 R.A. Phillips and J. Reichart, 'The Environment as a Stakeholder? A Fairness-Based Approach', 23 *Journal of Business Ethics* 185 (2000).

31 T. Donaldson and L.E. Preston, 'The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications', 20 *The Academy of Management Review* 65, at 70 (1995).

32 H.S. Birkmose, M. Neville & K. Sorensen, *The European Financial Market in Transition* (2012), at 178.

33 A. Berle and G. Means, *The Modern Corporation and Private Property* (1932).

34 M. Jensen & W. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure', 3 *Journal of Financial Economics* 305 (1976).

35 D. Millon, 'Theories of the Corporation', 1990 *Duke Law Journal* 201, at 215 (1990).

doi: 10.5553/ELR.000228

holder value whereas they gain either very little or no direct benefit when they improve the environmental performance of the company. From the perspective of the environment, this entails the risk of 'the environment being subjugated to providers of capital'.[36] Hence, so long as the structure of compensation schemes stays the same, the evolving view on stakeholders in theory will continue to encounter the barrier in practice posed by the formulation of compensation schemes.[37]

Based on similar arguments, scholars often argue the need to change the formulation incentive mechanisms to shift the motivation of executives.[38] From the societal and environmental perspectives, they offer changing the conventional 'pay for performance' to 'pay for social and environmental performance'.[39] However, this will be easier said than done since using alternative mechanisms will lead to a great deal of subjectivity in the assessment process. This subjectivity can be, first, regarding the parameters to be used in the evaluation process of the director's performance. Unlike the ultimate goal of increasing the share price, if environmental performance standards are adopted by companies, each company can choose separate criteria and assess executive performance based on different variables. Second, subjectivity can happen regarding the level of parameters used to measure executive performance on environmental matters. Even if two corporations adopt environmental parameters to be used in the executive compensation, one may choose to adopt an ambitious environmental policy and aim for a positive impact whereas the other can be satisfied with the accomplishment of the bare minimum based on legal obligations imposed through external laws. Furthermore, compensation schemes based on vague and broad environmental goals can enable executives to reap financial benefits by taking actions that actually do not provide an improvement in terms of the corporation's environmental performance. A lack of certainty in terms of targets and their achievement will also raise doubts about the transparency of the compensation scheme. Thus, if the Key Performance Indicators (KPIs) are to be tied to environmental performance, this should be based on objective and measurable targets, such as a percentage of reduction in greenhouse gas emissions in a determined timeline, rather than merely aiming to 'reduce' them.

4.2 The Lack of Guidance Stakeholder Theory Can Offer

The second major challenge in the management of the stakeholders is the absence of guidance for the management as to the act of balancing various interests. This is also a major point attacked by supporters of a more shareholder-centric approach as they state that 'their model at least gives the board of directors a clear, straight-forward and objectively verifiable direction to fulfil their duties for which directors can actually be held accountable'.[40] The stakeholder theory is heavily criticised because it does not specify how different stakeholders will be treated and largely depends on executives' discretion.[41]

In addition to this general scepticism, the problem with the management of interests can be specifically problematic for safeguarding and promoting environmental sustainability within the corporation. Unless supported by certain tasks for the executives or specific objectives for the corporation, it can lead to a higher degree of ambiguity. In contrast, the straightforwardness and comfort in achieving financial goals based on more concrete parameters can motivate the management to continue pursuing shareholder interests. This can lead to a strong path dependency in executive behaviour by favouring shareholder interests and neglecting environmental matters to the extent allowed by external laws the corporation is bound by. However, the focus on shareholder interests is not only because of the construction of compensation schemes or the lack of guidance. It can also be rooted in the inherent characteristics and the origins of the stakeholder theory. The following two sections will elaborate on these issues in more detail.

5 Problem III: The Stakeholder Theory Ultimately Aims to Serve the Interests of the Shareholders

Based on the ultimate objective pursued, approaches towards the stakeholder theory can be separated into two main groups as normative and instrumental. The normative approach to the stakeholder theory perceives the promotion of stakeholder interests as an end on its own whereas the instrumental approach sees it as a mean to maximise long-term shareholder value.[42] Starting from Freeman, the instrumental approach has been the traditional understanding of stakeholder theory. In fact, Freeman explains stakeholder theory as 'a reasoned perspective for how firms should manage their relationships with stakeholders to facilitate the development of competitive resources and attain the larger idea of sustainable success'.[43] Thus, under this view, the main motive for embracing the stakeholder theory is its potential contribution to the success of the business and eventu-

36 Sjåfjell and Mähönen, above n.10, at 14.

37 A. Edmans, 'Company Purpose and Profit Need Not Be in Conflict If We "Grow the Pie"', 40 *Economic Affairs* 287, at 291 (2020).

38 Tirole, above n. 23, at 3; Edmans, above n. 37, at 291.

39 C. Flammer, B. Hong & D. Minor, 'Corporate Governance and the Rise of Integrating Corporate Social Responsibility Criteria in Executive Compensation: Effectiveness and Implications for Firm Outcomes', 40 *Strategic Management Journal* 1097, at 1098 (2019).

40 M. Lokin and J. Veldman, 'The Potential of the Dutch Corporate Governance Model for Sustainable Governance and Long Term Stakeholder Value', 12 *Erasmus Law Review* 50, at 57 (2019).

41 L.A. Bebchuk and R. Tallarita, 'The Illusory Promise of Stakeholder Governance' 1052 *Cornell Law Review* 91, at 95 (2021).

42 *Ibid*., at 106.

43 Parmar et al., above n. 13, at 427.

doi: 10.5553/ELR.000228

ally, shareholder value. For this reason, Bebchuk and Tallarita view the instrumental approach to the stakeholder theory as a 'particular articulation of shareholder value'.[44]

The current perception of the stakeholder theory still largely leans towards the instrumental approach. Since the Organisation for Economic Cooperation and Development (OECD) establishes benchmarks for corporate practices all over the world, its approach can be taken as an important indicator to demonstrate this trend. The G20/OECD Principles of Corporate Governance envisage that 'corporations should recognise that the contributions of stakeholders constitute a valuable resource for building competitive and profitable companies'.[45] As can be understood from this statement, the OECD still treats stakeholder interests as a contribution to the competitiveness and profitability of a company. This supports the idea that, at the end of the day, stakeholder theory is still not adopted for the sake of stakeholders but rather for the benefit of the corporation and its shareholders. Under such a view, sustainability matters will remain to be treated as 'nice-to-have' option to improve shareholder value.[46] From the perspective of environmental sustainability, this means that the stakeholder theory will integrate environmental sustainability *so long as* it serves the shareholder value. Adopting this approach, however, will greatly underestimate the urgency and importance of environmental sustainability.

It may be controversial to expect corporations to uphold the interests of the wider society even at the cost of their private interests. This may even seem naïve by those who adopt an economic approach to the corporation that will not accept an action which will not serve the shareholder value let alone harm it. However, the realities of our day can blur the line between public and private interests in line with the needs of the society. Recent experiences also show that this idea is not just wishful thinking. In its landmark *Shell* decision, the Dutch court has stated that the public interest arising from the reduction obligation can *outweigh* the commercial interests of the corporation even if this means making financial sacrifices for the corporation:[47]

> This all justifies a reduction obligation concerning the policy formation by RDS for the entire, globally operating Shell group. **The compelling common interest that is served by complying with the reduction obligation outweighs the negative consequences RDS might face due to the reduction obligation and also the commercial interests of the Shell group,** which are served by an uncurtailed preservation or even increase of CO2-generating activities. Due to the serious threats and risks to the human rights of Dutch residents and the inhabitants of the Wadden region, private companies such as RDS may also be required to take drastic measures and **make financial sacrifices** to limit CO2 emissions to prevent dangerous climate change '(emphasis added)'.

In brief, what the court meant was that the public interest of society in the protection of the environment can prevail over the private interests of the corporation. Nevertheless, (instrumental) the stakeholder theory ultimately aims to serve the interests of the corporation. Under such a view, it cannot and will not see environmental sustainability as an end but merely a means for the promotion of shareholder value. Forsaking profits for the sake of environmental interests will not fit in its agenda. Therefore, under the instrumental version of the stakeholder theory, the management's obligation to consider environmental interests will be interpreted narrowly in an area between minimum legal requirements and up until their contribution to the success of the business. Anything above that line will be an extra and thus, will not be pursued.

6 Problem IV: The Stakeholder Theory Never Aimed to 'Save the Planet'

The last, and probably the most important, argument this article will provide regarding the unsuitability of the stakeholder theory in achieving corporate environmental sustainability concerns the original aims of the stakeholder theory. This last point can also act as an umbrella argument encompassing and summarising the previous ones. To again go back to the roots, Freeman explains his motive for introducing the stakeholder theory back in 1984 as a *necessity*. According to his view, other conceptual corporate theories at that time were 'inconsistent with both the quantity and kinds of change that are occurring in the business environment of the 1980's'.[48] As can be inferred from his statement, the stakeholder theory was established to answer the requirements of *that* time. The stakeholder theory may, or may not, have served the necessities of *that* day. This is not what this article wants to discuss. What is important here is why the same tool should not be used to tackle the challenges occurring in the business of the twenty first century. Currently, we are standing at the point where the urgency of environmental action has caused social intolerance in the public toward environmentally unsustainable business practices. Since corporations are kernel to the economy, they bear a shared responsibility to take action. However, the stakeholder theory was never designed to pursue social or environmental purposes in corporations, nor to answer the needs of society. The essence of the stakeholder theory is a 'theory of organi-

44 Bebchuk and Tallarita, above n. 41, at 106.

45 OECD, *G20/OECD Principles of Corporate Governance* (2015), at 9.

46 K. Raworth, *Doughnut Economics: Seven Ways to Think Like a 21st Century Economist*, at 215 (2017).

47 The Hague District Court's Shell Decision numbered ECLI:NL:RBDHA: 2021:5339 and dated 26 May 2021, at 4.4.54.

48 Freeman, above n. 14, at 5.

sational management and ethics'.[49] The following statement, which is from an article in which Freeman himself is one of the authors, strongly supports this argument: 'From its inception, it was not developed to promote policies or organizational behaviour associated with social goals such as corporate philanthropy or taking care of the environment'.[50]

For this reason, using the stakeholder theory to improve the relationship corporation has with society will either be a misinterpretation or a distortion of the term.[51] The stakeholder theory should not be perceived as a panacea for corporate ills. Its use should be narrowed to management and organisational studies.[52] While referring to it, one has to acknowledge its limitations. Additionally, expanding the meaning and use of this term to push companies to become more environmentally sustainable is not only inconvenient but can also be to the detriment of environmental interests. On this issue, Bebchuk and Tallarita have formulated the idea of an 'illusory promise' against the stakeholder theory.[53] In their view, promoting the stakeholder theory as the main tool to achieve corporate transitions in societal and environmental matters can deter legislators from adopting laws and policies which can actually be more effective in changing and shaping corporate behaviour. As for the environment, for instance, they believe that adopting legislations and strategies on the carbon tax or renewable energies should be the solution rather than relying on the stakeholder theory.[54]

Although this article agrees with the problem Bebchuk and Tallarita identify, that the stakeholder theory is not the proper tool to fundamentally transform corporate behaviour, it disagrees with the argument that the optimal solution can come from external regulation and legislation. Criticism of the use of the stakeholder theory in achieving broader societal and environmental goals through corporate activity does not lead to a direct referral to external regulation and legislation. It is believed that such a thinking pattern fails to notice the extra layer between the corporation and external regulation and legislation: corporate law. In line with this, the next section will elaborate on why and how corporate law can achieve a structural transformation in corporate behaviour and why it can be more effective than external regulation and legislation.

7 The Need to Reform Corporate Law

Until this point, this article has focused on the main problems the managerial stakeholder theory can pose before the effective integration of environmental sustainability into corporate behaviour and practice. To do this, the first section of the article elaborated on the reasons why corporations will continue to fall into deep-rooted shareholder-focused business patterns under the managerial stakeholder theory. These explanations were also provided to demonstrate the disadvantages of using the stakeholder theory in attempts to push corporations to become more environmentally sustainable. Nevertheless, this does not mean that there should be a direct recourse to external regulation and legislation. Figure 1 illustrates this view which this article opposes.

The kernel of this system is the corporation. Since the stakeholder theory is a managerial theory adopted by the corporation, it is endogenous. Hence, it lies within this inner circle. Conversely, any regulatory or legislative action coming from the outside should be drawn outside this inner circle as it would be exogenous. Nevertheless, corporate law has a special place for the corporation which differentiates it from external regulation and legislation. Thus, as illustrated in Figure 2, it should be positioned in between the corporation and external regulation and legislation.

49 A. Keay, 'Stakeholder Theory in Corporate Law: Has It Got What It Takes?', 9 *Richmond Journal of Global Law and Business* 249 (2010).

50 J.S. Harrison, R.E. Freeman & M.C. Sá de Abreu, 'Stakeholder Theory as an Ethical Approach to Effective Management: Applying the Theory to Multiple Contexts', 17 *Revista Brasileira De Gestão De Negócios* 858 (2015).

51 R. Phillips, R.E. Freeman & A.C. Wicks, 'What Stakeholder Theory Is Not', 13 *Business Ethics Quarterly* 479 (2003).

52 *Ibid.*

53 Bebchuk and Tallarita, above n. 41, at 69.

54 *Ibid.*, at 71.

doi: 10.5553/ELR.000228

Figure 1 *Narrow Approach to the Legal Layers of the Corporation*

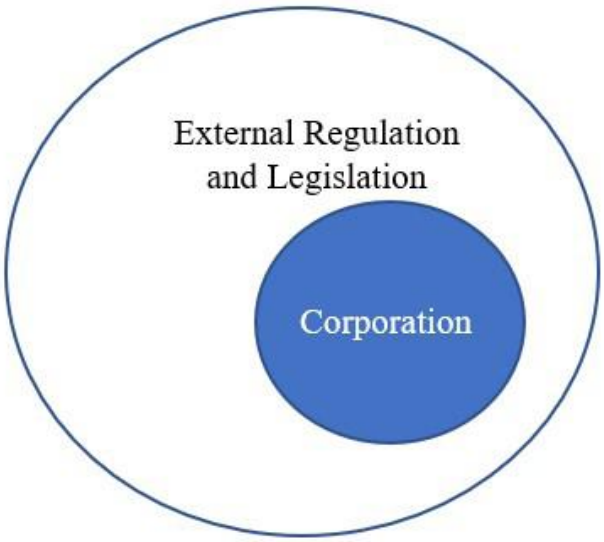
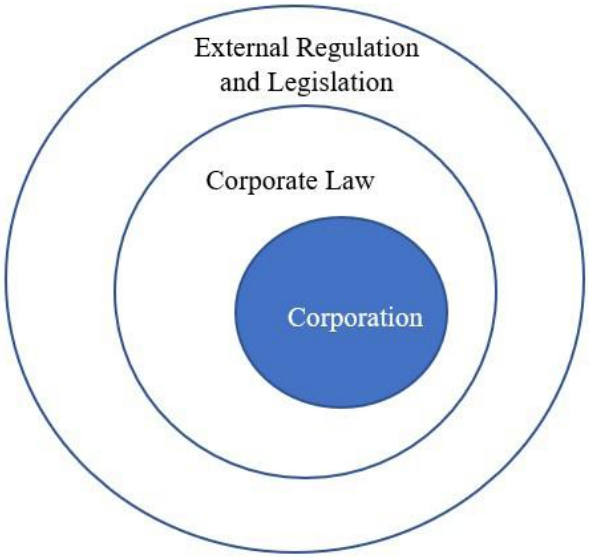


Figure 2 *Proposed Approach to the Legal Layers of the Corporation*



Corporate law is not inside the inner circle of the corporation but, at the same time, cannot be considered a totally external type of legislation since it is different from other fields of law. Companies owe their existence to the national corporate legislation of the jurisdiction they are domiciled in. In other words, corporate law creates the corporation.[55] Thus, corporate law is *existential* for a company. It not only encompasses the fundamental rules for the corporation's establishment and internal dynamics but also encompasses the rules regarding its relationships with other actors. This way, it can act as an intermediary between the corporation and its outer world. As the legal field closest to the heart of the corporation, it makes changes to corporate law directly and inevitably affects the corporation. This gives corporate law unparalleled power over the corporation and makes it a powerful tool to control, influence and change corporate behaviour. For this reason, in moving corporations to become environmentally sustainable, intervention in the area of company law can establish a practical, solid and solution-oriented legal framework.

These are also the features the stakeholder theory lacks. In fact, the stakeholder theory remains largely theoretical with few implications for corporate practice. Moreover, it does not delegate any legal or social responsibility to the management to find a cure for the adverse impacts its operations may cause on the environment and eventually, society. Finally, the stakeholder theory does not require the law to be changed.[56] In fact, it is based on 'non-legal ethical grounds'.[57] Nevertheless, past experiences with the stakeholder theory, and its 'ancestor' cor-

55 Mayer, above n. 3, at 149.

56 Parmar et al., above n. 13, at 412.

57 Sjåfjell and Mähönen, above n. 10, at 12.

porate social responsibility,[58] have proven that the effects of voluntary managerial actions are largely limited. Under the mechanisms supporting shareholders and their interests, corporations will continue to fall into deep-rooted, shareholder-focused business patterns. Structural changes in corporate law, on the other hand, can lead to remarkable changes in corporate behaviour if adopted with a pragmatist, well-structured and legislative approach. For this reason, solutions to unsustainable corporate behaviour should be obtained through a hard law intervention.

One may think that an argument in favour of corporate environmental sustainability will be against Milton Friedman's critical view on the responsibilities of the corporation. In contrast, this article rather agrees with it with a variation. Friedman believed that the solutions for society should come from the mandatory laws of the state and not from the management and its executives. This article also discussed in various parts the risks and/or inefficiencies of leaving integration of environmental sustainability to the management's human judgement under the stakeholder theory. Nevertheless, the point that this article opposes as regards Friedman's views is again the solution provided. Just like Bebchuk and Tallarita, Friedman also conceptualised these mandatory laws of the state as external legislation. Therefore, he also neglected the sphere of corporate law and argued that internal mechanisms of the corporation and external legislation are the only two options. However, Friedman acknowledged in his well-known article that even when they are maximising profits, corporations should conform 'to the basic rules of society, both those embodied in law and those embodied in ethical custom'.[59] What this article adds to his argumentation is that corporate law, as a law of the state, should be reconstructed in a way that environmental sustainability becomes a 'basic rule of the society' that corporations must conform to.

While working on a structural change in corporate law, the focus can be on one of the two principal corporate actors: Shareholders and the board of directors. To start with shareholders, they have a strong place in the corporation not because the laws explicitly say so but because their say in critical matters, such as election and dismissal of directors, grants them such power. Also, as mentioned under *Problem II*, the formulation of executive compensation schemes also strengthens their situation immensely. Therefore, shareholder interests can easily influence corporate motives and actions. Nevertheless, since the integration of environmental sustainability is a matter concerning the overall strategy of the corporation, focusing on the board of directors, rather than on the shareholders, will comply more with this objective as the board is the corporate body designated with this task. Because of this, the last part of the article will provide explanations on how to conduct a legal intervention in corporate law regarding directors and their duties. Here, the explanation of the recommended solutions will be based on the European Union (EU) to concretise the subject matter through examples. However, these explanations can also be implemented for other jurisdictions.

8 A New Perspective on Corporate Interest and Directors' Duties

In legal terms, directors are directors of the company and not agents to the shareholders unlike what the agency theory suggests. Thus, their primary legal duty should promote the interests of the corporation. Yet, corporate legislations often do not provide a definition for the term 'corporate interest'. For this reason, this term becomes subject to interpretation. The legal ambiguity of the term combined with the powers of shareholders often is the reason this term is translated as shareholders' interests, cynically exploiting their privileged position amongst other stakeholders. In these cases, a (re)interpretation of the term corporate interest is needed to shift the perspective toward directors and their duties. On the other hand, in some jurisdictions, the law's definition of corporate interest can explicitly uphold interests of the shareholders. For instance, under Finnish Limited Liability Companies Act, it is stated that the purpose of a company is to generate profits for the shareholders, *unless* otherwise provided in the articles of association of the company.[60] Thus, the mainstream corporate interest to be pursued by a director would be shareholder profit maximisation. Under this legal formulation, directors will not be keen on the idea of promoting environmental sustainability since it would mean deviating from the established norm. In these cases, not a reinterpretation but rather a reformulation of the term corporate interest should be aimed at. The link between the key concepts of corporate interest and directors' duties remains functionally important regardless of whether the law defines corporate interest in a way promoting shareholder interests or does not deal with its meaning through the law at all. The presence of such a link was also acknowledged in the report on the Study on Directors' Duties and Sustainable Corporate Governance prepared for the European Commission.[61] The report identifies the core problem in the EU before sustainable business practices as the 'trend for publicly listed companies within the EU to focus on short-term benefits of shareholders rather than on the long-term interests of the company'. After this, the report lists the main problem drivers.

58 Orts and Strudler, above n. 19, at 216.

59 M. Friedman, 'A Friedman Doctrine: The Social Responsibility of Business Is to Increase Its Profits', *The New York Times* (1970).

60 Section 5 of the Finnish Limited Liability Companies Act (*Osakeyhtiölaki 624/2006*).

61 EY, *Study on Directors' Duties and Sustainable Corporate Governance* (2020), at vi.

doi: 10.5553/ELR.000228

Figure 3 Relationship Between the Key Concepts of Corporate Interest and Directors' Duties

The first identified problem specifically deals with directors' duties. It states that 'directors' duties *and* company's interest are interpreted narrowly and tend to favour short-term maximisation of shareholders value' (emphasis added). Therefore, it identifies the interpretation of these two concepts ((i) directors' duties and (ii) company's interests) as a single combined cause that favours shareholder interests. It seems like the choice of making a combined statement with these two elements was a deliberate decision.

The link between these terms is also apparent in the EU when the corporate laws of the Member States are considered. In fact, most legislations in the EU use the term 'corporate interest', or a similar translation of this term, while defining the duties of the directors. Most national provisions on directors' duties will consist of a phrase that will more or less indicate that the board will perform its duties in line with the 'corporate interest'.[62] Figure 3 demonstrates this intertwined relationship between the key concepts of corporate interest and directors' duties:

This means that a legal intervention on directors' duties to achieve integration of environmental sustainability into corporate activity should take two consecutive steps: With a backward-looking approach (starting from the right of the illustration and moving towards the left), it can be inferred that the initial point to be considered should be the interpretation of the first keyword (i.e., corporate interest). In the current situation, as a result of the lack of a concrete definition for this term combined with the dominance of shareholder primacy approach, corporate interest is often translated as shareholders' interests. Thus, a well-established design of the term corporate interest can be the first step in busting the 'myth of shareholder primacy'[63] and overcoming the barriers it poses before corporate environmental sustainability.

The evaluation of the term corporate interest can act as an intermediary step to get one step closer to the primary actor, the board of directors. This is because the manner in which the term corporate interest is interpreted and/or formulated can have a direct effect on directors' behaviour due to the indispensable legal link between this term and directors' duties. If the term corporate interest can be reinterpreted or reformulated in a way encompassing the interests of the wider public, such as environmental sustainability, then the directors will owe these duties not only to their shareholders but also to other stakeholders. From the perspective of environmental sustainability, this can put great pressure on the directors to take adequate actions as they will now see it as a genuine liability risk. Under the present legal framework, the well-known business judgement rule, or similar concepts which offer protection to directors, are also related to the term corporate interest. A reformulation of the term corporate interest, therefore, will also prevent directors to be exonerated of all responsibility by merely arguing that their actions and decision were in line with (not-so-clear) 'corporate interest'. After working on the term corporate interest, the focus then can be shifted to directors' duties. An intervention in their duties can change the behaviour of the directors, and eventually, the corporation. This is because, as the brain of the company, directors are mostly framed by their duties while taking decisions and actions on behalf of the corporation. The formulation and perception of their duties, in a way, identify the outer limits where they can use their discretion. This is a potential that can also be used to change directors' approaches toward environmental sustainability.

As for the method of legal intervention, directors' duties can be amended in two ways. First, it can be done by including environmental matters within the scope of the current duties of the directors. This was the approach the European Commission adopted in the Proposal for the Directive on Corporate Sustainability Due Diligence (Proposal).[64] As it can be seen from the title of Article 25 of the Proposal, 'Duty of Care', the European Commission proposed to make consideration of environmental consequences arising from the corporate activities a part of the well-known duty of directors. Pursuant to this Article, Member States will have to ensure that

62 For instance, under the Dutch Civil Code, members of the management board shall be guided 'by the interests of the Corporation and its affiliated enterprise' while performing their duties. In a similar vein, the German Corporate Governance Code states under Art. 4 that the management board is responsible for managing the company 'in the interest of the enterprise'.

63 L.A. Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors* (2012).

64 Proposal for a Directive on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 COM(2022) 71 final.

> when fulfilling their duty to act in the best interest of the company, directors of companies referred to in Article 2(1) take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, *climate change and environmental consequences*. (emphasis added)

Therefore, it adds an external duty to the existing duties of the directors. Nevertheless, these kinds of reconstructions of the existing duties have less chance to provide an accountability mechanism to other stakeholders as they will still be restricted to the internal dynamics. Thus, directors' accountability will remain primarily to the shareholders. This can, however, be a disadvantage in holding directors accountable for environmental matters.

The second way of incorporating environmental sustainability into directors' duties can be through the establishment of a new type of duty. This was indeed what scholars suggest by proposing 'the duty of societal responsibility'.[65] For instance, in the Netherlands, twenty-five Dutch professors advocated the introduction of a social duty of care for the management and supervisory board members for them to consider the interests of the wider society while performing their tasks.[66] This kind of a legal intervention will not mean a reformulation of the existing duties but rather a creation of a new type of duty for the directors which can answer the social and environmental requirements. A well-established novel duty for the directors can have the advantage of being formulated in a way that can answer the environmental needs of the wider society since the design process. This way, directors can be held liable not only by the shareholders but also by the stakeholders who have suffered due to a failure in performing such duty adequately. This can be a potential advantage over the first way of intervention.

It is believed that changing the formulation of directors' duties can have a powerful impact on making directors feel accountable towards their societies and internalise environmental matters. Amendments to fiduciary duties can also be in different ways in terms of environmental protection as positive or negative.[67] Negative duties can indicate reducing, or if possible, preventing adverse impacts the corporation may have on the environment. However, the effectiveness of negative duties may be limited as directors can then avoid liability through tokenism without actually making the necessary changes in the corporation. In line with this, enforcement of these narrowly defined duties will also require a higher threshold to claim liability as a breach of such duty will only be accepted in exceptional cases. Imposing positive environmental duties, on the other hand, can be more ambitious and challenging for the corporation as then the directors will have to make sure that the corporation also makes a beneficial impact on the environment through active environmental policies and strategies.

In either case, the formulation and wording used through these legal interventions will be crucial and should not be vaguely determined. Formulating duties by using wording such as 'not harming the environment' for negative duties or 'respecting the environment' for positive duties can leave wide room for interpretation. This carries the risk of the duty being symbolic since directors can easily fulfil it without actually improving the corporation's environmental performance.[68] To prevent directors from taking advantage of these situations, duties should be defined in a precise way that can produce concrete results. In this regard, objective and quantifiable criteria should be chosen to concretise what is expected from the directors. Vague expressions such as 'taking into account' or 'considering' environmental impacts as the European Commission did in the Proposal can easily lead to legal ambiguity regarding what can be expected from the directors. Therefore, it is a matter of doubt how effective these provisions can be, if adopted, in shifting the board's behaviour. Conversely, integrating planetary boundaries,[69] for instance, can help to establish scientifically proven ecological limits to corporate activity.[70]

9 Conclusion

Recent movements towards a new business model, where non-shareholder stakeholders and their interests are safeguarded alongside shareholders and their interests, often take stakeholder theory as their base point. By relying on stakeholder theory, corporations believe that they can admit their responsibility towards environmental matters and address the demands and concerns of society in this regard. However, the necessities of our day require more than what stakeholder theory can offer to change corporate behaviour toward environmental sustainability. Stakeholder theory has important pitfalls when it comes to achieving these in practice. First, two consecutive steps of stakeholder theory (i.e., stakeholder identification and stakeholder management) does not provide adequate grounds to pay careful attention to the environmental interests to consider the environment (or the society as being the representative stakeholder group for environmental interests) as a stakeholder. It also does not provide any guidance to the management on how to thoroughly consider environmental matters while taking decisions or ac-

65 J. Winter, 'Towards a Duty of Societal Responsibility of the Board', 17 *European Company Law* 192 (2020).

66 https://pure.uva.nl/ws/files/55759850/Naar_een_zorgplicht_voor_bestuurders_en_commissarissen.pdf (last visited 4 January 2023).

67 B. Sjåfjell and B.J. Richardson, *Company Law and Sustainability: Legal Barriers and Opportunities* (2015), at 332.

68 M. Rodrigue, M. Magnan & C.H. Cho, 'Is Environmental Governance Substantive or Symbolic? An Empirical Investigation', 114 *Journal of Business Ethics* 107 (2013).

69 J. Rockström, et al., 'A safe operating space for humanity', 461 *Nature* 472 (2009).

70 H. Ahlström, 'Policy Hotspots for Sustainability: Changes in the EU Regulation of Sustainable Business and Finance', 11 *Sustainability* 499 (2019).

doi: 10.5553/ELR.000228

tions. Moreover, the powers of shareholders together with the lack of guidance on the stakeholder theory offers for the management exacerbates the impregnable position of shareholders and worsens the situation for other stakeholders. In addition to these, the essence and fundamental aims of stakeholder theory also do not correlate with the goal of achieving corporate environmental sustainability. Stakeholder theory was originally founded as a management concept and it ultimately aimed to serve the interests of the corporation. Answering the environmental concerns of society was not originally on its agenda let alone, as the title of this article goes, saving the planet. Assigning stakeholder theory with these tasks, therefore, constitutes not only a misinterpretation but also a distortion of the term. Stakeholder theory should not be perceived as the remedy for each and every corporate dysfunction. Its aims and capacity should be recognised as limitations for its usage.

Building upon the idea that stakeholder theory is incompatible with the goal of integrating environmental sustainability into corporate practice, the second part of the article was based on the necessity to use corporate law as a solution instead. A solution coming from a corporate law intervention can target the company at the core. How the two interrelated key concepts of corporate law (corporate interest and directors' duties) are interpreted and/or formulated can have far-reaching impacts on the directors' behaviour and actions which inevitably and eventually, influence and construe corporate behaviour. Hence, a legal reform in corporate law aiming to (re)formulate and/or (re)interpret these terms can help to make the desired transitions in corporate activity more effective.

It is true that corporations are a big part of today's environmental crisis, but this does not mean they can become a part of the solution, or even, *the* solution.[71] By making the right choices, they have the potential to change the course of things. However, they need a clear, mandatory and practical legal framework on this matter. Corporations are not only created but also shaped by corporate law. Thus, a shift from business as usual cannot be achieved by remaining indifferent to corporate law. It is no longer a question of *whether* corporate law should act on the current environmental crisis but a question of *how*, and this article aimed to shed some light on it. As the title of this article goes, 'stakeholder theory cannot save the planet'. However, businesses can if corporate law is adopted as the tool in pursuing this objective.

71 This phrase is taken from Emmanuel Faber's (Danone's former CEO and the Chairman of the Board of Directors) interview https://time.com/6121684/emmanuel-faber-danone-interview/.

doi: 10.5553/ELR.000228