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STAKEHOLDER THEORY IN CORPORATE LAW: HAS IT GOT WHAT IT TAKES?

*Andrew Keay**

I. INTRODUCTION

There has been much debate for many years regarding what should be the objective of the large public corporation. This issue is important for a number of reasons, not least of which is that the theory nominated will underpin corporate governance and dictate, to a large extent, the kind of corporate governance system that will exist. As far as the corporation's objective is concerned, two theories have been dominant: the shareholder primacy theory and the stakeholder theory. The former is operative in what I will call "Anglo-American jurisdictions," namely jurisdictions that model their law and practice on one or both of the United States or the United Kingdom. Jurisdictions falling within this category also include Canada, Australia, and New Zealand. The stakeholder theory operates in many continental European and East Asian countries. Prime examples are Germany and Japan.

Notwithstanding the fact that the United States, United Kingdom, and other Anglo-American jurisdictions regularly embrace shareholder primacy, there are many who feel that some of these jurisdictions are moving towards more of a stakeholder approach to corporate governance. This is due to a number of factors such as: the constituency statutes enacted in more than forty U.S. states;¹ the

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¹ The literature is too voluminous to cite in full. See Andrew Keay, *Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value and All That: Much Ado about Little?* (Univ. of Leeds School of Law Centre for Business Law and Practice, Working Paper, 2010) available at <http://ssrn.com/abstract=1530990>, for a recent discussion of these statutes. For more detailed discussions of these statutes, see generally Edward S. Adams & John H. Matheson, *A Statutory Model for Corporate Constituency Concerns*, 49 EMORY L.J. 1085 (2000); Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971 (1992); William J. Carney, *Does Defining Constituencies Matter?*, 59 U. CIN. L. REV. 385 (1990); Timothy L. Fort, *The Corporation as Mediating Institution: An Efficacious Synthesis of Stakeholder Theory and Corporate Constituency Statutes*, 73 NOTRE DAME L. REV. 173 (1997); James J. Hanks, Jr., *Playing with Fire: Nonshareholder Constituency Statutes in the 1990s*, 21 STETSON L. REV. 97 (1991); Jonathan R. Macey, *Fiduciary Duties as Residual Claim: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84

growth of literature in Anglo-American countries advocating stakeholder theory written by a wide range of people, including academics from various disciplines, lawyers, and directors and the assertion that the concerns raised by the stakeholder debate in the 1990s have not disappeared or been addressed;² the advent of enlightened shareholder value in the U.K. Companies Act of 2006; U.S. cases which specifically hold that no duty is imposed on directors to maximize shareholder wealth;³ research which indicates there has been greater use of stakeholder rhetoric in documents and communications of large U.S. public corporations;⁴ two critically important decisions by the Supreme Court of Canada⁵ in the past five years which appear to reject the idea that shareholder primacy is mandatory for Canadian corporations and that directors are permitted to consider a wide range of constituent interests; recent empirical research from a study of Australian directors which found “the majority of directors had a ‘stakeholder’ understanding of their obligations;”⁶ the increased amount of social reporting;⁷

CORNELL L. REV. 1266 (1999); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1992); Brett H. McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1227 (2004); Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14 (1992); Jonathan D. Springer, *Corporate Constituency Statutes: Hollow Hopes and False Fears*, 1999 ANN. SURV. AM. L. 85 (1999); Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163 (1991); *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253 (1990); Anthony Bisconti, Note, *The Double Bottom Line: Can Constituency Statutes Protect Socially Responsible Corporations Stuck in Revlon Land?*, 42 LOY. L.A. L. REV. 765 (2009); Kathleen Hale, Note, *Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes*, 45 ARIZ. L. REV. 823 (2003).

² John Armour et al., *Shareholder Primacy and the Trajectory of UK Corporate Governance*, 41 BRIT. J. INDUS. REL. 531, 549–50 (2003).

³ See, e.g., *Paramount Comm’n Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989); see also Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 650–51; Fordham Law Legal Studies Research Paper No. 105 (2006), available at SSRN: <http://ssrn.com/abstract=878391> (last visited Mar. 1, 2010) (discussing how the directors’ duty to maximize shareholder wealth is limited).

⁴ Lisa M. Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. CORP. L. 675, 676 (2006); Lisa M. Fairfax, *Easier Said Than Done? A Corporate Law Theory for Actualizing Social Responsibility Rhetoric*, 59 FLA. L. REV. 771, 774 (2007).

⁵ *People’s Dept Stores v. Wise*, [2004] 3 S.C.R. 461 (Can.); *BCE Inc. v. 1976 Debentureholders* [2008] 3 S.C.R. 560 (Can.).

⁶ Meredith Jones, Shelley Marshall, Richard Mitchell & Ian M. Ramsay, *Company Directors’ Views Regarding Stakeholders*, Research Report, University of Melbourne, available at <http://cclsr.law.unimelb.edu.au/go/centre-activities/research/>

and the comments of some writers questioning whether the dominance of the shareholder primacy theory may be problematic due to recent developments in law and finance.⁸ Furthermore, in 2000 many proclaimed that the Anglo-American corporate governance system based on shareholder primacy had become paramount and the European stakeholder systems were converging to the Anglo-American approach.⁹ However, since 2000, the world has witnessed the collapse of Enron and Worldcom; and, more recently, the demise of major banks such as Northern Rock in the United Kingdom, Lehman Bros in the United States, and the provision of government support for other banks and financial institutions, to such a degree that there is the virtual part nationalisation of several U.K. banks. These recent developments could well lead to a change of direction, since there is much questioning of the financial regulatory system in Anglo-American jurisdictions, and corporate governance in general. It is arguable that some of the problems to hit financial institutions have laid bare the deficiencies in corporate governance in Anglo-American jurisdictions.¹⁰

This article analyzes whether stakeholder theory should overtake shareholder primacy as the leading theory in Anglo-American jurisdictions. Specifically, the article examines the arguments propounded in support of stakeholder theory and evaluates the strength of these arguments with the aim of determining if there is sufficient justification for the theory to become wholeheartedly embraced in Anglo-American jurisdictions.

The article is structured as follows. Part II offers a brief background of the stakeholder theory. This is followed by an explanation of what the theory actually stands for. Part IV examines the rationales given for the theory's existence as well as the leading arguments put

research-reports-and-research-papers/index/cfm ("Centre Activities" hyperlink to "Research" and follow hyperlink "Research Reports and Research Papers") (last visited Mar. 1, 2010) (containing research findings undertaken by members of the Corporate Governance and Workplace Partnerships Project at the University of Melbourne).

⁷ See generally Steen Thomsen, *The Convergence of Corporate Governance Systems and European and Anglo-American Standards*, 4 EUR. BUS. ORG. L. REV. 31 (2003).

⁸ Douglas G. Baird & M. Todd Henderson, *Other People's Money*, 60 STAN. L. REV. 1309, 1311 (2008); Frederick Tung, *The New Death of Contract: Creeping Corporate Fiduciary Duties for Creditors*, 57 EMORY L.J. 809, 853 (2008).

⁹ Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001).

¹⁰ Cf. Brian R. Cheffins, *Did Corporate Governance 'Fail' During the 2008 Stock Market Meltdown? The Case of the S & P 500* (Univ. of Cambridge and Eur. Corp. Gov. Inst., Working Paper No. 124, 2009), available at <http://ssrn.com/abstract=1396126>.

forth in its favor by all corporations. Next, there is an identification and analysis of some of the primary arguments directed against the theory. Finally, some concluding remarks are offered.

II. BACKGROUND

There are more than just shareholders who contribute to a corporation, and there are others, in addition to shareholders, who are affected by the actions of the corporation. Scholars refer to persons and groups who contribute to the corporation as stakeholders,¹¹ constituencies, contributors, or even investors. As far as public corporations are concerned, it has been contended that a corporation's affairs are of such broad public concern and affect the lives and interests of so many that a corporation can no longer be managed solely for the benefit of shareholders.¹²

Several approaches may be classified as stakeholder in orientation. Of particular note are the communitarian (or progressive) and pluralist theories that have become popular in corporate law in the past twenty years. Reference to them will be made in places, but the focus of this article is on what is termed "stakeholder theory." This may imply there is only one form of the theory, but that is incorrect. It has actually been suggested that there is a genre of stakeholder theories, and not just one basic theory.¹³ This article intends to discuss the main aspects of stakeholder theory with the caveat that it does not purport to cover all possible views that may be influential in the development of stakeholder theory.¹⁴ There are many variations of certain points that may be seen as critical to the theory, and this has led to no little confusion. The following statement goes some way to explaining the situation: "The result [of the literature in the field] is a baffling exchange of stakeholder interpretations and aims that often have little in common and serve to mystify rather than clarify the intellectual terrain, rendering practical applications implausible if not impossi-

¹¹ R. Edward Freeman & David L. Reed, *Stockholders and Stakeholders: A New Perspective on Corporate Governance*, 25 CAL. MGMT. REV. 88, 89 (1983) (discussing how the term "stakeholder" can be traced back to a 1963 Stanford Research Institute memorandum where it was used to refer to "those groups without whose support the organization would cease to exist.").

¹² Robert S. Karmel, *Implications of the Stakeholder Model*, 61 GEO. WASH. L. REV. 1156, 1171-75 (1993); Lyman Johnson & David Millon, *Corporate Takeovers and Corporate Law: Who's in Control?*, 61 GEO. WASH. L. REV. 1177, 1197-1207 (1993).

¹³ R. Edward Freeman, *The Politics of Stakeholder Theory: Some Future Directions*, 4 BUS. ETHICS Q. 409, 413 (1994).

¹⁴ See generally Morten Huse & Dorthe Eide, *Stakeholder Management and the Avoidance of Corporate Control*, 35 BUS. & SOC'Y 211 (1996), for a discussion on the different types of prevalent stakeholder theories.

ble.”¹⁵ Those who would place themselves in the stakeholder theory group vary in thinking, so what is considered here are only what can be regarded as the views held by the majority of scholars and practitioners of the theory. The wide-ranging views that exist are consonant with the fact that stakeholding is a broad concept. The theory also continues to evolve as scholars address old and new issues. It should be noted that the stakeholder theory is also known as the “stakeholder model,” “stakeholder framework” or “stakeholder management.”¹⁶

Stakeholder theory, in broader social terms, has been invoked by several theorists for a great number of years, and one can trace it back to the work of the seventeenth century German social theorist, Johannes Althusius,¹⁷ and incipient forms of stakeholder theory have existed since the advent of industrialism.¹⁸ As one might expect, the theory changed throughout corporate history. Perhaps stakeholder ideas as we know them today can be traced back to J. Maurice Clark in an article from 1916,¹⁹ and it seems the first writer to develop the stakeholder idea in modern thought, but who did not use the term, was Mary Parker Follett in 1918.²⁰ It is possible to see the modern theory in some embryonic form in the work of Professor E. Merrick Dodd in the early 1930s. A more advanced form of stakeholder theory (referred to by one scholar as the “benign managerial model”²¹) was applied by academics like Edward Mason²² and Carl Kaysen²³ in the 1950s. The 1950s edition of stakeholder theory was also practiced by many successful American corporations (who made reference to their adoption of a “stakeholder management” approach) in the period from the 1920s

¹⁵ Christopher Stoney & Diana Winstanley, *Stakeholding: Confusion or Utopia? Mapping the Conceptual Terrain*, 38 J. MGMT. STUD. 603, 604 (2001).

¹⁶ R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 25 (1984). Some regard the last descriptor to be outdated, see Jörg Andriof et al., *Introduction to UNFOLDING STAKEHOLDER THINKING* 9 (J. Andriof, B. Hunter, S. Waddock & S. Rahman eds., 2002), for a more recent account.

¹⁷ E. Orts, *A North American Legal Perspective on Stakeholder Management Theory*, in PERSPECTIVES ON COMPANY LAW 170 (F. MacMillan Patfield ed., 1997).

¹⁸ Thomas Clarke, *The Stakeholder Corporation: A Business Philosophy for the Information Age*, 31 LONG RANGE PLAN. 182, 186 (1998).

¹⁹ J. Maurice Clark, *The Changing Basis of Economic Responsibility*, 24 J. POL. ECON. 203 (1916).

²⁰ JAMES E. POST ET AL., REDEFINING THE CORPORATION—STAKEHOLDER MANAGEMENT AND ORGANIZATIONAL WEALTH 18 (Stanford Business Books 2002).

²¹ John Parkinson, *Models of the Company and the Employment Relationship*, 41 BRIT J. INDUS. REL. 481, 493.

²² See generally Edward S. Mason, *The Apologetics of “Managerialism”*, 31 J. BUS. 1 (1958).

²³ See generally Carl Kaysen, *The Social Significance of the Modern Corporation*, 47 AMER. ECON. REV. 311 (1957).

to the 1950s.²⁴ For instance, in the 1920s, Owen Young, President of General Electric, acknowledged he had an obligation to the stockholders to pay a fair rate of return, but that he also had an obligation to the laborers, customers, and the public.²⁵ The chairman of the U.S. corporation, Standard Oil, stated, in 1946, that the business of corporations should be carried on in such a way as to maintain “an equitable and working balance among the claims of the various directly interested groups—stockholders, employees, customers and the public at large.”²⁶ The development of the theory in its organized modern form is usually traced to R. Edward Freeman and his influential book, *Strategic Management: A Stakeholder Approach*, published in 1984.²⁷ In the early 1980s, Freeman called for a rethinking of business organizations, arguing that the economic theories that had been preeminent in the 1970s were outdated.²⁸ Notwithstanding the fact that many years have now passed since Freeman’s first articulation of a stakeholder theory in relation to corporations, we have yet to see a robust and workable theory formulated, something on which critics often focus.

III. WHAT IS STAKEHOLDER THEORY?

Stakeholder theory is a theory of organisational management and ethics. The theory has been evolving as scholars address new aspects and confront alleged weaknesses. It purports to provide an account of the purpose of the corporation.²⁹ Before articulating the basic theory we should note that there are three aspects of the theory: normative, descriptive, and instrumental. The normative is an explanation, on a moral basis, of how those who are able to be classified as stakeholders should be treated, and it holds that stakeholders should be seen as “ends” and not “means.” Stakeholders are inherently valuable to the corporation and should be treated as such in the management of the affairs of the corporation.³⁰ This is a legitimacy claim,

²⁴ See Lee E. Preston & Harry J. Sapienza, *Stakeholder Management and Corporate Performance*, 19 J. BEHAV. ECON. 361, 362 (1990). John Hendry, *Missing the Target: Normative Stakeholder Theory and the Corporate Governance Debate*, 11 BUS. ETHICS Q. 159, 160 (2001) (describing the 1930s through 1970s marked by “industrial managerialism”).

²⁵ E. Merrick Dodd, *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1154 (1932).

²⁶ MARGARET BLAIR, *OWNERSHIP AND CONTROL* 212 (The Brookings Institute 1995).

²⁷ See generally FREEMAN, *supra* note 16.

²⁸ Thus, the theory was a response to the shareholder primacy theory. *Id.* at 52.

²⁹ See Bruce Langtry, *Stakeholders and the Moral Responsibilities of Business*, 4 BUS. ETHICS Q. 431, 431 (1994).

³⁰ Scott Reynolds et al., *Stakeholder Theory and Managerial Decision-Making: Constraints and Implications of Balancing Stakeholder Interests*, 64 J. BUS. ETHICS 285, 293 (2006).

and, at its heart, is a clear disagreement with shareholder primacy,³¹ that managers should run corporations primarily for the shareholders and to ensure that their wealth is maximised.³² The descriptive aspect of stakeholder theory is that it is used to explain specific corporate behavior. The instrumental aspect provides a framework for examining the links between the practice of stakeholder management and a corporation's performance, and is concerned with looking at how stakeholderism can improve a corporation's efficiency and success. There is a fourth aspect of the theory that is supported by some, and that is the convergent approach. It is a combination of the normative and instrumental aspects.³³

The core of the theory is normative,³⁴ and this article focuses on that aspect, but there is also discussion of some issues that are relevant to the instrumental aspect. This latter aspect tends to provide an approach that is closer to the Anglo-American idea of private ownership in corporate governance. While it does not advocate moving away from ownership rights, it does assert that emphasis should not be on the sole ownership of the corporation by shareholders, as many shareholder primacists do, because other stakeholders can claim ownership rights.³⁵ Perhaps the comment of Andrew Campbell that, "I support stakeholder theory not from some left wing reason of equity, but because I believe it to be fundamental to understanding how to make money in business"³⁶ is somewhat indicative of some who would take an instrumental approach.

Stakeholding notes that shareholders are merely one of many competing and diverse groups that have an interest in the affairs of a corporation. A stakeholder approach, in general terms, is premised on

³¹ Bert Van de Ven, *Human Rights as a Normative Basis for Stakeholder Legitimacy*, 5 CORP. GOVERNANCE 48, 51 (2005).

³² There is much written on the theory. See generally D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277 (1998); Lynn Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189 (2002); Jill Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637 (2006), available at <http://ssrn.com/abstract=878391> (last visited July 27, 2009); Andrew Keay, *Shareholder Primacy in Corporate Law. Can it Survive? Should it Survive?*, <http://ssrn.com/abstract=1498065>.

³³ Thomas Jones & Andrew Wicks, *Convergent Stakeholder Theory*, 24 ACAD. MGMT. REV. 206 (1999).

³⁴ Thomas Donaldson & Lee Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications*, ACAD. MGMT. REV., Jan. 1995, at 65, 74 (1995).

³⁵ Steve Letza et al., *Shareholding Versus Stakeholding: A Critical Review of Corporate Governance*, 12 CORP. GOVERNANCE: AN INT'L. REV. 242, 251 (2004).

³⁶ Andrew Campbell, *Stakeholders, the Case in Favour*, 30 LONG RANGE PLAN. 446, 446 (1997).

the notion that an inclusive approach towards all contributors is—from a social, economic and political perspective—valuable. The theory focuses on fostering the full potential of all contributors. The ideal in stakeholderism is that “all parties work together for a common goal and obtain shared benefits, ‘opting in’ to the business’s project.”³⁷ All those who contribute critical resources to the corporation should benefit. So, rather than the corporation working to create value for shareholders, the stakeholder theory adheres to the idea that the corporation works towards creation of value for all stakeholders. Furthermore, it is fundamental to stakeholding that organisations are managed for the benefit of, and accountable to, all stakeholders.³⁸ Stakeholding sees the purpose of the corporation as providing a vehicle to serve in such a way as to coordinate the interests of stakeholders,³⁹ and it is concerned about the damage that externalities can have on participants in the corporate enterprise.⁴⁰ Externalising is the practice of managers transferring the costs of the corporation to stakeholders and retaining resulting benefits for shareholders.⁴¹ This occurs, for example, where a corporation makes workers redundant so that dividends can be paid to shareholders and the share price will increase.⁴²

Under stakeholder theory, the duty of managers of corporations is to create optimal value for all social actors who might be regarded as parties who can affect or are affected by a corporation’s decisions.⁴³ The argument is that those who are able to affect or be affected by the corporation are stakeholders, and all stakeholders play

³⁷ JANICE DEAN, *DIRECTING PUBLIC COMPANIES*, 94 (Cavendish 2001).

³⁸ See generally WILL HUTTON, *THE STATE WE’RE IN* (Jonathan Cape 1995).

³⁹ Chris Metcalfe, *The Stakeholder Corporation*, 7 *BUS. ETHICS: EURO. REV.* 30, 30 (1998) (quoting W. Evan & R. Edward Freeman, *A Stakeholder Theory of the Modern Corporation*, in *ETHICAL THEORY AND BUSINESS* (Tom Beauchamp & Norman Bowie eds., 1974)).

⁴⁰ *Principles of Stakeholder Management*, 12 *BUS. ETHICS Q.* 257, 258 (2002).

⁴¹ It is argued by some shareholder primacy theorists that departing from shareholder primacy to ensure no externalities exist would add to agency costs and reduce social wealth. See Ian Lee, *Efficiency and Ethics in the Debate About Shareholder Primacy*, 31 *DEL. J. CORP. L.* 533, 539 (2006).

⁴² A prime example of this is the decision of Shell in late 2009 to boost the dollar value of the dividend by five per cent, notwithstanding a large decrease in profits. This occurred only after the corporation had axed 5,000 jobs: Carl Mortished, *Shell to Axe 5,000 Jobs Amid 73% Profit Fall*, *THE TIMES*, Oct. 29, 2009.

⁴³ FREEMAN, *supra* note 16. Some would restrict this more than Freeman. For instance, Professor Margaret Blair in the mid-1990s (she has subsequently embraced team production) limited those social actors who made specific investments in the company (something that she continues to hold to under the Team Production Approach). See generally Margaret Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 *VA. L. REV.* 247 (1999).

a vital role in the success of the corporate enterprise. Stakeholders have a right to be regarded as an end, and not a means to an end (i.e. they are not used just to benefit the corporation in the long run, but their benefits are an end for the corporation).⁴⁴ As a consequence, it is necessary for the managers to balance the interests of all stakeholders when making decisions.⁴⁵ The aim should be to make the corporation a place where stakeholder interests can be maximised in due course.⁴⁶

Stakeholder theory sees the role of directors as mediators, where they mediate between the various stakeholders.⁴⁷ This is related to the directors' obligation to engage in balancing the interests of stakeholders. Balancing involves "assessing, weighing and addressing the competing claims of those who have a stake in the actions of the organization."⁴⁸ In undertaking balancing, it must be noted that while all stakeholders might be regarded as equal, not all claims and interests of stakeholders are equal or relevant in a given situation. The facts will determine how one is to balance, and the outcome of managers' decision-making and who gets what from corporation outputs is based on a meritocracy, namely what did stakeholders contribute to the enterprise.⁴⁹ Managers should engage with stakeholders in mutual respect and ascertain what they are saying, so that there is not one-sided management.⁵⁰

The people who have a stake generally include the corporation's: customers, suppliers, financiers, creditors, shareholders, employees, and local communities, as well as local and national governments (including tax authorities). The rights of these groups must be honored, and, further, the groups must participate, in some sense, in decisions that substantially affect their welfare.⁵¹ Besides the fact that all stakeholder interests must be taken into account, the theory does not endorse any prioritisation of interests of stakeholders in relation to one another. Stakeholderism is "premised on the theory

⁴⁴ FREEMAN, *supra* note 16, at 97.

⁴⁵ Some might restrict it to "main" stakeholders. See, e.g., John Plender, *Giving People a Stake in the Future*, 31 LONG RANGE PLAN. 211, 214 (1998).

⁴⁶ R. Edward Freeman & Robert Phillips, *Stakeholder Theory: A Libertarian Defense*, 12 BUS. ETHICS Q. 331, 333 (2002).

⁴⁷ Karmel, *supra* note 12, at 1157.

⁴⁸ Scott Reynolds, et al., *Stakeholder Theory and Managerial Decision-Making: Constraints and Implications of Balancing Stakeholder Interests*, 64 J. BUS. ETHICS 285, 286 (2006).

⁴⁹ Robert Phillips, Edward Freeman & Andrew Wicks, *What Stakeholder Theory Is Not*, 13 BUS. ETHICS Q. 488 (2003).

⁵⁰ Andriof, et al., *supra* note 16, at 9.

⁵¹ W. Evan & R. Edward Freeman, *A Stakeholder Theory of the Modern Corporation: Kantian Capitalism*, in ETHICAL THEORY AND BUSINESS 103, 103 (Tom Beauchamp & Norman Bowie eds., 1988).

that groups in addition to shareholders have claims on a corporation's assets and earnings because those groups contribute to a corporation's capital."⁵² Inequality among stakeholders would be acceptable only if the action causing it improved the situation of the stakeholder most in need.⁵³ So, stakeholder theory rejects the idea of maximising a single objective, as one gets with shareholder primacy where the focus is all on maximising shareholder wealth. As a normative thesis, stakeholder theory holds to the legitimacy of the claims on the corporation by many different groups and people.⁵⁴ Managers are obliged to deal transparently and honestly with all stakeholders,⁵⁵ and ask: What will stakeholders think about the decision we are contemplating? They then should consider which stakeholders warrant or require consideration.⁵⁶

The notion of "stakeholder" involves people or groups being seen as having a stake in the corporation. A stake "is an asserted or real interest, claim or right, whether legal or moral, or an ownership share in an undertaking."⁵⁷ It is where someone has something that is at risk due to corporate action.⁵⁸ The idea of "stakeholder" connotes legitimacy, so it is legitimate for managers to spend time and resources on such persons.⁵⁹ William Evan and R. Edward Freeman have sought to extend acknowledgement of who are stakeholders to people and groups who have morally valid claims on the corporation, as opposed to just economic claims, thus covering a wider spread than those recognised by others.⁶⁰ The critical thing is that the corporation must "manage its relationships with its specific stakeholder groups in an action-oriented way."⁶¹ This involves directors being aware of the

⁵² Karmel, *supra* note 12, at 1171.

⁵³ Freeman, *supra* note 13, at 415–416.

⁵⁴ See Donaldson & Preston, *supra* note 34, at 66–67. Freeman has said that it is necessary for a company to identify those who are its stakeholders. FREEMAN *supra* note 16, at 54, 196.

⁵⁵ *Principles of Stakeholder Management*, *supra* note 40, at 259. How managers should act is set out on page 260 of the article and the principles reproduce those contained in THE CLARKSON CENTRE FOR BUSINESS ETHICS, PRINCIPLES OF STAKEHOLDER MANAGEMENT 60 (Univ. of Toronto, 1999).

⁵⁶ Ronald Mitchell, et al., *Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts*, 22 ACAD. OF MGMT. REV. 853, 855 (1997).

⁵⁷ Leo V. Ryan, *The Evolution of Stakeholder Management: Challenges and Potential Conflicts*, 3 INT'L J. VALUE BASED MGMT. 105, 108 (1990).

⁵⁸ *Principles of Stakeholder Management*, *supra* note 40, at 257–58.

⁵⁹ FREEMAN, *supra* note 16, at 45.

⁶⁰ Bruce Lantry, *Stakeholders and the Moral Responsibilities of Business*, 4 BUS. ETHICS Q. 431, 432 (1994).

⁶¹ FREEMAN, *supra* note, 16 at 53.

effect of their decisions on stakeholder groups, and then acting accordingly.⁶²

Identifying a corporation's stakeholders is not a straightforward issue. There are a number of approaches adopted for determining who are stakeholders, and there were twenty-eight different definitions of "stakeholder" proposed between 1963 and 1995.⁶³ A leading advocate of stakeholder theory, Professor Max Clarkson, adopted a narrow definition of stakeholders and regarded them as those who "bear some form of risk as a result of having invested some form of capital, human or financial, something of value, in a firm."⁶⁴ The approach has been endorsed by a substantial number of commentators.⁶⁵ Many commentators have distinguished between primary (inside or internal) stakeholders, on the one hand, and secondary (outside or external) stakeholders, on the other, with the former being the focus of the theory.

Primary stakeholders are seen as those who have a formal, official, or contractual relationship with the corporation, and without whom the corporation could not function. Many stakeholder theorists have identified five primary stakeholders: financiers, customers, suppliers, employees, and shareholders (some might also add communities). These various stakeholders will have priority at different times. There is a fair degree of interdependence between the corporation and these stakeholders.

Secondary stakeholders are those who have not negotiated with the corporation, but who can have influence and can affect the corporation. Their interests may, on occasion, require the corporation to refrain from a particular course of action.⁶⁶ Some deny that such persons and groups are stakeholders as they are not involved, arguably, in value exchanges.⁶⁷ Others deny them standing as stakeholders as they have no financial interest in the corporation.⁶⁸ Often it is said

⁶² *Id.* at 196.

⁶³ Mitchell, et al., *supra* note 56 at 853.

⁶⁴ Max Clarkson, "A risk based model of stakeholder theory," Proceedings of the Second Toronto Conference on Stakeholder Theory, Centre for Corporate Social Performance, University of Toronto, 1994 at 5, *quoted in* Amy Hillman and Gerald D. Klein, *Shareholder Value, Stakeholder Management and Social Issue. What's the Bottom Line?*, 22 STRATEGIC MGMT. J. 125, 126 (2001).

⁶⁵ See, e.g., Eric W. Orts & Alan Strudler, *The Ethical and Environmental Limits of Stakeholder Theory*, 12 BUS. ETHICS Q. 215 (2002).

⁶⁶ DEAN, *supra* note 37, at 99, 103.

⁶⁷ See, e.g., Richard Lee Miller, *Ethical Challenges in Corporate-Shareholder Investor Relations: Using the Value Exchange Model to Analyze and Respond*, 7 J. BUS. ETHICS 117, 121 (1988).

⁶⁸ Orts & Strudler, *supra* note 65, at 215.

that there are six secondary stakeholders: governments, environmentalists, NGOs, critics, the media, and others.⁶⁹

Archie Carroll divides stakeholders into three categories: those who have ownership, those who have a right or claim on the corporation (and this could be legal or moral), and those who assert an interest in the outcome of the corporation's business.⁷⁰ Some theorists distinguish those who merely influence the corporation from those who are truly stakeholders.⁷¹ In sum, most writers see the following as stakeholders: employees, shareholders, suppliers, financial institutions and lenders, general creditors, customers, the local community, local and national governments, and the environment. Of course, several people might possess a number of overlapping interests and may be both primary and secondary stakeholders or fall into more than one group of primary or secondary stakeholders. For instance, employees might hold shares in their corporation, buy products from their corporation, and live in the community where the corporation's factory/office is located, thereby falling into several stakeholder groups.

Unlike shareholder primacy which focuses on efficiency, stakeholder theory embraces a number of other values, whilst not rejecting efficiency. The value of trust is an important element in this theory. It is argued that it is critical that the corporation secures the trust and cooperation of its main stakeholder groups.⁷² The existence of trust means that there is no need for elaborate contracts to be formulated. As Dr. Janice Dean states, "The decision to trust, in business as elsewhere centres on interpersonal expectations, the willingness to accept temporary vulnerability and optimism about one's partner's behaviour."⁷³ Stakeholder theorists will argue that trust can lead to enhanced reputation. It also means that if action contrary to a stakeholder's interests is contemplated, the managers need to explain both the thinking behind the action and the consequences of it. The emphasis of the theory on values such as trust means that the involvement of stakeholders cannot be priced.

It has been said that there should be a provision for rules in corporations that insure the relations between stakeholders are governed by justice, and these rules must be endorsed by the stakeholders.⁷⁴ Some have even argued that there should be a board of directors

⁶⁹ Yves Fassin, *The Stakeholder Model Refined*, 84 J. BUS. ETHICS 113, 115 (2009).

⁷⁰ ARCHIE B. CARROL, BUSINESS AND SOCIETY: ETHICS AND STAKEHOLDER MANAGEMENT 56–57 (South-Western 1989).

⁷¹ Donaldson & Preston, *supra* note 34, at 86.

⁷² CHARLES HANDY, THE HUNGRY SPIRIT 181 (Broadway Books 1997).

⁷³ DEAN, *supra* note 37, at 107.

⁷⁴ Norman E. Bowie, *A Kantian Theory of Capitalism*, 8 BUS. ETHICS Q. 37, 47 (1998).

that is representative of the stakeholders in a corporation,⁷⁵ so stakeholders, in addition to shareholders, should have the opportunity to vote for the directors. Professor Kent Greenfield asserts that the best way for a board to engage in decision-making is to have all important stakeholders represented on it. Greenfield acknowledges that this mechanism presents difficulties but argues that employees, the communities in which the corporation employs a significant portion of its workers, long-term business partners, and creditors could all be represented.⁷⁶ We shall return to this issue later.

Directors in a stakeholding system are perceived as trustees of the stakeholders' interests. They are to have a focus on the long-term future of the corporation, and act as stewards of all that they manage.⁷⁷ As directors, they are to be trusted and relied on as professionals. Nevertheless, accountability measures should be put in place, but unlike with shareholder primacy, there is no presumption that the directors will act opportunistically or shirk.

In an attempt to have the theory taken seriously, Dean has suggested the following as an appropriate legislative provision that allows for stakeholding:

A director of a public limited company shall in all his/her conduct and decision making so act as to advance the development of the company in the interests of its customers, its employees and its shareholders and with proper regard for the effect of its operations on the environment and on the community. The interests to which a director of a public company should give due consideration include:

The provision for customers of safe and effective goods and services of good quality at fair prices;

The provision for employees of fair remuneration and secure work with reasonable opportunity for their interests to be heard within the company and for their promotion and development of skills;

The provision for shareholders of fair returns to remunerate past investment and encourage future investment in the company;

⁷⁵ See, e.g., Kent Greenfield & D. Gordon Smith, *Debate: Saving the World With Corporate Law?*, 57 EMORY L.J. 947, 978 (2008); Frederick R. Post, *A Response to "The Social Responsibility of Corporate Management: A Classical Critique,"* MID-AMERICAN J. BUS. 25, 32 (2003).

⁷⁶ Kent Greenfield, *Reclaiming Corporate Law in a New Gilded Age*, 2 HARV. L. & POL'Y REV. 1, 24 (2008).

⁷⁷ Plender, *supra* note 45, at 215.

The provision for key business associates including suppliers of goods and services of secure relationships and ongoing co-operation where such connections offer advantages to both parties;

The provision for the community of programmes to monitor and minimise the environmental impact of the company's operations and advance responsible conduct towards the company's neighbours.⁷⁸

Unlike shareholder value and communitarianism, both of which separate economics and ethics, stakeholder theory embraces both, with the theory being used as a basis for translating business ethics to management practice and strategy.⁷⁹ The separation provided for under shareholder primacy, with its focus on a single objective, means that shareholder value provides a narrow approach that, it is asserted, cannot "do justice to the panoply of human activity that is value creation and trade, i.e., business."⁸⁰ Stakeholder theory seeks to remedy that situation by being far broader.

The relationship between economics and ethics has always been ambiguous,⁸¹ and stakeholder theory seeks to bring the two together.⁸² Some stakeholder theorists even embrace a form of agency theory, with stakeholders being regarded as principals.⁸³ Also, while the nexus of contracts metaphor⁸⁴ for the corporation is often associated with the shareholder primacy theory, some of those holding to

⁷⁸ DEAN, *supra* note 37, at 138.

⁷⁹ Fassin, *supra* note 69, at 113.

⁸⁰ R. Edward Freeman et al., *Stakeholder Theory and the Corporate Objective Revisited*, 15 ORG. SCI. 364, 364 (2004).

⁸¹ John Hendry, *Missing the Target: Normative Stakeholder Theory and the Corporate Governance Debate* 11 BUS. ETHICS Q. 159, 161 (2001).

⁸² Interestingly, Elaine Sternberg, a shareholder primacy supporter also purports to bring them together. ELAINE STERNBERG, *JUST BUSINESS* (Little, Brown & Co., 2d ed. 2000).

⁸³ Charles W. Hill & Thomas M. Jones, *Stakeholder-Agency Theory*, 19 J. MGMT. STUD. 131 (1992).

⁸⁴ This is a theory that provides that the company is to be seen as nothing more than a number of complex, private consensual transactions or contract-based relations, either express or implied, and they consist of many different kinds of relations that are worked out by those voluntarily associating in a company. Frank Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1426 (1989). The literature considering the nexus of contracts is too voluminous to cite. See generally Armen Alchian & Harold Demsetz, *Production, Information Costs and Economic Organizations*, 62 AMERICAN ECON. REV. 777 (1972); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 228 at 290

stakeholder theory accept such a metaphor on the basis that all corporate constituents are part of the nexus and all are on an equal footing.⁸⁵ This is contrasted with the traditional articulation of nexus of contracts theory which does not see some who are generally thought of as stakeholders in most corporations, such as suppliers and customers, as actually part of the corporation.⁸⁶ Under stakeholder theory, corporations should be prepared to make disclosures to stakeholders where appropriate, and stakeholders should be encouraged by the corporation to be involved in the life of the corporation.⁸⁷ There is often an emphasis on the relationship between stakeholders and the corporation (represented by the managers). Theorists also emphasise that stakeholders interact with one another. This fosters the idea of interdependence that is a primary feature of stakeholder theory.

Stakeholder theory desires that stakeholders have a voice in the decision-making process in corporations, as well as an interest in the results of that process.⁸⁸ Consequently, some theorists have argued for institutional representation—places on the board of directors for the various stakeholders—something which has been high on the pluralist theory's agenda.⁸⁹ This is possible as Denmark, Sweden, and Luxembourg all have employee representatives on one-tier boards of directors.⁹⁰ While few theorists come to terms with how they see the nature of the corporation because they are more concerned with what the corporation does, it might be said that many would agree that a corporation is “a public association constituted through political and legal processes and as a social entity for the pursuing of collective goals with public obligations.”⁹¹

(1980); William W. Bratton Jr, *The 'Nexus of Contracts Corporation': A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989).

⁸⁵ See, e.g., Melvin A. Eisenberg, *The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 833 (1999).

⁸⁶ Luigi Zingales, *In Search of New Foundations*, 55 J. FIN. 1623, 1634 (2000).

⁸⁷ DEAN, *supra* note 37, at 101.

⁸⁸ FREEMAN, *supra* note 16, at 196; see generally Phillips, Freeman & Wicks, *supra* note 49.

⁸⁹ See generally Evan & Freeman, *supra* note 51. For a brief critique of this, see Andrew Keay, *The Ultimate Objective of the Public Company and the Enforcement of the Entity Maximisation and Sustainability Model*, (on file with author), available at <http://ssrn.com/abstract=1481250>.

⁹⁰ Franklin Allen, Elena Carletti, & Robert Marquez, *Stakeholder Capitalism, Corporate Governance and Firm Value*, 6 (Wharton Financial Institutions Center, Working Paper No. 09-28, 2007), available at <http://knowledge.wharton.upenn.edu/papers/1344.pdf>.

⁹¹ Silvia Ayuso et al., *Maximising Stakeholders' Interests: An Empirical Analysis of the Stakeholder Approach to Corporate Governance*, 3 (IESE Business School, Univ. of Navarra Working Paper No. 670, 2007).

Finally, stakeholder theory appeals to many people because, *inter alia*, it has been said to be a matter of “taming” the “harsher aspects of capitalism.”⁹² The theory asserts that there is more to business than just making money, and it seeks to ensure that the vision of managers is broadened.⁹³ In her study of the documents of Fortune 100 corporations in the United States, Professor Lisa Fairfax found that all but the documents and communications of two corporations included stakeholder rhetoric.⁹⁴ Additionally, it might be concluded from this that corporations engage in stakeholder rhetoric to offset the negative feelings that come from the pursuit of the maximisation of shareholder wealth, especially in difficult financial times. Stakeholder theory has portrayed the image of being able to right the wrongs caused by the perceived worst excesses of shareholder primacy in the management of corporations such as Enron.⁹⁵ It has become “the vocabulary and methodology for doing this because it is seen as being capable of satisfaction by the construction of a passive notion of social responsibility.”⁹⁶

IV. THE RATIONALE FOR, AND ARGUMENTS IN FAVOR OF, THE THEORY

Some take the view that shareholder primacy damages the interests of non-shareholding stakeholders, and this forms the basis for a legitimate claim that these stakeholders warrant consideration and protection in the management of a corporation’s affairs.⁹⁷ Others provide different rationales for stakeholding. One of the classic statements is made by R. Edward Freeman and his co-authors when they express the rationale behind the theory in this way:

Business is about putting together a deal so that suppliers, customers, employees, communities, managers and shareholders all win continuously over time. In short, at some level, stakeholder interests have to be joint—they must be traveling in the same direction—or else there will be exit, and a new collaboration formed.⁹⁸

⁹² J. Plender, *The Stakeholding Solution*, London, Nicholas Brealey, 1997 cited in J. Dean, *Directing Public Companies*, (London, Cavendish, 2001) at 117.

⁹³ Orts & Strudler, *supra* note 65, at 216.

⁹⁴ Lisa M. Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms*, 21 J. CORP. L. 675, 677–678, 713–715 (2005).

⁹⁵ See generally Jones & Wicks, *supra* note 33.

⁹⁶ Sally Wheeler, *Works Councils: Towards Stakeholding?*, 24 J.L. & Soc’y 44, 49 (1997).

⁹⁷ David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, in PROGRESSIVE CORPORATE LAW 3 (Lawrence Mitchell ed., 1995).

⁹⁸ Freeman et al., *supra* note 80, at 365.

There are two points here. First, a corporation needs a number of contributors to ensure that it thrives and survives. If directors do not consider other stakeholders then these people and groups will have no commitment to the corporation and this might lead to withdrawal of their investment or their unwillingness to support the corporation when it is in need. All of this could affect the performance and wealth of the corporation, thereby failing to enhance social wealth.

The second point is that it is best for everyone if the corporation functions so that stakeholders obtain as much value as possible.⁹⁹ Shareholder value advocates make a similar argument, but get there via a different route. The stakeholder theory school argues that it is more reasonable and beneficial to take into account all stakeholders rather than pursue shareholder primacy. For a corporation to thrive it must, *inter alia*, produce competitive returns for shareholders, satisfy customers in order to produce profits, recruit and motivate excellent employees, and build successful relationships with suppliers.¹⁰⁰ Stakeholding is the instrument through which efficiency, profitability, competition, and economic success can be promoted on the basis that if one removed cohesion among stakeholders it would not be possible for corporations to be competitive.¹⁰¹ The huge mining corporation, BHP Billiton, has effectively acknowledged this, and states that it seeks a competitive advantage by exploring new ways of approaching and engaging in relationships with its key stakeholders.¹⁰²

The theory provides that if the interests of stakeholders are catered for, and such stakeholders are shown loyalty; then the shareholders will benefit more than if shareholder wealth maximisation were practised, because the corporation would benefit and it would also produce greater social wealth.¹⁰³ However, many shareholder primacy theorists argue that shareholders' interests have to be the first priority or the corporation will not prosper. The fact of the matter is that it is probably a matter of the degree to which stakeholder interests are taken into account, and what happens when there is a conflict between shareholder interests and the interests of other stakeholders that really matters. Shareholder primacy scholars would say that the former are automatically to be preferred, while stakeholder theory

⁹⁹ *Id.*

¹⁰⁰ DEAN, *supra* note 37, at 251.

¹⁰¹ Andrew Campbell, *Stakeholders: The Case in Favour*, 30 LONG RANGE PLAN. 446 (1997).

¹⁰² BHP Billiton, *Submission 13*, p. 1 to the Australian Joint Parliamentary Committee on Corporations and Financial Services and referred to at para 3.18 of the report (*Corporate Responsibility: Managing Risk and Creating Value*, June 2006 at para 4.46 available at http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/2004-07/corporate_responsibility/report/index.htm).

¹⁰³ Greenfield & Smith, *supra* note 75, at 975.

would say that it depends on balancing a number of factors and the interests of stakeholders. Dean states that “[i]f the board had to consider the interests of all relevant stakeholders and the standards expected of directors were more clearly defined in law, the position would become simpler overall.”¹⁰⁴ The reason for this is that considering a broad range of stakeholders will enhance the corporation’s reputation and lead others to feel that the corporation is principled and can be trusted. Dean asserts that this would benefit everyone involved.¹⁰⁵ If stakeholders’ interests are taken into account by managers in running the corporation, and stakeholders are going to be rewarded, it is likely that they will be more ready to “go the extra mile” in their dealings with the corporation.¹⁰⁶ Employees might devote more time and care to their labor, suppliers might be ready to deliver smaller quantities of goods when doing so might be of marginal economic benefit to them, and customers will remain loyal through difficult times.

Besides relying on the need to keep stakeholders involved in corporations, Freeman and Philips have argued for the theory on the basis that stakeholders deserve protection as they have property rights in the corporation to which they have contributed.¹⁰⁷ For instance, suppliers have a property interest in what they supply to the corporation.¹⁰⁸ The idea is that stakeholder groups have a claim on the corporation’s property and profits as they contributed to the capital of the corporation.¹⁰⁹ Like shareholders, they have risked their investment in the corporation. Stakeholders make firm, specific investments in the corporation. For instance, employees may make an investment in corporations by way of undergoing specialised training that might not be able to be used elsewhere in other employment. Suppliers might acquire specialised machinery to enable them to supply the corporation with particular kinds of products, even if this machinery could not be used on any other current or future contract.

Leaving aside any notion of property rights, stakeholders warrant protection on other grounds. Shareholder primacists argue that non-shareholder constituencies are protected by contract, but the riposte is that most stakeholders are unable to negotiate on an even footing as there is inequality of bargaining power. So, a normative foundation for providing protection for stakeholders is that it makes sure that the legitimate expectations of such people, and those are

¹⁰⁴ DEAN, *supra* note 37, at 108

¹⁰⁵ *Id.* at 108.

¹⁰⁶ Plender, *supra* note 45, at 215.

¹⁰⁷ Freeman & Philips, *supra* note 46, at 338.

¹⁰⁸ *Id.*

¹⁰⁹ Karmel, *supra* note 12, at 1171.

above and beyond the terms of any contract, are fulfilled.¹¹⁰ When stakeholders get involved with a corporation this elicits an implied promise from the corporation that the directors will consider the interests of the stakeholders. This is a form of social contract approach to the issue.

From an efficiency viewpoint managers do not generally have a personal association or ties with shareholders, yet they do with many stakeholders.¹¹¹ Managers regularly deal with: employees, regarding work performance and working conditions; suppliers, concerning the quality of the goods delivered and non-delivery of goods; customers, who complain about the goods that the corporation markets; and local communities, concerning what the corporation is doing or not doing as a corporate citizen. If managers practice stakeholder theory, they can take into account stakeholder concerns, and, in many cases, demonstrate that they are considering the interests of the stakeholders. Consequently, managers gain respect and trust in the eyes of stakeholders; and, importantly for the corporation, they can do their job better and more efficiently.

Running a modern corporation leads to interdependencies involving many groups for whom the corporation should have a legitimate concern.¹¹² If the reasonable expectations of such groups are not met, then the long-term profitability of the corporation will suffer and stakeholder theory is concerned about the long-term. Taking into account all stakeholders' interests recognises the interdependence of parties involved in corporations and is likely to pre-empt selfish competition among constituents.¹¹³ Where conflict between stakeholders cannot be avoided, managers are to embrace actions that will at least compensate stakeholders for any loss suffered.¹¹⁴

It has been noted that the stakeholder theory rejects the idea of maximising a single objective. As a normative thesis, the theory holds to the legitimacy of the claims on the corporation that many different groups and people have, and this justifies its implementation.¹¹⁵ "[T]he economic and social purpose of the corporation is to create and distribute wealth and value to all its primary stakeholder groups with-

¹¹⁰ Wai Shun Wilson Leung, *The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime that Recognizes Non-Shareholder Interests*, 30 COLUM. J.L. & SOC. PROBS. 589, 622 (1997).

¹¹¹ E. Merrick Dodd Jr., *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 U. CHI. L. REV. 194, 202-03 (1935).

¹¹² Karmel, *supra* note 12, at 1169.

¹¹³ See Mitchell, *supra* note 1, at 641-43.

¹¹⁴ Millon, *supra* note 97, at 12.

¹¹⁵ See Donaldson & Preston, *supra* note 34, at 66-67.

out favoring one group at the expense of others.”¹¹⁶ Unlike shareholder primacy, no grouping has *prima facie* priority over another,¹¹⁷ and no group warrants priority over any other groups.¹¹⁸ Donaldson and Preston have said, that “each group of stakeholders merits consideration for its own sake and not merely because of its ability to further the interests of some group, such as shareowners.”¹¹⁹ In shareholder primacy, stakeholders are treated as a means, whereas the stakeholder theory holds that stakeholders should be treated as ends. The adherents to this latter theory have advocated concepts of individual autonomy and fairness to all members of society.¹²⁰ The theory posits the equality of all stakeholders in that they all have intrinsic value and all are morally entitled to be considered in the management of the corporation’s affairs, and to be considered simultaneously,¹²¹ even if this does not advance the interests of shareholders.¹²² The rights of these groups must be assured, and further, the groups must participate in decisions that substantially affect their welfare.¹²³ The moral basis is that a duty is imposed on all organisations in relation to all individuals who are involved with them. Failure to do so would be a breach of human rights irrespective of who was the stakeholder prejudiced.¹²⁴

This ties in with the arguments of the communitarian (or progressive) school, which asserts that stakeholders who are not shareholders are entitled to be shown consideration because they are owed more than what they have bargained for. Those involved in a corporation owe each other respect and support.¹²⁵ As mentioned earlier, stakeholder theory emphasizes trust, and a number of stakeholders have to rely on trust and virtually nothing else. The advantage of trustworthiness for the corporation is that it might enhance its reputation. Trust between corporations and their stakeholders can arguably

¹¹⁶ Max B.E. Clarkson, *A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance*, 20 ACAD. MGMT. REV. 92, 112 (1995).

¹¹⁷ See Donaldson & Preston, *supra* note 34, at 68.

¹¹⁸ Mohammed Omran et al., *Shareholders Versus Stakeholders: Corporate Mission Statements and Investor Returns*, 11 BUS. ETHICS: EURO. REV. 318, 318 (2002).

¹¹⁹ Donaldson & Preston, *supra* note 34, at 67.

¹²⁰ See generally John R. Boatright, *Fiduciary Duties and the Shareholder-Management Relation: Or, What’s So Special About Shareholders?*, 4 BUS. ETHICS Q. 393 (1994).

¹²¹ Mitchell et al., *supra* note 56, at 862.

¹²² Richard Marens & Andrew Wicks, *Getting Real: Stakeholder Theory, Managerial Practice and the General Irrelevance of Fiduciary Duties Owed to Shareholders*, 9 BUS. ETHICS Q. 273, 274 (1999).

¹²³ Evan & Freeman, *supra* note 51, at 103.

¹²⁴ Phillips, Freeman & Wicks, *supra* note 49, at 494.

¹²⁵ Millon, *supra* note 97, at 4.

reduce costs, as stakeholders seldom have to monitor the managers; they can trust the managers to do their job properly.

The theory posits that many stakeholders—who cannot obtain protection for reasons such as lack of bargaining power, ignorance, or insufficient funds to pay necessary costs (e.g. legal costs)—must rely on fair treatment. In actuality, contractual arrangements between equals occurs infrequently. Many contracts assume a “take it or leave it” approach with the result that costs are imposed on third parties with whom the corporation does business.¹²⁶ Several scholars have reported that contracts involving stakeholders are “neither complete nor perfectly priced.”¹²⁷

The theory may reflect the fact that the world has become more complex, and, as a result, the affairs and decisions of corporations affect or are affected by an increasing number of people and groups. For example, until recently, environmental issues have not been regularly or widely seen as causing major concern to corporations. Stakeholder theorists often argue that their theory takes into account the complexity of the world, whereas shareholder primacy is far too glib.

Undoubtedly, this model has a lot of attraction. It emphasizes endearing values like trust and fairness. The model also embraces both economics and ethics, elements which have been difficult to balance. The focus on stakeholders has, as we have noted, several advantages; however, a number of concerns have been raised in relation to the theory, which we now turn to examine.

V. CONCERNS WITH, AND ARGUMENTS AGAINST, THE THEORY

Some leading scholars have boldly proclaimed that the preeminence of stakeholder theory has extinguished shareholder primacy.¹²⁸ While the stakeholder theory has spread rapidly in both influence and application,¹²⁹ criticism of the theory endures. In general terms the theory has been described as, “naive, superficial and unrealistic. . . .”¹³⁰ One trenchant critic has said that the theory is “deeply dangerous and wholly unjustified”¹³¹ on the basis that it undercuts

¹²⁶ Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155, 1156 (1982).

¹²⁷ Fisch, *supra* note 32, at 659.

¹²⁸ See Freeman, *supra* note 13, at 413.

¹²⁹ Paddy Ireland, *Corporate Governance, Stakeholding, and the Company: Towards a Less Degenerate Capitalism?*, 23 J.L. & Soc’y 287, 296 (1996).

¹³⁰ Christopher Stoney & Diana Winstanley, *Stakeholding: Confusion or Utopia? Mapping the Conceptual Terrain*, 38 J. MGMT. STUD. 600, 606 (2001).

¹³¹ Elaine Sternberg, *The Defects of Stakeholder Theory*, 5 CORP. GOVERNANCE: AN INT’L REV. 3, 8 (1997).

private property, denies agents' duties to principals, and destroys wealth.¹³² It has even been said that it lacks the status of a theory and is instead merely a research tradition or framework.¹³³ As such, the literature dealing with stakeholder theory has tended to focus on justifying the approach rather than developing a systematic theory.¹³⁴

This part of the article seeks to identify and examine the concerns that have been expressed about the stakeholder theory, as well as analyzing the primary arguments that critics have raised. A number of the concerns considered and arguments put forward against the theory overlap but are separately categorized for purposes of exposition and clarity.

A. *Lack of Solid Normative Foundations*

The point has been made that stakeholder theory has failed to provide any normative foundations for its justification.¹³⁵ In particular, it fails to provide a normative base on which to ascertain who can be a stakeholder and what weight ought to be given to each stakeholder.¹³⁶ Consequently, there is no basis for a manager, in running the corporation, to prefer stakeholderism to other moral approaches. Freeman has asserted that no normative foundational justification is necessary, but does offer one, as explained below.¹³⁷

Many arguments in favor of the theory are grounded in economics, but stakeholding does have a moral basis in that it provides for how agents should treat each other. However, various apologists for the theory have differed in their explanations of the theory's philosophical bases. Some theorists have sought to build a foundation us-

¹³² *Id.* at 9.

¹³³ Linda Klebe Treviño & Gary R. Weaver, *The Stakeholder Research Tradition: Converging Theorists—Not Convergent Theory*, 24 *ACAD. MGMT. REV.* 222, 224 (1999).

¹³⁴ See generally Simon Learmount, *Theorizing Corporate Governance: New Organizational Alternatives* ESRC Centre for Business Research, University of Cambridge Working Paper No. 237, available at <http://www.cbr.cam.ac.uk/pdf/WP237.pdf> (last visited March 31, 2010).

¹³⁵ THOMAS DONALDSON, *THE ETHICS OF INTERNATIONAL BUSINESS* 45 (Oxford Univ. P, 1989); see Antonio Argandoña, *The Stakeholder Theory and the Common Good*, 17 *J. BUS. ETHICS* 1093, 1098 (1998); François Lépineux, *Stakeholder Theory, Society and Social Cohesion*, 5 *CORP. GOVERNANCE* 99, 99 (2005); SALLY WHEELER, *CORPORATIONS AND THE THIRD WAY* 6 (Hart Publishing 2002).

¹³⁶ Thomas Donaldson & Thomas W. Dunfee, *Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory*, 19 *ACAD. MGMT. REV.* 252, 254–55 (1994).

¹³⁷ R. Edward Freeman, *Ending the So-Called 'Friedman-Freeman' Debate, in Dialogue: Toward Superior Stakeholder Theory*, 18 *BUS. ETHICS Q.* 153, 162, 163 (2008).

ing the principle of fairness,¹³⁸ which entitles those who provide resources to the corporation to a return on their contributions.¹³⁹ As Robert Phillips explained:

Whenever persons or groups of persons voluntarily accept the benefits of a mutually beneficial scheme of cooperation requiring sacrifice or contribution on the parts of the participants and there exists the possibility of free-riding, obligations of fairness are created among the participants in the co-operative scheme in proportion to the benefits accepted.¹⁴⁰

Phillips argues that the concept of cooperative schemes encompasses commercial transactions and that consent is not necessary for a person to be regarded as a stakeholder.¹⁴¹ He suggests that the fairness principle is able to reconceptualize business relations as cooperative rather than adversarial.¹⁴² This approach, he argues, is likely to enable a resolution to a conflict situation between stakeholders.

Other scholars rely on different moral bases for the theory. For example, Evan and Freeman propose a deontological or duty foundation (rooted in Kantian philosophical foundations, with some reliance on social contract theory)¹⁴³ which provides that persons should respect others as equals.¹⁴⁴ As a corollary, all people and groups have intrinsic value and are to be regarded not as means to ends, but as ends themselves.¹⁴⁵ Hence, corporations should not be seen simply as profit producers for shareholders. A criticism of this view is that while the Kantian approach provides that humans are, as rational, moral agents, to be regarded as ends in themselves, the stakeholder theory also identifies non-persons, such as the environment and the community, as stakeholders, and is therefore inappropriate.¹⁴⁶

Another moral basis suggests that distributive justice entitles stakeholders to a share of corporate earnings as they contributed to the creation of the earnings and had legitimate expectations that they

¹³⁸ See generally FREEMAN, *supra* note 16.

¹³⁹ Metcalfe, *supra* note 39, at 32.

¹⁴⁰ FREEMAN, *supra* note 16, at 57.

¹⁴¹ *Id.* at 59.

¹⁴² *Id.* at 64.

¹⁴³ IMMANUEL KANT, *THE MORAL LAW OR KANT'S GROUNDWORK OF THE METAPHYSIC OF MORALS* 95 (H. J. Paton trans., 1956) ("[E]very rational being . . . must in all his actions, whether they are directed to himself or to other rational beings, always be viewed at the same time as an end.").

¹⁴⁴ See generally, Evan & Freeman, *supra* note 51.

¹⁴⁵ Kevin Gibson, *The Moral Basis of Stakeholder Theory*, 26 J. BUS. ETHICS 245, 248 (2000). See Donaldson & Preston, *supra* note 34, at 67.

¹⁴⁶ Sternberg, *supra* note 131, at 6.

would share in the corporation's success. Antonio Argandoña argues that the theory can be based on the concept of the common good.¹⁴⁷ The common good involves establishing the conditions that enable those linked with a corporation to achieve their personal goals.¹⁴⁸ While they do not develop it, Thomas Donaldson and Lee Preston suggest the theory is built upon property rights, and posit the idea that stakeholder rights can compete with those of shareholders.¹⁴⁹ Yet another basis given is that failure by managers to consider stakeholders would be a breach of the latter's human rights.¹⁵⁰ In fairness, many corporate law theories have various bases. But this concern is the least of stakeholder theory's problems.

B. Lack of Clarity

One of the major criticisms of stakeholder theory is that its underlying concepts lack clarity.¹⁵¹ Even zealous stakeholder theorists have admitted the theory suffers from vagueness, ambiguity, and breadth.¹⁵² James Humber views the theory as a collage of elements that are at odds with one another, thereby producing no systematic coherence.¹⁵³ Goyder compares adopting stakeholderism in lieu of shareholder primacy to sacrificing clarity for blanchmange, presumably because blanchmange is difficult to get a hold of.¹⁵⁴ One of the theory's major problems is that it is not always clearly articulated. It has been said that stakeholding is "a slippery creature . . . used by different people to mean widely different things which happen to suit their arguments."¹⁵⁵

Another reason that is given is that "most work in this field appears to be preoccupied with justifying a stakeholder approach to the firm, rather than the construction of systematic theory to describe more adequately contemporary organizational practices."¹⁵⁶ Further confusion might come from the fact that the theory provides that it is

¹⁴⁷ Antonio Argandoña, *supra* note 135, at 1093.

¹⁴⁸ *Id.* at 1097.

¹⁴⁹ Donaldson & Preston, *supra* note 34, at 83.

¹⁵⁰ B. Van de Ven, *Human Rights as a Normative Basis for Stakeholder Legitimacy*, 5 CORP. GOVERNANCE 48 (2005).

¹⁵¹ See Christopher Stoney & Diana Winstanley, *Stakeholding: Confusion or Utopia? Mapping the Conceptual Terrain*, 38 J. MGMT. STUD., 603, 605–06; (2001); Lépineux, *supra* note 135, at 100.

¹⁵² Phillips, Feeman, & Wicks, *supra* note 49, at 479–80.

¹⁵³ James M. Humber, *Beyond Stockholders and Stakeholders: A Plea for Moral Autonomy*, 36 J. BUS. ETHICS 207, 215 (2002).

¹⁵⁴ MARK GOYDER, *LIVING TOMORROW'S COMPANY* 3 (Gower, 1998).

¹⁵⁵ Martin Vander Weyer, *In an Ideal World*, MANAGEMENT TODAY, Sept. 1996, at 35.

¹⁵⁶ See generally Learmount, *supra* note 134.

morally correct for corporations to be managed for stakeholders, and that means that it is inconsistent with the relativism of the theory.¹⁵⁷

We now turn to specific issues with stakeholder theory. First and foremost, stakeholder theory has been a difficult concept to define.¹⁵⁸ One of the main difficulties for the theory, in this respect, and acknowledged by stakeholder theorists,¹⁵⁹ has been in identifying and defining who are, in fact, stakeholders.¹⁶⁰ Defining stakeholders is crucial as it is the first critical step in applying the theory.¹⁶¹ Notwithstanding the volume of the literature in the field, the concept of stakeholder is seen as vague and blurred.¹⁶² The concept is probably much more indefinite today than in the early days of modern stakeholderism, because more and more scholars have attempted to devise a definition. Definitions have varied from the narrow to the very broad. It is easier to broaden the concept, but when that is done the theory becomes more and more meaningless, and, therefore, according to some, useless.¹⁶³ Professors Simon Deakin and Alan Hughes have said that if the theory is so wide as to embrace interests of a broader range of people and groups, such as potential consumers and the interests of society, then the theory risks being regarded as irrelevant.¹⁶⁴

Our discussion about who stakeholders are starts from the admission that “there is no easy way to delineate the stakeholder class.”¹⁶⁵ Probably the first articulation of the concept was provided in an internal memorandum at the Stanford Research Institute in 1963,¹⁶⁶ which said that stakeholders were “those groups without whose support the organization would cease to exist.”¹⁶⁷ This tended to be narrow and the groups covered by the term were said to be shareholders, employees, customers, suppliers, lenders, and society.¹⁶⁸ Freeman built on this, and in 1984, he opined that the term “stake-

¹⁵⁷ Humber, *supra* note 153, at 215.

¹⁵⁸ M. Omran, et al., *Shareholders Versus Stakeholders: Corporate Mission Statements and Investor Returns*, 11 BUS. ETHICS: EUR. REV. 318, 318 (2002).

¹⁵⁹ See R. Phillips, *Stakeholder Legitimacy*, 13 BUS. ETHICS Q. 25, 25 (2003).

¹⁶⁰ Mitchell, et al., *supra* note 56, at 858 (identifying 27 definitions for stakeholders); see also Leung, *supra* note 110, at 618 (demonstrating this has also been a problem with the various so-called constituency statutes in the United States).

¹⁶¹ Fassin, *supra* note 69, at 125.

¹⁶² See Otts & Strutter, *supra* note 65, at 215.

¹⁶³ *Id.* at 218.

¹⁶⁴ Simon Deakin & Alan Hughes, *Comparative Corporate Governance: An Interdisciplinary Agenda*, 24 J. L. & Soc’y 1, 4 (1997).

¹⁶⁵ Leung, *supra* note 110, at 622.

¹⁶⁶ FREEMAN, *supra* note 16, at 31.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 32.

holder” should denote those who make a difference, and defined stakeholders as “any group or individual who can affect or is affected by the achievement of the organization’s objectives.”¹⁶⁹ This broadens the category of stakeholders to include governments, customers, environmental groups, etc. The criticism often voiced is that managers are given no basis or method for identifying who are stakeholders.¹⁷⁰ Furthermore, some stakeholders are more important than others, but there is no guidance to determine who are the more important stakeholders.¹⁷¹ There are a huge number of potential stakeholders, and the problem is determining how to address the needs of divergent groups.¹⁷²

The stakeholder case has probably been harmed by the fact that Freeman included terrorist groups as stakeholders in some corporations (on the basis that they can affect how corporations are run).¹⁷³ Many have sought to distance the theory from this approach. Some commentators have said that one must distinguish between those who influence the corporation and those who are true stakeholders.¹⁷⁴ Some investors are in both categories, while some, such as the media, are in the first category only.¹⁷⁵ Other commentators distinguish between primary or inside stakeholders, on the one hand, and secondary or outside stakeholders, on the other, with the former being the focus of attention.¹⁷⁶ Primary stakeholders are seen as those who have a formal, official or contractual relationship with the corporation.¹⁷⁷ Professor John Parkinson said that stakeholders included those who entered a long-term relationship with the corporation and held legitimate expectations of mutual gain from the continuing relationship.¹⁷⁸

Several commentators have introduced other ways of defining and differentiating stakeholders. Robert Phillips referred to normative, derivative, and dormant stakeholders.¹⁷⁹ Normative stakeholders are those to whom the corporation owes a moral obligation, while derivative stakeholders are ones who can either damage or benefit the

¹⁶⁹ *Id.* at 246.

¹⁷⁰ Humber, *supra* note 153, at 211.

¹⁷¹ Anant K. Sundaram, & Andrew C. Inkpen, *The Corporate Objective Revisited*, 15 *ORG. SCI.* 350, 352 (2004).

¹⁷² Leung, *supra* note 110, at 621.

¹⁷³ FREEMAN, *supra* note 16, at 53.

¹⁷⁴ Donaldson & Preston, *supra* note 34, at 86.

¹⁷⁵ *Id.*

¹⁷⁶ Fassin, *supra* note 69, at 129.

¹⁷⁷ ARCHIE CARROLL, *BUSINESS AND SOCIETY* 62 (1993).

¹⁷⁸ John Parkinson, *Company Law and Stakeholder Governance*, in *STAKEHOLDER CAPITALISM* 149–150 (Gavin Kelly et al. eds., 1997).

¹⁷⁹ *See generally* Phillips, *supra* note 159.

corporation, and no moral obligation is owed to them.¹⁸⁰ Dormant stakeholders are groups such as terrorists who may never affect the corporation, but can do so at some indeterminate point in the life of the corporation.¹⁸¹

The main distinction, as far as stakeholders are concerned, is between those without whom the corporation cannot function and those who can affect or be affected by the corporation, with the latter being the classical and managerial approach, and the former as more of a legal view.¹⁸² The latter approach is far broader, and, given the way that trade has developed, could encompass just about anyone.¹⁸³ Technically, it is not just actors who have contact with the corporation that could be included under this approach. Parties who deal with those who contract with the corporation also could be said to be stakeholders.¹⁸⁴ For example, a corporation, X, supplies bolts to Y corporation. Y supplies engine parts to carmaker, Z corporation. X could be regarded as a stakeholder in Z, even though there is no direct contact between the two corporations. Certainly, if Y lost its business with Z, it is likely that X would be affected significantly. Stakeholders of a corporation have their own subset of stakeholders, so the net grows ever wider.¹⁸⁵ In recent research, Yves Fassin found in excess of 100 stakeholder groups and sub-groups identified in the literature.¹⁸⁶ Dr. Elaine Sternberg has said that:

[G]iven the increasing internationalisation of modern life and the global connections made possible by improved transportation, telecommunications and computing power, those affected (at least distantly or indirectly) by any given organisation, and thus counting as its stakeholders includes virtually everyone, everything, everywhere.¹⁸⁷

Whilst she might be using hyperbole, the general point has merit. For instance, taking the illustration above, Z will be at the end of a chain of trading arrangements, and all of the businesses in the chain could be regarded as stakeholders of the large corporation that might be at the end of the chain. This means that a large corporation

¹⁸⁰ *Id.*

¹⁸¹ *Id.* at 31.

¹⁸² Fassin, *supra* note 69, at 117.

¹⁸³ Metcalfe, *supra* note 39.

¹⁸⁴ Fassin, *supra* note 69, at 119.

¹⁸⁵ Phillips, *supra* note 159, at 34.

¹⁸⁶ Fassin, *supra* note 69, at 120.

¹⁸⁷ Elaine Sternberg, *Stakeholder Theory: The Defective State It's In*, in *STAKEHOLDING AND ITS CRITICS* 70, 71–72 (Will Hutton ed., 1997).

like Z might have thousands of stakeholders who are indirectly (perhaps very indirectly) affected by its actions.

Andrew Campbell, a stakeholder theorist, has effectively said that one cannot identify stakeholders in the abstract; it will depend on the corporation's purpose.¹⁸⁸ The commentator has noted that most corporations will have four active stakeholders, namely: shareholders, employees, suppliers, and customers.¹⁸⁹ These clearly fit within the primary category mentioned earlier. They are also clearly interdependent, one of the main tenets of the theory. Where a broad approach is taken to defining stakeholders, some stakeholders are not able to be regarded as part of the interdependence.¹⁹⁰ In this light, one thinks of pressure groups and terrorists where there is no real relationship with the corporation and its stakeholders, as is presumed with interdependence.¹⁹¹ According to Fassin, there is unanimity with respect to only three stakeholders: financiers, employees, and customers.¹⁹² It is assumed that shareholders are not included because the research undertaken by Fassin did not concentrate solely on corporations but took into account other forms of business. It is patent that nearly all commentators will include shareholders as stakeholders when addressing corporations. An added problem is that once one has identified who are stakeholders, some stakeholder groups are large and not homogeneous. This creates further difficulties, as we will see shortly, for directors seeking to balance interests.

A way of responding to this criticism might be to follow a suggestion by John Parkinson, that "stakeholder" should be restricted to people and groups who enter long-term cooperative relationships with the corporation.¹⁹³ This has the advantage of permitting the managers to have a better idea of knowing who are the stakeholders of the corporation, and moving away from reliance on legal rights and toward developing trust.¹⁹⁴ The problem might be in determining what a long-term cooperative relationship entails.

It has not yet been determined, and may be impossible to determine, the nature and extent of the responsibility that directors have to each stakeholder. In a similar vein, John Argenti has pointed out that it is not clear what stakeholders should expect to get out of a corporation with which they are involved.¹⁹⁵ The response typically is that

¹⁸⁸ Campbell, *supra* note 101, at 448.

¹⁸⁹ *Id.*

¹⁹⁰ Fassin, *supra* note 69, at 120.

¹⁹¹ *Id.*

¹⁹² Fassin, *supra* note 69, at 120.

¹⁹³ Parkinson, *supra* note 178, at 149.

¹⁹⁴ *Id.*

¹⁹⁵ Campbell, *supra* note 101, at 446.

this cannot be outlined in the general as it is matter for the board to specify and convey it to the stakeholders.¹⁹⁶ As far as the earnings of the corporation are concerned, there is no indication which groups will receive any benefits. Shareholder primacy theorists indicate that they are concerned that if stakeholder theory applies then directors, because they have no objective guidelines, will act in a self-interested fashion.

C. *Problem of Balancing*

The theory presupposes the fact that directors will, when making decisions and running the corporation, balance the interests of all stakeholders. This is necessary as stakeholders will often have conflicting interests, so balancing is a critical aspect of the theory. The idea of balancing interests appears to be an attractive and reasonable way of dealing with constituencies with conflicting interests. But, in fact, stakeholder management involves, in the words of adherents to the theory, “a neverending task of balancing and integrating multiple relationships and multiple objectives.”¹⁹⁷ Thus, the primary argument mounted against the stakeholder approach is that the requirement that directors have to balance the interests of all stakeholders means they are faced with an impossible task.¹⁹⁸ Even Evan and Freeman have said that the task of the managers is “akin to that of King Solomon.”¹⁹⁹ Also, and this is the concern of many, the process of balancing might lead directors to opportunism, namely benefiting themselves at the expense of others; or shirking, failing to do their job well, because directors end up accountable to no one but an amorphous group.

There are several problems directors encounter when engaging in balancing. As we have seen, potentially there are a huge number of stakeholders. The first problem for managers is ascertaining who are stakeholders that can be considered in a fair balancing of interests and claims. The second is to determine how the directors are to address the needs of divergent groups.²⁰⁰ This is akin to comparing apples and oranges. Further, directors are not always aware of what stakeholders will consider a benefit, and this is exacerbated by the fact that even within a particular stakeholder group there may be different views

¹⁹⁶ *Id.* at 448.

¹⁹⁷ R. Edward Freeman & J. McVea, *A Stakeholder Approach to Strategic Management*, in *HANDBOOK OF STRATEGIC MANAGEMENT*, 194 (M. Hitt, R. Edward Freeman & J. Harrison eds., 2001).

¹⁹⁸ *See generally* B. SHENFIELD, *COMPANY BOARDS*, Ch. 7 (George Allen & Unwin, London 1971).

¹⁹⁹ Evan & Freeman, *supra* note 39, at 314.

²⁰⁰ Leung, *supra* note 110, at 621.

and attitudes.²⁰¹ How can managers know what stakeholders consider a benefit or what they see as within their interests?²⁰² As mentioned above, groups are not marked by homogeneity, so this creates further difficulties for directors seeking to balance.

Not only is the board balancing different stakeholder groups, it may also have to balance within groups. Take creditors as an example. Corporations might have all or any of the following creditors: secured creditors, suppliers with the benefit of a retention of title clause in their supply contracts, suppliers without the benefit of such a clause, general trade creditors, suppliers under long-term contracts, lessors, holders of unexpired intellectual property licences, employees owed wages, tax authorities, tort victims with claims, and customers who have paid deposits for goods or services not yet supplied by the corporation. There is, for instance, likely to be a significant difference between the interests of a bank who is a creditor with a security interest over corporation assets, compared with an unsecured trade creditor. In considering creditor interests, what does a director do if the interests of different groups do not accord? There is going to be conflict within groups themselves, and this internecine conflict can be as difficult to resolve as the group versus group conflict.

Returning to the problem of a lack of homogeneity within the same group, we can note that often members of sub-groups might not even have the same interests. For instance, let us take the broad sub-grouping of trade creditors. These creditors are generally treated in the same way by the law, and certainly they are when it comes to a liquidation of an insolvent corporation. This sub-group might include, at one extreme, large corporations that supply significant quantities of goods to the corporation, and, at the other end of the spectrum, self-employed tradespersons, like plumbers, who do the occasional job for the corporation when it is necessary. The former type of creditors might have a turnover of many millions of dollars/pounds/euro/yen per annum and are likely to be more willing to accept the directors embracing ventures and actions that involve a greater amount of risk. The reason is that large corporation suppliers are probably not as reliant as the tradespersons, whose turnover is likely to be only in the region of thousands of dollars/pounds/euro/yen, on being paid the debt owed. While the large corporation can, in effect, gamble with its debt, tradespersons cannot. The latter would prefer to be assured of receiving, say half of what is owed, rather than seeing corporation funds used in such a way that *might* lead to full payment of the debt but could just as likely lead to no funds being left to pay creditors on liquidation. In contrast, the large corporation might be ready to approve of

²⁰¹ Letza et al., *supra* note 35, at 255

²⁰² Sternberg, *supra* note 131, at 4.

directors engaging in what is, effectively, gambling because if it does not get paid, it can still survive.

Stakeholder theorists assert that corporations need to engage with stakeholders to ascertain their interests and needs, but the practical concern is: how is this to be done, especially as managers are not going to be aware of the existence of some stakeholders when the stakeholding category is defined widely?

A third issue is: What does balancing actually entail? Does it mean embracing compromise or taking such action that enables the interests of stakeholders to coincide?²⁰³ The former might not be acceptable to many, and might leave some disenchanted, and the latter does not, for the most part, appear to be possible. In this respect, a concern for directors is to know the basis on which they are to balance interests. How do directors deal with the case where several constituencies are deserving, but it is impossible to favor them all equally? One particular problem identified by many scholars is that it is often not possible to advance the interests of non-shareholder stakeholders in conjunction with those of the shareholders.²⁰⁴ There is no specification, or even guidance, given to managers permitting them to identify the values relied on in with the stakeholding approach, and there is no indication how these are to inform their decision-making.²⁰⁵ There are no standards devised for assigning relative weight to the interests of the constituencies involved and no criteria for solving problems.²⁰⁶ Effectively, directors are presented with “standardless discretion.”²⁰⁷ This is emphasised by Ronald Mitchell who stated that the extent to which priority is given by managers to particular stakeholders whose claims are in conflict with others cannot be explained by the stakeholder framework as complex issues are involved.²⁰⁸ Michael Jensen has stated, in the context of directors having to consider all interests and to balance them: “It is logically impossible to maximize in more than one dimension at the same time.”²⁰⁹ Jensen’s concern is that there is no objective on which a manager can focus, thus leading to confusion.²¹⁰ In response to Jensen’s criticism of the theory as confus-

²⁰³ See generally BARBRA SHENFIELD, *COMPANY BOARD* 149 (George Allen & Unwin Ltd, 1971).

²⁰⁴ See Amir Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 DEL. J. CORP. L. 649, 686 n. 126 (2004).

²⁰⁵ Sundaram & Inkpen, *supra* note 171, at 353; Michael Jensen, *Value Maximisation, Stakeholder Theory, and the Corporate Objective Function*, 7 EUROPEAN FINANCIAL MANAGEMENT 297, 305 (2001).

²⁰⁶ DONALDSON, *supra* note 135, at 45.

²⁰⁷ Mitchell, *supra* note 1, at 589.

²⁰⁸ Mitchell, et al., *supra* note 56, at 854.

²⁰⁹ Jensen, *supra* note 205, at 300–301.

²¹⁰ *Id.* at 301.

ing for managers, Professor Amir Licht takes the view that Jensen is depicting managers as being unable to “walk and chew gum at the same time.”²¹¹ But, in fairness to Jensen’s point, there is little guidance, as we have seen, and even experienced managers might ask where they should start in balancing interests when difficult decisions have to be made.

John Parkinson’s view on this point is that:

There seems no reason in principle why management performance cannot be effectively evaluated by reference to multiple standards. What is required is an independent process of review that is capable of discriminating between management actions that result from incompetence or the pursuit of self-interest on the one hand, and those motivated by attempts to accommodate the legitimate interests of affected parties on the other.²¹²

However, the response from shareholder primacists would likely be that directors might be able to muddy the waters in such a way as to leave a reviewer, possibly a judge, unable to come to the view that the directors have not at least attempted to benefit one stakeholder.

The lack of direction is further exemplified by what the Supreme Court of Canada said in the recent case of *BCE Inc v 1976 Debentureholders*.²¹³ It said that there is no legal principle that one set of interests should prevail over another.²¹⁴ Then the Court said that which set prevails depends on the situation that is before the directors, and they have to use their business judgment.²¹⁵ Again, no guidance whatsoever is provided, especially concerning what weight is to be given to particular interests. Some scholars would say that judges are envisaged as the reviewers of what directors do, and it is not possible for judges to be involved in passing judgment on what directors have done, in using their commercial judgment, as judges lack, *inter alia*, competence. But this is an overly restricted opinion of the caliber of modern common law judges, many of whom specialised in commercial and/or corporate law while in practice, and, arguably, are able to grasp

²¹¹ Licht, *supra* note 204, at 731.

²¹² John Parkinson, *Models of the Company and the Employment Relationship* 41 BRIT. J. INDUS. REL. 481, 499 (2003). See also John Kay & Aubrey Silberston, *Corporate Governance* (1995) NAT’L INST. ECON. REV. 84, 93–95.

²¹³ *BCE Inc v 1976 Debentureholders*, [2008] 3 S.C.R. 560 (Can.).

²¹⁴ *Id.* at ¶ 84.

²¹⁵ *Id.*

managerial issues if assisted by suitable oral and documentary evidence.²¹⁶

It is argued that arriving at a set of values that accounts for the concerns across a heterogeneous group of stakeholders requires managers to fulfil unrealistic expectations.²¹⁷ Furthermore, as mentioned above, it is contended by many scholars that it is not in fact possible to advance the interests of non-shareholding stakeholders in conjunction with those of the shareholders.²¹⁸ To adapt what Michael Jensen has said, one cannot possibly seek to develop benefits for more than one constituent at the same time.²¹⁹ Balancing is made difficult by the fact that contracts are incomplete the constituencies of a corporation will usually have conflicting claims, and each constituency will be subject to the opportunistic actions of other constituencies.²²⁰ This complicates any decisions that the directors are to make in balancing interests.

The challenge for stakeholder theory is to specify how managers are to balance between stakeholders. A critical element for stakeholder theory is the need to satisfy legitimate expectations of all stakeholders. A vague requirement that such expectations are to be taken into account does not provide guidance, but leaves the managers none-the-wiser and, perhaps, even more confused.²²¹ Even with the best of intentions, it would be very difficult for directors to know the best interests of individual stakeholders. This is exacerbated by the fact that stakeholders in a corporation will be continually changing, and the expectations of existing ones could be revised. Added to this is the fact that a long-term approach is championed by stakeholder theory, requiring managers to look not to present interests, but to the future. This is not an easy task, particularly when one accepts that

²¹⁶ See Keay, *supra* note 89. A good example of judges who specialise are the judges of the Companies Court in the Chancery Division of the High Court of England. Another is the judges of the Chancery Court in the State of Delaware.

²¹⁷ Sundaram & Inkpen, *supra* note 171, at 353.

²¹⁸ Licht, *supra* note 204, at 686 n.126.

²¹⁹ Jensen, *supra* note 205, at 301.

²²⁰ Blair & Stout, *supra* note 43, at 276–287. The answer, according to the commentators pursuant to what they call “the team production theory,” is that the board must make the ultimate decisions in reconciling competing interests and disputes. *Id.* at 276–277.

²²¹ Jensen, *supra* note 205, at 301. Judges who have to consider this issue in relation to claims made that a company’s affairs have been conducted oppressively or in an unfairly prejudicial manner often find it onerous. See, e.g. Companies Act, 2006, 46 § 994 (U.K.); Canada Business Corporations Act, R.S.C., ch. C-44 (1985); Corporations Act, 2001, § 232 (Austral.).

stakeholders themselves are likely not to be able to articulate their long-term interests.²²²

The fact is that during the life of a corporation some stakeholders will be more important to a corporation than others. If this is so, are directors to take this into account in balancing interests? If they do they might be subject to claims of unethical conduct, but if they do not they might hamper the success of the corporation. Of course, the more stakeholder groups there are in a corporation, the more difficult it is, potentially, for directors to take all interests into account in what they propose to do.

The danger is that in some circumstances the directors are in a “no win situation” and might feel that the preferable thing to do is nothing. Kenneth Goodpaster is concerned that the stakeholder approach is likely to push “decision-making towards paralysis because of the dilemmas posed by divided loyalties and, in the final analysis, represents nothing less than the conversion of the modern private corporation into a public institution”²²³ Ultimately, this could prejudice all stakeholders.

As noted earlier, it is quite possible that a person can be a constituent of more than one stakeholder group, for instance an employee might also be a customer, and the theory fails to determine in which capacity he or she is to be included in the managers’ balancing calculation.²²⁴ Members of the same group might not agree on what is a benefit for that group,²²⁵ so how are managers in fact to make a determination? Further, directors have the dual responsibility of deciding who is a stakeholder and then implementing their decision, which leaves room for self-dealing.

It might be argued that the need to engage in balancing can exacerbate the transaction costs of corporations. However, stakeholder theorists might counter that the trust engendered between corporations and their stakeholders can reduce costs as stakeholders will not feel the need to require the same checks and balances as they would if management were pursuing a different approach.

One specific concern that writers have with balancing is where the managers are identified as stakeholders, for it is the managers

²²² SANDRA S. BERNIS, *COMPANY LAW AND GOVERNANCE: AN AUSTRALIAN PERSPECTIVE* 149 (Oxford Univ. P. 1998).

²²³ Kenneth E. Goodpaster, *Business Ethics and Stakeholder Analysis*, in *THE CORPORATION AND ITS STAKEHOLDERS: CLASSIC AND CONTEMPORARY READINGS* 115 (M. Clarkson ed., 1998).

²²⁴ Sternberg, *supra* note 131, at 4.

²²⁵ *Id.* at 5.

who will usually be required to do the balancing.²²⁶ If they have a stakeholder role, are they then not judges in their own cause? But many will regard managers as a mediating body between the stakeholder groups, rather than stakeholders per se.²²⁷ This latter approach is certainly to be preferred because they cannot take their interests into account in balancing. Of course, the sceptic might say that the managers would take their interests into account first before doing any balancing whatsoever.

While balancing seems meritorious, in practice it would be very difficult for a director, in many situations, to know what to do. The main problem is that balancing is a nebulous idea unless there is a goal that has been set for the balancing exercise. To what end is the balancing to be directed? To be effective any balancing must be done in the context of achieving an aim. The problem is that “[a]dvocates of traditional stakeholder theory . . . hand managers a theory that makes purposeful decisions impossible. And, with no way to keep score, stakeholder theory forces managers to be unaccountable for the very actions through which they were to be evaluated.”²²⁸

Another leading argument against the theory, and based on the notion that directors have to consider many interests, is that directors are given licence to do whatever they like, and that state of affairs is likely to lead to directors, as rational actors, engaging in either or both of two kinds of behavior. The first is opportunistic activity: directors taking the opportunity to benefit themselves at the expense of others. The second is shirking: not devoting their best efforts to the tasks at hand. These kinds of activity are possible because directors end up accountable to no one (known as the “too many masters” problem). Judge Frank Easterbrook and Professor Daniel Fischel have stated that “[a] manager who is told to serve two masters (a little for the equity holders, a little for the community) has been freed of both

²²⁶ See Philip Coelho et al., *The Social Responsibility of Management: A Reprise* 18 MID-AMERICAN J. OF BUS. 51, 53 (2003).

²²⁷ Lawrence. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263, 1272 (1992); see Stephen Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003); see also Ronald Colombo, *Ownership, Limited: Reconciling Traditional and Progressive Corporate Law via an Aristotelian Understanding of Ownership*, 34 J. CORP. L. 247, 249 (2008).

²²⁸ Thomas Donaldson, *The Stakeholder Revolution and the Clarkson Principles*, 12 BUS. ETHICS Q. 107 (2002); see also F. Robins, *Why Corporate Social Responsibility Should be Popularised but not Imposed*, 8 CORP. GOVERNANCE 330, 333 (2007).

and is answerable to neither. . . . Agency costs rise and social wealth falls.”²²⁹

It is likely that “[a]ll but the most egregious self-serving managerial behavior will doubtless serve the interests of *some* stakeholder constituencies and work against the interests of others”²³⁰ Hence, directors can mount a credible defence in relation to what they have done and can play off one group against another. They can claim that after balancing interests they made a decision to benefit stakeholders X and Y, and this decision just happened to benefit or protect themselves. It is difficult to impugn the decision. Professor Oliver Hart says that requiring managers to consider the interests of all constituencies “is essentially vacuous, because it allows management to justify almost any action on the grounds that it benefits some group.”²³¹ In such a system the directors are arguably given unfettered discretion that cannot be monitored. The concern is that directors will pay lip-service to the need to consider the interests of stakeholders, and then make the decision that they want, possibly based on self-interest. There is the general point that directors should not be permitted to decide what to do with corporation assets and its business based on caprice because they should be accountable for what they do with other people’s property. While it has been said that managers will be more accountable and subjected to greater monitoring if they have to take into account all stakeholders,²³² it makes sense to say that if they have a responsibility to a lot of stakeholders they virtually become accountable to no one.²³³ Consequently, one of the problems is to ascertain how one can make directors sufficiently accountable.

The riposte from the adherents of stakeholder theory might be that the view expressed in the last paragraph is too cynical, and managers, as professionals, will be concerned about their reputation and integrity and will refrain from acting opportunistically or shirking. Stakeholderism states that we have to rely upon the trustworthiness of the directors. Professors Margaret Blair and Lynn Stout, amongst others, point out there is ample evidence from behavioral theory of people acting altruistically and sacrificing selfish interests to achieve a result that benefits others, and this is consistent with ethical behav-

²²⁹ FRANK EASTERBROOK & DANIEL FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 38 (Harv. Univ. Press, 1991); see also Jensen, *supra* note 205, at 305.

²³⁰ Alexei M. Marcoux, *Balancing Act*, *CONTEMPORARY ISSUES IN BUSINESS ETHICS* 97 (J. DesJardins & J. McCall eds., 2000).

²³¹ Oliver Hart, *An Economist’s View of Fiduciary Duty*, 43 U. TORONTO L.J. 299, 303 (1993).

²³² Kent Greenfield, *A New Era for Corporate Law*, in *PAPER SERIES ON CORPORATE DESIGN*, 19, 23 (Allen White & Marjorie Kelly, eds. 2007), available at <http://www.corporation2020.org/pdfs/SummitPaperSeries.pdf> (last visited Mar. 1, 2010).

²³³ Blair, *supra* note 26, at 225.

ior.²³⁴ Under the stewardship theory, embraced by many favoring stakeholder theory or something akin to it, there is a focus on directors' need for achievement, responsibility, recognition, altruism, and respect for authority. As a result, they can be seen not as opportunistic, but as good stewards who will act in the best interests of the stakeholders.

The issue boils down to a philosophical debate. The shareholder primacy school says that you cannot trust directors because human nature is such that it will want to seek benefits at every possible turn (and you must have tight monitoring measures in place), whereas the stakeholder theory school states that while there will be some improper actions by directors, generally they will be fair, can be trusted, and will act in good faith, making them good stewards of the corporation. The latter view asserts that directors have other motives beyond self-interest including professionalism, satisfaction in performing well, and respect for authority.

Another concern is that in the United States and some other jurisdictions, such as Australia,²³⁵ directors are protected by the business judgment rule.²³⁶ In the United States the business judgments of directors are only reviewed in extraordinary circumstances²³⁷ because of the business judgment rule which might be regarded as U.S. corporate law's central doctrine,²³⁸ and pervades every aspect of corporate law in the United States.²³⁹ The rule takes the focus of the court from whether the director made the correct decision to whether the director adhered to adequate and appropriate processes that led to the decision. Consequently, it is said to provide a "safe harbor" for directors. So, American directors are entitled to rely on the business judgment rule if they can establish, in relation to the particular judgment in question, that: they exercised a business judgment (including a decision to refrain from taking action); the judgment was made in good faith for a proper purpose; they did not have a material personal interest in the subject matter of the judgment, so that there was no conflict of interest; they informed themselves about the subject matter of the judgment to the extent that they reasonably believed to be appropri-

²³⁴ Margaret Blair & Lynn. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH U. L.Q. 403, 438–39 (2001).

²³⁵ Corporations Act, 2001, c. 180(2) (Austl.).

²³⁶ See, e.g., *In re Healthco Int'l Inc.* 208 B.R. 288, 306 (Mass. 1997). See also PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: RESTATEMENT AND RECOMMENDATIONS § 4.01 (Am. Law Inst., Tentative draft No. 1 1982).

²³⁷ David Rosenberg, *Galactic Stupidity and the Business Judgment Rule*, 32 J. CORP. L. 301, 301–02 (2007).

²³⁸ See generally STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 241 (Foundation Press 2002).

²³⁹ *Id.* at 301.

ate;²⁴⁰ and they rationally believed that the judgment was in the best interests of the corporation.²⁴¹ The presumption is that the director had acted properly and it is the job of the plaintiff to rebut this presumption.²⁴² If the plaintiff can do so, then the director has to establish the fairness of the transaction that is impugned.²⁴³

The rule is designed to preserve directors' discretion and to protect the directors from courts using hindsight to find them liable. The rule provides, in a nutshell, that courts will not substitute their business judgment for that of the informed, reasonable director who acts bona fide in the best interests of the corporation,²⁴⁴ and an action will fail even if the claimant can demonstrate that the action of the directors has caused loss to the corporation, unless the director's actions do not meet the aforementioned qualities.²⁴⁵ So, a U.S. director cannot be held liable if he or she makes a bad judgment or a decision which he or she makes is unsuccessful, provided the above factors can be established on his or her behalf.²⁴⁶ In the context of our discussion, it means that in the United States if a director has acted in good faith then it will not matter whose interests have been enhanced.

While the business judgment rule does not apply in the United Kingdom, a derivation of it arguably does.²⁴⁷ The courts do not second guess what directors have done. In fact, U.K. judges have consistently

²⁴⁰ See *Cede & Co. v. Technicolor, Inc.* 634 A.2d 345, 369–70 (Del. 1993) (holding that the directors failed to reach an informed decision).

²⁴¹ PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: ANALYSIS AND RECOMMENDATIONS § 4.01 (Am. Law Inst., Tentative draft No. 1 1982). See, e.g., *Parnes v. Bally Entm't*, 722 A.2d 1243, 1246 (Del. 1999) (citing *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)); see also BAINBRIDGE, *supra* note 238, at 274–75.

²⁴² BAINBRIDGE, *supra* note 238, at 269–70 (asserting that the Business Judgment Rule is really an assumption and not a presumption in the “strict evidentiary sense” of presumption).

²⁴³ Lyman Johnson, *The Modest Business Judgment Rule*, 55 BUS. LAW. 625, 628 (2000).

²⁴⁴ See, e.g., *Spiegel v. Buntrock*, 571 A.2d 767, 774 (Del. 1990); *Moran v. Household Int'l Inc.* 500 A. 2d 1346, 1356 (Del. 1985); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); Richard Cieri et al., *The Fiduciary Duties of Directors of Financially Troubled Companies*, 3 J. BANKR. L. & PRAC. 405, 408 (1994).

²⁴⁵ David Millon, *Why Is Corporate Management Obsessed with Quarterly Earnings and What Should Be Done About It?*, 70 GEO. WASH. L. REV. 890, 903–04 (2002).

²⁴⁶ *Joy v. North*, 692 F.2d 880, 885 (2d Cir. 1982).

²⁴⁷ THE LAW COMMISSION, *COMPANY DIRECTORS: REGULATING CONFLICTS OF INTEREST AND FORMULATING A STATEMENT OF DUTIES*, 1999, LC261, at 286. See also *Company Law Review, Modern Company Law for a Competitive Economy: Developing the Framework* (DTI, 2000) at ¶ 3.69–3.70 (determining statutory statement rule would add complexity by being overly harsh in some cases and giving too much leeway in others).

refrained from reviewing business judgments made by directors,²⁴⁸ and thus they have protected directors from the use of judicial hindsight. In the United Kingdom, directors are required under section 172 of the Companies Act 2006 to act in the way that they consider, in good faith, would be most likely to promote the success of their company for the benefit of the members as a whole and in doing so they are to have regard for:

- (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 between the members of the company.²⁴⁹

The fact of the matter is that while the provision seems to be stakeholder-oriented, it is up to the directors, and not the courts, to decide what should benefit the shareholders and which of the factors listed, if any, should affect what they decide to do, provided that the directors act in good faith.²⁵⁰ Except for cases of egregiously bad behavior, it is likely to be very difficult to demonstrate that the directors have breached their duty of good faith.²⁵¹ It is very difficult, in most cases, to impugn the actions of someone who is able to state clearly that he or she believed that what was done was in the corporation's best interest. Directors normally assert that their motives were pure. Courts will be reluctant to decline to accept oral evidence from directors concerning their motives, especially because finding the existence of improper motives is relatively serious.²⁵²

²⁴⁸ Rupert Reed, *Company Directors – Collective or Functional Responsibility*, 27 CO. LAW. 170, 170 n.2 (2006).

²⁴⁹ Companies Act, 2006, 46 § 172(1) (U.K.).

²⁵⁰ Andrew Keay, *Enlightened Shareholder Value, the Reform of the Duties of Corporation Directors and the Corporate Objective*, LLOYDS MAR. & COM. L.Q. 335, 336 (2006); see generally ANDREW KEAY, *DIRECTORS' DUTIES* (Jordan Publishing 2009).

²⁵¹ PAUL DAVIES, *GOWER AND DAVIES' PRINCIPLES OF COMPANY LAW* 389 (Sweet & Maxwell 2003). See also Richard Nolan, *The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report*, 6 THEORETICAL INQUIRIES IN LAW 413, 424 (2005).

²⁵² ROBIN HOLLINGTON, *SHAREHOLDERS' RIGHTS* 51 (Sweet & Maxwell 2007).

Before closing this part of the article we must acknowledge the fact that there are responses to the concern over the issue of balancing those constituents with conflicting interests. First, it might be said that balancing is part and parcel of being a director. Some management specialists have even said that managing competing interests is a primary function of management.²⁵³ The fact that balancing diverse interests is within directors' abilities and skills is something that has been recognised as far back as 1973 by a U.K. Department of Trade and Industry Report,²⁵⁴ and by some American courts.²⁵⁵ It is not unmanageable or unreasonable for persons occupying positions like directors to make allocative decisions. Directors have been classified as fiduciaries, and society regularly requires those who are fiduciaries to make balanced decisions that can be quite difficult.²⁵⁶ Proponents of this view might point to another kind of fiduciary: the trustee. Trustees have to make investment decisions sometimes with various categories of beneficiaries in mind. This can involve weighing risk in a similar manner that is required by a director under a duty to consider creditor interests when his or her corporation is insolvent.²⁵⁷ It usually involves the steering of a middle course, whatever that might entail in a given case.

Second, although balancing might be demanding, there is evidence that directors are often seeking to balance interests in the decisions they make.²⁵⁸ A corporate reputation survey of Fortune 500 corporations (the largest listed corporations in the United States) found that satisfying the interests of one stakeholder does not automatically mean it is at the expense of other stakeholders.²⁵⁹ It might

²⁵³ H. IGOR ANSOFF, *IMPLANTING STRATEGIC MANAGEMENT* (Prentice-Hall 1984); see also Jeffrey Harrison & R. Edward Freeman, *Stakeholders, Social Responsibility and Performance: Empirical Evidence and Theoretical Perspectives*, 42 *ACAD. OF MGMT. J.* 479, 479 (1999). Management commentators have asserted that directors are in effect to act as referees between two stakeholder groups; see also MASAHIKO. AOKI, *THE CO-OPERATIVE GAME THEORY OF THE FIRM* (1984).

²⁵⁴ *Company Law Reform*, (London DTI) Cmnd. 5391 at [55]–[59].

²⁵⁵ See, e.g., *Unocal Corp. v. Mesa Petroleum Corp.*, 493 A.2d 946 (Del. 1985).

²⁵⁶ Rutherford B. Campbell, Jr., *Corporate Fiduciary Principles for the Post-Contractarian Era*, 23 *FLA. ST. UNIV. L. REV.* 561, 593 (1996).

²⁵⁷ It might be asserted, with some merit, that directors and trustees are regarded differently in a number of ways. For example, a trustee is not permitted to engage in the same amount of risk-taking as directors, whose role is partly entrepreneurial. See ANDREW KEAY, *DIRECTORS' DUTIES*, *supra* note 250, at 18–21.

²⁵⁸ It has been noted that directors do already consider the interests of various constituents. See Janet Dine, *Implementation of European Initiatives in the UK: The Role of Fiduciary Duties*, 3 *COMPANY. FIN. & INSOLVENCY L. REV.* 28, 223 (1999).

²⁵⁹ See generally Lee E. Preston & Harry J. Sapienza, *Stakeholder Management and Corporate Performance*, 19 *J. BEHAV. ECON.* 361 (1990).

be concluded that considering the interests of non-shareholding stakeholders are considered does not necessarily mean that shareholders' interests will be prejudiced. It has been found empirically, in a study of U.K. private water companies, that the requirement that directors consider customer interests as well as that of shareholders can result in "mutual benefits for different stakeholder groups with apparently conflicting economic interests."²⁶⁰ For instance, if directors take into account stakeholder interests by reviewing all available material information relating to the corporation before embarking on any actions, shareholders might well benefit in that the corporation might be spared from pursuing an inappropriate strategy. Further, in undertaking the necessary monitoring to protect stakeholder interests, directors could identify improvements in the corporation's affairs, thereby promoting overall benefits for the corporation.²⁶¹

Third, even with shareholder primacy it is necessary for directors to engage in some balancing. Shares come in different shapes and sizes, and corporations often have different kinds of shares, such as ordinary (common) and preferred, and it is incumbent on directors to balance the interests of different kinds of shareholders, so that they act fairly between them²⁶² as, on occasions, these different classes of shareholders have opposing interests.²⁶³ Some preferred shareholders may have interests that resemble those of fixed claimants, such as creditors, more than those associated with ordinary (common) shareholders.²⁶⁴ Some shareholders intend only to retain shares for a short term, while others are in for the long haul. Other shareholders hold a diversified portfolio, with their investment spread around a number of corporations, and still others might have all their investment concen-

²⁶⁰ Stuart Ogden & Robert Watson, *Corporate Performance and Stakeholder Management: Balancing Shareholder and Customer Interests in the UK Privatized Water Industry*, 42 ACAD. MGMT. J. 526, 536 (1999).

²⁶¹ Empirical evidence, obtained in a study by the Financial Times of Europe's most respected companies, found that chief executive officers were of the view that one of the features of a good company was the ability to balance the interests of stakeholder groups. Of course, most of the non-UK companies surveyed would favor a stakeholder approach to corporate governance. Eileen Scholes & David Clutterbuck, *Communication with Stakeholders: An Integrated Approach*, 31 LONG RANGE PLAN. 227, 230 (1998).

²⁶² See *Mills v. Mills*, 60 C.L.R. 150, 164 (1938); *Re BSB Holdings Ltd. (No. 2)*, [1996] 1 B.C.L.C. 155, 246-49.

²⁶³ See Morey W. McDaniel, *Bondholders and Stockholders*, 13 J. CORP. L. 205, 273 (1998); see also Campbell, *supra* note 256, at 593; Royce de R. Barondes, *Fiduciary Duties of Officers and Directors of Distressed Corporations*, 7 GEO. MASON L. REV. 45, 78 (1998).

²⁶⁴ See Jonathan R. Macey & Geoffrey P. Miller, *Corporate Stakeholders: A Contractual Perspective*, 43 U. TORONTO L.J. 401, 433 (1993).

trated in the one corporation. Notwithstanding this, no concerns are voiced about the stresses of decision-making for directors in undertaking a balancing of the interests of the various types of shareholders, nor is it argued that directors, in balancing those interests, are too burdened.

D. Unworkable

The problem that exists when there is a large and apparently untrammelled stakeholder grouping, something that underlies the material considered in the previous two sections of the article, is that the concept is unworkable. There are a huge number of potential stakeholders where large corporations are concerned, and the problem for a board is to determine how they are to address the needs of divergent groups.²⁶⁵

It has always been perceived that one of the strengths of the shareholder primacy position, certainly when compared with stakeholder theory, has been that it provides greater certainty and it is workable.²⁶⁶ In fact, one of the main arguments against the stakeholder theory is that it has problems when it comes to application—it is indecisive and imprecise. Elaine Sternberg has said that the “essential principle of stakeholder theory that corporations are accountable to *all* their stakeholders” is something that is “unworkable.”²⁶⁷

The Hampel Report, delivered in 1998 as part of the development of a corporate governance code in the United Kingdom, stated that having directors’ duties defined in:

[T]erms of the stakeholders would mean identifying all the various stakeholder groups; and deciding the extent and nature of the directors’ responsibility to each. The result would be that the directors were not effectively accountable to anyone since there would be no clear yardstick by which to judge their performance. This is a recipe neither for good governance nor for corporate success.²⁶⁸

The approach in stakeholder theory is to incorporate values as a critical aspect of the strategic management process, but the riposte from shareholder primacy advocates is: how do managers identify these values and how are they to inform decision-making?²⁶⁹ They argue that arriving at a set of values that accounts for the concerns that

²⁶⁵ Leung, *supra* note 110, at 621.

²⁶⁶ This is debatable. See Keay, *supra* note 32.

²⁶⁷ Sternberg, *supra* note 131, at 5.

²⁶⁸ ROBERT HAMPEL, FINAL REPORT OF THE COMMITTEE ON CORPORATE GOVERNANCE (1998), ¶ 1.17.

²⁶⁹ Sundaram & Inkpen, *supra* note 171, at 353.

exist across a heterogeneous group of stakeholders requires managers to fulfil unrealistic expectations.²⁷⁰

The Company Law Review Steering Group (“CLRSG”), established in 1998 to examine U.K. company law and recommend reform measures, was against stakeholder theory (it referred to it as “pluralism”)²⁷¹ because:

[I]n particular that this would impose a distributive economic role on directors in allocating the benefits and burdens of management of the company’s resources; that this role would be uncontrolled if left to directors in the form of a power or discretion; and that a similarly broad role would be imposed on the judges if the new arrangement took the form of an enforceable obligation conferring rights on all the interested parties to argue for their interests in court.²⁷²

Frederick, Davis, and Post have sought to make stakeholder theory work, and they have proposed several stages in conducting stakeholder analysis, namely: mapping stakeholder relationships, mapping stakeholder coalitions, assessing the nature of each stakeholder interest, assessing the nature of each stakeholder’s power, constructing a matrix of stakeholder priorities, and monitoring shifting coalitions.²⁷³ The problem is that this involves an extremely complicated and time-consuming enterprise which is, arguably, not an approach managers can adopt when faced with the rigours of decision-making and managing of complex corporations. Even if one can carry out what these scholars recommend, it is highly debatable whether it would facilitate the decision-making of the directors. The theory provides that directors are to be accountable to all stakeholders, but that is not possible. As we have seen earlier, what happens with large corporations which have many stakeholders is that the managers become accountable to no one;²⁷⁴ managers are able to defend allegations that they have failed to act properly by asserting that they have sought to balance stakeholder interests.

²⁷⁰ *Id.* at 353.

²⁷¹ See DEAN, *supra* note 37, at 93. Arguably pluralism differs in some respects from stakeholder theory. Dr Janice Dean states that the former implies diversity and conflict while the latter emphasises inclusivity. Nevertheless, there are many similarities.

²⁷² Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the Framework*, ¶ 2.12 (2000).

²⁷³ Gerald Vinten, *Shareholder v. Stakeholder—Is There A Governance Dilemma?*, 9 CORP. GOVERNANCE: AN INT’L REV. 36, 41 (2001) (*citing* W. FREDERICK ET AL., *BUSINESS AND SOCIETY* (McGraw-Hill 1988)).

²⁷⁴ Sternberg, *supra* note 131, at 4.

Many stakeholder theorists argue that to make stakeholder theory work it is necessary to have stakeholders represented on the board of directors, thereby providing, *inter alia*, procedural justice.²⁷⁵ As with corporations in some European states and elsewhere, it is said that employees should have director representatives on boards or works councils that have a part to play in the decision-making process. But how could one possibly have some form of representation from all stakeholders on one board? Assuming one can determine who the stakeholders in the corporation are, a difficult task as already noted, there is likely to be too many stakeholder groups, even if one applies the narrow approach to the definition of stakeholder, for all of them to be represented. In the 1970s Ralph Nader recognized the fact that it seemed to be “impossible to design a general ‘interest group’ formula which will assure all affected constituencies of large industrial corporations will be represented”²⁷⁶ In European corporations where representation occurs, many of the corporations have a two-tier board system, and representation is on the supervisory board alone, and not the management board. The supervisory board can be large and does not have to be as flexible as the management board or the one tier board used elsewhere, most notably in Anglo-American jurisdictions.

E. Stakeholders are Protected by Contract and/or Regulation

Shareholder primacy scholars argue that non-shareholding stakeholders, such as creditors and employees are, unlike shareholders, adequately protected by contract and/or statutory provisions, so managers should not manage for the benefit of these stakeholders.²⁷⁷ For instance, stakeholders can provide in the terms of the contracts which they make with the corporation that they are granted safeguards in the nature of governance rights.²⁷⁸ All of this leads to the argument that if directors are required to take the interests of such constituencies into account, the constituencies are receiving very special, preferential treatment, or “having a second bite of the apple.” Critics compare this to shareholders who have no such benefits.

Stakeholder theorists usually take issue with the general assertion that constituencies are able to protect themselves by the terms of the contracts that they make. It is acknowledged that some groups,

²⁷⁵ See, e.g., Phillips, Freeman & Wicks, *supra* note 49.

²⁷⁶ D. Gordon Smith, *The Dystopian Potential of Corporate Law*, 56 EMORY L.J. 985, 996 (2008) (citing RALPH NADER ET AL., *TAMING THE GIANT CORPORATION* 124 (1976)).

²⁷⁷ Hansmann, *supra* note 9, at 442.

²⁷⁸ G. Kelly & J. Parkinson, *The Conceptual Foundations of the Corporation: a Pluralist Approach*, in *THE POLITICAL ECONOMY OF THE CORPORATION* 118, 118 (J. Parkinson et al. eds., 2000); see also Fisch, *supra* note 32.

such as powerful creditors like banks, might acquire protection via contract, but most constituencies do not obtain protection for a number of reasons, such as lack of bargaining power, ignorance, or insufficient funds to pay necessary professional costs. In the real world it is infrequent to find contractual arrangements made by equals, and many contracts allow little room for negotiation. The result is that costs are imposed on third parties with whom the corporation does business.²⁷⁹ Stakeholder adherents point to the fact that when making contracts, many stakeholders often suffer from informational asymmetry in that the managers of corporations know far more than they do, particularly about the performance and systems of the corporation. Also, it is widely reported that the kinds of contracts we are considering are incomplete.²⁸⁰ This means that there are gaps in the terms and the parties have not envisioned future events.

Besides being protected by contract, shareholder primacists submit that non-shareholding stakeholders are also safeguarded by regulatory law, such as employment and consumer laws.²⁸¹ Stakeholder theorists usually respond that this is too broad an assertion, as many laws are of limited or no benefit to stakeholders.²⁸² Even if they are, stakeholders have to take the initiative to inform regulatory authorities, or take civil action themselves. This involves a significant time/cost factor.

F. Enforcement

Adolf Berle observed that if one abandons the focus on shareholder primacy there needs to be a clear and reasonably enforceable scheme put in its place.²⁸³ Enforcing the stakeholder approach has, as recognised as far back as the 1930s, significant problems in implementation.²⁸⁴ Berle was of the view that running corporations for many constituencies was attractive, but he could not determine how it could be done.²⁸⁵ He could not see how corporations could be run for stakeholders, and so that is why he regarded shareholder primacy as the way forward.²⁸⁶ It was a scheme that allowed for the control of directors and shareholders.²⁸⁷ Even E. Merrick Dodd, a proponent of an

²⁷⁹ Easterbrook & Fischel, *supra* note 126, at 1156.

²⁸⁰ Fisch, *supra* note 32.

²⁸¹ Dodd, *supra* note 111, at 195.

²⁸² *Id.* at 194.

²⁸³ A. A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932).

²⁸⁴ *E.g.*, Dodd, *supra* note 111, at 199.

²⁸⁵ *See* Berle, *supra* note 283, at 1368.

²⁸⁶ *Id.*

²⁸⁷ *Id.*

early version of stakeholder theory, acknowledged that there were significant problems in implementation of a stakeholder approach to corporate governance.²⁸⁸

Another major problem is enforcing any breach of a stakeholder approach.²⁸⁹ Do you give the power to anyone who is a stakeholder to bring proceedings where there is a breach of duty? Are legal proceedings appropriate? The leading problem in this area is that the breach will usually be perpetrated by one or more directors and it will hurt the corporation.²⁹⁰ It is trite law across jurisdictions that only the corporation can enforce any harm done to it.²⁹¹ As the directors manage the corporation and have the power to decide whether or not legal proceedings should be initiated on the part of the corporation, if they have breached their duties they are unlikely to sanction proceeding against themselves. In most Anglo-American jurisdictions there is legislative²⁹² and/or judicial authority that permits shareholders to take derivative proceedings against the directors and/or other miscreants who have damaged the corporation in order to obtain a judgment in favour of the corporation.²⁹³ But, derivative proceedings will not help most stakeholders as the only ones who can bring such proceedings, for the most part, are the shareholders.²⁹⁴ Except where they can see some benefit for them in due course, or they are members of other stakeholder groups, shareholders, as rational economic actors, are not likely to be inclined to embark on litigation (which opens them up to a costs order in most jurisdictions).²⁹⁵

²⁸⁸ Dodd, *supra* note 111, at 205.

²⁸⁹ *Id.* at 197.

²⁹⁰ *Id.*

²⁹¹ *Id.*

²⁹² See, e.g., Canada Business Corporations Act, R.S.C., ch. 239 (1985); Corporations Act, 2001, c. 236 (Austl.); Singapore Companies Act, § 216A; New Zealand Companies Act 1993, No. 105, § 165; Hong Kong Companies Ordinance, (2005) Cap. 32, § 168BC. (H.K.).

²⁹³ For examples from the United States, see, e.g., *Kusner v. First Pa. Corp.*, 395 F. Supp. 276, 280–81 (E.D. Pa. 1975); *Dorfman v. Chem. Bank*, 56 F.R.D. 363, 364–65 (S.D. N.Y. 1972).

²⁹⁴ *But see* Canada Business Corporations Act, R.S.C., ch. 238(d) (1985) (including, amongst those who may make applications, “any other person who, in the discretion of a court, is a proper person to make an application.”); Singapore Companies Act, § 216A(1)(c) (providing that the range of persons who can apply for a derivative action includes “any other person who, in the discretion of the Court, is a proper person.”). For further discussion of this issue, see Keay, *supra* note 89.

²⁹⁵ Shareholders are rarely going to take action to protect other stakeholders. It is rare to see activist shareholders succeeding with large corporations. But recently some BP shareholders have done this in relation to the company’s investment in Canada’s oil sands. See Robin Pagnamenta, *BP Faces Protest at Oil Sands Devel-*

John Parkinson recognized the enforcement problem when he said that placing a duty on directors to balance conflicting interests would:

[P]resent the courts with a near-impossible task . . . not only would the court need to assess the likely impact on each group of a contested business policy, in both the short and the long term, but also it would have to evaluate the policy in accordance with a theory which stipulated when one set of interests should prevail over the others.²⁹⁶

Even if there were proceedings that could be taken by a stakeholder, it would be hard to assess if the interests of some stakeholders have been prejudiced, and then it may well be difficult to quantify the extent of the loss, so any proceedings could, arguably, only lead to an award for the corporation, as at present.²⁹⁷

G. *Wrong View on Accountability*

Elaine Sternberg argues that the stakeholder theory is confused when it comes to the issue of accountability.²⁹⁸ She asserts that a corporation cannot be accountable to all people, groups, or things that are related in some way, even if obscurely; and while it may be said that a corporation should respond to so-called stakeholders such as employees or suppliers, this does not mean that it is accountable to them, except where there is some contractual (or legislative) provision requiring it in some form or another.²⁹⁹ Further, those whose cooperation is sought by a corporation cannot expect the corporation to account to them.³⁰⁰ If they are not content with what the managers are doing then they have the option of withdrawing their cooperation.³⁰¹

opment, THE TIMES, Feb. 7, 2010, available at http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article7018483.ece.

²⁹⁶ J.E. PARKINSON, CORPORATE POWER AND RESPONSIBILITY 86 (1993).

²⁹⁷ Gregory Scott Crespi, *Redefining the Fiduciary Duties of Corporate Directors in Accordance with the Team Production Model of Corporate Governance*, 36 CREIGHTON L. REV. 623, 637–41(2003) (attempting to explain how a court might go about determining whether a stakeholder had been injured by the decision-making of the directors, and, if so, to what extent. But, with respect, the process with which a court would be faced, if the learned commentator's explanation were applied, is extremely complex. Crespi seemed to acknowledge this problem later in the article in which his views were asserted as he states that any obligation on a director in relation to stakeholder interests would have to be an aspirational norm rather than a legal directive.).

²⁹⁸ STERNBERG, *supra* note 82, at 50.

²⁹⁹ Sternberg, *supra* note 131, at 7.

³⁰⁰ *Id.*

³⁰¹ *Id.*

One response might be that most stakeholders will not be in a position to withdraw their involvement in the corporation. For instance, employees whose skills are inextricably related to what the corporation does and not easily transferable elsewhere, and suppliers who are bound to provide goods or services for a prescribed period of time are instances of stakeholders who cannot end their cooperation in the short term.

H. Fairness

The value of fairness is often highlighted as an element of stakeholder theory.³⁰² But, it is argued by some contractarians that favoring non-shareholding stakeholders when they do not have contractual rights to warrant such favor involves an unfair and illegitimate transfer of value and comes at the expense of the shareholders.³⁰³ It is contended that employing stakeholder theory ignores the free choice that was made to set up the corporation;³⁰⁴ the establishment of the corporation was engineered by the shareholders, and they expected the corporation to be their investment. When contracting, stakeholders are able to “price up” their provision of resources and so protect themselves while shareholders cannot do so.³⁰⁵

It has also been argued that stakeholders are not as vulnerable as they are often painted to be, so taking into account their interests means that they are unfairly advantaged.³⁰⁶ It is asserted that non-shareholding stakeholders do not invest all of their resources in the corporation at the one time, but incrementally, so if their expectations are not met or the bargain they struck is not honored, they can withdraw their investment without substantial loss.³⁰⁷

Another issue of fairness that is relevant is that it is contended that corporations who wish to engage in stakeholderism are not able to treat all stakeholders equally.³⁰⁸ It is acknowledged by stakeholder theory that there will have to be, on occasions, partiality shown. It might be said that this, therefore, constitutes unfairness, given that many regard the theory to be based on Kantian notions of equality.³⁰⁹

³⁰² Millon, *supra* note 97, at 1.

³⁰³ *Id.*

³⁰⁴ Timothy L. Fort, *The Corporation as Mediating Institution: An Efficacious Synthesis of Stakeholder Theory and Corporate Constituency Statutes*, 73 NOTRE DAME L. REV. 173, 187 (1998).

³⁰⁵ Alexei M. Marcoux, *A Fiduciary Argument Against Stakeholder Theory*, 13 BUS. ETHICS Q. 1, 17 (2003).

³⁰⁶ *Id.*

³⁰⁷ *Id.*

³⁰⁸ *Id.* at 5 and 19.

³⁰⁹ Fort, *supra* note 304, at 184.

It is always possible that managers could, in purporting to implement stakeholder theory, choose to favor constituencies which have the best bargaining strength or political clout, thus furthering their own interests, and if they did so it would clearly be a breach of the value of fairness.

I. Inefficient

It has been submitted that if those (the shareholders) who do not receive the marginal gains from the corporation's endeavor are not influencing decision-making, the corporation's wealth will not be maximized and, therefore, those involved in the corporation will not benefit.³¹⁰ The reason for this is that if stakeholders' interests are to be taken into account then the directors will have to enter into only those ventures which will satisfy these interests. It is likely that these sorts of ventures will be, generally, low risk as it is not in the interests of creditors, employees, and others with fixed interests that the corporation embarks on projects that might produce huge benefits, but are of high risk.³¹¹ This is because most non-shareholding stakeholders will not benefit from any great successes of the corporation, but will lose significantly if the risky action fails and the corporation becomes insolvent. It might be contended that limiting the corporation to low risk activity could stifle the corporation's opportunities for higher returns, and the corporation's resources are not being used efficiently. This might curtail social wealth.

J. Vagueness in Promises to Stakeholders

Some assert that directors are obliged to consider stakeholder interests in order to fulfil implied promises made to stakeholders.³¹² This assertion suffers from the same or similar problems as it does in relation to shareholder primacy theory.³¹³ No such promises are generally ever made to stakeholders, and no contract exists between the managers and the stakeholders; any contracts are between the corporation and the stakeholders.³¹⁴ There is no indication as to the sub-

³¹⁰ EASTERBROOK & FISCHER, *supra* note 229, at 69.

³¹¹ See Jensen & Meckling, *supra* note 84, at 348–49 (discussing how shareholders at times may support the taking of excessive risk at the direct expense of other stakeholders, particularly creditors, in the hope of realising higher returns, and in the process running the risk of betting the company away (i.e. the asset substitution problem)); see also Clifford W. Smith & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117, 119 (1979).

³¹² See Keay, *supra* note 32, at 27–28.

³¹³ *Id.* at 44.

³¹⁴ Of course, the directors could make a contract with stakeholders on behalf of the company.

stance of the promise. For many stakeholders it would be impossible to establish what directors are to do in relation to them and their interests, and what interests they are to consider and favor. Take the community for instance. As Eugene Schlossberger has stated, “[T]he ways in which a company should be sensitive to the needs of its community are complex, flexible, subtle and changing characteristics ill-suited to a contract.”³¹⁵ The body of creditors is one of the few stakeholder groups that might secure promises from management. In agreeing to provide funds or credit, creditors might elicit a promise that directors will engage in certain kinds of contact or refrain from engaging in others.

Finally, rather than relying on particular promises, some theorists rely upon the fact that managers should consider stakeholder interests out of benevolence.³¹⁶

VI. CONCLUSION

Stakeholder theory is a theory that determines what should be the aim of the large public corporation. After explaining what the theory is, this article has sought to analyze the reasons given for theory, as well as the arguments that have been raised against it. Stakeholder theory purports to bring economics and ethics together, and to ensure that the interests of all stakeholders are taken into account by managers when deciding what action should be taken by the corporation. Importantly, stakeholders are not to be seen as the means by which managers maximize the wealth of shareholders; considering stakeholder interests and benefiting such groups should be seen as an end in itself.

One of the major disagreements between the two leading theories that seek to determine what the corporate objective is relates to the issue of whether the managers can or cannot be trusted. Can they be trusted to seek the betterment of the constituencies notwithstanding a lack of certainty in how they are to operate? The stakeholder theory relies on the professionalism and trustworthiness of the directors, while the shareholder primacy theory does not accept this as a relevant element as it assumes that directors will act opportunistically or shirk.

It might be argued that implementation is a problem for stakeholder theory even leaving director opportunism and shirking aside. Directors who want to act honorably and properly would have difficulty in some situations knowing what to do. For instance, what if a course of action will benefit constituencies A, B, and C, but not D and

³¹⁵ Eugene Schlossberger, *A New Model of Business: Dual-Investor Theory*, 4 BUS. ETHICS Q. 459, 463 (1994).

³¹⁶ *Id.* at 462.

E? Another equally efficient course of action will benefit constituencies A, D and E, but not B and C. What does the director do? How do the directors decide which of the two actions should be taken? They cannot benefit all groups, and they have no real guidance as to which action they should take. Should they, therefore, take no action at all? Conceivably, inertia could damage all constituencies.

The stakeholder model is attractive to many people and groups. It emphasises values like trust and fairness, but it has, recognised as far back as the 1930s,³¹⁷ significant problems regarding clarity and implementation. Adolf Berle was of the view that running corporations for many constituencies was appealing, but he could not determine how it could be done.

The fact is, stakeholder theory has a lot of adherents and continues to have influence outside of stakeholder oriented jurisdictions, but, as with many models, it has substantial difficulties. Chief among these are: its failure to define who are stakeholders of a corporation; an inability to explain critical aspects of the theory, such as how directors are to balance the interests of stakeholders; its lack of clarity; a failure to articulate how the theory would work; the fact that it struggles to provide a normative basis; and it has not laid down a convincing answer to how the theory can be enforced. Arguably, shareholder primacy is not as attractive from a normative perspective, although it might be regarded as more pragmatic and workable. While stakeholder theory has attractions, normatively speaking, it is not practical, and it has been argued³¹⁸ that stakeholder theory, while solving the problem of shareholder opportunism,³¹⁹ leads to a more serious problem of stakeholder opportunism, which can cause corporations to pay a higher cost for public equity capital,³²⁰ because investors are concerned about protecting their investment from rent-seeking by stakeholders.

So, there are significant points that favor the idea that directors should balance the interests of all stakeholders. However, it is submitted that they are outweighed by the many problems that are caused by endeavoring to strike a balance between interests. Clearly, most commentators, whatever view they take, accept that the balancing of stakeholder interests is a tricky issue. It means that directors

³¹⁷ Dodd, *supra* note 111, at 199.

³¹⁸ Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1440 (2006).

³¹⁹ See Jensen & Meckling, *supra* note 84, at 348 (discussing how shareholders choose to take excessive risk at the direct expense of creditors in the hope of realising higher returns, and in the process run the risk of betting the company away (i.e. the asset substitution problem)).

³²⁰ Smith, *supra* note 276, at 1008.

have to solve what some commentators see as impossible conflicts of interests.³²¹ The conclusion of this article is that stakeholder theory does not have what it takes to be the objective of public corporations. So, if stakeholder theory is lacking, what is the alternative? Many would say that it is shareholder primacy, but there are clearly some convincing arguments that can be mounted against its employment,³²² and consequently there needs to be some further thinking about other viable alternatives.³²³

³²¹ There are many American commentators who take this view. See, e.g., Jonathon R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 31 (1991); Vladimir Jelisavcic, *A Safe Harbour Proposal to Define the Limits of Directors' Fiduciary Duty to Creditors in the "Vicinity of Insolvency:" Credit Lyonnais V. Pathe*, 17 J. CORP. LAW 145, 148 (1992); Norwood P. Beveridge, Jr., *Does a Corporation's Board of Directors Owe a Fiduciary Duty to its Creditors?*, 25 ST MARY'S L.J. 589, 621 (1994); see also *Royal Bank of Canada v. First Pioneer Inv. Ltd.*, [1979] 27 O.R.2d 352, 354 (Can.).

³²² See Keay, *supra* note 32.

³²³ See Andrew Keay, *Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model*, 71 MOD. L. REV. 663 (2008) (describing one such alternative).

FOREWORD

Daniel T. Murphy

This year's annual symposium sponsored by the *Richmond Journal of Global Law and Business* is titled "A Collision of Authority: The U.S. Constitution and Universal Jurisdiction." During the symposium spirited presentations were given by three extremely prominent constitutional law and international law scholars: Dean Erwin Chemerinsky, Professor Mary Ellen O'Connell, and Professor Jeremy Rabkin.¹

The doctrine of universal jurisdiction, or the universality principle, is an international law principle supporting a nation state's authority to enact laws asserting criminal jurisdiction over certain conduct when the more usual bases supporting the assertion of jurisdiction are not present. Normally a state regulates or punishes conduct on the basis that the actor or the victim is one of its nationals or when the conduct takes place within its territory or its effects are felt there. The universality principle is generally used to support the assertion of jurisdiction over conduct such as piracy, genocide, or war crimes.² The notion is that such conduct is an affront to humanity in general and that thus any nation state has the right to punish such conduct. The principle thus would support a state's right to enact a statute punishing genocide even though the conduct took place outside of its territory, and neither the victims nor the perpetrators were its nationals.³

¹ Dean Erwin Chemerinsky, School of Law, University of California, Irvine; Professor Mary Ellen O'Connell, Robert & Marion Short Professor of Law and Research Professor of International Dispute Resolution, Law School, Notre Dame University; Professor Jeremy A. Rabkin, School of Law, George Mason University.

² The universality principle itself is not a law or statute punishing such conduct. It is the international law doctrine supporting a nation state's specific statute punishing such conduct. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES §404 (1986); MALCOLM SHAW, INTERNATIONAL LAW 668 (6th ed. 2008).

³ See The Genocide Convention Implementation (Proxmire) Act of 1987, 18 U.S.C. § 1091 (2009). The jurisdictional provision of the Proxmire Act was amended, effective December, 2009, to read as follows:

- (e) Jurisdiction. – There is jurisdiction over the offenses described in subsections (a), (c) and (d) if -
 - (1) the offense is committed in whole or in part in within the United States; or
 - (2) regardless of where the offense is committed, the alleged offender is –

The focus of the discussion during the symposium was on the application of the universality doctrine to conduct of the United States in the post 9/11 era.

Professor O'Connell centered her remarks on choice of law issues. She clearly explained the international law distinctions among the laws applicable within a country during a period of international armed conflict, a period of armed but not international conflict, and peacetime. In her view there is no conflict between the Constitution and the principle of universal jurisdiction. As an example of universal jurisdiction she noted that a provision common to all four of the Geneva conventions⁴ requires signatory states to investigate and prosecute grave breaches of the conventions including among such breaches willful killing, torture, and unlawful confinement of persons protected under the conventions.⁵ The conflict of law rules determine the proper

-
- (A) a national of the United States . . . ;
 - (B) an alien lawfully admitted for permanent residence in the United States . . . ;
 - (C) a stateless person whose habitual residence is in the United States; or
 - (D) present in the United States.

18 U.S.C. § 1091(e). Prior to 2007 the Act only applied to conduct taking place in the United States or to conduct of a U.S. national. *See* Genocide Convention Implementation (Proxmire) Act of 1987, 18 U.S.C. § 1091(d) (2002). In 2007 a new subsection (d)(5) was added to the statute providing that “after the conduct required for the offense occurs, the alleged offender is brought into, or found in, the United States, even if that conduct occurred outside the United States.” *See* Genocide Convention Implementation (Proxmire) Act of 1987, 18 U.S.C. § 1091(d)(5) (2007). The 2009 amendments deleted former subsection (d) and added a new subsection (d) criminalizing attempts and conspiracies to commit the covered offenses and added the new subsection (e) which clarifies the jurisdictional reach of the Act. *See* Genocide Convention Implementation (Proxmire) Act of 1987, 18 U.S.C. § 1091(d), (e) (2009).

Subsection (e)(2)(D) clearly seems to be based on the universality principle. It would allow criminal prosecution of a non-US national for conduct perpetrated outside the United States so long as the person was present in the United States. The language of that subsection is interesting to consider in relation to the Supreme Court's extraordinarily generous deference to governmental conduct in obtaining personal jurisdiction over a defendant in the *Alvarez-Machain* case. *United States v. Alvarez-Machain*, 504 U.S. 655 (1992). *See generally* STEVEN R. RATNER, JASON S. ABRAMS & JAMES L. BISHOFF, ACCOUNTABILITY FOR HUMAN RIGHTS ATROCITIES IN INTERNATIONAL LAW (3d ed. 2009) (discussing state jurisdiction over crimes of genocide).

⁴ *See, e.g.*, Geneva Convention Relative to the Protection of Civilian Persons in Time of War, art. 146 & 147, Aug. 12, 1949, 6 U.S.T. 3516, 75 U.N.T.S. 287 [hereinafter Geneva IV].

⁵ The conventions actually first call upon the signatory countries to enact laws criminalizing such conduct. Geneva IV, *supra* note 4, at art. 146. There is an

law to be applied. She maintained that during an international armed conflict the conventions apply to the conduct covered by them to the exclusion of any other law. Since all nations of the world are signatories to these conventions, it is appropriate that statutes in other countries provide for the prosecution of those responsible for the infamous “torture memos” or the rendition of individuals to the custody of governmental agents of countries where they will be tortured. There is nothing in the Constitution inconsistent with another nation’s assertion of jurisdiction in such cases. Her remarks lead easily into those of Dean Chemerinsky.

In Dean Chemerinsky’s view, the notion of the principle of universal jurisdiction and statutes based on it have been part of our constitutional tradition from the earliest days of republic. The Alien Tort Statute,⁶ which is part of the Judiciary Act of 1789,⁷ was given as an example of this sensitivity to international matters. Throughout our history, in times of national distress the Constitution has not always provided the promised protections to its citizens, and correspondingly government officials have been allowed to act in ways inconsistent with those protections. While this is not a new phenomenon⁸, the government’s conduct in the post 9/11 era has certainly provided ample evidence of these deficiencies. In his view, the government’s creation of the class of individuals known as “enemy combatants,” who the government claimed can be detained indefinitely and whose status is not reviewable in any court, created a legal “black hole,” and in this hole the enemy combatants were thrown. Of course, the Supreme Court has reversed many of the government’s positions.⁹ But he argued that nonetheless universal jurisdiction and the possibility that actions of our government agents engaged in conduct amounting to gross abuse of human rights may be reviewable and punished under the criminal law of other nations provides a necessary check on the government’s

argument that statutes enacted by a nation state with respect to punishment of breaches of the law of war are not enacted under the support of the universality principle, but rather they are supported by the treaty and the mutual consent of the treaty signatories. IAN BROWNLIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW* 306 (7th ed. 2008).

⁶ “The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.” 28 U.S.C. §1350.

⁷ Act of Sept. 24, 1789, 1 Stat. 73.

⁸ Among these times of crisis he noted the internment of citizens of Japanese ancestry during the second world war, *Korematsu v. United States*, 323 U.S. 214 (1944), and the excesses of the McCarthy era *United States, Dennis v. United States*, 341 U.S. 494 (1951).

⁹ See, e.g., *Hamdan v. Rumsfeld*, 548 U.S. 557 (2006); *Hamdi v. Rumsfeld*, 542 U.S. 507 (2004).

tendency to overreact. It is also the means by which the “rule of law” in times of national emergency will prevail.

Professor Rabkin’s presentation was a forceful rejection of Dean Chemerinsky’s and Professor O’Connell’s positions. In his view, reference to the principle of universal jurisdiction is not a long-standing part of our constitutional tradition. In his view, the constitutional power of Congress “to define and punish Piracies and Felonies committed on the high seas and Offenses against the Law of Nations”¹⁰ is not an authorization to enact a statute supported by universal jurisdiction. In his view, the framers in drafting the quoted section of the Constitution had in mind piracies and other offenses on the high seas committed by or against US citizens or their property and offenses against the law of nations committed in the United States.¹¹ Moreover, in his view, the universality principle gloss placed on the Alien Tort Statute is of recent vintage, first manifesting itself in the Second Circuit’s 1980 opinion in the *Filartiga*¹² case. He noted that nations with different sensibilities and cultures may very well have differing interpretations as to what constitutes the grievous offenses punishable as war crimes, etc. and certainly will require different elements of proof of the offense. To allow courts in other countries to judge the legitimacy of decisions taken by government officials here is thought to be inconsistent with the Constitution, and the notion of constitutionalism in general, because it undermines the ability of the courts where the action is taken or whose nationals are involved, and thus have the greatest interest in the matter, to determine for themselves legitimacy of the action. As a

¹⁰ U.S. CONST., art. I § 8 cl. 10.

¹¹ See generally Eugene Kantorovich, *Symposium: Public International Law and Economics: The Inefficiency of Universal Jurisdiction*, 2008 ILL. L. REV. 389 (2008); Eugene Kantorovich, *The Piracy Analogy: Modern Universal Jurisdiction’s Hollow Foundation*, 45 HARV. INT’L L.J. 183 (2004). The Alien Tort Statute was enacted in part in response to assaults in Philadelphia and New York City on foreign diplomats. *Respublica v. DeLongchamps*, 1 U.S. 111 (1784); see generally *Sosa v. Alvarez-Machain*, 542 U.S. 692, 716-717 (2004).

¹² *Filartiga v. Pena-Irala*, 630 F.2d 876 (2d Cir. 1980); see also *Kadic v. Karadzic*, 70 F.3d 232 (2d Cir. 1995); *Abebe-Jira v. Negewo*, 72 F.3d 844 (11th Cir. 1996). Judge Friendly of the Second Circuit has referred to the Alien Tort Act as a “legal Lohengrin” noting that “no one seems to know whence it came.” *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1015 (2d Cir. 1975). See Justice Souter’s lengthy exposition of the historical background of the ATA in *Sosa v. Alvarez-Machain*, 542 U.S. 692, 712–21 (2004).

consequence the doctrine is destabilizing, and instead of contributing to the “rule of law,” it works to undermine that rule.

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**A COLLISION OF AUTHORITY:
THE U.S. CONSTITUTION AND UNIVERSAL
JURISDICTION**

Remarks by

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INTRODUCTION

Parker Clote, Symposium Chair, 2009-10: Good Afternoon. Thank you all for coming. I think we are about ready to start. Again thanks everyone for coming to the Volume Nine Symposium – A Collision of Authority: The U.S. Constitution and Universal Jurisdiction. I would like to thank our distinguished panel for coming, some of whom have come a long way, and I would like to thank Dean Kristine Henderson for her help, and Professor Jack Preis for being our moderator, and also my ad hoc committee. You all did great work. Unfortunately, our fourth panelist Dr. Anthony Arend is unable to be here today due to an illness in the family. We wish him well. As for our panelists: Erwin Chemerinsky is the Dean of UC Irving. He is the inaugural Dean. He spent most of his time at Duke Law and USC. His list of publications

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is as voluminous as it is distinguished, and I think he has helped more than one of us through a Con Law exam. Professor Mary Ellen O'Connell is here from Notre Dame Law. She is an authority in the international community, in international law, and in the law of war. She also graduated from Northwestern undergrad, and spent time in the London School of Economics and Cambridge, and she earned her J.D. from Columbia. She is a member of the American Society of International Law, the German Society of International Law, and the Council of Foreign Relations. Our last panelist is professor Jeremy Rabkin. He is a professor of law at George Mason University, and he spent over twenty years at Cornell as a political science professor. We are very honored to have them all here today, and I hope that you enjoy the presentation.

Professor Jack Preis, University of Richmond School of Law: Welcome, I'm Jack Preis. I'm going to very briefly set the stage. The issue today really has many facets, and I'll start it with something very simple. Really the centerpiece is courts. The governments create courts, and the governments tell these courts what to do.

So the government in Germany might create a court system in Germany, and they might say if there are a bunch of slip and falls on the streets of Munich, we want you to resolve these disputes, very simple right? That is the type of judicial power we are very familiar with. What if we change the facts a little bit, and Germany says to its' court, "We want you to resolve disputes where the defendant is not a German, where the plaintiff or the victim is not a German, where the events did not occur in Germany, and where neither the defendant nor the victim is any longer near Germany." That starts to sound a little bit different. The German's power to resolve that type of dispute, if it exists at all, and that's one of the issues we'll be talking about today, if that power exists at all, it would be a power that derives from a doctrine known as universal jurisdiction.

Under this doctrine, courts of a particular sovereign are empowered to resolve what are commonly called "crimes against humanity" in their own domestic courts. You might think of it this way: crimes against humanity under this doctrine can be tried anywhere humanity resides, and humanity resides everywhere there is a country in a sense, right? So every country is competent to resolve this type of dispute. A quick example could be, what if Germany decides to prosecute Eric Holder for mistreatment of Iraqis that occurred on a CIA base in Turkey? Nothing has to do with Germany except the court itself. What do we think of that?

So today we are going to talk about these issues, and there are a couple different facets that arise which our panelists will have a variety of things to say. One issue that might come up is just power it-

self. Where does this German court actually get the power to declare for all the world what Eric Holder should and should not do? Another issue is the nature of the wrongs that can be addressed through courts exerting international jurisdiction. What if Germany's view of torture is out of step with the rest of the world's view? What if Eric Holder's view on torture is out of step with the rest of the world? A third view might be instrumental – is a court, particularly a court in Germany, far removed from the dispute itself, the right place to resolve difficult issues of international politics? Are the restrictions of the judicial system fit, and maybe even further, might it be that local governments can always resolve their own problems? Is the American government competent to resolve problems with Eric Holder? Maybe so. So why do we need Germany? Well, that's all I'll say as a way to set the stage because we have some people who have studied this in much more detail than I have, and we are happy to have them. The way this will work is they will speak for approximately ten to twenty minutes each depending on the points they'd like to make. We'll probably have to return here and there for some responses, but we look forward to hearing your questions as well. Thank you very much. Professor O'Connell, please begin.

O'CONNELL COMMENTARY

Professor Mary O'Connell: Well, it's a great pleasure to be here back on your beautiful campus where my niece, Libby Gragg is a senior. And it's also very satisfying to be a part of another important discussion on these issues. And I'm really grateful to Parker Clote that he has organized this event, and I am looking forward to participating in it with all of you.

Despite the provocative title of our panel today, "Collision of Authority: The US Constitution and Universal Jurisdiction," I'm going to try to persuade you that the fundamental issue here is not very controversial, and that it is in fact quite straightforward. We have a very good set of rules to determine when courts should decide which legal issues, the kind of legal issues that Professor Preis just mentioned. The law spells this out, and if we follow the law, we really do avoid some of the very egregious controversies that have arisen since 9/11. So let me make some preliminary remarks to show you, to at least begin this attempt to show you, that there is straightforward law governing conflicts of jurisdiction, governing when courts should take jurisdiction in which kinds of cases and which courts. So for example, we of course are dealing with these kinds of overlapping jurisdictional questions all the time. In the United States we have a federal system so there are overlapping jurisdictional questions, controversies, or collisions of authority between our local governments, our local courts, municipal courts, state courts, federal courts, and then of course also

we live in a global world in which many of us are travelling, doing business, serving in the armed forces outside of the United States and that is when other courts come in to play.

But international law has a way for sorting out these overlapping jurisdictional issues, for helping us understand both international law and our own domestic law, for sorting out these kinds of conflicts, and I think it's really rather straight forward. So I'll give a very common example before I go into the cases that I think are of the greatest interest to us today, the post 9/11 cases, as they are now known, and maybe this will make the rest of the discussion a little easier. So let's say that we have an Indiana farmer where I'm from, South Bend, Indiana, and he is selling corn to a French manufacturer of biofuels. So this is an international contract for the sale of goods. In this kind of case, if the parties come to a dispute, the law governing that dispute, governing the contract, will either be the law of the place of the greatest contact to the contract. International law allows any of these three choices of law to sort out which law should govern this contract. We have to use international law to sort out conflicts or potential conflicts of legal authority or legal jurisdiction to sort out these conflicts of legal authority or legal jurisdiction because we have persons of more than one country involved here, the U.S. and France in my little hypothetical. If the French party decides to sue in the United States under the contract, which of course international law would allow, a second set of U.S. rules governing our court system that come into play, and in particular, U.S. Constitutional rules or civil procedure rules about the authority of our courts to take jurisdiction in such a dispute, and they have to look to such issues as whether there are sufficient ties to the U.S. court to hear cases of that kind or *forum non conveniens* issues etc.

On 9/11, attacks were carried out in this country by non-Americans resulting in the deaths of 3000 people and of course considerable destruction of property. Within days of those attacks, the United Nations Security Council found that the attacks had triggered the U.S.'s legal right under the United Nations charter to act in self-defense. By October 7, 2001, the U.S. and the United Kingdom had determined that Afghanistan was responsible under international law, and in particular under the International Rules of State Responsibility for violations of international law, that Afghanistan was responsible for the 9/11 attacks because of the close ties between Afghanistan's then government under Mullah Omar and his Taliban colleagues and the actual 9/11 perpetrators, members of Al-Qaida. The United States and the United Kingdom then acted on their right of self-defense and attacked Afghanistan. When they did so, and upon engagement by Afghan forces, international law made clear- makes clear- that the general peacetime law prevailing in Afghanistan, the law governing

acts of violence, like criminal law, was moved out of the legal system and the international law of armed conflict then became the prevailing law in the conflict zone.

The international law of armed conflict is found in a variety of treaties, many of which we know very well, the famous Hague Conventions, the Geneva Conventions, but it is also found in important rules of customary international law and principles, general principles of international law, such as the necessity to use force, and the requirement that any attack be proportional. This law pertaining to armed conflict permits certain privileges to the regular members of the armed forces. These privileges do not apply in peacetime. The most important of these privileges apply only in wartime, only during an armed conflict, and only to regular armed forces: of the right to kill without warning, to detain without trial, and to seize property or to destroy property if it is related to enemy's military efforts. These are extraordinary privileges that international law makes clear only apply in a war zone and even then, these privileges are limited within the context of very important and serious protections on all persons in the conflict zone. International law of armed conflict applies territorially, it applies to places where armed conflict is going on. In all other places, the regular prevailing peacetime criminal law applies to acts of violence, or just in general, peacetime civil rights and criminal/civil law applies. This is a basic and core conflict or choice of law rules that we find in international law very important to our discussion today.

The international armed conflict in Afghanistan ended in June 2002. When Hamid Karzai took over the Afghan government and then changed the relationship with the United States and the United Kingdom. He then requested that these two countries and others, now members of ISAF, come to Afghanistan and assist him in bringing stability and order to that country. It became a non-international armed conflict within Afghanistan and to non-international armed conflict international law also has a set of rules that contains the three core privileges that we just talked about but somewhat less, a lesser group of protections. Still, the law of both kinds of armed conflict is quite extensive and quite similar. So far so good with respect to sorting out conflicts of legal authority between situations of war and situations of peace.

But then a strange thing happened, a novel and unexpected thing in our country. In November 2001, the President issued an executive order called Military Order of November 13, 2001: Detention, Treatment, and Trial of Certain Non-citizens in the War Against Terrorism, and this document asserted a right to try persons before military commissions, who, as a member of Al-Qaida or anyone, this is a quote from the order, who has engaged in, aided or abetted, conspired to commit acts of international terrorism.

Now, military commissions may be applied and may be used to persons detained in the hostilities of an armed conflict but not outside of an armed conflict. The order, however, made its choice of law, its determination to use a particular part of the law of armed conflict, the right to try persons before military commissions, based not on location, not on the standard rule of choice of law and international law, but on the identity of certain persons. This is not supported by international law. It was an error by us to make this kind of choice. It erroneously applied a law of armed conflict rule to persons not necessarily engaged in an armed conflict. But something even more insupportable in law was to follow. In February 2002, the White House received a memo from the Office of Legal Counsel making another choice of law based again not on who persons are and not where they are. This memo asserted that the law of armed conflict privileges applied everywhere in the world, but the Geneva Convention protections did not apply to all persons perceived to be part of this international armed conflict, and that was the Taliban and Al-Qaida were not to be protected by the Geneva Convention protections prevailing during armed conflict. And then, of course, by August 2002, the Office of Legal Counsel had written yet another infamous memo, this one justifying forms of harsh interrogation as not violative of the rules governing interrogation, rule in peacetime law – the convention against torture, and wartime law – the Geneva Conventions.

As I've already explained, the law of armed conflict applies where armed conflict occurs. It has territorial application to all persons in the combat zone, or zone of hostilities, privileges, and for fighters and protections to all persons in the armed conflict zone. Outside the armed conflict zone, peacetime criminal law applies to the acts of violence – criminal law that must in turn comply with international human rights law. The law leaves no person out of its protection.

I believe Dean Erwin Chemerinsky will discuss U.S. criminal law, applicable to persons suspected of carrying out violent acts of terrorism. I'll continue my remarks by further explaining why the law of armed conflict properly applies only in Afghanistan, Iraq, and later in Iraq and Somalia. But, that outside of these war zones, because it is only there that the law of armed conflict or that the choice of law would apply, the U.S. was in error to try to apply and take the privileges, and certainly made an error to not apply the protections of the rule of armed conflict.

All of this turns on the fact that there is an armed conflict in Afghanistan and later in Iraq and Somalia. International law, of course, it is expected that international law will define what an armed conflict is, since this is such an important distinction and makes the difference in terms of applying – making a choice of law between law of peace and law of war. International law in fact does have a definition

of armed conflict. An armed conflict cannot be constructed to suit a particular purpose. Armed conflict is determined today by facts of fighting, not mere declarations, as it appeared before the adoption of the UN Charter. The International Law Association, a leading scholarly organization of international lawyers, tasked a committee on the use of force in 2005 to report on the evidence within international law of the definition of armed conflict. The committee, in its initial report given in 2008, said this: "Looking to element treaties, in particular international humanitarian law treaties, rules of customary international law, general principles of international law, judicial decisions, and the writings of scholars, the committee has found that all armed conflicts, whether international or non-international, have at least two minimum characteristics: the existence of organized armed groups engaged in fighting on a certain amount of intensity. These situations are more than internal disturbances/tensions such as rise in isolated and sporadic acts of violence, like terrorist acts. The single one-off terrorist act is not, under international law, an armed conflict, and the law of armed conflict, whether privileges or protections, does not apply."

Within an armed conflict, as I suggested, the law of armed conflict must be followed. It not only gives privileges, but it demands that certain protections be afforded to all persons in the territory of the armed conflict. Violation of certain fundamental protections in the law of armed conflict leads to an obligation on all states under principles of universal jurisdiction to take action to investigate and prosecute. This was the international choice of law rule as to the enforcement of the fundamental law of armed conflict, especially violations in the form of grave breaches.

Let me just read for you some of the grave breaches listed in the third Geneva Convention, by way of example. Grave breaches include: "willful killing, torture, or inhuman treatment, including biological experiments; willfully causing great suffering, or the serious injury to body or health." If any permutation of these violations occurs, every state in the world is obligated under international law to investigate and prosecute. Again, and I'll quote from the Geneva Conventions, "all states shall be under the obligation to search for persons alleged to have committed or to have ordered to be committed such grave breaches and shall bring such persons, regardless of their nationality, to its own courts, and may also, if it prefers, in accordance with the provisions of its own legislation, hand such persons over for trial to another high-contracting party to the Geneva Conventions, provided such high-contracting party has made out a prima facie case."

All states in the world today are parties to the Geneva Conventions – all 192 sovereign states. So every state in the world has the obligation to investigate and prosecute grave breaches of these Con-

ventions. Spain, today, is carrying out such a prosecution against ten United States officials, including the drafter – the primary drafter – of three memos that I mentioned, John Yoo, but also our Secretary of Defense Donald Rumsfeld. This prosecution is going forward as an enforcement of the Geneva Convention because of torture that was alleged to have been carried out at Guantanamo Bay against persons who I've not yet asserted were or were not a part of an armed conflict in Afghanistan. They may also have protections under the Convention against torture, which has similar universal jurisdiction enforcement provisions. But Spain, in carrying out this prosecution's investigation, and potential prosecution, is not acting in conflict with any other law. Under international choice of law, that is the proper procedure for enforcing the law of armed conflict. So I do not see any collision in this particular case of universal jurisdiction or the exercise of universal jurisdiction. There should be no collision with the United States Constitution, because if you properly apply choice of law provisions, they lead to a choice of law of armed conflict, including its provisions for enforcement of universal jurisdiction. That's the proper law. It's not the U.S. Constitution in these cases, and so that should not lead to a conflict.

By the same analysis, persons suspected of violent acts or plots, such as Abdulmutallab, who alleged to have tried to carry out a terrorist act on an airplane flying from the Netherlands to Detroit on Christmas Day. He carried out his action outside of an armed conflict. He was not a participant in hostilities. So he is only properly tried before a regular civilian criminal court, and not before a military commission.

In conclusion, there's no true collision of authority at stake, as I suggest to you in these cases. If you do not see a clash between the U.S. constitution and the conflicting principles of otherwise applicable jurisdictional or legal authorities, it is a matter of good faith choice of law made consistently within the overarching paradigm of the rule of law.

CHEMERINSKY COMMENTARY

Dean Erwin Chemerinsky: It is really an honor and a pleasure to be with you. I was delighted to see the invitation from Parker Clote, and I've known Parker Clote longer than he or I would like to admit. His parents, Paul and Jackie, are dear friends of mine, very important in my life, and made the trip from Houston here for the symposium.

The question I pose at the outset is why are we talking about universal jurisdiction in February of 2010? The answer, of course, is that individuals at the highest levels of American government violated American international law and have not been held accountable in American courts. The fact of the matter is: are there tribunals else-

where in the world where they can be held accountable? I think to talk about this, we've got to place the events since September 11th in historical context. I believe that since September 11th, some of the worst aspects of American history have been repeated. Throughout American history, whenever there's been a crisis, especially a foreign-based crisis, the response has been repression. The concept I've come to realize is that we weren't any safer.

The story can start in the earliest days of the republic, when in 1798, Congress passed the Alien and Sedition Act, that made it a crime to falsely criticize the government or government acts. Individuals were convicted under this law for speech tamer than what Jay Leno or David Letterman say on a daily basis. Thomas Jefferson ran for president in 1800, in part on a platform to get the Alien and Sedition Act repealed. This led to pardons for those who were convicted under it. A century and a half later, the Supreme Court said that the Alien and Sedition Act was declared unconstitutional in recorded history. However nice that metaphor is, it doesn't obscure the reality that people went to prison just for criticizing the president. During the Civil War, Abraham Lincoln suspended the writ of habeas corpus even though the president has no authority to do this. Hundreds, maybe thousands, of individuals went to prison simply for criticizing the way the north was waging the Civil War. Historians show us these imprisonments violated the Constitution and did nothing to help the north in its effort to win the war.

During World War I, Congress passed two statutes in 1917 and 1918 that made it a federal crime to criticize the war. Those who study First Amendment law have undoubtedly read the case of *Schenk v. United States*, where a man was sentenced to ten years in prison just for circulating a leaflet that said the draft was unconstitutional as involuntary servitude. There wasn't a shred of evidence that this leaflet interfered with the war effort, and yet the Supreme Court upheld the conviction of the sentence.

During World War II, 110,000 Japanese Americans aliens and citizens, and 70,000 were United States citizens, were uprooted from their homes and placed in what president Roosevelt called concentration camps. Not one Japanese American was ever indicted or convicted of espionage against this country. The deprivation of liberty was enormous.

One more example before getting to contemporary events, the McCarthy era, it was truly the age of suspicion when merely being accused of being a communist was enough for people to lose their jobs and sometimes their liberty. The leading Supreme Court case during the era was *United States v. Dennis* - four people were sentenced to twenty years in prison for the crime of conspiracy to advocate the overthrow of the United States government. What did they do? Organized

to teach the works of Marx, Lenin, and Engles. They weren't plotting the overthrow of the government; they weren't even convicted of advocating the overthrow of the government. Their crime was conspiracy to advocate the overthrow of the government, and the Supreme Court upheld their convictions and sentences, with Chief Justice Fred Vincent saying, "when the evil is as grave as the overthrow of the government, there doesn't have to be any proof that the speech increases the likelihood."

Sadly I believe that since September 11th we've repeated this, engaged in repression that hasn't made the country any safer. I'd like to make three points this afternoon. First, I want to argue that the government since September 11th has claimed the authority to act unconstrained by any law. Second, I want to argue that this is wrong, that all individuals who were detained must be held and treated according to the constitution and international law. Then finally and most briefly, I want to argue that in this context universal jurisdiction is appropriate. Where there is clear law then tribunals can exist to try those who are accused of violating that law. As to the first of the points I want to make, I think there are two key premises that what has gone on since September 11th that explain why we are talking about universal jurisdiction. First, the government has claimed the authority to detain and treat certain individuals unconstrained by the Constitution or international law, and second, they claim that no court has the authority to review these actions. Both of these premises should be familiar to us. As to the former, starting soon after September 11th, the Bush administration claimed that it could detain individuals as enemy combatants without either the Constitution or international law applying. Now international law does not create the concept of enemy combatant. In international law there is the notion of a lawful combatant, somebody who is fighting for a nation in a war because there are certain things that a person can do in a war including using deadly force that would otherwise be a crime. But there's not a separate category of individuals that are unlawful combatants excluded from protection by the Constitution or international law.

Nonetheless, from the earliest days after September 11th, the Bush administration claimed that it could detain people and treat them without either the Constitution or international law applying. These examples should be familiar to you. There is the example of Jose Padilla, apprehended in Chicago at an airport in May of 2002. His alleged crime was to plot to build and detonate a dirty bomb in the U.S. The Bush administration claimed that he could be held as an enemy combatant and did not need to be indicted tried or convicted.

Think of how stunning this is as a claim of power. It's no less than an authority to suspend the Fourth Amendment, which generally requires a warrant before someone is arrested. The Fifth Amendment,

which requires a grand jury indictment before someone is held. And the Sixth Amendment, which requires conviction by a jury before somebody is imprisoned. The Bush administration took the position that since Padilla was an enemy combatant, international law and the Geneva Courts did not apply to him either. There is the example of Ali Al-Marri, a graduate student at Bradley University in Peoria, Illinois. He too was apprehended in 2002. The government once more said that he could be held indefinitely as an enemy combatant and neither the protections of the Constitution nor international law applied. There is Yaser Hamdi, an American citizen apprehended on the battlefield in Afghanistan, brought to Guantanamo. There it was discovered that he was an American citizen and he was brought then to the United States. Once more, the government took the position that he could be held indefinitely as an enemy combatant, that neither the Constitution nor international law provided any protection. There are the Guantanamo detainees, over 700 individuals have been held in Guantanamo since January 2002.

I have been representing a Guantanamo detainee since July of 2002, a man by the name of Salim Gherebi. I can tell you in all candor, without revealing any classified information, that I have no idea why Gherebi is in Guantanamo. He may be a very dangerous man who deserves to be held, or he may be there by mistake. Many were brought to Guantanamo by mistake. The United States paid warlords in Afghanistan to name those with ties to Al-Qaida. Some warlords named rivals to get them out of the way. Some just gave names to collect bounties. Gherebi has never had any meaningful hearing; there has been no trial. There is no way to know whether he should be detained. The Bush administration consistently took the position from the time the first detainees were brought to Guantanamo that they could be held as enemy combatants and neither the Constitution nor international law applied.

And then there were those who were taken to rendition camps. We don't know how many. In Jane Mayer's stunning book *The Dark Side*, she suggests the sum would be hundreds of thousands. What's more, the government has taken the position that no law, not the Constitution nor international law, applies to detainees. In fact the Bush administration has taken the position that its treatment of these detainees is unconstrained by law. The so called "torture memos" by Jay Bybee and John Yoo are so important because they claim that the President unilaterally could ignore both treaties and statutes that proscribed torture, that the President could apply his own definition of torture that allowed extreme interrogation and allow things that have been regarded as torture for decades.

So that's one reason we are talking about universal jurisdiction, because we have a government that has claimed for almost a dec-

ade that it could hold people unconstrained by any law. The other reason we are talking about it is we have a government that has claimed that its action are not reviewable in any court. In each of the cases that I mentioned, the position of the Bush administration was that no court has the authority to review the detention and treatment. That was the position of the government in the Padilla case. In fact, at the oral argument of the Padilla case there was a stunning exchange between Justice Ginsburg and Paul Clement, then the Deputy Solicitor General. Justice Ginsburg said, "Is it your position that Jose Padilla could be held for the rest of his life without any form of due process?" And Mr. Clement's response was "The only due process that Padilla is entitled to is to respond to the questions put to him by his interrogators." Justice Ginsburg responded saying, and also said in the companion case, *Rasul v. Bush*, about the Guantanamo case, "Are you saying that even if those in Guantanamo were tortured, there would still be no forum where they could have recourse?" And the response that was given, was that of course that the United States military would never engage in torture. What a coincidence, that night were the first reports on the national news of what occurred at Abu Ghraib. We will never know if that influenced what the Supreme Court said.

The Supreme Court in the Hamdi case said that while he could be held as an enemy combatant, he had to be given due process. The Supreme Court, in *Rasul v. Bush* and *Boumediene v. Bush*, held that those in Guantanamo had access to federal habeas corpus. It is unclear what remedies federal courts can give; that is an issue pending right now before the Supreme Court. It is also unclear whether or not habeas corpus will extend to those detained in rendition camps, and that is now pending in D.C. courts. It is unclear what remedies will be available, for example, even the Obama administration is urging a broad state secrets doctrine that would preclude any civil suits for abuses.

An example of this, before the Bush administration, was a man by the name of Khaled El-Masri. El-Masri was stopped at the German border, he was stopped based on mistaken identity. He was simply confused with another individual with the same name. Nonetheless he was taken to a rendition camp where he was brutally tortured. According to Jane Mayer's book, a high official at Langley had the suspicion that he was somebody with Al-Qaida ties, and as he did not reveal any useful information, the extreme interrogation of torture escalated. Once it was discovered he was there by mistake, he was dumped on the streets of Albania. He brought a lawsuit for recourse in federal courts. Ultimately the Court of Appeals held that the because of the state secrets doctrine, he could not get any recourse. The Obama administration has considered continuing the position of the Bush ad-

ministration using the state secrets doctrine to block any judicial review.

So these two premises: one, that individuals who are detained and treated where no law applied, and that no court would have the opportunity to review, got us talking about universal jurisdiction. Going along with them, I think, is the choice of the Obama administration not to investigate or prosecute those in the Bush administration responsible for violations of the law. Entirely for political reasons, the Obama administration has said that even if those in the top-level of the Bush administration had violated the law it would be better not to have a truth commission, better not to have an investigation, better not to have prosecutions.

This explains then, why we're talking about universal jurisdiction. Well, the second point I want to make I hope is the most obvious. All who are detained must be done so in accord with the Constitution and international law. There is no authority of any government to act unconstrained by any law. No. I can give you a pragmatic reason for this. I've given so many speeches since September 11th. What I've always been surprised to see is that individuals in the audience mostly in agreement with my position are those who have served in the military or with loved ones in the military. What I've heard from them over and over again is, "How can the United States expects foreign governments to follow international law in treating American prisoners if the United States doesn't follow international law in treating foreign prisoners?" There's also a principle that's involved here. It's the principle of the rule of law – that when the government deprives individuals of liberty, it has to follow the law. The rule of law requires that there be predictable legal standards and that they be enforceable. And those standards exist. The standards are following the United States Constitution. Now the reach of the United States Constitution is uncertain.

We know the Constitution applies to anyone who is apprehended in the United States. There's no doubt the Constitution applies to Jose Padillo or Ali Al-Marri who were apprehended for actions in the United States. I think it applies clearly to any who are detained in the United States. That would include then Yaser Hamdi or anyone brought to the United States. I think by implication, the Supreme Court in *Hasul* and *Boumediene* were saying that Guantanamo, since it's under American sovereignty, is also covered by the Constitution. Does the Constitution apply to rendition camps? That we don't know. But even there, there's law to be applied. Professor O'Connell put it out. There are the Geneva Courts, there are the covenants of individual liberties and civil rights. And my position is that anytime any government is detaining individuals, treating individuals, it has to comply

with the law. There is no black hole where individuals can be held and treated unconstrained by the law.

Well this then brings me to the third and final point I'm going to make. To me this explains why universal jurisdiction is appropriate. It is appropriate for tribunals throughout the world to try those who violate their national standards. Now it might seem that this is a radical proposition, but it's been part of American law, at least with regard to civil liabilities, since the earliest days of the republic. One of the very first statutes that Congress adopted was the Alien Tort Statute. The Alien Tort Statute creates civil liability in American courts for those who violate the law of nations. Just a few years ago, in *Sosa v. Alvarez-Machain*, the Supreme Court reaffirmed that individuals can be sued in the United States for human rights violations, even if they occur elsewhere. And there have been lawsuits brought under the Alien Tort Statute, successful ones, for human rights violations that occurred throughout the world.

This is universal jurisdiction. Tribunals have been created that exercise universal jurisdiction. To give you an example - the Nuremberg Tribunal that existed after World War II. What authority did the United States and other notorious nations have to try German war criminals? Their defense was that they were just following the law of their country and the United States took the position and, nations throughout the world, that there is a law of nations and that tribunals can be created to enforce that law of nations. That is what the principle of universal jurisdiction is about.

So is it appropriate for Donald Rumsfeld to hold you and others for violating international law? Yes, now whether they can get personal jurisdiction over these individuals is a different matter. But in terms of subject matter jurisdiction, universal jurisdiction exists. I conclude with two quotes from the late Supreme Court justices. One is from the late Justice Robert Jackson who said, "The Constitution is not a suicide pact." Of course he is right. But before we give up constitutional rights, is it really necessary to do so for national security? The Constitution has been able to be complied with for 200 years. The point of my examples from the beginning is when we deviated from it in the name of national security, did we really make the country any safer? The other quote comes from the late Justice Lewis Brandeis, he said, "The greatest threat to liberty will come from a proclaimed act for beneficial purposes." He said people know to resist the tyranny of despots. He said the insidious threat to freedom will come from well meaning people with zeal, with a little understanding of what the Constitution is about. If Lewis Brandeis ever knew John Ashcroft, or Alberto Gonzales, or John Yoo, or Dick Cheney, it couldn't have been better words for them.

RABKIN COMMENTARY

Professor Jeremy Rabkin: I have a different view or two. And I guess I should say, when I was invited to come here, I was told they really wanted John Bolton, but he wasn't available, you're his understudy. I said, "Oh, thank you." To be the understudy of John Bolton is very flattering, and I will try to live up to that distinguished honor.

What you just heard Professor Chermersky say was we have been doing this since 1789. We've been doing this since 1789 because we've always had this view if you commit a terrible crime you should be punished. And it's not punished by American authorities, you should be punished by international authorities. That was always our view.

I want you to just stop and think. He gave you his version of American history: terrible depression through the first world war - some people were put in jail. Alien-sedition Acts - some people were put in jail. Here's my version of American History: for the first hundred years we had millions of people in awful bondage in slavery. The first twenty years after the Constitution went into affect we were participating in the international slave trade at a time when everyone else in the world thought, "oh that's really awful." We did a lot of bad stuff in the Civil War, as probably some people from the South remember, and let's just skip to more recent times. He's concerned about, "some people were prosecuted for their speeches." We killed about 600,000 German civilians by bombing their cities in the second world war, and then as you recall we dropped two atomic bombs on Japan. Now if it were true that universal jurisdiction was "always part of world heritage law," you have to ask how come General Sherman, how come General Grant weren't afraid to travel the world? How come southern officials who were involved in the slave trade weren't afraid to travel the world? How come President Truman and people in his administration weren't afraid to travel the world? And of course the real answer is this is a doctrine that is made up which never previously existed. We did not think in 1789 we could try anyone or that anyone could try us. This is a very, very recent creation.

Don't be misled by their focusing on John Yoo. That's, I mean I'm sorry, but this is a fetish. I guess law professors are upset about it, and I'm a law professor. But the truth is, right now, President Obama is ordering air strikes on people who are not combatants in Pakistan and in Yemen. If it's true that there is international law, and it is absolutely clear because Professor O'Connell and the Red Cross have said so, so it's absolutely clear, you are either engaged in a recognized international conflict, which means an international conflict in a particular place where there's armies fighting, or else you are entitled to civilian trials, or otherwise it's a black hole. Obama is doing some-

thing much worse than anything John Yoo did. What Obama is doing is killing civilians in Yemen and Pakistan without any warning, let alone a trial. Let's all take a deep breath and focus on that. We aren't talking about John Yoo; we are talking about Barack Obama. And, we are probably talking about Eric Holder and people in the Justice Department who told him, "Yeah, that's okay." We're for sure talking about people in the Defense Department who not only said its okay, but salute it, and did it. So we're not talking about the Bush people, we're talking about Obama, we're talking about now. What's happening in the world? Well, some people criticize, some people raise questions. I haven't heard anyone say there should be universal jurisdiction trials of Obama and his cabinet in Europe. And why not? I think the real reason is because none of this is serious, we're just kidding, and it's all just stunts. Let me start with, oh let me just say one other thing on this rebuttal - we were talking about how terrible it was that people who were being held - combatant people who weren't really combatants were being held in Guantanamo, and wasn't that terrible?

Because what I understood Professor O'Connell to say was there are only two categories: you are a privileged combatant in which case you can hold people - because it's a real war, and you are privileged to be a combatant in a real war, and if you're captured in a real war you can hold them; or else there has to be ordinary due process. There is no in between, that would be a black hole, and that would be a war crime or, in any way, a crime against humanity, or any way against international law to do the "in between." Well, if that's really the doctrine, and if people who say, "Yes, it's OK to do the in between," are international criminals who, if not tried here, can be tried elsewhere, we should start with Justice O'Connor, she's still alive. And she's out there. She's not in office, so she won't have official immunity. Let's get her, because she authorized this. She said, "Yes." You can hold people in Guantanamo. It doesn't matter where they came from, it's not just people that were captured in a war zone, not just combatants. You can hold them there if they are dangerous. And if they are right, if that's against international law, let's have the (Germans? Journalists?) go after Justice O'Connor. Good luck.

I want to start by saying - I mean what I wanted to say - I think if we want to talk about collision. I guess my fellow panelists were saying, "Well there is no collision because good people in America are for universal justice, and the world is for universal justice, and the constitution is for universal justice, so it's all universal and it's all just, and there is no collision." I disagree with that. And I want to start by saying I think there is question whether the Constitution does authorize universal jurisdiction. There is this clause, of course, in Article I, Section 8, Clause 10: "The powers of Congress include the powers to

define and punish piracies and felonies committed on high seas, and offenses against the law of nations.” If you stop and think about this, which almost no one does, it’s interesting that they break out those things separately. Why don’t they just say offenses against the law of nations? Why piracy, and other offenses on the high seas? Why isn’t that all included in the law of nations? A really excellent article by a scholar at Northwestern, Eugene Kontorovich, who used to be my colleague at George Mason University – great article if you are really interested in this – and he digs out that, actually if you go back to the founders, they thought of these as separate categories, and what they were really thinking about was piracies committed against Americans, offenses on the high seas committed by Americans, and offenses against the law of nations committed in the United States. Each one of these separate items had a different jurisdictional basis.

There was actually a big debate in 1800 in the House of Representatives involving the sailors who had been involved in a mutiny on a British ship. They were British sailors who killed their British officers. Some of them came into the United States, and President Adams extradited them back to Britain for trial. This was criticized, and people said, “Why are we giving in to Britain? They won’t get justice there. We should have our own trial.” Somebody got up in the House of Representatives and said, “We couldn’t possibly have jurisdiction over a crime committed on a British ship by British nationals on the high seas.” He said, “That clause in the Constitution which enables Congress to define and punish piracies and felonies on the high seas can never be construed to make to the government a grant of power which the people making it do themselves possess. The people of the United States have no jurisdiction over offenses committed onboard foreign ships against a foreign nation. Of consequence, in framing a government for themselves they cannot have passed this jurisdiction to that government.”

In other words, the meaning of this clause couldn’t possibly refer to “you can just try anyone for anything without any jurisdictional connection to the United States.” The person who gave this speech was John Marshall, Congressman from Virginia. President Adams said, “That is a terrific speech; you should be Secretary of State.” And after that he said, “Come to think of it, you should be Chief Justice of the Supreme Court.” And his decisions for the Supreme Court are consistent with this in regard to piracy. He said, “We don’t have jurisdiction over even acts of piracy if committed by non-Americans against non-Americans out on the high seas. Universal jurisdiction is not something that the United States can exercise.”

Nobody has yet found a case in which the United States did exercise this in the nineteenth century, or anytime in the twentieth century until, really, it starts with this case - *Filartiga v. Pena-Irala*

in 1980, in which some international lawyers persuaded the Second Circuit that, “Oh yes, we could have jurisdiction under this 1789 statute which doesn’t mean what you used to think it meant.” If it really meant universal jurisdiction, anyone can file suit against anyone else in American courts. We should have loads of cases because that would be so much fun to do. A lot of people would like to have done that. No one before 1980 thought this, and the Supreme Court has subsequently told us, “Well no, not really. Actually kind of . . . no.”

So, I think it is a real question whether we are authorized to do this by the Constitution, whether Congress is. The one important deception is if whether it were by treaty, then I think that Congress could assert jurisdiction, but it wouldn’t be universal jurisdiction. We would have jurisdiction in those situations in which other countries, signatories to the treaty, had agreed to it, and I think that it could cover certain international tribunals. I think in the case of Nuremberg, our actual justification was you surrendered unconditionally to us, we are now in charge – the four occupying powers. It was delegated authority, it wasn’t universal jurisdiction. I believe the reason why Marshall and other people, to begin with, thought this cannot be right – it cannot be this free floating, just put anyone on trial for anything if you want to. I believe they have this understanding that the logic of that would undermine our own Constitution at home.

Let me just quickly, I don’t have time to argue this through, but let me just pose this to you. A few things in the United States Constitution – Congress has the power to declare war and to make rules for the government in regulation of the armed forces. If I understood Professor McConnell’s argument it is that when you act in a way that violates international standards, other countries can prosecute you if you don’t prosecute the people who did it. So suppose Congress declares a war that other countries think is improper under international law. Suppose we authorize our troops to do things that other countries think are improper. It seems to me the logic of universal jurisdiction is that the other countries can then put our defense officials on trial, maybe our members of Congress on trial, and where that goes is that we don’t get to decide for ourselves. And these provisions in the Constitution that vest this power in Congress become nullified. The President has the power under the Constitution, Article 2, to pardon offenses against the United States. Well, if other countries don’t have to respect the pardon or the amnesty that the president may give, has the power to give, then it turns out that he doesn’t really have an effective pardon power because people still have to be afraid that, “Oh, I am going to be prosecuted in Germany or somewhere else.” So the pardon power which was supposed to be a way for us to settle some claims, it doesn’t settle them anymore, we always have to be worried about Spain, France, Germany, one of those other countries. The Con-

stitution is the supreme law of the land, according to Article 6, that means it overrides everything else. Well, how can it if adhering to our constitutional norms we can be prosecuted in other countries?

A point which I do really want to emphasize – we shouldn't think of this as just the favorite provisions of my colleagues here. There are a lot of things that other countries think that are international law or should be international law. Professor McConnell mentioned customary international law. Customary international law is very, very loose. A lot of people think customary international law can be determined by UN resolutions, where we have now had I think four UN resolutions saying basically if you insult Islam you have violated human rights, and you should be prosecuted. A lot of countries have a view of free speech which is free speech needs to be constrained if some people are offended. It is ultimately the international covenant of civil and political rights that you have no right to advocate for war or engage in hate speech. A lot of countries think that allowing this in America is wrong, or they are moving towards that view. So I think you can easily extrapolate, not very far down the road, other countries saying that we are all suppressing this, so you should be doing the same. I hope Professor Chemerinsky will be on my side then and say, "Oh wait, actually America is entitled to have its own view and we shouldn't allow foreigners to prosecute Americans for living under the American Constitution."

But I believe the logic of what he said leads in the other direction, which is if you don't adhere to the international standard then other countries have the right to prosecute Americans for not living up to what these other countries think is the proper international standard. I want to say in conclusion I think if you think this through, it is not only potentially at odds, there is collision, potentially, with the American Constitution, but I think the whole idea of constitutionalism. Because the logic of this is not limited to actual treaties but to interpretation of treaties, the Geneva Convention citation that you have there – gee there should have been lots and lots of prosecutions under that if it were understood by other countries the way it was presented. Nobody has had such prosecution happen. I don't think it was understood that way. I don't believe the United States would have agreed to that in 1949 if they understood what they were saying was, "Oh yeah, and if you think there is any question about how we fought our most recent war go ahead and prosecute Americans." I don't believe that that's what it means. But if you are saying other countries interpretations of treaties, and even worse, other countries interpretations of evolving standards of practice, decency, custom, whatever you want to call it, if you think those things lay the basis for prosecution, then there is not just potential collision with our own Constitution, but with the idea of constitutionalism.

The history of the world, if I could give my history. This is somewhat broader. People used to think there should be a universal authority - a papacy, a caliphate, because they know what justice is in the way that God wants it to be. And the other alternative there was there are many gods, and every city has its own god and therefore should be ruled by someone in contact with the particular god of the city to say what is just and unjust. In the history of the world we are constantly getting sort of theological, theocratic, interpretations, with people claiming the authority to enforce them. What I think is most crucial about modern constitutional government and how we have come to understand it is this is a way in which a people constitutes itself and says these are the rules by which we agree to be governed.

This vision of universal jurisdiction which just sort of flows along, which just evolves and has new interpretations of new practices is really at odds with a fundamental understanding that we have in the modern world of what a constitutional government is. Constitutional government is, in the first place, what you want to know is who is authorized to make law. We know what it is here – it's the House the Senate, the President. We have this little debate about reconciliation and the filibuster, but we know for sure that it is the House, the Senate, and the President. Obama cannot say, "You know what, the Senate is just too much trouble. I won in the House – that is good enough." We have a constitution that spells this out. We have nothing like this for the evolving standards to be applied by the courts invoking universal jurisdiction, and so I think we, and we know who gets to vote for the House and the Senate. We have rules about this, and some of these rules are in the Constitution, the most important ones are – this is how we constitute ourselves. Who gets to hand down decisions invoking universal jurisdiction? Which countries? Is it only democracies? What about the tyrannies? What about the anti-American countries? What about the really nasty hostile countries - does their authority count just as much? It's supposed to be universal.

We have really no way of knowing where this is going or what it is really about, so I think potentially it is really a very serious collision, and I think it is very important for us to be clear, however much you hate John Yoo, call him names, write articles, denounce him, if you want you can say that he will never be hired at your law school. If you want, you can even say that the Justice Department was wrong. By the way the Justice Department cleared him, so we are saying now that the Justice Department is not fit to decide whether John Yoo committed a crime, we need a court in Germany. Don't do that, that is a very dangerous thing, let us decide for ourselves what our standards should be, and who should be punished. It's really the worst thing you can do. I think it is a betrayal not only of this country but of the idea of constitutional government, and I firmly do believe that it is a betrayal

of any possibility of international order, countries living together in peace if you let loose this very new thing which has no real foundation to it, and very little practice behind it. Yeah, if we don't like something you did our courts can just go after you even if you have no connection to our country, it is a really terrible mistake – and we shouldn't let it loose. Thank you.

DISCUSSION

Preis: We've heard three great presentations from our guests. And I am sure each of them will have something to say to the other two, so we can take this in any order you'd like, who'd ever like to begin.

O'Connell: I am not sure I followed everything Professor Rabkin was putting forth, but I do feel very strongly about a number of his points, and I want to just respond to a few of the most important. I heard Professor Rabkin say again and again something about Americans shouldn't be prosecuted abroad. Americans are prosecuted abroad regularly. If they are living in another country in France, in Chad, in Costa Rica and they violate the law of that country they will be prosecuted. It is simply a myth that, and I am not sure exactly what Professor Rabkin had in mind, that Americans are somehow only subject to U.S. national courts. That is not the way the world works, and we have as a world agreed that we held several very important principles in common, and that these are the rules of the road for our coexistence as an international community, and these rules, the most important rules, we agree should be prosecuted, should be enforced and if one, if the state that is the most natural state to do it, usually the state of nationality doesn't. Others will. These are the agreements we've made. We don't live up to our agreements very well, but I think it is our obligation, especially as lawyers, to constantly work to make sure we do uphold our highest principles that we have committed to in our treaties and in our most important rules of customary international law. We decided at Nuremburg, it was this country that decided that crimes of genocide, war crimes, violations of the 1929 Geneva Convention for the protection of prisoners, and crimes against humanity, fundamental human rights crimes, should not go unpunished.

And we, not out of the blue, but working on a model that had already been developed in the Treaty of Versailles, for trying the Kaiser in the first world war, we created a court that would hold persons, on behalf of the whole international community, for these important crimes. That was 1946 that the judgment in the international military tribunal came down. The Geneva Conventions that we honor today, and we are a party too, that govern our armed forces in the field were adopted in 1949, three years after Nuremburg. So, Professor Rabkin, we knew very well what we were doing in Stockholm at the Geneva

Convention negotiations, and in the final negotiations. We sent some of our most brilliant military officers to negotiate for us at those Geneva Conventions.

These are the documents that they wanted, and these are the documents that we train our armed forces in over the years that, under which, we have modified our uniformed code of military justice to comply with so we are at the international standard, that we have tried persons such as Lieutenant Calley, where we did fulfill our obligations, and then in the Gulf War, we fought in a model way. My husband was a United States Army interrogator in the Gulf War, and he was also the Geneva Convention's trainer for his division, and he is not a lawyer, but he has always told me that it was the fact that he and his men knew what the rules were that made them feel that they were fighting in a righteous way and in a righteous conflict, and in which we did not have the cases of Post Traumatic Stress Disorder. Our soldiers then knew the rules and they knew they were fighting in compliance with them. When we captured persons, we didn't know if they were combatants subject to detention or not, or might have been civilians, we held hearings under Article Five of the Third Geneva Conventions. We held almost 1500 such hearings. We did it by the book. We kept prisoners according to the Geneva Conventions standards, and we won that war after 100 hours of fighting. Many persons in the Iraqi armed forces surrendered to the United States armed forces because they knew they would be well treated. We are still in Afghanistan, eight years after 9/11, nine years, going on nine years. I suggest to you if we had made the same care and concern about how we were fighting that conflict, we would be in far better shape today.

But the other thing that I do have to say, in agreement with Professor Rabkin, is that I never said the Obama administration has somehow turned the page and has brought us to a new day in which we are in compliance, in which we are supporting the rule of law in the world, in particular the Geneva Conventions and the important human rights treaties, especially the convention against torture. Very sadly, I believe the Obama administration is taking very bad advice and following along on the Bush administration's path that is not helping our country, that is not helping our world. I have written a number of articles in which I have argued that the use of drones in Pakistan today, being run by the CIA, not by our armed forces, who have no right to use military force even in an armed conflict, and there is not an armed conflict in much of Pakistan in which we are using drones. And we do not have a right to do it, and I believe it is as serious a violation of the Geneva Conventions and the law of armed conflict as many of the violations that occurred during the Obama administration. So, I do take umbrage with Professor Rabkin that he

would suggest that this is a political position rather than an objective and important legal position that I put forward.

Rabkin: I totally agree with your first point. Of course Americans, when they commit a crime in another country are subject to the jurisdiction of that country. No one is disputing that. I didn't think that had anything to do with universal jurisdiction. Every country has jurisdiction in its own territory. I also concede that when somebody makes a decision in the United States that has an effect in another country, victims in the other country might have some claim to jurisdiction. That's going to be difficult, and we hope that they will be really cautious and careful about that, but what makes universal jurisdiction so dangerous is it's inviting 200 countries in the world to say, "Ah yeah, come to think of it, we have a view on this too." And I do not think it is true that there is any history of that. If there were history of that, the world would have been much more chaotic than it was.

I want to say briefly what you said about, "This is something new because in the Vietnam War we prosecuted Lieutenant Calley." Well yes we did, and then President Nixon pardoned him. He committed a monstrous crime, right? This is a guy who burned this village and killed a lot of people – I think about 100 people – women and children – a really ugly, horrible crime. President Nixon pardoned him, I think after one year.

O'Connell: Commuted his sentence. Didn't pardon him. Commuted his sentence.

Rabkin: Commuted his sentence, eh!

O'Connell: He shortened it from life in prison.

Rabkin: To?

O'Connell: To house arrest; he did serve some time.

Rabkin: Not very much! I think there were a lot of things that we did in Vietnam which were very questionable and a lot of the world thought that in fact it was a terribly unjust war and the Americans were behaving very badly. We didn't see any prosecutions of Americans at that time. If Vietnam wanted to assert jurisdiction, that would be something else, but we didn't see France, Germany, the Netherlands, Spain doing it. I have absolutely no doubt that your husband behaved extremely honorably. I'm in favor of the Geneva Conventions. I'm in favor of conforming to the right standards of interrogation. I didn't mean to mock any of that. I do say though that there are reasonable questions of interpretation, and it is not reasonable to have

third parties that have nothing to do with it come in and say, “No, the American interpretation is wrong, or the American practice is wrong. And, therefore, we’re going to prosecute.”

The last thing, you said that you were taking umbrage that I was suggesting that you were being partisan. No – I withdraw that. I am sorry. I didn’t mean to say that you were being partisan. What I did mean to say, and will say again is I think it is short-sighted for anyone to think that this approach to justice once it is unleashed can be limited to the people you happen to think are really bad, like John Yoo. Once it is unleashed in the world it could be applied to a lot of people, and although you think that President Obama is behaving badly, I personally think that what he is doing is very reasonable. I have a lot of respect for the armed forces, I don’t believe those JAG lawyers would be all so quiet if they thought that it was against international law. So I think that a lot of serious people, who are at least as serious as you and me, and probably more so because their careers really revolve around making these decisions, have told President Obama that this is a reasonable thing to do, and I don’t think that it should be second guessed, at least at the level of criminal law, by countries in Europe who will not do anything to help us actually fighting in Afghanistan.

Chemerinsky: I think that all three of us agree about the importance of constitutionalism and of enforcing the Constitution’s protections for individuals. I think we all agree about the importance of treaties and treaties being enforced. So, what we’re really talking about is: what is the best way to achieve this?

Now, when I was talking I made three points. One was that since September 11th the government has claimed the authority to detain and treat people unconstrained by the Constitution or international law. I think that it is so important to keep this in mind. It is the context for our discussion of universal jurisdiction, and if we’re going to talk about what is unprecedented – this really is unprecedented in American history. In the Vietnam War the United States created an accord with the Geneva courts, tribunals to determine whether or not individuals were Viet Cong or innocent civilians. Even though the Viet Cong were not following the protocols of war and the Geneva Accords, we held the tribunals that the Geneva Accords required. As Professor O’Connell said, we did this with regard to the Iraq War. To my knowledge, never before in American history had the United States claimed it could detain and treat people completely without regard to the Constitution or international law. To my knowledge, never before in American history had the United States government claimed the authority to torture individuals, unconstrained by federal law or international law. Going back to the time of George Washington, the

United States always prided itself on humane treatment of foreign prisoners, even when our enemy was not treating American prisoners in a humane fashion. The United States was a key party making sure the Geneva Accords were drafted and adopted.

The second point that I made was that all who are held, all who are treated, must be done so in accord with the Constitution and international law. Professor Rabkin talked about the importance of Constitutionalism, and I could not agree more. There should never be an instance where a government can hold individuals unconstrained by any law. That is inconsistent with the very notion of the rule of law.

So that brought me to my third point, the concept of universal jurisdiction. Now I realize that one way all of us on this panel have been at fault this afternoon is we've never defined what we mean by universal jurisdiction. And I realize that part of the problem, what may be generating unnecessary heat, is that we may not have the same definition of universal jurisdiction. I think universal jurisdiction is the authority of an accord to try individuals, civilly or criminally, for conduct that did not occur within its territorial jurisdiction. Now, we may have different definitions of universal jurisdiction, but I think that is what we are talking about here. And then there is really a descriptive and a normative question: descriptively, has universal jurisdiction ever existed? Have nations ever tried individuals for things that occurred outside the territorial jurisdiction? And the answer is it has gone on for centuries. I gave the example of the Alien Tort Statute; it was adopted in 1789. It says that federal courts have jurisdiction to hear civil suits against those who violate the Law of Nations. Now, we can certainly argue the extent to which it went on before 1980, we would disagree over that, but I don't think we can disagree that the United States Supreme Court, just a few years ago, in *Sosa v. Alvarez-Machain*, reaffirmed that federal courts have the authority to hear civil suits in actions that occurred outside of the United States, outside of our territorial jurisdiction, that violate the Law of Nations.

I'll give you one example: *Doe v. Unocal*. There was a lawsuit brought in federal district court in California against Unocal for using slave labor in Burma. The plaintiffs were individuals whose rights were violated outside the territorial United States. I can give you dozens of civil suits that were brought by individuals for human rights violations that occurred outside the United States. Descriptively, there's no doubt that there's this form of universal jurisdiction.

Both Professor O'Connell and I have mentioned the Nuremberg tribunals. There's no doubt that this occurred – they were trying individuals for things that were lawful under their country's law. And the United States, leading the way, said there are crimes against laws of nations. Now, so in this sense, universal jurisdiction has long existed. Now, Professor Rabkin says, but look at all the instances where uni-

versal jurisdiction wasn't exercised. And of course he's right, but the fact that it hasn't been used in many instances doesn't deny that, descriptively, it exists. Now there are many reasons it hasn't been used in the past. I briefly mentioned the concept of personal jurisdiction – I mean, the difficulty of personal jurisdiction is enormous because you can hold whatever kind of trial you want, but it's meaningless if you don't have the territorial authority to bring that person in. And nations often lack that. And the lack of territorial authority of personal jurisdiction is why you often don't see universal jurisdiction exercised. But the fact that it hasn't been used in many instances descriptively doesn't deny that it exists.

Also, power matters enormously. The reality is that those who win the war can then exercise universal jurisdiction; those who lose the war don't. Those who have power can exercise universal jurisdiction; those who don't haven't used it. I think of the trials that have occurred at the Hague, say, against Milosevic. That's an exercise of universal jurisdiction.

Now – so, descriptively, it exists. And that leaves us to talking about: normatively, should it exist? I think a lot of the arguments that are made against it are really strawpersons. For example, Professor Rabkin repeatedly wants to talk about – what are the amorphous standards that are used? I'm talking about the Constitution and treaties that exist. I'm not talking about some amorphous concept here. We ratified the Geneva Accords. We ratified treaties that prohibit torture. And the question is: if that law is violated, can there be prosecution?

Professor Rabkin wants to talk about the importance of constitutionalism. We agree – to me, that's what the rule of law is all about. And to the extent there are written legal standards, or for that matter, customary international law – and they're there in the form of our Constitution, treaties, or what the Supreme Court has referred to as the law of nations – then I think there can be prosecutions. But I'm going to agree with Professor Rabkin that there is a danger to universal jurisdiction. There's certainly the possibility that people could be prosecuted in a way that we don't like. Maybe it will be exercised against those for exercising free speech that we value. Now I take some comfort from Professor Rabkin's point that it hasn't been used this way. So the fact that it hasn't been used this way leads me to believe it's not likely to be used in that way. But there is that danger. But there's also a danger of not having universal jurisdiction. Because what happens when people violate their own laws, the laws of nations, and there's nowhere they're held accountable? Their country won't prosecute them – what happens then? Where would the German war criminals have been tried but for an assertion of universal jurisdiction? Where would Milosevic be tried but for an assertion of universal jurisdiction? And so in the end, as you think about this discussion,

what it really comes down to from a normative perspective: are the benefits that we gain by having the concept of universal jurisdiction, as a way of enforcing the rule of law, greater than the risks that there are that people might be tried for things that we don't want them tried for?

I take comfort in the very history that Professor Rabkin evokes and believes – that it's clear to me that, if we believe in the rule of law, there has to be someplace where there can be prosecutions. And I think that history gives us reason not to be too concerned about that.

Audience Member: My question is directed to the panel, but particularly to professor O'Connell. Is there some way that you can define either enemy combatant or armed conflict, in a way that affords proper balance to the individual liberties and to protection of security?

O'Connell: Well, I think the way international law has defined both combatant and armed conflict is respectful of security concerns. There had been a move in some years, in particular, by human rights advocates, to eventually restrict all military force to a rule of necessity, basically a law enforcement rule. That is not the rule in international law today. When a state is attacked significantly, as Kuwait was invaded by Iraq in 1990, international law does allow a right of self-defense and the use of an armed conflict military force of a significant level to liberate a state in that case. And those who are members of the regular armed forces are combatants, defined in the Geneva Conventions and in the additional protocols and in the paper I included in the materials just in case you'd like some more detail on this and some footnotes. It's called *Combatants in the Combat Zone*. But I think in America today we're still misled by this belief that we can accomplish great security through military force. Military force is suitable and appropriate, as I said before, I'm married to a soldier, so I do think that it's appropriate in some occasions. But I think that we have had a tendency, in part, due to our own history, and we're a country that was built under both the rule of law and in a revolutionary war, so we've had a great deal of confidence that we can accomplish a lot for our country through military force. But we're at a time now when we have to be more clever than that, when we have to use far more sophisticated and fine-tuned responses to the challenges to our country, of many kinds, in particular, security.

What we've seen in the actual cases is that law enforcement, through international cooperation, is the most effective means of responding to terrorism in particular. In the last month, over fourteen high-ranking members of the Taliban have been arrested in Pakistan. That is a far more sure way of getting a stable Pakistan, one that doesn't foment and create persons who want to do serious harm to the

United States than attacking unlawfully, under international law, which is well known to Pakistanis and creating revenge and anger against the United States, which only fuels the cycle of revenge and creates a more insecure place. International law is very old law. It's even older than the United States Constitution. 1648 is when we tend to date modern international law. The rules on the use of force have grown up slowly over time, through great consensus, through trial and error, through great catastrophe, and doing better. And by now, if we would comply with, and I agree with Professor Rabkin that we have a poor record of really getting enforcement, and that's some place where I think we can do better, but these rules are wise rules that will guide our country to a better international community and a better future. If we had complied with the rules of international law, we would not have invaded Iraq, we would not have opened Guantanamo Bay, we would not have tortured persons. And all three of those have led to great insecurity for our country. So in my view and after almost thirty years of studying international law, especially the law of armed conflict, I would suggest to you that it's the best guide for creating both a world in which human rights will thrive, including our own human rights as Americans, and in which we will have greater security going forward in the future.

Audience Member: I have a question for Dean Chemerinsky, especially regarding your second point about how the Bush administration claimed that no law applied to these detainees and how universal jurisdiction needed to be invoked to make certain Bush officials accountable for their acts according to that stance. However, doesn't international law require a different outcome? Specifically that the United States courts take up these claims because local remedies must be exhausted. Local law has to apply before international law, so isn't it far too early to even consider evoking your universal jurisdiction for the Bush administration's claims because the United States courts still have to interpret the Constitution and in fact have granted these detainees due process rights and have kind of struck down the Bush administration's stance.

Chemerinsky: Your point, I think, is a simple one, that all individuals whose liberty is denied, all who are treated at the deprivation of liberty, must have the law applied, that the Constitution and international law have to apply to them. I completely agree that the preferable forum is a domestic forum. The question is: can there be an international forum? And as uncomfortable as it is, I don't see how if you'll accept the premise that our leaders violated treaties, international law, why they're any more immune from the forums that tried Milosevic, why they're any more immune than others who have violated international law. So yes, in terms of your question, but I don't

think that that denies what I'm saying, only to the extent that Spain wants to say that these individuals can be held accountable for violating international law, then I don't see how that's any different from instances where American courts under the Alien Tort statute have held individuals to be liable for acts that occurred outside their country. Now, when they say that the Alien Tort statute was wrong, that the Supreme Court was wrong in *Alvarez-Machain*, but that again confuses the descriptive and the normative.

Rabkin: Ok, so I'll use this opportunity to respond to what is I think a grotesque misrepresentation of what we're talking about. What Professor Chemerinsky is saying here is anytime American courts or any court takes jurisdiction over an incident which occurred outside of its territorial limits, well that's a precedent for universal jurisdiction. No it isn't. Not at all. I don't know anyone who seriously believes that. Of course there are some little, at the margins, claims of jurisdiction for things that happened outside your territory, but that's because there's some other nexus. It involves your citizens, either as the perpetrators or as the victims. That's the usual thing. What universal jurisdiction means is anyone. Universal means everyone. Anyone can assert jurisdiction over any incident that is satisfied by somebody's idea of whatever it is that is now in universal jurisdiction. Really bad human rights violations, whatever they are. Anyone, without any other nexus, just saying, "We in Germany believe in human rights (because we all know how much they believe in human rights) so we have the duty to go out there and prosecute Donald Rumsfeld."

Now that is not the Spanish case. The Spanish case is not universal jurisdiction at all. The Spanish case is: these are Spanish citizens who were injured in Guantanamo and we're standing up for them. I'm unhappy about that, but I don't think, woo that's terrible, that's a new precedent. That's a typical kind of conflict of laws, conflict of jurisdiction thing, and we have to negotiate with Spain about what to do there. That is going to happen in the world. The United States itself does that and has done that from the beginning. The piracy clause in the Constitution – surely, surely, nobody ever thought that it was involving things that happen in the United States. By definition it says in the Constitution "on the high seas," but that doesn't mean it's precedent for universal jurisdiction. What they were thinking of was either pirate attacks on American ships or Americans engaging in piracy. Well good then, we would have jurisdiction.

That is very different from saying that the whole world can jump in whenever it wants to. That is a really bad idea. Among other reasons it is a really bad idea, and not only because there are so many other countries and it is so hard to bargain simultaneously. It's a bad idea because it makes the issue completely abstract. You can't say, as

the Germans did, our paragons of human rights, we feel really bad that some people got killed in Afghanistan because we called in an air strike and it was a mistake. We feel really bad, a million Euros? Would a million Euros do it? Two million? I mean, they're trying to buy them off, which they probably will do. And that is not actually unreasonable. They're saying, "Oh, we're sorry but these things happen." If it's one country that is asserting jurisdiction, you could hope to deal with the actual litigants. Maybe not, but you have a better chance. If it's just a completely abstract claim based on just: this is wrong, and the world has an obligation to see that justice is done in the world. I don't think I'm caricaturing it. I think that is what Professor Chemerinsky is saying: "We need to have universal jurisdiction because we need to have this fall back to make sure that justice is done in the world." No we don't. This is preposterous.

I mean why even talk about some Americans did this and some Americans did that. How many people were killed in China? Fifty million? 100 million? I mean it's unbelievable what happened in China. How many people were killed by the Bolsheviks over seventy years of power in Russia? It's at least in the tens of millions. Nobody was prosecuted in Russia. Nobody in Europe was so worked up about Guantanamo and John Yoo. Has any of them said, "We've got to prosecute some of the worst Communist perpetrators in Russia."? Of course not. In China, do they say that someone has to be prosecuted? No, of course not. How is it that Europeans can go to sleep at night, knowing that monstrous crimes have gone unpunished? By the way has Spain ever prosecuted any of those responsible for Fascism? No. Germany? Did they really go through and comprehensively punish everyone? Ha, ha, ha. Don't be silly. So how is it that they can accept all these things? Well, they say the following, which is not unreasonable: "The world has to go forward and it is not always the best thing to ensure that everyone who deserves to be punished is punished."

If I could just give one last example which means a lot to me because I lived in Washington, and now I live in Virginia. President Lincoln said during the Civil War, "Those who have killed black troops during the Civil War, we will kill you. This is terrible. This is against the law of war." And what happened afterwards? We have an amnesty. No one was punished for that. People did terrible things but there was an amnesty. A decision was made, a political decision. It was more important to bring the country together. I believe this is the most generous interpretation of why people in Western Europe who were so high in their moral standards looked at Russia and China and said, "We're not telling you what to do." Move forward the best that you can. To say that that decision can never be made, there can never be an amnesty, there can never be a pardon unless you persuade 200

other countries and they relent and say it's ok to let John Yoo continue at Berkeley, this is not a recipe for a more peaceful world.

O'Connell: Just very briefly, I think they can find us. We are all on the World Wide Web. I just think in closing that the idea of a chaotic world out there, where Europeans are running after Americans in order to try them for all kinds of unfair reasons, while at the same time they are letting all kinds of Chinese tyrants and murderers go free. This is just a caricature, of course. We have very few of our most important treaties: the Geneva Conventions, the Convention Against Torture, and just a few other human rights treaties that provide for universal jurisdiction. And the fact that it's not being exercised more often, I think, is unfortunate. I do think that the United States should be encouraged to respect its own provisions of its treaties that it's committed to, and bring these prosecutions internally. That is the ideal. If we do not do it, and other countries that are equally committed to these very important, very few, very well-drafted, long-standing treaties, around which much of our law and much our understanding of how to be normative people in the world, moral individuals of moral countries, if we need encouragement to do the right thing here, that is why we are part of an international community. So, I don't want this sense that there is chaos running amuck. We have a system that we are committed to, that we have been committed to for a very long time, decades, this is new law since the second world war. I, for one, would like to see it better enforced, not let go because some people fear it will become a world of chaos. That's not what's happening now, and there's no real evidence that that is what will happen.

