The Fiduciary Duty of Corporate Directors to Protect the Environment for Future Generations

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ABSTRACT: The 'business judgement rule' requires corporate directors only to act with honesty and reasonable care in the interest of shareholders. A stronger 'fiduciary' duty is required where one party requires protection from another. This paper argues that where corporations take risks with the environment, directors are fiduciaries. Stakeholders are in that case the general public, future generations and other species, which have not voluntarily accepted risk and cannot limit liability. Recognition of fiduciary duty in such cases is consistent with recent trends in the law of equity. It would require all economic activities to move from open to closed (sustainable) systems.

KEYWORDS: Corporate responsibilities, fiduciary duties, future generations

What do today's corporate directors owe to future generations in relation to the natural environment? In particular, what standard of care they must exercise in environmental matters? May they exercise their judgement in accordance with the relatively liberal 'business judgements rule'? Or must they be governed by the far stricter standards of fiduciary duties? I suggest that consistent application of existing legal principles would force us to recognize the duty as a fiduciary one.

Let us compare the standard of environmental care which ought to be demanded of corporate directors to their more traditional duties. In Canadian corporate law, a director's duty is to manage the corporation on behalf of the owners, i.e. the shareholders. That duty is classified into at least two parts and recognizes two distinct standards of care. The lower standard of care is the business judgement rule; the higher holds a director to the standard of a fiduciary.

1. THE BUSINESS JUDGEMENT RULE

The majority of the decisions which a director must make on behalf of a corporation are governed by the 'business judgement rule'. The directors must establish policies, hire senior executives, oversee the annual budget and generally manage or supervise the management of the firm. These are usually matters which do not involve any conflict between the interests of the director and those

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of the corporation. They are also matters in relation to which no single 'correct' decision may exist; a broad number of potential choices may seem equally correct. Rather, the directors are called on to use their best judgement in any given set of circumstances, and the circumstances that present themselves are extremely varied.

The standard of care for these types of decisions is essentially a standard of reasonable care. The civil liability of directors to the company or the shareholders for ordinary business decisions is limited by the 'business judgement rule' first laid down in *Re City Equitable Fire Insurance Co. Ltd.*[1] and now codified in many federal and provincial corporations' statutes.[2] This rule states that where there is no actual or potential conflict of interest between the directors and the company, the directors are entitled to make a wide range of business decisions as they see fit. The directors must only act honestly and with reasonable diligence.[3]

One commentator describes the business judgement rule as follows:

> Directors must maintain a level of conduct at a level higher than that of the marketplace. They have a duty to be honest, take care, be diligent, act to the best of their ability, and be as prudent as a prudent businessman and give their whole ability, business knowledge and attention to the best interests of the company.[4]

Directors are expected to be careful, but the standard is not the lofty one of utmost, constant care.[5] They need have no particular expertise. They are not expected to exhibit a greater degree of skill than may reasonably be expected of persons with their knowledge and experience.[6]

The business judgement rule seems to strike a fair and effective balance between the interests of shareholders and directors, and indeed between the various interests of shareholders. The essence of the business judgement rule is that it allows the directors to take a certain degree of risk. Such risk-taking is a necessary and desirable part of a market economy; indeed, it was to foster such risk-taking that limited liability corporations were invented and encouraged by the law. Given that directors are frequently not the shareholders, it may be objected that the directors are taking these risks with other people's money. However, this is appropriate as between the directors and the corporation (or the shareholders) because:

(a) the shareholders have voluntarily agreed to accept those risks by investing in the corporation;

(b) they do so in the hope and expectation of personal profit if the venture is successful;

(c) the shareholders' risk is limited to the degree that they themselves have chosen, that is, to the amount of their investment in the corporation;

(d) the shareholders can reasonably expect that the directors' discretion will be exercised in the best interests of the corporation, because[7]

(i) the directors are accountable to the shareholders each year for their decisions and perforrnance; and

(ii) the directors are not permitted to have personal interests which are in conflict with those of the corporation.

2. FIDUCIARY DUTIES

This justification for the business judgement rule does not apply where the shareholders cannot reasonably expect that the directors' discretion will be exercised in their best interests. Typically, this occurs when there is a conflict of interest, or a potential for such a conflict, between the interests of the corporation and the personal interests of the director. In such cases, the broad discretion characteristic of the business judgement rule is replaced by the duty of a fiduciary, the highest standard known to law.

'Fiduciary' is a legal category invented by the courts of equity to describe certain relationships where the courts felt that, in fairness, one party deserved special protection from the other. Such protection was typically granted where one party was entrusted with special power over the property of another, and where the true owner was unusually vulnerable and unable to protect him/herself. The classic example is the relationship between a trustee and the beneficiaries of the trust, where the beneficiaries are the true owners of property but all decisions are made for them by the trustee. The courts created the special duties of a fiduciary to offset in part the imbalance of power between the trustee (the 'fiduciary') and the beneficiaries.

The standard of care of a fiduciary is one of the 'utmost good faith'.[8] No one who has duties of a fiduciary nature to perform, whether a trustee or not, is allowed to enter into engagements in which he has, or can have, a personal interest conflicting with the interests of those he is bound to protect. A fiduciary must scrupulously avoid putting herself in a conflict of interest, or even an appearance of conflict. A fiduciary has a duty not to profit at the expense of those s/he is obliged to protect.

The courts and the legislatures have recognized the strong temptations which may face a director and the many opportunities which s/he may have to misappropriate the economic opportunities of the company. The company and the shareholders are quite vulnerable to misappropriation of this kind because of the largely unfettered authority that the directors enjoy, and the position of trust vis-à-vis the shareholders which they hold. The extremely high standard of care of a fiduciary is intended to counterbalance those temptations and the vulnerability of the shareholders, who cannot otherwise protect their legitimate interests.[9]

3. WHICH STANDARD SHOULD APPLY TO ENVIRONMENTAL MATTERS?

The business judgement rule is no longer the appropriate benchmark of responsibility for decisions made by corporate directors which will permanently affect the natural environment because:

(1) The stakeholders in the environment are, at least, the public as a whole. They include future generations and other species.

(2) Future generations have not agreed to accept risks to the environment in order to make the corporation successful. Nor can they expect personal profits from the corporation's success. In the environmental area, the public pays all of the costs and may get none of the benefits.

(3) When environmental risks are taken, there may be no limit to the damage which may result. The public lacks the essential protection which shareholders have of limited liability, liability which is exclusively financial and which is limited in amount.[10]

(4) Future generations have no reasonable means of assuring that the discretion of today's corporate directors will be exercised in their best interests:

   (i) Future generations have no means of calling today's directors to account.

   (ii) Due to the fact that pollution is a negative extemality imposed upon future generations which today's corporations do not pay for, there is a direct conflict of interest between the profit motive of today's directors (and the corporations they represent) and future generations.

As the World Commission on Environment and Development put it:

> We borrow environmental capital from future generations with no intention or prospect of repaying. They may damn us for our spendthrift ways, but they can never collect on our debt to them. We act as we do because we can get away with it: future generations do not vote; they have no political or financial power; they cannot challenge our decisions. But the results of the present profligacy are rapidly closing the options for future generations.[11]

The interest of future generations in a healthy environment is both more urgent and more vulnerable in relation to corporate decision-making than the interests of the shareholders (which are merely financial) are in relation to the personal financial interests of a director. If a fiduciary standard is justified to protect the financial interests of shareholders,[12] it is even more justified to protect the interest of future generations in the environment.

4. THE NEW EQUITY

Recognition of a fiduciary duty owed by corporate directors to future generations in relation to environmental protection is consistent with recent trends in the law of equity. As Chief Justice Dickson has said, "The categories of the fiduciary … should not be considered closed".[13] Although, traditionally, a fiduciary must have undertaken to act for the beneficiary,[14] Canadian courts have shown an increasing willingness in recent years to expand the scope of fiduciary duties where lower standards of care do not appear to be sufficient to protect important interests.[15]

In the 'new equity', a fiduciary duty arises where:

(1) The fiduciary has scope for the exercise of some discretion or power.

(2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.

(3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.[16]

The relationship between the corporate directors whose companies pollute, and future generations, satisfies these three conditions. The nature of today's corporate activities will strongly affect the essential practical interests of future generations in the kind of environment they will receive from us, yet future generations can do nothing to protect those interests; they are totally at the mercy of today's decision makers.

The argument here is that very important, indeed fundamental, social interests are imperilled when business decisions cause environmental degradation. The business judgement rule has not been sufficient to prevent such degradation; corporations have continued to use up the natural capital of the world[17] because it has been lawful and profitable to do so. Other species and the natural world in general are unable to protect themselves from corporate destruction[18]; nor can those whose well-being depends upon a healthy environment, including future generations. These conditions suffice to invite the intervention of equity.

The fact that this new duty would be owed to future generations which are not yet in being is not an insuperable obstacle. When private actions are necessary, the duty could be enforced by the Crown or by another person appointed by the court as their representative.[19] The duty can also be enforced through its impact on the standard of due diligence in a prosecution.[20]

The scope of the duty of loyalty owed by a fiduciary depends upon the extent of his discretion to harm the interests of the beneficiary. The greater the discretion, and the greater the potential harrn, the more intense the loyalty which is owed.[21] As today's directors are completely beyond the control of future generations, and as the harm they may suffer is unlimited and incalculable, the standard of care attached to this duty should be one of the utmost good faith. The more difficult question is to define the content of the duty, and to define it in a way that permits corporate directors to determine what is required of them.

As a starting point, we cannot do better than John Rawls. He suggests that each generation owes the next a world that is a better place for our having lived in it.[22] To translate this noble goal into reality, the new fiduciary duty would oblige corporate executives to leave the natural environment affected by the activities under their control in better condition than it was when the activities began, or perhaps than when they received control of the enterprise from their predecessors.[23]

We would have a new perspective on the scale of caring, from the point of view of future generations. The more that any act could affect future generations, the more care must be exercised to avoid it. Corporate executives would be required to do their utmost to avoid permanent environmental damage.[24] The more temporary and the more repairable the damage threatened by an activity, the less stringent would be the duty to prevent that damage. If damage did occur, corporate executives would be obliged to act as fiduciaries in repairing the damage, i.e. to do everything possible.

5. PRACTICAL IMPLICATIONS

Legal recognition of this new fiduciary duty would have enormous practical implications. In the short run, the new fiduciary duty would increase the standard of care required to show due diligence in preventing pollution. Many companies would have to dramatically upgrade their environmental protection programs if they wished to qualify for acquittal in a Canadian environmental prosecution, or a favourable verdict in a civil suit. The standard of care in repairing pollution which has already occurred would also rise. The Ontario approach, which limits the obligation to repair to what is 'practicable',[25] might no longer go far enough.

We would immediately cease to permit any activity which would destroy the habitat of an endangered species. The value of each individual species is 'literally incalculable'.

> From the most narrow possible point of view, it is in the best interests of mankind to minimize the loss of genetic variations. The reason is simple: they are potential resources. They are keys to puzzles which we cannot solve, and may provide answers to questions which we have not yet learned to ask … Who knows, or can say, what potential cures for cancer or other scourges, present or future, may be locked up in the structures of plants which may yet be undiscovered, much less analyzed? … Sheer self-interest impels us to be cautious.[26]

There would be no tolerable discharges of persistent toxic chemicals. There would be no tolerable discharge of chemicals which attack the ozone layer. Businesses which released carbon (e.g. through the burning of fossil fuels), would be responsible for planting enough trees to absorb the carbon they produce.[27] Businesses of all kinds would have to find cleaner methods of production.

New 'developments' of land would be subject to stringent and strictly enforced rules of 'no net loss'. If building a new factory would cut down trees, new trees would be planted and cared for to maturity, at least as many as are needed to ensure full replacement of those destroyed, after proper allowances tor insects and other losses. If a development would destroy wetlands, new wetlands would have to be created first, large enough to make allowance for the lower productivity of artificially created wetlands.

No business with remaining assets would be allowed to shut down without decommissioning its site and removing all contamination. Site cleanup would have to consist of real treatment of the contaminants, not merely digging them up and transporting them somewhere else.

In the long run, all economic activities would have to move from open to closed systems, living on the ‘interest’ of nature rather than its capital. Businesses and municipalities would no longer be permitted to take in clean air and water and discharge it fouled. They might, for example, be required to make each industry over a certain size a closed system, constantly reusing the same water and air. (Swaps between businesses would be permitted). Smaller businesses would have to operate within municipal environmental rules as an organic part of the local ecosystem, taking in only what could be spared and discharging only what can assuredly be absorbed.

No one would be allowed to create garbage, i.e. wastes which cannot be recycled or reused but which cannot be re-absorbed into the natural environment without causing harm. We would have to find ways to mine out existing garbage dumps for the valuable metals and other materials they contain.

We would have to rethink how we use fossil fuels.

6. CONCLUSION

The new fiduciary duty will not be an easy duty to discharge. It will markedly change the perceived costs of many traditional ways of doing business. Inefficient businesses in old plants will be hard-pressed to adapt to the new imperative; many will close. New businesses will arise to take their place. The dislocations of this change will be costly and sometimes painful. They will take time.

We must not forget that even the utmost good faith will not fully resolve the problems of vagueness and uncertainty which bedevil environmental regulation. We are poor predictors of the consequences of our acts. Many of our most crucial environmental problems, such as the ozone hole, global warming and acid rain, are unexpected consequences of apparently innocent acts. Nor do we wish to fall into the trap of attempting to prevent and control everything without any tolerance for error.

Nevertheless, we need to do better than we have been doing. We must learn to treat the natural world like the closed system that it is, not like the inexhaustible reservoir that we used to imagine it to be. We need strong tools to redirect some of the ingenuity and energy of business from short term profits to sustainable development. Recognition of a fiduciary duty to do so will help us to find the way.

NOTES

[1] [1925] 1 Ch. 407 (C.A.).
[2] See Feltham and Rauenbusch, 1976.
[3] See American Law Institute, 1985.
[4] Wainberg, 1987.
[5] Institute of Law Research and Reform, 1989, p. 8.
[6] Directors were also protected procedurally by the rule in *Foss v. Harbottle* (1843), 2 Hare 461, 67 E.R. 189, which severely restricted the ability of aggrieved shareholders to sue directors. Partly as a result of the low standard of care, and partly because of the procedural protection of Foss v. Harbottle, directors have been successfully sued for breach of the business judgement rule in relatively few cases: J. Bishop Jr., 1968; Institute of Law Research and Reform, 1989, pp. 13 and 17.
[7] Unless the shareholders agree to give up these protections, as through the inclusion of 'weighted voting rights' (see *Bushell v. Faith* [l970] A. C. 1099).
[8] Gower, 1969, p. 519.
[9] For corporate law purposes, the fiduciary duty is formally owed to the corporation, and not directly to the shareholders. However, the shareholders are the human beings whose money is ultimately at stake.
[10] Consider Chernobyl, Three Mile Island and the Exxon Valdez.
[11] World Commisssion on Environment and Development, 1987, p. 8.
[12] An interesting example of the potential for confiicts of interest between the directors and the shareholders occurs when the directors and the corporation are both charged with an environmental offence. One of the major advantages for the Crown in charging both corporate executives and the corporation is that the corporate executives are often willing (indeed anxious) to plead the corporation guilty in exchange for withdrawal of charges against themselves. This undoubtedly saves substantial court time, and may sometimes be in the shareholders' best interest. However, if all the directors are charged, who can make that determination on the corporation's behalf? The potential for conflict may ripen into an actual conflict if the executive pleads the company guilty despite the existence of a legitimate defence, or if the executive agrees to a larger fine against the company in exchange for the withdrawal of charges against herself.

Professor Glasbeek argues that it is improper and unwise for the Crown to accept guilty pleas by the corporation in exchange for the withdrawal of charges against the directors: see Glasbeek, 1984. Nevertheless, this practice is extremely common. A certain judicial resistance to this practice appeared in *U.S. v. Pennwalt Corp., Inc. and Orwal High* (November 13,1989) *Corporate Crime Reporter* **17**, in which the corporation and plant manager pleaded guilty to charges of discharging a pollutant and failing to report the spill; charges against senior head office staff were withdrawn as part of the plea agreement. A large, poorly maintained tank had collapsed, spilling 75,000 gallons of toxins into a watercourse. The court insisted that the chairman personally attend court and enter the plea for the corporation.

In 1991, the Ontario Ministry of the Environment announced that it would no longer withdraw charges against individuals associated with a corporation in exchange for a guilty plea by the corporation. At the same time, the Ministry accelerated its programme of charging as many individual defendants as possible when a corporation was charged. This has had the result of decreasing the number of cases resolved through plea bargaining, and increasing the length and expense of trials. It has also caused a number of companies to divert resources from fighting pollution to fighting the government. The Ministry responded by increasing its investigation and prosecution staff. All of this is very good for counsel in private practice, but it is less clear that the environment as a whole has benefited.

[13] Guerin v. The Queen (1984), 13 D.L.R. (4th) 321 at p. 341, [1984] 2 S.C.R. 335.

[14] Maddaugh and McCamus, 1990, p. 579.

[15] E.g.: Lac Minerals Ltd v International Corona Resources Ltd (1989), 61 D.L.R. (4th) 14, [1989] 2 S.C.R. 574; Canadian Aero Service Ltd v. O'Malley (1973), 40 D.L R. (3d) 371, [1974] S.C.R. 592; Standard Investments Ltd v. Canadian Imperial Bank of Commerce (1986), 22 D.L.R. (4th) 410, 52 O.R. (2d) 473 (C.A.); W.J. Christie & Co. Ltd v. Greer (1981), 121 D.L.R. (3d) 472, [1981] 4 W.W.R. 34 (Man. C.A.); MacMillan Bloedel v. Binstead (1983), 22 B.L.R. 255, 14 E.T.R. 269 (B.C.S.C.). See Note [Walter Hinnant]: "Fiduciary Duties of Directors: How Far Do They Go?" (1988), 23 Wake Forest L. Rev. 163; Note, "Directors as Fiduciaries" (1979), 8 Sydney L. Rev. 668.

[16] Wilson J. in Frame v. Smith, [1987] 2 S.C.R. 99 at p. 136, cited with approval in Lac Minerals Ltd v. International Corona Resources Ltd [1989] 2 S.C.R. 574 at p. 645 per La Forest J. and at p. 598-9 per Sopinka J..

[17] Our common heritage of both renewable and non-renewable resources, including the diversity of species, the availability of raw materials, clean air, healthy soil and pure water.

[18] Except perhaps in the very long term sense that the natural world may become so overburdened that we make our species extinct.

[19] Given the strong moral mandate now recognized in Canada for the use of the courts to combat environmental degradation, it is likely that these new remedies will in fact be used. Moreover, the Ontario government is now taking a number of initiatives to facilitate judicial recourse in cases of environmental damage. For example, the new Class Proceedings Act will aid individuals or small groups to establish class actions, and sets up a fund to underwrite their costs. Intervenor funding is provided through several Boards to encourage community participation in environmental hearings. Standing rules have been relaxed. The anticipated Environmental Bill of Rights is expected to expressly recognize a new cause of action arising out of harm to the natural environment, which will not be shackled to traditional concepts of property damage.

[20] Ontario (with about 9 million people) now launches one thousand environmental prosecutions a year. These prosecutions have been surprisingly effective in motivating behavioural change among business people. See Saxe, 1991.

[21] Scott, 1949.

[22] Rawls, 1971, p. 289.

[23] See also, Waring, 1990 and Riley, 1980.

[24] A fiduciary standard would require corporate executives to treat the risk of permanent darnage with the utmost seriousness, even if the risk is small. An example of this approach occurred in a British Columbia case, which admittedly was not one of prosecution.

In 1972, a British Columbia subdivision approving officer refused to allow a developer to register a subdivision plan for residences in an area of the Rocky Mountains potentially subject to rock slides. The developer appealed this decision to the Supreme Court of British Columbia. The evidence before Justice Thomas Berger was that a rock slide could occur some time in the next 10,000 years. A representative of the Sierra Club of British Columbia, who was given standing by Justice Berger to oppose the developer, argued that this was a substantial enough risk to prevent the development. The developer argued that in hurnan affairs, a generation is a long enough time, and that no one should be expected to order his affairs on a geological time scale. The development company offered to undertake to advise all future purchasers of the risk of a slide if the Court approved the subdivision. Justice Berger said:

> "On a human time scale, there is a risk here. It is a risk that can be understood. It is a substantial risk. It may not be an immediate risk, yet it is there. Who is to say that the life of the subdivision would be merely one generation?...The evidence shows that there is a risk – a risk that reasonable men cannot exclude – that a disaster will occur within the life of a community. The approving officer adopted a policy of safety first. I think he was nght to do so."

Justice Berger upheld the decision of the approving officer. The rock slide occurred one year later. Case described by Swaigen, 1988.

[25] As defined in the Ontario *Environmental Protection Act*

[26] Congressional Debates on the Endangered Species Act, cited in *Tennessee Valley Authority v. Hill*, 437 U.S. 153 (1978) at p. 178.

[27] To avoid promotion of global warming.

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