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# Fair Truth and Fiduciary Duty: The Power of Corporate Shareholders to Make a Difference

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## I. Introduction

The power of the American consumer is well established. Consumers wishing to encourage certain business practices may employ a variety of measures, including boycotts, advertising campaigns for or against a certain product, and lobbying efforts. While the strength of a fair truth label campaign may ultimately grow with the support of like-minded consumers, corporate shareholders represent another powerful group often unrecognized by consumer activists.

Corporations owe fiduciary duties to their shareholders. For most publicly traded corporations, communication with shareholders takes place in the form of annual shareholder meetings. As corporations become more powerful in American law and society, shareholders who wish to promote a specific cause are becoming more outspoken and influential in corporate shareholder meetings. The result is a unique type of activist: the "cause shareholder."

This paper will examine the duties of publicly traded corporations to their shareholders, and analyze how these duties can empower shareholders to create social change. As part owners of publicly traded companies, cause shareholders have a distinctive platform for sharing their concerns and encouraging corporate action. For the fair truth label campaign, cause shareholders may provide a new avenue of activism: shareholders can pressure corporations from within to promote the fair truth label.

## II. The Roles of Shareholders in Publicly Traded Corporations

Corporations are creatures of state law. Each state may draft its own corporate law statute, and the statutes differ in important areas.[1] Regardless of these differences, most corporations are organized in a traditional manner. The benefit of the corporate structure is that it permits a large number of people to share in the profits of the corporation, but is managed by a small, centralized group of agents known as the board of directors.[2]

The board cannot complete each of these tasks themselves; in many cases, board members have "day jobs" with other companies. Thus, the board hires officers to serve as the "actors," full-time employees who will carry out the directives of the board. The category of officers often includes a "CEO" (Chief Executive Officer), "CTO" (Chief Technical Officer) and "CFO" (Chief Financial Officer). These individuals operate the corporation for its shareholders, who are the true "owners" of the corporation and will receive corporate profits in the form of dividends. Shareholders hold the power to vote for directors; theoretically, any director who displeases shareholders may be voted out of office.

Despite the many benefits of the traditional corporate structure, some dangers exist. The property of a large group of shareholders is essentially entrusted to a small number of directors and officers, and the potential for fraud or malfeasance is prevalent. High profile corporate scandals, such as the fall of Enron, illuminate the risks inherent in the corporate structure.[3]

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[1] For example, California allows shareholders to vote cumulatively, while Florida only permits cumulative voting if a corporation's articles of incorporation specifically provide so. *Compare* Cal. Corp. Code § 708 (2011) *with* Florida Code Title XXXVI, Business Organizations § 607.0101.

[2] The invention of the corporation enabled the creation of the modern business world. As one scholar wrote in 1911, "I weigh my words when I say that in my judgment the limited liability corporation is the greatest single discovery of modern times…Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it." Nicholas Murray Butler, "Address at the 143rd Annual Banquet of the Chamber of Commerce of the State of New York, November 16, 1911," *cited in* The Kauffman Task Force on Law, Innovation and Growth, Rules for Growth: Promoting Innovation and Growth Through Legal Reform (2011), *available at* http://ssrn.com/abstract=1757982.

[3] For an excellent analysis of the Enron scandal, *see* Bethany McLean and Peter Elkind, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2003).

## A. The Fiduciary Duty Concept

In an attempt to mitigate these dangers, corporate law statutes impose fiduciary duties on directors and officers. A commonly cited definition of "fiduciary duty" provides: "A trustee [or corporate officer or director] is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."[4]

This broad term encompasses the fiduciary duties of care and loyalty. These duties impose an obligation on directors and corporate officers to make decisions in an informed and carefully deliberated manner.[5] Directors must also act in good faith and "in a manner the director reasonably believes to be in the best interest of the corporation."[6] Failure to follow these duties may result in personal liability for directors or corporate officers.[7] This potential liability is meant to discourage directors and officers from using their corporate powers for the benefit of anyone other than the corporation and its shareholders.

## B. The Property and Social Entity Models of the Corporation

Under traditional corporate law, directors and officers were charged with the task of making profits for the owners of the corporation: shareholders. With profit maximization trumping all other goals, directors and officers were discouraged from considering constituencies other than shareholders, such as employees, creditors, consumers, or local citizens. This traditional perspective has been identified as the "property model of the

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[4] *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928).
[5] Directors, or a committee of directors, "when becoming informed in connection with their decision-making function or devoting attention to their oversight function, shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances." Model Business Corporation Act § 8.30 (b) (2008).
[6] *Id.* at § 8.30(a).
[7] *Id.* at § 8.31.

public corporation."[8] Under this theory, any attempt by directors to spend money for a purpose other than maximizing profits is viewed as "agents spending other people's money in pursuit of their own, perhaps eccentric, views of the public good."[9]

The contrasting theory is the "social entity" model of the corporation, which provides that corporations have a public purpose meant to advance the welfare of society.[10] Directors' duties are not limited to profit enhancement, but also extend to all constituents affected by the corporation, including employees, consumers, and local citizens.[11] Within this model, corporations are encouraged to consider more than just shareholder profits when making business decisions. The fair truth label campaign, which is incentivizing consumers to reward those corporations treating their employees and others in a fair manner, reflects the social entity perspective.

Henry Ford articulated this viewpoint when he testified in 1919 that he intended to refrain from distributing Ford Motor Company's profits as dividends to the company's shareholders. In a suit brought by those shareholders, Ford stated that his ambition was "to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes."[12] Ford lost the lawsuit when the court held, in accordance with the property model of the corporation, that the power of directors should be "carried on primarily for the profit of the stockholders."[13]

The *Dodge v. Ford Motor Co.* court's opinion was doctrinally correct: the property model of the corporation was the traditional standard under American law. Even so, the social entity model is gaining traction in the modern era. This is particularly true given the rising populist anger toward corporations in our post-Enron, post-mortgage crisis economy. With shareholders losing gains, employees losing jobs and consumers losing

[8] William T. Allen, *Our Schizophrenic Conception of the Business Corporation,* 14 Cardozo L. Rev. 261, 264-5 (1992).
[9] *Id.* at 268.
[10] *Id.* at 271.
[11] *Id.* at 271.
[12] *Dodge v. Ford Motor Co.,* 204 Mich. 459, 468 (1919).
[13] *Id.* at 507.

confidence, American corporate directors can no longer depend on the passivity of shareholders to "rubber stamp" their business decisions. Cognizant of the fiduciary duties owed to them by corporate managers, shareholders are becoming active and vocal dissenters in shareholders' meetings and public forums. These activist shareholders are speaking directly to corporate directors on a variety of topics, including executive compensation and transparency in corporate governance.[14] For some shareholders, these meetings and forums also provide an opportunity to advance social causes, including—potentially—a fair truth label campaign.

**C. Cause Shareholders: A Case Study**

The accomplishments of Sister Patricia Daly serve as an instructive example for fair truth advocates. Sister Daly is a member of the Sisters of Saint Dominic of Caldwell, N.J. She is also the executive director of the Tri-State Coalition for Responsible Investment, a group of Catholic institutions from the New York area, and a member of the Interfaith Center on Corporate Responsibility.[15]

Sister Daly has dedicated her career to persuading Ford, G.M., Exxon-Mobil, and other American corporations to consider issues beyond shareholder profits. Sister Daly is more than an advocate; she and her fellow nuns invest their pension funds in these publicly traded companies, and she is therefore a shareholder owner.[16] Accordingly, corporate directors owe fiduciary duties to her. Moreover, in her role as a part owner of these companies, Sister Daly has access to shareholder meetings.

Sister Daly uses this access to pressure companies to "take action on issues as varied as genetically modified organisms and health care for employees for HIV."[17] While she recognizes the duty of corporations to make profits (and indeed, "her own retirement

[14] Michael Reilly, *The Return of Shareholder Activism,* BUSINESS INSIDER (Mar. 18, 2011), *available at http://www.businessinsider.com/the-return-of-shareholder-activism-2011-3.*
[15] Dashka Slater, "Resolved: Public Corporations Shall Take Us Seriously," THE NEW YORK TIMES (August 12, 2007), *available* at http://www.nytimes.com/2007/08/12/magazine/12exxon-t.html.
[16] *Id.*
[17] *Id.*

depends on it,"), Sister Daly regularly brings proposals related to social causes to shareholder meetings.[18] In 2007, she brought a greenhouse-gas-reduction proposal to ExxonMobil's annual shareholder meeting. Her efforts to convince the company to consider global warming matters included the argument that climate change is a risk to "nearly every sector of the economy."[19] As such, she argued, the company should consider the result of global warming on its long-term profits.

Sister Daly's proposal received 31 percent of the shareholder vote at the meeting.[20] Procedurally, her proposal cannot force the ExxonMobil executives to reduce greenhouse gas emissions. However, the fact that her proposal was approved by 31 percent of the company's shareholders indicates some measure of success. Shareholders were now thinking about more than profits, and "to walk away with a third of the vote was just a remarkable win."[21]

Sister Daly's efforts are successful in part because of her perseverance. She frequently communicates with corporate executives and attends shareholder meetings. She expects directors to consider the sound economic reasoning of her social causes. By asking directors to use their fiduciary responsibilities to act in the best interests of both companies and the broader society, Sister Daly represents the new "cause shareholder."

Other shareholders are taking notice of this new social movement. In fact, shareholder activists are bringing causes to the attention of corporate managers "nationwide, thanks to the fall of Enron, the rise of socially responsible investment funds, a new sense of mission on the part of institutional investors and an Internet-age impulse toward participatory democracy."[22] When shareholders speak, corporate directors increasingly listen.

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[18] *Id.* To learn more about the substance and procedure of shareholder proposals, *see* 17 C.F.R. § 240.14a-8 (2011).
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*

### D. Fair Truth Activists as Cause Shareholders

This movement could provide a new stage for fair truth activists, who might further the fair truth label campaign by becoming cause shareholders in publicly traded companies. As part owners of these corporations, fair truth activists could have direct access to meetings, documents, and corporate managers. More importantly, these managers would have fiduciary duties to shareholder activists. While corporate directors may argue under the property model of the corporation that their duty is simply to maximize profits, Sister Daly's work provides an example of the power of shareholders to motivate companies to consider social concerns as part of their economic goals.

For example, fair truth activists have a strong financial argument that the fair truth label can help a company's bottom line. The fair truth label indicates to the public that a company pays a fair living wage to its employees and employs other "fair-truth good-capitalism practices."[23] In this way, consumers can be informed about the social impact of their purchasing choices and can choose to buy products from fair truth companies. As this movement becomes more widespread, consumer demand may offset the costs of fair wages, sustainable manufacturing, and other fair truth principles. Shareholder interest in this idea, as expressed through proposal votes at shareholder meetings, would encourage corporate directors to consider signing on to the fair truth label as a good business decision.

## III. Conclusion

The rise of the cause shareholder signifies a convergence of the property model and social entity model of the corporation. As a cause shareholder would argue, sometimes directors' duties to shareholders may be fulfilled, long-term profit maximization may be realized, and society's general welfare may improve—all as a result of a corporation "doing the right thing."

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[23] *See* http://fairtruth.org/concept.php (last visited September 6, 2011).

The fair truth label campaign may be broadened through this developing social movement. As active shareholders, fair truth activists would bring a new voice to shareholder meetings. They could motivate corporations to recognize the strength of a fair truth label, and argue that corporations will benefit economically by signaling their fair truth commitment to consumers. Ultimately, the fair truth label campaign could represent a new way to merge corporate profits and fair labor practices.