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ESG: MYTHS and REALITIES

ESG is Corporate Socialism

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ESG is Corporate Socialism

Bruce Pardy

Introduction

According to Milton Friedman, in a capitalist society the sole role of business is to make money. "[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud" (Friedman, 2002: 133).

ESG, the "Environmental, Social, and Governance" model of business administration, operates on the opposite premise: that the responsibility of business is to achieve social good. Also known as "stakeholder capitalism" and "corporate social responsibility", under ESG, companies must endorse and pursue progressive social and political objectives. In the words of Michael McCain, president and chief executive of Maple Leaf Foods, the role of business is "to channel resources to tackle the monumental social and environmental issues of our time, including our climate crisis and food insecurity. Leading this effort cannot be confined to government, NGOs or social activists. It can only succeed with the direct engagement of forward-thinking business leaders" (McCain, 2022, January 14).

ESG's vision of social good is not a neutral, benign vision of a better world but an ideological agenda with an emphasis on climate activism, critical race theory, and central planning. Inside the corporate structure, ESG undermines the duty of officers and directors to act in the best interests of the corporation, thereby empowering management at the expense of shareholders, creating an executive aristocracy. From the outside, ESG assesses corporate value by measuring commitment to political goals rather than profitability, thereby threatening companies who dissent from its mandates.

Capitalism, socialism, and corporations

Capital is property: land and buildings, machines and vehicles, money and credit, intellectual property such as patents and trademarks, and so on. "Capital-ism" is a political and economic system in which those who own property are the ones who decide what the property is used for. Capitalism, in other words, simply gives full effect to private property rights.[1]

Socialism is the opposite: a system in which someone other than the owner of property decides the purposes to which the property shall be put, putting the interests of society before and above the rights of the property owner.

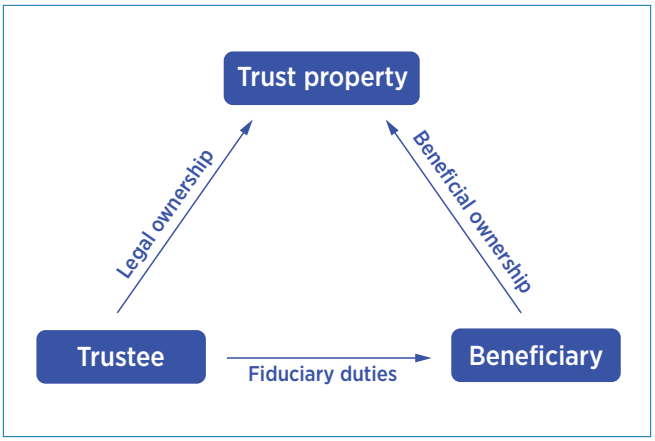
Corporations exist because statutes say that they can. But why have them at all? Compared to individual persons, who must operate businesses either as sole proprietors (a business operated by an individual in his own name) or partnerships (a contractual relationship between individuals running a business together), corporations can pool capital more easily in greater amounts. Many persons can buy shares and thereby contribute resources to the enterprise. Unlike becoming a partner in a traditional partnership,[2] shareholders are protected by limited liability for the acts of the corporation, making it less risky to invest. Because corporations can concentrate capital, they can be more efficient and economically powerful than other forms of business, controlling more assets, employing more people, and potentially achieving "horizontal integration" (producing a wide array of related products), and/or "vertical integration" (owning and operating its own supply chain).[3]

The danger is that corporate executives will wield the economic might of their corporations to influence the political sphere and governments will demand that companies pursue public policy goals, a scenario often referred to as "corporatism" (Stuttaford, 2020, July 9; Darwall, 2021). The danger of executive power is mitigated by what has traditionally been the core feature of corporate governance: the fiduciary duty of officers and directors to act in the best interests of the corporation.

Undermining the duty to act in the best interests of the corporation

Shareholders own the corporation. Officers and directors run it. What legal principles should apply when property owned by one person is controlled by another?

A useful analogy is the trust. A trust is a property relationship in which one person, the trustee, holds property for the benefit of another, the beneficiary. The beneficiary is said to hold "equitable title" to the trust property, while the trustee holds legal title. The trustee is empowered to deal with the property—to keep, invest, sell, safeguard, and so on—and the



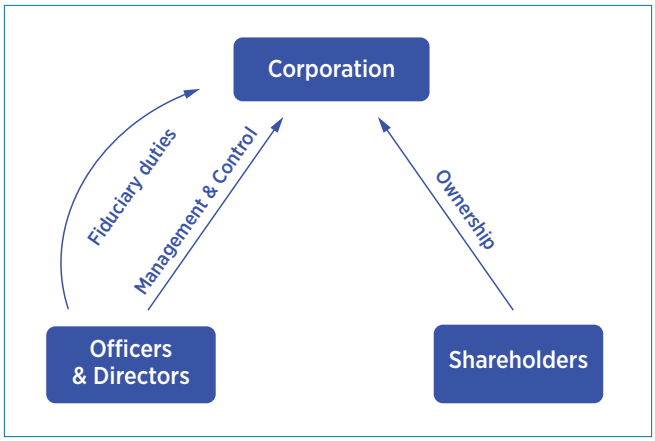
beneficiary is entitled to the benefit of that property, whether to investment returns, to the whole property once the beneficiary reaches a certain age, to be housed in the trust property if it is a residence, or the like. The beneficiary's entitlements are defined in the terms of the trust.

The trustee owes fiduciary duties to the beneficiary to hold and control the property with a reasonable degree of care and skill for that person's benefit. "The fiduciary relationship impresses the office of trustee with three fundamental duties: the trustee must act honestly and with reasonable skill and prudence, the trustee cannot delegate the office, and the trustee cannot personally profit from its dealings with the trust property or its beneficiaries" (*Canada v. Canada North Group Inc.*, [2021] SCJ No 30 at para 48).

The relationship between a corporation's shareholders and its officers and directors is abstractly similar. Shareholders own the corporation, but officers and directors deal with its assets and run the business. That is a trust-like relationship: one group holds the beneficial interest in the property and the other controls it. Traditionally, officers and directors are thought to owe a fiduciary duty comparable to that of a trustee. For example, the *Canada Business Corporations Act* (RSC 1985, c. C-44) states:

> 122 (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall
>
> (a) act honestly and in good faith with a view to the best interests of the corporation; and
>
> (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Although the source of this obligation is statutory, the duty is fiduciary in nature (*Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] SCJ No 64 at para 32; *McClurg v. Canada*, [1990] 3 SCR 1020 at para 23). It requires directors and officers "to manage the company according to their best judgment; that judgment must be an informed judgment; it must have a reasonable basis. If there are no reasonable grounds to support an assertion by the directors that they have acted in the best interests of the company, a court will be justified in finding that the directors acted for an improper purpose" (*Maple Leaf Foods Inc. v. Schneider Corporation* (1998), 42 OR (3d) 177 at para 34 (CA)). The duty is owed not directly to the shareholders as individuals, but to the welfare of the corporation, whose success and profitability will amount to benefit to the shareholders as a group (*Maple Leaf Foods Inc. v. Schneider Corporation* (1998), para 35; *McClurg v. Canada*, [1990] 3 SCR 1020, note 9, quoting Welling, 1984: 614).



The fiduciary duty owed by the directors and officers, like the duty of a trustee, is necessary to ensure that they do not use corporate resources in their own interests or for their own purposes. The best interests of the corporation are generally those actions that maximize the value of the corporation, which in the broad sense reflect the interests of the shareholders in generating a return on investment (*Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] SCJ No 64 at para 42; Berle, 1932: 1367, quoted by Yalden, 2002: 10). In Canada, corporate law has traditionally been based on the notion that management is to work for the interests of shareholders (VanDuzer, 1997: 346).

The primacy of the corporation's bottom line does not prevent companies from treating employees, creditors, suppliers, and customers fairly, from doing good deeds in the community, or from complying with laws and regulations. Any action that enhances profits, such as generating community goodwill, maintaining a content workforce, developing good relationships with suppliers and creditors, and staying out of legal trouble, will be consistent with the duty. If consideration for employees, creditors, suppliers, customers, environmental causes, and community interests is consistent with and enhances the company's prospects, such as by attracting new customers through its good works, then no problem arises. However, when executives pursue good deeds that conflict with the company's financial interests, they may breach their duty to act in the best interests of the corporation. As the Supreme Court of Canada has stated:

> "When executives pursue good deeds that conflict with the company's financial interests, they may breach their duty to act in the best interests of the corporation."

> … directors owe a fiduciary duty to the corporation, and only to the corporation. People sometimes speak in terms of directors owing a duty to both the corporation and to stakeholders. Usually this is harmless, since the reasonable expectations of the stakeholder in a particular outcome often coincide with what is in the best interests of the corporation. However, cases… may arise where these interests do not coincide. In such cases, it is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation. (*BCE Inc. v. 1976 Debentureholders*, [2008] 3 SCR 560 at para 66)[4]

Thus, any decision made by officers or directors must have as its object the betterment of the corporation in the financial sense. The fiduciary responsibility of officers and directors is to increase the corporation's profits. Milton Friedman would approve.

But that is not how ESG works. ESG corporate governance demands that directors and officers act in the interests of a wide array of "stakeholders." Stakeholders can include other groups of people, such as employees, creditors, suppliers, and customers, but also inanimate interests, including environmental causes such as climate action, and social goals such as DIE (diversity, inclusion, and equity) quotas.

"ESG corporate governance demands that directors and officers act in the interests of a wide array of 'stakeholders.'"

Stakeholder governance makes shareholders just one of numerous stakeholders to be considered in management decisions. Stakeholder governance dilutes directors' and officers' fiduciary duties and broadens their discretion. It provides executives with a mandate to put corporate assets towards political causes that they deem important. It turns companies into social welfare institutions and gives business leaders licence to pursue "social good" at their discretion with other peoples' money. Friedman wrote:

> Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. This is a fundamentally subversive doctrine. If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is? Can they decide how great a burden they are justified in placing on themselves or their stockholders to serve that social interest? (Friedman, 2002: 133-134.)

Social credit scoring for corporations: rejecting profit as the corporation's measure of value

Markets are patterns of exchanges that make both parties better off. When parties transact, they trade property rights. If I pay my neighbour $100 for his old bicycle, I am acquiring his property rights in the bike in exchange for my property in the money that I hand to him. We make this exchange because I would rather have the bike than my $100, and vice versa. If that were not so, the trade would not occur.

A business sells products or services when people perceive that they will be better off to purchase than not. A successful company, therefore, is successful because it satisfies wants and needs of its customers. This is Adam Smith's invisible hand in action:

> It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.… he intends only his own gain; and he is in this, as in many other cases, led by an invisible hand to promote an end which was not part of his intention.... By pursuing his

> own interest he frequently promotes that of the society more effectually than when he really intends to promote it. (Smith 1776: Book 1, Chapter 2)

Profits reflect the company's value (assuming the absence of government intervention or policies protecting the company from competition).

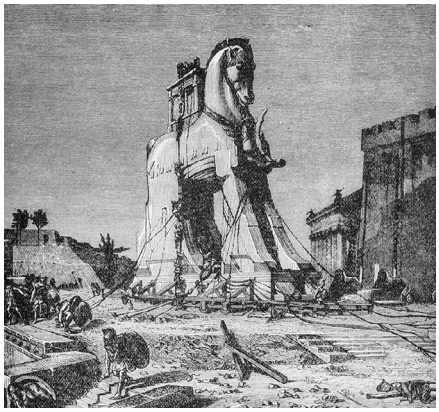
> "ESG rating agencies assess business comportment with progressive values to determine their 'sustainability,' in what amounts to social credit scoring for corporations."

But not with ESG, which rejects the notion that profits measure value, and instead treats profits as an evil by-product of capitalism. ESG rating agencies assess business comportment with progressive values to determine their "sustainability," in what amounts to social credit scoring for corporations.

Companies found lacking in the kind of environmental, social, and governance policies preferred by ESG advocates risk low scores and denunciation. Individual and institutional investors rely on agency reports to make investment decisions, and banks and other financial institutions to make credit decisions. ESG empowers a sophisticated "woke mob" to demand that corporations pursue certain preferred objectives.[5] As Friedman put it, "the doctrine of 'social responsibility' involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses" (Friedman, 1970, September 13). As ESG reporting becomes standard and increasingly mandatory, so must ideological compliance. Along with digital currency and digital identification, both presently in development, ESG represents centralized, political supervision of the economy.

Conclusion: Undermining capitalism and Western civilization

Michael McCain of Maple Leaf Foods laments what capitalism has done to the world. Planet Earth, he says, "is on fire." Inequality and social injustice, he suggests, has risen to intolerable levels. Like many business leaders, McCain adopts the premises of ESG. He proposes a "new Charter for Capitalism," the first element of which is to "recognize multi-stakeholders equally, rejecting the primacy of shareholders, by including the environment, natural life and society as equally critical stakeholders" (McCain, 2022, January 14.)



In embracing ESG, no doubt some business leaders believe they are doing good. They fail to grasp that ESG is a Trojan horse that undermines capitalism[6] and their own free societies. Once a singular focus on making profits comes to be regarded as unacceptable, business decisions will no longer belong to businesses to decide on their own. Instead, the moral and political content of corporate actions will require technocratic supervision. Friedman wrote, "the external forces that curb the market will

not be the social consciences, however highly developed, of the pontificating executives; it will be the iron fist of Government bureaucrats" (Friedman, 1970, Sept 13.)

ESG threatens the end of apolitical commerce, establishing instead a collectivist, illiberal, manipulated economy.

Endnotes

1 Capitalism: "The economic system based on private property and private enterprise. Under this system all, or a major proportion, of economic activity is undertaken by private profit-seeking individuals or organizations, and land and other material means of production are largely privately owned. Under capitalism parts of the economy may be in public ownership. The government may impose certain regulations on the activities of the private sector regarding public health and safety, enforcement of competition, and protection of the environment" (Black, Hashimzade, and Myles, 2009: 33).

2 In traditional partnerships, partners are legally responsible for anything any member of the partnership does. In recent decades, limited liability partnerships have become possible in many jurisdictions in some circumstances.

3 In the production of a car, for example, it is possible for one company to own more than one of the many businesses that produce distinct products or services that together combine to create the product for sale in the showroom: the mine that digs the iron ore; the smelter that produces the steel; the engineering department that designs the motor; the stamping factory that shapes the steel into parts; the assembly plant that puts the parts together; the financing company that loans money for customer purchases; the transportation that takes the cars from the plant to the showroom; and so on. Without the corporate form, the argument goes, accomplishing such tasks would take the coordination of hundreds of sole proprietorships facing monumental organizational and contractual challenges.

4 Also see Peoples Department Stores Inc. (Trustee of) v. Wise, [2004] SCJ No 64 at para 43.

5 "The International Organization for Standardization has announced a new initiative to help businesses measure and improve their sustainability performance, to reduce their carbon footprints. With certain firms doing more harm than good in this area of environmental responsibility, rating agencies must continue to hold them accountable" (Impact Investor, 2022, June 21).

6 "The battle over ESG is a fight for the future of capitalism—for its continued capacity to generate economic growth and the higher living standards on which its legitimacy as an economic system rests. That legitimacy was not built by becoming an instrument of political power wielded by Wall Street oligarchs. The weaponization of finance constitutes a potentially lethal strategic move, one that would end capitalism as we know it" (Rupert, 2021: 17).

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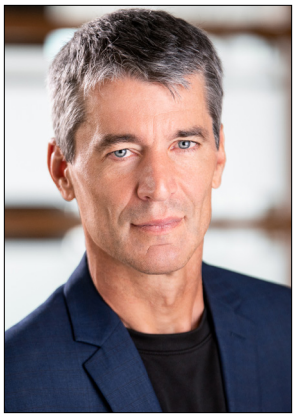

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