Hastings Law Journal

Volume 30 | Issue 5 Article 1

1-1979

Foreword to the Corporate Social Resposibility Symposium: Reflections on Directions

William L. Cary

Harvey J. Goldschmid

Foreward to the Corporate Social Responsibility Symposium: Reflections on Directions

By William L. Cary*
Harvey J. Goldschmid**

General Observations

Historically, the states have played the central role in shaping the law as to the governance of business corporations. During the first years of the nineteenth century, states granted special franchises to corporations that limited their size, duration, and management prerogatives. Later, under the aegis of terms like "liberal," "modern," and "enabling," Delaware led a movement among the states that resulted in law that was, by a near-consensus view, highly permissive.[1]

The regulation of corporations was not, of course, left entirely to the states. In selected areas of national concern, the federal government imposed effective external controls on corporations. The Sherman Act, in 1890, began the federalization of antitrust, and waves of Congressional enactments, particularly in the 1930s and 1960s, imposed federal strictures in a wide array of fields.

Within the past five years, however, reformers have increasingly questioned the efficacy of our "enabling-regulatory" mix. As the rich citations *infra* of Professor Epstein and Mr. Small demonstrate, questions about the power, efficiency, social responsibility, and accountability of large modern corporations have been raised with accelerating frequency and intensity.

---

* Dwight Professor of Law, Columbia University. B.A., 1931, LL.B., 1934 Yale; M.B.A. 1938, Harvard University; LL.D., 1965, Amherst College.

** Professor of Law, Columbia University. B.A., 1962, J.D., 1965, Columbia University.

1. For our views on this permissiveness, see, *e.g.*, Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974); Goldschmid, *The Greening of the Board Room: Reflections on Corporate Responsibility*, 10 COLUM. J.L. & SOC. PROB. 17 (1973).

The questions posed in this symposium are timely indeed. As this issue goes to press, these questions are the subject of study (or proposed study) by, for example, the Congress, the American Law Institute, the American Bar Association, the SEC, and the FTC. Moreover, the states and many corporations have shown a willingness to consider thoughtful criticism. Recent state cases dealing with fiduciary standards have, for example, noticeably tightened the law[2]; there is considerable voluntary experimentation by corporations in the governance area.

The editors of *The Hastings Law Journal* have wisely added three unusual features to this symposium. First, they have made it an interdisciplinary endeavor; several of the principal writers (*e.g.*, Professors Epstein and Jones and Dr. Hessen) draw their inspirations from sources outside the law. Second, the format of lead articles followed by short essays of comment helps both to sharpen issues and to provide balance. Finally, there is a lively mixture of American pragmatism and European conceptualism represented in the lead articles.

In Europe, for example, "corporate personality" is widely discussed, but here, whether or not to disregard the corporate form or "pierce the corporate veil" is approached in pragmatic rather than theoretical terms. Judicial decisions turn on facts and context: Have corporate funds and functions been intermingled? Has the corporation been too thinly capitalized? Are we dealing in contract (where trade creditors may protect themselves) or tort? In the end, the basic inquiry turns on whether "piercing the corporate veil" would prevent fraud or, taking account of countervailing considerations such as the encouragement of capital formation and the enhancement of certainty, be equitable and fair.

Similarly, American law does not take seriously long, theoretical discussions of the concession theory and whether the corporation is a creature of the state. We ignore history in this regard and assume the corporation is here to stay. When considering new corporate regulation, we ask whether governmental intervention will be socially beneficial in the long run. If on balance new legislation is thought desirable, Congressional powers under the Commerce Clause or similar constitutional provisions or state "police power" interpretations—not concession rationales—provide the basis for the enactment. In the words of

2. *See, e.g.*, Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977); Tanzer v. International Industries, Inc., 379 A.2d 1121 (Del. 1977); *Jones v. H.F. Ahmanson & Co.* 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969) (en banc).

Professor Willard F. Mueller, "[m]ost Americans seem to have forgotton that business corporations are created and survive only as a special privilege of the state";[3] we concur in this interpretation.

Thus, because Americans tend to conceptualize the problems of the corporation and corporate laws less than our European friends, it is refreshing to have a volume that comprehensively reviews European developments. In terms of pragmatic American reform approaches, this volume demonstrates that there is both much common ground and some real diversity. Set forth below are what we consider to be basic tenets of most current American corporate reform thinking:

1. Most reform proposals remain free-market oriented. While most proposals would require new legislation, they do *not* take ownership or control of our major corporations out of private hands. In contrast to much European debate, corporate reformers here do not generally propose more government ownership, broad national planning or other fundamental change. Socialism does not have a large following in the United States. While proposals such as the Humphrey-Javits Balanced Growth and Economic Planning Act surface periodically, most Americans appear to agree with France's President Giscard d'Estaing who reportedly described his country's relatively unhappy experience with planning as the simple "substit[ution of] error for chance."[4]

2. Most reformers purport to be acting in the interest of keeping the corporation an effective economic entity. For example, although consumer advocates and environmentalists often speak about "taking additional considerations into account" beyond corporate profitability, Professor Schwartz *infra* and other leading reformers accept the goal of long-term profit maximization (within the law) as an adequate description of corporate objectives. The main point, we think, that Professors Epstein and Schwartz are making herein is that what is socially desirable is *not necessarily* inconsistent—indeed, may be quite consistent—with long-term corporate profitability. They are each concerned about developing an internal corporate "process" for sensitively harmonizing societal concerns and long-term profitability.

3. Most reformers share with us a concern about creating a large, new federal bureaucracy. A premise of the original proposal for a fed-

3. N.Y. Times, Oct. 31, 1971, at 63, col. 1.

4. H. GOLDSCHMID, BUSINESS DISCLOSURE: GOVERNMENT'S NEED TO KNOW 201 (1979). For a comprehensive discussion of planning proposals for the United States and a review of the French experience, see *id.* at 201-61.

eral minimum-standards act was that the SEC would play no new role and no new bureaucracy would be created.

4. Most proposals retain and, within the limit of what is practicable, try to enhance the role of shareholders. Shareholders remain the basic risk-takers (*e.g.*, as holders of Penn Central discovered) in the corporate system. Facile assertions during the 1950s and 1960s about refinancing through self-generating funds have now been replaced by fears of a capital shortage. On a pragmatic level, shareholders also represent the best constituency for counterbalancing management power, and they are free of many of the personal or career conflicts (*e.g.*, when a hostile tender offer is made) associated with corporate managers. In addition, many reform proposals would heighten the duties of loyalty running to shareholders from directors, officers, and controlling shareholders.

5. While, as Mr. Small indicates, proposals to reform the board of directors are diverse and sometimes quite inconsistent, almost all share a sense that there is need to strengthen the governance role of directors and to provide an independent, ongoing check of corporate managers.

6. Finally, many proponents of corporate law reform advocate new federal legislation. For example, the following statement was endorsed by eighty corporation law professors from sixty-two different institutions:

> [W]e are in general agreement that state corporation statutes and case law have suffered over the years from what . . . has [been] called a "race to the bottom," and that as a consequence they no longer serve to guide and regulate the activity of large corporations and their managers . . . . [T]here is a particular urgency at this time for the Congress to consider some form of federal intervention in this area, whether through the means of a federal chartering statute, through federal "minimum standards" for state corporation laws, or some other mechanism.[5]

For the most part, in short, and certainly for the American writers gathered in this Symposium, the modern corporate social responsibility debate is not about radical solutions. Our spectrum of views is not wide when judged by European standards.

Reflections on the Symposium and on Reform Directions

The first Article in the symposium is by Professor Thomas M.

5. *Hearings on Corporate Rights and Reasponsibilities before the Senate Comm. on Commerce*, 94th Cong., 2d Sess. 343-44 (1976).

Jones, of the School of Business Administration of the University of Washington, and because it is the only piece without an accompanying commentary, we will discuss it at some length. Focusing upon the 1932 Berle and Means hypothesis concerning the divorce of management from control, Professor Jones analyzes the premise thoroughly before agreeing with it. He cites the work of Robert Larner in 1966 and devotes much of his paper to attacking Morris Zeitlin's critique of the Berle and Means thesis in the *American Journal of Sociology*. Professor Jones finds that the Zeitlin structural analysis has not shaken the Berle and Means approach and that massive research would be necessary for behavioral analysis to investigate more deeply.

One point is made in Professor Jones' article that cannot be overemphasized, namely, the difference between retaining existing control and newly securing it. Unless there is some traumatic change in the business or unless an outside party, typically a corporation with great resources, attempts to make a tender offer, continuation of control in an existing group (presumably management) is almost inevitable. Furthermore, when we are talking about "control" it should be recognized that a takeover bid, as distinguished from a proxy context, is initiated typically by an outsider and not a long-standing shareholder.

It is true that Professor Melvin A. Eisenberg, in *The Structure of the Corporation*,[6] points to substantial data showing the continued presence of a significant degree of concentration of stockholding even in the very largest companies. At the same time, Professor Jones concludes that although wealthy individuals and institutions do still hold large blocks of stock in major companies, this could be an attempt to diversify their portfolios or stabilize their incomes rather than a coordinated macro-control mechanism.

Professor Jones believes that the role of law in establishing the relative power of shareholders and management has been ignored by social scientists and that careful analysis of existing law and changes in it probably can tell us more about corporate control than can further studies of shares ownership. Thus, a nonlawyer in the field of business administration throws us back into the law in determining the sources of control.

In conclusion, Professor Jones might agree that the empirical issue of control is still an open one, but he would reject as inadequate Zeitlin's remedy for closing the gap—a comprehensive structural analysis.

6. M. EISENBERG, THE STRUCTURE OF THE CORPORATION 45-51 (1976).

He argues that given the inherent advantage held by an incumbent management, any ownership position of less than ten percent, held by an insurgent group, is a relatively trivial factor in a proxy fight. He persuasively suggests that despite the fact that shareholders have voting power, which ultimately could be dispositive in corporate control struggles, they lack both the incentive and other political resources seriously to threaten management hegemony. Further, he believes that stockholders rarely overcome their lack of cohesiveness because management has sufficient resources including time, information, legal advantage, and the financial and organizational strength of the firm itself to effectively neutralize potential aggregate shareholder power. Thus, he identifies the locus of corporate power back in the management; we find it hard to disagree.

In the second Article, Professor Edwin M. Epstein, of Berkeley's School of Business Administration, properly recognizes that debates about corporate responsibility and governance are primarily focused on the "megacorporation." Although there are approximately 2,000,000 corporations in the United States, something more than sixty percent of the nation's manufacturing wealth is owned by the largest 200; in 1977, the 500 largest industrial corporations listed by *Fortune* magazine employed approximately 15,000,000 people.[7] Professor Epstein seems to believe that corporate critics are talking about roughly 1,000-4,000 corporations. This may be a bit too restrictive. For many issues (*e.g.*, new fiduciary standards), it may be helpful to think in terms of the 10,000-15,000 corporations covered by the American Law Institute's proposed Federal Securities Code.

Professor Epstein wisely draws an analytical distinction between "internal" questions (*e.g.*, corporate governance and legitimacy issues) and "external" questions (*i.e.*, the corporation's obligation to other sectors of society). He observes that corporate social responsibilty issues are often value-laden and dynamic. He makes a substantial contribution by, in effect, urging corporate reformers to focus on developing a "process" whereby "management anticipates and takes account of, to the fullest extent possible, the total ramifications—economic and noneconomic—of its decisions."

In urging attention to "total ramifications," Professor Epstein is not rejecting the traditional corporate goal of long-term profitability.

7. *Hearings on The Merger Act of 1979 before the Senate Comm. on the Judiciary*, 96th Cong., 1st Sess. (1979) (unpublished statement of Alfred F. Dougherty, Jr., Director of the Bureau of Competition, FTC).

He is simply recognizing, as we read him, that the large modern corporation must respond effectively to societal demands if it is to retain its capacity to produce goods and services efficiently. Epstein does not ascribe to what Professor Conard, his commentator, terms the "reallocation" theory of corporate resonsibility. Conard indicates that a "reallocation" theory would require "radical change in the composition of governing boards"; investor representatives, employees, consumers, and environmentalists would "presumably trade off their respective interests, perhaps in the same way that senators from Maine and Arizona trade off reclamation expenditures for harbor improvements."

We question whether there is much to be gained by bringing the real tensions that should exist, for example, between management and labor, into the board room. Do we really want either side to bargain less hard? Even if a practical way were found to provide consumers, environmentalists, and others with board representation, what costs would be involved in having corporations—without legislative guidance—reconcile tensions among competing economic, social, and political goals? Long-term profit maximization is, of course, a malleable concept. Do we want to move away from it and give corporate decisionmakers even wider discretion?

We should hesitate to ask corporations—economic institutions that by and large serve us well—to carry too much baggage. What is so persuasive about Professor Epstein's "process" point is that it accepts the profitability concept and only urges that it be applied with subtlety, a long-term perspective, and care.

Marshall Small's piece is a lawyer's delight. While it may be easy to quibble with one conclusion or another, in general we agree with commentator Schwartz as to the high order of Small's "wisdom, practical advice, and first-rate scholarship."

Small provides a comprehensive review of the "evolving role of the director in corporate governance." He effectively covers the trends toward nonmanagement directors, the increased use of board committees, and significant due diligence requirements for individual directors. As to the long-term profit-maximization standard, he concludes that in the "usual case the long-term interests of the enterprise will be consistent with the interests of . . . other constituencies." In cases of real conflict, Small finds that the long-term interests of the owners must prevail.

Small has a deep and perceptive discussion of what responsibilities directors can reasonably be expected to assume. Until recently (when "under the direction of" was inserted into many corporation laws), most state corporation laws absolutely and majestically commanded that "the business of a corporation shall be managed by its board of directors." But, as numerous scholars have documented, there was a considerable gap between myth and reality as to the role played by the board. The law's expectations, taken literally, were too high; the performances of many directors, especially prior to the securities law explosion of the late 1960s and early 1970s, were abysmally low. Mr. Small's outline of a modern director's duties provides sensible balance. A careful reading of his discussion will be richly rewarded.

Dr. Hessen's article on the concession theory (and his advocacy of a "private property model") has a quaint eighteenth century ring. Dr. Hessen seems to ask: What is wrong with providing corporate managers with absolute freedom from legal restrictions? The essence of capitalism, he argues, is the "inviolability of individual rights, including the right to use or invest wealth as one chooses and the right to associate with others for any purpose and under any mutually acceptable terms of association." As to problems created by management power, Dr. Hessen responds: "Ownership without control is not an evil if the owners freely consent to that relationship."

Not even Adam Smith would be as bold as Dr. Hessen. Smith, for example, would have punished antitrust violations such as conspiracies to raise price. In modern terms, is it really debatable whether the right to associate for "any purpose" may properly be restricted by antritrust and other trade regulation rules, criminal laws, health and safety concerns, or whatever other measures legislatures enact for sound public purposes?

As to the argument that providing corporate managers with freedom from legal restrictions is acceptable because shareholders are consenting adults, we simply question Dr. Hessen's assumption. Shareholders of our largest corporations do not negotiate arm's-length "bargains" with management. If the law does not intervene to establish basic fiduciary and governance "rules of the game," managers will inevitably attain unbridled power. Indeed, this has been a fundamental problem under state "enabling" statutes. We believe unchecked management power could, for example, have the following negative consequences.

First, *it encourages capricious corporate decisionmaking*. A "horrible" example of the negative impact of managerial caprice is found in SEC and Congressional reports on the collapse of the Penn Central.

Caprice was evident in decisions about, for example, whether to merge, how to merge, the calculation of "merger savings," and the negotiation of labor contracts. Penn Central's board was alleged to have received almost no realistic financial information; it ignored indications of impending disaster.[8]

In response to more moderate calls than Dr. Hessen's for unrestricted management authority, Dean Courtney Brown, who has spent over two decades serving on some of the nation's most important boards, persuasively answered:

> [A] single major blunder of judgment can damage an enterprise seriously. It would be interesting to know the extent to which write-offs, ranging from $100 million to $500 million, that have been recorded in recent years by such well-known companies as Anaconda, Ford, General Dynamics, Occidental Petroleum, RCA, and United Aircraft stemmed from the dominant influence of one decision maker. Or, in a different type of situation, a head man's prolonged lack of imaginative leadership or judgment can result in a gradual erosion of the organization's vitality over a number of years.
>
> The strength of our form of political democracy is in its system of checks and balances . . . . As the modern corporation confronts the progressively more complex problems of what has been called the post-industrial era, it will stand in progressively greater need of the advantages of a system of checks and balances within its own operations.[9]

Second, *managers may misallocate corporate resources because they have somewhat different interests than the shareholders they theoretically serve.* Dr. Hessen accepts the corporate goal of long-term profit maximization. But economists such as John Galbraith argue that "growth," rather than profit maximization, is often management's goal. Without the law setting standards would managers subordinate their goals to those of remote and unknown shareholders? Similarly, might not senior managers, aware their performances will be measured over a relatively few years, be tempted to subordinate long-term corporate advantages for short-term profits?

Third, *managers may succumb to inherent conflicts-of-interest.* Consider, for example, (i) compensation questions, (ii) management's position when either hostile (*e.g.*, with careers at stake) or friendly (*e.g.*, with various "carrots" being offered) tender offers are made, and (iii)

8. *See, e.g.*, SEC, THE FINANCIAL COLLAPSE OF THE PENN CENTRAL COMPANY; HOUSE COMM. ON BANKING AND CURRENCY, STAFF REPORT, H.R. DOC. NO. 1264, 91st Cong., 2d Sess. (1970); J. DAUGHEN & P. BINZEN, THE WRECK OF THE PENN CENTRAL (1971).

9. C. BROWN, PUTTING THE CORPORATE BOARD TO WORK 16, 19 (1976).

the various "going private" scenarios, and the need for some restraint on managers becomes abundantly clear.

In sum, if put into effect, we believe Dr. Hessen's "private property model" would grievously injure modern capital formation. We discussed our approach to the concession theory earlier. In general, unfortunately, we concur with Professor Hamilton's critical review of the Hessen piece.

Professor Gunter H. Roth with the help of Professor Hanns Fitz has provided us with a very thoughtful analysis of the European model with respect to corporate social responsibility. There are movements in Europe of which we should be more keenly aware; some are possible straws in our own wind. For example, Professor Roth points to the development of social accounting in a few German companies, and indeed, has provided us with a remarkable example of a social accounting sheet from the 1977 statement of the German Shell Corporation. Although it has weaknesses that he has identified, it nevertheless is a constructive and concrete way of fostering some self-consciousness on the part of corporate managers with respect to their responsibilities not only to shareholders and employees but also to the community. Roth recognizes there are difficulties in trying to make "social advancements" clear in terms of numbers; for example, there are problems of allocation and measurement. On the other hand, everything does not have to be quantified and the disclosure process provides a stimulus to management's self-analysis of a company's role in the public realm.

Professors Roth and Fitz also discuss the development, particularly in Germany, of co-determination and conclude interestingly enough that employee democracy does not seem to be much better than shareholder democracy for which they have little respect. It appears that the employee representatives are actually representatives of the trade unions rather than of the company itself, and that trade union membership in Germany includes less than fifty percent of the labor force. In consequence, even if the voice of employees were heard it would not be that of a majority.

Professors Roth and Fitz have not, nor has anyone to our knowledge, provided us information as to the impact of participation by workers on the Supervisory Board upon the social and community problems of the corporation.

Professor Christopher Stone, of the University of Southern California, has expressed doubt whether more direct representation by shareholders would lead to as much recognition of corporate social responsibility as is now assumed by management;[10] the shareholders' sole interest might be dividends and market value. In the same vein, a worthwhile study could be undertaken to determine whether labor in Germany has shown itself exclusively interested in wages and terms of employment. Does labor ignore the broader social outlook that many managements have embraced?

As to the growth of a co-determination movement in this country, most of us would agree with the comment of Professor Vagts (who the editors wisely asked to write a special foreword on European law) that labor seems to have no interest in it. It was raised once by the United Auto Workers in negotiation with Chrysler but subsided. It seems contrary to the adversary philosophy and collective-bargaining traditions of American labor.

Professor Clive M. Schmitthoff suggests that co-determination by employees in Germany has undoubtedly contributed to the fairly peaceful labor relations existing in that country and points to the development of works councils and to the Dutch Company Law Reform, which has adopted the principle of co-optation. Under the Dutch mode of selection, if there is a vacancy on the supervisory board, the board itself selects a candidate with the shareholders and employees having a right to veto.

A basic reform recommendation of Professor Roth is premised on his general reaction that "shareholder democracy" has little vitality and that employee democracy does not seem much better. His suggestion is that "a much better approach would be to make management the trustee of all interests involved. Such a system would entail a conflict-of-interest-free supervisory body established on a super-management level." He points out that writers in this country have emphasized the ineffectiveness of shareholder voting rights. He believes that if shareholder voting did not exist there would be a reasonable and realistic foundation for a more socially responsible managment. The theory is that the greater the independent authority to be exercised by the fiduciary, the greater the scope of his duty. Only with the abolition of the theory founded upon the "ultimate control" of the shareholders will management's fiduciary duties be expanded to include a concern for the general social interest.

This idyllic, self-perpetuating board has initial appeal. On the other hand, do not American shareholders play a most helpful role in

10. C. STONE, WHERE THE LAW ENDS 233 (1975).

restraining or goading management? The very fact that control of the corporation may shift by the purchase of the shares in a tender offer has undoubtedly tended to keep management alert as opposed to self-satisfied or lethargic. Also, there is no better constituency than shareholders for preventing corporate officers and directors from becoming beneficiaries of their own unrestrained munificence. Even "trustees" cannot be relied upon for impersonal and objective self-appraisal. Perhaps Professor Roth's model might still permit the shareholders' derivative suit, which has been such a useful device in keeping some managements in line. We agree that the role of "shareholder democracy" has been exaggerated by some writers. Nevertheless, in our view, the voting process and proxy contests, shareholder proposals, and tender offers represent a positive force for making management responsible and efficient. Without some role for shareholders we would be concerned that American industry might lose sight of its basic profit-maximization function. In general, we question the applicability of the trustee model (presumably self-perpetuating) to the American scene.

We have each set forth proposals for corporate law reform elsewhere at some length.[11] Fundamentally, we believe new federal legislation is necessary. Such legislation, briefly sketched, should provide for: (1) replacement of inadequate state laws in specified sensitive areas; (2) the establishment of a basic governance structure which would provide for a corporate board capable of checking or monitoring management and an enhanced (but realistically measured) role for shareholders; (3) the establishment of a spectrum of new remedies and penalties (*e.g.*, suspensions and civil money penalties for derelictions by officers or directors); and (4) carefully constructed governance provisions aimed at assuring corporate compliance with the law.

Our approach neither takes corporate control out of private hands nor creates a new government bureaucracy. It is intended to make the large corporation a more effective economic animal. Aside from increased emphasis on obedience to the law, it in no way departs from the goal of long-term profitability.

Our view is that any legislation in this area should be drafted with an eye on what is fundamental. Our drafting analogy should be the Constitution not the Internal Revenue Code.

If new legislation includes governance provisions that help assure

---

11. *See* Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974); *Hearings on Corporate Rights and Responsibilities before the Senate Comm. on Commerce*, 94th Cong., 2d Sess. 241 (1976) (statement of Harvey J. Goldschmid).

corporate compliance with the law, we would hope that the net effect of such legislation would be *less* government regulation. In the long run, we think, legislators would feel less compulsion to impose costly, redundant, external checks on corporations because of fears about what might be happening inside. Finally, the kind of board and shareholder roles we envision might necessitate fewer shareholder suits. This, of course, is particularly true in the various conflict-of-interest situations.

In conclusion, we offer our congratulations to the editors of *The Hastings Law Journal* for inspiring this important volume.