

TITLE

Corporate Governance in a Market with Morality

CITE

“Corporate Governance in a Market with Morality,” 62 *Law and Contemporary Problems*, Duke University Law School, 129-158, Summer 1999.

AUTHOR

Thomas W. Dunfee^a

The Wharton School

a- Kolodny Professor of Social Responsibility, Department of Legal Studies, The Wharton School. The author expresses deep gratitude to David Hess who contributed significantly to this article. Thanks also to Eric Orts who provided helpful and cogent comments. The author also recognizes the support of the Carol and Lawrence Zicklin Center for Business Ethics Research.

Moral desires are embodied in markets relevant to corporate governance. This article analyzes the implications stemming from the existence of morality within consumer and capital markets for corporate governance. Analysis of the role of moral desires within markets represents a new way of looking at the long-standing debate concerning the social responsibility of corporations. The focus of this article is normative, that is, it is concerned with how managers should act.¹ Four particularly important conclusions derive from this approach. First, managers cannot satisfy their primary duties to shareholders if they fail to consider adequately the influence of morality within the markets affecting their firms. Second, managers should deviate from maximizing shareholder welfare when demonstrable, objective evidence exists that marketplace morality² *requires* such deviation; or manifest universal ethical norms require such a departure. Third, managers may deviate from maximizing shareholder welfare when demonstrable, objective evidence exists that marketplace morality *allows* such deviation. Fourth, legal rules should generally not interfere with the liberty of market participants to act on the basis of their moral desires. Instead, public policy and legal frameworks should generally support a marketplace of morality.

I. The Role of the Corporation: Does it Encompass Social Responsibility?

Competing, mutually exclusive visions exist concerning the ultimate purpose and true nature of the corporation. Various descriptions exist, such as communitarian versus contractarian,³ the Berle v. Dodd debate⁴, the shareholder paradox⁵ or the separation thesis,⁶ these differing visions reflect conflicting political and moral preferences concerning the nature of corporations. Most famously, the debate is reflected in the sharply contrasting views of Milton Friedman⁷ and his many critics.⁸ Ultimately, the basis of the disagreement boils down to a pluralistic versus a monotonic view of corporate objectives.⁹

A. The Monotonicist/Pluralist Debate

The monotonic view emphasizes maximization of shareholder wealth. “(S)hareholders claim the corporation’s heart. This shareholder-centric focus of corporate law is often referred to as shareholder primacy.”¹⁰ The objective reduces to calculations of short-term results for shareholders. Legal mandates must be followed, but most other extra-shareholder considerations are verboten as reflecting inappropriate social or political considerations, violations of innate property rights, or even worse, as a subterfuge allowing managers to act in furtherance of their own personal interests. Based upon a view of a corporation as a nexus of contracts, this approach eschews public intervention in support of non-shareholder obligations.¹¹ Working from a foundation of liberty, monotonicists assume that non-shareholders with an interest in corporate decisions can either explicitly contract to protect their interests¹² or can be treated as having implicitly contracted with shareholders to represent their interests¹³. Milton Friedman is strongly identified with the monotonic position:

In a free-enterprise, private-property system a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.¹⁴

The pluralistic view, on the other hand, emphasizes broader constituencies or stakeholders (variously, bondholders, suppliers, distributors, creditors, local communities, consumers, users, state and federal governments, special interest groups, etc.) of the corporation¹⁵ and has even been extended by some to a general obligation to act consistently with the general needs of society.¹⁶ This view is supported in two distinct ways. First, the argument is made that management has an ethical obligation to act in furtherance of the interests of stakeholders. Advocates of ethically based fiduciary-like obligations to stakeholders have even gone so far as to ask “what’s so special about shareholders?”¹⁷ Second, an instrumental argument is made that firms will be more successful in achieving their primary objective of enhancing shareholder wealth by adequately reflecting stakeholder interests.¹⁸ The pluralistic view is operationalized in the academic management

literature under the rubric of corporate social responsiveness. Corporate social responsiveness focuses on the ability and readiness of a corporation to respond to stakeholders.¹⁹ The literature identifies strategies and processes, such as crisis management teams, to be put in place to insure that proper responses occur.

The debate between monotonists and pluralists has run on for decades and while its character and some of the specific issues have changed, it still remains essentially a debate as to the extent to which corporations should be governed to achieve objectives other than shareholder wealth maximization. The debate has been ably and thoroughly described elsewhere²⁰ and it is not necessary to go into greater detail here. As a starting point, it should be noted that no serious writings advocate the two extreme positions on the monotonic-pluralistic continuum: nothing should ever constrain shareholder wealth maximization — corporations should be managed solely to benefit non-shareholder stakeholders. Rational people do not advocate the position that corporations have an obligation to do anything (such as hiring a hitman to murder a key witness against the firm in a major product liability case) that would increase shareholder wealth. Nor do rational people expect that publicly held corporations will be operated in furtherance of social or altruistic objectives with little or no reference to the interests of investors.

Where then on the continuum does the proper position lie? Should managers seek to balance the long-term and short term welfare of shareholders? Or toward the opposite end, actively seek to “balance the interests of all the firm’s constituencies”²¹ in every decision, a position criticized by A.A. Sommer. Part of the reason for the divergence in viewpoints concerning corporate responsibility stems from the wide variety of activities that fall within its purview. Actions implicating the question of for whom the corporation is to be managed include such things as:

- corporate giving, philanthropy
- considering community interests in deciding on plant location or closure,
- rejecting premiums offered in hostile takeovers
- making products safer than the law requires

-putting in environmental controls beyond what the law requires

Two cases help to emphasize the types of issues that underlie the monotonist/ pluralist debate.

Case 1: Merck and Mectizan²²

In the late 1970s, Merck scientists discovered that ivermectin, a drug they produced to control parasites in animals, might help millions of people afflicted by onchocerciasis. This disease, known as river blindness, exists primarily in poorer countries in Africa. The disease is transmitted through the bites of black flies whereby larvae entered the victim's body. The larvae produce offspring which cause itching so severe some people have committed suicide and, if the eyes are affected, blindness. Merck incurred great costs in developing the drug; costs that could not be recouped directly from those who had the disease because they were too poor to pay a profit-generating price. Ultimately, Merck spent ten years developing the drug and then decided to give the drug away without charge, and even to financially support the distribution of the drug to remote areas. The drug provides significant benefits and can be taken orally once a year.

Case 2: Shell Oil and the Brent Spar Rig

In 1995, Shell proposed to sink a decommissioned oilrig in the North Sea. They consulted with various stakeholder groups, engaged noted scientists in the process, and obtained approvals from the British government.²³ Greenpeace challenged the proposed deep sea dumping claiming that Shell's solution of sinking the rig would cause serious harm to the environment. Shell disputed the claim on scientific grounds and argued that sinking was the best available option.²⁴ Because Shell refused to abandon its plans, Greenpeace surrounded the rig with small boats and even occupied it in 1995.²⁵ Due to Greenpeace's pressure and consumer boycotts, Shell abandoned its plans and towed the rig to a Norwegian fiord where it remained for close to three years.²⁶ The reversal of the original plan cost Shell considerable expense.²⁷ After Shell abandoned its dumping plans, independent scientists investigated and found that Shell had been correct—the environmental impact from sinking the rig would be 'minimal.'²⁸ Greenpeace admitted they were wrong on that specific claim.²⁹

Both cases involve decisions, which may have an impact on shareholder wealth. Merck spent millions developing the drug and then incurred even greater costs by giving it away and helping support the distribution of the drug. Roy Vagelos, the then Chairman, indicated that he spent an enormous amount of time on the project.³⁰ True, such an action might help Merck in hiring and retaining research scientists, and could help in their relationship with certain physicians, customers and regulators. On the other hand, few customers may even be aware of their action and the precise benefits are hard to measure against the clear expenditures the decision cost. Assuredly, if Merck were to decide to invest half of all its research and development budget in likely unprofitable drugs it would have a serious negative impact on shareholder wealth.

Shell tried to consider the interests of stakeholders in their decision process and incurred costs in so doing. Yet their efforts were for naught because they apparently failed to correctly evaluate the likely public reaction to their decision.³¹ The costs Shell incurred in dealing with the project, coupled with the costs of a consumer boycott, etc. probably had a negative effect on shareholder wealth. A more accurate reading of the “moral market” they faced would have benefitted shareholders.

B. Does Extant Law Resolve the Monotonicist/Pluralist Debate?

Assuming that Merck explicitly considered the interests of stakeholders³² and that Shell’s misreading of stakeholder concerns regarding the Brent Spar cost shareholders money, can one say that the management of the two firms acted in violation of their legal obligations?³³ If one interprets the law as requiring a sterile decision-making process, devoid of any consideration of marketplace morality, then perhaps the answer is yes. If, instead, the law is interpreted to mean that managers must have reasonable grounds for assuming that extra-economic considerations may benefit shareholders, then the answer is no. The Merck and Shell cases demonstrate the difficulty in making a definitive assessment of impact on shareholder wealth. It appears likely that Shell’s actions hurt shareholders in that there were identifiable costs and no clear-cut benefits. The Merck case is less clear because a reasonable case can be made that, as a result of the enormous

favorable publicity Merck received, plus the potential opening of other markets in Africa, Merck reaped a substantial benefit. The question is whether the benefits exceeded the unquestionably significant costs.

Thus, the legal regime is dependent to some extent upon assumptions concerning the likely effect of managerial consideration of stakeholder interests. The shareholder primacy norm, if fully incorporated into the legal regime, would still require that stakeholder interests be considered when doing so has a foreseeable impact upon shareholder wealth. The legal debate concerning the proper interpretation of extant corporate law reflects this empirical uncertainty with the competing advocates working from diametrically different assumptions concerning the likely impact of acting on behalf of stakeholders.³⁴ It is not surprising that much of the legal debate pertains to issues where the agency problem is greatest, that is where the potential conflict of interest between the shareholder owners and the managers is likely to be at its greatest. Potential conflicts abound in hostile take-overs where managers may lose perks, even their jobs, if ownership changes hands.³⁵ The monetarists are rightly concerned that where interests dramatically diverge managers may put their own ahead of those of investors. Managers may do this while covering their self interest with claims that their actions are in furtherance of the public good or are required by business ethics.

The corporation is a legal entity.³⁶ As such, debates concerning their role and function must of necessity reflect their legal character. Inevitably the legal arguments revolve around two primary questions: (1) how should extant law be interpreted and applied; and (2) what is the optimal legal regime for corporations. Both are reflected in the current controversy concerning the proper role of corporate constituency statutes.³⁷ First adopted in Pennsylvania in 1983, the majority of states have enacted them.³⁸ Most provide that managers and directors “may” consider the effects of any action on some broader constituency such as employees, suppliers, customers, communities and so on. The statutes generally do not mandate that stakeholder interests be considered. Instead, they are merely permissive; management will not be liable for having demonstratively considered such interests.³⁹ Most of the statutes were adopted in response to the threat of hostile takeovers⁴⁰ and were extensively lobbied for by management of potential target firms.⁴¹ This heritage taints their

status as legitimizing a broadly pluralistic approach to corporate governance. Significant issues exist as to how the constituency statutes should be properly interpreted and how they can be enforced. So long as they cannot be directly enforced by stakeholder plaintiffs, they will be of limited impact.⁴² Interestingly, they have seen surprisingly little use considering the extent to which, at least upon first impression, they appear to change the substantive law in this area.⁴³

The fact that the constituency statute regime has had a limited impact does not necessarily lead to the conclusion that the law fully supports the monotonic approach. To the contrary, there is substantial support for the proposition that corporate law allows management to act to further many types of interests other than pure short-term shareholder wealth maximization.⁴⁴ The American Law Institute's Principles on Corporate Governance explicitly approves of managerial actions that are "made on the basis of ethical considerations even when doing so would not enhance corporate profit or shareholder gain."⁴⁵ The most well-established use of corporate funds that does not improve short-term shareholder wealth—charitable donations—is approved by statute in every state.⁴⁶ In general, the business judgment rule gives management broad discretion in what interests they choose to further so long as managers can present a rational basis for the claim that their business judgment is in the best interests of the corporation.⁴⁷ In conclusion, the current legal regime does not appear to provide a definitive resolution to the monotonic/pluralist debate. Instead, as is true of so much United States law, its prophylactic nature allows it to evolve in a manner consistent with changing moral and political expectations. Before proceeding to a discussion of the role of marketplace morality, we need to briefly consider claims that there is no real debate between monotonists and pluralists, that when properly framed their viewpoints converge.

C. Claims That There Is No Real Debate Between Pluralists and Monotonists

Before analyzing the nature of morality that exists in markets and its implications for corporate governance, it is necessary to consider two arguments to the effect that there isn't really a substantive disagreement between the monotonists and pluralists after all. Neither argument, however, appears to dispose of the issue.

The first argument is based upon empirical assumptions concerning the affect of a pluralistic approach on shareholder wealth. Although shadowed in the legal literature⁴⁸, it is within the business ethics literature that the debate whether there is a true separation between obligations owed to shareholders and stakeholders has reached full extension.⁴⁹ There, those who deny the existence of a separation claim that proper consideration of stakeholder interests resolves any potential conflicts because such actions will also benefit shareholders. They believe that when management astutely responds to stakeholder interests such actions will either be in the best long-term interests of shareholders or will otherwise be legally or morally compelled.

Akin to selling ethics on the grounds that it enhances profitability, the view that shareholder and stakeholder interests invariably converge is based upon highly optimistic assumptions concerning potential congruence between the interests of shareholders and stakeholders. Divergence of interests between stakeholders and shareholders disappears, if at all, solely on the basis of a highly circumscribed view of the pluralist position, that is, if the pluralist strategy is limited to those win-win actions where there is a clear congruence between stakeholder and shareholder interests. In the everyday life of corporate managers, trade-offs between interests⁵⁰ of corporate constituencies arise with regularity, business life is not somehow miraculously limited to win-win decisions. Many potentially socially responsive activities may be implemented in such a way as to have a substantial negative impact on the wealth interests of shareholders, for example, the payment of significantly above-market wages to employees. So long as that is possible, then until there is clear agreement on the parameters of proper corporate behavior the issue (or paradox) remains relevant for our purposes.

The second argument is based upon the actual language used by Milton Friedman. What exactly does he mean by the use of the phrase “while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom”⁵¹? Interpreted broadly, this language, particularly the reference to ethical custom, could be used to justify substantial recognition of stakeholder interests. Interpreted narrowly, the language would only reflect the truism that corporations must act in conformity with the law and that firms need only conform with clear cut

obligations of honesty and promise-keeping. There does not appear to be support in the monotonist literature for the broad interpretation of this language, although as might be expected, pluralists advocate such a reading.⁵² The narrow interpretation does not, of course, resolve the monotonist/pluralist dispute.

Whether or not participants in capital and consumer markets have moral desires which they do and should try to implement in their marketplace decisions is relevant to the discussion of the proper role and function of the corporation. If such morality is present in markets, then what effect should it have? Is it actually discernible in some objective sense? If so, then should firms pay some attention to morality in markets⁵³? Is it desirable that people act in this way? Before seeking to answer these questions and connect the conclusions reached to the debate about the nature of the firm, it is first necessary to discuss what is meant by the existence of morality in markets.

II. Morality in Markets

Surely moral desires⁵⁴ influence the preferences of participants in markets. Moral desires pertain to personal beliefs concerning right and wrong behavior and may be contrasted with purely economic desires to obtain desired goods and services at the lowest possible price. Moral desires may encompass refusing to do business with someone deemed to be unfair, boycotting certain firms on the basis of identification of the firm with disfavored policies, and so on. The claim that there is no discernible impact of moral desires on capital and consumer markets is counter-intuitive. It seems similarly implausible to claim that moral desires are a dominant force in many markets for goods and services.⁵⁵ Instead, the real question is whether there is some discernible impact.⁵⁶ Are there, for example, identifiable contexts in which the price and quantity sold of goods and services are influenced by moral desires? It seems quite plausible to claim that some people trade off moral desires against desires for good quality and low price in their own decision making. Across the universe of those acting on the basis of moral desires, some will hold differing moral desires and some marketplace actions based on moral desires will cancel the effect of those acting on the opposite desires.⁵⁷

Moral desires may be an influence in a variety of circumstances. Familiar capital market examples include buying mutual funds that engage in social screening, or screening personal investments. There are people who refuse to own tobacco or gambling stocks in their own portfolios. Some pension funds eschew securities of certain firms, often on the basis of social criteria that presumably reflect the preferences of their beneficiaries⁵⁸. Although the total impact of all forms of screening is hard to measure, Merrill Lynch estimated that the amount invested in socially screened mutual funds increased from \$639 Billion in 1995 to \$1.18 Trillion in 1997⁵⁹. Hylton notes a “persistent inability on the part of all participants in the debate to develop a simple, coherent definition of what is meant by socially responsible investing,” while noting with some dismay that many funds purporting to engage in the practice have little in common.⁶⁰ However, an exogenous definition of what constitutes socially responsible behavior is inconsistent with the idea that, with disclosure, some investors will invest influenced by their own moral desires. Thus, someone might buy a fund that eschews firms that violate the MacBride Principles in Northern Ireland while another investor might be totally indifferent to that issue and buy a screened fund that includes non-MacBride observing firms in its portfolio but does not include tobacco and gambling stocks.

Similar actions are found in consumer markets. Consumers supported their desires for a clean environment by paying more for pollution-reducing gasoline at a time when they weren't required by law to purchase it.⁶¹ Similarly the sales of Star Kist tuna went up when it raised its prices as a result of switching to suppliers who protected dolphins.⁶² Firms such as the Body Shop, Tom's of Maine and Ben & Jerry's develop strategic responses to these desires by engaging in social cause marketing. They work to identify their firms with social causes, such as saving whales, as a means of attracting consumers who share those beliefs. Consumers may choose to do business with them solely on the basis of an assumed alignment of moral preferences. They may even be willing to pay a higher price, or accept less desirable goods in order to realize a desire to support a favored cause through their purchasing decisions. The recent growth of these strategies is reflected in \$535 million in payments to well-known charities in order for corporations to associate their names with marketing campaigns⁶³. Consumers may also participate in boycotts as has occurred in opposition

to Shell's failure to intercede in the execution of Ken Saro Wiwa in Nigeria, Nestles' marketing practices for selling infant formula in developing countries and Exxon's handling of the Valdez oil spill. Kahneman et al. found that individuals indicate a willingness to incur additional costs, such as paying a higher price or traveling a greater distance in order to punish a retailer who in their opinion had acted unfairly by trying to take advantage of a condition of scarcity.⁶⁴

Robert Frank found similar effects in labor markets identifying the existence of a compensating wage premium for less altruistic jobs.⁶⁵ Frank gives as examples the large salary gaps between profit and nonprofit jobs, corporate and public interest law, and between expert witnesses for the tobacco companies and those for the public interest groups in opposition⁶⁶.

Thus, the claim that there is morality in markets in the sense that some market participants are influenced by their own moral desires seems easily supportable.⁶⁷ For most markets, it may be that price and quality considerations dominate, but for certain sub-markets it may be the case that moral desires are dominant. Attitudes about morality may be a major influence in reference to such products and services as furs, certain types of drugs, prostitution, even the scalping of sports and entertainment tickets.

The use of economic analysis to consider various dimensions of human interaction reinforces the claim that there is discernible morality in markets. Gary Becker⁶⁸ is a leading practitioner of this relatively new art. He makes use of a very broad analysis of tastes/preferences including such things as personal and social capital pertaining to future consumption,⁶⁹ discounting the future,⁷⁰ and desires for things such as religiosity or health.⁷¹ In so doing, Becker gives explicit recognition to the fact that individuals may attempt to satisfy what I have described as moral desires in their decisions concerning current consumption. Even some of the assumptions underlying Richard Posner's⁷² controversial analysis of human sexuality and sexual practices is consistent with this core idea.

III. The Implications of Marketplace Morality for Corporate Governance

If marketplace morality has discernible effects on relevant consumer and capital markets, then a straightforward economic analysis would require that management give careful consideration to its presence. Otherwise, managers would not be maximizing the potential return to shareholders due to a failure to appreciate fully the preferences of investors and consumers. In the context of the social responsibility debate, however, the ultimate question is whether there is discernible marketplace morality requiring management to take actions inconsistent with the monotonic approach to corporate governance.

A. Does Marketplace Morality Support Monotonists or Pluralists?

In answering the ultimate question we must first determine whether marketplace morality supports either the pluralist or monotonic approaches to corporate governance.⁷³ If it does, then the framework of analysis is determined. If the support is for the monotonic position, then the straightforward norm of shareholder primacy is ethically required. If instead, there is support for a pluralistic position, then more analysis is required to determine which pluralistic vision is supported by marketplace morality. Survey data is limited, although some appears to support the pluralistic position. One massive study of managers posed the Friedman question directly as follows: Which of these opinions do you think most other people in your own country would think better represents the goals of a company, (a) or (b)

(A) the only real goal of a company is making profit.

(B) a company, besides making profit, has a goal of attaining the well-being of various stakeholders, such as employees, customers, etc.⁷⁴

The question was posed to over 15,000 middle managers from 12 different countries. In no country did a majority of managers agree with answer (a). The United States had the highest percentage of agreement with (a), 40%. This is consistent with an earlier survey that found managers at all levels consistently ranked the general public as more important than shareholders.⁷⁵

Statements by United States and global business groups representing senior managers decisively rejecting the Friedman formulation of the monotonic approach are relatively common. For example, the United States Business Roundtable has stated that: “Corporations are chartered to serve both their shareholders and society as a whole.... The other stakeholders in the corporation are its employees, customers, suppliers, creditors, the communities where the corporation does business, and society as a whole.”⁷⁶ The well-known and widely accepted Principles offered by the global Caux Round Table stress stakeholder obligations throughout by emphasizing responsibilities toward customers, employees, suppliers, social/political communities, and even (controversially) competitors.⁷⁷ Monotonists might be expected to question whether these statements represent genuine positions of significant business groups and to claim that they are more in the nature of generic public relations. One would expect that the general public would have an even stronger preference against the monotonic positions, preferring instead that corporate managers seek to act consistently with unambiguous popular morality.

A precise, uncontroversial resolution of the relationship between marketplace morality and the pluralist/monotonicist debate is probably not feasible at this time. Furthermore, as has been stressed, marketplace morality may change over time. Nor is a definitive resolution necessary to our analysis. Instead, it is possible to identify alternative frameworks, depending on the nature of marketplace morality within a given community.

B. Justifications for Respecting Marketplace Morality

Two basic justifications for incorporating the consideration of marketplace morality into corporate governance are offered, one normative and one instrumental.

The first, normative justification, relies upon a hypothetical social contract that requires managers to identify and act consistently with legitimate ethical norms found in the communities in which their firms operate. Tom Donaldson and I have elaborated at length upon this social contract in a theory we have called Integrative Social Contracts Theory (ISCT).⁷⁸ ISCT is grounded in the familiar idea

that social norms serve as a foundation for rules of behavior in communities. Donaldson and I hypothesize that rational global contractors would seek to provide for the need for a moral background essential to sustain productive business while at the same time retaining the ability to select their own values and moral rules to the greatest extent possible. The four key terms of this global social contract are as follows:

The first two:

1. Local economic and political communities may specify ethical norms for their members through social contracts (moral free space)
2. Norm-generating microsocial contracts must be grounded in informed consent buttressed by rights of exit and voice

Communities are at the core of the macrosocial contract. A community is defined in ISCT as a self-defined, self-circumscribed group of people who interact in the context of shared tasks, values, or goals and who are capable of establishing norms of ethical behavior for themselves. Corporations, subsidiaries, even departments or informal units within an organization, along with partnerships, professional groups, trade associations and nation states may all be ISCT communities in the context of a given ethical decision. In focusing on communities, ISCT recognizes that norm-governed group activity is a critical component of economic life.

A major impact of ISCT is to establish that norms are obligatory for dissenting members of communities when an authentic norm has been identified and it satisfies the other requirements of ISCT given below. The obligation stems from the consent given when one acts as a member of a community, perhaps by accepting the benefits of the community environment. However, ISCT imposes some additional requirements on the operation of the community. The community must respect the right of members to withdraw or exit from group membership. Thus, a dissenting member of a community who is quite distressed about a particular authentic norm may elect to leave

the community. Employees may, and generally should, leave a corporation whose values are significantly at odds with important personal values. Similarly, an individual should have the opportunity to exercise voice within the community. This is consistent with much of the organizational justice literature documenting employee attitudes concerned with procedural justice. Often, some form of voice, e.g. the right to a hearing to present one's side of the case, or to confront an accuser is critical to employee judgments that a firm has acted justly. A norm meeting these requirements is considered "authentic."⁷⁹

To avoid excessive relativism, and with the recognition that communities do indeed develop authentic norms supporting racial and gender based discrimination as well as other problematic practices, it is assumed in ISCT that the original contractors would wish to recognize a limited set of universal principles that would constrain the relativism of community moral free space. Accordingly, the third term of the macrosocial contract states:

3. In order to be obligatory, a microsocial contract norm must be compatible with hypernorms.

Hypernorms are defined as "principles so fundamental to human existence that we would expect them to be reflected in a convergence of religious, philosophical and cultural beliefs."⁸⁰ As expressed by Walzer⁸¹ they would be a thin "set of standards to which all societies can be held-negative injunctions, most likely, rules against murder, deceit, torture, oppression and tyranny."

Hypernorms thus bound the moral free space of communities. If, for example, a hypernorm prohibiting coarse bribery exists, then any authentic norm recognizing bribery among, say, a community of corrupt government officials in Russia is not legitimate ipso facto. A norm meeting the hypernorm requirement is considered "legitimate."⁸² However, hypernorms do not provide a complete bounding of the moral free space of communities. There may still be a conflict between two or more norms that are legitimate.

4. In the case of conflicts among norms satisfying terms 1-3, priority must be established through the application of rules consistent with the spirit and letter of the macrosocial contract.

It will often be the case that multiple legitimate norms applicable to the same ethical judgment come into conflict. This may happen when a transaction crosses two distinctly different communities, as is often the case in global business transactions. Cultures may have quite different norms concerning what constitutes appropriate corporate behavior. In the United States corporate philanthropy is well established, in certain Asian countries corporate philanthropy may not be considered proper. If both the pro and anti-philanthropy norms are clearly authentic and they are both legitimate because neither violates a hypernorm. To resolve problems of this type, ISCT specifies a loose set of six priority rules which are derived from the macrosocial contract while based on experience with international conflicts of law. The six rules are as follows:⁸³

- i) Transactions solely with a single community, which do not have significant adverse effects on other humans or communities, should be governed by host community norms;
- ii) Community norms for resolving priority should be applied, so long as they do not have significant adverse effects on other humans or communities;
- iii) The more extensive the community which is the source of the norm, the greater the priority which should be given to the norm;
- iv) Norms essential to the maintenance of the economic environment in which the transaction occurs should have priority over norms potentially damaging to that environment;
- v) Where multiple conflicting norms are involved, patterns of consistency among the alternative norms provide a basis for prioritization;
- vi) Well-defined norms should ordinarily have priority over more general, less precise norms.

The implications of this contractarian analysis for marketplace morality are relatively

straightforward. Managers have an obligation, based in social contract, to respond to mandatory marketplace morality reflected in legitimate authentic norms. Where marketplace morality is instead permissive, then managers are acting within moral free space and have a range of choice as to how they may act. In all actions managers are bound by hypernorms reflected in manifest universal norms or principles. Obligations then vary on the basis of specific authentic norms. Before spelling out the implications for corporate governance, we must briefly consider the instrumental justification for paying attention to marketplace morality

Even if marketplace morality supports the monotonic position, the presence of morality within consumer and capital markets still has implications for the committed monotonic manager. If a manager fails to react to conspicuous signs of moral expectations for her firm, she may implement strategies doomed to underperform or even produce losses for the firm. Both outcomes will have a negative impact on shareholder wealth. The experience of Shell with the Brent Spar provides an example where managers may have detracted from shareholder wealth by failing to anticipate the impact of marketplace morality. Shell may have thought that the issue of how to dispose of the rig was merely a technical one. If so, all they had to do was to explain the science of the decision to relevant stakeholders. It turned out to be a very different type of issue. A sufficiently significant portion of the public chose to believe Greenpeace and thereby supported actions which prevented Shell from carrying out its plans. Public support for Greenpeace occurred even though Greenpeace was ultimately proven wrong on critical scientific facts. One explanation for this seemingly irrational result pertains to the nature of trust, particularly in reference to decisions affecting the natural environment. As a result of a series of controversial incidents over time involving Shell,⁸⁴ coupled with the potential of a conflict of interest on the part of Shell who stood to profit from actions harmful to the environment, many people apparently concluded that Shell was acting in a manner inconsistent with their moral desires.

A similar analysis may be used in reference to the tobacco companies and to Exxon's handling of the Valdez oil spill. The case may be made that the Tobacco companies failed to discern changing public attitudes about their product, particularly in regard to rather cavalier industry attitudes about

encouraging teenage smoking. RJR's Joe Camel campaign provoked enormous controversy as being obviously targeted toward children. In spite of the protestations of the industry that they had little to do with it, by the mid 1990s young smokers were the only group in the United States among whom smoking was increasing.⁸⁵ It may well be that the enormous costs ultimately incurred by the companies as a result of political and legal actions would have been significantly smaller had the companies acted more responsibly when it became clear that public sentiment was changing.

The infamous grounding and subsequent oil spill of the Exxon *Valdez* off the shores of Alaska is a well-known corporate disaster. The manner in which Exxon management responded to the spill has been significantly criticized⁸⁶ and Exxon was, for awhile, the poster boy for how not to manage a crisis. The company allowed unsafe practices, was not prepared to act quickly to deal with a spill of the type and magnitude in Alaska, issued contradictory statements defending their actions, did not send senior leadership to the site immediately afterwards, and was accused of appearing arrogant about their responsibility for the incident.⁸⁷ Exxon paid over \$3.4 billion in direct charges, was subject to boycotts (some holders cut up their credit cards and returned them to the company), and was ultimately assessed over \$5 billion in punitive damages in a law suit in 1994.⁸⁸ Again, the failure to respond adequately to the moral desires in the market cost shareholders.

C. Principles for Respecting Marketplace Morality. Principles for All Managers

The following four guiding principles for managers derive from the normative and instrumental justifications for respecting marketplace morality. They are not based on assumptions concerning the specific nature of marketplace morality. Instead, they are open to whatever output occurs with an expectation that marketplace morality will change over time.

1. There is a presumption that all corporate actions must be undertaken to maximize shareholder wealth.
2. Managers must respond to and anticipate existing and changing marketplace morality relevant to the firm that may have a negative impact on shareholder wealth.

3. The presumption in principle 1 may be rebutted where clear and convincing evidence exists that marketplace morality relevant to the firm would justify a decision that cannot be shown to directly maximize shareholder wealth.
4. Managers must act consistently with hypernorms (manifest universal norms and principles.)

Principle 1. First Duty is to Maximize shareholder wealth.

This principle is supported in law, agency principles, property rights, and moral analysis of the corporation.⁸⁹ It is the core of the monotonic approach. Yet, the basic obligation to generate profits for shareholders is recognized in most pluralistic approaches. Note that Principle 1 requires shareholder wealth maximization as a first duty, not as the sole duty. Remembering Milton Friedman's qualification - "while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom" - even strong monotonists recognize it only as a first duty, albeit a strong and dominating one. The dispute between the monotonists and pluralists concerns the circumstances and extent to which the first duty may be overridden. This agreement is recognized here by creating a rebuttable presumption in favor of shareholder wealth maximization. The next two principles specify the circumstances in which marketplace morality may overcome the presumption. The fourth principle then indicates the limits placed on both marketplace morality and shareholder wealth maximization by manifest universal ethical norms and principles.

Principle 2. Respond to market signals concerning moral preferences

The discussion, *supra*, has emphasized how the interaction between marketplace morality and corporate decision-making can have either a beneficial or negative impact on shareholder wealth. To the extent this is true, the critical issue becomes how to identify marketplace morality with sufficient specificity to enable responsive strategies. The search must begin with an identification of the relevant communities in which marketplace morality will be contained. The key place to look is in markets directly relevant to the firm. These would include, for example, consumer markets

targeted by the firm, the labor markets from which the firm hires and the capital markets tapped by the firm.

The second question is what to look for. Marketplace morality will be reflected in what was described earlier as authentic norms.⁹⁰ Authentic norms represent a consensus pertaining to the propriety of particular actions based on aggregate attitudes and behaviors of individuals within a particular community. An example would be the norm held by the television industry and also apparently the public that hard liquor firms should not advertise on television. This norm was observed for many years through the voluntary behavior of the industry. However, as Seagram's actions in breaking with the long-standing norm by advertising on television in 1996 make clear, such norms may be malleable and susceptible to change.

Donaldson and I suggest the following process for identifying important moral norms:

An authentic norm is presumed to exist when supported by the following sources. The more sources which support a particular candidate for an authentic norm, the stronger the presumption in its favor.

An authentic norm may be presumed to exist on the basis of the following:

- Many people in the community believe it exists and are able to express it in words
- Inclusion in a formal professional code
- Inclusion in a corporate code
- Commonly listed in the media as an ethical standard for the relevant community
- Commonly referred to as an ethical standard by business leaders
- Identified as a standard in competent opinion surveys

The presumption in favor of authentic norm status may be overcome on the basis of:

- Evidence of substantial deviance from the putative norm
- Evidence of an inconsistent or contrary norm in the same community
- Evidence of coercion relating to the norm within the relevant community
- Evidence of deception influencing the emergence or evolution of the norm

The more proxies supporting the existence of an authentic norm, the stronger the contrary evidence required to conclude that the authentic norm is, in fact, ersatz.

The type of evidence required for these judgments will generally be commonly known and readily available. It will not require an elaborate amount of research. The presumption will not result in perfect judgments and there is always some chance of either failing to identify a genuine authentic norm, or in pronouncing ersatz norms to be authentic. On the other hand, we would expect that the prima facie norms recognized on the basis of the presumption will generally hold up if subjected to an ex post test. Nor do such tests have to be complicated, expensive or elaborate. Common techniques such as the use of focus groups chosen as a valid sample of the target community may be used to test the authenticity of putative norms.⁹¹

One result of this search may be to discover that the various markets relevant to a given firm send conflicting signals regarding moral preferences. It may be the case for example, that the marketplace morality of the firm's investors are at odds with those found in labor or consumer markets relevant to the firm. Such a conflict may be resolved by evaluating the issue in the context of the morality existing in a broader market that subsumes the competing sub-markets. Thus, if the issue is workplace or product safety, the broader political community may have discernable, clear-cut authentic norms which would establish a priority among any competing norms in the sub-market. If no resolution is provided by looking to a broader community, then management needs to assess the relative importance of the different markets in the context of the firm's ability to achieve its goals. There shouldn't be a serious problem of incommensurability in that under principle two the ultimate test is the welfare of shareholders.

It should be stressed that marketplace morality often indicates profit-making opportunities for the firm. Taking steps to align the firm with the moral desires of important consumer or labor market groups may result in enhanced sales or recruiting. Realizing that judgments concerning the profit potential of such opportunities aren't crystal clear, particular leeway should be given to managers who experiment with reaching these special markets.

There may be circumstances in which a decision may initially appear to maximize shareholder

wealth, such as Exxon taking a hard defensive position immediately after the *Valdez* incident, or R. J. Reynolds actively seeking new smokers by finding ways to encourage pre-teens to experiment with smoking. But the action, when considered against evidence of marketplace morality, may be foreseen to actually hurt shareholders in the long run. In such circumstances, managers have an obligation to search for evidence of conflicting morality and to bring their actions into conformity with that of dominant authentic norms. Again, here the test is the ultimate welfare of shareholders.

Principle 3. Justifying Actions Failing to Maximize Shareholder Wealth

We turn now to the pluralist arguments that managers have an ethical or social obligation to act to satisfy objectives other than maximizing shareholder wealth. Following the principles presented here helps to resolve many of these issues. Where there is clear-cut evidence of marketplace morality in support of common practices, then they are perfectly permissible⁹² even though they cannot be shown to enhance shareholder wealth. A good example is the widespread and long standing acceptance of corporate philanthropy. Recognized in law, and supported by well-established and recognized custom, philanthropy is unquestionably supported by an authentic norm.⁹³ In spite of the neoclassical economic claims that “spending money on corporate giving is wrong because it represents a waste of corporate assets,”⁹⁴ the practice is clearly justifiable under this analysis. Presumably this conclusion extends even to giving money to charity in times of operating losses. Ben & Jerry’s, following the practice of many other firms, gave \$255,384 to charity in 1994, a year in which they incurred operating losses.⁹⁵

The case of the pluralistic manager who wishes to act on behalf of stakeholders on the basis of criteria other than that corresponding to clearly evident community morality is more difficult.⁹⁶ The business ethics literature suggests various criteria that might be used as a rationale for incorporating the interests of stakeholders into corporate decision-making. The most elaborate among the attempts at justification has been based upon Kantian-derived stakeholder rights, particularly in the work of Evan and Freeman.⁹⁷ Donaldson and Preston⁹⁸ suggested, but did not detail, a foundation based upon property rights recognizing that stakeholders possess certain rights which may compete or interrelate with those possessed by shareholders. Earlier, Donaldson had used a social contract

theory as a means of “either replacing or augmenting the stakeholder model” in his treatment of international business ethics.⁹⁹

Assume then that our pluralistic manager wishes to follow a Kantian analysis and in so doing is acting in a manner inconsistent with the assumed or actual wishes of the shareholders and in a manner inconsistent with clearly evident marketplace morality.¹⁰⁰ Such an approach is directly inconsistent with principles two and three. A purposeful strategy of acting inconsistently with shareholder wealth maximization and marketplace morality is highly problematic.

On the other hand, marketplace morality may often be permissive rather than mandatory in the sense that the moral desires of people in markets relevant to the firm may support allowing managers to follow their own morality in many circumstances. Donaldson and I¹⁰¹ refer to this as the domain of “moral free space” in which one makes choices based upon community norms and personal values. This is probably the case for the Merck example given above. It was certainly neither legally nor morally mandatory that Merck develop and then give away Mectizan. But it was permissible on both counts. There is no evidence to the effect that Merck’s actions were inconsistent with the marketplace morality of any of its relevant communities.

Principle 4. Managers must act consistently with mandatory hypernorms.

There is one circumstance, however, where following marketplace morality and/or the monotonic approach to shareholder wealth maximization is problematic. That is when the action violates what Donaldson and I have characterized as hypernorms.¹⁰² As discussed above, hypernorms are second-order norms¹⁰³ which serve to judge, and if necessary invalidate, local laws and local morality. Hypernorms “entail principles ... fundamental to human existence.... As such, we would expect them to be reflected in a convergence of religious, philosophical, and cultural beliefs....”¹⁰⁴ This is a high standard for a set of universal principles and presumably the number and scope of such standards would be limited. Consider the example of selling carcinogen contaminated pajamas in poor countries with insufficient background institutions to control the sale of such products.¹⁰⁵ This strategy for disposing of the product may well increase shareholder wealth and overseas sales

may not violate clearly identifiable marketplace morality in the firm's relevant markets. On the other hand, the product is prohibited for sale in the United States and in Europe and is potentially harmful to the intended users. Taking DeGeorge's first principle - Multinationals should do no intentional direct harm (unless there is a cardinal overriding justification)¹⁰⁶ - as a hypernorm, it becomes the obligation of all organizations to recognize this principle in regard to stakeholders.

Again, Donaldson and I¹⁰⁷ suggest the use of presumptions as a means for identifying relevant hypernorms. We suggest that if:

two or more of the following types of evidence confirm widespread recognition of an ethical principle, the decision-maker should operate on the basis of a rebuttable presumption that it constitutes a hypernorm. The more types of evidence in support of a hypernorm, the stronger the presumption.

Evidence in support of a principle having hypernorm status:

- Wide-spread consensus that the principle is universal
- Component of well known global industry standards
- Supported by prominent non-governmental organizations such as the International Labour Organization or Transparency International
- Supported by regional government organizations such as the European Community, the OECD, or the Organization of American States
- Consistently referred to as a global ethical standard by international media
- Known to be consistent with precepts of major religions
- Supported by global business organizations such as the International Chamber of Commerce or the Caux Round Table
- Known to be consistent with precepts of major philosophies generally supported by a relevant international community of professionals, e.g. accountants or environmental engineers
- Known to be consistent with empirical findings concerning universal human values
- Supported by the laws of many different countries

Once having gone through these steps and having identified a presumptive hypernorm, the decision-maker needs to consider whether evidence exists to overcome the presumption. If two or more of the following are found, then the presumption may be rebutted. However, the more types of evidence that support the presumption in favor of hypernorm status, the more types of evidence necessary to override the presumption.

Evidence countering the hypernorm presumption:

- Evidence from the presumptive list to the contrary, e.g. that the putative hypernorm principle does not represent a universal value
- Evidence from the presumptive list in support of hypernorm status for a mutually exclusive principle.¹⁰⁸

The marketplace morality approach places a high standard on those managers who wish to use a claim of stakeholder interests or general morality to act in a manner inconsistent with maximization of shareholder wealth. It requires that managers do more than just assert a consistency between their actions and moral obligation.¹⁰⁹ Instead, they should develop justifications in advance and stand ready to defend their stakeholder-based actions with evidence supporting the existence of hypernorms or objective evidence of validating marketplace morality.

IV. The Implications of Marketplace Morality for Law and Public Policy

A major foundation for a market morality based analysis is the liberty of individuals to hold moral desires and to seek to implement them in their daily decision making. For some people, implementing their moral desires is the most significant element of their lives. Each person should have a maximal opportunity to act as they prefer in this domain. Individuals acting on the basis of their moral desires may implement them through a wide variety of economic, political and social channels. They may vote consistently with their desires, lobby legislatures, boycott products, support social issue shareholder resolutions, buy or sell their stock in certain firms, try to persuade friends and strangers to act in a similar way and so on. Individuals also face many constraints in exercising their moral desires, particularly in the form of restrictive public policy and laws. Because there are many competing moral desires in political and social markets, this is to be expected. Those who find themselves blocked in one channel (e.g. legal interpretations of corporate governance standards, restrictions limiting social issue shareholder resolutions) may turn to other channels (lobbying for legislation, boycotts) as a means of giving effect to their preferences. Among

the many channels open to moral desires, the securities markets appear to be among the most open. One may buy and sell securities, at least for oneself, on the basis of whatever criteria one chooses.

As a general matter, supporting disclosure and individual choice in support of a marketplace of ideas is consistent with American traditions and ideals. As Oliver Wendall Holmes, dissenting in *Abrams v. United States*, put it so nicely: "... the ultimate good desired is better reached by free trade in ideas - that the best test of truth is the power of the thought to get itself accepted in the competition of the market and that truth is the only ground upon which their wishes safely can be carried out. That at any rate is the theory of our Constitution."¹¹⁰ The concept of market morality is also consistent with the concept of reflexive law which seeks to provide access to information and documentation of statements toward supporting decisions by private actors.¹¹¹ On the other hand, market morality is not consistent with the idea of legal endorsement of inauthentic norms. For example, it is not clear that the implied contract for job security argued for by O'Conner,¹¹² which would require directors to act as mediators between stockholders and employees, would meet the test of authentic norms.

The extreme monotonic view, implemented through the business judgment rule would have the effect of not only denying managers the ability to respond to marketplace morality, but might, in certain circumstances, result in managers violating mandatory hypernorms. Instead, the business judgment rule and other relevant policies should be interpreted consistently with the four guiding principles:

1. There is a presumption that all corporate actions must be undertaken to maximize shareholder wealth.
2. Managers must respond to and anticipate existing and changing marketplace morality relevant to the firm that may have a negative impact on shareholder wealth.

3. The presumption in principle 1 may be rebutted where clear and convincing evidence exists that marketplace morality relevant to the firm would justify a decision that cannot be shown to directly maximize shareholder wealth.
4. Managers must act consistently with hypernorms (manifest universal norms and principles.)

V. Conclusion

Analysis of the existence and nature of marketplace morality provides insights concerning the extent to which firm managers should consider the interests of stakeholders. Managers will more effectively satisfy their primary duty to shareholders when they accurately read signs indicating the presence of significant moral preferences within capital, consumer and labor markets relevant to the firm. Managers have a further obligation, based in a social contract, to act consistently with mandatory marketplace morality and manifest universal norms.

REFERENCES

- Abzug, Rikki and Natalie J. Webb. 1997. "Rational and Extra-Rational Motivations for Corporate Giving: Complementing Economic Theory with Organizational Science. 41 **New York Law School Law Review** 1035.
- Becker, Gary S. and Guity Nashat Becker. 1997. The Economics of Life. New York: McGraw-Hill.
- Becker, Gary S. 1996. Accounting for Tastes. Cambridge: Harvard University Press.
- Boatright, John R. "What's So Special About Shareholders?" Business Ethics Quarterly 4, no. 4 (1994): 393-407.
- Bollier, David. 1991. **Merck & Company**. Stanford, CA: The Business Enterprise Trust.
- Business Enterprise Trust. 1991. Merck & Co. (A)-(D).

Caux Round Table Principles for Business. Caux Round Table Secretariat, Washington, D.C. 1994.

Donaldson, Thomas, and Thomas W. Dunfee. 1999. **Ties That Bind: A Social Contracts Approach to Business Ethics**. Cambridge: Harvard Business School Press.

Donaldson, Thomas. and Thomas W. Dunfee. "Integrative Social Contracts Theory: A Communitarian Conception of Economic Ethics." Economics and Philosophy 11, no. 1 (1995): 85-112.

Donaldson, Thomas., and Thomas W. Dunfee. "Towards a Unified Conception of Business Ethics: Integrative Social Contracts Theory." Academy of Management Review 19, no. 2 (1994): 252-84.

Donaldson, Thomas, and Lee E. Preston. "The Stakeholder Theory for the Corporation: Concepts, Evidence, Implications." Academy of Management Review 20, no. 1 (1995): 65-91.

Donaldson, Thomas. The Ethics of International Business. New York: Oxford University Press, 1989.

Dunfee, Thomas W. 1998. The marketplace of morality: First steps toward a theory of moral choice. **Business Ethics Quarterly**, 8(1): 127-145.

Epstein, Edwin M. 1987A. "The Corporate Social Policy Process". *California Management Review*, 29(3) 99-114.

Epstein, Edwin M. 1987B. "The Corporate Social Policy Process and the Process of Corporate Governance", *American Business Law Journal*, 25(3):361-383.

Evan, William .M., and R.Edward Freeman. "A Stakeholder Theory of the Modern Corporation: Kantian Capitalism." In Ethical Theory and Business (4Th Ed.), edited by T. Beauchamp and N. Bowie, 75-93. Englewood Cliffs, NJ: Prentice Hall, 1988.

Frank, Robert H. 1996. "Can Socially Responsible Firms Survive in a Competitive Environment?" In David M. Messick and Ann E. Tenbrunsel, **Codes of Conduct: Behavioral Research Into Business Ethics**. New York: Russell Sage Foundation.

Freeman, R.E. "The Politics of Stakeholder Theory: Some Future Directions." Business Ethics Quarterly 4, no. 4 (1994): 409-21.

Frederick, William C. 1986. "Toward CSR3: Why Ethical Analysis is Indispensable and Unavoidable in Corporate Affairs, *California Management Review*, 28(2) 126- 141.

Friedman, Milton "The Social Responsibility of Business is to Increase Its Profits." New York Times Magazine, 13 September 1970, p. 32-33, 122,124,126.

Goodpaster, Kenneth E., and Laura L. Nash and John B. Matthews. 1998. **Policies and Persons: A Casebook in Business Ethics**. New York: McGraw-Hill. Case "Exxon Valdez: Corporate Recklessness on Trial, written by Beth Goodpaster under supervision of Thomas Holloran.

Goodpaster, Kenneth E., and Thomas E. Holloran. "In Defense of a Paradox." Business Ethics Quarterly 4, no. 4 (1994): 423-29.

Goodpaster, Kenneth E. "Business Ethics and Stakeholder Analysis." Business Ethics Quarterly 1, no. 1 (1991): 53-74.

Hampden-Turner, Charles. & Fons Trompenaars. The Seven Cultures of Capitalism. New York: Doubleday, 1993.

Hylton, Maria O'Brien. 1992. " 'Socially Responsible' Investing: Doing Good Versus Doing Well in an Inefficient Market". 42 **American University Law Review** 1

Kahneman, D., Knetsch, J. L. & Thaler R. "Fairness as a Constraint on Profit Seeking: Entitlements in the Market." American Economic Review 76, no.4 (September 1986):728-41.

Langbein, John H. 1985. "Social Investing of Pension Funds and University Endowments: Unprincipled, Futile and Illegal" in John H. Langbein, et. al. **Disinvestment: Is it Legal? Is it Moral? Is it Productive?**

Maitland, Ian. "The Morality of the Corporation: An Empirical or Normative Disagreement." Business Ethics Quarterly 4, no. 4 (1994): 445-58.

Messick, David M. 1996. "Why Ethics is Not the Only Thing that Matters." Business Ethics Quarterly 6(2): 223-226.

Millon, David. 1993. "Communitarians, Contractarians, and The Crisis in Corporate Law", Washington and Lee Law Review, 50(4): 1373-1393.

Mitchell, Lawrence E. 1995. Ed. *Progressive Corporate Law*. Boulder, Colorado: Westview Press.

O'Connor, Marlene A. 1995. "Promoting Economic Justice in Plant Closings: Exploring the Fiduciary/ Contract Law Distinction to Enforce Implicit Employment Agreements". In Lawrence E. Mitchell, Ed. **Progressive Corporate Law**. Boulder CO.: Westview Press.

Orts, Eric W. 1995. "Reflexive Environmental Law," *Northwestern Law Review* 89(4), pp. 1227-1340.

Orts, Eric W. 1993. "The Complexity and Legitimacy of Corporate Law", *Washington and Lee Law Review* 50(4): 1565-1623.

Orts, Eric W. (1992). "Beyond Shareholders: Interpreting Corporate Constituency Statutes," *George Washington Law Review* 61(1) pp. 14-135.

Posner, Richard A. 1992. **Sex and Reason**. Cambridge: St. Martin's Press.

Schulze, Robert John. 1997. Book Note. "Can This Marriage Be Saved? Reconciling Progressivism with Profits in Corporate Governance Laws." 49 *Stanford Law Review* 1607.

Sethi, S. Prakash, and Paul Steidlmeier. 1997. **Up Against the Corporate Wall: Cases in Business and Society**. 6th Ed. Upper Saddle River, NJ: Prentice-Hall.

Solomon, Lewis D. 1993. "On the Frontier of Capitalism: Implementation of Humanomics by Modern Public Held Corporations: A Critical Assessment". **Washington & Lee Law Review**. 50(4):1625-1671.

Endnotes

¹- Most of the principles developed in this article are consistent with extant corporate law. To the extent they diverge it raises an issue of whether the law should be modified.

²- The term "marketplace morality" is used throughout the article to refer to discernible aggregate moral preferences among an economic or socio-political group relevant to a particular firm, e.g. current and potential investors, consumers, employees, a political entity such as a state or the United States, etc.

³- David Millon, *Communitarians, Contractarians, and The Crisis in Corporate Law*, 50 *Washington and Lee L. Rev.* 1373 (1993) [hereinafter Millon, *Crisis*].

⁴- See A. A. Berle, *Corporate Powers as Powers in Trust*, 44 *Harv. L. Rev.* 1049 (1931); E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 *Harv. L. Rev.* 1145 (1932); A. A. Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 *Harv. L. Rev.* 1365 (1932). See also, A.A. Sommer, *Whom Should the Corporation Serve? The Berle-Dodd Debate revisited Sixty Years Later*. 16 *Del. J. Corp. L.* 33 (1991).

⁵- See 4(4) *Business Ethics Journal* (1994) and articles therein.

⁶- R. Edward Freeman, *The Politics of Stakeholder Theory: Some Future Directions*, 4 *Bus. Ethics. Q.* 409 (1994).

⁷- Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits*, *N.Y. Times Mag.*, September 13, 1970, at 32-33, 122,124,126.

⁸- See, generally, Lawrence E. Mitchell (ed.) *Progressive Corporate Law* (1995); Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 Wash. and Lee L. Rev. 1565 (1993); Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 Wash. & Lee L. Rev. 1409 (1993); David Millon, *Redefining Corporate Law*, 24 Ind. L. Rev. 223 (1991); Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 Tex. L. Rev. 865 (1990). For a bibliography of communitarian writing, which rejects the idea of shareholder primacy, see Millon, *Crisis*, *supra* note 4, at 1391-93.

⁹- Eric W. Orts is a consistent advocate for a pluralistic view arguing that an "... unidimensional economic view of corporate law is an incorrect empirical description" and that "(t)he policies underlying corporate law cannot (and presumably should not) be reduced to a unidimensional value, such as the economic objective of 'maximizing shareholders' wealth'..." Orts, *supra* note 9, at 1587.

¹⁰- D. Gordon Smith, *The Shareholder Primacy Norm*, 24 J. of Corp.L. 277, 278 (1998) (challenging the relevancy of the putative norm).

¹¹- See generally, Frank H. Easterbrook & Daniel R. Fischel, *The Economic Structure of Corporate Law* (1991); Larry E. Ribstein, *The Mandatory Nature of the ALI Code*, 61 Geo. Wash. L. Rev. 984 (1993); Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Green*, 50 Wash. & Lee L. Rev. 1423 (1993); Michael E. DeBow & Dwight R. Lee, *Shareholders, Nonshareholders and Corporate Law: Communitarianism and Resource Allocation*, 18 Del. J. Corp. L. 393 (1993).

¹²- For example, bondholders, distributors and suppliers may easily contract with the firm to protect their own economic interests.

¹³- Maitland argues that the disagreement between monotonists and pluralists boils down to different empirical assumptions. Ian Maitland, *The Morality of the Corporation: An Empirical or Normative Disagreement*, 4 Bus. Ethics Q. 445 (1994). Both sides want to recognize the self-determination of stakeholders. Monotonists conclude that stakeholder self-determination is reflected in their explicit or implied contracts with the shareholders; pluralists disagree and argue that public policy must intervene to protect stakeholder self-determination. *Id.*

¹⁴- Friedman, *supra* note 8, at 33.

¹⁵- Millon, *Crisis*, *supra* note 4, at 1378-79;

¹⁶- *Id.* at 1379

Interestingly, the same divergence of viewpoints is reflected in the 1994 Company Law in China, which provides a legal framework for the organization and operation of private stock companies. The new law sends mixed messages concerning corporate objectives and governance. Article 102 provides that shareholders "shall be the organ of authority of the company"; while Article 14 provides that "companies must ... strengthen the establishment of a socialist spiritual civilization, and accept the supervision of the government and the public". Michael Irl Nikkel, *Note: "Chinese Characteristics" in Corporate Clothing: Questions of Fiduciary Duty in China's Company Law*, 80 Minn. L. Rev. 503, 523 (1995).

¹⁷- John R. Boatright, *What's So Special About Shareholders?*, 4 Bus. Ethics Q. 393 (1994).

¹⁸- Kenneth E Goodpaster, *Business Ethics and Stakeholder Analysis*, 1 Business Ethics Quarterly 53 (1991).

¹⁹- See Edwin M. Epstein, *The Corporate Social Policy Process*, 29 Cal. Mgmt. Rev. 99 (1987); Edwin M. Epstein, *The Corporate Social Policy Process and the Process of Corporate Governance*, 25 Am. Bus. L.J. 361 (1987); William C. Frederick, *Toward CSR3: Why Ethical Analysis is Indispensable and Unavoidable in Corporate Affairs*, 28 Cal. Mgmt. Rev. 126 (1986).

²⁰- See generally Millon, *Crisis*, *supra* note 4; David Millon, *Theories of the Corporation*, 1990 Duke L.J. 210; William W. Bratton, *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 Cornell L. Rev. 407 (1989); Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship* (book review), 82 Cornell L. Rev. 856 (1997).

²¹- Cindy Schipani & Jim Walsh, *The Modern Firm: Is There Liberty and Justice for All?* 28 *Dividend* (University of Michigan School) 19, 23, 1997, (quoting A.A. Sommer.)

²²- The following discussion is taken from Business Enterprise Trust, *Case: Merck & Co. (A)-(D)* (1991), which provides an elaborate discussion of the case and the decision process at Merck.

²³- See Graeme Smith, *Precedent feared as Shell saves 34m: Atlantic grave approved for giant oil installation*, *The Herald* (Glasgow), Feb. 17, 1995, at 9.

²⁴- *Greenpeace admits error against Shell*, *L.A. Times*, September 6, 1995, at D2.

²⁵- *Shell oil platform to become a pier*, *The Houston Chronicle*, Jan. 30, 1998, at Business, p.1.

²⁶- *Id.*

²⁷- *Id.* In January 1998, after considering many disposal proposals, Shell decided to cut up the rig and make it into a pier in Norway. This plan will cost Shell around \$42 million, which is more than twice what it would cost to dump the rig at sea. *Id.*

²⁸- *L.A. Times*, *supra* note 25, at D2.

²⁹- *Id.*

³⁰- David Bollier, *Merck & Company* 11 (1991).

³¹- Shell UK director John Wybrew said that even after spending four years making the decision on what to do with the Brent Spar—which was the technically correct decision—the company failed to understand the public's opinion and the international interest the action would attract. Roger Cowe, *Shell Chief Laments PR Failure in Move to Dump Brent Spar*, *The Guardian* (London), Sept. 15, 1995, at 21.

³²- The claim may be made that this decision was made solely in reference to shareholder welfare with the firm calculating the likely benefits from reputation with future employees, customers and regulators. It is not clear that Merck management considered these factors other than in vague terms: e.g., research on ivermectin might lead to other discoveries. The better view appears to be that a primary motive for Merck was to benefit those afflicted with a horrible condition, regardless of whether they were able to realize direct profits from the product.

³³- “[A] decision that may be rational on purely business grounds is nonetheless subject to invalidation if management candidly admits that its motives were other than profit-based.” Kenneth Davis, *Discretion of Corporate Management to Do Good at the Expense of Shareholder Gain: A Survey of, and Commentary on, the U.S. Corporate Law*, 13 *Can.-U.S. L. J.* 7, 32 (1988). Professor Bainbridge states that corporate law generally holds to the following proposition. Bainbridge, *supra* note 12, at 1424.

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes. . . . [I]t is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of

benefitting others

Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

This statement is consistent with the traditional view that any consideration of non-shareholder interests must be rationally related to improving shareholder welfare. In some situations, the consideration of other interests (in the absence of an applicable other constituency statute) may be strictly forbidden. For example, in *Revlon v. MacAndrews & Forbes Holding, Inc.*, 506 A.2d 173 (Del. 1985) the court stated that it was inappropriate for the Revlon board to justify its actions by stating that it was protecting the corporation's noteholders when the company was clearly up for sale.

³⁴- For example, see the debate between Ronald Green and Stephen Bainbridge. See Green, *supra* note 9; Bainbridge, *supra* note 12. Green argues that strict adherence to the monotonist view can cause (or even require) managers to ignore small risks to stakeholders if acting on those risks would decrease shareholder wealth. Green, *supra* note 9, at 1419-21 (arguing that Union Carbide's managers would have a difficult time justifying expenditures to take extra safety precautions at their plant in Bhopal, India (which suffered an accident causing the deaths of over 2000 persons), because the risks of an accident were extremely small and the costs to improve the facility would be great). Bainbridge, however, argues that management acting on behalf of stakeholders can cause many problems, including a conflict of interest problem. Bainbridge, *supra* note 12, at 1446. Bainbridge also asks the question "How would I feel about living in a world governed by the moral rules implicit in the shareholder wealth maximization norm?" and responds "pretty good." *Id.* "For many years, the basic rule that shareholder interests come first has governed public corporations. That rule has helped produce an economy that is dominated by public corporations, which in turn has produced the highest standard of living of any society in the history of the world." *Id.*

In the business ethics literature, Norman Bowie argues that there are "unenlightened" and "enlightened" Friedmanites. While both types agree that a corporation exists to earn a profit within certain bounds, the unenlightened manager exploits nonshareholder stakeholders to increase short-term profits, but fails in the long-run due to lowered productivity and cooperation of those stakeholders. The enlightened Friedmanite manager, however, is concerned with the well-being of all its stakeholders and is able to sustain or improve long-term performance. Norman Bowie, *New Directions in Corporate Social Responsibility*, 34 Bus. Horizons 56 (July/August 1991), reprinted in Tom Beauchamp & Norman Bowie, *Ethical Theory & Business* 96-107, 97 (5th ed. 1997).

³⁵- It is interesting that there has not been more of a debate concerning corporate philanthropy. When a corporation gives money to a senior manager's alma mater or favorite cultural charity, a conflict of interest exists. The conflict is exacerbated when the gift results in memorializing the manager, as when a university building or an opera lounge is named for the manager even though the funds are provided by the firm.

³⁶- Corporations may also be natural entities, but that "fact" doesn't detract from their being legal entities.

³⁷- See generally Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 George Washington Law Review 14 (1992) [Hereinafter Orts, *Beyond Shareholders*].

³⁸- For a list of the states with other constituency statutes, see Wai Shun Wilson Leung, *The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime that Recognizes Non-Shareholder Interests*, 30 Colum. J.L. & Soc. Probs. 587, 613 n.140 & 620 n.171 (1997).

³⁹- Connecticut is an exception in that it requires consideration of nonshareholder interests. Conn. Gen. Stat. Ann. Section 33-133(e) (West Supp. 1993); Leung, *supra* note 39, at 619.

⁴⁰- Orts, *Beyond Shareholders*, *supra* note 38, at 24.

⁴¹- Orts notes that certain labor unions also lobbied for constituency statutes which mitigates the common wisdom that they are purely management self-interest statutes. *Id.* at 24-25.

⁴²- On the unenforceability of constituency statutes due to a failure to give nonshareholders standing to enforce a claim, see, e.g., Gary von Stange, *Corporate Social Responsibility through Constituency Statutes: Legend or Lie?*, 11 Hofstra Lab. L.J. 461, 488 (1994); Orts, *Beyond Shareholders*, *supra* note 38, at 55; Rima Fawal Hartman, *Situation-Specific Fiduciary Duties for Corporate Directors: Enforceable Obligations or Toothless Ideals*, 50 Wash. & Lee L. Rev. 1761, 178-87 (1993); Leung, *supra* note 39, at 617-18.

⁴³- See generally Orts, *Beyond Shareholders*, *supra* note 38, at 44, 92 (noting that corporate constituency statutes may not really be a change corporate law)

⁴⁴- As Solomon puts it, "(t)oday in the Anglo-American legal system, corporations have considerable flexibility in undertaking socially responsible activities." Lewis D. Solomon, *On the Frontier of Capitalism: Implementation of Humanomics by Modern Public Held Corporations: A Critical Assessment*, 50 Wash. & Lee L. Rev. 1625, 1626 (1993).

⁴⁵- Smith, *supra* note 11, at 290 (quoting the ALI Principles of Corporate Governance).

⁴⁶- For a list of the state statutes, see Edward Adams & Karl Knutsen, *A Charitable Corporate Giving Justification for the Socially Responsible Investment of Pension Funds: A Populist Argument for the Public use of Private Funds*, 80 Iowa L. Rev. 211, 232 (1995). For a discussion of the some of the issues raised by corporate philanthropy see Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. Rev. 579 (1997).

⁴⁷- Kenneth Davis, *Discretion of Corporate Management to Do Good at the Expense of Shareholder Gain: A Survey of, and Commentary on, the U.S. Corporate Law*, 13 Can.-U.S. L. J. 7, 22-23 (1988) (stating that the law faces many hurdles in "developing meaningful limits on management's discretion to pass off voluntarism as enlightened long-term profitmaking").

⁴⁸- See discussion, *supra*, notes 33 to 48.

⁴⁹- The debate has centered on the existence of a "paradox" for managers who must simultaneously satisfy stakeholder claims and maximize for the shareholder owners. See generally Boatright, *supra* note 18; R. E. Freeman, *The Politics of Stakeholder Theory: Some Future Directions*, 4 *Business Ethics Quarterly* 409 (1994); Kenneth Goodpaster, & Thomas E. Holloran, *In Defense of a Paradox*, 4 *Business Ethics Quarterly* 423 (1994). Boatright, for example, seeks to resolve the paradox by suggesting that managers may consider stakeholder claims independent of shareholder interests only when management does not have a direct fiduciary obligation to shareholders.

⁵⁰- The trade-offs can be between stakeholder and shareholder interests, or among stakeholder interests themselves when different groups of stakeholders hold mutually exclusive positions.

⁵¹- Friedman, *supra* note 8, at 33.

⁵²- Christopher Stone has criticized Friedman for not seriously considering those rules embodied in ethical custom, or perhaps Friedman considers them to be synonymous. See Christopher Stone, *Where the Law Ends: The Social Control of Corporate Behavior* 76 (1975). For example, Friedman asks whether a corporation is to make expenditures to reduce pollution "beyond the amount that is in the best interest of the corporation or that is required by law." Friedman, *supra* note 8, at 33. Friedman states that making that expenditure "for a general social interest" would be spending someone else's money. *Id.* Stone, however, argues that a different conclusion may be reached if the rules of ethical custom are considered. Stone, *supra* this note, at 76-77.

Norman Bowie also suggests that the rules of ethical custom could place duties on a Friedmanite manager "to not cause avoidable harms, or to honor individual stakeholder rights, or to adhere to the ordinary canons of justice." Bowie, *supra*, at 97. Bowie, however, also cites the views of Albert Carr and Theodore Levitt who

believe that it is not the ethical customs of society in general (or “ordinary morality”) that matters, but the distinct standards of business. *Id.* For example, Carr likens business’s ethics to those of poker, where deception, concealment, and ignoring friendships is what matters. *Id.*

⁵³ - “Corporations which exist solely to maximize profit become disconnected from their soul- the spiritual interconnectedness of humanity”. Ben & Jerry’s Annual Report, 1990, at 2 (quoted in Solomon, *supra* note 45, at 1625).

⁵⁴ - Elsewhere I have defined moral desires as pertaining to personal beliefs concerning right and wrong. Thomas W. Dunfee, *The Marketplace of Morality: First Steps Toward a Theory of Moral Choice*, 8 *Bus. Ethics Q.* 127 (1998). They “may be based in religious, ethical or sociopolitical convictions. Examples include observance of religious dietary laws or a religious-based refusal to accept any form of medical assistance. (Moral desires) may reflect a belief that it is wrong to discriminate on the basis of gender or sexual preferences. (They) may be motivated by a hope for salvation, by an interest in leading a virtuous life, or by a more immediate need for approval by peers.” *Id.* at 129.

⁵⁵ - Messick’s observation that ethics is not the only thing that matters is unquestionably true. David M. Messick, *Why Ethics is Not the Only Thing that Matters*, 6 *Bus. Ethics Q.* 223 (1996). It is hard to imagine serious advocacy of either extreme position: ethics never matters; only ethics matters.

⁵⁶ - Richard Posner appears willing to recognize the existence of some morality in the market, but refuses to believe that it would ever have much of an impact. “..people seem to behave morally in situations in which the costs of behaving morally are small, but to respond to incentives in situations in which those costs are large.” Richard Posner, *The Problems of Jurisprudence* 195 (1990).

⁵⁷ - A personal example helps to demonstrate. When the civil rights movement reached West Virginia in the early 1960s, my parents who had patronized a segregated cafeteria in my home town stopped eating there reflecting their support for integration. Parents of a neighbor, who had rarely ever eaten at the cafeteria, starting eating there regularly while the cafeteria was under pressure to integrate. The overall effect of those boycotting, or supporting, all acting on the basis of their moral desires was to decrease the business for the cafeteria. The issue of whether a desire for segregation can be characterized as a “moral desire” is discussed, *infra*, at note 67.

⁵⁸ - If the screening does not accurately reflect the preferences of the beneficiaries, the fund managers may be in breach of their legal duties. See John H. Langbein, *Social Investing of Pension Funds and University Endowments: Unprincipled, Futile and Illegal*, in *Disinvestment: Is it Legal? Is it Moral? Is it Productive?* (John H. Langbein et al. eds., (1985). However, critics such as Langbein appear to extend their opposition to the concept of social investing itself. So long as there is full disclosure and the screening is demonstrably consistent with the overall desires of the beneficiaries, it is consistent with the idea of morality in markets, and as will be argued, *infra*, a highly desirable phenomenon.

⁵⁹ - Merrill Lynch, *Priority Client Investor*, January, 1998.

⁶⁰ - Maria O’Brien Hylton, ‘*Socially Responsible’ Investing: Doing Good Versus Doing Well in an Inefficient Market*, 42 *Am. Univ. L. Rev.* 1, 2 (1992).

⁶¹ - Harold H. Kassirjian. *Incorporating Ecology into Marketing Strategy: The Case of Air Pollution*, 35 *Journal of Marketing* 61, 65 (July 1971). “Within six weeks after the introduction of the [pollution-reducing] gasoline, more than half of the population had paid an additional two to 12 cents per gallon to try the new brand.” *Id.*

⁶² Robert H. Frank, *Can Socially Responsible Firms Survive in a Competitive Environment?*, 95 in *Codes of Conduct: Behavioral Research Into Business Ethics* (David M. Messick and Ann E. Tenbrunsel eds., 1996).

⁶³- Fogarty, Thomas A., *Corporations Use Causes for Effect*, USA Today. Nov. 10, 1997, at 7B.

⁶⁴- D. Kahneman, J.L. Knetsch, & R. Thaler R., *Fairness as a Constraint on Profit Seeking: Entitlements in the Market*, 76 Am. Econ. Rev. 728 (1986).

⁶⁵- Frank, *supra* note 63, at 96.

⁶⁶- Frank also contrasts attitudes toward being a lawyer for the National Rifle Association and being a lawyer for the Sierra Club. Frank, *supra* note 63. This is apparently based on the assumption that most people would prefer to work for the Sierra Club than the NRA. But there may be people whose moral desires favor the right to own and use guns and who, consistent with the approach taken in this article, would be willing to work for the NRA for a lower salary than they would require to work for Handgun Control. Moral desires come in all hues and tones in the overall market and within the overall market the effect may be to cancel out the impact of particular competing desires. Some “moral” desires in the market such as the example given earlier of a preference for racial segregation may violate universal moral principles, or hypernorms as discussed *infra*. In many instances they will be canceled out by contrary preferences as was the case in the example of civil rights in West Virginia. If they come to dominate and become a community norm, they are nonetheless illegitimate because they violate hypernorms.

⁶⁷- Note that I am not making the claim that morality itself should be viewed as the output of a market. There are some interesting possibilities, however, in thinking of morality in market terms. There may be certain moral issues, such as the use of severance packages in downsizing, the use of animals in medical research, even abortion, where the input of competing moral desires operates in a manner similar to if not totally congruent with a market. In such a context, one could consider the demand factor to be a demand for resolution of the particular moral conflict. The supply is the competing moral desires as reflected in a variety of capital, consumer, labor and political market contexts. The outcome is the number of abortions, the typical size of severance packages, the number of animals used in research, and so on. These ideas are tentatively explored in Dunfee, *supra* note 55.

⁶⁸- *See*, Gary S. Becker, and Guity Nashat Becker, The Economics of Life (1997); Gary S. Becker, Accounting for Tastes (1996).

⁶⁹- Personal capital refers to “relevant past consumption and other personal experiences that affect current and future utilities,” while social capital refers to “the influence of past actions by peers and others in an individual’s social network.” Becker, *supra* note 69, at 4.

⁷⁰- *Id.* at 10-12.

⁷¹- *Id.* at 5-6.

⁷²- *See* Richard A. Posner, Sex and Reason (1992).

⁷³- One could just engage in a political analysis to determine whether the political system has somehow dictated that pluralistic values should be observed. It is well beyond the scope of this article, but there is obviously a question of how effective the political system is in giving effect to the moral desires of any relevant groups of people.

⁷⁴- Charles Hampden-Turner & Fons Trompenaars, The Seven Cultures of Capitalism 32 (1993).

⁷⁵- Barry Posner & Warren Schmidt, *Values and the American Manager*, 26 Cal. Mgmt. Rev. 202, 207 (1984).

⁷⁶- Orts, *Beyond Shareholders*, *supra* note 38, at 21.

⁷⁷- Caux Round Table Principles for Business (Caux Round Table Secretariat, Washington D.C., 1994)

The Caux Round Table is an organization comprised of very senior executives from Asia, Europe and the United States. It takes its name from its practice of holding its annual meetings at the Mountain House in Caux, Switzerland.

⁷⁸ - Thomas Donaldson and Thomas W. Dunfee, Ties That Bind: A Social Contracts Approach to Business Ethics (Forthcoming Cambridge: Harvard Business School Press, 1999) [Hereinafter Donaldson and Dunfee, *Ties That Bind*]; Thomas Donaldson and Thomas W. Dunfee, *Integrative Social Contracts Theory: A Communitarian Conception of Economic Ethics*, 11 *Econ. and Phil.* 85 (1995) [hereinafter Donaldson and Dunfee, *Communitarian*]; Thomas Donaldson, and Thomas W. Dunfee, *Towards a Unified Conception of Business Ethics: Integrative Social Contracts Theory*, 19 *Academy of Mgmt. Rev.* 252 (1994) [Hereinafter Donaldson and Dunfee, *ISCT*]. The description of ISCT used here tracks closely with Thomas W. Dunfee, *International Business Ethics*, in Rosalie Tung, The IEBM Handbook of International Business, London: International Thomson Business Press (forthcoming, 1998.)

⁷⁹ - Authentic norms are discussed further *infra* at III.C.

⁸⁰ - Donaldson and Dunfee, *ISCT*, *supra* note 79, at 265.

⁸¹ - M. Walzer, *Moral Minimalism* 9, in The Twilight of Probability: Ethics and Politics, (W.R. Shea & G.A. Spadafora eds., 1992).

⁸² - Determining what is a hypernorm is discussed *infra* at III.C.

⁸³ - Donaldson and Dunfee, *Communitarian*, *supra* note 79, at 105-106.

⁸⁴ - Shell has been involved in many controversial incidents, a few of the major events are listed here. For a discussion on Shell's public relations history, see Andrew Rowell, *Unlovable Shell, the goddess of oil*, *The Guardian* (London), November 15, 1997, at 23. After World War II, Shell manufactured pesticides on a site in the Rocky Mountains that the US military had previously used to make nerve gas. In 1960, a game warden notified Shell of harm to local wildlife that was believed to be caused by Shell's activities, but Shell continued operations in the area until 1982. *Id.* In 1988 and 1989, Shell operations caused a discharge of 440,000 gallons of oil into the San Francisco Bay and 150 tons of crude oil into the River Mersey in the United Kingdom. *Id.* Also in the 1980s, Shell refused to go along with a United Nations and OPEC boycott of oil supplies in South Africa. Yvette Cooper & David Orr, *When the people take on an oil giant*, *The Independent* (London), Nov. 14, 1995, at 15. Beginning in the early 1990s, the Ogoni people in Nigeria demanded that Shell compensate them for damage done to their homeland caused by Shell's operations. Rowell, *supra* this note, at 23. This situation became a major international event in 1995 (shortly after the Brent Spar incident) when the Nigerian military government executed Ken Saro-Wiwa, an Ogoni leader protesting Shell's activities, and eight others. The eight had been convicted by the Nigerian government for the murder of opposition tribal leaders. The Nigerian action was very controversial and drew worldwide condemnation. Shell failed to intervene or condemn the actions of the Nigerian government and many alleged that Shell had supported the military regime. Cooper & Orr, *supra* this note, at 15.

⁸⁵ - S. Prakash Sethi and Paul Steidlmeier, Up Against the Corporate Wall: Cases in Business and Society (6th ed., 1997).

⁸⁶ - Beth Goodpaster (under the supervision of Thomas Holloran), *Case: Exxon Valdez: Corporate Recklessness on Trial*, in Policies and Persons: A Casebook in Business Ethics (Kenneth E. Goodpaster, Laura L. Nash and John B. Matthews, eds., 1998)

⁸⁷ - *Id.*

⁸⁸ - Keith Schneider, *Exxon is Ordered to Pay \$5 Billion for Alaska Spill*, *N.Y. Times*, Sept. 17, 1994, at

1.

⁸⁹ - See *supra* part I.

⁹⁰ - See *supra* Part III.B.

⁹¹ - Donaldson and Dunfee, *Ties That Bind*, *supra* note 79.

⁹² - Unless, of course, they violate manifest universal ethical norms or principles. See the discussion of principle 4, *infra*.

⁹³ - See *supra* note 47 and accompanying text.

⁹⁴ - Rikki Abzug, and Natalie J. Webb, *Rational and Extra-Rational Motivations for Corporate Giving: Complementing Economic Theory with Organizational Science*, 41 New York Law School Law Review 1035, 1035 (1997).

⁹⁵ - Robert John Schulze, *Book Note: Can This Marriage Be Saved? Reconciling Progressivism with Profits in Corporate Governance Laws*, 49 Stanford L. Rev. 1607, 1612 (1997).

⁹⁶ - Goodpaster incorporates a “Nemo Dat Principle” into his discussion of stakeholder synthesis nothing that investors cannot expect managers to act on their behalf in a manner “that would be inconsistent with the reasonable expectations of the community.” Kenneth E. Goodpaster, *Business Ethics and Stakeholder Analysis*, 1 Business Ethics Q. 53-74, at 68 (1991).

⁹⁷ - William M. Evan, and R. Edward Freeman, *A Stakeholder Theory of the Modern Corporation: Kantian Capitalism*, in Ethical Theory and Business 75-93 (T. Beauchamp & N. Bowie, eds., 4th ed. 1988).

⁹⁸ - Thomas Donaldson, and Lee E. Preston, *The Stakeholder Theory for the Corporation: Concepts, Evidence, Implications*, 20 Academy of Mgmt. Rev. 65 (1995).

⁹⁹ - Thomas Donaldson, The Ethics of International Business 47 (1989).

¹⁰⁰ - Presumably such cases will be rare and Kantian morality will typically be congruent with marketplace morality in relevant communities.

¹⁰¹ - Donaldson and Dunfee, *Ties That Bind*, *supra* note 79; Donaldson and Dunfee, *ISCT*, *supra* note 79.

¹⁰² - See *supra* Part III.B.

¹⁰³ - By second order, we mean higher. Thus first order norms are judged by and are inferior to second order norms.

¹⁰⁴ - Donaldson and Dunfee, *ISCT*, *supra* note 79, at 265.

¹⁰⁵ - See Richard T. DeGeorge 46 Competing with Integrity in International Business. (1993)

¹⁰⁶ - *Id.*

¹⁰⁷ - Donaldson and Dunfee, *Ties That Bind*, *supra* note 79.

¹⁰⁸ - Donaldson & Dunfee, *Ties that Bind*, *supra* note 79.

¹⁰⁹ - The emphasis on objective or manifest evidence is responsive to the concerns of critics such as Schulze who worry that the pluralistic proposals are “unworkable because they eliminate much of the guidance for managerial decision making. Under (the pluralistic) reforms, executives would be free to manage corporations based on caprice or bias. Moreover, the proposals leave no objective legal standard by which to judge and evaluate managerial performance.” Schulze, *supra* note 96, at 1612.

¹¹⁰ - 250 U.S. 616, 630 (1920).

¹¹¹ - See Eric W. Orts, *Reflexive Environmental Law*, 89 *Northwestern Law Review* 1227 (1995); David W. Hess, *Legislating Corporate Social Responsiveness Reflexively Through Social Reports*, paper presented at the Society of Business Ethics annual meeting (August 7-9, 1998). Reflexive laws can be distinguished from “substantive” law on how they, as regulatory schemes, take responsibility for the outcome of social activity. Substantive law essentially mandates a certain outcome, while reflexive law preserves the freedom of regulated parties to reach their own outcomes but establishes procedures that will force those parties to “take account of various externalities.” Gunther Teubner, *Substantive and Reflexive Elements in Modern Law*, 17 *Law & Soc. Rev.* 239, 255-57 (1983). Orts argues for environmental audits as a reflexive law alternative to substantive regulation (e.g., command-control regulation) because they work towards institutionalizing environmental responsibility within corporations. Orts, *supra* this note, at 1339. Similar to the National Environmental Policy Act, which requires agencies to prepare environmental impact statements, environmental audits work on the assumption that the process of preparing an audit will promote responsible decision-making. *Id.* at 1272-75. Some of the key components of an environmental audit regulatory scheme are third party verification and public disclosure. *Id.* at 1322-24. Similar to securities regulation, these requirements promote more efficient markets by giving the market participants more information. *Id.* at 1312.

¹¹² - Marlene A. O’Connor, *Promoting Economic Justice in Plant Closings: Exploring the Fiduciary/Contract Law Distinction to Enforce Implicit Employment Agreements*, in Progressive Corporate Law (Lawrence E. Mitchell, ed., 1995) at p. 235. See also, Marleen A. O’Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 *Cornell L. Rev.* 899 (1993).