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## SERVING TWO MASTERS: INCORPORATING SOCIAL RESPONSIBILITY INTO THE CORPORATE PARADIGM

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### INTRODUCTION

Since the 1930s, the debate concerning the purpose of the corporation has pervaded modern corporate law.<sup>1</sup> Even today, the question of whether the purpose of the corporation is to serve the interests of shareholders—to the exclusion of all other interests—or whether it can also consider the interests of other corporate constituencies remains unsettled. The inability to resolve the debate persists despite the importance of its conclusion, in that the purpose of the corporation shapes the normative content of corporate law and the roles and obligations of corporate managers.<sup>2</sup> More

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1. The debate over the purpose of the corporation first began in the pages of the Harvard Law Review, in which a noted corporate scholar, Adolf A. Berle, argued in favor of profit as a corporation's sole purpose. E. Merrick Dodd, on the contrary, argued that a corporation has both profit-making and social service functions. Adolf A. Berle Jr., *For Whom Corporate Managers are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932); E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932). The argument about the purpose of the corporation continues today. See, e.g., Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE. L. REV. 1423 (1993); Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law*, 59 ALA. L. REV. 1385 (2008); Ian B. Lee, *Corporate Law, Profit Maximization, and the "Responsible Shareholder,"* 10 STAN. J.L. BUS. & FIN. 31, 40 (2005); Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174 (2001); Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189 (2002); Leo E. Strine, Jr., Lecture and Commentary, *The Social Responsibility of Boards of Directors and Stockholders in Charge of Control Transactions: Is There Any "There" There?*, 75 S. CAL. L. REV. 1169 (2002).

2. Norms in corporate law determine the beneficiary of fiduciary duties, but not the content of those duties. D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L.

importantly, resolving the debate in favor of shareholder interests would mean that corporate managers<sup>3</sup> are obliged to focus their actions solely on the task of immediately measurable profit maximization goals.

The longevity of the debate surrounding corporate purpose is particularly surprising given the links between attention to the interests of corporate constituents and maximization of the long-term value of a corporation.<sup>4</sup> Once thought of as tangential to business, the interests of employees, communities, customers and other corporate constituents are becoming significant factors in the long-term success of the corporation.<sup>5</sup>

International recognition of the relationship between corporations and their effects on non-shareholder corporate stakeholders is also growing. In a recent report, United Nations Special Representative John Ruggie outlined a framework for addressing issues arising from the intersection of corporations and human rights.<sup>6</sup> The framework details obligations and duties for corporations in the respect and promotion of human rights. Professor Ruggie specifically acknowledged the breadth of corporate obligations in this area in observing that “[t]here are virtually no [internationally recognized] rights that businesses [cannot] affect.”<sup>7</sup>

The United Nations’ involvement in the intersection of business and rights-based discourse follows from similar reports on the growing importance of multinational corporations.<sup>8</sup> The United Nations Conference on Trade and Development reports that approximately 77,000 multinational corporations operate in today’s global economy, many of which are

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277, 284 (1998).

3. “Corporate managers” refers both to directors and officers.

4. See Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APP. CORP. FIN. 8, 16 (2001) (defining “value” as equity plus the sum of all financial claims on the firm including debt, warrants, and preferred stock).

5. See Ian Davis, *What is the Business of Business?*, MCKINSEY Q. 104 (2005) (“Social issues are not so much tangential to the business of business as fundamental to it . . . Social issues have a significant effect on the long-term prospects of the corporation, and even if the effect of social pressures may not be immediate, it is poor strategy for companies to delay preparing for or tackling them.”).

6. The Representative of the Secretary-General, *Protect, Respect and Remedy: A Framework for Business and Human Rights*, ¶¶ 10-26 A/HRC/8/5 (April 7, 2008) [hereinafter *Ruggie Report*] (prepared by John Ruggie).

7. Frances William, *Human Rights Duty for Business*, FIN. TIMES, June 6, 2008, available at [http://www.ft.com/cms/s/0/30fee3aa-3312-11dd-8a25-0000779fd2ac.html?nclick\\_check=1](http://www.ft.com/cms/s/0/30fee3aa-3312-11dd-8a25-0000779fd2ac.html?nclick_check=1); see also *Ruggie Report*, supra note 6, at ¶¶ 6, 52 (“[T]here are few if any internationally recognized rights that businesses cannot impact—or be perceived to impact—in some manner.”).

8. Compare U.N. CONFERENCE ON TRADE AND DEV., WORLD INVESTMENT REPORT 2007—TRANSNATIONAL CORPORATIONS, EXTRACTIVE INDUSTRIES, AND DEVELOPMENT, UNCTAD/WIR/2007, U.N. Sales No. E.07.II.D.9 (2007) with U.N. CONFERENCE ON TRADE AND DEV., WORLD INVESTMENT REPORT 1999—FOREIGN DIRECT INVESTMENT AND THE CHALLENGE OF DEVELOPMENT, UNCTAD/WIR/199, U.N. Sales No. E.99.II.D.3 (1999).

headquartered in the United States.<sup>9</sup> In fact, over twenty-five percent of the world's top multinational corporations are U.S. based corporations, which implicates the importance of U.S. corporate law.<sup>10</sup>

Despite the links between non-shareholder financial interests (and maximization of corporate value) and the growing dominance of multinational corporations (and their increasing ability to impact individuals' rights), the debate surrounding corporate purpose continues.<sup>11</sup> In part, this may be a result of the inability to reconcile the competing views—neither of which is wholly accurate—of the purpose of the corporation. While modern corporate law accepts that one purpose of a corporation is profit maximization, it does not accept that this is its *exclusive* purpose. Rather, modern corporate law is ambiguous as to the purpose of the corporation.<sup>12</sup>

The lack of clarity, however, in defining the purpose of the corporation has created an element of discretion within the existing corporate paradigm. Today's corporate managers have the choice to direct corporate goals either towards shareholders' financial interests or towards other interests.<sup>13</sup> These other interests pertain to a variety of corporate constituents besides shareholders, including employees, creditors, and customers. In effect, then, as a result of its ambiguous nature, corporate law provides managers with the discretionary ability to take socially responsible<sup>14</sup> actions. This discretion can and should be exercised.

Part I of this Article explores the ambiguities of corporate law by challenging corporate governance models that favor only one view of corporate purpose, and by identifying the differing norms that corporate case law and statutes impose. In particular, it examines the underlying premises of both the property-centric and contractarian views of a

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9. U.N. CONFERENCE ON TRADE AND DEV., WORLD INVESTMENT REPORT 2006—FDI FROM DEVELOPING AND TRANSITION ECONOMIES: IMPLICATIONS FOR DEVELOPMENT, at xviii and Annex A.I.11, UNCTAD/WIR/2006, U.N. Sales No. E.06.II.D.11(2006).

10. *See id.* at Annex A.I.11 (noting that although U.S. subsidiaries may operate under the national laws of the state in which they incorporate, for many states in which regulation is lax or non-existent, U.S. corporate law may be the only constraint on their behavior).

11. For example, Chancellor Allen has suggested that the corporate purpose is subject to an answer that will hold for the here and now, but which will be torn down in the future, only to be reformulated again and again. *See* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 280-281 (1992).

12. The ambiguity of the corporate purpose has caused others to label corporate law as ambivalent or even schizophrenic. *See* Allen, *supra* note 11, at 261; William T. Allen et al., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1067 (2002).

13. The discretion that affords corporate managers this choice is principally exercised through use of the business judgment rule. *See infra* Part III.A.

14. The term "socially responsible" is used to refer to acts aimed at producing a positive impact on society.

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corporation that support the idea of shareholder primacy and emphasizes that neither corporate case law nor statutes demand a norm of unconditional profit maximization. Part I concludes by positing that corporate managers can actually serve two masters: both financial and non-financial interests.

In Part II, this Article describes the normative bases that justify corporate managers' use of discretion—afforded by the ambiguities in corporate law—to depart from profit maximization goals. In the first case, it argues that the potential for a convergence between non-shareholder interests and the long-run interests of the corporation makes a relatively straightforward case for justifying a departure from the profit maximization norm. In the more difficult cases, where links between consideration of non-financial interests and profit goals are less tangible, it argues that considerations of fairness also justify a departure from a pure profit maximization norm, particularly where corporations operate in globalized economies.

Part III discusses current doctrinal rules that can be used by corporate managers to employ discretion. By focusing on the business judgment rule, fiduciary duties, and board supported shareholder proposals, this part suggests that, without reformulation, the existing corporate paradigm can support a model in which corporate actions attend to more than immediately measurable profit goals.

Part IV explores how social responsibility issues can be integrated into a corporate manager's decision-making process. Departing from traditional corporate social responsibility scholarship, this Article argues that profit maximization can continue to operate as a presumptive norm in order to facilitate day-to-day decision-making. Nevertheless, the norm of profit maximization should be tempered when markets or social norms so demand.

Finally, recognizing the problems often related to the use of discretion, Part V explores the limits on a corporate manager's ability to embrace the ambiguities in corporate law. In particular, this part observes that limits are necessary to prevent corporate managers from using their discretion to serve only their own self-interests.

## I. THE AMBIGUOUS NATURE OF CORPORATE LAW

The ambiguous<sup>15</sup> nature of corporate law has caused it to be described as “ambivalent”<sup>16</sup> and, more interestingly, as “schizophrenic.”<sup>17</sup> Although the purpose of the corporation and the beneficiary of the duties of corporate

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15. By ambiguous, I mean that the purpose of the corporation and the beneficiary of fiduciary duties are unclear.

16. Allen et al., *supra* note 12, at 1067.

17. Allen, *supra* note 11.

managers remain uncertain, some commentators continue to dispute the contradictory nature of corporate law, and instead argue that the sole purpose of corporate law is unconditional profit maximization.<sup>18</sup> While the role of the corporation as a creator of shareholder wealth cannot be ignored, the singular focus of corporate law on shareholder primacy<sup>19</sup> and, by extension, profit maximization, has been overstated.

A. *Corporate Governance Models, Shareholder Primacy, and Profit Maximization*

The conclusion that the purpose of corporations is solely for the maximization of profit is premised on the idea of shareholder primacy, or that corporate powers are exercisable only for the benefit of shareholders.<sup>20</sup> In turn, the concept of shareholder primacy has been derived primarily through reliance on various corporate governance models. One model stems from a property-centric view of corporations, while the other model views the corporation as a “nexus of contracts.”

The most famous champion of the property-centric view of the corporation was Milton Friedman.<sup>21</sup> Friedman argued that in a free-enterprise, private-property system, corporate executives are the employees of the business owners (the shareholders) and, accordingly, owe these owners a duty to conduct the business so as to make as much money as possible.<sup>22</sup> Under this theory, the corporation is seen as the property of the

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18. Bainbridge, *supra* note 1, at 1423-24; Arnoud W.A. Boot & Jonathan R. Macey, *Monitoring Corporate Performance: The Role of Objectivity, Proximity, and Adaptability in Corporate Governance*, 89 CORNELL L. REV. 356, 363 n.21 (2004) (citing Lawrence A. Hamermesh, *The Shareholder Rights By-Law: Doubts from Delaware*, 5 CORP. GOVERNANCE ADVISOR 9, 9 (1997)) (“[T]he business and affairs of a Delaware for profit, stock corporation are to be managed so as to maximize the value of the investment of one group and one group only, its stockholders.”); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) (“[C]orporate law should principally strive to increase long-term shareholder value.”); Romano, *supra* note 1, at 186 n.30 (“The objective of U.S. corporate law . . . is to maximize share value.”).

19. Shareholder primacy is the view that the corporation exists only to advance the interests of shareholders by maximizing their wealth. See David Millon, *New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1374 (1993).

20. Adolph A. Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (“[A]ll powers granted to a corporation or to the management of a corporation . . . [are] at all times exercisable only for the ratable benefit of all the shareholders as their interest appears”); Smith, *supra* note 2, at 278 (“Corporate directors have a . . . duty to make decisions that are in the best interests of the shareholders” and “shareholders claim the corporation’s heart.”).

21. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, (Magazine).

22. *Id.* at 33.

shareholders and the corporate managers, as the agents of the shareholders, are obliged to act to advance the latter's financial interests.<sup>23</sup>

However, the analogy between shareholders and owners of a business is flawed.<sup>24</sup> Shareholders do not own a publicly held corporation; they merely own its shares. As such, they are not entitled to the same rights as the owners of a business.<sup>25</sup> Unlike business owners, shareholders do not own title to the business, they cannot directly control the assets of a business, and they cannot access the earnings of the business, save for when dividends are declared by the board of directors.<sup>26</sup> Moreover, shareholder control over the actions of the corporation is only indirect and is a task mainly left to the board of directors.<sup>27</sup> Even in a widely held corporation, shareholder influence over the acts of the board of directors may be so diluted as to be rendered insignificant.<sup>28</sup> Because shareholders do not hold title to a business, directly control its acts or assets, and do not have open access to business earnings, the property-centric view of the corporation undercuts the idea of shareholders as owners. Without viewing shareholders as the owners of a business, the notion of shareholder primacy is similarly undercut.<sup>29</sup>

A second corporate governance theory, the "nexus of contracts" theory, also emphasizes views of shareholder primacy. Contractarians see a corporation as the nexus of private contracts between corporate constituents.<sup>30</sup> Pursuant to this theory, non-shareholder corporate constituents, such as employees or creditors, enter into explicit contracts with the corporation, while shareholders rely on implicit contracts that

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23. Allen, *supra* note 11, at 265; *see also* Lee, *supra* note 1, at 40 ("[C]orporate property is the property of the shareholders in special form, and corporate acts are acts on behalf of the shareholders.").

24. Stout, *supra* note 1, at 1190 (arguing "the most common, and the worst, of the standard arguments for shareholder primacy . . . is the argument—really, the naked assertion—that the public corporation 'belongs' to its shareholders."); *see also* Allen, *supra* note 11, at 269; Bainbridge, *supra* note 1, at 1427; Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409, 1416 (1993).

25. Stout, *supra* note 1 at 1191; Green, *supra* note 24, at 1413.

26. DEL. CODE ANN. tit. 8 §§ 141(a), 170(a) (2008).

27. Bainbridge, *supra* note 1, at 1442 (noting shareholders have essentially no power to initiate corporate action); Green, *supra* note 24, at 1415 (noting shareholders "do not 'call the shots'"); Stout, *supra* note 1, at 1191.

28. ADOLPH A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 78-82 (2003); Stout, *supra* note 1, at 1191.

29. Millon, *supra* note 19, at 1374. Under the concept of shareholder primacy, the corporation exists only to advance the interests of shareholders by maximizing their wealth.

30. FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 14-15 (1991); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 552-61 (2003).

entitle them to residual claims.<sup>31</sup> Corporate law is thus seen as a set of default rules that represent the bargains corporate constituents would have demanded had they determined the rules governing their relationship before the corporation was formed.<sup>32</sup> Viewed in this way, shareholders warrant primacy in corporate decision-making because, as residual risk bearers, it is assumed they would have demanded this right.<sup>33</sup> That is, contractarians assume that profit maximization is the goal of the corporation because this is the expectation, or “bargained for right,” under which shareholders have implicitly contracted with the corporation.<sup>34</sup>

As with the property-centric view of the corporation, several flaws appear in the nexus of contracts theory’s conclusions. First, if corporate law reflects a set of default rules that represent parties’ expectations or bargains, and profit maximization represents one such expectation or bargain, why is the mandate of profit maximization not explicitly provided for in corporate law? For example, none of the state statutes impose a mandate to profit-maximize.<sup>35</sup> Moreover, although the lone 1919 decision of *Dodge v. Ford Motor Co.*<sup>36</sup> emphasized a corporation’s mandate to maximize profits for shareholders, recent Delaware case law has not followed the holding in *Dodge* and has advocated in favor of deviations from profit maximization in certain circumstances.<sup>37</sup>

Second, even if shareholders had initially only implicitly contracted for profit maximization, what has prevented them from subsequently explicitly contracting for this? Because corporate law’s default rules do not

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31. EASTERBROOK & FISCHER, *supra* note 30, at 36.

32. *Id.*; Bainbridge, *supra* note 30, at 577 (“[C]ontractarians contend that corporate law is comprised mainly of default rules, from which shareholders are free to depart, rather than mandatory rules.”).

33. EASTERBROOK & FISCHER, *supra* note 30, at 36-39, 92-93; Bainbridge, *supra* note 30, at 577-87 (stating that shareholders would strike a bargain with directors to pursue shareholder wealth maximization).

34. EASTERBROOK & FISCHER, *supra* note 30, at 36; Bainbridge, *supra* note 30, at 579 (stating that shareholders will bargain for shareholder wealth maximization because they are the ultimate beneficiaries of director fiduciary duties).

35. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738 (2005) (“None of the fifty states has a statute that imposes a duty to profit-maximize or that makes profit-maximization the sole purpose of the corporation.”).

36. 170 N.W. 668, 684 (Mich. 1919) (imposing a duty on managers to maximize shareholder profit).

37. *Paramount Comm., Inc. v. Time, Inc.*, 571 A.2d 1140, 1150 (Del. 1989) (allowing managers to forgo a tender offer in order to protect company culture); *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (permitting managers to take defensive actions in response to threats to the corporation even if the threat provides the highest short-term profit); see also *infra* Part I.B (discussing a corporation’s legal rights regarding charitable contributions). However, in *Revlon v. MacAndrews*, 506 A.2d 173, 182 (Del. 1986), the court mandated the maximization of share price where sale, break-up or change of control of the corporation becomes inevitable.

explicitly provide for profit maximization, parties are free to contract around these rules to provide for this mandate in articles of incorporation or corporate charters.<sup>38</sup> Yet, this practice is never undertaken.<sup>39</sup> The lack of explicit reference to a mandate of profit maximization may simply be a result of the mandate being assumed<sup>40</sup> or a result of shareholders never having bargained for profit maximization to the exclusion of all other interests.

Contractarians also view a singular goal of profit maximization as integral to reducing agency costs.<sup>41</sup> Profit maximization as a goal, it is argued, limits corporate managers' discretion to pursue their own self-interest.<sup>42</sup> Corporate law, however, already provides for broad managerial discretion through the business judgment rule.<sup>43</sup> Under the latitude of the business judgment rule, corporate managers can consider non-shareholder interests, or even corporate managers' own self-interest in corporate decisions, so long as the decision furthers the best interests of the

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38. Stout, *supra* note 1, at 1206-07 (stating that promoters are free to modify the default rules to be followed by a corporation under Delaware law through bylaw and charter amendments); *see also* J. Robert Brown, Jr. & Sandeep Gopalan, *Opting Only In: Contractarians, Waiver of Liability Provisions, and the Race to the Bottom* 1 (University of Denver Sturm College of Law Legal Research Paper Series, Working Paper No. 08-02, 2002), *available at* <http://ssrn.com/abstract=1087404> (stating that Contractarians view market actors as being able to engage in private ordering and to bargain for the most efficient arrangements).

39. Stout, *supra* note 1, at 1206-07 (stating that, in practice, shareholder primacy amendments are generally not made).

40. *See* Brown & Gopalan, *supra* note 38, at 11 (arguing that Contractarians simply assume the conditions necessary for private ordering).

41. Agency costs relate to divergences of interest between the principal and the agent are the sum of the contracting cost, the principal's monitoring cost (the cost to monitor the agent), the bonding cost by the agent (payments to the agent to protect against the agent's deviations from the principal's interest), and residual loss (reduction in principal's welfare due to divergences. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure* 5-6 (1976), *available at* [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=94043](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=94043) (stating that because an agent and the agent's principal are both utility maximizers, the agent will not always act in the best interest of the principal).

42. EASTERBROOK & FISCHER, *supra* note 30, at 38; Bainbridge, *supra* note 1, at 1427, 1435, 1438 (stating that shareholder primacy ensures that directors serve only one master and that management does not pursue its own self-interest by playing shareholders against non-shareholders); Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001) (stating that shareholder primacy ensures that managers have limited discretion to prevent them from maximizing only their own wealth).

43. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (stating that the business judgment rule protects business decisions which are made on an informed basis, in good faith and which are in the best interests of the corporation); *see also infra* Part III.A (explaining the business judgment rule).



corporation.<sup>44</sup> Just as an act that furthers the best interests of the corporation need not necessarily further the financial interests of the shareholders,<sup>45</sup> even under a norm of profit maximization, the business judgment rule can be used by corporate managers to pursue self-interests, so long as the act can be shown to have even a tenuous link to the interests of the corporation.<sup>46</sup> A norm of unconditional profit maximization, therefore, does not necessarily reduce agency costs.<sup>47</sup>

Finally, the “nexus of contracts” theory argues that shareholder primacy is justified because stakeholder interests enjoy contractual protection that is not similarly available to shareholders.<sup>48</sup> Contractarians assume that stakeholders will contract *ex ante* for a level of fixed payments that will fully compensate them for losses sustained as a result of the shareholder primacy norm.<sup>49</sup> However, this may prove problematic if stakeholders underestimate the risks to which the shareholder primacy

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44. See Bainbridge, *supra* note 1, at 1439 (acknowledging that even with a goal of profit maximization, directors often take non-shareholder constituency interests into account).

45. The “best interests of the corporation” can include the long and short-term interests of the corporation, the interests of the shareholders, the interests of the corporation’s employees, customers, creditors and suppliers, and community and societal considerations. See, e.g., CONN. GEN. STAT. ANN. § 33-756(d) (West 1997) (stating that a director of a corporation shall consider, in determining what he or she reasonably believes to be in the best interests of the corporation, the long-term as well as the short-term interests of the corporation). The best interests of the corporation can also be evidenced by demonstrating that a person of ordinary sound business judgment would say that the corporation received fair benefit. See *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 370-72 (N.Y. App. Div. 1982). In *Unocal*, the court also held that takeover offers need to be in the best interests of the corporation before requiring that corporate managers assess the impact of the takeover on creditors, customers, employees and the community. 493 A.2d at 954-55.

46. For example, corporate managers using corporate funds to create more luxurious corporate offices can be justified as furthering the best interests of the corporation, and are thus protected under the business judgment rule.

47. Bainbridge argues that even though the business judgment rule renders the rhetoric of profit maximization largely unenforceable, profit maximization may be needed as a psychological restraint to remind directors of where their duties lie. Bainbridge, *supra* note 30, at 582. However, where profit maximization as a goal is not wholly abandoned, but only tempered in certain circumstances, the psychological restraint on directors remains (although it may be loosened under certain circumstances). See *infra* Part IV (discussing psychological restraint on directors).

48. Bainbridge, *supra* note 30, at 579 (stating that even where shareholder and non-shareholder interests conflict, non-shareholders receive superior protection from contracts); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1446-47 (1989) (arguing residual risk bearers have contracted for a promise to maximize long-run profits of the firm, while non-shareholders contract for fixed payouts. Accordingly, risk bearing shareholders get a residual claim to profit; those who do not bear risk on the margin get fixed terms of trade).

49. Lee, *supra* note 1, at 51 (predicting that both stakeholders and non-stakeholders will seek *ex ante* contracts for a level of fixed payments to minimize risk).

mandate exposes them.<sup>50</sup> Problems may also arise if the power imbalance between the corporation and some corporate constituents (such as low-level employees) affects the latter's ability to bargain for an effective level of compensation. Moreover, even if stakeholders can effectively protect their interests contractually, parties in an involuntary relationship with the corporation cannot similarly protect themselves.<sup>51</sup> For example, individuals that have become victims of a multinational corporation's abuses—such as villagers killed to make way for a pipeline or protesters abused for complaining about corporate practices<sup>52</sup>—cannot be assumed to have implicitly contracted for unconditional profit maximization as the corporation's mandate.

### B. *Corporate Case Law and Statutes and the Singular Pursuit of Profit*

Corporate law neither statutorily imposes a duty to maximize profits nor mandates profit maximization as the sole purpose of the corporation.<sup>53</sup> Instead, there is a growing trend in corporate case law and statutes accepting that a corporation's purpose can involve interests other than pure profit maximization.

For example, statutes in every state now authorize corporations to make donations for charitable, scientific, or educational purposes,<sup>54</sup> and in

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50. *Id.* at 51, n.182 (suggesting individuals tend to underestimate the likelihood that bad events will happen to them).

51. Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1920 (1991) (explaining that tort victims, unlike contract creditors, cannot assess the potential credit-worthiness of a corporation before they are injured, much less insist on compensation for bearing the risk that they will suffer harms that the corporation's assets are insufficient to cover); *see also* Robert J. Rhee, *Corporate Ethics, Agency and the Theory of the Firm*, J. BUS. & TECH. 1101, 1102 (2008) (stating that corporations impart significant negative externalities on those who are outside the nexus of contracts).

52. *See, e.g.*, *Doe I v. Unocal*, 395 F.3d 932, 932 (9th Cir. 2002) (describing a corporation which allegedly purchased security services from the Burmese government resulting in the military extermination of a village to facilitate the laying of a pipeline); *Wiwa v. Royal Dutch Petroleum*, 226 F.3d 88, 88 (2d Cir. 2000) (describing a corporation which allegedly directed and aided government security forces to remove protestors and to ensure that its business activities could proceed "as usual").

53. Elhauge, *supra* note 35, at 738 (stating that no state has a statute that imposes a duty to profit-maximize or that makes profit-maximization the sole purpose of the corporation).

54. ALA. CODE § 10-2B-3.02(13), (15) (1994); ALASKA STAT. § 10.06.010(13) (Michie 1998); ARIZ. REV. STAT. ANN. § 10-302(15), (17) (1996); ARK. CODE ANN. § 4-26-204(A)(6) (Michie 1987); CAL. CORP. CODE § 207(E) (West 1990); COLO. REV. STAT. ANN. § 7-103-102(1)(M), (N) (West 1998); CONN. GEN. STAT. ANN. § 33-647(13), (15) (West 1997); DEL. CODE ANN. tit. 8, § 122(9) (1991); D.C. CODE ANN. § 29-505(13) (Michie 1996); FLA. STAT. ANN. § 607.0302(12), (14) (West 1993); GA. CODE ANN. § 14-2-302(13), (16) (1994); HAW. REV. STAT. ANN. § 415-4(13) (Michie 1997); IDAHO CODE § 30-1-4(M) (1996); IND. CODE ANN. § 23-1-22-2(13), (15) (Michie 1999); IOWA CODE ANN. § 490.302(13), (15) (West

many states donations are permissible regardless of direct corporate benefit.<sup>55</sup> In fact, the Model Business Corporations Act separates the power of corporations to make donations for the public welfare or for charitable purposes from the power to make payments or donations that further the business and affairs of the corporation.<sup>56</sup> Distinguishing between donations made for public welfare reasons from those made for business purposes suggests that corporate action need not necessarily be contingent on profit maximization.

Delaware law also does not require exclusive profit maximization, particularly in the context of takeovers. For example, in *Unocal*, the court sustained the board of directors' decision to reject a takeover bid, finding

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1991); KY. REV. STAT. ANN. § 271B.3-020(1)(M), (O) (Banks-Baldwin 1989); LA. REV. STAT. ANN. § 12:41(B)(12) (1999); ME. REV. STAT. ANN. tit. 13-A, § 202(1)(G) (1981); MD. CODE ANN., CORPS. & ASS'NS § 2-103(13) (West 1996); MASS. GEN. LAWS ANN. ch. 155, § 12C (West 1992); MINN. STAT. ANN. § 302A.161(11) (West 1999); MISS. CODE ANN. § 79-4-3.02(13), (15) (1996); MO. ANN. STAT. § 351.385(15) (West 1991); MONT. CODE ANN. § 35-1-115(13), (15) (1997); NEB. REV. STAT. § 21-2025(13), (15) (1996); NEV. REV. STAT. ANN. § 78.070(6) (Michie 1997); N.H. REV. STAT. ANN. § 293-A:3.02(13), (15) (1998); N.J. STAT. ANN. § 14A:3-4(1) (West 1998); N.M. STAT. ANN. § 53-11-4(M) (Michie 1993); N.Y. BUS. CORP. LAW § 202(A)(12) (Mckinney 1986); N.C. GEN. STAT. § 55-3-02(A)(13), (15) (1998); N.D. CENT. CODE § 10-19.1-26(11) (1997); OHIO REV. CODE ANN. § 1701.13(D) (Anderson 1997); OKLA. STAT. ANN. tit. 18, § 1016(9) (West 1999); OR. REV. STAT. § 60.077(2)(N), (P) (1998); 15 PA. CONS. STAT. ANN. § 1502(A)(9) (West 1995); R.I. GEN. LAWS § 7-1.1-4(13) (1992); S.C. CODE ANN. § 33-3-102(13), (15) (Law. Co-op. 1990); S.D. CODIFIED LAWS § 47-2-58(13) (Michie 1991); TENN. CODE ANN. § 48-13-102(13), (14) (1995); TEX. BUS. CORP. ACT ANN. art. 2.02(A)(14) (Vernon 1999); UTAH CODE ANN. § 16-10A-302(13), (15) (1995); VT. STAT. ANN. tit. 11A, § 3.02(13), (15) (1997); VA. CODE ANN. § 13.1-627(A)(12), (13) (Michie 1998); WASH. REV. CODE ANN. § 23B.03.020(2)(o), (q) (West 1994); W. VA. CODE § 31-1-8(M) (1996); WIS. STAT. ANN. § 180.0302(15), (19) (West 1998); WYO. STAT. ANN. § 17-16-302(A)(XIII), (XV) (Michie 1997).

55. Faith Stelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 602-03 (1997) (stating that corporations have the power to make donations for the public welfare in twenty-four states and the District of Columbia); PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01, Reporter's Note ¶ 2 (Am. L. Inst. 1992) (exemplifying that modern cases permit "the utilization of corporate resources for public welfare, humanitarian, educational, or philanthropic purposes without requiring a showing that a direct benefit is likely"). For example, in *Theodora Holding Corp. v. Henderson*, 257 A.2d 398, 405 (Del. Ch. 1969), the court allowed a reasonable corporation donation, which deprived shareholders of immediate income otherwise payable to them, because this loss of income "is far out-weighted by the overall benefits flowing from the placing of such gift in channels where it serves to benefit those in need of philanthropic or educational support." Similarly, in *Sorensen v. Chicago, B. & O. Ry. Co.*, 199 N.W. 534 (Neb. 1924), the court permitted the defendant railroad company to donate half the train fare for ministers of religion and other charitable workers, even though this was thought to reduce the net earnings of the company.

56. Compare MODEL BUS. CORP. ACT § 3.02(13) (2005) (permitting a corporation to make donations for the public welfare or for charitable, scientific, or educational purposes), with MODEL BUS. CORP. ACT § 3.02(15) (2005) (permitting a corporation to make payments or donations, or do any other act that furthers the business and affairs of the corporation).

that the board had an obligation to determine whether the takeover offer was in the best interests of the corporation *and* its shareholders.<sup>57</sup> As the court observed, defensive measures to takeover bids must be reasonable in relation to the threat posed, requiring an analysis of the effects of the takeover bid on the corporate enterprise.<sup>58</sup> Pursuant to this analysis, the court held that directors can consider the adequacy of the price in addition to the bid's "impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."<sup>59</sup>

Similarly, in *Paramount Communications v. Time*, the court specified that a board of directors is not under any per se duty to maximize shareholder value in the short-term.<sup>60</sup> Instead, the duty to maximize shareholder value arises only when the corporation initiates an active bidding process seeking to sell itself or where there is an abandonment of the corporation's continued existence.<sup>61</sup> As the *Paramount* court held, the business judgment rule encapsulates the board of directors' duty to select the timeframe for achievement of corporate goals, eliminating the need for directors to have to abandon deliberately conceived corporate plans for short-term shareholder profits.<sup>62</sup>

Effectively, *Paramount* argues in favor of allowing corporate managers to pursue corporate goals without a definitive relationship to immediately measurable profits.<sup>63</sup> Thus, even in *Revlon*, where the court confined board discretion to consider the interests of non-shareholder constituents to situations where these considerations would have "rationally

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57. See *Unocal*, 493 A.2d at 954 (finding that this duty was no different from any other responsibility that the board of directors shoulders).

58. *Id.*

59. *Id.* at 955.

60. *Paramount*, 571 A.2d at 1150. As the court noted, "the question of 'long-term' versus 'short-term' values is largely irrelevant because directors, generally, are obliged to chart a course for a corporation which is in its best interests without regard to a fixed investment horizon." *Id.*

61. See *id.*; *Revlon*, 506 A.2d at 182; see also *Paramount Comm., Inc. v. QVC Network Inc.*, 637 A.2d 34, 48 (Del. 1994) (holding that when a corporation undertakes a transaction which will cause: (a) a change in corporate control; or (b) a break-up of the corporate entity, the directors' obligation is to seek the best value reasonably available to the stockholders).

62. *Paramount*, 571 A.2d at 1154.

63. For example, in *Paramount*, the court rejected a mathematical evaluation of the competing bids for Time, prohibiting a comparison of the discounted value of Time-Warner's expected trading price at some future date with Paramount's offer in order to assess which is higher. 571 A.2d at 1153; see also Elhauge, *supra* note 35, at 819 (describing the Delaware Supreme Court's conclusion that managers could justify blocking takeovers on paternalistic grounds that managers could assess the value of expected future profits more accurately than the stock market in setting the current stock price).

related to benefit[s] accruing to the stockholders,”<sup>64</sup> *Paramount* suggests that the timeframe for these benefits need not be short-term.<sup>65</sup> In effect, then, corporate acts not relating to immediately measurable profit maximization goals are permissible in many instances. *Paramount* also highlights the discretion given to boards of directors to pursue corporate goals, within an unspecified timeframe, even if the result of this discretion affects shareholders’ financial interests negatively in the short-run.<sup>66</sup>

The departure from the pure profit motivation of a corporation is similarly reflected in the American Law Institute’s Principles of Corporate Governance (“the Principles”). Although the Principles reflect the standard presumption that corporations should act to enhance profit and shareholder gain, they further note that corporations may take into account ethical considerations for the responsible conduct of business.<sup>67</sup> In addition, the Principles allow for corporations to devote a reasonable amount of resources to public welfare and philanthropic purposes, even if corporate profit and shareholder gain are not enhanced.<sup>68</sup>

The Principles also reflect the lack of clarity within corporate law, noting that the present law “cannot be stated with precision, because the case law is evolving and not entirely harmonious.”<sup>69</sup> For example, in support of the presumption that corporations should maximize profits, the Principles cite to the well-known *Dodge* case in which the corporation’s purpose to generate profits for shareholders is forcefully articulated by the court.<sup>70</sup> However, the Principles also cite several contrary decisions in which the court supports the board of directors’ actions to further interests not related to profit maximization, where the acts serve the best interests of both the corporation and the shareholders or the long-term interests of the corporation.<sup>71</sup>

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64. *Revlon*, 506 A.2d at 176.

65. *Id.* at 182.

66. In *Paramount*, the offer from Paramount to purchase Time shares was two-hundred dollars cash per share whereas the merger with Warner Communications would result in Time shareholders receiving securities trading at \$150 per share. See Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 785 n.70 (2006) (discussing the prominence of shareholder wealth maximization in manager decision making).

67. AM. LAW INST., PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1992).

68. *Id.* at (b)(2) and (3).

69. *Id.* at § 2.01, Comment (a).

70. *Dodge*, 170 N.W. at 684. Aside from *Dodge*, there are no other cases that “actually operationalize the rule that corporations must maximize profits.” Jonathan Macey, *A Close Read of an Excellent Commentary on Dodge v. Ford*, 3. VA. L. & BUS. REV. 177, 180 (2008).

71. See, e.g., *Kelly & Wyndham, Inc. v. Bell*, 266 A.2d 878, 879 (Del. 1970) (refusing to classify the payments made by the corporation as a gift, the court determined that, regardless of classification, the directors had good reason to believe the corporation would

Goals of pure profit maximization are also not reflected in constituency statutes.<sup>72</sup> Enacted by approximately thirty states, these statutes permit corporate managers to consider the effects of any corporate action upon a wide variety of stakeholders including employees, suppliers, customers, creditors and communities.<sup>73</sup> However, rather than resolving the ambiguity of the purpose of the corporation, the statutes exacerbate it through use of permissive and non-obligatory language. For example, the Nevada statute provides that directors, in exercising their powers, “*may* consider the interests of the corporation’s employees, suppliers, creditors and customers [and] . . . [t]he interests of the community and of society.”<sup>74</sup> Similarly, the New York statute provides that directors “shall be entitled to consider . . . both the long-term and short-term interests of the corporation and its shareholders” and the effects of the corporation’s actions on employees, creditors, customers, and the community.<sup>75</sup> Even the Iowa statute, which permits directors to reject tender offers or proposals of

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derive substantial benefit from the payment); *Union Pac. R.R. v. Tr., Inc.*, 329 P.2d 398, 401-02, (Utah 1958) (arguing that the directors would not have proceeded with the program if they were not sure that the corporation “would receive a quid pro quo” as a result of its contributions); *Shlensky v. Wrigley*, 237 N.E.2d 776, 780-71 (Ill. App. 1968) (finding that the directors were not acting contrary to the best interests of the corporation).

72. However, constituency statutes were introduced primarily as anti-takeover devices. See Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 23-26 (1992). As a Pennsylvania senator explained, in describing the legislative intent of the first constituency statute, the statute provides “Pennsylvania boardrooms with the breathing room necessary to direct their attention to product development and research and global competition rather than fending off takeovers and paying greenmail.” Charles E. Dorkey III, *Change of Corporate Control—Balancing Obligations to Shareholders with Obligations to Employees, Customers, The Surrounding Community and Other Constituencies*, 70 PA. B. ASS’N. Q. 109, 111 n.6 (1999) (citing Remarks of Sen. Wenger, Legislative Journal—Senate, Pennsylvania General Assembly 1947 (Apr. 23, 1990)).

73. See ARIZ. REV. STAT. ANN. § 10-2702 (West 2004); CONN. GEN. STAT. ANN. § 33-756(d) (West 1997); FLA. STAT. ANN. § 607.0830 (West 2001); GA. CODE ANN. § 14-2202(b)(5) (2003); HAW. REV. STAT. § 414-221(b) (2004); IDAHO CODE § 30-1702 (Michie 2005); 805 ILL. COMP. STAT. 5/8-85 (West 2004); IND. CODE ANN. § 23-1-35-1(d) (Michie 1999); IOWA CODE ANN. § 491.101b (1) (West 1999); KY. REV. STAT. ANN. § 271b.12-210(4) (Michie 2003); LA. REV. STAT. ANN. § 12:92(g) (1994); ME. REV. STAT. ANN. tit. 13-c, § 831(6) (2005); MASS. GEN. LAWS ANN. ch. 156b, § 65 (LexisNexis 2005 Supp.); MINN. STAT. ANN. § 302a.251 subd. 5 (West 2004); MISS. CODE ANN. § 79-4-8.30(f) (2001); MO. REV. STAT. § 351.347 (2000); NEV. REV. STAT. § 78.138(4) (2000); N.J. STAT. ANN. § 14a:6-1(2) (West 2003); N.M. STAT. ANN. § 53-11-35(d) (LexisNexis 2001); N.Y. BUS. CORP. LAW § 717(b) (McKinney 2003); N.D. CENT. CODE § 10-19.1-50(6) (Michie 1995); OHIO REV. CODE ANN. § 1701.59(e) (LexisNexis 2004); OR. REV. STAT. § 60.357(5) (2001); 15 PA. CONS. STAT. ANN. § 1715 (West 1995); R.I. GEN. LAWS § 7-5.2-8 (1999); S.D. CODIFIED LAWS § 47-33-4 (2004); TENN. CODE ANN. § 48-103-204 (2002); VT. STAT. ANN. tit. 11a, § 8.30(a) (Michie 2004 Supp.); WIS. STAT. ANN. § 180.0827 (West 2002); WYO. STAT. ANN. § 17-16-830(e) (2005).

74. NEV. REV. STAT. § 78.138(4) (2000).

75. N.Y. BUS. CORP. LAW § 717(b) (McKinney 2003).

acquisitions or mergers on the basis of community interest factors<sup>76</sup> despite any financial loss to the shareholders, is phrased in the permissive.<sup>77</sup> Only the Connecticut statute mandates that directors consider stakeholder interests.<sup>78</sup>

Corporate law is similarly ambiguous in its identification of the beneficiaries of fiduciary duties. Courts have held that fiduciary duties are owed both to the corporation *and* to the shareholders.<sup>79</sup> However, only shareholders can initiate lawsuits to enforce these duties.<sup>80</sup> Although this may suggest that fiduciary duties are owed primarily to shareholders, the concept of the derivative lawsuit challenges this idea. The derivative lawsuit allows a shareholder to step into the shoes of the corporation and seek restitution against an individual who has wronged the corporation, even though the claim rightly belongs to the corporation.<sup>81</sup> The shareholder bringing the suit does not have a right or an interest in the claim itself and recovery is for the benefit of the corporation alone.<sup>82</sup>

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76. These include the effects of the corporate action on non-shareholder constituents. See IOWA CODE ANN. §491.101b (1).

77. *Id.*

78. CONN. GEN. STAT. ANN. § 33-756(d) (West 1997). ([A] Director . . . shall consider, in determining what he reasonably believes to be in the best interests of the corporation, (1) the long-term as well as the short-term interests of the corporation, (2) the interests of the shareholders, long-term as well as short-term, including the possibility that those interests may be best served by the continued independence of the corporation, (3) the interests of the corporation's employees, customers, creditors and suppliers, and (4) community and societal considerations . . . .")

79. *In re Stat-Tech Int'l Corp.*, 47 F.3d 1054, 1058-59 (10th Cir. 1995); *In re Fleming Packaging Corp.*, 370 B.R. 774, 788 (Bankr. C.D. Ill., 2007); *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1280 (Del. 1988); *Smith v. Van Gorkom*, 488 A.2d 858, 46 A.L.R.4th 821, 872 (Del. 1985); *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939); *Enchanted Valley RV Resort, Ltd. v. Weese*, 241 Ga. App. 415, 423 (Ga. Ct. App. 1999).

80. See J. William Callison, *Why a Fiduciary Duty Shift to Creditors of Insolvent Business Entities is Incorrect as a Matter of Theory and Practice*, 1 J. BUS. & TECH. L. 431, 441 (2007); Daniel J.H. Greenwood, *The Dividend Puzzle: Are Shares Entitled to the Residual?*, 32 J. CORP. L. 103, 145 (2006); Stefan J. Padfield, *In Search of a Higher Standard: Rethinking Fiduciary Duties of Directors of Wholly-Owned Subsidiaries*, 10 FORDHAM J. CORP. & FIN. L. 79, 122 (2004). Note that where the corporation becomes insolvent, creditors are allowed to step into the shoes of shareholders to initiate derivative lawsuits.

81. *Cohen v. Beneficial Loan Corp.*, 337 U.S. 541, 548 (1949); *Lynam v. Livingston*, 257 F.Supp. 520, 524 (D.C. Del. 1966) (illustrating how, in the case of a stockholder's derivative suit, the cause of action belongs to the corporation, not the stockholder and how the wrong which the suit seeks to redress is one which the corporation has sustained).

82. *Lewis v. Chiles*, 719 F.2d 1044, 1047 (9th Cir. 1983) (reasoning that a derivative suit is an intangible asset of the corporation and it results in recovery for the corporation); *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979) (finding that derivative claims against corporate directors belong to the corporation itself); see also Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 294-95 (1999) (noting that if a derivative suit is successful, any damages recovered must go into the corporation's coffers).

Recovery by the corporation therefore not only increases the shareholder's share price, but similarly protects the interests of the other corporate constituents by ensuring the value of the corporation.<sup>83</sup> Derivative actions also prevent wealth transfers to shareholders at the expense of other corporate constituents by preventing the shareholders from directly recovering from the losses to the corporation.<sup>84</sup> Thus, while fiduciary duties owed to shareholders can be protected through derivative suits, directing recovery to the corporation in these suits also ensures that fiduciary duties owed to the corporation are similarly protected.

### C. *Serving Two Masters*

In Carlo Goldoni's eighteenth century play entitled *The Servant of Two Masters*, Truffaldino, a servant, takes on the task of serving more than one master.<sup>85</sup> Although difficulties arise, Truffaldino aptly serves the interests of both masters even when the masters' tasks are presented to him simultaneously and the potential for conflict arises.<sup>86</sup> Like Truffaldino, corporate managers should also be able to serve both the financial interests of shareholders and the interests of non-shareholder corporate constituents through use of the ambiguity of the corporate purpose.<sup>87</sup>

In fact, the lack of clarity in the corporate purpose suggests corporate law can neither commit itself to an exclusive profit maximization mandate nor to operating as a vehicle for the creation of societal wealth. The truth of the corporate purpose must, then, somehow lie between these two positions.

Scholars have tended to advocate strongly in favor of one of the two extreme positions. Shareholder primacy theorists have vociferously defended a singular focus on profits,<sup>88</sup> while corporate social responsibility

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83. Stephen J. Choi & Robert B. Thompson, *Securities Litigation and its Lawyers: Changes During the First Decade After The PSLRA*, 106 COLUM. L. REV. 1489, 1491 (2006) (noting that in derivative suits, individual shareholders gain only indirectly via a proportionate increase in the value of the overall corporate entity); WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 388 (2003); Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and its Impact upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 475 (1990) (noting that recovery in a derivative action inures to the benefit of the corporation and increases its asset value).

84. Carlo Goldoni, *The Servant of Two Masters*, in THE SERVANT OF TWO MASTERS: AND OTHER ITALIAN CLASSICS (Eric Bentley ed., 2000); see also Blair & Stout, *supra* note 82, at 295 (stating that, "[t]his sort of wealth transfer usually harms creditors, employees, and other stakeholders in the corporation").

85. Goldoni, *supra* note 84.

86. *Id.* at 97.

87. *Id.* at 131.

88. See, e.g., Stephen M. Bainbridge, *In Defense of the Shareholder Wealth*



theorists have tended to downplay or negate the profit maximization mandate.<sup>89</sup> Yet, if the true corporate purpose lies between these two extremes, corporate managers should be able to serve *both* the financial interests of the shareholders and the interests of non-shareholder corporate constituents, even if both masters cannot always be served at the same time.

In part, the ability of corporate managers to serve the financial interests of shareholders and the interests of non-corporate constituents relies on a presumption of profit maximization. Thus, the actions of corporate managers should continue to be guided by financial considerations. This also prevents corporate managers from serving any interests but their own.<sup>90</sup> However, in order to incorporate the interests of non-shareholder corporate constituents into the corporate purpose, the presumptive norm of profit maximization should be tempered in certain circumstances.<sup>91</sup> Effectively, the ambiguity of the corporate purpose suggests that corporate managers can balance their competing obligations between two masters: financial and non-financial interests.

## II. THE NORMATIVE BASES THAT JUSTIFY THE USE OF DISCRETION IN CORPORATE LAW

Even if the ambiguous nature of corporate law has resulted in managerial discretion to direct corporate acts in furtherance of interests other than profit maximization, the issue remains why corporate managers should act without utilizing profit maximization as the sole *raison d'être*. As profit maximization proponents have argued, this norm accords with both concepts of utilitarianism and a “greatest-good-for-the-greatest-number” philosophy.<sup>92</sup> Neither concept, however, fully provides a normative basis for sole profit maximization.

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*Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1423-24 (1993); Hansmann & Kraakman, *supra* note 18, at 439; Romano, *supra* note 1, at 186 n.30.

89. Under this approach, the corporation serves the interests of all the corporation's stakeholders, including shareholders, but the shareholders do not enjoy primacy over other stakeholders. See generally Blair & Stout, *supra* note 82; Green, *supra* note 24; Kent Greenfield, *Proposition: Saving the World with Corporate Law*, 57 EMORY L.J. 948, 967 (2008).

90. This is the typical critique against serving more than one master. See, e.g., Bainbridge, *supra* note 1, at 1427, 1435, 1438; Roe, *supra* note 42, at 2065.

91. Consideration of non-shareholder interests may not be appropriate in relation to every corporate action taken. For circumstances in which deviations from profit goals are justified and Part V for a discussion on limits on managerial discretion to deviate from profit goals, see *infra* Part IV.

92. Roe, *supra* note 42, at 2064; Allen et al., *supra* note 12, at 1089 (arguing that if equity investors do not have the assurance that their interests will be placed at the head of the line, less capital might flow into the markets, thereby diminishing economic growth).

A. *Challenging the Normative Basis of Profit Maximization*

Profit maximization proponents argue that utilitarian justifications for this goal arise from an interest in strong capital markets and distributional efficiency.<sup>93</sup> In the long run, the costs occasioned by reduced incentives for investment if profit maximization were not a corporation's sole goal, would greatly exceed any social costs incurred by stakeholders.<sup>94</sup> Therefore, proponents argue, the pursuit of aggregate social welfare is best served through a singular focus on profits.<sup>95</sup>

However, neither utilitarianism nor an aggregate social welfare philosophy concludes definitively in favor of a singular focus on profits. For example, utility theories, which link profit maximization to the existence of strong capital markets, tend to presume that without shareholder primacy equity investors will be less inclined to invest, diminishing economic growth.<sup>96</sup> Ultimately, utilitarian theorists assume that shareholders' utility is solely dependent on the corporation's ability to create shareholder wealth. Yet, this presumption does not account for the increasing numbers of investors whose investments are guided by some concern for social responsibility.<sup>97</sup> Even the most self-interested shareholders will likely have some moral and non-financial interests which will limit the extent to which they want the corporation to pursue unconditional profit goals.<sup>98</sup> Thus, it can no longer be assumed that the

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93. *Id.*

94. Allen et al., *supra* note 12, at 1089.

95. Hansmann & Kraakman, *supra* note 18, at 441 (stating that "there is convergence on a consensus that the best means to this end (that is, the pursuit of aggregate social welfare) is to make corporate managers strongly accountable to shareholder interests and, at least in direct terms, only to those interests").

96. Allen et al., *supra* note 12, at 1089. Ultimately, utilitarianism is based on the idea that liberty of the individual is fundamental. Strong capital markets and distributional efficiency as goals thus reflect deeper assumptions that these goals best maximize individual freedom and accordingly, via the free market, maximize aggregate happiness measured as wealth in dollar terms.

97. *See generally* Elhauge, *supra* note 35, at 784; ARTHUR SMALL & JOSHUA GRAFF ZIVIN, A MODIGLIANI-MILLER THEORY OF ALTRUISTIC CORPORATE SOCIAL RESPONSIBILITY 5-6 (2005), [http://search.ssrn.com/sol3/papers.cfm?abstract\\_id=325921](http://search.ssrn.com/sol3/papers.cfm?abstract_id=325921); Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 BUS. LAW. 681, 681 (2002); Douglas M. Branson, *Corporate Social Responsibility Redux*, 76 Tul. L. Rev. 1207, 1219 (2002); Henry T.C. Hu, *Buffett, Corporate Objectives, and the Nature of Sheep*, 19 CARDOZO L. REV. 379, 391-92 (1997).

98. SMALL & ZIVIN, *supra* note 97, at 14 (noting that many shareholders derive utility from socially minded activities undertaken by managers on their behalf); Elhauge, *supra* note 35, at 783 (noting that, at least to some extent, shareholders value nonfinancial aspects of corporate activities, such as whether those activities further the shareholders' social and moral views); Rhee, *supra* note 51, at 1111 (arguing that for a reasonable shareholder, the choice of profit is conditional).

rational shareholders' utility is maximized exclusively by profit considerations. Conversely, given the diversity of shareholders who invest in public corporations, some of whom will be interested only in profit maximization and others of whom will also have non-financial interests, the utility of aggregate shareholders is better served when corporate acts both serve the interests of stakeholders and maximize the long-run market value of the firm.<sup>99</sup>

In fact, the diversity in shareholder interests challenges the idea that shareholder primacy influences equity investment. Shareholders can differ in terms of risk tolerance due to varying levels of diversification, tax considerations, investment time periods, purposes for holding the stock, moral and ethical concerns, and the extent to which they are willing to forgo profits for social responsibility issues.<sup>100</sup> Accordingly, shareholder interests can involve expectations that the corporation will maximize profits, perform badly, or do nothing at all.<sup>101</sup> Given the plurality of interests associated with shareholders, profit maximization by itself cannot represent all shareholder interests.

Similarly, a goal of profit maximization does not necessarily translate into the pursuit of aggregate social welfare. A corporation that maximizes profits for its shareholders does not necessarily create benefits for its non-

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99. Still, the utility of some shareholders will not be maximized if the act decreases profits in the short-run.

100. See generally Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561 (2006); Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021 (1996); see also RUTH V. AGUILERA, DEBORAH E. RUPP, CYNTHIA A. WILLIAMS, & JYOTI GANAPATHI, PUTTING THE S BACK IN CORPORATE SOCIAL RESPONSIBILITY: A MULTI-LEVEL THEORY OF SOCIAL CHANGE IN ORGANIZATIONS 20 (2007), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=820466](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=820466).

101. A shareholder that owns shares in one corporation will hope that the corporation maximizes its profits. A hedge fund shareholder that temporarily owns shares through stock-lending hopes that, as a result of short-selling, the corporation will perform badly and allow the hedge fund to buy the shares back at a lower price. A shareholder that owns shares in two competing companies involved in a takeover hopes that one of the corporations it has invested in will not do anything in order to harm the second corporation. See Donald Norberg, *The Ethics of Corporate Governance* 17-18 (Jul. 27, 2007) (unpublished working paper), available at [http://works.bepress.com/cgi/viewcontent.cgi?article=1003&context=donald\\_nordberg](http://works.bepress.com/cgi/viewcontent.cgi?article=1003&context=donald_nordberg) (discussing the varying interests of corporate shareholders); see also Allen et al., *supra* note 12, at 1077 (explaining that because most investors hold diversified portfolios, any gains achieved in hostile takeovers from holding target companies will likely be offset by losses holding acquirer companies); Green, *supra* note 24, at 1414 (stating that, in some cases, a shareholder's portfolio may benefit from a stock declining in value). See generally, Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) (analyzing the effects of decoupling voting rights from economic ownership, which can lead to a vote holder having an incentive to vote in ways that will reduce the share price of the firm).

shareholder constituents or for society. Without a distributional mechanism to allocate corporate gains to stakeholders, the “trickle-down” effect cannot be presumed.<sup>102</sup> In some instances, corporate profit can even result from a transfer of wealth from stakeholders to shareholders, for example by paying employees substandard wages or engaging in environmentally damaging acts in order to reduce costs.<sup>103</sup> Moreover, where private and social costs and benefits are not aligned, competitive markets do not produce efficient outcomes and these “market failures” result in discrepancies between the best interests of the corporation and the best interests of society.<sup>104</sup>

Non-shareholder constituents must also rely on contract or external regulation to protect their interests. However, both contract and regulation contain gaps, which may expose non-shareholder constituents to significant risks to their welfare.<sup>105</sup> Profit maximization activities, pursued by corporate managers because they are not prohibited by law, can even result in the infliction of serious harm to non-shareholder constituents, such that the acts actually reduce social welfare.<sup>106</sup> These instances have been recently highlighted in a number of Alien Tort Claims Act disputes in which a lack of external regulation has allowed corporations to become

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102. See George W. Dent, Jr., *Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance*, 44 HOUS. L. REV. 1213, 1273 (2008) (stating that CEO domination of public corporations results in wealth diversion to executives and does not trickle down to other stakeholders); Greenfield, *supra* note 89, at 967 (2008) (explaining that a firm does not necessarily create wealth for others or society when it makes money for shareholders).

103. Greenfield, *supra* note 89, at 967. For example, Greenfield notes that Wal-Mart’s employee wages are so low that its workers require government assistance to live, such that government programs effectively subsidize the profits of Wal-Mart. *Id.* at n.87.

104. See Francis M. Bator, *The Anatomy of Market Failure*, 72 Q. J. ECON. 351, 359-60 (1958) (analyzing how profit-maximizing production decisions can lead to outputs below what is socially desirable); JOSEPH E. STIGLITZ, MAKING GLOBALIZATION WORK 190 (2006) (“[E]ven [Adam] Smith realized that in an unfettered market economy private incentives are often not aligned with social costs and benefits—and when that happens, the pursuit of self-interest will not result in the well-being of society.”); Geoffrey M. Heal, *Corporate Social Responsibility—An Economic and Financial Framework*, at 3-4 (2004), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=642762](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=642762) (asserting that conflicts arise between corporations and society when there are discrepancies between private and social costs and benefits).

105. See *supra* Part I.A. for a discussion concerning gaps in contractual protection; see also Elhauge, *supra* note 35, at 747-48 (discussing the imperfections of regulation); Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1437 (2006) (discussing problems associated with gaps in external regulation).

106. For example, the release of gas in Bhopal, India by an Indian subsidiary of the American corporation Union Carbide caused the death or injuries of thousands of residents of Bhopal. Because of operating losses, Union Carbide had cut costs relating to maintenance of the plant and the training and number of personnel operating the plant, which may have contributed to the accident. Green, *supra* note 24, at 1419-21.

complicit in the violations of individuals' rights in order to ensure business activities could proceed "as usual."<sup>107</sup>

*B. The Normative Bases that Justify Deviations from Profit Maximization*

Simply challenging the normative basis for profit maximization does not, by itself, justify deviations from profit maximization. Instead, the normative bases for deviations from profit maximization arise in two parts. First, socially responsible acts can accord with profit interests in the long run, and, second, for those areas in which even long-term profit rationales cannot justify deviations from the profit motive, fairness, meaning considerations of justness or equity, dictates that deviations from profit are justified to prevent corporations from causing serious negative externalities.

1. Convergence of Non-Shareholder Interests with Long-run Profit Maximization

In many instances, the divide that separates the two purposes of a corporation is not as wide as it may first appear. Where non-shareholder interests converge with profit maximization, the debate narrows to a choice between maximizing short-term and long-term profits, as socially responsible behavior may often pose a cost in the short run, but act to maximize shareholder wealth in the long run. As the Chancellors of the Delaware Chancery Court have observed, the fair treatment of stakeholders may be "instrumentally useful" in creating shareholder wealth.<sup>108</sup> In fact, alignment of social responsibility issues with profit maximization is thought to be a necessary condition for corporate managers to undertake corporate acts without a clear financial purpose.<sup>109</sup>

The links between corporate acts without immediately measurable profit goals and long-term profitability have been well documented.<sup>110</sup>

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107. See, e.g., *Doe I*, 395 F.3d at 932 (discussing human rights violations by Myanmar military in furtherance of oil pipeline project); *Wiwa*, 226 F.3d at 88 (discussing human rights violations by companies in retaliation for opposition to oil exploration activities in Nigeria).

108. Allen et al., *supra* note 12, at 1089.

109. See Aguilera et al., *supra* note 100, at 26 (arguing that managers implement corporate social responsibility initiatives when those initiatives align with increasing competitiveness and profitability).

110. Studies have found correlations between social responsibility actions and corporate profitability. See Glen Dowell, Stuart Hart & Bernard Yeung, *Do Corporate Global Environmental Standards Create Or Destroy Market Value?*, 46 *MANAGEMENT SCIENCE* 1059, 1059 (2000) (showing positive correlations between capital market performance and a company's environmental performance); Marc Orlitzky et al., *Corporate Social and Financial Performance: A Meta-Analysis*, 24 *ORG. STUD.* 403, 427 (2003), available at

Corporate actions deviating from profit maximization goals can enhance the reputation of the corporation,<sup>111</sup> improve its attractiveness as an employer,<sup>112</sup> increase operational efficiency,<sup>113</sup> enhance a corporation's branding,<sup>114</sup> reduce risks,<sup>115</sup> and lower the cost of capital.<sup>116</sup> Consequently, many corporations now pursue ventures that achieve measurable results in terms of both finances and the social good.<sup>117</sup>

In truth, many corporate acts without an immediately measurable profit goal can be tied to the long-term profitability of the corporation. For example, Merck justified its donation of a drug it developed that cures river blindness with the expectation that the long-term consequences of the

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<http://www.global100.org/Corporate%20Social%20&%20Environmental%20Performance.pdf> (concluding there are positive correlations between financial performance and social and environmental performance). *But see* Daniel Franklin, Special Report on Corporate Social Responsibility, *The Next Question*, THE ECONOMIST, Jan. 19, 2008, at 10 (“[T]here is in fact a positive link between companies’ social and financial performance—but only a weak one.”).

111. *See* Ribstein, *supra* note 105, at 1451 (discussing how employees are attracted to corporations with better reputations for social responsibility); Aguilera et al., *supra* note 100, at 21 (arguing that, even where a firm’s goal is shareholder wealth-maximization, it will seek social legitimization); Sarah Roberts et al., *The Business Case for Corporate Citizenship* 1-2 (2002) (explaining the importance of reputation to corporate success), available at <http://www.weforum.org/pdf/GCCI/ADL.pdf>.

112. Daniel W. Greening & Daniel B. Turban, *Corporate Social Performance as a Competitive Advantage in Attracting a Quality Workforce*, 39 BUS. & SOC’Y 254, 254 (2000); Ribstein, *supra* note 105, at 1451; Aguilera et al., *supra* note 100, at 10; David B. Montgomery & Catherine A. Ramus, *Corporate Social Responsibility Reputation Effects on MBA Job Choice* 3 (2003), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=412124](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=412124); Heal, *supra* note 104, at 16-17; Roberts et al., *supra* note 111, at 3.

113. Roberts et al., *supra* note 111, at 6; *see* Heal, *supra* note 104, at 2 (noting that markets work well for society and align social and corporate interests when a corporation’s private and social costs are the same).

114. Rob Harrison, *Corporate Social Responsibility and the Consumer Movement*, 13 CONSUMER POL’Y REV. 127, 128 (2003); Abigail McWilliams and Donald Siegel, *Corporate Social Responsibility: A Theory of the Firm Perspective*, 26 ACAD. MGMT. REV. 117, 119-22 (2001); Zivin & Small, *supra* note 97, at 5; Heal, *supra* note 104, at 15-16.

115. Aguilera et al., *supra* note 100, at 21; Heal, *supra* note 104, at 22; Roberts et al., *supra* note 111, at 3; *see* Ribstein, *supra* note 105, at 1445 (“[I]f firms could not . . . commit to future disclosures [of regulatory risks], their cost of capital would reflect exposure to unknown future risks.”).

116. *See* Ribstein, *supra* note 105, at 1444. Ribstein notes that without disclosing potential risks, companies’ cost of capital would reflect exposure to unknown future risks. *Id.* Further, he adds that “the share price penalty that occurs when a specific corporate wrong is revealed may exceed the projected costs from that wrong because of the market’s concern that additional problems may be lurking.” *Id.*

117. *See generally* Janet E. Kerr, *Sustainability Meets Profitability: The Convenient Truth Of How The Business Judgment Rule Protects A Board’s Decision To Engage In Social Entrepreneurship*, 29 CARDOZO L. REV. 623 (2007) (describing the social entrepreneurship of Google, Dow Chemical, Toyota, GlaxoSmithKline and others).

action, although uncertain, would “somehow . . . pay off.”<sup>118</sup> So long as an act without a clear profit goal can be tied to a rationally related corporate goal, courts will be reluctant to challenge the relationship between the act and its effect on profits. As the *Dodge* court noted, judges are not business experts.<sup>119</sup> Similarly, judges are not able to predict which corporate acts will benefit or harm the corporation in the future.<sup>120</sup> Consequently, corporate acts, without a clear profit focus but that are rationally related to the corporation, will likely survive judicial scrutiny.

Nonetheless, not every act without an immediately measurable profit goal positively affects profits in the long run.<sup>121</sup> To justify the instances of these non-profit-motivated, purely altruistic acts, a second normative base is needed.

## 2. Fairness

Where private and social costs are aligned, competitive markets produce efficient outcomes and profitability for the corporation translates into societal wealth.<sup>122</sup> However, even when efficiency is achieved by aligning private and social costs, it is not necessarily in a socially optimal manner in that distribution of benefits may not be fair or perceived as such.<sup>123</sup> Conflicts between society and corporations can therefore arise when discrepancies between private and social costs arise or unfairness, or the lack of justness or equity, is present or perceived.

In many instances, these conflicts have arisen when corporations have externalized the differences between private and social costs. For example, in the pursuit of profit maximization, corporate acts can impose costs on employees, the environment or the community. Stakeholders affected by a corporation’s negative externalities can attempt to compel the corporation to internalize these costs through economic power.<sup>124</sup> Thus, customer

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118. JONATHAN M. TISCH, *SUCCESSING THROUGH PARTNERSHIPS*, 123 (2004). As then-CEO of Merck, P. Roy Vagelos, stated: “The long-term consequences of [such actions] are not always clear, but somehow I think they always pay off.” *Id.*

119. *Dodge*, 170 N.W. at 684.

120. Macey, *supra* note 70, at 180-81 (“[I]t . . . is not possible or practical for courts to discern ex post when a company is maximizing value for shareholders . . .”).

121. For example, an oil exploration company operating in Burma that decides to relocate its pipeline from its original location because of protests from the local community, can both negatively affect profits and fail to improve a corporation’s long run profits. Principally, this is because oil companies are not customer-driven companies, such that non-environmental “bad” acts do not affect the corporation’s reputation and also because the protests of Burmese villagers will likely have only negligible coverage in the U.S. This hypothetical is based on the facts in *Doe I*, 395 F.3d at 932.

122. Stiglitz, *supra* note 104, at 189; Heal, *supra* note 104, at 3.

123. *Id.*

124. Ian B. Lee, *Efficiency and Ethics in the Debate about Shareholder Primacy*, 31

pressure forced Dow Chemical, Nike, and Heinz to internalize the adverse social costs of their corporate activities.<sup>125</sup> Stakeholders facing negative externalities from corporations can also seek protection in external regulation. In this way, the law can act as a guide to align corporate profits with social welfare and to sanction non-social welfare-enhancing acts.<sup>126</sup>

However, not all affected stakeholders possess sufficient economic power to compel corporations to internalize social costs. As one commentator has noted, the corporation can “impose costs on parties who are not in a position . . . to bargain.”<sup>127</sup> Similarly, external regulation, shaped by interest groups including businesses, may leave gaps in protecting third parties.<sup>128</sup> In effect, then, profit maximizing acts may affect stakeholders who lack economic or legal power.

Consequently, where a lack of power or gaps in regulatory protection can result in corporate acts imposing serious negative externalities on stakeholders, fairness suggests that the goal of profit maximization be tempered, particularly where the affected stakeholders are not in a voluntary relationship with the corporation.<sup>129</sup> For example, where a corporate manager is faced with making a decision in which the corporate act would play an intentional and substantial role in the violation of the basic rights or liberties of an individual, fairness suggests that the corporate manager should not pursue that act even if to do so would maximize profits. Fairness, then, dictates that corporate managers should elect to prevent harm to others over goals of profit maximization.<sup>130</sup>

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DEL. J. CORP. L. 533, 578 (2006).

125. Heal, *supra* note 104, at 6-7, 10-11. For example, in response to customer pressure, Dow Chemical reduced all sources of pollution, Nike stopped the practice of using sweatshop labor, and Heinz adopted a dolphin-friendly method of catching tuna. *Id.*

126. Ribstein, *supra* note 105, at 1437.

127. *Id.* at 1438; *see also* Elhauge, *supra* note 35, at 749 (“Unfortunately, economic sanctions are also likely to be imperfect for various reasons. Those harmed by our actions may not have a relationship with us that allows them to impose economic sanctions. Even if they are, they may not be informed enough to do so, or may not be able to inflict a large enough economic sanction to deter the misconduct. When many parties are harmed, they may also have collective action problems that mean none of them have incentives to engage in individually costly decisions to impose economic sanctions.”).

128. *Id.* at 747-748; Ribstein, *supra* note 105, at 1437.

129. *See* Green, *supra* note 24, at 1420-21 (“Modern corporations frequently find themselves in circumstances in which reducing the risk of serious harm to stakeholders is both expensive and not legally required . . . . That these situations arise more and more frequently, as a result of the power and risks of modern corporate activities, tells us that the weaknesses in the traditional model . . . . evidence themselves in actual corporate decisionmaking and . . . can potentially contribute to the infliction of serious harm on stakeholders.”); *see also* Hansmann & Kraakman, *supra* note 51, at 1920 (describing tort victims as those not in a voluntary relationship with a corporation).

130. *See* Rhee, *supra* note 51, at 1114-15 (discussing the link between the profit maximization norm and the problem of ethical choice).



This idea of fairness is premised on the assumption that even if a corporation's purpose is not to pursue the maximization of aggregate social welfare, it should refrain from actions that negatively impact social welfare.<sup>131</sup> More broadly, ideals of fairness suggest that deviations from profit maximization may be necessary to prevent corporations from imposing their externalities on society in order to preserve a harmonious relationship between corporations and society.<sup>132</sup>

Having explored the ambiguity of the corporation's purpose and the normative bases justifying corporate managers' use of the discretion left open by that ambiguity, the next issue is the identification of mechanisms within the corporate paradigm that allow corporate managers to use this discretion to pursue goals deviating from profit maximization. Without reformulating corporate governance models, three possibilities within the current corporate paradigm present themselves: the business judgment rule, fiduciary duties, and board sanctioned-shareholder proposals.

### C. *The Business Judgment Rule*

The most widely-used mechanism in the corporate paradigm that clears the path for decisions deviating from profit maximization is the business judgment rule.<sup>133</sup> Even the most ardent supporter of profit maximization recognizes the ability of the business judgment rule to render the norm of profit maximization unenforceable.<sup>134</sup>

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131. See Tom Campbell, *The Normative Grounding of Corporate Social Responsibility: A Human Rights Approach*, in *THE NEW CORPORATE ACCOUNTABILITY: CORPORATE SOCIAL RESPONSIBILITY AND THE LAW* 529, 562-64 (Doreen McBarnet, Aurora Voiculescu, & Tom Campbell eds., 2007) (arguing corporate social responsibility actions without a profit motive are justified only if the acts are used to fulfill a corporation's human rights obligations and that this requires corporations to refrain from harming others).

132. See Lance C. Buhl, *The Ethical Frame of Corporate Philanthropy in CORPORATE PHILANTHROPY AT THE CROSSROADS*, 127, 127-43 (1996) (stating that the fulfillment of corporate social responsibility obligations is in the unwritten social contract between society and the engines of production it sanctions); Dodd, *supra* note 1, at 1149 ("[B]usiness is permitted and encouraged by the law primarily because it is of service to the community rather than because it is a source of profit to its owners."); Heal, *supra* note 104, at 13 ("[W]here costs are externalized, corporations bargain with society about who will ultimately bear these costs. The corporation is not . . . currently . . . legally bound to bear them but society could change this . . . . The result is an implicit contract: society accepts the legal *status quo* provided that the corporation does not exploit it to society's disadvantage.").

133. See Bruner, *supra* note 1, at 32; Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 428-29 (2001); Blair & Stout, *supra* note 82, at 299-305; Elhauge, *supra* note 35, at 770-75; Allen, *supra* note 8, at 272-73.

134. Bainbridge, *supra* note 30, at 582 (noting the business judgment rule renders the rhetoric of the shareholder wealth maximization norm largely unenforceable).

Aimed at recognizing the business expertise of the board of directors in exercising its managerial power, the business judgment rule has evolved to create a discretion which insulates the decisions of corporate managers from judicial scrutiny.<sup>135</sup> In fact, the business judgment rule operates on the presumption that corporate managers make business decisions on an informed basis, in good faith and with the belief that the decision was in the best interests of the company.<sup>136</sup> Accordingly, the business judgment rule can be challenged only if the presumptions supporting the rule are not met, for example, if the decision in question was grossly negligent, implicated a conflict of interest, or advanced a purpose other than the best interests of the corporation.<sup>137</sup>

Decisions which can be attributed to “any rational business purpose” also find protection under the business judgment rule.<sup>138</sup> However, the time frame for achieving any corporate goal lies within the discretion of corporate managers pursuant to the business judgment rule.<sup>139</sup> Thus, a decision to deviate from profit maximization will continue to find support under the business judgment rule so long as corporate managers articulate even a loosely related rational corporate goal that can be met at some indiscriminate time in the future.<sup>140</sup>

The business judgment rule also does not require that decisions seeking protection under it affect profit maximization.<sup>141</sup> Instead, the requirement that decisions under the business judgment rule advance the best interests of the corporation suggests that decisions under this rubric need only further the interests of *any* aspect of the corporation.<sup>142</sup> Benefits to shareholders, employees, customers, creditors, the community, society, or the corporation itself thus all fall within the purview of the best interests of the corporation so long as they can be tied to a rational business

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135. Directors exercise their managerial power pursuant to § 141(a) of the Delaware General Corporation Law. Del. Code Ann. 8 § 141 (a) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .”); *Continuing Creditors’ Committee of Star Telecommunications Inc. v. Edgcomb*, 385 F. Supp. 2d 449 (D. Del. 2004); *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 782 (Del. 1981); *Moran v. Household Int’l, Inc.*, 490 A.2d 1059, 1076 (Del. Ch. 1985), *aff’d* 500 A.2d 1346 (Del. 1985).

136. *Aronson*, 473 A.2d at 812; *Van Gorkom*, 488 A.2d at 872.

137. *Aronson*, 473 A.2d at 812; *In re Walt Disney Derivative Litig.*, 906 A.2d 27, 62 (Del. 2006).

138. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

139. *Paramount*, 571 A.2d at 1154.

140. *Blair & Stout*, *supra* note 82, at 299-305; *Bruner*, *supra* note 1, at 32; *Elhauge*, *supra* note 35, at 770-75.

141. *Aronson*, 473 A.2d at 812; *Van Gorkom*, 488 A.2d at 872; *Disney*, 906 A.2d at 62 (Del. 2006). The rule operates on the presumption that business decisions are made on an informed basis, in good faith, and in the best interests of the corporation. *Id.*

142. *See supra* note 45.

purpose.<sup>143</sup> That is, furthering the financial interests of the shareholders alone is not a necessary condition for finding that an act is in the best interests of the corporation.<sup>144</sup> Consequently, a corporate decision that promotes the interests of any corporate stakeholder, but fails to align with profit goals, will likely still find protection under the business judgment rule.

Incorporating the interests of stakeholders and shareholders alike within the best interests of the corporation, and consequently within the purview of the business judgment rule, may draw in part from the need to ensure the long-term stability and sustainability of the corporation.<sup>145</sup> For example, the court in *Paramount* expressly rejected a cost comparison between the two competing bids for Time and protected the Time board of directors' interest in preserving "Time culture" within the purview of the business judgment rule.<sup>146</sup> In particular, the court held that the Time directors' decision to reject a cash offer of \$200 per share, which was well-above the normal trading price for Time shares, was protected by the business judgment rule.<sup>147</sup> *Paramount* thus suggests that the long-term stability and sustainability interests of a corporation, for example through preservation of corporate culture, can both trump short-term profit interests and find protection under the business judgment rule.

#### D. *Fiduciary Duties*

In 1932, Merrick Dodd observed that the voluntary acceptance of social responsibility by corporate managers was contrary to corporate law, but only if the law viewed corporate managers as the fiduciaries of shareholders.<sup>148</sup> Dodd argued that by viewing corporate managers as the fiduciaries of the corporation rather than the shareholders, they would be free to accept social responsibilities.<sup>149</sup>

Although the debate as to whom fiduciary duties are owed continues, the law remains neutral in the meantime, holding that corporate managers

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143. For example, under the Connecticut constituency statute, the best interests of the corporation can include the long and short-term interests of the corporation, the interests of the shareholders, the interests of the corporation's employees, customers, creditors and suppliers, and community and societal considerations. See CONN. GEN. STAT. ANN. § 33-756(d) (West 1997). Best interests of the corporation can also include the interests of creditors, customers, employees, and the community. See *Unocal*, 493 A.2d at 954-55.

144. Mark J. Loewenstein & William K.S. Wang, *The Corporation as Insider Trader*, 30 DEL. J. CORP. L. 45, 52 (2005). See also the discussion at Part IV.A.

145. Bruner, *supra* note 1, at 31.

146. *Paramount*, 571 A.2d at 1151-52, 1153.

147. *Id.* at 1149; see also Bainbridge, *supra* note 67, at n.70.

148. Dodd, *supra* note 1, at 1162-63.

149. *Id.* at 1162.

stand in a fiduciary relationship to the corporation *and* its shareholders.<sup>150</sup> Thus, to the extent that the law recognizes fiduciary duties as flowing to the corporation, corporate managers can undertake acts of social responsibility that are in the best interests of the corporation.

Fiduciary duties are also closely related to the business judgment rule in that they delineate aspects of the substance of the decisions that the business judgment rule procedurally protects. Accordingly, fiduciary duties set limits on the latitude created by the business judgment: a decision which breaches a fiduciary duty rebuts the presumption of the business judgment rule.<sup>151</sup>

### 1. The Duties of Loyalty and Care

The substance of fiduciary duties has traditionally been compartmentalized into the duty of loyalty and the duty of care. Some courts have also recognized a triad of duties: loyalty, care, and good faith; although in a recent decision the Delaware courts included good faith within the duty of loyalty.<sup>152</sup>

In essence, the duty of loyalty mandates that the best interests of the corporation and its shareholders take precedence over any interest possessed by a corporate manager. It also prohibits corporate managers from using their position of trust to further their own financial interests.<sup>153</sup> Self-dealing, fraud, and usurpation of corporate opportunities are, accordingly, violations of the duty of loyalty.<sup>154</sup> However, the duty of

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150. *Guth*, 5 A.2d at 510; *Aronson*, 473 A.2d at 811; *Condec Corp. v. Lunkenheimer Co.*, 43 Del. Ch. 353, 363, 230 A.2d 769, 776-77 (1967); *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984).

151. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) (“To rebut the [business judgment] rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any . . . of their fiduciary dut[ies] . . . . If a shareholder plaintiff fails to meet this evidentiary burden, the business judgment rule attaches to protect . . . the decision[] . . . . If the rule is rebutted, the burden shifts to the defendant directors . . . to prove . . . the ‘entire fairness’ of the transaction . . . .”); *Disney*, 906 A.2d at 52-53.

152. The triad of duties has been referred to in *Cede*, 634 A.2d 345, 361; *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170, 1172 (Del. 2000); *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998). However, in *AmSouth Bancorporation v. Ritter*, 911 A.2d 362 (Del. 2006), the court subsumed good faith into the duty of loyalty. See also Claire A. Hill & Brett H. McDonnell, *Stone v. Ritter and the Expanding Duty Of Loyalty*, 76 *FORDHAM L. REV.* 1769 (2007) (discussing good faith as an aspect of the duty of loyalty).

153. *Guth*, 5 A.2d at 510; *Disney*, 907 A.2d 693, 751 (Del. 2005); *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 191 (Del. Ch. 2005).

154. *Broz v. Cellular Info. Sys.*, 673 A.2d 148, 149 (Del. 1996); *Benihana*, 891 A.2d 150; *McGowan v. Ferro*, 859 A.2d 1012 (Del. Ch. 2004). Self-dealing refers to situations where corporate fiduciaries appear on both sides of a transaction. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156 (Del. 1995).

loyalty does not generally prohibit corporate managers from engaging in strategic business decisions that result in non-monetary benefits to themselves, so long as the acts are not solely motivated out of self interest.<sup>155</sup> Thus, whereas a donation to a corporate manager's "pet" charity would be prohibited, charitable donations made indiscriminately would not.<sup>156</sup>

The duty of loyalty further requires that corporate managers act in good faith, in the belief that their actions are in the corporation's best interest.<sup>157</sup> Good faith, in turn, can be measured by whether corporate managers have engaged in an intentional dereliction of duty, a conscious disregard for responsibilities, or deliberate indifference and inaction in the face of a duty to act.<sup>158</sup> Thus, a failure to act in good faith may be evidenced by the fiduciary acting to advance a purpose other than that which is in the best interests of the corporation, acting intentionally to violate applicable positive law, or intentionally failing to act in the face of a known duty to act.<sup>159</sup>

In *Stone v. Ritter*, the court also re-characterized *Caremark* duties as part of the duty of loyalty.<sup>160</sup> Traditionally thought to be an aspect of the duty of care, *Caremark* duties impose liability on corporate managers for a sustained or systematic failure to exercise oversight.<sup>161</sup> However, the *Stone* court held that because the duty of loyalty requires corporate managers to act in the face of a known duty to act, oversight liability<sup>162</sup> results in liability for breach of the duty of loyalty as well.<sup>163</sup>

In contrast, the duty of care generally requires corporate managers to exercise a standard of care which an ordinarily careful and prudent person

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155. Blair & Stout, *supra* note 82, at 299 (arguing that the duty of loyalty does not apply in circumstances where directors make strategic business decisions that provide *nonmonetary* benefits to themselves at shareholders' expense). *But see* Robert Flannigan, *The Economics of Fiduciary Accountability*, 32 DEL. J. CORP. L. 393, 426 (2007) (arguing that decisions that result in nonmonetary benefits to directors could be actionable if the self-regard of the directors could be proved).

156. *See* A. P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 590 (N.J. 1953) (allowing indiscriminate donations rather than those championed by an influential corporate manager).

157. Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003); *see, e.g.,* *Disney*, 906 A.2d at 67 ("The good faith required of a corporate fiduciary includes not simply the duties of care and loyalty . . . but all actions required by a true faithfulness and devotion to the interests of the corporation and its shareholders.").

158. *Disney*, 906 A.2d at 62.

159. *Id.* at 67.

160. 911 A.2d 362, 370 (Del. 2006).

161. *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996).

162. Oversight liability is described as failing to implement a reporting or information system or controls or consciously failing to monitor or oversee an implemented system or controls. *Stone*, 911 A.2d at 369.

163. *Id.*

would exercise under similar circumstances.<sup>164</sup> The focus is on the reasonableness of the decision-making process rather than on the reasonableness of the decision itself. As a result, informed decisions, in which all material facts reasonably available were consulted, will generally meet the standard for the duty of care, while grossly negligent decisions will not.<sup>165</sup>

## 2. Using Fiduciary Duties to Promote Social Responsibility

Fiduciary duties can provide several means of promoting socially responsible acts. For example, the duty of loyalty allows corporate managers to act in furtherance of non-monetary interests so long as their act is not motivated solely out of self-regard. Thus, in addition to permitting charitable donations, non-monetary actions that are rationally related to the corporation will fall within the purview of the duty of loyalty. Accordingly, the duty of loyalty includes corporate actions that converge stakeholder interests with financial interests.

Good faith, as a subset of the duty of loyalty, can also encourage socially responsible acts. As the duty of loyalty requires corporate managers to act in the good faith belief that their actions are in the corporation's best interest, socially responsible acts can be justified if they are in accordance with the corporation's best interest. Because a corporation's best interests are self-determined by the board of directors, the board can interpret the best interests of a corporation to support and encapsulate the socially responsible act.<sup>166</sup>

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164. *Benihana*, 891 A.2d at 150; *In re NCS Healthcare, Inc. S'holders Litig.*, 825 A.2d 240, 245 (Del. Ch. 2002); *Graham v. Allis-Chalmers Mfg., Co.*, 188 A.2d 125, 130 (Del. Ch. 1963).

165. *See Malpiede v. Townson*, 780 A.2d 1075, 1082 (Del. 2001) (discussing the duty of care standard); *Brehm v. Eisner*, 746 A.2d 244, 260-263 (Del. 2000) (discussing standard for duty of care); *Van Gorkom*, 488 A.2d at 873-75 (discussing actions triggering a duty of care breach); *see also* Meredith M. Brown, *The Duties of Target Company Directors under State Law: The Business Judgment Rule and Other Standards of Judicial Review*, 1351 PRACTISING L. INST.: CORP. L. & PRAC. HANDBOOK SERIES, 177, 185, 201 (2007) (discussing the business judgment rule).

166. *See Aronoff*, 446 N.Y.S.2d at 370-71 (noting that the existence of benefit to the corporation "is generally committed to the sound business judgment of the directors). The objecting stockholder must demonstrate that no person of ordinary sound business judgment would say that the corporation received fair benefit." *Id.*; *see also* *Warshaw v. Calhoun*, 221 A.2d 487, 493 (Del. 1966) (stating that "the acts of directors are presumptively acts taken in good faith and inspired for the best interests of the corporation"). Note also that at least one court decision has recognized that the best interests of the firm may translate into maximizing the economic value of the corporation. *See Prod. Res. Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 791 (Del. Ch. 2004) (discussing what constitutes the best interests of a firm). Nevertheless, limits on the discretion of corporate managers to self-define the best interests of the corporation may still be necessary. *See also infra*, Part IV

In addition, the duty of loyalty requires fiduciaries to act in the face of a known duty to act. It is for this reason that *Caremark* and *Stone* mandate the implementation of a monitored control system to alert corporate managers of risks to the corporation. However, risks to corporations are increasingly beginning to arise on social or environmental fronts, which have traditionally not been monitored. For example, increases in Alien Tort Claims Act litigation, allegations of violations of environmental regulations, and litigation over stakeholder issues can allow circumstances to develop which expose the corporation to enormous amounts of liability.<sup>167</sup> As a result, the duty of loyalty requires both that these social risks be monitored and that corporate managers act to mitigate these risks. Moreover, in monitoring and assessing these risks, the duty to disclose these risks may also arise under the duty of loyalty. Knowledge of corporate risks is particularly necessary as the costs from a failure to disclose risks may result in penalties to both shareholders and to society at large, neither of which is in the best interests of the corporation.<sup>168</sup>

#### E. Shareholder Proposals

Rule 14a-8 of the Exchange Act of 1934 provides shareholders with a mechanism to inform boards of directors about matters that are of interest to shareholders.<sup>169</sup> Unlike the business judgment rule and fiduciary duties,

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(discussing these limits).

167. Cynthia A. Williams & John M. Conley, *Is There an Emerging Fiduciary Duty to Consider Human Rights?*, 74 U. CIN. L. REV. 75, 87-93 (2005) (observing that risk of ATCA litigation to business is significant and that companies can suffer important losses from social and environmental allegations).

168. Penalties can arise from reductions in share prices, increased cost of capital or increased litigation. See Joseph T. Walsh, *The Fiduciary Foundation of Corporate Law*, 27 J. CORP. L. 333, 339 (2002) (arguing a fiduciary duty of disclosure extends beyond the interests of shareholders and that fiduciary duties for directors relate to the economic efficiency of the entity for the benefit of shareholders, but not in disregard of the social implications of corporate conduct); see also Ribstein, *supra* note 105, at 1444-45 (noting that penalties can arise from reductions in share prices, increased cost of capital or increased litigation); Justice Joseph T. Walsh, *The Fiduciary Foundation of Corporate Law*, 27 IOWA J. CORP. L. 333, 339 (2002) (arguing a fiduciary duty of disclosure extends beyond the interests of shareholders and that fiduciary duties for directors relate to the economic efficiency of the entity for the benefit of shareholders, but not in disregard of the social implications of corporate conduct).

169. See 17 C.F.R. § 240.14a-8 (2004) (discussing how shareholders may inform boards of directors about matters that are of interest to the group in the form of a proxy at shareholder meetings). See generally Robert B. Ahdieh, *The Dialectical Regulation Of Rule 14a-8: Intersystemic Governance In Corporate Law*, 2 J. BUS. & TECH. L. 165, 169-71 (2007) (outlining the scope and bounds of shareholder proposals); Adam J. Sulkowski & Kent Greenfield, *A Bridle, A Prod, And A Big Stick: An Evaluation Of Class Actions, Shareholder Proposals, and the Ultra Vires Doctrine as Methods for Controlling Corporate Behavior*, 79 ST. JOHN'S L. REV. 929, 937-945 (2005) (discussing the limitations and

which only give corporate managers the latitude to divert from profit maximization norms, shareholder proposals give shareholders an opportunity to express an interest in privileging social responsibility over profitability.<sup>170</sup>

As the corporation bears the cost of distributing shareholder proposals, commentators have described shareholder proposals as a tax on all shareholders to promote the voice of a few.<sup>171</sup> In fact, critics of socially oriented shareholder proposals have described them as antithetical to improving corporate performance or a means of publicly criticizing the corporation.<sup>172</sup>

Despite criticisms directed at social responsibility shareholder proposals, these types of proposals continue to increase.<sup>173</sup> A recent study reports that approximately twenty percent of all shareholder proposals are social responsibility proposals.<sup>174</sup> However, traditionally these types of shareholder proposals have enjoyed limited success, in part because they have not received support from corporate managers.<sup>175</sup>

In contrast, social responsibility shareholder proposals with board support tend to find tremendous success. For example, Tyco International, Ltd. management recommended that shareholders support a shareholder

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obstacles faced by shareholder proposals); James F. Cotter & Randall S. Thomas, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, Vanderbilt Law and Economics Research Paper No. 05-30 (2007) (discussing common subject matter in shareholder proposals).

170. *Med. Comm. for Human Rights v. SEC*, 432 F. 2d 659, 681 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972) (stating shareholders can present to their co-owners “the question of whether they wish to have their assets used in a manner which they believe to be more socially responsible but possibly less profitable than that which is dictated by present company policy”).

171. *See* Cotter & Thomas, *supra* note 169, at 4 (noting that the corporation bears a cost for adopting shareholder proposals, which typically relate only to a subset of shareholders).

172. Romano, *supra* note 1, at 185; *see also* Stephen Bainbridge, *Shareholder 14a-8 Proposals relating to Universal Health Care*, BUSINESSASSOCIATIONSBLOG.COM, May 27, 2008,

[http://www.businessassociationsblog.com/lawandbusiness/comments/shareholder\\_14a\\_8\\_proposals\\_relating\\_to\\_universal\\_health\\_care/](http://www.businessassociationsblog.com/lawandbusiness/comments/shareholder_14a_8_proposals_relating_to_universal_health_care/) (referring to social responsibility shareholder proposals as a “soap-box” through which minority shareholders can disseminate their views).

173. Meg Voorhes, *The Rising Tide of Shareholder Activism*, 11 CORP. STRATEGY TODAY 20, 25 (2005) (noting there has been a steady and corresponding increase in the numbers of proposals filed on environmental, labor, and other social issues. The 200 social issues proposals voted on in 2004 are the highest of any year tracked).

174. *See* Cotter & Thomas, *supra* note 169, at 8-9 (providing data collected by the Investor Responsibility Research Center, relating to the number of shareholder proposals).

175. *See id.* at 12 (providing data relating to corporate support for shareholder proposals); *see also* Romano, *supra* note 1, at 185 (discussing reaction to social responsibility shareholder proposals); Lee, *supra* note 1, at 131 (discussing response to social responsibility shareholder proposals).



proposal, which requested company-wide environmental reporting as a means of reducing emissions of toxins like lead and dioxin.<sup>176</sup> Ninety-two percent of shareholders supported the proposal. Similarly, Coca-Cola shareholders proposed that the company prepare a report on the economic impact of HIV/AIDS, tuberculosis and malaria. The Coca-Cola board of directors supported the proposal and it received ninety-eight percent of shareholders support.<sup>177</sup>

In several cases, boards of directors have supported social responsibility shareholder proposals prior to a vote on the proposal, causing the proponent of the proposal to withdraw it. For example, Dell committed to improve its recovery rate of used computer products by fifty percent and Anadarko Petroleum adopted a greenhouse gas management system, prior to the shareholder vote causing the shareholder to withdraw its proposal.<sup>178</sup> A recent study reports that almost eighty percent of withdrawn resolutions resulted in concrete action by the corporation, suggesting that withdrawal of a socially-minded shareholder proposal can also indicate some degree of success for the subject-matter of the proposal.<sup>179</sup>

Board sanctioned shareholder proposals are, therefore, arguably the only means of ensuring the success of the subject matter of a social responsibility shareholder proposal.<sup>180</sup> Without board support prior to or at the vote on the proposal, social responsibility shareholder proposals may be viewed as idiosyncratic and of limited concern to a wide audience of shareholders, consequently garnering little support.<sup>181</sup>

Joint action between boards and shareholders, in the form of board

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176. See Social Investment Forum, *Socially Responsible Investing Advanced on Multiple Fronts in 2004, Setting Stage For More Progress in 2005*, GREENMONEYJOURNAL.COM (2005), <http://www.greenmoneyjournal.com/article.mpl?newsletterid=34&articleid=421> (discussing the company's desire to research).

177. *Id.*

178. See *id.* (noting Dell's commitment to managing the production of greenhouse gases); Ethical Funds Company, *The Ethical Funds Company Focus List for the 2006 Shareholder Action Program* (2006), [https://www.ethicalfunds.com/en/Investor/ChangingTheWorld/DifferencesWeMake/MakingGoodCompaniesBetter/Pages/FocusList\\_2006.aspx](https://www.ethicalfunds.com/en/Investor/ChangingTheWorld/DifferencesWeMake/MakingGoodCompaniesBetter/Pages/FocusList_2006.aspx) (recognizing Dell's goal to improve labor conditions in other countries).

179. Paula Tkac, *One Proxy at a Time: Pursuing Social Change Through Shareholder Proposals*, ECONOMIC REVIEW, Third Quarter 2006, at 13, 17, available at [http://www.frbatlanta.org/frbatlanta/filelegacydocs/erq306\\_tkac.pdf](http://www.frbatlanta.org/frbatlanta/filelegacydocs/erq306_tkac.pdf).

180. However, shareholder support for social proposals, notwithstanding board support, is increasing. See Megan Voorhes, *Social Proposals Receive Greater Support in Institutional Shareholder Services 2006 Postseason Report-Spotlight On Executive Pay And Board Accountability*, 1579 PLI/CORP. 859, 893 (2007) (discussing the need for management support of social responsibility shareholder proposals).

181. Tkac reports that the average level of shareholder support for a social shareholder proposal is 8.2 percent and that only four of the 1,472 proposals in her data set that went to a shareholder vote won the support of the majority of shareholders. Tkac, *supra* note 179, at 15.

support for social responsibility shareholder proposals, may, in fact, be warranted in certain circumstances. Given the relationship between social responsibility actions and maximization of corporate value, corporate managers should support social responsibility shareholder proposals when the subject matter of the proposal has material importance to the best interests of the corporation. Thus, for example, the Coca-Cola board of directors likely supported the shareholder proposal (requesting that they study the impact of HIV/AIDS) because several interest groups had already publicly complained about Coca-Cola's inaction in this area and were making viable threats to the reputation of the company.<sup>182</sup> Accordingly, Coca-Cola's board of directors' support of the shareholder proposal was in the best interests of the corporation.

Board support of social responsibility shareholder proposals that are materially important to the best interests of the corporation challenges criticism that the subject matter of social responsibility shareholder proposals are of little interest to the majority of shareholders.<sup>183</sup> Any corporate action, stemming from a social responsibility shareholder proposal, which materially accords with the best interests of the corporation, should be of interest to the majority of shareholders—particularly if the corporate action can impact on the profitability of the corporation in the long run.<sup>184</sup> These types of shareholder proposals are also less likely to be viewed as a tax or a subsidy paid by the majority to promote the views of the minority, given that they represent the interests of the majority of shareholders.<sup>185</sup> In addition, if board support of social

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182. Six-hundred protesters rallied in front of Coca-Cola's main headquarters in New York and thousands marched nationwide, including a rally in Atlanta in front of the World of Coca-Cola museum demanding that Coke supply full medical coverage—including HIV/AIDS treatment—to all its workers in Africa. One protestor noted: "Until they implement changes, we'll drag their name through the mud . . ." Lisa Weinert, *Can Coke Prevent AIDS?*, THE NATION, Oct. 24, 2002, available at <http://www.thenation.com/doc/20021111/weinert20021024>.

183. See Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1279 (1982) (arguing that if a corporation decides to modify its behavior in response to a social responsibility shareholder proposal, "shareholders as a class have little to be excited about. What has occurred is that a tiny minority, subsidized by the vast majority of shareholders, has caused the corporation to abandon a wealth-maximizing strategy favored by the . . . majority of shareholders . . .").

184. Only shareholders interested in maximizing profits in the *short run* and at any cost will not be interested in shareholder proposals which are in the best interests of the corporation. For further discussion on the content of the "best interests of the corporation," see discussion at Part III.A. and *supra* note 45 (discussing in detail the best interests of the corporation).

185. Fischel argues that shareholder proposals are subsidized by the majority of shareholders to promote the views of the minority. Fischel, *supra* note 183, at 1279; see also Cotter & Thomas, *supra* note 169, at 4 (discussing the power of the minority shareholder).

responsibility shareholder proposals is triggered by coherence between the subject matter of the proposal and the best interests of the corporation, agency costs may be reduced for the majority of shareholders.<sup>186</sup>

#### IV. PROFIT MAXIMIZING AND TEMPERING THE DUTY TO PROFIT MAXIMIZE

So long as corporate law remains unclear about its purpose, corporate managers can arguably serve the interests of either of its masters: financial interests or non-financial interests. However, this conclusion does not accord with traditional corporate social responsibility scholarship. These commentators have advocated the abandonment of the profit maximization goal in favor of a stakeholder model.<sup>187</sup> Under this view, the corporation serves the interests of all the corporation's stakeholders, including shareholders, but the shareholders do not enjoy primacy over other stakeholders.<sup>188</sup>

Yet this position does not flow from the ambiguity of corporate purpose. While the debate about corporate purpose continues, corporate law has adopted a neutral stance, holding that a corporation's purpose is to serve the interests of the shareholders *and* the interests of the corporation.<sup>189</sup> If the interests of shareholders were subsumed into the interests of the corporation, courts would not distinguish between the interests of the corporation and the interests of shareholders. Additionally, because courts separate shareholder interests from the interests of the corporation, shareholder interests need not be synonymous with the interests of the corporation.<sup>190</sup> Accordingly, financial interests in the form

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186. Cotter and Thomas observe that majority shareholder support of a shareholder proposal along with board responsiveness to the proposal can reduce agency costs even if the effects of the proposal have insignificant effects on shareholder wealth. Cotter & Thomas, *supra* note 169, at 22. However, agency costs are only reduced if the idea of the "best interests of the corporation" is not interpreted to mean maximization of profits in the short-run.

187. *See generally* Blair & Stout, *supra* note 82, at 290 (advocating a stakeholder model rather than a profit maximization goal); Green, *supra* note 24, at 1413 (discussing the benefit of a stakeholder model); Greenfield, *supra* note 89, at 960 (discussing the stakeholder model as an alternative to the profit maximization goal).

188. *Id.*

189. For example, in *Unocal* the court held the board had an obligation to determine whether the takeover offer was in the best interests of the corporation and its shareholders. *Unocal*, 493 A.2d at 954; *see also* *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998) (noting that corporations owe a duty to the corporation and its shareholders); *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1287 (Del. 1989) (discussing the responsibility a corporation owes to the corporation and the shareholders); *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939) (recognizing that corporate executives owe a duty to the corporation and its shareholders).

190. *See* Loewenstein & Wang, *supra* note 144, at 52 (stating that corporate agents "are

of profit maximization need to continue to be served and can remain an important presumptive, but not sole, duty of corporate managers.<sup>191</sup> In part, the need for the profit maximization presumption may arise in order to facilitate corporate managers' decision-making. Without an easily identifiable goal, corporate managers may be crippled when making decisions if they are constantly forced to prioritize all corporate constituents' interests in relation to every decision. That being said, as the interests of the corporation must also be served, the duty to profit maximize should also be tempered in certain circumstances in order to accommodate non-financial interests.

A. *Circumstances under which the Duty to Profit Maximize Should be Tempered*

Although, in many cases, the duty to maximize profit can align with the duty to promote the interests of the corporation, in other cases either short-term or long-term profits can be negatively affected by a corporate act which serves the best interests of the corporation.<sup>192</sup> However, corporate acts that deviate from the duty to maximize profit should still be taken if the act responds to market views of corporate responsibility obligations or if it conforms to the basic rules of the society.

1. Market Views

The duty to maximize profits should be tempered to respond to views about corporate responsibility obligations—advocated by participants in the relevant markets within which the corporation operates—that represent a consensus in that market.<sup>193</sup> For most corporations, this will involve views

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obligated to act in the best interests of the corporation, which may not coincide with the best interests of an individual shareholder transacting business with the corporation. There is no reason to impose a fiduciary obligation on these actors to act in the best interests of an individual shareholder when that shareholder proposes a course of conduct not in the best interests of the corporation”).

191. Thomas W. Dunfee, *Corporate Governance in a Market with Morality*, 62 LAW & CONTEMP. PROBS. 129, 149 (1999) (arguing shareholder wealth maximization is a rebuttable presumption); Bruner, *supra* note 1, at 42-43 (also characterizing shareholder wealth maximization as a presumption).

192. For a discussion of the content of the “best interest of the corporation,” see Part III.A. and *supra* note 45 (providing an in-depth discussion of the “best interest of the corporation”).

193. See Dunfee, *supra* note 191, at 150 (referring to views from the market as authentic norms, which he argues, can be ascertained from community views, reflection in codes of conduct, media views, business leaders' views, and opinion surveys); see also Ribstein, *supra* note 105, at 1433 (arguing that markets can reflect political and social tastes and socially-relevant information).

from consumer markets in which the corporation's products or services are sold, labor markets from which the corporation draws its employees, and capital markets.<sup>194</sup>

In addition to perpetuating a social wrong, failure to respond to, or in some cases anticipate, a particular market's view of corporate responsibility obligations can negatively impact both shareholder wealth and the economic value of the corporation.<sup>195</sup> For example, whereas Nike failed to anticipate its consumer market's views on corporate responsibility in the clothing production process, causing its reputation harm,<sup>196</sup> Merck responded to its labor market's views by donating an unprofitable drug invented by its scientists-employees, to prevent them from becoming demoralized, and in turn, began to attract top scientists to the corporation.<sup>197</sup>

## 2. The Basic Rules of Society

The duty to maximize profits should also be tempered if the corporation's act could prevent compliance with the basic rules of the society.<sup>198</sup> As profit maximization proponent Friedman observed, the responsibility of businesses is to maximize profit "while conforming to the

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194. See Dunfee, *supra* note 191, at 149 (discussing the relevant market constituencies which the corporation is obligated to appease).

195. See Aguilera et al., *supra* note 100, at 21 (ADD); Ribstein, *supra* note 105, at 1451 (discussing how, even within the shareholder wealth-maximization framework, firms will seek social legitimization). See generally Dowell et al., *supra* note 110 (concluding that "better firms" pollute less and adopt higher environmental standards); Jensen, *supra* note 4 (recognizing that shareholder wealth refers primarily to shareholders' stock prices, whereas the economic value of the corporation is defined in terms of its equity and other financial claims); Orlitzky et al., *supra* note 110 (suggesting that corporate social responsibility likely results in improved corporate financial performance).

196. See Thomas Katzenmeyer et al., *The Fifth Driker Forum For Excellence In The Law Corporate Citizenship And The Law* (Nov. 8, 2004), in 51 WAYNE L. REV. 1015, 1035 (2005) (discussing the public's disenfranchisement with Nike's clothing production process); The Honorable Delissa A. Ridgway and Mariya A. Talib, *Globalization and Development—Free Trade, Foreign Aid, Investment and the Rule of Law*, 33 CAL. W. INT'L L.J. 325, 330 (2003) (discussing how Nike's use of sweatshops in Asia sparked public criticism).

197. See P. ROY VAGELOS AND LOUIS GALAMBOS, *MEDICINE, SCIENCE AND MERCK* 254 (Cambridge University Press 2004) (noting that Merck's policy on the Mexctizan drug helped the company recruit the best scientists in the world); FRANKLIN C. ASHBY, *REVITALIZE YOUR CORPORATE CULTURE: POWERFUL WAYS TO TRANSFORM YOUR COMPANY INTO A HIGH-PERFORMANCE ORGANIZATION* 86 (1999) (noting that Merck's decision to provide certain drugs to Third World countries at no cost was driven by the fact that not doing so would have demoralized its scientists).

198. The basic rules of society are defined by the legal and moral norms in the community in which the corporation operates, supplemented by those fundamental principles of international law which are accepted by the international community.

basic rules of the society, both those embodied in law and those embodied in ethical custom.”<sup>199</sup> Thus, even Friedman did not advocate in favor of profit maximization acts that are contrary to legal or ethical rules.

In part, tempering the duty to maximize profits to conform to society’s rules—both those drawn from the community in which the corporation operates and from international norms—also arises out of a fairness concern in preventing corporations from imposing negative externalities. Such externalities can arise when corporate acts are not constrained by law or morality.<sup>200</sup> The corporation’s ability to impose negative externalities is particularly heightened as a result of globalization, which allows corporations to operate in countries in which regulatory controls over corporate activity may be non-existent.<sup>201</sup> Thus, corporate acts which would be legally impermissible in Country X may be permissible in Country Y, or, even if prohibited by law in Country Y, may not be legally enforceable. Accordingly, in the absence of legal controls, ethical custom may be the only constraint on corporate acts to prevent negative externalities.

Although Friedman referred to “ethical custom” as the honesty, integrity and fidelity needed to ensure that market mechanisms would function,<sup>202</sup> ethical customs can also be defined by reference to market views on corporate responsibility obligations or international norms.<sup>203</sup> For example, the practice of “sweatshop” labor is legally permitted in countries devoid of labor laws, which results in cost savings to the corporation but can also impose negative externalities on the laborers.<sup>204</sup> Regardless of effect, the corporate act still conforms to the law. However, negative consumer reaction to this practice and international norms, for example as reflected in the International Labour Organization principles, would

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199. Friedman, *supra* note 21.

200. See *supra* Part II.B.ii (arguing that fairness requires that corporate managers refrain from profit-maximizing when such a choice would beget externalities adversely impacting society).

201. Rhee, *supra* note 51, at 1114.

202. John W. Houck & Oliver F. Williams, *Preface to IS THE GOOD CORPORATION DEAD? SOCIAL RESPONSIBILITY IN A GLOBAL ECONOMY*, at ix (John W. Houck & Oliver F. Williams eds., 1996).

203. Elhauge draws a similar conclusion between gaps in legal regulation and the need for social and moral sanctions that operate internationally to supplement these gaps. Elhauge, *supra* note 35, at 803 (arguing that variations in regulatory law among nations will limit the effectiveness of legal restraints and thus social and moral sanctions are needed to incentivize desirable behavior).

204. See Nicholas D. Kristof & Sheryl Wudunn, *Two Cheers for Sweatshops*, N.Y. TIMES, Sept. 24, 2000, (Magazine), available at <http://www.nytimes.com/library/magazine/home/20000924mag-sweatshops.html> (noting the hazardous and occasionally brutal working conditions in which laborers in Chinese sweatshops work).

suggest that this practice is contrary to ethical custom.<sup>205</sup> As a result, the corporate act should arguably be considered contrary to the basic rules of society and, therefore, an act warranting a deviation from the duty to maximize profit.

Instances in which the need to temper the profit maximization norm may also arise from competing or conflicting non-shareholder corporate constituents' interests. Thus, a decision to move a corporation's plant operations from its existing location to a more environmentally sound location, due to demand from consumer markets, can result in objections from the corporations' existing employees. In this case, the interests of consumers conflict with the interests of employees. How should the decisions of the corporation be guided in this type of scenario? In a clear case of conflict between non-shareholder corporate constituents' interests, socially responsible actions need to be guided by the corporate managers' views on the best interests of the corporation. In many cases, this may require an analysis of which outcome will maximize profits in the long run, but profits need not be the only consideration. In fact, profits may not fully represent the long-term value of the corporation.<sup>206</sup> Thus, issues of goodwill, reputation, preservation of culture, or other deeply held firm values may need to factor into the analysis of determining which outcome most closely aligns with the best interests of the corporation.

#### V. LIMITS ON THE DISCRETION ARISING FROM THE AMBIGUITY OF THE CORPORATE PURPOSE

As profit maximization proponents have warned, vastly broadening the discretion of corporate managers can leave management with so much discretion that neither shareholder, employee, nor consumer wealth is maximized, but instead only their own.<sup>207</sup> Thus, although the ambiguity of

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205. International norms can be deduced from international law, international custom, *jus cogens* principles, the domestic laws of countries or academic writings. See Statute of the International Court of Justice art. 38(1), June 26, 1945; Vienna Convention on the Law of Treaties art. 53, May 23 1969, 1155 U.N.T.S 331 (stating that peremptory norms, which may be comprised of international custom, are supreme over treaties and should be applied by the ICJ).

206. Note that Jensen defines corporate value in terms of the values of all financial claims on the corporation, including debt, warrants, preferred stock, and equity. See generally Jensen, *supra* note 4.

207. See Bainbridge, *supra* note 30, at 581-82 (arguing that the greater the number of available justificatory explanations that a manager may cite, the easier it is for managers to use such explanations as a cover for their own interests); Ribstein, *supra* note 105, at 1434 (arguing that requiring managers to consider the interests of non-shareholders would effectively reduce their overall accountability); Roe, *supra* note 42, at 2065 (arguing that requiring managers to be accountable to non-shareholder stakeholders would actually provide managers with increased discretion to pursue their self-interest).

the corporate purpose permits discretion on the part of corporate managers to consider interests other than profit, limits to the discretion must also exist.

In many cases, limits on deviations from profit maximization are already built into the corporate structure. The classic limit on management's ability to deviate from profit goals is the Wall Street rule—shareholders dissatisfied with corporate governance will sell their stock—which, if practiced by numerous shareholders, would compromise the corporation's ability to raise capital.<sup>208</sup> Moreover, concerns about maintaining share prices and resisting takeover bids brought on by low stock prices will also limit corporate managers' acts in departing from profit goals.<sup>209</sup> In addition, for those corporate managers compensated with stocks and stock options, self-interest in both ensuring that their stocks and stock options remain lucrative and in job preservation will further limit deviations from profit maximization.<sup>210</sup>

Nevertheless, where inherent limits stemming from the corporate structure cannot limit managerial discretion, additional limits are necessary. First, the discretion to deviate from profit maximization should be exercised in response to market views of corporate responsibility obligations, and to conform to the basic rules of society and to ideals of fairness.<sup>211</sup> Where these conditions are not present, the presumption of the duty to maximize profits should continue to guide corporate action. Second, where decisions to deviate from profit maximizations are made to further the interests of the corporation, deviations should result in a sacrifice of only a reasonable amount of corporate resources, to prevent

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208. See Bainbridge, *supra* note 1, at 1442 (if shareholder interests are inadequately protected, they can refuse to invest); Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 619 (2006) (describing the Wall Street Rule as a shareholder ploy to sell their shares in a company if they are dissatisfied with the performance of the company); Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 716 (2007) (explaining the Wall Street Rule as the principle that dissatisfied shareholder can express their dissatisfaction by selling their shares and finding an alternative investment); Carol Goforth, *Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late*, 43 AM. U. L. REV. 379, 406 (1994) (explaining the Wall Street Rule as the principle that dissatisfied shareholder can express their dissatisfaction by selling their shares and finding an alternative investment).

209. Lee, *supra* note 1, at 37.

210. See Elhauge, *supra* note 35, at 808-09 (arguing that managers will have less incentive to sacrifice corporate profits if their compensation, value of stock and stock options, and subsequent employment prospects are determined by profits); see also Lee, *supra* note 1, at 37.

211. For a discussion on market views of corporate responsibility obligations and conformance to the basic rules of society, see *supra* Part IV.B.i. For a discussion on fairness, see *supra* Part II.B.ii.



excessive corporate generosity.<sup>212</sup> The reasonableness of the amount sacrificed can be determined with reference to the corporation's stated goals, purpose or philosophy or whether the act will maximize the long-term market value of the corporation.<sup>213</sup> For example, the reasonableness of profits sacrificed by Google Inc., which boasts long-term focus, employee satisfaction, and "making the world a better place" as part of its vision,<sup>214</sup> is likely to be higher than the amount of profits sacrificed by an investment holding company.

Limits are also needed to prevent corporate managers from deviating from the duty of profit maximization merely to satisfy personal preferences. In the same way that the law does not condone a donation to a "pet" charity, deviations from corporate profit goals to promote self-interests should not be permissible.<sup>215</sup> Without this limit, corporate acts could be used to promote idiosyncratic organizations with which corporate managers have a personal connection, but which do not reflect the interests of the corporation.<sup>216</sup> Accordingly, deviations from profit goals should be limited by requiring a rational connection with the corporation and its goals.

Most importantly, limits are needed to curtail management's ability to deviate from profit goals to serve their own self-interests. As a commentator has noted, corporate managers that are not constrained by profit goals are free to serve *both* the interests of society and their own self interests.<sup>217</sup>

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212. Cf. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01, Reporter's Note ¶ 2 (Am. L. Inst. 1992) (noting that the corporation may devote a reasonable amount of "corporate resources to public welfare, humanitarian, educational, or philanthropic purposes").

213. Jensen, *supra* note 4, at 8 (arguing that in evaluating alternative courses of corporate conduct, corporate managers should use the criterion of maximization of the long-term market value of the firm, with "firm value," meaning the sum of the values of *all* financial claims on the firm—debt, warrants, preferred stock, and common stock).

214. Press Release, Google, Google.org Announces Core Initiatives to Combat Climate Change, Poverty and Emerging Threats (Jan. 17, 2008), *available at* [http://www.google.com/intl/en/press/pressrel/20080117\\_googleorg.html](http://www.google.com/intl/en/press/pressrel/20080117_googleorg.html); *see* Letter from the Founders: "An Owner's Manual" for Google's Shareholders (S-1 Registration Statement), Google (2004), *available at* [http://investor.google.com/ipo\\_letter.html](http://investor.google.com/ipo_letter.html). (announcing in early 2008, unsurprisingly, to "devote approximately 1 percent of the company's equity plus 1 percent of annual profits to philanthropy").

215. *See* A. P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 590 (N.J. 1953) (holding that corporate donations are permissible so long as they are not directed toward pet charities or personal, as opposed to corporate, ends).

216. Note, however, that as deviations from profit goals are encouraged only in response to moral demands from markets or to accord with societal norms and prevent serious negative externalities, the ability for corporate managers to sacrifice profits only to satisfy personal whims is also constrained by these preconditions.

217. *See* Ribstein, *supra* note 105, at 1460-61 (arguing that managers released from a duty to account to shareholders would be freer to serve *both* their own interests and those of

Although the psychological constraint<sup>218</sup> of profit maximization is not wholly abandoned in a model where the duty to maximize profits still operates presumptively, but can be tempered, the resulting discretion can still permit managers to prefer self-interests over the interests of the shareholders. For example, suppose a manager must choose between two alternative courses of conduct, one that would maximize profits and one that would promote the basic rules of society.<sup>219</sup> If he elects to maximize profits, the corporation will grant a contract to Corporation A. If, alternatively, he elects to conform to the rules of society, the contract is awarded to Corporation B. Assume the manager elects to award the contract to Corporation B, supposedly under the guise that to do so would promote the best interests of the corporation. In truth, the contract is awarded to Corporation B because it is served by X, an independent director who happens to sit on the manager's board of directors. Thereafter, when the manager needs a critical vote of support—e.g., to ensure job retention—X can be counted on to vote in favor of the manager's position.

For the most part, a deviation from the duty to profit maximize that is mainly intended to promote a corporate manager's self-interest will be limited by judicial scrutiny. This is because conflicts of interest are not protected under the business judgment rule and are considered a breach of the duty of loyalty.<sup>220</sup> Thus, in the above hypothetical, it is likely that the action of the corporate manager in awarding the contract to Corporation B

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society). It is not clear that managers freed from the shareholders would serve society rather than themselves.

218. See Bainbridge, *supra* note 30, at 582 (claiming that the shareholder wealth maximization norm functions as a psychological device that inhibits directors from pursuing their own self-interests at the expense of shareholders).

219. See Jayne W. Barnard, *Corporate Philanthropy, Executives' Pet Charities and the Agency Problem*, 41 N.Y.L. SCH. L. REV. 1147, 1161 (1997) (noting that Ross Johnson, then CEO of RJR Nabisco, used a number of techniques to ensure his board of directors' personal loyalty to him. For example, when he needed a critical vote from Paul Sticht, a former RJR executive serving on the company's board, Johnson offered Sticht a generous consulting contract and also arranged a six million dollar donation from RJR to the J. Paul Sticht Center on Aging at the Bowman Gray School of Medicine. "'Sticht soon came around,' observers note."); Elhauge, *supra* note 35, at 854 (noting that some advocate that judges should determine whether the public interest views of corporate managers constitute social or moral norms).

220. See *Disney*, 906 A.2d at 62 (Del. 2006) (finding that the directors had not acted in bad faith under the standard of intentional dereliction expounded by the Chancery Court); *Aronson*, 473 A.2d at 812 (noting that if director self-dealing is present, absent approval by a majority of disinterested directors, the transaction is not protected by the business judgment rule); *Guth*, 5 A.2d at 510 (noting that the corporate opportunity rule does not protect directors who violate their fiduciary duties by engaging in self-dealing); *Disney*, 907 A.2d at 751 (Del. Ch. 2005) (stating that corporate officers cannot use their position to further private interests).

would be considered a conflict of interest, and therefore a breach of the duty of loyalty.

However, deviations from profit goals for reasons of self-interest, under the guise of social responsibility, can also be subject to the *Unocal* reasonableness standard of review. In *Unocal*, the court held that due to concerns about corporate managers acting in their own interests in rejecting takeover bids, judicial examination at the threshold was required before decisions could be protected under the business judgment rule.<sup>221</sup> Specifically, it required corporate managers to demonstrate that they had reasonable grounds to believe that a danger to corporate policy existed and that measures taken to respond to the danger were reasonable in relation to the threat posed, by analyzing the nature of the takeover bid and its effect on the corporation.<sup>222</sup> Similarly, where issues of self-interest are implicated in corporate actions that deviate from profit goals, the reasonableness of the action taken can be scrutinized. Thus, corporate managers should demonstrate that the action was taken to promote the best interests of the corporation<sup>223</sup> and that the action taken was reasonable in light of the purpose sought to be achieved, by reference to the nature of the action and its effect on corporate constituents. Although the process, and not the substance of the action, would be reviewable on a reasonableness standard, the possibility of the review itself should deter at least some actions designed to promote corporate managers' self-interest under the guise of social responsibility. However, as tempering the duty to profit maximize does not alter the amount of discretion corporate managers already possess to engage in acts of self-interest, in the end, under this model agency costs are not increased.

#### CONCLUSION

Decades of debate have not been able to resolve the purpose of the corporation. Instead, the law offers only ambiguous, at times even contradictory, answers. In part, courts and law makers' inability, or refusal, to adopt a uniform position on the purpose of the corporation may reflect an agreement between the two opposing positions to ensure that the law can accommodate either position, as needed.<sup>224</sup> The ambiguities in

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221. See *Unocal*, 493 A.2d at 954 ("Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.").

222. *Id.* at 955.

223. For a discussion of what constitutes the best interest of the corporation, see *supra* Part III.A. and *supra* note 45.

224. See E. Norman Veasey, *Musings on the Dynamics of Corporate Governance Issues, Director Liability Concerns, Corporate Control Transactions, Ethics, and Federalism*, 152

corporate law may also have been allowed to persist due to society's lack of consensus on the meaning of social obligations which informs the discussion on the purpose of the corporation.<sup>225</sup>

In any case, as long as the debate remains open, corporate managers are afforded the discretion to pursue goals other than profit maximization. The need for such alternative goals is becoming increasingly more important. As Jensen has recognized, enlightened management cannot maximize the long-term value of a corporation by ignoring or mistreating any important corporate constituent.<sup>226</sup> Issues of social responsibility are thus integral to the long-term success of the corporation.<sup>227</sup>

The growing dominance of multinational corporations has also given greater importance to issues of social responsibility. Multinational corporations have become as integral as states in protecting and respecting the rights of individuals.<sup>228</sup> Yet in practice, operating in Warsaw or Wichita can make little difference to the repercussions of focusing corporate purpose solely on profits. In either environment, a narrow focus can result in harms to a corporation's non-shareholder corporate constituents and negate any unanticipated outcomes for its shareholders.<sup>229</sup> Action from within the corporate paradigm is thus as important as external regulation in addressing issues of social responsibility.

In the end, however, without an overriding duty to take into account issues of social responsibility, the decision to do so ultimately becomes a matter of choice for corporate managers. Still tethered to the presumption of profit maximization, liability risks and concerns about job retention will likely continue to pull them in the direction of profits. Only time will tell whether corporate managers will choose to break free from their tethers, when issues of social responsibility arise, to embrace the ambiguities in corporate law and choose responsibility over profit.

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U. PA. L. REV. 1007, 1015 (2003) ("Delaware does not slavishly embrace either [the property or the entity] model . . . . Maybe that is good-like a settlement where there are no clear-cut winners or losers.").

225. Allen, *supra* note 11, at 281.

226. Jensen, *supra* note 4, at 16.

227. See Ian Davis, What is the Business of Business?, MCKINSEY Q. 104 (2005). ("Social issues are not so much tangential to the business of business as fundamental to it. . . . Social issues have a significant effect on the long-term prospects of the corporation, and even if the effect of social pressures may not be immediate, it is poor strategy for companies to delay preparing for or tackling them.").

228. Ruggie Report, *supra* note 6.

229. Kerr, *supra* note 117, at 662.