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THE RIDDLE OF SHAREHOLDER RIGHTS AND CORPORATE SOCIAL RESPONSIBILITY

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Abstract

Shareholders own the entrepreneurial interests in corporations. As such, the law has historically held that they must be run primarily to generate profit for those investors. Progressives and some enlightened business leaders however have long claimed that this "shareholder primacy" rule is inadequate and urged that the larger needs of the community must also be a concern of business decision-makers. This corporate social responsibility movement (CSR) has gained legal traction during the last several decades with legislative initiatives like constituency statutes and the benefit corporation. In recent years reformers have advocated it even more forcefully as a solution to grave and growing public evils such as income inequality and environmental degradation.

Shareholders and their lawyers however continue to play indispensable roles in our economic system by policing corporate corruption and holding executives accountable to provide needed returns to their investors. The drive for corporate social responsibility therefore should not undercut shareholder rights but promote ever more creative ways that businesses can serve the triple bottom line of profits, people, and the planet.

I Introduction

Corporations exist primarily to make profit for their shareholders. This has been the black letter rule of law and the reigning orthodoxy of American business for a century.[1] And for

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most of the last 100 years, large corporations[2] have generally served the nation well. They have been the prime vehicles for providing needed goods and services while they have continually improved their products to better satisfy their consumers. They have also been the source of good jobs for countless workers.

Yet through the years certain legal and social theorists have advocated that these business behemoths should have a broader mandate. In the last several decades that outlook has grown to a large scale movement called corporate social responsibility (CSR). It asserts that a more expansive corporate mission is needed now more than ever as income inequality has increased to alarming proportions and environmental issues threaten the sustainability of life on our planet.

This Article contends that both these corporate goals, profit and social responsibility, are compatible. Shareholders play an indispensable role in the structure of American business. In addition, economic gain, if widely shared, is a major benefit to our common life. Yet corporate leaders, as stewards of our society's resources, must also be charged with serving the larger interests of their workers and the communities where they do business.

This Article will therefore begin with a discussion of the important role that shareholders play in the corporate structure. It will trace how stockholders were initially instrumental in America's industrial development, yet because of the rise of a managerial class they lost their ability to control the enterprises that they owned. Shareholders however regained some of their

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1 *See e.g.* Dodge v. Ford, 204 Mich. 459, 170 N.W. 668 (1919) and *infra* notes ** and accompanying text.

2 Today there are approximately 6,700 large public companies whose shares are actively traded. Even though they comprise a small fraction of the 5.8 million U.S. businesses operating in the corporate form, these firms generate the lion's share of our country's economic activity. Howard M. Friedman, <u>Publicly-held Corporations: A Lawyer's Guide</u> 1 (2011).

power in the tender offer era of the 1970s and 80s and since then their influence has continued to grow through aggressive stockholder litigation and the movement for better corporate governance. Both those trends have served society well by promoting managerial accountability and checking corrupt business practices.

The Article will next explain how the rule arose that corporations must be run primarily to make profit for their shareholders. Through ensuing decades, progressive commentators and some business leaders themselves criticized that approach as being too narrow a mandate for these powerful economic units. In response, a new outlook congealed during the social ferment of the 1960s and 70s that corporations must embrace broader goals. By the 1990s that movement came to be called CSR and it demanded that large firms have a "triple bottom line" characterized as the three "Ps"—profit, people, and the planet.

Most recently, as this Article will discuss, CSR has gained increasing sophistication in its approach and has garnered support not only from progressive thinkers and religious leaders, but from members of the business community and the general population as well. When presented against the backdrop of America's growing income inequality, CSR now makes compelling claims that large businesses must not only serve the interests of their investors but also of society as a whole. The Article will conclude with a renewed call for a national corporate law that would provide a structure to accomplish that goal.

II. The Indispensable Shareholder

A. The Shareholder's Role

The law governing for-profit corporations provides that there must be some group that has the final claim on their wealth[3] and there also must be someone to whom their directors are accountable.[4] Common shareholders occupy both positions. They supply a firm's risk capital and therefore have the ultimate entrepreneurial stake in the company. They are also the residual owners of its profits and thus the ones to whom its managers must be responsible. Shareholders are therefore fundamental constituents of a for-profit corporation.

In addition, such a system of private investing has many virtues. It can channel economic resources to their most efficient uses because it rewards intelligent risk-takers with the profits from their investments. It is also an altogether good idea to encourage wide-spread holdings in the equity of our country's businesses. Half of American households are shareholders, either directly or through their retirement plans.[5] Since stock ownership returns more over time than fixed obligations like bonds or bank deposits it allows investors to maximize the growth of their savings.

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3 *See e.g.* Model Bus. Corp. Act (MBCA) § 6.01(b)(2)

4 *See, e.g.* MCBA § 6.01(b)(1)

5 Annie Lowrey, *Top 10% Took Home Half of U.S. Income in 2012,* N.Y. Times, Sept. 11, 2013.

A large percentage of that stock ownership however is now held by the richest Americas and most working people, with little disposable income have been unable to participate in the recent stock market gains. James Surowiecki, *The Pay is Too Damn Low,* New Yorker, Aug. 12, 2013

B. Shareholders in Early American Corporate History

When the American industrial revolution got started in earnest in the first part of the 19th century, the United States was already a country with a prosperous middle class. Since those folks had some savings and were generally eager to share in the profitability of new firms, businesses found it advantageous to secure capital from them.[6]

The corporate form aided that process.[7] Limited liability for shareholders was already one of its standard features and by the time of the Civil War obtaining a corporate charter had become a simple process. By then entrepreneurs no longer needed a specific legislative act to create a corporation but could bring such a separate legal entity into existence by merely filing certain documents with a public official.[8] The opportunities those developments afforded business people in the latter decades of the 19th century were aptly described by two leading legal historians.

> In the Gilded Age, the decades after the Civil War, it was the device of the corporation that made possible the growth of the new commercial empires including railroads, steel, iron, rubber, automobiles, food process, and oil. The corporation allowed for the pooling of vast sums of capital, an essential requirement for industries with large, fixed-cost components: track, locomotives, railway cars, buildings, factories, furnaces, and machines. With enormous sums

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6 *See* John Steele Gordon, An Empire of Wealth (2004). There the author recounts, for instance, how most of the money to build the Erie canal came from small New York investors. *Id.* at 107

7 The author has written of the rise of modern corporations in America, Daniel J. Morrissey, *Toward a New/Old Theory of Corporate Social Responsibility* 40 Syr. L. Rev. 1005, 1006-09 (1989)

8 J. Hurst, The Legitimacy of the Business Corporation in the Law of the United States, at 13-57 (1970).

of capital at risk, the limitation on liability worked as the perfect inducement of investors.[9]

Nicholas Murray Butler, the renowned president of Columbia University, spoke for many in the early part of the 20th century when he praised the privileged status enjoyed by shareholders and described how it benefited society. "In my judgment," he said, "the limited liability corporation is the greatest single discovery of modern times…even the steam engine and electricity are far less important than the limited liability corporation and they would be reduced to comparative impotence without it."[10]

In large enterprises, the corporation's structure also provided a distinct governance advantage. It would obviously be impractical to follow the partnership model there and allow each of the numerous and far-flung shareholder/owners to make legally binding commitments for the business. Happily, the corporation solved that problem by centralizing management in a board of directors. Under "the basic and long-standing principle of corporate law"[11] stockholders elect the board, but after that they have no right to make decisions for the business.

C. Shareholders Lose their Voice

Yet as large corporations were achieving their pre-eminent status in the American economy, a new development changed the nature of how shareholders related to their companies. In the early years of corporate prominence, large stockholders were typically the directors of

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[9] Stephen B. Presser & Jamil S. Zainaldin, Law and Jurisprudence in American History (6th ed. 2006) 359

[10] William M. Fletcher, 1 Cyclopedia of the Law of Private Corporations § 21 (1917)

[11] Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power,* 118 Harv. L. Rev. 833, 844 (2005)

their firms.[12] As stock became more widely-held after sale to the public, however, ownership became diffuse and far-flung. By 1932, as Professors Berle and Means demonstrated in a famous study, it was rare in large companies that one shareholder held more than 1% of the outstanding stock.[13] In the mid-1980s Professor John Coffee summed up those landmark findings with these remarks.

> A little over fifty years ago, Berle and Means reported that the separation of ownership and control in the modern corporation had left shareholders effectively powerless as managers could neither be ousted from office by shareholders who were widely dispersed and therefore incapable of coordinated action, nor disciplined effectively by the capital market—at least so long as managers could rely on internal cash flow to finance corporate expansion.[14]

Yet in the prosperous post-World War II era no one, except perhaps the occasional shareholder gadfly, seemed particularly concerned that stockholders were powerless. De facto supremacy had gone to a managerial class that perpetuated its authority by soliciting shareholder

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12 Andrei Schleifer & Robert Vishny, *Large Shareholders and Corporate Control,* 94 J. Pol. Econ. 461 (1986);

In their treatise on Corporate Governance, A.G. Monks & Nell Minow explain how the great industrialists of that time like John D. Rockefeller, Andrew Carnegie, Andrew Mellon, and Cornelius Vanderbilt sold shares of their companies to the public but continued to dominate them. Monks & Minow, Corporate Governance 120 (5th ed. 2011);

See also Lorraine Talbot, Progressive Corporate Governance for the 21st Century, 222 (2013) who critically describes that ownership pattern with this comment, "In the United States, controlling shareholders in the 19th century sought to dominate the economy through legal mechanisms such as special charters and trusts."

13 Adolf A. Berle & Gardiner Coit Means, The Modern Corporation and Private Property, (1932).

14 John C. Coffee, Jr., *Shareholders Versus Managers: The Strains in the Corporate Web,* 85 Mich. L. Rev. 1, 15 (1986).

proxies to elect its nominees to the board.[15] Yet who could fault that business elite which was then guiding the country to unparalleled productivity and growth?[16]

As America moved through the 20th century, the achievements of its large public companies became legendary. They developed all kinds of products that promoted higher standards of living and became places where vast numbers could earn good livelihoods. They constructed our infrastructure and financed scientific research that led to further increases in our standard of living. Professor Lawrence Mitchell aptly laid out their successes.

> The modern American business corporation has been a subject of wonder…for innovative and risky projects that create technological miracles and human comforts…Wonder because in these ways modern American business corporations have created material well-being that allows so many people to live the eighteenth-century liberal idea on which America was founded, an ideal of individual freedom, autonomy, and choice.[17]

Other observers just as forcefully described the predominant status that the modern corporation had achieved. "Corporations are such a pervasive element in everyday life that it can be difficult to step back far enough to see them clearly. Corporations do not just determine what goods and services are available in the marketplace, but, more than any other institution, corporations determine the quality of the air we breathe and the water we drink, and even where we live."[18]

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15 Monks & Minow, *supra note *, at 125* attribute this "disenfranchisement" of shareholders to "management's vastly superior access to the proxy, both procedurally (in terms of resources) and substantively (in terms of appropriate subject matter)."

16 "In 1965, America's big companies had a hell of a year. The stock market was booming. Sales were rising briskly, profit margins were fat, and corporate profits as a percentage of G.D.P. were at an all-time high." James Surowiecki, *The Financial Page, Open Season,* New Yorker, Oct. 21, 2013 at 31.

17 Lawrence E. Mitchell, <u>Corporate Irresponsibility</u> 1 (2001)

18 Monks*, supra note* *, at 9.

D. The Time of Tender Offers

The post-war era of corporate complacency ended however when a new type of shareholder activism took hold during the 1970s and 80s. Hostile take-overs then began shaking up the corporate world. Corporate raiders, as these unwelcomed purchasers were pejoratively called, tried to gain control of companies by making public proposals to shareholders to buy their stock at a premium in cash over their current market prices.[19] According to the emerging law and economic school, however, these tender offers were really a form of shareholder empowerment where the true owners could regain a measure of control over the unaccountable managers of their corporations.[20]

Inefficient management, they wrote, fails to make proper use of a firm's resources which causes its stock price to go down. The underperforming company then attracts a hostile bidder who wants to gain control so he can dismiss the firm's management and restructure it to achieve more profitability. Such a result is good for everyone, according to the theory, except the officers and directors who are replaced. Shareholders have their wealth enhanced, the new owner gains from better deployment of the firm's resources, and the overall economy is enriched

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19 During that time, the author wrote extensively about that phenomenon, *See* Daniel J. Morrissey, *Defensive Tactics in Tender Offers, Does Anything Go?"* 54 Tenn. L. Rev. 103 (1986), *Law, Ethics, and the Leveraged Buyout,* 65 U. Det. L. Rev. 403, (1988) and *Safeguarding the Public Interest in Leveraged Buyouts,* 60 Or. L. Rev. 47 (1990)

20 *See* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer,* 94 Harv. L. Rev. 1161 (1981) and Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers,* 33 Stan. L. Rev. 819 (1981).

by a more productive use of corporate wealth. Even the possibility of a tender offer disciplines an underachieving management to increase share value to ward off such undesired advances. [21]

A series of judicial rulings from the Delaware Supreme Court however failed to follow that logic. Instead they deferred to the business judgment of incumbent boards and allowed them to employ various defensive tactics like poison pills to deter unwanted tender offers.[22] Yet those decisions also represented an overall victory for shareholder rights. While condoning the short-range anti-takeover strategies of management, the Courts also recognized a board's ultimate duty to increase shareholder value. That would become a compelling consideration when a decision was made to sell the company because management would then have to actively seek the highest bid for its firm.[23]

E. Shareholder Litigation Enforcing Fiduciary Duties and Corporate Honesty

Shareholders have also been increasingly asserting their influence in corporate matters through litigation. Just as all who manage the property of others, directors have fiduciary duties.[24] While most shareholders today may not be the proverbial "widows and orphans," almost all of them are counting on the prudent management of funds they have committed to

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[21] In the same vein Judge Henry Friendly called takeovers "the sharpest blade for the improvement of corporate management," *See* Henry J. Friendly, Senior Judge, U.S. Court of Appeals, Speech to the ALI-ABA, 3 ALI-ABA Course Materials J. no. 3, 1979 at 93, 128.

[22] Chief among those were Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del.1985) and Moran v. Householder Int'l Inc., 500 A.2d 1346 (Del. 1985).

[23] Two leading cases establishing that principle are Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) and Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. 506 A.2d 173 (Del. 1986).

[24] Brehm v. Eisner, 746 A.2d 244, 256 (Del. 2000)

public companies.[25] The need to safeguard this trusting relationship is even greater now, during the time of "self-funded" pensions, when working people must depend on earnings from stock in their 401(k) plans to retire.[26]

In these suits shareholders have made valuable contributions to assure the integrity of American business by taking action against faithless or corrupt corporate officials. Toward that end, corporate and securities laws give stockholders the right to bring legal actions to discipline dishonest management. These claims for redress take two forms, derivative suits[27] and shareholder class actions.[28]

In a derivative suit, a shareholder maintains an action on behalf of her corporation, usually against its officers or directors who have harmed it. An early, classic case from Delaware, *Guth v. Loft, Inc.*[29] exemplifies how shareholders can use this tool to remedy self-dealing and other wrongdoing by corporate officials. Guth was the president of a company called Loft that operated a chain of candy stores. In that capacity he discovered that the company which produced Pepsi-Cola was for sale. But instead of channeling that opportunity to Loft, he secretly bought the soft-drink company himself and even used Loft's facilities to

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[25] A good example of such a breach of trust is *Surrowitz v. Hilton Hotels Corp.,* 383 U.S.363 (1966). There the plaintiff was an immigrant who saved her money earned as a seamstress and invested it in the defendant corporation that ended up defrauding her.

[26] *See generally,* Martha Priddy Patterson, The 401(k) Handbook, §100, (2013)

[27] The author has written two articles on derivative suits. Daniel J. Morrissey, *The Path of Corporate Law in the 21st Century,* 86 Or. L. Rev. 975 (2008) and *New Rulings Threaten the Derivative Suit—Will the "Needed Policeman" Keep Walking the Beat?* 36 S.C. L. Rev. 631 (1985)

[28] The author's major piece on this is Daniel J. Morrissey, *Shareholder Litigation after the Meltdown*, 114 W. Va. L. Rev. 531, 547-49 (2012)

[29] 5 A.2d 503 (Del. 1939).

produce it. The Court found that Guth's actions were a breach of his duty of loyalty to Loft and held him responsible to that company's shareholders for the amounts he had made in Pepsi.

Because of cases like that by the middle of the twentieth century the derivative suit had become what the Supreme Court called, "the chief regulator of corporate management."[30] One commentator appropriately said it was a "needed policeman"[31] citing the observation of a Court that it "has done much to educate corporate directors in the principles of fiduciary duties and undivided loyalty."[32] In that vein, Judge Wyzanski perhaps best captured the importance of the derivative suit when he said, "It is recognized that while minority [shareholders] are often actuated by selfish interests, they…become the most effective instruments for ferreting out wrongdoing, for pursuing it publicly and for giving point to the only sanctions actual and potential wrongdoers fear."[33]

More recent observers have continued to praise the shareholder derivative suit for promoting integrity and sanctioning corporate officials for their roles in a string of scandals.[34] Among the most notorious and wide-spread of those has been options-backdating. There executives doctored corporate records to make it appear that those rights to purchase stock were

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30 Cohen v. Beneficial Indus. Loan Corp. 337 U.S. 541, 548 (1949)

31 Daniel J. Dykstra, *The Revival of the Derivative Suit,* 116 U.Pa. L. Rev. 74, 78 (1967).

32 Brendle v. Smith, 46 F. Supp. 522 (S.D.N.Y. 1942)

33 Pomerantz v. Clark, 101 F. Supp. 341 (D .Mass. 1951)

34 *See e.g.,* Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis,* 51 Wm. & Mary L. Rev. 1749, 1829; Robert B. Thompson, *The Public and Private Faces of Derivative Law Suits,* 57 Van. L. Rev. 1747, 1749; Michael P. Dooley, *The Role of Corporate Litigation in the Twenty-First Century,* 25 Del. J. Corp. L. 131, 143 (2000).

issued at earlier times when the shares were trading at lesser prices. The corrupt officials could then exercise the options at those lower costs and make unlawful gain.[35]

Shareholders have also used derivative suits to challenge various forms of looting by corporate insiders that take the form of excessive executive compensation[36] and other types of self-dealing. The action also has proven invaluable by allowing shareholders to seek redress for frauds involving mergers with various types of double-dealing by corporate insiders and their financial advisers.[37]

As one commentator has said of the precedents set by those actions, "These decisions changed the rules for future legal practice by allowing well-motivated legal counselors to get their clients to accept better conduct and procedures. Moreover, derivative suits against private companies perform an important, if less heralded role in policing conflict of interest transactions and duty of care violations."[38] Statements like that were echoed by the U.S. Supreme Court when it recently recognized that shareholder suits are an important adjunct to business success. "A dynamic, free economy presupposes a high degree of integrity in all of its parts, an integrity that must be underwritten by rules enforceable in fair, independent, accessible courts."[39]

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35 The author discussed that corrupt practice at length in Daniel J. Morrissey, *The Path of Corporate Law: Of Options Backdating, Derivative Suits, and the Business Judgment Rule*, *supra* note *, at 983-85

36 *In re* Citigroup Inc. S'holder Derivative Litig., 906 A 2d 106 (Del Ch. 2009); The author's recent article on that perfidious practice is Daniel J. Morrissey, *Executive Compensation and Income Inequality,* 4 Wm. & M. Bus. L. Rev. 1 (2013)

37 The author discussed a number of those cases in Daniel J. Morrissey, *M&A Fiduciary Duties: Delaware's Murky Jurisprudence,* 58 Vill. L. Rev. 121, 154-60 (2013)

38 Robert B. Thompson, *The Public and Private Faces of Derivative Suits,* 57 Vand. L. Rev. 1747, 1749 (2004).

39 Stoneridge Investment Partners v. Scientific-Atlanta, 552 U.S. 148, 161 (2008),

In like manner the other major shareholder litigation right, securities class actions, is both a mechanism for stockholders to protect their assets and an important tool to promote the public interest. These suits combine the causes of action of like situated stockholders who have been injured by fraudulent corporate reports and financial statements. As one respected commentator noted, "The sheer size of the aggregated claim attracts not only the entrepreneurial instincts of the class action lawyer but also commands the full attention of the defendant."[40]

Similar to its remarks about the law's important role in maintaining integrity in business, the Supreme Court made this statement in 2007 about the value of shareholder class actions. "The Court has long recognized that meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the Securities and Exchange Commission (SEC)."[41]

The SEC, the federal agency charged with enforcing the securities laws, has readily admitted it can prosecute only a small percentage of such frauds.[42] Compounding that deficiency, the Commission's once sterling reputation as the "Cops of Wall Street" has been tarnished by its recent ineffectiveness. That was unfortunately epitomized by the SEC's inability

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40 James D. Cox, *Making Securities Fraud Class Actions Virtuous,* 39 Ariz. L. Rev. 497 (1997)

41 Tellabs, Inc. v. Makor Issues & Rights, Ltd. 551 U.S. 308, 313 (2007)

42 As three former SEC *chairmen* put it recently, "The problem with the SEC today is that it lacks the money, manpower, and tools it needs to do its job." William Donaldson et al., *Muzzling the Watchdog, N.Y. Times, Apr. 29, 2008, at* A19 The author has also recently written on the underfunding of the SEC, Daniel J. Morrissey, *Wall Street Needs this Beast,* National Law Journal, Feb. 28, 2011

to discover a decades-long Ponzi scheme by Bernard Madoff that bilked thousands of investors out of 10s of billions of dollars.[43]

F. Shareholder Contributions to Improved Corporate Governance

Another area where vigilant stockholders can provide an important service for society is by taking an active role in corporate governance. Two leading authorities define that process as being "about how public companies are structured and directed."[44] They then go on to describe how it should ideally work. "When corporate governance operates optimally, the three key players—the executives, the board of directors, and the shareholders—provide through a system of checks and balances, a system for a transparent and accountable system for promoting objectively determined goals and benchmarks."[45]

Problems occur there when top executives of public companies do not act responsibly to promote the interests of their shareholders and other constituents. Such wrongdoing is often compounded because their supervisors, the directors, fail to prevent those transgressions. Officers, in the worst case, may enrich themselves through self-dealings with the corporation. Guth v. Loft is a good example of that harmful behavior. A leading shareholder advocate recently described other substantial wrongdoing that boards condone.

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43 The SEC's own report on its bungled inquiries into Madoff's massive fraud is instructive here. SEC, *Office of Investigations, Investigations of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme (Aug. 31, 2009).*

44 Monks*, supra*, note *, at xviii

45 *Id.*

> Is it fair that CEOs make 700 times what the average worker makes, even if the chief executive is doing a terrible job and thousands of workers are laid off? Why do CEOs get awarded huge bonuses by friendly boards when the shareholder prices are down by double digits and then get their options reset to lower levels as an "incentive?"[46]

To a lesser but also troubling extent executives may shirk their duties[47] or engage in empire-building that benefits themselves at the expense of their shareholders.[48] Alternatively, they may follow excessively conservative strategies that protect their positions but do not serve their stockholders well. That wrongful conduct may ultimately be just as harmful to the corporation and society as outright looting.[49] Yet it is harder to challenge because corporate officials have the protection of the business judgment rule which embodies the reluctance of Courts to review situations where only a board's duty of care is implicated.[50]

Proper corporate governance has become more compelling during the last several decades as increasing instances of corrupt business activity have come to light. Investigations after the Watergate scandal revealed a wide-spread pattern of illegal campaign contributions and

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46 Carl Icahn, *Challenging the Imperial Boardroom,* Wall St. J., Sept. 10, 2013 at A19

47 Franklin A. Gevurtz, Corporation Law, 236 (2nd ed. 2010)

48 Robert C. Clark, Corporate Law, 536, (1986).

49 Gevurtz, *supra* note *, at 236-37.

50 As the Delaware Supreme Court put it, "[a} board of directors enjoys a presumption of sound business judgment and its decisions will not be disturbed if they can be attributed to any rational business purpose," Sinclair Oil Corp. v. Levien, 280 A2d 717, 720 (Del. 1971).

That discretion has been reinforced by the famous Delaware "raincoat" Del. Code Ann. tit. 8, section 102(b)(7) that allows corporations to amend their articles to exculpate their officers and directors for improper conduct unless it involves activities like those done in bad faith, intentional wrongdoing, breaches of duties of loyalty, or knowing violations of law. *See also* Model Bus. Corp. Act €8.31(a) other improper activity by a large number of major corporations.[51] In response the SEC began demanding more disclosure of the composition and workings of public boards.[52] The American Law Institute followed suit with a 16 year project that culminated in its "Principles of Corporate Governance." It included "good practice" guidelines for the make-up and operation of boards.[53]

Then after the dot.com bubble burst at the turn of the century prominent financial frauds like Enron and World-com came to light.[54] They resulted in the loss of billions of dollars of shareholder wealth and precipitated the Sarbanes-Oxley Act of 2002.[55] That law had stringent requirements for disclosures about the governance practices of public companies. Those included whether the firms had watchdog board committees to oversee audits, executive compensation, and the nomination of new directors.[56] The Act also demanded transparency about whether the directors on those panels were independent from the top executives of their companies.[57] The major stock exchanges soon followed with their own "independence" standards for the boards of companies whose shares are listed there.[58]

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51 *See* M. Thomas Arnold, "*It's Déjà vu All Over Again" Using Bounty Hunters to Leverage Gate Keeper Duties,* 45 U. Tul. L. Rev. 419, 427 (2010).

52 Gevurtz, *supra* note *, at 241

53 *Id.*

54 For two good books about the Enron scandal, *see* Bethany McLean & Peter Elkind, The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron (2003); Rebecca Smith & John R. Emshwiller, 24 Days: How Two Wall Street Journal Reporters Uncovered the Lies That Destroyed Faith in Corporate America (2003). For a good description of the WorldCom accounting fraud, *see* Peter Eistrom, *How to Hide $3.8 billion in Expenses,* Bus Wk. July 8, 2002 at 41.

55 Public L. No. 107-204, 116 Stat. 745 (2002)

56 Sarbanes-Oxley Act §301 (amending Section 10A of the Securities Exchange Act)

57 *Id. §302*

58 Gevertz, *supra* note *, at 242

That required disclosure was geared to making the leaders of public companies more accountable to their shareholders and the public. Sadly it did little to stop the devastating financial meltdown of 2008. As one commentator observed after that, “The recent financial crisis makes clear that the directors and officers of public companies have not internalized Enron’s lessons.”[59]

Congress responded with more legislation, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010[60] (Dodd-Frank) that among other things provided additional requirement for shareholder participation in governance. The law requires disclosure about situations where the same individual is both CEO and Chair of the Board[61]and with its “Say-on-Pay” provision also gave shareholders an advisory vote on executive compensation.[62]

G. Surmounting Resistance to Reform

For those shareholder governance rights to be effective, however, they must overcome several traditional drawbacks. First is the “rational apathy” that discourages most stockholders from reviewing management conduct in the firms where they invest. Such activity hardly seems worth the effort when a limited percentage of ownership means there is so little at stake for a particular stockholder. Better to follow the “Wall Street Rule” and sell, goes the logic, rather

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59 Hillary A. Sale, *The New “Public” Corporation,* Washington U. in St. Louis, Legal Studies Research Paper Series, Paper No. 11-04-01, 1 (2011).

60 Pub. L. 111-203, HR 4173; *See generally* Daniel J. Morrissey, *Dodd-Frank Reins in Wall Street,* Nat’l Law J. Aug. 30, 2010

61 *Id.* § 972

62 *Id.* § 951

than challenge improper practices by corporate officials.[63] Such departures by disgruntled shareholders may drive down share prices but they do little to remedy harmful managerial conduct.[64]

Another long-standing barrier to shareholder engagement is management's control over the mechanism for soliciting proxies to elect directors.[65] Top executives always have their own slate for those lucrative positions and a shareholder who puts forth her competing candidates must pay the significant expense of garnering support from other stockholders. Several years ago the SEC made a rule that would change that by allowing a significant shareholder to propose her own nominees for directors and have them sent out at the company's expense. The Court of Appeals however invalidated that initiative to foster shareholder democracy on the grounds that the Commission did not do a proper study of its costs and benefits.[66]

Yet the push for shareholder participation in corporate governance continues to gain ground. Commentators keep assailing the "domination of public companies by self-serving executives [that] costs America billions of dollars every year and contributed to the economic meltdown."[67] The exposure of those abusive practices has propelled new corporate governance models designed to reform the "old boy" network of boards that has been all too inclined to rubberstamp decisions of dominant chief executives.

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63 Gevertz, *supra* note *, at 232.

64 Monks, *supra* note *, at 129-30.

65 Gevertz, *supra* note *, at 233.

66 Business Roundtable v. SEC, 647 F.3d 1144 (2011)

67 George W. Dent Jr., *The Essential Unit of Shareholders and the Myth of Investor Short-Termism,* 35 Del. J. Corp. L. 97 (2010).

At the heart of these are measures for independent directors who would serve on audit and compensation committees to make sure there are meaningful internal checks on fraud and other illegal activity by management. Several leading academics have lent their support here arguing that to counter those abuses shareholders must be given increased rights to guard against improper management conduct[68] or at least be empowered to exercise the rights they already have in a more meaningful way.[69]

Professor Lucien Bebchuck points out that the interests of management often are not aligned with those of its shareholders. Because of that corporate officials may engage in various self-dealing activities, reject beneficial acquisition offers, or engage in empire-building. To counter that Bebchuck persuasively contends that shareholders should be given more rights to approve or disapprove those major corporation actions. Dodd-Frank's Say-on-Pay provision[70] is a step toward such enhanced shareholder voting rights.

Professor Julian Velasco differs from Bebchuck, by not calling for more measures empowering shareholders. What is really needed, he says, is just that stockholders take their current rights seriously and be supported in that by legal authorities. For instance, Section 14(a) of the Securities Exchange Act of 1934 already charges the SEC with regulating proxy solicitations and the legislative history of that provision states that this must be done for the benefit of investors.[71] No doubt Professor Velsasco would rue the Court of Appeals' decision

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68 Lucian Arye Bebchuck, *The Case for Increasing Shareholder Power,* 118 Harv. L. Rev. 833 (2005).

69 Julian Velasco, *Taking Shareholder Rights Seriously,* 41 U.C. Davis L. Rev. 605 (2007).

70 *See supra* note * and accompanying text.

71 Velasco, *supra* note *, at 614.

discussed above that struck down the SEC's proxy access rule. That would have made it less expensive for shareholders to nominate their own slate of directors but it fell victim to a judicial ideology excessively sensitive to management's prerogatives.[72]

In other areas, however, Professor Velasco sounds more like Professor Bebchuck. Velasco points out that shareholder rights to vote on important matters like mergers and by-law amendments are severely restricted because there directors must first approve those initiatives. He also calls for other reforms that activist shareholders are already including in settlements of derivative suits as ways to remedy wrongful management conduct.[73]

One of these new requirements is that directors must receive a majority of all votes cast. Unlike the traditional rule that a director is elected by a merely plurality, the majority requirement would give shareholders a greater power to prevent the election of undesirable candidates.[74]

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72 *See, supra* note * and accompanying text.

73 Since derivative suits are equitable in nature, the Court has broad discretion in granting relief. Debroah A. DeMott and David F. Cavers, Shareholder Derivative Actions: Law and Practice, §7.6 (2013). *See generally* Prunty, *The Shareholders' Derivative Suit, Notes on its Derivation,* 32 N.Y.U. L. Rev. 980 (1957).

See e.g., In re Pfizer Inc. S'holder Derivative Litig., 780 F. Supp. 2d 336 (S.D.N.Y. 2011) where the Court approved a settlement involving the creation of a new board-level regulatory committee. *See also* settlements in in re News Corp. S'holder Derivative Liti.', http://www.newscorpderivativesettlement.com/pdf/mou.pdf and Johnson and Johnson Derivative Litig., 900 F. Supp. 467 (D NJ 2012) that contained significant provisions geared to enhance board-level responsibility for legal and regulatory compliance.

74 In 2012 directors at 41 public companies failed to gain 50% shareholder approval for their reelection, yet they have remained in office. James B. Stewart, *When Shareholder Democracy is Sham Democracy,* N.Y Times, Apr. 13, 2013 at B1

Another is the elimination of staggered boards of directors.[75] In that system directors have multi-year terms and are classified so that they do not all stand for election every year. Annual election of directors, by contrast makes them less entrenched and more accountable to shareholders. It might also remove a deterrent to a tender offer that could return increased value to shareholders. A potential bidder then would not be put off by having to wait more than a year to gain control of a board once she has achieved majority stock ownership.

Along those lines Velasco points out that corporate law is mostly geared toward enabling a firm's activity and does not mandate its substantive conduct. The statutory rules for corporate governance therefore are only default provisions and can be changed. In that regard he points to shareholder initiated reforms that more corporations are accepting such as the requirement that each director be elected by a majority of the shareholders.

Professor Velasco also notes the increasing dominance of institutional shareholders with large holdings in particular stocks. He sees that as a likely counterweight to traditional shareholder apathy.[76] He also dismisses an argument which is often made to deprecate the legitimate rights of shareholders--that stockholders will only use their power opportunistically to advance their own interests.[77] Two well-known corporate authorities Vice-Chancellor (now Chancellor) Leo Strine[78] and Professor Steven Bainbridge[79] have recently asserted that position,

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75 Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards,* 78 J. Fin. Econ. 409 (2005)

76 Velasco, *supra* note *, at 623.

77 Velasco, *supra* note *, at 635-37.

78 Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America,* 119 Harv. L. Rev. 1759 (2006).

79 Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment,* 119 Harv. L. Rev. 1735 (2006).

arguing that stockholders often have viewpoints that are inconsistent with the long-term best interests of their corporations.

Professor George Dent however goes even further than Velasco in refuting that often-made case against shareholder empowerment. He contends that those misgivings are exaggerated and have no empirical basis. For the most part shareholders are not short-term oriented but instead want their officers to maximize the long-term value of their firms. [80]

Dent also convincingly asserts that shareholder choices are entitled to respect in the same manner as those of voters in a political democracy. Citizens may not be capable of statecraft, but they are appropriately given the power to elect those who will run their government. By the same logic shareholders should be able to choose directors to manage the companies that they own.

H. Hopeful Signs of Shareholder Activism

The need for greater accountability by corporate officials is most compelling. There have to be effective checks on their innate tendencies to enrich themselves at the expense of various corporate constituents and society itself. Carl Ichan, a major investor and shareholder activist, puts it bluntly with this historic analogy. "In the middle ages, feudal lords asserted the 'divine right' of royalty to justify their lordly positions while plundering the peasants. Today's boards act like they are vested with similar powers."[81]

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80 Dent, *supra* note *, at 122-28

81 Ichan, *supra,* note *.

Ichan then notes how formerly disconnected shareholders can be united by social media and other communication tools and he pledges to use them "to make more shareholders aware of their rights and what can be done to keep those rights from being trampled on."[82]   Other shareholder activists have put out similar calls for unified action.[83]

For instance, John Liu, New York City's comptroller oversees the city's pension funds that own a large stake in Cablevision. Expressing outrage at directors who lost elections but remained on the company's board Liu said, "As fiduciaries we cannot make a mockery of our fundamental right to elect directors." He urged a proxy fight against such "zombie directors," stating "[S]hare owners need accountable directors who will ensure the company isn't being run for the benefit of insiders at our expense."[84]

Activist stockholders are also becoming effective at controlling excessive executive compensation. 128,000 shareholders of Verizon who are retirees of its predecessor companies achieved a partial victory this year when the company agreed to cut back performance-based stock awards for its officials if Verizon's stock does not do well. The group has also moved against any severance awards at the company that are more than 3 time the retiring officers' base pay and incentives. [85] In similar fashion, investment officers at the California State Teachers'

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82 *Id.*

83 These efforts appear to be bearing fruit as some boards are inviting activist shareholders to join them as directors. David Benoit, *Companies, Activists Declare Truce in Boardroom Battles,* Wall St. J. p. 1, Dec. 10, 2013

84 Stewart, *supra,* note *.

85 Gretchen Morgenson, *As Shareholders Say 'Enough Already' Some Boards are Starting to Listen*, N.Y. Times, Apr. 7, 2013 at BU 1.

Retirement System (Calpers) are questioning peer group standards for executive pay that are out of line with compensation paid at truly comparable companies.[86]

III. The Rule of Shareholder Primacy and its Discontents

A. Early Statements of the Corporate Purpose—Dodge v. Ford

As valuable as shareholders are in our economic system, their rights are not paramount. Such was the approach taken by the pre-industrial common law as Anglo-American cases then stressed the communal duties of early corporations.[87] Yet as large scale manufacturing took hold the law began to move in another direction. By the second half of the 19th century, it had made the shareholders' right to profit a firm's dominant duty.

That approach to the central issue of corporate law developed in an era that one scholar has called, "a curious admixture of classical economics, Neo-Calvinism, Social Darwinism, Lockean political philosophy, and a large component of anti-statism."[88] That was also the time when laissez-faire economics reigned supreme and an age correspondingly when property and contract rights were given strong constitutional protection.[89]

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86 Gretchen Morgenson, *A Better Way to Compare C.E.O. Pay*, N.Y. Times, Sept. 22, 2013 at BU1.

87 As the leading English jurist of the 18th century stated "…It has been found necessary…to constitute artificial persons who may maintain a perpetual succession, and enjoy a kind of legal immorality. These artificial persons are called bodies politics, bodies corporate (*corpora corporate),* or corporations of which there is a great variety subsisting, for the advancement of religion, of learning, and of commerce…" 1 William Blackstone, Commentaries on the Laws of England, ch. XVIII

88 Richard Epstein, *Societal, Managerial and Legal Perspectives on Corporate Social Responsibility—Product and Process,* 30 Hastings L. J. 1287, 1295 (1979)

89 *See e.g.* Lochner v. New York, 198 U.S. 45 (1905)

In this high capitalist culture it should not have been a surprise when a Court invalidated a contrary business philosophy even when it was practiced by a leading industrialist. Henry Ford owned a majority of the stock of his car company and controlled its board. It was lushly profitable and he wanted to use part of his firm's surplus to reduce the price of its automobiles. Ford had already become famous for raising the base pay of his workers to the unheard of amount of $5 per day.[90]

When the Dodge Brothers who owned 10% of the company's stock challenged Ford's policy of minimum dividends he expressly defended it with these philanthropic sentiments, "[M]y ambition is 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. To do this we are putting the greatest share of our profits back into the business."[91]

Ford's approach, though daring, was not novel. He was following in the foot-steps of earlier industrialist from the late 19th century such as William Lever, a famed English soap manufacturer, and George Pullman, the American railroad car magnet.[92] Both established company towns near their operations in Liverpool and Chicago where the needs of their workers were provided for. To be sure, self-interest was at work there because such a beneficent and

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90 Hedrick Smith, *When Capitalists Cared*, N.Y. Times, Sept. 3, 2012 at A19.

Recent studies however show that today those with wealth and power pay scant attention to people without it. Daniel Goleman, *Rich People Just Care Less*, N.Y. Times, Oct. 5, 2013 at SR 12.

91 Dodge v. Ford, 204 Mich. 459, 468; 170 N.W. 668, 671 (1919)

92 Chris Howell, *When it Comes to CSR, Size Matters,* Instead Knowledge, http://www.forbes.com/sites/instead Aug. 14, 2013

paternalistic strategy was designed to quell labor unrest. Yet it also was a forthright plan to share the wealth generated by those companies.

The Michigan Supreme Court however found that Ford's dividends were too small for a company with such huge profits. The Justices rejected Ford's policies with these forceful remarks that became the definitive law on corporate purpose.

> There should be no confusion (of which there is evidence) of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which in law he and his co-directors owe to a protesting minority of stockholders. A business corporation is organized and carried on primarily for the profit of shareholders. The powers of directors are to be employed for that end.
>
> The discretion of the directors is to be exercised in the choice of the means to attain that end, and does not extend to a change in the end itself, and to the reduction of profits or the non-distribution of profits among shareholders in order to devote them to other purposes.[93]

That attitude, however, was not universal, even in that era. Other cases and statutes then permitted corporations to make charitable donations if they served the business in some way[94] and some social advocates were even arguing for a fuller vision of corporate purpose. As one put it, "Not merely public office, but private business is a public trust."[95] President Theodore Roosevelt railed against the "Malefactors of Great Wealth" and in an address to Congress he asserted, "Great corporations exist only because they are created and safeguarded by our

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93 *Dodge,* 204 Mich. at 507, 170 N.W. at 684

94 People v. Hotchkiss, 136 A.D. 150, 120 N.Y.S. 649 (N.Y. App. Div. 1909); Steinway v. Steinway & Sons, 17 Misc. 43, 40 N.Y.S. 718 (N.Y. Sup. Ct. N.Y. Co., 1896); Tex. Civ. Stats. tit. 25, art. 1164 (Vernon 1918)

95 Small, *Private Business is a Public Trust, 1 Am. J. Soc. 276, 282 (1895)*

institutions; and it is therefore our right and our duty to see that they work in harmony with these institutions."[96]

Likewise, Henry Higginson, a prominent Boston businessman, made these remarks in 1911, a time coincident to the "Social Gospel movement"[97] that was pushing American Protestantism to apply Christian principles to questions of social justice.

> I do not believe that because a man owns property it belongs to him to do with as he pleases. The property belongs to the community, and he has charge of it, and can dispose of it, if it is well done and not with the sole regard to himself and his shareholders.[98]

B. <u>The Great Depression and its Aftermath</u>

The stock market crash of 1929 and the resulting Great Depression brought about a new public attitude about the social responsibility of business. Even Republican President Herbert Hoover made this telling critique of the American economic system, "The trouble with capitalism is the capitalists. They are too damn greedy."[99] His successor, Franklin Delano Roosevelt, went further in his first inaugural address with this famous admonition. "There must be an end to a conduct in banking and in business which too often has given to a sacred trust the likeness of callous and selfish wrongdoing."[100]

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[96] Theodore Roosevelt, First Annual Message to Congress, Dec. 3, 1901. A fine new book on his clash with his hand-picked successor William Howard Taft is Doris Kearns Goodwin, <u>The Bully Pulpit</u>, 2013.

[97] *See* Walter Rauschenbusch, <u>Christianity and Social Crisis</u> (1907)

[98] *Quoted in* Robert Bellah et al, <u>Habits of the Heart</u> 260 (1985)

[99] David Shipley, *Remembering Herbert Hoover,* N.Y. Times, Aug. 10, 1992

[100] Franklin D. Roosevelt, First Inaugural Address (March 4, 1933).

Roosevelt's New Deal responded with landmark federal legislation regulating the sale of securities[101] as well as the markets in which they are trade.[102] It established a disclosure regime where public companies are compelled to lay bare all important aspects of their businesses.[103] While those federal securities laws contained little substantive regulation of corporations, they at least established that publicly-held firms would be accountable to their shareholders and the public by having to truthfully inform them about their operations and financial conditions. In addition, the statutes set up the SEC as a new federal regulation agency, empowered to make rules delineating the particular disclosures public companies would be required to make in their periodic reports and proxy statements.[104]

C. A Changing Corporate Climate

Those hard economic times also caused commentators and even business leaders themselves to reassess the duties of public companies. Some urged that they undertake civic responsibilities as every citizen should. Professor Merrick Dodd became one of the prime spokespersons for this new vision of "corporate statesmanship."[105] Managers of firms, he said,

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101 Securities Act of 1933, 15 U.S.C.§§77a-77z

102 Securities Exchange Act of 1934, (Exchange Act) 15 U.S.C.§78a *et seq.*

103 *See* Exchange Act §§ 13(a), and 14(a), 15 U.S.C.§§78m(a), and 78n(a)

104 Section 4 of the Exchange Act established the SEC. 15 U.S.C.§78d.

Sections 12(b) and 12(g) of that Act require that "exchange-listed" and other "publicly-held" companies register with the SEC, 15 U.S.C. §§78l(b) and 78l(g). Section 13(a) of the Exchange Act then requires that these "reporting companies" file annual, quarterly, and current reports on forms 10-K, 10-Q, and 8-K respectively, Exchange Act Rule 13a-1, 13a-13, and 13a-11. Section 14(a) of the Exchange Act empowers the SEC to make rules regarding proxy solicitation by reporting companies. 15 U.S.C.§78n(a). Using this authority, the SEC has promulgated elaborate rules for disclosure to shareholders, Exchange Act Regulation 14A, 17 C.F.R. §§14a-1 to 240.14a-14, Schedule 14A

105 Merrick Dodd, *For Whom are Corporate Managers Trustees?,* 45 Harv. L. Rev. 1145 (1932)

should not just be concerned with making profit for stockholders, but ought to consider themselves fiduciaries and act for all who are impacted by their firms. Those constituents would include their workers and the communities where they do business.

Dodd was also the first to speak of what has become the "team" concept of a corporation.[106] As the Latin origin of its name connotes, a corporation is a "body," not just a collection of individuals. Its leaders should therefore make sure its actions benefit the entity as a whole, rather than just one of its members, the shareholders. Dodd also drew from the new Keynesian economics that was having a profound impact on policy makers.[107] He asserted that actions which serve the interests of a firm's broader groups like the payment of good wages to its workers also redound to the advantage of its shareholders by creating stronger purchasing power for the company's products.[108]

A prominent case in the immediate post-war era epitomized how Dodd's more expansive views had taken hold.[109] When a shareholder challenged a corporate contribution to Princeton University by his New Jersey based firm, the High Court of that state resoundingly affirm the appropriateness of the donation. It first found that the gift was in the corporation's "enlightened self-interest"[110] by creating goodwill for the firm and helping to education its future workers.

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[106] *See e.g.,* Margaret M. Blair and Lynn A. Stout, *A Team Production Theory of Corporate Law,* 85 Va. L. Rev. 247 (1999)

[107] John Maynard Keynes, <u>The General Theory of Employment, Interest, and Money </u>(1936)

[108] Dodd*, supra* note *, at 1156.

[109] A. P. Smith Mfg. Co. v. Barlow, 98 A2d 581 (N.J. 1953) appeal dismissed, 346 U.S. 861 (1953).

[110] *See* Clark s*upra* note * at 681-84.

But the Court went beyond that to uphold the contribution because of the company's broader obligations to society. Most of America's wealth, it observed, are held by corporations and as such it is appropriate for them "to assume the modern obligations of good citizenship in the same manner as humans do." "Modern conditions," it said, "require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities in which they operate."[111]

IV. The Rise of Corporate Social Responsibility (CSR)

A. The Social Activism of the 1960s and 70s

Despite such notions of corporate statesmanship the post-war era saw little real movement to define or embrace that mission beyond limited philanthropic activity. It was a time for the most part of collective complacency when the tradition "shareholder primacy" paradigm was generally accepted without question. One notable exception was the far-sighted management expert Peter Drucker. He argued that business leaders should also be concerned with political or social issues that might be important to their "alternative constituencies" like workers and consumers.[112]

Even most liberals then, however, believed that the "regulatory state" established by the New Deal was sufficient to guarantee that corporations would not harm the public interest.[113]

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111 A.P. Smith Mfg. Co*., 98 A.2d at 154.*

112 Jerome J. Shestack, *Corporate Social Responsibility in a Changing Corporate World, in* Ramon Mullerate, Corporate Social Responsibilit*y 15 (2011)*; *See also* Lorraine Talbot, Progressive Corporate Governance for the 21st Century 105 (2013)

113 *See generally H. Hart & Albert Sacks, The Legal Process (1958).*

The business elite seemed to go along with that system by not challenging those bureaucracies. It was thus no surprise that in that era of relative good feeling, corporate law did nothing to particularly prescribe how businesses must act.

As one commentator said, corporate codes then were just a "black box," a series of rules governing the technical operation of those firms, having no real effect on what public companies actually did.[114] In the same vein, another legal scholar of that period said corporate law had become "trivial"[115] and one more described it with rhetorical flourish as "great empty corporate statutes—towering skyscrapers of rusted girders internally welded together and containing nothing but wind."[116] In sum, corporate law then contained no requirements how businesses should behave and it prescribed no goals for them other than profit-making.

All that would change, however, in the period of unrest that became known as the '60s. The civil rights and anti-war movements of that time inspired an idealistic youth culture that brought about a generalized discontent with the status quo.[117] As concern for the historically

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But see, David G. Yosifon, *The Public Choice Problem in Corporate Law: Corporate Social Responsibility After Citizens United,* 89 N.C. L. Rev. 1197 (2011). The author argues that because of the Supreme Court's decision in Citizens United which struck down laws limiting political spending by corporations, those firms will be much more able to influence government. As a result it will be less able to restrict corporate excesses that are visited on non-shareholding stakeholders such as workers and consumers. Boards must therefore play that role, the author urges, and be attentive to the needs of those groups.

114 Ronald J. Gilson, *Corporate Governance and Economic Efficiency: When Do Institutions Matter?* 74 Wash. U. L. Q. 327 (1996)

115 Bernard Black, *Is Corporate Law Trivial? A Political and Economic Analysis,* 84 Nw. U. L. Rev. 542 (1990)

116 Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker,* 72 Yale L. J. 233, 245 (1962).

117 *See* Todd Gitlin, The Sixties: Years of Hope, Days of Rage (1987)

disadvantaged and the environment took center stage, corporations became the focal point of much of that dissatisfaction.[118] Reformers like Ralph Nader claimed that they were responsible for a number of significant evils.[119] Those included industrial pollution, unsafe products, deceptive advertising, and discriminatory employment practices. In addition critics attacked the dominant corporate culture as alienating and stressful.

One early response to that dissatisfaction was the growth of in-house corporate foundations. Some firms such as Dayton-Hudson, Levi Strauss, and Cummins Engines began giving up to 5% of their pre-tax earnings to eleemosynary efforts. [120] But an even more significant result was the beginnings of the corporate social responsibility movement.[121] In that first era of its prominence CSR's influence reached a high-point in the mid-1970s when prominent legal scholars joined with social activists to urge that the federal government replace states as the ultimate source of corporate law.[122]

Federal chartering of corporations, they argued, should displace state-based regimes where jurisdictions like Delaware had won the "race to the bottom" with their lax standards for management's conduct.[123] The ensuing federal law would then require better governance

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[118] Blumberg, *The Politalization of the Corporation*, 51 B.U. L. Rev. 425 (1971).

[119] Ralph Nader, Mark Smith, and Joel Seligman, *Taming the Giant Corporation: How the Largest Corporations Control our Lives (*WW Norton & Co. Inc. 1976).

[120] Craig Smith, *The New Corporate Philanthropy,* in Harvard Business Review on Corporate Responsibility, 161 (2003).

[121] Douglas M. Branson, *Corporate Social Responsibility Redux,* 76 Tul. L. Rev. 1207, 1211-12 (2002)

[122] Talbott, *supra* note *, at 113

[123] William L. Cary, *Federalism, and Corporate Law, Reflections on Delaware,* 83 Yale L. J. 663, 705 (1974)

practices and mandate that corporations engage in socially beneficial activity that would be enforced by public interest directors.[124]

B. The Push Back

Those fervent efforts at reform however met strong immediate resistance from laissez-faire economists, most prominently the Nobel Laureate Milton Friedman. He countered that a corporate official is merely an employee of its shareholders—the owners of the business. As such, he wrote, "He [a corporate executive] has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally is to make as much money as possible while conforming to the basic rules of society, both those embodied in law and those embodied in ethical customs."[125]

For Friedman non-profit activity was not the business of business, but of government and private charity. In addition, as other defenders of the traditional view noted, if corporate goals other than profit-maximizing were legitimate, boards would be divided and distracted from achieving the highest return on the capital entrusted to them.[126] The rights of other corporate "constituents" such as employees and creditors should therefore be set only by the contracts they make with the firm.[127] Management, they argued, should just be attentive to the wishes of its masters, the shareholders.

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124 Branson, *supra* note *, at 1213-14.

125 Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits,* N.Y. Times, Sept. 13, 1970, (Magazine), at 32.

126 Bayless Manning, *Thinking Straight about Corporate Law Reform,* 4 Law & Contemp. Probs. 1, 10 (1977)

127 Williamson, *Corporate Governance,* 93 Yale L. J. 1197 (1984)

These attitudes were quickly re-enforced by two new developments, one in politics and the in other legal scholarship. By the late 1970s, a resurgence of conservatism was taking hold, first signaled by the taxpayers' revolt of Proposition 13 in California.[128] Part of its agenda was to deregulate business. That was at first tentatively embraced by the Carter administration and then welcomed without reserve by President Reagan after his election in 1980. Reagan's presidency ushered in a new, full-throated form of capitalism that became the "Greed is Good,"[129] era—hardly an attitude that would be friendly to any diversions of business from its profit-making goals.

Going hand in hand with those political events was a new school of jurisprudence, law and economics.[130] Legal rules, it held, should promote the efficient allocation of society's resources and the best way to do that was to encourage market forces. Any laws which interfered with that pricing mechanism were harmful to wealth enhancement. Private ordering by contract was therefore the preferred mode of business organization and a corporation should thus be seen as a mere "nexus" of those relationships.[131] This highly individualist approach left all members of the corporate community except stockholders to fend for themselves and

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[128] Officially titled the "The People's Initiative to Limit Property Taxation," Proposition 13 was approved by a California voter referendum in 1978 and is now Article 13A of the Constitution of the state of California.

[129] Financier Ivan Boesky made that signature statement at a business school commencement speech shortly before he was indicted for insider trading. Patrick Dillon & Carl M. Cannon, Circle of Greed 108 (2010). It was the template for Gordon Gecko's famous declaration in Oliver Stone's 1987 movie, *Wall Street* (20th Century Fox Film Corp.) Michael Douglas won an academy award for his role as Gecko.

[130] The founding text in that school is Richard Posner, <u>The Economic Analysis of Law</u> (1973)

[131] Jeffrey Bone, *Legal Perspective on Corporate Responsibility, Contractarian or Communitarian Thought,* 24 Can. J. of L. & J. 277, 285 (2011) (contrasting this viewpoint to a more communal notion of the corporation)

prescribed no other duties for corporate officials other than maximizing the value of their shares.[132]

C. The Mixed Results for CSR from the Tender Offer Era

As discussed earlier, the tender offer movement that came on strong in the 1980s re-empowered shareholders by affording them more lucrative offers for their stock than existed in its trading market.[133] The potential for such hostile take-overs would, according to law and economics theory, lead incumbent managements to make their firms more profitable to ward off those unwelcomed overtures. As a consequence a corporation might have to forgo socially beneficial activity that could reduce its bottom line.

That unfortunate result however was blunted by a series of decisions from Delaware. It affirmed management's prerogative to adopt defensive measures that could, up to a point, thwart hostile bids. In one such leading opinion, Unocal v. Mesa Petroleum,[134] the Delaware Supreme Court held that directors facing a tender offer could consider the effect that it might have on constituencies other than its shareholders. Those would include creditors, customers, employees, and the community.

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132 *See* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer,* 94 Harv. L. Rev. 1161 (1981); Ronald J. Gilson, *A Structural Approach to Corporations: The Case against Defensive Tactics in Tender Offers,* 33 Stan. L. Rev. 819 (1981)

133 As one author wrote of that phenomenon, "[d]uring the 1980s, nearly half of all U.S. companies were restructured, more than 80,000 were acquired or merged and over 700,000 sought bankruptcy protection in order to reorganize and continue operations." Andrew J. Sherman, Mergers and Acquisitions from A to Z, (2010) at xii.

134 493 A.2d 946 (Del. 1985).

Likewise, that High Court stated a year later that so long as the directors have not made a decision to sell the company, "a board may have regard for various constituents…provided that there are rationally related benefits accruing to the stockholders."[135] Three years later the Delaware Supreme Court refined that position giving the board the power to reject even a high priced offer if it was not "offered by a reputable and responsible bidder."[136] A board might make that determination based at least in part on concerns for corporate constituents other than shareholders.[137]

The same year in Paramount Communications v. Time, Inc. Chancellor Allen refused a shareholder's request to enjoin a merger entered into to forestall a hostile takeover. The stockholder/plaintiff had argued that the combination should be stopped because it would frustrate the immediate maximization of share value. The Chancellor however ruled that management is allowed to engage in such strategic maneuvers even at the expense of short-term shareholder gain.[138] The Delaware Supreme Court affirmed, holding that absent a limited set of circumstances management "is not under any *per se* duty to maximize shareholder gain in the short-term." [139]

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135 Revlon, Inc. v. MacAndrews & Forbes Holding, Inc., 506 A. 2d. 173, 182 (Del. 1986).

For comment on how that might impact CSR issues, *see* James Roselle, *The Triple Bottom Line, Building Shareholder Value, in* Mullerat, *supra* note *, at 132; *See also* Anthony Bisonti, *The Double Bottom Line: Can Constituency Statutes Protect Socially Responsible Corporations Stuck in Revlon Land?* 42 Loy. L.A. L. Rev. 765 (2009)

136 Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, * (Del. 1989)

137 Radu Mares, The Dynamics of Corporate Social Responsibility (2008) at 39 citing D.G. Smith, *The Shareholder Primacy Norm,* 23 J. Corp. L. 285 (1998).

138 *In re* Time Inc. S'holder Litig., No. 10670, slip op. at 56 (Del. Ch. July 14, 1989)

139 Paramount Communications v. Times, Inc., 571 A. 2d. 1140, 1150. (1989)

The tender offer epoch also led many state legislatures to enact so-called "Constituency Statutes" as part of their corporate codes. These took a broad view of corporate welfare and specifically gave boards a mandate to consider the effects of any corporate action upon its non-shareholders stakeholders such as employees, suppliers, and customers of the corporation.[140] Directors were also allowed to take into account the effects of their decisions on the "communities in which offices or other establishments of the corporation are located and all other pertinent factors."[141]

States also amended their corporate codes allowing boards to adopt a variety of anti-take-over provisions. These varied in content but their intended result was to allow management to impede or delay a hostile bid. The constituency and anti-takeover statutes were thus designed to give boards both explicit grounds and specific tactics that they could use to deter and resist tender offers.

Such initiatives did not sit well with business groups and law and economic theorists. They challenged those state provisions as specifically geared to inhibit contests for corporate control which they claimed would promote more efficient commercial operations and be wealth enhancing for stockholders. Advocates of that position went even further and claimed that their version of laissez-faire economics was required by the Commerce Clause of the U.S. Constitution.[142] The U.S. Supreme Court however turned aside those arguments finding that

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140 *See generally,* Eric W. Otis, *Beyond Shareholders: Interpreting Corporate Constituency Statutes,* 61 Geo. Wash. L. Rev. 14 (1992); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 Tex, L. Rev. 579 (1992); Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes,* 19 Pepp.. L. Rev. 971 (1992).

141 Mares *supra* * at 38, citing D.G. Smith, *The Shareholder Primacy Norm,* 23 J. Corp. L. 285 (1998)

142 U.S. Constitution, Art. 1, §8(3)

absent express federal pre-emption, corporate law is state law. Under the internal affairs doctrine states were therefore free to prescribe the governing rules for businesses that are incorporated in their jurisdictions.[143]

CSR advocates also achieved a partial victory during the 1980s when the American Law Institute adopted Section 2.01 of its *Principles of Corporate Governance, The Objectives and Conduct of the Business Corporation*.[144] It began by reaffirming the traditional purpose of a corporation as profit and shareholder gain. In succeeding paragraphs however it qualified that by approving of other corporate activity although it might not be remunerative for the firm.

In subpart (b) the ALI stated that in the conduct of its business a corporation "may take ethical considerations into account that are reasonably regarded as appropriate to the responsible conduct of the business."[145] In subpart (c) the ALI went even further and said that a corporation "may devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes."[146] In similar fashion, Section 302(13) of the Revised Model Business Corporations Act, adopted at about the same time lists among a corporation's general powers, "to make donations for the public welfare or for charitable, scientific, or educational purposes."[147]

D. <u>CSR Theory Develops More Fully in the 1990s</u>

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143 CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987)

144 American Law Institute, Principles of Corporate Governance: Analysis and Recommendation §201 (1984).

145 *Id.* §201(b)

146 *Id.* §201(c)

147 RMCA §302(13)

In a famous address delivered in 1992 Delaware Chancellor William T. Allen acknowledged how "turbulent" the 1980s had been for corporate law.[148] Two different and contradictory approaches to a corporation's raison d'etre, he said, had peacefully co-existed for decades. One which he called the "property" model was premised on shareholder primacy and held that the board's paramount duty was to maximize profits.[149] The other which he labeled the "entity" model charged the corporation with broader obligations.[150] This conflict, he said, had been "papered over"[151] by the general acceptance that corporate philanthropy could be justified as being in the long term best interest of the firm and its shareholders.

Such an approach, said the Chancellor, had worked fine when American companies were free from global competition and impervious to hostile take-overs. The dynamic world economy and the rise of tender offer however had exposed the inconsistencies of that position and forced the law to grapple with issues pitting corporate social responsibility against shareholder value. Courts, he said, were hardly eager to decide those questions because there was no "widely accepted doctrine [that] offered a clear guide."[152]

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148 William T. Allen, *Our Schizophrenic Conception of the Business Corporation, 14 Cardozo L. Rev.* 261, 263 (1992)

As one commentator said of Chancellor Allen's particular expertise, "Especially during the 1980s and early 1990s, when Chancellor Allen was deciding cases, the Delaware Court of Chancery was the center of the corporate law universe." D. Gordon Smith, *Chancellor Allen and the Fundamental Question,* 21 Seattle U. L. Rev. 577 (1998)

149 *Id.* at 264-65

150 *Id.* at 265

151 *Id.* at 272

152 *Id.* at 275

With landmark decisions like Paramount Pictures,[153] Allen said, the Courts had punted the problem back to corporate boards. Conscientious directors now have to grapple with them. It all comes down, the Chancellor wisely observed, to a fundamental clash between one notion of corporations as economic and financial entities as opposed to another which sees them as institutions of political and social significance.

As most Americans experienced increasing economic insecurity during the latter part of the 20th century,[154] advocates for CSR became even more forceful. Accelerating ecological concerns contributed to its increasing prominence as well. It was thus in the early 1990s that a well-known environmentalist, John Elkington, coined the term "triple bottom line."[155] It succinctly asserted that in a system of sustainable capitalism a corporation's profit-making goals

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153 *See supra* notes ** and accompanying text.

154 This is perhaps the most pressing problem facing the United States and the author has written extensively about it in Daniel J. Morrissey, *Executive Compensation and Income Inequality,* 4 Wm. & Mary Bus. L. Rev. 1 (2013).

Among the many fine studies on this important issue, Hendrick Smith, Who Stole in American Dream, (2012) is one the best. As the author there wrote of that disturbing trend which began in the late 1970s:

> The soaring wealth of the super-rich has brought the unraveling of the American Dream for the middle class—the dream of a steady job with decent pay and health benefits, rising living standards, a home of your own, a secure retirement, and the hope that your children will enjoy a better future. Smith, at xvi

The harmful psychological effect of this insecurity on American workers is described in a series of articles that appeared in the September/October, 2013 American Prospect under the apt title, *Work in the Age of Anxiety.* The lead piece, Harold Meyerson, *The Forty-Year Slump* presents the effects of the decline in real wages since 1974.

The impact of this poor compensation on workers' commitments to their jobs is predictable. The Gallup poll reports that 52% of workers are mentally "checked out" and an additional 18% are actively disengaged. John Stancavage, *A Cure for Workplace Zombies is Possible*, Tulsa World, Aug. 11, 2013 at E1.

155 Michael Kerr, Richard Janda, Chip Pitts, Corporate Social Responsibility: A Legal Analysis 24 (2009)

had to be both eco-friendly and tempered by a commitment to a fair distribution of the world's resources.

A report from the John F. Kennedy School of Government at Harvard aptly described how different movements were then coalescing in this drive for an enhanced corporate mandate. It found that reformers were demanding corporations serve not just their shareholders' interests for financial gain but also attend to the needs of their employees, consumers, communities, and society as a whole. The report described these varied efforts in this fashion.

> The term [CSR] is often used interchangeably with corporate responsibility, corporate citizenship, social enterprise, sustainability, sustainable development, triple-bottom line, corporate ethics, and in some cases corporate governance. Though these terms are different, they all point in the same direction; throughout the industrialized world, and in many developing countries there has been a sharp escalation in the social roles corporations are expected to play.[156]

V. CSR Today

A. <u>The Movement Grows</u>

In the years since the 21st century began, the push for CSR has continued to gain momentum. The phenomenon is attributable at least in part to the global rise of social and environmental awareness that quite naturally focuses on corporate behavior. For instance, business was first made responsible for making development sustainable at the United Nations Conference on Environment and Development held in Rio de Janeiro in 1992. The follow-up

156 *Id.* at 8

conference held in Johannesburg 10 years later not only re-enforced that but called for "continuous improvement in corporate practices" to achieve it.[157]

Such agendas are fostered by concerned groups that have sprung up over the last several decades to address particular evils. There are now thousands of these non-governmental organizations (NGOs) and many of them focus on activities by business, especially those that operate on a world-wide scale. Their attention is on labor, environmental, and human rights issues and those that involve corrupt conduct. CorpWatch, an American organization, is a good example. Its mission is "[to investigate and expose] corporate violations of human rights, environmental crimes, fraud and corruption around the world [and to] work to foster global justice, independent media activism and democratic control over corporations."[158]

Such activity has engendered a favorable response from business. A majority of Fortune 500 companies now put out a CSR or sustainability report, up from just a handful 10 years ago.[159] Internationally the result is much the same. 70% of the companies listed on the Toronto Stock Exchange now issue such reports annually[160] and more than 8,000 business world-wide have sign on to the UN Global Compact promising responsible action in the areas of human rights, labor standards, and environmental protection.[161]

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157 *Id.* at 18-19.

158 *Id.* at 37

159 Knowedge@Wharton, *Why Companies Can No Longer Afford to Ignore their Social Responsibilities,* http://business.time/2012/05/28, May 28, 2012

160 Craig Kielburger and Marc Kielburger, *The Rise of Corporate Social Responsibility,* http://www.huffingtonpost.com, Feb. 6, 2088

161 Knowledge@Wharton, *supra*, note *

Many of these moves have been initiated by business leaders themselves. In a famous speech at the World Economic Forum in Davos in 2007 Bill Gates called for a new system of "creative capitalism" to tackle problems like the eradication of malaria. To that end Gates said, "It is mainly corporations that have the skills to make technological innovations work for the poor. To make the most of those skills, [we must] stretch the reach of market forces so that more companies can benefit from doing work that makes more people better off."[162]

In that vein, John Mackey, the president of Whole Foods, has recently co-authored a book called <u>Conscious Capitalism: Liberating the Heroic Spirit of Business</u>. As its title states, Mackey believes most business people are motivated not just to make profit but at least in part to do good for others. Mackey and Gates's efforts are two prime examples of what some have called, "philantrocapitalism…a more self-consciously innovative and entrepreneurial effort to tackle the world's most urgent social problems."[163]

Those nobler purposes should be specifically acknowledged, says Mackey, and business should therefore take into account the interests of all their stakeholders, like their employees and the communities that they serve.[164] The founders of Google professed a similar commitment to the common good in their prospectus when the company went public in 2004 stating, "We believe strongly that the long term will be better served as shareholders and in other ways–by a company that does good things for the world...even if we have to forgo short terms gains."[165]

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162 Bill Gates, Davos Annual Meeting, 2007, www.youtube.com/watch?v=Burr2aidH-E

163 Chrystia Freeland, *Plutocrats vs. Populists*, N.Y. Times, Nov. 3, 2013 at SR1.

164 Alan Murray, *Chicken Soup For a Davos Soul,* Wall St. J. Jan. 16, 2013

165 Google Prospectus, vi, Apr. 24, 2004

Such sentiments resonate with the public at large. 77% of consumers now say it is important for business to be socially responsible[166] and 50% of them take that into consideration when they buy things.[167] Such concerns are even stronger among young people. 85% of them say they are interested in how corporations act[168] and 70% of Millennials, those ages 18-26, tell opinion researches that they want to work at a company that is dedicated to improving its community.[169]

Religious leaders and public intellectuals have also given CSR momentum. Pope Francis made this forceful statement in his November, 2013 Apostolic Exhortation, "How can it be that it is not news when an elderly homeless person dies of exposure, but it is news when the stock market loses two points." In addition he criticized those who defend unfettered laissez-faire capitalism with these pointed remarks. "…[s]ome people continue to defend trickle-down theories which assume that economic growth, encouraged by a free market, will inevitably succeed in bringing about justice and inclusiveness in the world. This opinion, which has never been confirmed by the facts, express and crude and naïve trust in the goodness of those wielding economic power and in the sacred workings of the prevailing economic system."[170]

The 2012 presidential election even served as a referendum of sorts on this outlook. Republican presidential candidate Mitt Romney had made a large fortune at Bain capital, a firm

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166 Knowledge@Wharton, *supra*, note *

167 Kielburger, *supra, note **

168 Huffington, *supra,* note *

169 Knowledge@Wharton, *supra,* note *.

170 http://www.vatican.va/holy_father/apost_exhortations. For a similar take from a leading American philosopher who has advocated our collective responsibilities to one another, *see* Michael J. Sandel, What Money Can't Buy, The Moral Limits of Markets (2012).

that specialized in financing corporate restructuring that displaced many workers and hurt local communities. As one commentator said, it was "a form of 'cut-throat' capitalism that sent unheard of profits to the prosperous while threatening the jobs and eroding the wages of the rest."[171] President Obama made an issue of Romney's business background, especially in key battle grown states like Michigan and Ohio that he carried on the way to his reelection.[172]

B. The Causes for its Growth

If the CSR movement is not yet the dominant theme in business, at least it has become an important one. Even its critics attest to that. As Clive Crook, the then deputy editor of *The Economist* acknowledged in 2005, "The movement for corporate social responsibility has won the battle of ideas. CSR commands the attention of executives everywhere and it would be a challenge to find a recent annual report of any big international company that justifies the firm's existence merely in terms of profits rather than service to the community."[173]

Part of that surge in support may be attributable to the self-interest of business itself that recognizes the good will it can generate from this socially responsible activity[174]or conversely

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171 Eduardo Porter, *At the Polls Choose Your Capitalism*, N.Y. Times, B1 Oct. 31, 2012.

172 George Will, *Status Quo Preserved in U.S. Politics,* Tulsa World, A20, Nov. 9, 2012

173 Kerr, *supra* note *, at 33

174 Mark Pfitzer, Valerie Bockstette, and Mike Stamp, *Innovating for Share Value,* Harvard Bus. Rev., Sept. 2013, at 101*;* Michael E. Porter and Mark R. Kramer, *Strategy and Society, The Link Between Competitive Advantage and Corporate Social Responsibility,* Harvard Bus. Rev., Dec. 2006 at 78

See also Forest L. Reinhardt, Robert N. Stavins, and Rich H.K. Vietor, *Corporate Social Responsibility Through an Economic Lens*, Association of Environmental and Resource Economists, Oxford University Press (2008) (questioning whether CSR requires companies to sacrifice profits) and Jeffrey D. Sachs, The Price of Civilization, 42-48 (2011) (arguing the efficiency and fairness may reinforce each other) the ill-will that can come from its neglect. Two recent prime examples of that are the devastating BP oil spill in the Gulf of Mexico[175] and the horrible fires and sweat-shop conditions in Bangladesh factories that make clothes sold by U.S. retailers.[176]

Along those lines, many businesses have also profited by cost savings that have been taken for environmental reasons. Dow Chemical is a good illustration of that.[177] Likewise companies like Gap, Inc. are proud to boast how their employee friendly policies have led to increased profitability. As the company stated in its 2005-06 *Social Responsibility Report,* "When factories treat workers well, they also tend to produce higher-quality product and deliver it on time. The more we respect and empower our own employees, the more creative and innovative our products and marketing tend to be." [178]

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175 Jeffrey Hollander, co-founder of the American Sustainable Business Council and the Sustainability Institute had these harsh words for BP's shortsightedness in 2010.

"If British Petroleum was an authentically responsible corporation, would the Gulf be in the mess it is now...An oil company driven by a mission of genuine responsibility would have voluntarily installed the non-required safety gear…Yes these things can take money. An automatic switch that closes off the blowouts, for example, runs about $500,000. But compared to the $30 billion drop in market value of BP stock has experienced since the spill, not to mention what it might cost to clean up the entire Gulf, that's a drop in the bucket." Mullerat, *supra* note *, at 78

176 *See* Junfikary Ali Manik and Jim Yardly, *Bangladesh Finds Gross Negligence in Factory Fire,* N.Y. Times, Dec. 17, 2012 describing the Nov. 24, 2012 fire at the Tazreen Fashion Factory where 112 workers lost their lives. I made clothes for global retailers like Walmart and Sears.

See also Anner, Mark; Bair, Jennifer, Blasi, Jeremy *Toward Joint Liability in Global Supply Chains: Addressing the Root Causes of Labor Violations in International Subcontracting Networks*, 35 Comp. Lab. L. & Policy J. 1, (2013)

177 Because of energy reducing initiatives, Dow Chemical said in 2004 that it had achieved approximately $3 billion in savings. Kerr, *supra* note *, at 42

178 *Id. at* 42

This "paradigm shift" in business[179] is owing to the dedicated activity of a large number of individuals. The CSR agenda has been pushed forward by the efforts of human rights and public interest groups along with lobbying and campaigning by concerned citizens. Many of the reforms it has championed have also been taken up by public officials and shareholders who have been stirred to action by well publicized corporate scandals and other harmful conduct.[180]

Institutional investors have led the way here too. CalPers with its $264 billion fund, has identified 111 initiatives that focus on issues such as green energy and regions that are "underserved by investment capital."[181] In addition, a new surge of student activism with roots in the 60s anti-war protests and the 80s movement to end apartheid has been agitating on campus calling on universities to divest their holdings in fossil fuel companies.[182]

All these undertakings have been substantially assisted by the rise of social media that can link people immediately in ways never before imagined. As one observer put it so well:

> The billions of cell phones in the world will increasingly be used to record, upload, forward and display corporate and other abuses, whether of sweatshops employing child labor, pipeline leaks, trafficking of women and children, or corporate resources being used to support crimes against humanity or genocide… These new, powerful, ubiquitous and interactive communication technologies…empower rapid, bottom up democratic 'WikiAdvocacy' by individuals, 'citizen journalists,' bloggers, and self-organized coalitions, while

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179 Roselle, *in* Mullerate *supra, note *, at* 129

180 Greg Hills, Adeeb Mahmud, and Leigh Fiske*, Anti-Corruption as Strategic CSR: A Call to Action for Corporations, FSG Social Impact Advisors* (May, 2009); Mark Walsh & John Lowry, *CSR and Corporate Governance, in* Mullerat*, supra* note *, at 45-46

181 Randall Smith, *A New Investment Program Focus on Campus: Fossil Fuels,* N.Y. Times May 5, 2013

182 Change Up, *From Campus Protests to Your Retirement Fund, How Divesting from Fossil Fuels and Investng in ESGs Work,* Mar. 18, 2013, Bangor Daily News, http://changeup.bangorrdailynews.com

simultaneously allowing greater scrutiny and pressure from investors, consumers, communities, established NGOs and other market monitors.[183]

C. CSR's Increased Sophistication

As it has grown in strength and influence, the CSR movement has sharpened the theories that support its agenda. Two major themes now stand out. Corporations must combine their profit making efforts with environmental and social concerns. And they must give appropriate consideration to the interests of all their stakeholders.[184] In doing this, companies must go beyond minimal legal requirements and conventional philanthropy[185] and stake out positive commitments to these broader concerns.[186]

Books[187] and articles on these topics now abound and with their proliferation have come new ideas about how companies can balance profit with larger principles. In the school of Progressive Corporate Law, American professors Lawrence Mitchell[188] and Douglas Branson[189]

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183 Joe W. (Chip) Pitts III, *Corporate Social Responsibility: Current Status and Future Evolution,* 6 Rutgers J.L. & Pub. Pol'y 334, 336

184 Kerr , *supra* note *, at 11-12

185 Chris Howells, *When it Comes to CSR, Size Matters,* Insead, Aug. 14, 2013, http://www.forbes.com/sites/insead

186 Hills, *supra* note *, at 2

187 *See e.g.* Kerr, *supra* note *, Mulrate, *supra* note *, Mares, *supra* note *, and McBarnet *infra* note *.

188 Lawrence E. Mitchell, Progressive Corporate Law, (1995)

189 Douglas M. Branson, Corporate Governance, (1993)

have led the way and Canadian legal scholar Joel Balkan has made a significant contribution with his work, The Corporation: The Pathological Pursuit of Profit and Power.

Though Balkan acknowledged there that a corporation is a "remarkably efficient wealth-creating machine"[190] he argued that it should be committed to social welfare as well as profit. "Though individualistic self-interest and consumer desires are core parts of who we are and nothing to be ashamed about," he wrote, "they are not all of who we are."[191] By extension the ethical mandate which applies to each person should therefore also control the actions of such significant human institution as corporations.

Part of the theory supporting CSR has also targeted short-termism which pushes corporations to externalize the costs of their demand for quick profits on the rest of society. This can take the form of worker mistreatment, environmental pollution, and a general failure to provide for the sustainability of the enterprise.[192] There is an obvious overlap here between corporate governance and corporate social responsibility.[193]

It is ultimately up to the board to be the corporate conscience and restrain this short-sightedness.[194] The business judgment rule which affords directors discretion in running a

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190 Joel Balkan, The Corporation: The Patholigical Pursuit of Profit and Power 159 (2004)

191 *Id.* at 166

192 Doreen McBarnet, Aurora Voiculescu and Tom Campbell, *The New Corporate Accountability,* (2007) at 282-83

193 Walsh, *supra* note *, *in* Mullerat at 45

194 Kenneth B. Goodpaster and John R. Matthew, Jr. *Can a Corporation Have a Conscience?* Harvard Bus. Rev. *supra* note *, at 131

corporation, gives them legal support to follow such a balanced approach.[195] Chancellor Allen explained the justification for that deference with these comments, "Resolving the often conflicting claims of the various corporate constituents calls for judgment, indeed calls for wisdom by the board of directors of the corporation."[196]

As another commentator put it,

> In recent years, a growing number of public companies have come to recognize that sustainable corporate profit does not come from the single-minded pursuit of financial gain. Rather sustainable growth and shareholder value are best achieved by working through a broad framework of economic, social, environmental and ethical values and shared objectives that involve constant interaction between the company and its various stakeholders.[197]

In much the same vein, CSR theorists have been increasingly focusing a more direct attack on Milton Friedman's classic one dimensional definition of corporate purpose—to only maximize profits for shareholders.[198] One pointed out that as opposed to the holistic response of CSR, Friedman's view represented "the atomizing perspective of the traditional individualist approach."[199] Another picked up on Friedman's concession that corporations should obey laws and "ethical customs."[200] Since social responsibility is certainly a moral norm for individuals,

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195 *See supra* note * and accompanying text.

196 Allen, *supra* note *, at 271

197 Roselle, *supra* note *, *in* Mullerat at 129

198 *See supra* note * and accompanying text.

199 McBarnet, *supra* note *, at 416

200 Friedman, *supra* note *, at 17.

why shouldn't it also be one for corporate citizens?[201] In Mitt Romney's famous dictum, "corporations are people."[202]

Leading corporate scholars like Hillary Sale and Margaret Stout have also written of this communal notion of corporate identity. Sale points out that the adjective "public" which modifies large companies with many shareholders implies that those firms should serve all people in a society.[203] Stout's concept of the corporation as a "team" which connotes that it needs the talents of many players to make it successful also speaks to the broader ideas that underlie CSR theory.[204]

In addition, the rise of a new legal form that a business may take, the "Benefit" or "B" corporation, addresses those aspirations even more directly.[205] Such a company may state in its charter that in addition to making profit it may engage in less remunerative activity that will

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201 Kerr, *supra note *,* at 53-54

202 Philip Rucker, *Mitt Romney says Corporations are People,* Washington Post, Aug. 11, 2011.

203 Hillary Sale, *The New "Public" Corporation,* Washington U. in St. Louis School of Law, Paper No. 11-04-01 at 1 (March, 2011).

204 *See* note * *supra* and accompanying text.

205 *See generally,* Christopher Lacovara, *Strange Creatures: A Hybrid Approach to Fiduciary Duty in Benefit Corporations,* 2011 Colum. Bus. L. Rev. 815 (2011); Judd F. Sneirson *Green is Good: Sustainability, Profitability and a New Paradigm for Corporate Governance,* 94 Iowa L. Rev. 987 (2009)

The author there cleverly parodied Gordon Geicko notorious "Greed is Good" speech to the board of a paper producing company, *supra* note *, in this fashion:

> The point is, ladies and gentlemen, that green, for lack of a better work, is good. Green is right. Green works. Green clarifies, cuts through, and captures the essence of the evolutionary spirit. Green in all of its forms—green for life, for money, for love, knowledge—has marked the upward surge of mankind. And green, you mark my words, will not only save Teldar Paper, but that other malfunction corporation called the U.S.A. *Id.* at 1; *See also supra,* note *, and accompanying text.

produce social good. Such an innovation is in line with diverse approaches to corporate governance taken in other countries.

One prominent and successful example of that are the Workers' Councils of Germany. They collaborate with management in that highly productive and prosperous country and lead their firms to embrace broad social goals.[206]   Such a new corporate model might even have some resonance with the state capitalism of China where a new generation of leaders speaks openly of the need to pay better wages to factory workers so they can buy the products they make.[207]

D. Answering Inequality

The rapid growth of the CSR movement during the last several decades can be explained, at least in part, as a response to the increasing disparity in income and wealth among Americans. In the decades after World War II most firms in our country paid high wages. That in turn led to robust consumer spending that spurred the economy to even more productivity. Such widely shared affluence thus engendered a virtuous cycle of ever stronger business activity.[208]

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206 For a fine book that makes this point while discussing the disadvantages American workers face in comparison with their much better off German counterparts, *see* Thomas Geoghegan, Were you Born on the Wrong Continent (2010).

207 James Fallows*, Mr. China Comes to America*, The Atlantic, December, 2012 at 54

208 *See* Jordan Weissman, *60 Years of American Economic History, Told in 1 Graph*, The Atlantic, August 23, 2012.

As Hedrick Smith writes of that era: "In the heyday of the middle class, for thirty years after World War II, America's great companies paid high wages and good benefits. Tens of millions of families had steady income, and they spent it, generating high consumer demand." Smith, *supra* note, * at xxiv.

Robert Reich's recent movie, *Inequality for All*, contrasts that era of wide-spread prosperity to the current time when the disparities in income have grown to alarming proportions.   It was favorably

Yet despite significant gains in productivity over the last thirty years wage growth has been stagnant.[209] During that time, technology and globalization[210] have destroyed many manufacturing and clerical jobs in this country—leaving behind only poorly paying service jobs.[211] By contrast those in the upper echelons of society, principally financiers and executives, have grown ever richer.[212]

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reviewed by Nicolas Rapold, *Chasm Between the Very Rich and Everyone Else,* N.Y. Times, Sept. 26, 2013

[209] William Galston, *Behind the Middle-Class Funk*, Wall St. J. Aug. 7, 2013 at A11

This is so even while American workers are more productive than those in European countries. Discussing the substantial wealth increase in America during the last several decades, Thomas Geoghegan writes:

> Technically we seem far ahead but don't drool. The U.S. superrich gobble up well over two-thirds of the increase. In 2005 the real hourly wage for production workers in America was approximately 8 percent lower than it was in 1973 while our national output per hour is 55 percent higher. So it's dubious whether most Americans have gained even a penny in purchasing power since 1989. Geoghegan, *supra* note *, at 13.

[210] Nobel-prize-winning economist Joseph E. Stiglitz aptly described this phenomenon.

> [L]aborsaving technologies have reduced the demand for many "good" middle-class, blue-collar jobs. Globalization has created has created a worldwide marketplace, pitting expensive, unskilled workers in America against cheap unskilled workers overseas. Social changes have also played a role—for instance, the decline of unions, which once represented a third of American workers and now represent about 12 percent. Joseph E. Sitglitz, *Of the 1%, by the 1%, for the 1%* Vanity Fair, Apr. 5, 2011.

[211] In an earlier piece, the author has marshalled a number of statistical measurements to substantiate this income inequality and wealth concentration. Daniel J. Morrissey, *Executive Compensation and Income Inequality,* 4 Wm. & M. 1, 4-8 (2013)

[212] *Id.* at 13-16.

In the last two years, despite substantial criticism of exorbitant corporate compensation, the pay of top executives has continued to soar. *See* Nelson D. Schwartz, *The Infinity Pool of Executive Pay*, N.Y. Times, April 7, 2013, BU 1; Gretchen Morgenson, *The Unstoppable Climb in C.E.O. Pay, June 30, 2013 at BU 1.*

The gap between the wealthiest Americans and almost everyone else has continued to accelerate.[213] Even worse this general decline in the American economy was masked by an illusory prosperity. It came first in a run-up of high-tech dot.com stocks,[214] and then in a surge in real estate prices. When the latter bubble finally burst in 2008 it brought on the worst financial panic since 1929.[215]

Thanks to fiscal and monetary bailouts by the federal government, the nation avoided a depression and the stock market rebounded, soaring again to new heights.[216] Yet hardly any of that "created" money trickled down to middle income Americans who work for wages and salaries. Statistics continue to pour out showing that the gap between the wealthiest Americans and everyone else keeps growing. Last year, for instance, the richest 10% got over one-half the income our country produced.[217] Even recent job gains that have come as the country has slowly emerged from this great recession have been almost entirely in the low-paid service and retail

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[213] Even conservatives are acknowledging this growing income inequality, while blaming it on government policies. *See* David Malpass, *How Big Government Drives Inequality,* Wall St. J., Jan. 16, 2014 at A15.

[214] The 1990s saw astounding gains in the stock market. The Dow Jones Industrial Average increased from 2753 to 11224 and the NASDAQ went from 454 to 3620. *Rollicking, Rocketing Stock Markets,* Wall St. J. December 13, 1999 at C1, C23.

[215] For the author's take on the meltdown and its impact on the economy *see* Daniel J. Morrissey, *After the Meltdown,* 45 U. Tul. L. Rev. 393, 393-97 (2010)

[216] The stock market had its best year in 2013 since 1997. The Standard and Poors 500 Stock index rose 29.6%. Adam Shell, USA Today, December 31, 2013

[217] Annie Lowrey, *Top 10% Took Home Half of U.S. Income in 2012* N.Y. Times, Sept. 11, 2013

sectors.[218] As one commentator sadly put it, "We are becoming a nation of hamburger flippers."[219]

That very troubling trend is best exemplified by the disparity between the pay of top corporate officials and that of average workers. In 1965 it was 24-1, but by 2010 at the 300 largest companies it had sky-rocketed to 343-1.[220] The discontent spawned by that huge inequality is evident in the Occupy Wall Street movement[221] and sporadic strikes by fast food workers.[222] As one union official said in endorsing those work stoppages, "We think it's important to back low-wage workers who are willing to stand up and have the courage to strike to make the case that the economy is creating jobs that people can't support their families on."[223]

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218 Paul Wiseman, *New Jobs Disproportionately Low-pay, Part-time,* Tulsa World, Aug. 4, 2013 at A9

219 Aaron Task, *"We Have Become a Nation of Hamburger Flippers": Dan Alpert Breaks Down the Jobs Report,* The Daily Ticker, Aug. 2, 2013, http://finance.yahoo.com/blogs/daily-ticker

220 Jennifer Liberto, *CEOs Earn 343 Times More than Typical Worker,* CNN MONEY (Apr. 20, 2011), http://money.cnn.com/2011/04/19

221 Erick Eckholm & Timothy Williams, *Anti-Wall Street Protests Spreading to Cities Large and Small,* N.Y. Times, Oct. 4, 2011 at A18

222 Steven Greenhouse, *A Day's Strike Seeks to Raise Fast-Food Pay*, N.Y. Times, July 31, 2013

Today America's three largest private sector employers are all low-wage retailers: Wall Mart, Yum Brands (Taco Bell, Pizza Hut, Kentucky Fried Chicken) and McDonald's. Meyerson, *supra* note *, at 27.

Another commentator said this income inequality. "And it is exemplified by fantastically profitable companies like McDonald's choosing to pay employees so little that they have to live in poverty. " Henry Blodget, *Hate to Say it, But if Companies Don't Start Paying People Better, We May Need Unions,* Business Insider, Aug. 2, 2013, http://www.businessinsider.com/author/henry-bodget

As one commentator noted, "McDonald's was widely derided for releasing a budget to its employees plan financially since that only underscored how brutally hard it is to live on a McDonald's wage. Surowiecki, *supra* note *. Don Thompson, McDonald's CEO made $14 million in compensation in 2012. Sam Polk, *For the Love of Money,* N.Y. Times, Jan. 19, 2014 (Sunday Review 1).

223 Greenhouse, *supra* note *.

All this has had a real effect on our social fabric, particularly the promise of upward mobility that generations of Americans have taken for granted which is now vanishing.[224] As the renowned social historian Francis Fukuyama has recently stated,

> The fact is, however, that the rates of intergenerational social mobility are far lower in the United States than many Americans believe them to be…Over time the elites are able to protect their positions by gaming the political system, moving their money off-shore to avoid taxation, and transmitting these advantages to their children through favored access to elite institutions.[225]

Another author made much the same point saying, "Most of Western Europe today is both more equal in incomes and more economically mobile than the United States."[226] More and more Americans are becoming aware of that painful reality. A survey recently found that only 55% of those asked said they believed that their children will have a better life than they have, the lowest percentage since the survey began in 1987.[227] Corporate officials now have to face the ultimate question--does our system now work for most people?

VI. Achieving the Triple Bottom Line

A. Renewing the Call for National Corporate Law

Given this dire situation, it is time to go beyond sporadic efforts at reform and enact comprehensive national legislation regulating large public companies. This is not a new idea. At least three times during the last century, during the presidencies of Theodore and Franklin

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224 President Obama has taken this as a major theme in his second term. Gerald P. Seib, *Obama's Speeches: Progressive, Populist,* Jul. 26, 2013 at A4

225 Francis Fukuyama, The Origins of Political Order, 9 (2011).

226 Timothy Noah, *The Mobility Myth,* New Republic, Mar. 1, 2012 at 14

227 Emily Alpert, *Lower Class Descriptor Rising*, Tulsa World, Sept. 18, 2013 at A10

Roosevelt and Jimmy Carter, serious efforts were made to require that large companies be federally chartered.[228]

The ensuing legal framework should not endanger the innovative edge American corporations have long enjoyed in the global economy. Nor should it diminish the personal responsibility of each worker to use her or his talents skillfully for the common good. But it should serve to not only protect investors more fully from wrongdoing by corporate insiders but also to mandate a broader purpose for these highly productive enterprises to make sure they serve the larger public interest.

Such regulation would require among other things that corporations adopt more balanced compensation structures narrowing the egregious difference that now exists between the pay of top executives and front-line workers. It would also mandate that these companies make meaningful efforts to expand their work forces and pay them good wages thus creating a prosperity that would be shared by a large majority of our citizens, many of whom are now in danger of falling into a permanent underclass. Such an approach can be justified on both principled and pragmatic grounds.

B. <u>The Reasons for Federal Law That Defines Corporate Purpose</u>

First it is eminently sensible that these large firms with countrywide and international operations be regulated by our national government. Observers have long pointed out that the preeminence of Delaware here is an historical anomaly.[229] The internal affairs doctrine has

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228 Mark J. Roe, *Delaware's Competition,* 117 Harv. L. Rev. 588, 597 (2003)

229 In the first part of the 20th century, Delaware copied the corporate act of New Jersey, which was then the leading jurisdiction for incorporations. When a reforming Governor named Woodrow Wilson

allowed that small, non-industrial state to be the de facto law-giver for corporate America with continuing charges that firms flock there to incorporate because of its lax regulation.[230] In addition, there is ample warrant for a national mandate that corporations have a broader purpose than just profit.

Firms that do business in the corporate form receive substantial support from the larger community. Shareholders, who have the ultimate claim on the accumulated wealth of those companies, are given the privilege of limited liability.[231] Such businesses are also granted the legal rights afforded natural persons under the constitution[232] and they are supported by political institutions in myriad ways. Those include tax breaks, infrastructure construction, education of their workforce, government contracts and financial bailouts. It is therefore only right that large public companies owe reciprocal duties to society as a whole.

And from a practical perspective, corporate executives have substantial resources under their control. They also have the expertise to use them to expand the productive capacities of their enterprises so that they can give meaningful employment to a larger workforce. In addition they can distribute the revenue of their firms in ways that both reduce the egregious income inequality that now threatens the stability of our society and also promotes widespread purchasing power that will secure a market for their products.

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tightened New Jersey's law, many of the firms incorporated there migrated to Delaware and never left. Cary, *supra* note *.

[230] Cary's famous observation there is "there is no policy left in Delaware corporate law except the object of raising revenue." *Id.* at 684

[231] *See supra* notes 7 and 8 and accompanying text

[232] Citizens United v. Federal Election Commission, 558 U.S. 310 (2010) is the most notorious example of this where the High Court ruled that a corporation's free speech rights prohibited any restrictions on contributions it might make to political campaigns.

As this Article has pointed out, some business leaders have acknowledged the need for this more pervasive mandate. They and a large percentage of the general population recognize that personal satisfaction comes from working in enterprises that not only provide good livings for their employees but also serve the larger purposes of society.

In addition a large number of state legislatures have already led the way here by adding provisions to their corporate codes that directors may take the interests of an array of corporate constituents into account.[233] More recently many states have also allowed for the chartering of so-called "benefit corporations" that can be set up to not just make profit but also to achieve broader social goals.[234] Those efforts represent a platform upon which to build national legislation.

VII. CONCLUSION

For the last several decades two seemingly incompatible ideas have been moving forward in corporate law. One is shareholder rights and the other is corporate social responsibility. Yet even the conservative economist Milton Freedman, the prime spokesperson for the shareholder primacy approach, conceded that corporations are bound not only to obey the law but also to abide by ethical customs. As that sense of public morality has expanded to include many of the ideas found in CSR there appears to have emerged a new "reflective equilibrium" on this issue.

The highly respected social philosopher, John Rawls,[235] used that term to describe an adjustment to previously-held principles brought about by a more complete understanding of the

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233 *See supra* note * and accompanying text.

234 *See supra* note * and accompanying text.

235 John Rawls, A Theory of Justice (1971)

demands of justice. Now that CSR theory has achieved its maturity such equipoise may have arrived. Corporate law no longer need be “schizophrenic” as Chancellor Allen claimed, but can embrace as its goals both shareholder rights and CSR. As this Article has argued, both are important for our society. If either by the wise choices of corporate boards or by legislative mandate business leaders accept those responsibilities our nation will be much the better for it.