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# Corporate Responsibility in a Free and Democratic Society

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# KEYNOTE ADDRESS

# CORPORATE RESPONSIBILITY IN A FREE AND DEMOCRATIC SOCIETY*

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There is a New Yorker cartoon by Leo Cullum that I like. It shows a board meeting, and the guy at the end of the table is laughing his head off. He looks like the chairman of the board. And he is talking: "I was just going to say 'Well, I don't make the rules.' But, of course, I *do* make the rules." [1] The cartoon illustrates the problem that occurs when people who exercise power do not recognize their own power—or they do not recognize the need to exercise it wisely.

But is it correct to say that corporate executives "make the rules"? One might argue that this is not the case. For example, one might believe that the law requires corporate executives to promote the interests of the shareholders by maximizing profits. Or one might argue the opposite—that the law requires corporate executives to further the interests of multiple stakeholders. It is true that the law does impose boundaries on the behavior of corporations (and their executives), so in that sense the managers do not "make the rules." But in another sense, it *is* true to say that managers and corporate boards of directors are in charge. The law does not mandate all actions of corporations: whatever boundaries it imposes on corporate

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[1] Leo Cullum, Cartoon, NEW YORKER, Jan. 6, 1986.

conduct, it leaves a wide range of choice about how to achieve corporate goals, as well as in defining what those goals should be. Even if we believe the law imposes a single goal (such as maximizing profits for shareholders), there is *always* more than one way to make money. And the business judgment rule insulates corporate executives from fear of liability when they exercise their judgment to attain legitimate corporate ends, no matter how they are defined.

The question, then, is how corporations should think about the range of choices they have. In particular, do they have any obligations to society, to the communities in which they operate, or to those with whom the corporation engages in cooperative relationships? Can corporate executives legitimately say "don't blame me, I don't make the rules" if they pursue profit for shareholders at the expense of all other goals?

It will help to consider some examples. Imagine: The president of a corporation fires thousands of workers and cuts the wages and benefits of those who remain. Corporate profits soar, and the board of directors rewards the president with millions of dollars in bonuses and a big raise in his salary. He cashes in on millions of dollars in stock options. Not a bad year for the president, considering that in 2007, the minimum wage workers in his company earned $5.85 an hour, or $12,168.00 for the whole year.

The corporation then asks the town in which its facilities are located for an exemption from local property taxes. The company expects to receive town services, such as police and fire protection and homeland security, and of course it needs workers who can read and write and do math, but it is not really interested in paying taxes to support those public benefits. The town objects, so the corporation threatens to move its factory to a town in another state that has already offered to exempt the company from local property taxes for twenty-five years. The town gives in because it needs the jobs. Another plus for the bottom line.

Then the company seeks to expand its facilities but thirty-five homes are in the way. Some of those owners have refused to sell. So the corporation asks the town to take the homes by eminent domain. The town designates the area as blighted, opening the way for eminent domain proceedings. The company then needs the town to rezone the land from residential to commercial purposes, and, once again, the town goes along because, well, what can you expect? The town needs the jobs; it needs the company. Then the company lobbies the state legislature to oppose new pollution regulations. And so on.

Each of these acts by the corporation is understandable; indeed, they are perfectly rational. Each choice promotes the bottom line, at least in the short run. Good for the stockholders, right? And don't corporations exist to make money for shareholders? Moreover, in each case, we see the free market at work; the corporation is exercising its bargaining power to get the best deal it can from others with whom it is engaged in long term relationships. Is this not how the free market works? Are not each of us free to do the best we can for ourselves, given our circumstances?[2] The corporation is using its property as it wishes and entering contracts that maximize its welfare. What is there to complain about?

At the same time, on hearing these stories, many of us feel nagging doubts. Why is that? I think there are two reasons. First, in each case, the corporation pursues profit at the expense of others. In our system, we are free to live our lives as we please; each of us has the freedom to pursue happiness. Yet our free actions become problematic when they impose costs on others. A free society does not entitle us to ignore the interests of others. My freedom to move my fist ends at your chin. Freedom must be curtailed to protect the freedoms of others. As John Locke explained, there is no liberty without law.[3]

Second, in each of my examples, the corporation appears to violate basic principles of morality. Cutting wages of people earning barely enough to survive, while accepting a salary fit for a king, betrays a certain, shall we say, moral obtuseness. So does polluting the environment, using public services without paying for them, and taking people's homes to build a parking lot.[4]

Now it is true that we have different moral codes that apply to different spheres of social life. The morality of the market is not the same as the morality of the family. Competitors put each other out of business while family members look out for each other. Consumers try to get goods as cheaply as possible while being generous in their gifts to charitable organizations. Businesses try to cut costs while governments spend money on basic infrastructure.

We should recognize that the morality of the market is not the same as the morality of the family, the community, or of social life generally. At the same time, it is also true that the market has a moral code. Through both custom and law, our market system reconciles the

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[2] Alan Schwartz, *Justice and the Law of Contracts: A Case for the Traditional Approach*, 9 HARV. J.L. & PUB. POL'Y 107, 107 (1986).

[3] "[W]here there is no law there is no freedom." JOHN LOCKE, 2 TWO TREATISES OF GOVERNMENT 305 (Peter Laslett ed., Cambridge Univ. Press, 1988) (1690).

[4] *See* Casino Reinvestment Dev. Auth. v. Banin, 727 A.2d 102 (N.J. 1998).

pursuit of self-interest with the promotion of the public welfare by limiting our freedom of action to protect the legitimate interests of others. Corporations may be in the business of maximizing profits, but they are not and should not be in the business of undermining the social fabric by ignoring applicable law and legitimate moral limits on their conduct. A corporation that fails to consider the impact of its activity on society and on those with whom it forms collaborative arrangements will undermine the conditions that make profit maximizing possible. More importantly, it will undermine the social norms that underlie our way of life. We live in a free and democratic society, and, although we will never have complete agreement on what that means, we are likely to agree on what it does not mean. I want to argue that it means at least these things: that opportunity must be equal, that power must be dispersed, that wealth must be attainable, that inequality must be limited, that individuals must be treated with dignity, and that market relationships must comply with minimum standards compatible with the contours of a free and democratic society.[5] While we may disagree about the parameters of each of the items on this list, I believe I can demonstrate that each of us does believe in each of these norms in some form. At any rate, each of them does receive substantial expression both in social custom and in legal regulations.

But you would not think so if you listen to academics who argue that corporations have no social obligations at all. There is a view—a very prevalent view—that corporations have only one obligation and that is to maximize profits within the bounds of the law. They are obligated, in other words, to act like Holmes's bad man. Not only are they interested in knowing what they can get away with, they are—and should be—intent on getting away with it.

What could possibly justify this view? This view is plausible only because it makes two problematic assumptions: first, that corporations are free to pursue wealth by any means as long as they comply with existing regulatory requirements that are likely to be imposed on them; second, even if those laws are imperfect, we need not worry because we can expect the invisible hand of the market to adequately protect both individuals and social interests.

Both these assumptions are based on a fundamental conception of property. Think about a home owner; she owns a single family home

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[5] Joseph William Singer, *Things that We Would Like to Take for Granted: Minimum Standards for the Legal Framework of a Free and Democratic Society*, 2 HARV. L. & POL'Y REV. 139 (2008).

on a quarter acre of land. The law clearly defines the borders between her property and that of others, and in so doing defines the realm of her freedom. She can do what she likes within the borders of her land, and she has the absolute power to exclude others. Conversely, she is not free to enter or use the property of others without their consent. Duncan Kennedy calls this the model of "powers absolute within their spheres."[6] Rigid boundaries determine the areas within which one is free to act, just as the law determines what one cannot do; whatever is not prohibited is allowed. Add the assumption that all individuals have equal rights, that property ownership is widely (if not universally) dispersed, and we can conclude that each person has free access to the means necessary to participate in economic life. If this is true, then we need not worry that individuals or corporations are free to act in a self-interested manner, without regard to the needs, wants, desires, or dreams of others. An economic system shaped by fair legal rules should work to spread opportunity around to everyone. On this view, the invisible hand is a reality, not a dream.

If this view is correct, it provides corporate executives with the luxury of indifference. They need not feel bad about firing workers, polluting the environment, displacing small businesses and homeowners, or receiving government subsidies. There is no need to think about or worry about the external costs of corporate activity. As long as one does not invade the boundaries of others as defined by law, one is free to use one's liberty and property as one sees fit, and one is free to make whatever contracts one wishes. This is the American way.

I want to argue that the two assumptions on which this paradigm rests are false. If I am right about this, then this way of thinking about the role of corporations in society is inaccurate and misleading. It reflects neither our existing legal system nor basic principles of law, morality, or social justice. The idea that corporations can or should pursue profit in any way and at any cost is a malign distortion of both law and morality.

Consider the first assumption—that individuals are free to do what they please as long as they stay within the bounds of clearly defined legal limits. This assumption contradicts basic principles of our legal system. The law governing the market system depends on background rules of contract, tort, and property law taught in the first year of law school. What are the principles underlying those areas of law? Do

[6] Duncan Kennedy, *Toward an Historical Understanding of Legal Consciousness: The Case of Classical Legal Thought, 1850-1940*, 3 RES. IN L. & SOC. 3 (1980).

they in fact stand for the proposition that, as long as one does not violate any statutory or administrative regulations, that one is free to ignore the legitimate interests of others?

The answer is a resounding no. Although we are free to live our lives by our own lights, tort law is founded on the basic principle that we have an obligation to act reasonably. This obligation is most centrally established by the law of negligence, and it requires us to temper our self-interest by attending to the needs of others. We are required to abide by clear statutory and regulatory limitations on our freedom. But we are also under a continuing duty not to act negligently; we are not free to act unreasonably so as to cause significant harm to others. We are not free to ignore the interests of others as we go about our daily lives; indeed, we have a basic obligation to consider the ways in which our actions affect others. And not only do we have a duty to consider the effects of our actions on others, but we have an obligation to balance their interests against our own to determine whether we can justify the harm we may cause them. Can we explain to a neutral third party why we acted as we did? Can we explain to those who suffer the consequences of our actions why they suffered a tragedy but not an injustice?

Tort law is based on the fundamental notion that no one is an island and that we should do unto others as we would have them do unto us. Of course, the law cannot prohibit all harms; we would have no liberty at all if the law micromanaged our every action. The law of negligence does not turn all immoral actions into legal wrongs; we value autonomy and dignity too much to turn government into Big Brother. But the law does prohibit actions that create an unreasonable risk of harm when the harm is of a type or amount that we should not have to bear for the good of society, at least in the absence of compensation.

Perhaps surprisingly, contract law has a similar moral valence. We live in a free market system and we are entitled to pursue our own interests, to make money, to amass wealth, to profit from business opportunities created by our own labor and ingenuity. But we are not free to ignore the interests of others with whom we engage in cooperative ventures. For one thing, all contracts are regulated by the state; those regulations impose minimum standards on all contractual relationships to ensure that they comply with basic norms of fairness. Think about the major contracts we are likely to enter into in our lives: getting a job, buying a house, getting married, buying insurance, buying consumer goods, borrowing money. Each of these contracts is heavily regulated by state and federal statutes and

regulations designed to ensure that the terms of the contracts comply with minimum standards. Those standards are designed to ensure that we get what we think we are paying for, but they are also designed to ensure that we get a certain minimum package of rights and benefits from each of those contractual relationships.

Nor are we free to do as we please once we comply with those regulatory limits. Our system of freedom of contract does not entitle us to engage in fraud or to cheat our contracting partners out of bargained-for benefits. All contracting partners are subject to fundamental obligations to refrain from dishonest conduct. The common law of fraud prohibits market actors from duping others into parting with their money by false pretences or misleading assertions. While shareholders are protected from fraud to a much greater extent than are workers,[7] the principle is fundamental that it is both wrong and illegal to take money from someone else under false pretences. For this reason, all contracts are subject to a fundamental principle that requires us to carry out our obligations in good faith. We have a common law and moral duty to do what it appears we promised to do, not to slither out of contractual obligations by finding clever loopholes in the fine print in the language of the agreement. The duty of good faith requires us to consider how our promises will be understood by our contracting partners. We are required to look out, not only for our own interests, but the interests of others with whom we have ongoing dealings. Contract law requires us to understand how others see the deal and to act accordingly. Like the negligence principle in tort law, contract law embodies a version of the Golden Rule.

Finally, property law also contains other-regarding obligations. Contrary to the idea that owners have absolute rights within the borders of their property, the law of nuisance prohibits land owners from using their own property in ways that unreasonably interfere with the use and enjoyment of neighboring land. Although we are free to act within the borders of our land, we are obligated to attend to the effects our actions will have on others and to refrain from acts that will cause unreasonable harm. Once again, we are not allowed to consider our own interests alone; we are required to think of the effects of exercising our property rights on both the personal and property rights of others.

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[7] *See* Kent Greenfield, *The Unjustified Absence of Federal Fraud Protection in the Labor Market*, 107 YALE L.J. 715 (1997).

In addition, property law shapes the contours of allowable ownership entitlements in a manner that is attentive to the systemic effects of property rights. Various principles of law (such as the rules regulating the estates systems, servitudes, leaseholds, and marital property) limit the packages of property rights we are entitled to create. They do so to ensure that ownership structures are compatible with the institutional framework of a free and democratic society that treats each person with equal concern and respect. Property is not only an individual right but a social and economic system. If there were no limits on property rights, we could create packages of rights that would violate norms underlying our way of life. We have abolished feudalism, slavery, the rights of husbands to control the property of their wives, racial segregation, religious establishment, economic monopolies. Traditional common law rules of property, combined with statutory regulations, ensure that property rights are structured so as to promote widespread ownership of property, as well as norms of autonomy, privacy, associational freedom, and equality. The law of property is not indifferent to the effects of exercising property rights nor on the structure of those rights themselves. Indeed, core principles of property law seek to ensure that our market system spreads opportunity, prevents harm, and demonstrates respect for the interests of all participants in the system.

All the basic areas of law governing the market system, including tort, contract, and property law, rest on the idea that we are obligated to attend to the effects our actions have on others; this *obligation of attentiveness* applies not only to the interests of strangers, but to those with whom we form continuing market relationships, and those with whom we fashion other relationships of trust.

Debates about corporate responsibility often focus on amorphous claims about corporate duties to society, resulting in the worry that corporations cannot comply with such vague obligations. What these debates ignore is that the law of the market itself already requires market actors to attend to the interests of others. The law does so partly by creating clear limits through statutes and regulations, but *it also does so through pervasive and fundamental common law duties to act reasonably.* Our system refuses to grant individuals (including corporate executives) blanket immunity from the duty to consider the interests of others, as well as our own interests. General standards of reasonableness embodied in the rules of negligence, nuisance, fraud, good faith, and property law require individual actors to consider how their actions will effect others and then to imagine how they would justify their actions to a neutral third party. And that task itself

requires considering how one would justify one's actions to the victims of one's conduct.

Of course, we would rather think of ourselves alone and ignore the interest of others. Sometimes we see actors justifying their actions by reference to legality. "What we did was perfectly legal," they might say, suggesting that legality implies morality. This would be true if the existing statutory and regulatory rules worked perfectly to prevent unreasonable, harmful actions. But it is obvious that our laws do not work perfectly in that regard. Indeed, the impossibility of such perfection is why the law of the market holds individuals to a standard of reasonableness.

It is true that clear rules have many advantages. They appear to promote both fairness and efficiency. Clear rules seem fair because they define what our rights and obligations are, they prevent unfair surprise, they protect justified expectations, and they ensure that like cases are treated alike. Clear rules seem efficient because they reduce the costs of determining who owns various resources and they facilitate bargaining. But clear rules also have distinct disadvantages, on both fairness and efficiency grounds. Clear rules allow the bad person to walk the line, engaging in behavior that is socially destructive, while standards promote greater care by forcing actors to consider whether they can justify their conduct to a neutral third party.

Flexible standards, in contrast, allow the decision maker to find that the actor did not live up to expected standards of conduct. Conversely, they allow the decision maker to approve of conduct whose effects seem reasonable both to society as a whole and to those who suffer the ill effects of the defendant's actions. Of course, we want clear rules to give us guidelines about what we are and are not allowed to do. But *we also want a fuzzy edge of substantive standards* to induce us to think before we act—to be *attentive to the ways in which our actions affect others.* Such fuzzy edges create appropriate incentives to think about the effects of one's actions on others and to consider the judgments that others would make about the justice or appropriateness of our own conduct, given the impact it will have on others who, after all, have equal rights. And we care so much about this that we have enshrined it in the basic law governing the market system.

Attentiveness is not only good for others; it is good for ourselves. Corporations and corporate executives get in trouble when they ignore this principle. When we find loopholes that skirt the edge of the law, there is always the chance that others will find that we

slipped over the boundary. If it looked too good to be true, it probably was.

I have argued that it is not true that corporations are free to do whatever they please as long as they comply with existing regulatory requirements. The common law requires them to attend to the effects of their actions on others and to engage in mature judgment about whether their actions can be justified to a neutral observer if it came to that.

I want to conclude by arguing that the second assumption underlying the profit maximization norm is as wrong as the first. That assumption is even if our regulatory laws are imperfect, we need not worry because we can expect the invisible hand of the market to adequately protect both individuals and social interests. This assumption is demonstrably incorrect. Our system has not worked adequately to prevent corporations from defrauding their shareholders; it has not adequately aligned the profit motive with the motive of protecting the environment; it has not worked well enough to ensure equal opportunity for all. Corporations cannot fulfill their fiduciary obligations unless they ensure that the business and social environment in which they operate is stable, that the rule of law is promoted, and that both power and opportunity are dispersed and balanced.

Scholars have long debated whether corporations should focus solely on maximizing profits for shareholders or should also promote the interests of workers, creditors, communities, and society as a whole. One major worry is that social responsibilities will be too difficult for corporations to manage. How do they balance the interests of shareholders against the interests of others? A second worry is that social responsibility gives executives ready excuses to put their own interests above the interests of everyone else and then justify it as in the long run interest of some corporate constituency or other. I submit that both of these worries are overblown. My invocation of the common law of tort, contract, and property shows why. Our legal system has always figured out ways to limit the relentless pursuit of self-interest (otherwise known as profit) to ensure protection of the rights of others as well as the general welfare. The law sometimes accomplishes these ends by placing substantive limits on what actors can do—and those actors include corporations. At other times, our legal system creates procedural mechanisms or institutional frameworks to provide checks and balances to limit actors who impose externalities on others, especially when those

externalities endanger the infrastructure of a free and democratic society.

Do corporations have obligations to society? The question is a no-brainer. Max Barry answered this question in a funny, satiric novel called *Jennifer Government*.[8] The story takes place in a future time when government has been privatized and the free market set loose. Laws are enforced only if one is willing and able to pay to enforce them, and corporations feel entitled to pursue any ends by any means if they can get away with it. Inevitably, what began as economic competition degenerates into open warfare. Thomas Hobbes told us that in the state of nature, life was "solitary, poore, nasty, brutish, and short."[9] We would do well to remember this.

This does not mean that corporations can never fire workers or seek tax exemptions. It does not mean that they cannot seek to minimize costs. It does mean that corporations do not have a blanket immunity from the normal obligations all of us have in our day-to-day interactions with others. It also means that corporations cannot justify self-aggrandizing acts unless the economic and legal system adequately cabins harmful externalities and spreads opportunity and prosperity in a defensible manner. An executive can feel comfortable with layoffs only if the economy is working well enough to create other jobs for those whose interests are sacrificed to increase corporate profits. And executive salaries can be justified only if employees are being adequately compensated for their labor and the benefits of corporate activity are fairly shared among all those who contribute to the success of the entity.

When executives go home and tell their children "I had a good day today," they should be able to mean it. They should be able to say I made money, and I did the right thing. But they will only be able to say this if our institutions spread opportunity and if those executives have in fact acted like grown-ups and not like spoiled children. Like children, they need to learn to play well with others. The market cannot exist without the support of regulations, laws, and institutions that comprise the necessary infrastructure of our free and democratic society. If this is so, then corporations should support, rather than oppose, legal and political and economic reforms that shore up this infrastructure. And, as I have shown, the law of our market system rests on the fundamental principle that we must be attentive to the

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[8] MAX BARRY, JENNIFER GOVERNMENT (Doubleday 2003).

[9] THOMAS HOBBES, THE LEVIATHAN 186 (C B. MacPherson ed., Penguin Books 1968) (1651).

effects our actions have on others and to consider whether our actions are reasonable. That principle requires us to engage in moral reasoning and to exercise practical wisdom. Those who run corporations are not immune from this fundamental responsibility.