



2002

## Never Trust a Corporation

William W. Bratton

*Georgetown University Law Center*, [wwb@law.georgetown.edu](mailto:wwb@law.georgetown.edu)

This paper can be downloaded free of charge from:  
<https://scholarship.law.georgetown.edu/facpub/49>

---

70 Geo. Wash. L. Rev. 867-874 (2002)

This open-access article is brought to you by the Georgetown Law Library. Posted with permission of the author.  
Follow this and additional works at: <https://scholarship.law.georgetown.edu/facpub>



Part of the [Business Organizations Law Commons](#)

# GEORGETOWN LAW

## Faculty Publications



January 2010

## Never Trust a Corporation

70 Geo. Wash. L. Rev. 867-874 (2002)

William Wilson Bratton

Professor of Law

Georgetown University Law Center

[wwb@law.georgetown.edu](mailto:wwb@law.georgetown.edu)

This paper can be downloaded without charge from:  
Scholarly Commons: <http://scholarship.law.georgetown.edu/facpub/49/>

Posted with permission of the author

# Never Trust a Corporation

William W. Bratton\*

I would like to start by noting multitudinous objections to assertions made in Larry Mitchell's *Corporate Irresponsibility: America's Newest Export*.<sup>1</sup> But I waive these points for purposes of this Symposium. I would prefer to take the occasion to celebrate the book. So I will make two points on the subject of corporate social responsibility on which the book and I stand in complete accord.

## I. *The Enduring Debate*

The first point is that corporate social responsibility is a problem that never goes away, whether from policy agendas in academic corporate law or in the wider economy and polity. So a book like *Corporate Irresponsibility* is always welcome even if it heralds no regulatory revolution. The book is particularly welcome at present, as we look back at the immediate past—an era in which the norm of shareholder value maximization was carried forth to the world as America's greatest gift to the global economy since mass production itself.

My second point is that corporations are inherently untrustworthy. *Corporate Irresponsibility* does an especially able job of teaching this lesson. The book describes the difference between human beings as moral actors and human beings as corporate actors, persuasively depicting corporate actors as otherwise responsible people who can become irresponsible as they go forth in pursuit of their firms' objectives. In the book's description, people leave behind the human exercises of choice and responsibility as they act out their corporate roles. Although we model corporations in law as constructed human beings and accord them the privilege to act as if they were human beings, they do not and cannot replicate our moral sentiments.<sup>2</sup> Thus, says the book, a corporation cannot commit to a relationship of trust in the same way as a human being. Nor should it be expected to replicate the actions of a good citizen.

Ultimately, these two points collapse into a single point. To see corporations as inherently untrustworthy is to see why corporate social responsibility is a policy problem that never goes away. Many of my generation view this subject as something people worried about in the 1970s, in days of Watergate witch-hunts and reflexive left-of-center political assumptions. Corporate social responsibility is remembered as a bubble of policy talk that grew and grew only to burst after 1980, when cold water was poured on all visionary schemes proposed in the public interest. But that 1970s attack on the corpo-

---

\* Samuel Tyler Research Professor of Law, The George Washington University Law School.

<sup>1</sup> LAWRENCE E. MITCHELL, *CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT* (2001).

<sup>2</sup> See *id.* at 41-48.

ration, though intense, was not a one-time-only event. It carried on a discussion that began as soon as corporate mass production's implications for society and the economy became clear at the turn of the last century.<sup>3</sup>

The main issues in the current debate were identified no later than 1932, when the *Harvard Law Review* published the famous Berle-Dodd debate.<sup>4</sup> The participants in this Symposium could remain here for an indefinite period debating the question whether something concrete can be done to make corporations more responsible, and I suspect that little more would be accomplished than a restatement of points made by Berle and Dodd. Dodd played the role that Larry Mitchell assumes in the book, arguing that management must be enabled to take moral responsibility.<sup>5</sup> Berle took what we now call the shareholder value position, arguing that fidelity to the shareholder interest imports the only feasible constraint on management empowerment.<sup>6</sup> Today's debates differ primarily in their extension to the global venue and a consequent increase in the stakes. But if, as seems likely, the present generation leaves the problem of corporate social responsibility unsolved, a subsequent generation will reinvent the discussion yet again.

## II. *Can a Corporation Act Responsibly?*

To develop further the assertion that corporations are inherently untrustworthy, I would like to interrogate a contrary possibility. Recall that visionary governance schemes designed to make management socially responsible encounter a standard dismissal: in a world with price competition, a stable equilibrium of responsible governance could never evolve because some firms would always give in to the temptation to defect and gain market share by saving the costs of responsibility. But need that be the case? Suppose we take the view that life is just one big Prisoners' Dilemma in which cooperation, if we can sustain it, makes us better off in the long run. Given this assumption, corporations in the long run arguably should find cooperation with their wider societies to be compatible with self-interest. If we take this point—that cooperation should be incentive compatible for a corporation—we can at least plausibly suggest that corporations could learn that cooperation with the society in which they operate lies in their long-term interest. Once thus instructed, corporations could become responsible actors in society, even as they remain purposive actors without the experience of moral sentiments.

The economist Robert Frank takes us a couple of steps in the direction of this vision of a responsible corporation. He suggests that socially responsible firms might indeed survive in a competitive environment. Responsibility, he argues, makes a firm better able to solve commitment problems amongst

---

<sup>3</sup> See, e.g., THORSTEN VEBLÉN, *THE THEORY OF BUSINESS ENTERPRISE* (1904) (pioneering work of institutional economics).

<sup>4</sup> 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).

<sup>5</sup> See Dodd, *supra* note 4, at 1153-54.

<sup>6</sup> See Berle, *supra* note 4, at 1367-68.

its shareholders, managers, and employees.<sup>7</sup> It improves customer relations.<sup>8</sup> It facilitates the recruitment of the best personnel.<sup>9</sup> It makes long-term cooperation with other firms easier to sustain.<sup>10</sup> Finally, a reputation for responsible behavior might even advantage a corporation in the product market.<sup>11</sup>

Frank clearly is right. Corporations have plenty of elbowroom in which to be responsible and may even collect significant financial rewards for so doing. Responsibility can be in a corporation's economic interests, and we should not be surprised when we see corporations acting responsibly.

### III. Corporations as Defectors

The greater point that the public may rely upon corporations to behave responsibly does not, however, follow from the lesser point that responsibility can be compatible with shareholder value enhancement. With corporations, responsible behavior is inevitably contingent on the total dispensation of circumstances. They always actively threaten to disappoint us. I would like to make a case for this assertion that parallels the case made in the book. My argument begins with Robert Frank's famous commitment model, a source on which the book also draws.<sup>12</sup>

Frank taught us that because human beings have feelings, they can sustain cooperation, unlike the economists' rational actors. In Frank's description, emotions lead us to act against self interest and thereby help us to stick to our commitments. Emotions make us more fit as relational counterparties. Given gains from cooperation, morally motivated actors will outperform the economists' rational actors.<sup>13</sup> Moreover, in order to construct a robust model of sustained cooperation over time, we will have to leave the rational actor out of the description and substitute cooperative actors in whom cultural training and behavioral predisposition interact to generate moral sentiments.<sup>14</sup>

Now, consider two other points offered by Frank. Frank observes that scale economies figure importantly in the emergence of cooperation: we cooperate because we must to get the cost benefits of production in large facilities.<sup>15</sup> Extending the point, even though firms are uncooperative actors, production in firms is an intensely cooperative phenomenon. When actors within firms cooperate, they develop cultures that distinguish sharply between inside and outside interests. The second point comes from the evolu-

---

7 Robert H. Frank, *Can Socially Responsible Firms Survive in a Competitive Environment?*, in *CODES OF CONDUCT: BEHAVIORAL RESEARCH INTO BUSINESS ETHICS* 86, 91-93 (David M. Messick & Ann E. Tenbrunsel eds., 1996).

8 *Id.* at 91.

9 *Id.* at 102.

10 *Id.* at 94-95.

11 *Id.* at 95-96.

12 MITCHELL, *supra* note 1, at 51.

13 See ROBERT H. FRANK, *PASSIONS WITHIN REASON: THE STRATEGIC ROLE OF THE EMOTIONS* 1-7 (1988).

14 See Robert H. Frank, *A Theory of Moral Sentiments*, in *BEYOND SELF INTEREST* 71, 73-77 (Jane T. Mansbridge ed., 1990).

15 *Id.* at 89-90.

tionary game theory in which Frank's commitment model is situated: cooperators and defectors can coexist and evolve together without either group disappearing over time.<sup>16</sup>

The two points, once juxtaposed with the commitment model, trigger the same question posed in *Corporate Irresponsibility*: in a model of evolutionary cooperation, is it ever safe to assume that players that happen to be corporations have the same cooperative make up as players who happen to be human beings? If emotion matters, as Frank and Mitchell both insist, then firms *are* different from people. When the circumstances indicate that the payoff requires rational action, a firm will be more likely to mimic the rational economic actor and defect. A firm is more likely to act rationally because it is unconstrained by moral sentiments encompassing the interests of actors on the outside. Not a human being, a firm cannot feel when it acts in the outside economy. It accordingly represents a constant threat to cooperative types.

The classic description of separated ownership and control in the large, publicly traded firm implies a similar warning. Separated ownership and control presents a governance problem because managers who own small equity stakes do not have the same incentive to be responsibly possessed by 100% property owners. In game theoretic terms, management operating under the separation of ownership and control receives different payoffs from a given action than the firm considered as a separate entity. Or in lawyerly terms, there is a conflict of interest. The vision of the corporation as a potential defector applies to both situations—where management pursues the overall firm interest and where management pursues its own interest. In either situation, the corporation will approximate a rational economic actor more closely than will most human beings.

Now, there are theories of the firm that might be deployed to refute this assertion. The personified “real” firm of the twentieth century's early decades was thought substantially to substitute for a real person.<sup>17</sup> Such a living, organizational organism conceivably could be a cooperator in Frank's sense. Unsurprisingly, that theory's proponents also advocated an expanded zone of freedom of action for firms. Trust the firms, they said; they are real, like you, and will make you better off. Later managerialists continued the “trust us” line even as the “real” firm lost its respectability under critique from social theorists and legal realists. Managers were people too, they said, and could be relied upon to do the statesmanlike thing if empowered.<sup>18</sup> The contemporary nexus of contracts theory of the firm approaches the problem of the firm's intrinsic tendency to defect from another angle. Here, we deny the firm's existence as an independent actor in the economy.<sup>19</sup> You deal not with a firm, which is a thought construct and legal fiction, but with other

---

<sup>16</sup> See *id.* at 82-87.

<sup>17</sup> For discussion of this theory, see William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 *STAN. L. REV.* 1471, 1489-91 (1989).

<sup>18</sup> See Dodd, *supra* note 4, at 1158-61.

<sup>19</sup> The base text is Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 *J. FIN. ECON.* 305, 310 (1976). Here, the firm is disaggregated into constituent contracts, each ultimately with a human being. Al-

human beings who may cause the legal fiction to defect or cooperate as the case may be. Look through to the people.

But the legal fiction's actions will not necessarily reflect the moral sentiments of its human agents. Let us say the firm's chief executive officer is a cooperative sort. Will not a firm led by a cooperative type be a cooperative entity? With Frank we must admit the possibility. The problem is that the firm may also be more ready to defect than would that same chief executive officer in the context of a personal relationship. The human being can act against interest and stick to a commitment without having to worry about a responsibility to maximize shareholder value, the well-being of other corporate constituents, or just the internal politics of the glass office tower.

The firm that wants to break a commitment transfers responsibility from the human actors who made the commitment to a reification, the thought construct that is the corporate entity. It thereby makes it possible for even cooperative human types to side-step the dictates of moral sentiments: "Well, there were competing concerns and I can't impose my feelings on the organization." Indeed, the invention of a vehicle free of immediate moral scruples must take place with cost reduction in an economic account of the firm's very existence.

Returning to Frank's commitment model, we see that not all human beings have the same commitment to cooperation. Some people are more likely to defect than others. We sort out one another when we make and seek commitments, laboring under an information asymmetry. In Frank's model, facial gestures and other tell-tale signals that are unique to people help cooperative types search among potential counterparties for other cooperative types. Obviously, such sorting also goes on when we deal with the agents of firms. But in the long run, there is a difference. Because the agents represent organizations with decisionmaking structures that may be beyond the dictates of any one actor, any long-term commitment must be deemed contingent unless backed by a triple-riveted contract enforceable by the might of the sovereign, or in the alternative, a mandatory regulatory regime.

As you go further down the hierarchical ladder in your interaction with the firm, whether as a supplier, customer, investor, employee, or member of a community, the firm with which you interact becomes less and less identifiable with a particular human being and more and more a construct of a public relations machine. This generalized firm will be a thought construct loudly committed to solicitude to your interests, personified with photos and graphics full of excited, committed, and grateful human beings. Firms project this image of commitment to mimic the human actors in the commitment model. But they never do this perfectly. That is why we should join Mitchell to retain a reservoir of healthy suspicion.

#### *IV. Reputational Constraints*

Speaking of public relations, what about reputational constraints? It is a truism of law and economics that repeat players worry about their reputa-

---

though the theory deploys rational actors, its insistence that the substance lies in bilateral transacting between human beings opens up a possibility for a turn to responsibility.

tions; the greater the value of an actor's reputation, the more reliable the actor will be as a counterparty. Reputational constraints do operate in this way, of course. Indeed, reputation may constrain a firm when it leaves unconstrained many an uncooperative human being. A large firm has a large public profile, and, like a politician, a correspondingly large vulnerability to bad publicity. This vulnerability constrains the firm, unlike a small-time human defector who can just walk away and move on to new victims.

But as Enron's collapse points out in no uncertain terms, reputational constraints on actors in firms are inadequate as security for performance. Firm cultures can become ingrown and demented, blinding actors in firms to their own long-term interests.<sup>20</sup> Furthermore, reputational concerns become substantially diluted when attention turns from performance with counterparties to corporate good citizenship.

Firms wishing to escape the reputational consequences of bad actions also have options that people do not. They can morph by selling their assets, merging, changing their name, or just repopulating and recreating themselves. The reinvention of self that is the unattainable ideal of the postmodern subject is easy for a firm. If some stub of Enron's business emerges from Chapter 11 to continue producing for the purpose of making payments to its legions of stiffed creditors, it will bear a new name and show a new logo. *Fidelion* seems like a good choice.

This should not be taken to say that firms always defect. Nor should it be taken to say that reputation does not matter. This should be taken as a warning: when you deal with a firm, as opposed to a human being, information asymmetries always will be bigger and moral controls always will be diluted. Given a firm's purposive decisionmaking system, it is more likely than an individual to behave like a rational economic actor.

## V. Evolutionary Survival

Where does this leave us, as consumers and workers living in a three-dimensional world where firms that are not sentient do most of the producing? Another model from evolutionary game theory helps answer this question.<sup>21</sup> It bids us to imagine a universe of cooperators and defectors who play Prisoners' Dilemma in a one-dimensional space.<sup>22</sup> They do not randomly interact in a vacuum. Instead, they occupy and are arranged in a long but finite row.

In this model, they play Prisoners' Dilemma with their immediate neighbors across generations. Everyone except the two players at the two ends of this very long row has two neighbors. The model shows that over time, like individuals will cluster along the row. To see why, imagine a segment occupied by defectors, then place a single cooperator into it. That cooperator will be eliminated. Similarly, isolated cooperators scattered in groups of two in defectors' spaces will be eliminated. But if you can get a colony of four con-

---

<sup>20</sup> On Enron, firm culture, and reputational constraints, see William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002).

<sup>21</sup> See BRIAN SKYRMS, *EVOLUTION OF THE SOCIAL CONTRACT* 58-61 (1996).

<sup>22</sup> *Id.* at 58.



tiguous cooperators together, cooperation will have a higher average fitness than defection within that segment. Over time, the numbers of cooperators will increase in the segment.

The defector who deals with the cooperator at the end of the segment of cooperators, however, will have a higher average fitness than that of the cooperators. Accordingly, the cooperators cannot grow so as ultimately to eliminate the defectors. The defectors will persist as predators on the periphery of communities of cooperators.

This image tells us something about the interrelations of corporations and people, with the qualification that corporations can enter into communities of cooperators, acting as cooperators and taking the benefits of cooperation. This can continue for extended periods of time. But later, if rationality signals defection, corporations move to the periphery.

By way of example, let me cite the implicit contracts that developed between firms and their long-term employees in the post-war period and persisted until the mid to late 1980s. Significant human capital contributions early in the employee's career with the firm triggered a quasi-entitlement to compensation in the form of long-term employment. These commitments were destroyed at many firms by defecting managers and shareholders. Thus, American corporations evolved from post war managerialism to the shareholder valuumism of the 1990s. The managerialist cooperator firms became defectors that adroitly moved from the midst of the human community to its periphery, there to step up their payoffs and enhance shareholder value.<sup>23</sup>

I believe we all intuitively grasp the point that corporations have a special propensity to defect, just as they also can have special reasons to cooperate. Note that such worries about defection come to bear even more squarely against governmental organizations, activating the many legal institutions addressed to limiting government power.

Having established this point of commonality, let us now contrast our treatment of questions of government responsibility with our treatment of questions of corporate responsibility. With government, affected constituencies get input through democratic processes. Not so with firms. Alternatively, with government, many argue that, all other things being equal, regulatory jurisdiction should be vested at the most junior, but feasible level. State and local regulatory jurisdiction supposedly keeps government more responsive to citizen preferences. Smaller is better unless you have a very good reason. Not so with firms.

Assuming continuation of the global trend toward concentration of production in the hands of a small number of multinationals, I accordingly would predict more and more dissatisfaction concerning the level of responsibility corporations take for the consequences of their actions. The Victorians had a

---

<sup>23</sup> These observations complement but do not replicate the Berle and Means point about the separation of ownership and control. See ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (rev. ed. 1991). To them, separation of ownership and control was a bad thing because it implied that management did not have the same incentive to be responsible as that possessed by a 100% property owner.

point when they said that big firms hold out intrinsic dangers to a free market republic.<sup>24</sup> A century ago, we waived this objection to take the benefits of scale economies. The resulting tension never goes away, even as the reproach against corporate power has lost its individualist coloration.

### VI. Darkening Clouds

Let me add one more point. Not only are firms more likely to act rationally than are human beings, they are, as rationalized collectives, adept at exploiting the collective action problems of others. Consider a statistic. All OECD countries have tended to decrease their corporate tax rates over the last two decades.<sup>25</sup> The average top corporate tax rate in OECD countries was 6 points lower at the end of the 1980s than it was at the beginning of the decade for a proportionate reduction of 12%.<sup>26</sup> The average top rate on interest income dropped 13 points for a proportional reduction of 25%.<sup>27</sup> Meanwhile, taxation on labor—on people—has gone up. In the EU, during a thirteen year period, tax rates on employed labor grew by one-fifth, while rates on capital decreased by one-tenth.<sup>28</sup> Doubtless these changes resulted in part from an ideological shift. Maybe firms wield influence better as well. And maybe they play a holdup game, bidding tax rates down by threatening to move their capital to a lower tax jurisdiction. Labor—people more tied to homes and communities than capital and therefore more committed to society—gets left holding the bag. Whatever the theoretical pluses and minuses of taxing capital, there is something wrong going on—something *irresponsible*.

This jump-shift to taxation lets me close with a reference to the Berle-Dodd debate. Berle thought that corporate responsibility was best handled through outside regulation. Today, public economic theory advances on that view, suggesting that regulatory goals should be accomplished with pinpoint Pigouvian taxes. Social ills should be remedied through government spending rather than through the imposition of exhaustive regulatory rule books. I believe these assertions to be sound, at least in theory. But the points ring hollow if firms can escape taxation in the first place by exploiting coordination problems.

---

<sup>24</sup> See JAMES WILLARD HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES: 1780-1970* 43, 45, 48, 55-57 (1970).

<sup>25</sup> See Jeremy Edwards & Michael Keene, *Tax Competition and Leviathan*, 40 *EUR. ECON. REV.* 113, 113-14 (1996).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> See William W. Bratton & Joseph A. McCahery, *Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation*, 38 *COMMON MKT. L. REV.* 677, 684 (2001).