

## THE CORPORATION AS IMPERFECT SOCIETY

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### ABSTRACT

*The way we think determines the way we will act. The way we conceive of a corporation will have profound implications for how judges, legislators, directors and employees will act with respect to a corporation. Current corporation theory is dominated by private law conceptions of the corporation. Such a conception places, in the realm of private ordering, not only corporate law, but corporate decision making. Yet, corporations, especially publicly traded ones, are public entities. Ontologically they are more similar to governments than private contractual relations. This Article argues that rather than contract or property law, public constitutional law is a more appropriate hermeneutic for understanding the corporation. Consequently the Article applies Aristotelian political philosophy to the corporate enterprise. The Article argues that the corporation is one of the many imperfect societies that form the perfect society of the nation. The implications of such understanding involve a recognition that the corporation must be governed consistently with the common good of the corporation but with due attention paid to the common good of the perfect society of which the corporation is a part.*

*The Article turns from theory to practice and briefly examines some of the main aspects of modern corporate law. The analysis reveals that the principles of Aristotelian political philosophy are evident in the results of corporate law decisions. This is not surprising since the corporate form developed in the shadow of such philosophy which formed the basis of Western political philosophy generally.*

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## I. INTRODUCTION

If we judge it less cynically, the idea of corporate governance is at least useful in reminding us that companies *are* systems of government.

Debates about the role, composition and duties of the board of directors; about the role and rights of shareholders, either individually, in groups, or as a whole; and about the ways in

which directors and shareholders interact within a company, all raise some fundamental questions about the structures and processes of government within corporations.<sup>1</sup>

Corporations are ubiquitous in modern society.<sup>2</sup> They pervade every aspect of our life, as well as our consumer, professional, and investment activity. People probably have more contact with corporations on a daily basis than any other institution, including government.<sup>3</sup> From the South Sea Bubble to the Stock Market Crash of 1929 to Enron to General Motors and Countrywide Mortgage, corporate scandals and controversies invite fundamental questions about corporate law. This Article attempts to bring a fresh perspective to the question: "What is a corporation and how should the law treat it?" This Article articulates a corporate metaphysics rooted in political philosophy.

The dominant models of corporate law and philosophy are rooted in the realm of private law: particularly contract, agency, and property law. Corporations are viewed as a nexus of contracts or as vehicles for joint ownership of a pool of economic assets. Conceptualizing corporate law as an area of law facilitating private ordering has led to the entrenchment of the principle of shareholder wealth maximization. Corporations exist to maximize shareholder wealth. This conception affects the philosophy underpinning the system of corporate law. Although some commentators and policy makers have argued for some attention to the interests of other stakeholders or constituencies of a corporation, their arguments are still couched primarily within the hermeneutic of private law, albeit somewhat modified by their concern for particular groups or stakeholders. Placing corporate law within a political venue, however, allows corporate law to ask more fundamental questions such as: What is the purpose of a corporation within the larger society? How should its organization be structured? What claims should its authorities have over other members of the corporation? What are the roles and responsibilities of authority figures in a political community? As created, corporations are a legal entity "separate from the flesh-and-blood people who were its owners and managers."<sup>4</sup> This leaves the

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<sup>1</sup>Stephen Bottomley, *From Contractualism to Constitutionalism: A Framework for Corporate Governance*, 19 SYDNEY L. REV. 277, 277 (1997).

<sup>2</sup>See Daniel J.H. Greenwood, *Markets and Democracy: The Illegitimacy of Corporate Law*, 74 UMKC L. REV. 41, 47, 58 (2005).

<sup>3</sup>*Id.* at 42 ("[C]orporate managers are entrusted with stewardship of enormous concentrations of wealth and power—in many instances both larger and more important in our daily lives than most governmental units").

<sup>4</sup>JOEL BAKAN, *THE CORPORATION: THE PATHOLOGICAL PURSUIT OF PROFIT AND POWER*

question of whether the corporation is "essentially a private association subject to the laws of the state but with no greater obligation than making money, or a public one which is supposed to act in the public interest?"<sup>5</sup>

Based on Aristotelian political philosophy, this Article constructs a theory of corporations as political entities. In this light, corporate law is really a form of public law and not private ordering. Corporations are in the language of Aristotelian philosophy, imperfect communities which are one of several constituent parts of a perfect community, the civil polity. The end of corporations, production of certain economic goods, is an imperfect end. Corporations also lack internally all the means to achieve their end and are dependent on the rest of civil society to attain it. Several implications flow from this vision. Those who command authority within the corporate community have obligations to the larger perfect community as well as to all the members of the corporate community. The imperfect ends of corporations must be harmonized to the common good of the civil society. Those exercising political authority within the imperfect community have the obligation to exercise that authority for the common good of the corporation, not just the individual good of any one member, be they managers, directors, shareholders, creditors, suppliers, customers, or employees. This Article concludes by observing that, although this vision of the corporation differs from much of the commentary on corporate metaphysics, corporate law and many corporate practices are actually more consistent with this vision of the corporation as an imperfect society committed to the common good than the shareholder wealth maximization standard. The philosophy of corporate law should be realigned to take account of this reality.

Part II of this Article presents a critical summary of the dominant forms of corporate metaphysics rooted in concepts of private law. Part III presents a constitutional theory of the corporation. By examining the Aristotelian understanding of a political community and the differences between a perfect and an imperfect community this part argues that a corporation ought to be understood within the framework of political philosophy rather than private law. The analysis demonstrates that a corporation is a form of imperfect society. Part IV considers an implication of the corporation being considered a political community: the requirement of the common good that attaches to all authorities of a political community. From this concept of the common good the common purpose of a corporation is found in the satisfaction of customers of a corporation. Part V demonstrates that the vision of the corporation as an imperfect community

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16 (2004).

<sup>5</sup>JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, *THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA* 54 (2003).

committed to the common good is reflected in the reality of corporate law as it exists.

## II. AN OVERVIEW OF CORPORATE METAPHYSICS

### A. *Corporate Law as Property Law*

One conceptualization of the corporation that has pervaded the last century's discussion is rooted in property law. The corporation is the property of the shareholders; thus, corporate law is a form of private property law. Chancellor Allen summarizes this view: "[T]he corporation is seen as the private property of its stockholder-owners. The corporation's purpose is to advance the purposes of these owners (predominantly to increase their wealth), and the function of directors, as agents of the owners, is faithfully to advance the financial interests of the owners."<sup>6</sup> This view of the corporation as the private property of its shareholders may make sense for a company that is entirely—or at least a majority—financed by its shareholders. Yet, with large scale financing of public companies by debt, is it really accurate to think of these as entities owned by its shareholders? For public North American companies reporting balance sheet information for fiscal year 2008, the average ratio of total liabilities to stockholders equity was 17.25.<sup>7</sup> The median and mode for the same group of companies was 1.12 and 4.08, respectively.<sup>8</sup> Even when only long-term debt is compared to shareholders' equity, the average, median, and mode were reduced to 16.05, 0.054, and 2.32, respectively.<sup>9</sup> Thus, the capital invested in public companies does not come exclusively from shareholders and in many cases it comes many times over from debt investors. Can anyone say that company such as California Petroleum Transport Corporation, which had a debt to equity ratio of 68,039, is really owned by its shareholders?<sup>10</sup> Taking a less extreme example, one of the companies in the mode with a ratio of 2.32, BWAY Holding Company,

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<sup>6</sup>William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264-65 (1992).

<sup>7</sup>This figure was derived from data made available by Compustat North America and is an average of 6900 companies for which both liabilities and shareholders' equity was reported and which had a positive ratio. The calculation excludes five companies whose ratio was zero (or virtually zero) and 667 companies with a negative ratio. There were 1662 companies for which either liabilities or shareholders' equity data was unavailable.

<sup>8</sup>*Id.*

<sup>9</sup>When calculating the ratio of long term debt to shareholders equity there were 2,138 companies with a negative ratio and 478 with a ratio of zero (or virtually zero).

<sup>10</sup>CAL. PETROLEUM TRANSP. CORP., ANNUAL REPORT (Form 10-K) (March 19, 2010) (listing long term debt as \$68.039 million and shareholders' equity as \$1000).

had a shareholders' equity of \$173.7 million and total long term debt of \$402.4 million, while its total liabilities were \$708.7 million.<sup>11</sup> Can shareholders who have contributed less than half of the total capital of a business really be considered its owners? If all liabilities were considered capital, this figure would fall to less than a quarter of the total capital.

Beyond the financing of corporations, commentators have argued that in light of modern forms of stock ownership, "shareholders . . . do not resemble traditional owners" of property.<sup>12</sup> With the advent of tiered ownership through nominees and multi-layered mutual funds, shareholders are often institutionally removed from the corporations that the property theorists purport to argue that they own.<sup>13</sup> As much as two-thirds of equity securities are now owned through institutional, mediated structures.<sup>14</sup> Even if ownership is direct, shareholders "own shares, not the corporation," and "lack most of the rights ordinarily associated with" ownership of property.<sup>15</sup> At best, the property ownership model may only be a metaphor for the corporation/shareholder relationship, and a strained one at that.<sup>16</sup>

Despite such pointed criticism, the model of a corporation as the property of shareholders has a long history. Adolf A. Berle and Gardiner C.

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<sup>11</sup>BWAY, ANNUAL REPORT (Form 10-K) (December 11, 2009) (citing financial information for the fiscal year ending September 28, 2008).

<sup>12</sup>Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 649 (2005).

<sup>13</sup>See Roberta S. Karmel, *Implications of the Stakeholder Model*, 61 GEO. WASH. L. REV. 1156, 1158 (1993) (taking note of the effect of institutional ownership on corporate ownership).

<sup>14</sup>THE CONFERENCE BOARD, *THE 2008 INSTITUTIONAL INVESTMENT REPORT* 5, 20 (2008) (noting that institutional investor holdings grew from 6.1% of total equity markets in 1950 to 66.3% in 2006).

<sup>15</sup>Greenwood, *supra* note 2, at 53.

<sup>16</sup>Daniel J.H. Greenwood, *Fictional Shareholders: For Whom are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021, 1029 (1996). A further discussion of the metaphor stated:

As powerful as the fiduciary and principal-agent metaphors have been, it is not hard to see that in many ways, they misrepresent the realities of the shareholder-management relationship. . . . One problem, long acknowledged in corporate law, is that ownership of a corporation is significantly different from the ownership of personal possessions. By and large, shareholders have no right to control the use of corporate assets. . . . This separation [of ownership and control] complicates the simple and morally compelling picture of owners exercising their will through agents whom they have expressly hired for that purpose and who correspondingly owe them duties of loyalty and service. In fact, in exchange for a good return on their investment, shareholders of public corporations have, by everyone's admission, already relinquished most of what we normally think of as the powers of ownership.

Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE. L. REV. 1409, 1413 (1993).

Means gave clear expression to the view of corporations as property of shareholders in their book *The Modern Corporation and Private Property*.<sup>17</sup> As the title implies, corporations are seen as property and corporate law contains the rules affecting the management of that property. Daniel P. Sullivan and Donald E. Conlon observe:

Berle and Means . . . reconceived the norms of governance in terms of the principle that the corporation's property is the property of the shareholders and "it is unquestionably on their behalf that the directors are bound to act. . . . Managerial powers are held in trust for stockholders as sole beneficiaries of the corporate enterprise."<sup>18</sup>

As this quotation indicates, the fact that the owner's property is managed by another implicates another form of private law in corporate law, the law of trusts and agency. Through much of the nineteenth century, corporate law—especially as it relates to corporate directors—was written in the language of private trust and agency law. Williston describes this original conceptualization in this way: "The old idea was rather that the corporation held all its property strictly as a trustee, and that the shareholders were, strictly speaking, *cestuis que trust*, being in equity co-owners of the corporate property."<sup>19</sup> The employment of the language borrowed from trust

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<sup>17</sup>ADOLF A. BERLE, JR., & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932) (examining the implications of the separation of the ownership of this property from the control of the property); *see also* Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1, 3 (2002) (describing the defining characteristic of a corporation as the separation of ownership in the shareholders from control in the managers).

<sup>18</sup>Daniel P. Sullivan & Donald E. Conlon, *Crisis and Transition in Corporate Governance Paradigms: The Role of the Chancery Court of Delaware*, 31 LAW & SOC'Y REV. 713, 731 (1997) (quoting E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1147 (1932)).

<sup>19</sup>Samuel Williston, *History of the Law of Business Corporations Before 1800*, 2 HARV. L. REV. 149, 149-50 (1888). Williston quotes from the case of *Charitable Corp. v. Sutton*, which speaks of the potential liability of directors (called committee-men) as a "breach of trust," and uses other language of trust and agency. *Id.* at 158 (quoting Lord Hardwicke in *Charitable Corp. v. Sutton*, 2 Atk. 400, 400 (1742)). Williston continues: "Committee-men are most properly agents to those who employ them in this trust, and who empower them to direct and superintend the affairs of the corporation. In this respect they may be guilty of acts of commission or omission, of malfeasance or nonfeasance." *Id.* (quoting Lord Hardwicke in *Sutton*, 2 Atk. at 405); *see also* Koehler v. Black River Falls Iron Co., 67 U.S. 715, 721 (1862) ("The directors are the trustees or managing partners, and the stockholders are the *cestuis que trust*, and have a joint interest in all the property and effects of the corporation. . . ."); *Hale v. Republican River Bridge Co.*, 8 Kan. 466, 472 (1871) ("Directors of a corporation, in reference to the corporate property, act in the relation of trustees. The stockholders are the *cestuis que trust*."); *Butts v. Wood*, 37 N.Y. 317, 318 (1867)

and agency law produced the phrasing of conclusions about the duties of the directors sounding in trust language:

The directors are the trustees or managing partners, and the stockholders are the cestuis que trust, and have a joint interest in all the property and effects of the corporation, and no injury that the stockholders may sustain by a fraudulent breach of trust can, upon the general principles of equity, be suffered to pass without a remedy.<sup>20</sup>

By the end of the nineteenth century, commentators began to realize that corporate law was not really a species of trust law but only generally analogous to it.<sup>21</sup> A case that exemplifies the lack of clarity regarding to whom directors owed duties is *Stewart v. Harris*.<sup>22</sup> In their opinion, the Supreme Court of Kansas observed:

That they [the managers of a corporation] are trustees for the corporation and the corporate property all the authorities are agreed. It would be difficult to lay down a general rule comprehensive of the extent and all the instances in which their trusteeship exists as to the stockholders of the corporation.<sup>23</sup>

The adoption of the business judgment rule, which lies at the foundation of modern corporate law and directors' duties, marked a judicial rejection of the agency theory of corporate directors.<sup>24</sup> The directors' powers and duties are not delegated from shareholders but by the applicable

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(describing the shareholder/director relationship as "that of trustee and *cestui que trust*").

<sup>20</sup>*Koehler*, 67 U.S. at 721 (1862) (citation omitted).

<sup>21</sup>See, e.g., SEYMOUR D. THOMPSON, COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS § 1217, at 168 (2d ed. 1909) (discussing the "[r]elation of directors to individual stockholders" and how many cases affirm that directors do not stand in an actual fiduciary relation toward the individual shareholder). In an earlier work, this same commentator expressed the same sentiment as follows:

It is by no means a well-settled point what is the precise relation which directors sustain to the stockholders. They are undoubtedly said in many authorities to be trustees, but that as I apprehend is only in a general sense, as we term an agent or any bailee intrusted with the care and management of the property of another.

SEYMOUR D. THOMPSON, THE LIABILITY OF DIRECTORS AND OTHER OFFICERS AND AGENTS OF CORPORATIONS 236 (1880).

<sup>22</sup>77 P. 277 (1904).

<sup>23</sup>*Id.* at 279.

<sup>24</sup>See Reuven S. Avi-Yonah, *The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility*, 30 DEL. J. CORP. L. 767, 799 (2005).



corporation law.<sup>25</sup> "The business and affairs of every corporation . . . shall be managed by or under . . . a board of directors[.]"<sup>26</sup> not by and under the direction of shareholders. If shareholders were principals delegating to director agents, they would have the right to call into question decisions of their agents in a way precluded by the business judgment rule.

Despite corporate law's recognition of an ambiguity as to whom a trust or agency duty is owed (the corporation or the shareholders) and ultimate rejection of the agency view of corporate management, throughout the twentieth century corporate theory still spoke about the shareholders as owners, and directors and managers as at least analogous to trustees. Directors and managers are viewed by this persistent theory as "mere stewards of the shareholders' interest."<sup>27</sup> This philosophy is reflected most strongly in the shareholder wealth maximization conception of the corporation. The obligations of directors, whether rooted in property or trust law, center on making money for shareholders as ultimate owners.<sup>28</sup> As Milton Friedman, champion of this conception of the corporation, stated, the responsibility of directors is to "conduct the business . . . to make as much money as possible while conforming to the basic rules of the society."<sup>29</sup> Professor Joel Bakan cynically observes: "CEO's . . . 'have learned to repeat almost mindlessly', like a mantra, that 'corporations exist to maximize shareholder value'; they are trained to believe self interest is 'the first law of business.'"<sup>30</sup> Finally, Steven Bainbridge summarizes the causal connection between the property theory of the corporation and shareholder wealth maximization:

The corporation is a thing, so it can be owned. The shareholders own the corporation, so directors are merely stewards of their interests. Because no one can serve two

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<sup>25</sup>*Id.* at 799-800; *see also* DEL. CODE ANN. tit. 8, §141 (a) (2006) ("[T]he powers and duties conferred or imposed upon the board of directors *by this chapter . . .*") (emphasis added).

<sup>26</sup>DEL. CODE ANN. tit. 8, §141 (a) (2006).

<sup>27</sup>Bainbridge, *supra* note 17, at 6.

<sup>28</sup>It is possible, however, to accept a property model of the corporation and argue that directors owe some obligations to constituencies other than shareholders. *See* Ronald J. Colombo, *Ownership, Limited: Reconciling Traditional and Progressive Corporate Law via an Aristotelian Understanding of Ownership*, 34 J. CORP. L. 247, 249-50 (2008) (arguing that directors, although acting on behalf of shareholder owners, are bound by the same moral constraints in using property as the actual owners would be if it were owned directly).

<sup>29</sup>Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES, Sept. 13, 1970, § 6 (Magazine), at 33.

<sup>30</sup>BAKAN, *supra* note 4, at 142 (quoting Robert Simons et al., *Memo To: CEOs, FAST COMPANY*, June 2002, at 117, 118).

masters at the same time, if shareholder and stakeholder interests conflict, directors cannot be loyal to both constituencies. The board of directors' role as stewards requires it to prefer the interests of its shareholder masters.<sup>31</sup>

Notwithstanding the conflict between agency theory and the business judgment rule, by the late twentieth century this idea of an explicit property right or trust duty gave way to some sort of a consensus that the managers of corporations have to manage the corporation in response to shareholder interest alone. As Henry Hansmann summarized it:

The principal elements of this emerging consensus are that ultimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; other corporate constituencies, such as creditors, employees, suppliers, and customers, should have their interests protected by contractual and regulatory means rather than through participation in corporate governance. . . .<sup>32</sup>

The agency or trust view of the corporate directors still echoes throughout corporate theory, even if rejected by corporate law.

### B. *Corporate Law as Contract Law*

As an alternative to property-based metaphysics, some scholars have offered a contractual explanation for corporations. This theory examines a corporation as a creature of contract, rather than property or agency law.<sup>33</sup> Corporate law is seen as a subset of contract law; corporate governance and management, as creatures of real or purported contracts. The body of law identified as corporate law is merely a special set of contract terms applicable to this subset of contracts addressing corporate governance. It serves primarily as a set of gap filling terms that complete the purported

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<sup>31</sup>Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 1005 (1992).

<sup>32</sup>Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440-441 (2001).

<sup>33</sup>See Bottomley, *supra* note 1, at 280 (discussing the concept of legal contractualism as it is understood in Australian corporate law scholarship).

contracts between shareholders and managers the way that the common law of contracts and the Uniform Commercial Code contain gap filling terms for other contracts.<sup>34</sup>

This contract, like the fictional contract in social contractarian political philosophy, is only a metaphor or construct. The shareholders do not really enter into an actual contract. Their consent to the terms of the constitutional documents, prepared by the incorporators, is deemed to be given by their acquisition of shares.<sup>35</sup> This process has none of the hallmarks of contract formation.<sup>36</sup> There is no negotiation between directors and shareholders in public companies; nor is there execution by the shareholders of any written document. Further anomalies to typical contracts exist as well. For example, the contract can be changed without the consent of all contracting parties and issues of interpretation are not resolved by courts examining the intent of the parties.<sup>37</sup> Contract law is generally "interventionist," with substantive law mediating the effects of bargained agreements.<sup>38</sup> This stands

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<sup>34</sup>FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 34 (1991).

[C]orporate law is a set of terms available off-the-rack so that participants in corporate ventures can save the cost of contracting. . . . Corporate law—and in particular the fiduciary principle enforced by courts—fills in the blanks and oversights with the terms that people would have bargained for had they anticipated the problems and been able to transact costlessly in advance. On this view corporate law supplements but never displaces actual bargains . . . .

*Id.*

<sup>35</sup>See Bottomley, *supra* note 1, at 279-82 (noting the peculiarities of the corporate as compared to the classical contract in Australian corporate law).

<sup>36</sup>Green, *supra* note 16, at 1413-14. Green, citing John Boatright, goes on to note that:

The image of shareholders as owners-principals who enter into solemn agreements with either senior managers or directors breaks down further if we seek to identify any of the promises, covenants, or contracts, which this vision presumes. At what point do shareholders and managers ever freely enter into a relationship in which one party promises to perform specified services in return for payment or other consideration?

[T]he idea of a contract is most at home in situations in which two parties are able to negotiate a set of mutual obligations which governs specific interactions.

In the case of shareholders and management, however, there is virtually no opportunity for the two parties to negotiate the terms of their relation.

*Id.* (quoting John R. Boatright, *The Shareholder-Management Relation and the Stakeholder Paradox* (paper presented at the Annual Meeting of the Society for Business Ethics, Atlanta, Ga., Aug. 6-7, 1993)).

<sup>37</sup>See Bottomley, *supra* note 1, at 281 (discussing this phenomena in the context of Australian law).

<sup>38</sup>Greenwood, *supra* note 2, at 51-52.

in contrast to corporate law, which "is not interventionist at all."<sup>39</sup> Despite these anomalies, the contract theory persists.

Acceptance of a contractarian model brings with it several consequences. One is that corporate decision making is placed in the realm of economic decision making, which is rooted in the idea of negotiating for one's particular or individual economic best interest. Contract law is about economic negotiating and decision making. When a corporation is seen as a vehicle for contractual (economic) decisions, corporate decision makers are encouraged to make decisions in purely economic ways.<sup>40</sup> A contractarian view of corporations also engenders skepticism about government interference with, or regulation of, corporate dealings and decision making. Contract law is considered a type of private law where governments should primarily enforce the private agreements of parties, subject to limited exceptions.<sup>41</sup> Freedom of contract is an underlying principle of a contractual framework.<sup>42</sup>

Some scholars offer a more complicated understanding of corporate law as contract law.<sup>43</sup> According to them, a corporation is more than a simple contract between shareholders and managers; it is a nexus of all sorts of contracts, both within the corporation as well as between the corporation and outside parties.<sup>44</sup> Rather than a hierarchical relationship between shareholder/owners and manager/agents, the corporation is a "complex web

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<sup>39</sup>*Id.* at 52.

<sup>40</sup>CHANDRAN KUKATHAS & PHILIP PETTIT, RAWLS: A THEORY OF JUSTICE AND ITS CRITICS 32 (1990) ("The economic way is for each to calculate what best suits his own interests and then to try to get this . . .").

<sup>41</sup>See Bottomley, *supra* note 1, at 289.

<sup>42</sup>*Id.*

<sup>43</sup>See, e.g., Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 307-08 (1976) (noting that the specification of property rights is usually "effected through contracting").

<sup>44</sup>See Bainbridge, *supra* note 17, at 5-6; see also Melvin A. Eisenberg, *The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 825-27 (1999) (discussing the difficulties of viewing shareholders as owners of the corporation under the nexus-of-contracts conception). Professor Bainbridge notes that:

[A]ll [nexus of contract scholars] visualize the firm not as an entity but as an aggregate of various inputs acting together to produce goods or services. . . . In this model, the firm is a legal fiction representing a complex set of contractual relationships. In other words, the firm is not a thing, but rather a nexus or web of explicit and implicit contracts establishing rights and obligations among the various inputs making up the firm. Because shareholders are simply one of the inputs bound together by this web of voluntary agreements, ownership is not a meaningful concept under this model. Each input is owned by someone, but no one input owns the totality.

Bainbridge, *supra* note 31, at 1005-06 (footnotes omitted).

of explicit and implicit contracts."<sup>45</sup> Proponents of the "nexus of contract" theory do not see the corporation as anything other than the sum of the individual market transactions among interested parties that are amalgamated in what we call a corporation.<sup>46</sup>

Despite anchoring their conception of the corporation in contract law, as opposed to property and agency law, most nexus of contract adherents "continue to treat directors and officers as agents of the shareholders, with fiduciary obligations to maximize shareholder wealth."<sup>47</sup> The wealth maximization obligation derives not from an agency or trust relationship, but merely because that is what the shareholders, implicitly or explicitly, contracted for when they purchased their investment.<sup>48</sup> "[O]ne key term in the shareholders' contract with management [one of the many contracts in the nexus] is the open-ended injunction that management act 'in the best interests of the corporation and its shareholders.'"<sup>49</sup>

Like the property and agency metaphysical foundation, the contract theory of corporations presents several problems. First, it is, to at least some degree, a fiction. The hallmarks of a contractual relationship are not evident. Many of these contracts simply do not exist. Further, despite changing the basis of metaphysics, the ultimate conclusion is the same as the property/agency metaphysics: the purpose of corporations is to maximize profits for shareholders.

### C. Stakeholder Model

Whether rooted in property or contractarian principles, the shareholder primacy conclusion is certainly the dominant conception of the corporation today.<sup>50</sup> A rival theory has emerged questioning this conclusion in the form of the stakeholder model of the corporation. The stakeholder, or constituency model, of the corporation is difficult to describe precisely. A group of scholars can generally be discerned as sharing a common opinion that, to a varying degree, boards of directors ought to consider the interests

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<sup>45</sup>Bainbridge, *supra* note 17, at 6.

<sup>46</sup>See David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, in *PROGRESSIVE CORPORATE LAW* 1, 3 (1995).

<sup>47</sup>See Bainbridge, *supra* note 17, at 6.

<sup>48</sup>See Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 *WASH & LEE L. REV.* 1423, 1427, 1442-45 (1993) (noting the merits of a shareholder wealth maximization model of the corporation).

<sup>49</sup>Millon, *supra* note 46, at 3.

<sup>50</sup>S.A. Cortright & Michael J. Naughton, *Introduction* to *RETHINKING THE PURPOSE OF BUSINESS* 24 (S.A. Cortright & Michael J. Naughton eds., 2002).

of identifiable groups of interested parties other than shareholders.<sup>51</sup> Although such scholars may disagree about the extent and implementation of consideration of stakeholder concerns, starting with E. Merrick Dodd in the 1930s, the crux of the stakeholder model has been that managers of a corporate enterprise can "legitimately use corporate resources to address the interests of other constituents."<sup>52</sup>

Yet this group has not presented a consistent justification for this position, nor a metaphysical answer to what aspect of the nature of the corporation requires, or at least suggests, this attention to non-shareholder concerns.<sup>53</sup> Some stakeholder theorists argue from a nexus of contract theory of the corporation.<sup>54</sup> They emphasize different aspects of implicit or explicit contracts to argue that the contractual make-up of the nexus of contracts requires managers to consider interests of various contracting parties, not exclusively those of shareholders.<sup>55</sup>

Another strand of stakeholder theory relies not on the nexus of contract vision, but on the property notion of the corporation. Rather than seeing the corporation as the sole property of the shareholders, these scholars see the corporation as joint property, owned by a variety of constituencies whose ownership takes different forms.<sup>56</sup> Shareholders, employees, and to

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<sup>51</sup>See, e.g., Colombo, *supra* note 28, at 257 ("[T]here is some consensus among stakeholder theorists with regard to what a board of directors ought to be doing with regard to nonshareholder stakeholders.").

<sup>52</sup>Lisa M. Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. CORP. L. 675, 681 (2006) (citing E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1160-61 (1932)).

<sup>53</sup>See Colombo, *supra* note 28, at 256-57 ("The philosophical underpinnings of the stakeholder model of the corporation are difficult to summarize, as their articulation has varied from proponent to proponent. . . . [T]here is apparently little consensus on the nature of the corporation itself."); see also Millon, *supra* note 46, at 12-13 noting that:

The characterization issue is unimportant in so far as the objective is concerned. What unites these various communitarian approaches to the problem of non-shareholder vulnerability is the basic conviction that corporate law can do more than simply provide a framework within which the various participants in the corporate enterprise define their respective rights and duties through bargain.

<sup>54</sup>See Bainbridge, *supra* note 31, at 1006-07 (describing an implicit contractual relationship between stakeholders and the corporation); see also Millon, *supra* note 46, at 16-19 (discussing the theory of "progressive contractarianism"); Lee A. Tavis, *Modern Contract Theory and the Purpose of the Firm*, in RETHINKING THE PURPOSE OF BUSINESS 216-18 (S.A. Cortright & Michael J. Naughton eds., 2002) (noting that the "contractual theory of the firm" provides the "basis of both the shareholder and stakeholder models").

<sup>55</sup>See Lee A. Tavis, *Modern Contract Theory and the Purpose of the Firm*, in RETHINKING THE PURPOSE OF BUSINESS, *supra* note 54, at 218.

<sup>56</sup>See Lynne L. Dallas, *Working Toward a New Paradigm in PROGRESSIVE CORPORATE LAW* 35, 37 (1995) (arguing that since "a number of different persons, beyond simply shareholders, have significant interests in the corporation's performance and governance," there exists a "need for

some extent the community, own inputs (capital, labor, resources) used by the corporation and thus their joint ownership of these inputs needs to be reflected in corporate decision making. Some stakeholder advocates look to an expanded fiduciary model of corporate constituency management. In this model, shareholders elect directors but the board would have duties to all stakeholders.<sup>57</sup> This approach is reflected in some state statutes commonly known as "constituency statutes."<sup>58</sup>

Some stakeholder theorists advocate a representative model where different groups of interested parties are entitled to representation within management or even on the company's board.<sup>59</sup> There are even some scholars who argue that corporate law rooted in the value of shareholder primacy actually benefits the other stakeholders or constituencies within a corporation.<sup>60</sup> Thus, stakeholder theory is anything but a unified theory.

Aside from the fact that stakeholder theorists have not presented a consistent vision of the corporation that supports their practical proposals, it seems that they only reinterpreted the property and contract theories of a corporation. They see different implications from the vision of a corporation as private property or a bundle of contracts, but they accept either one of these metaphysical premises, which underlie the shareholder wealth maximization movement.

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property rights of stakeholders [understood as more than shareholders] over corporate assets and their functioning must be addressed"); see also Jeff Gates, *Reengineering Ownership for the Common Good*, in RETHINKING THE PURPOSE OF BUSINESS 281 (S.A. Cortright & Michael J. Naughton eds., 2002) ("[A]s human capital becomes the most valued asset in a business organization, it makes no sense to limit ownership to those who provide financial capital.").

<sup>57</sup>Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 447-48 (2001).

<sup>58</sup>Allen, *supra* note 6, at 276. Chancellor Allen continues by noting that:

The statutes of Indiana, Pennsylvania, and Connecticut are particularly notable. The Indiana statute, as amended in 1989, and the Pennsylvania statute enacted in 1990, explicitly provide that directors are not required to give dominant or controlling effect to any particular constituency or interest. These statutes appear explicitly to decouple directors' duties to the corporation from any distinctive duty to shareholders.

*Id.* (internal citations omitted).

<sup>59</sup>Hansmann & Kraakman, *supra* note 57, at 447-48; see also Kent Greenfield, *Corporate Ethics in a Devilish System*, 3 J. BUS. & TECH. L. 427, 434 (2008) (answering concerns about increasing stakeholder involvement in corporate governance).

<sup>60</sup>Hansmann & Kraakman, *supra* note 57, at 442 (2001).

Of course, asserting the primacy of shareholder interests in corporate law does not imply that the interests of corporate stakeholders must or should go unprotected. It merely indicates that the most efficacious legal mechanisms for protecting the interests of nonshareholder constituencies—or at least all constituencies other than creditors—lie outside of corporate law.

*Id.*

### III. CORPORATE CONSTITUTIONALISM—SEEING THE CORPORATION AS A POLITICAL COMMUNITY

Having noted that the existing corporation theories do not satisfactorily describe the nature of the corporation, this part proposes a different metaphysical vision of the corporation not rooted in private law. This part will argue that a corporation is a constituted political community and therefore corporate law is a form of constitutional or political law. This paradigm, although uncommon in the literature, is not novel. Daniel Greenwood has argued that corporations are "state-like," and resemble the government in many respects.<sup>61</sup> Over ten years ago, Australian corporate scholar, Stephen Bottomley, advocated a theory of corporate constitutionalism.<sup>62</sup> Certainly corporations, particularly large public corporations, "are prominent and powerful actors in our public life."<sup>63</sup> Mark Roe has persuasively argued that the politics of a country and the forms of corporate law and governance are interrelated, with corporate law often playing a role in reaching political compromises.<sup>64</sup> Bottomley argues, however, that beyond their role in the public life of nations, corporations are coherent systems "in which power and authority, rights and obligations, duties and expectations, benefits and disadvantages, are allocated and exercised . . . . Each company is a body politic, a governance system."<sup>65</sup>

The foregoing issues and concerns are ones we generally associate with political decision making, not private contracting. The difference between a corporation and the state is that the state makes such decisions with respect to all citizens, but a corporation only makes decisions concerning its various constituent parts: investors, managers, employees, customers, and suppliers. Bottomley observes that such a political conception of a corporate entity is not new and has been held by thinkers as diverse as Thomas Hobbes, C. Wright Mills, and Adolph Berle.<sup>66</sup> He notes:

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<sup>61</sup>Greenwood, *supra* note 2, at 43-44, 54-55.

<sup>62</sup>See Bottomley, *supra* note 1, at 277-79. More recently, Nina Walton has released a draft working paper arguing that corporate governance default rules should be made in light of principles of political economy. Nina Walton, *On the Optimal Allocation of Power Between Shareholders and Managers*, (University of Southern California Law & Econ. Working Paper Series, Working Paper No. 118), available at <http://law.bepress.com/usclwps/lewps/art118>.

<sup>63</sup>Bottomley, *supra* note 1, at 291.

<sup>64</sup>See generally MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT (2003).

<sup>65</sup>Bottomley, *supra* note 1, at 291.

<sup>66</sup>See *id.*



For many years a variety of commentators, from a variety of perspectives, have made the same point. Maitland noted that the company and the state are two species within a single genus – that of more or less permanently organised groups of individual actors, group units to which we attribute actions, intentions, praise and blame. More recently, Unger has made the similar observation that modern society looks more like "a constellation of governments, rather than an association of individuals held together by a single government."<sup>67</sup>

Although both Bottomley and Greenwood note the apparent similarities between a corporation and a state or other explicitly political body, neither of them rigorously and systematically present a vision of a political body. I believe that this lack of metaphysical analysis results from rooting their constitutionalism only in late eighteenth century liberal political theory or liberal democratic theory, such as those found in the writings of Thomas Hobbes, John Locke, Jeremy Bentham, James Madison, and John Stuart Mill.<sup>68</sup> This Article approaches the hermeneutic of corporate constitutionalism from a different perspective which transcends the specifics of modern politic thought. It uses the principles of Aristotelian political philosophy to consider the nature of a corporation and the implications of this nature for corporate law.

#### A. *Aristotelian Notions of Society—Perfect and Imperfect Communities*

Aristotle defined a political community as a "human association . . . instituted for the sake of obtaining some good."<sup>69</sup> Communities are different from "a mere multitude of men," in that a political community is "bound together by a particular agreement, looking toward a particular end, and existing under a particular head."<sup>70</sup> Two elements from this definition emerge: (1) an agreed common end or purpose; and (2) an authority structure to make decisions relevant to attaining that end. Each of these will be considered in turn.

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<sup>67</sup>*Id.* (internal citations omitted).

<sup>68</sup>Bottomley, *supra* note 1, at 293 & n.75.

<sup>69</sup>THOMAS AQUINAS, COMMENTARY ON ARISTOTLE'S *POLITICS*, bk. I. ch. 1. at 4 (Richard J. Regan trans., 2007) [hereinafter AQUINAS, ARISTOTLE'S *POLITICS*].

<sup>70</sup>FRANCISCO SUÁREZ, *On Laws and God the Lawgiver*, in SELECTIONS FROM THREE WORKS OF FRANCISCO SUÁREZ, Vol. 2, 86 (Gwladys L. Williams, et al., trans., Clarendon Press, 1944).

Political communities can be either perfect<sup>71</sup> or imperfect.<sup>72</sup> A perfect community possesses both the perfect or most complete end as well as the complete means of attaining such an end.<sup>73</sup> In a word, the perfect community is completely self-sufficient.<sup>74</sup> A community which aims at a complete good and thus incorporates the goods of all lesser communities is this perfect community.<sup>75</sup> The nation<sup>76</sup> is a perfect community because it pursues the ultimate end, human happiness, and is self-sufficient in the means to attain that end.<sup>77</sup> The perfect community is comprised of a variety of different imperfect communities, such as families, households, villages, etc.<sup>78</sup> Each of these associations share a common end, but each is only to some extent self-sufficient.<sup>79</sup> The family's purpose is to provide the basic nourishments of life

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<sup>71</sup>In this Article, "perfect" is used in a precise sense to mean complete or fulfilled and not necessarily good or virtuous. See Wladyslaw Tatarkiewicz, *Paradoxes of Perfection*, 1 DIALECTICS & HUMANISM 77, 78 (1980) (contrasting the Aristotelian notion of perfection as "complete," "finished," or "flawless" with a paradoxical view of perfection as "ceaseless improvement").

<sup>72</sup>SUÁREZ, *supra* note 70, at 86.

<sup>73</sup>See *id.* at 86-87; THOMAS AQUINAS, *De Regimine Principum*, pt. I. bk. I. ch. II, at 11, in AQUINAS: SELECTED POLITICAL WRITINGS (A. P. D' Entrèves ed., J. G. Dawson trans., 1974) [hereinafter AQUINAS, POLITICAL WRITINGS]; Nicholas Aroney, *Subsidiarity, Federalism, and the Best Constitution: Aquinas on City, Province, and Empire*, 26 LAW AND PHIL. 161, 174-77 (2007).

<sup>74</sup>SUÁREZ, *supra* note 70, at 86.

<sup>75</sup>AQUINAS, ARISTOTLE'S *POLITICS*, *supra* note 69, bk. I, ch. I., at 4 ("And the association that is supreme and includes all other associations is the absolutely supreme good.")

<sup>76</sup>The name of this perfect community varies from age to age and author to author. Aristotle referred to the *polis* or "city-state." Aroney, *supra* note 73, at 170. Aquinas varyingly refers to the perfect community as the *civitas* (city), *regnum* (kingdom), and *provincia* (province). *Id.* at n.34. Suárez uses the term *civitas* when referring to Aristotle's perfect community. See SUÁREZ, *supra* note 70, at 37. The translators use the word "state" for *civitas* in this passage. *Id.* at 86. In the modern context, I have chosen the word "nation" as most approximating the concept of the *polis* in Aristotle's time because it lacks the negative modern connotations of the word state.

<sup>77</sup>AQUINAS, ARISTOTLE'S *POLITICS*, *supra* note 69, bk. I., ch. 1, at 5 ("And the perfect association . . . is the political community, now complete, having a self-sufficient end . . . . Therefore, the political community was instituted for the sake of protecting life and exists to promote the good life."); "[Aristotle] shows that the good to which the political community is directed is the supreme human good." *Id.* at 7. "[I]t follows that a communal society is the more perfect to the extent that it is sufficient in providing for life's necessities." AQUINAS, POLITICAL WRITINGS, *supra* note 73, pt. I, bk. I, ch. I., at 9.

<sup>78</sup>See AQUINAS, ARISTOTLE'S *POLITICS*, *supra* note 69, bk. I, ch. I, at 5 (showing how the union of men and women combine to form households, and households combine to form villages, and villages unite to form the political community); see also *id.* at 2 (stating that "since there are indeed different grades and orders of these associations, the ultimate association is the political community directed to the things self-sufficient for human life"). Aristotle continues by proposing "the true relation of other associations to the political community[.] . . . First, he explains the association of one person to another. Second, he explains the association of the household, which includes different associations of persons. Third, he explains the association of the village, which includes many households." *Id.* bk. I, ch. I, at 9; AQUINAS, POLITICAL WRITINGS, *supra* note 73, bk. I, ch. I, at 9 (containing the same list of family, household, and city).

<sup>79</sup>See AQUINAS, POLITICAL WRITINGS, *supra* note 73, bk. I, ch. 1, at 9.

for one household and the begetting of children.<sup>80</sup> The village<sup>81</sup> aims at the necessities for a particular trade or profession. The perfect community, city, or province has the aim of achieving all the necessities of human life and defense against external danger.<sup>82</sup> Each imperfect community aims to an aspect of the complete good but does not encompass all of that complete good, the good life, or human happiness; they are parts of a whole.<sup>83</sup>

Despite being perfect and embodying the supreme good, the perfect community—or nation—is not supreme in the sense of overriding or preempting the ends of the imperfect communities. According to Aristotle, the nation "pursues a goal that encompasses the lesser and narrower goals of those subordinate human communities of which it is composed."<sup>84</sup> Although the nation comprises the supreme good, the imperfect communities are not obliterated within the whole. The relationship between the perfect community and the various constituent parts is subtle. The parts are composed into the whole since it is more complete and perfect, yet the smaller communities retain an aspect of independent operation.<sup>85</sup> The difference between the smaller communities and the nation—the perfect community—is one of degree.<sup>86</sup> The linchpin reconciling this unity of the whole but the independence of the parts is the concept of the common good discussed in the next section.

The second hallmark of a community, as opposed to an amalgamation of persons, is a sovereign, someone who can direct the community to its end.<sup>87</sup> The nature of the authority figure in an imperfect community differs

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<sup>80</sup>*Id.*

<sup>81</sup>The term *vicus* translated "village" has an economic overtone more than the modern word neighborhood or village, as can be seen when Aquinas says that a village is self-sufficient with respect to "a particular trade or calling." *Id.* Elsewhere, Aquinas refers to the fact that in many Medieval towns, streets or sections of a town were divided on the basis of occupation, as evidenced when he says "in one [*vicus*] smiths practice their craft, in another of which weavers practice theirs." AQUINAS, ARISTOTLE'S *POLITICS*, *supra* note 69, bk. I, ch. I, at 15.

<sup>82</sup>AQUINAS, POLITICAL WRITINGS, *supra* note 73, bk. I, ch. 1, at 9.

<sup>83</sup>AQUINAS, ARISTOTLE'S *POLITICS*, *supra* note 69, bk. I, ch. I, cmt. 2, at 7 (stating that "an association is a whole, and wholes are ordered so that one that includes another is superior. . . . And the association that includes other associations is likewise superior. But the political community clearly includes all other associations, since households and villages are included in the political community"); *see also supra* note 79 and accompanying text.

<sup>84</sup>Aroney, *supra* note 73, at 173.

<sup>85</sup>*See* ST. THOMAS AQUINAS, COMMENTARY ON THE NICOMACHEAN ETHICS bk. I, Lecture 1, cmt. 5, (C.I. Litzinger, trans., Henry Regnery Co. 1964) [hereinafter AQUINAS, NICOMACHEAN]; *see also* Aroney, *supra* note 73, at 176-77.

<sup>86</sup>*See* Aroney, *supra* note 73, at 182-83 (noting that for Aquinas, the difference between lower and higher orders is that the higher are "more universal" and "more perfect").

<sup>87</sup>*See* AQUINAS, POLITICAL WRITINGS, *supra* note 73, bk. I, ch. I, at 3-5.

[W]henver a certain end has been decided upon . . . some one must provide

from that of a perfect community, although it is analogous.<sup>88</sup> The leaders who take care of their imperfect communities make decisions—analogueous to making laws—for their own community.<sup>89</sup> Although the smaller communities are to a degree autonomous and self-governing,<sup>90</sup> as a part, it must be harmonized with the whole,<sup>91</sup> the authority exercised over an imperfect community must be harmonized with the government of the perfect community of which it is a part.<sup>92</sup>

Having summarized the nature, operation, and relationship of perfect and imperfect communities the next section will argue that the corporation is an imperfect community. It will argue that the corporate form is, and throughout its history has been understood to be, an imperfect community.

### B. *The Corporation as an Imperfect Community*

This section will proceed to demonstrate that the corporate form meets the criteria of an imperfect community. First, throughout its history a corporation has been identified as a community and not a mere transient partnership of individuals. It is organized for the attainment of an end or good. Finally, a corporation has the hallmark of authority.

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direction if that end is to be expeditiously attained. . . . For if a great number of people were to live, each intent only upon his own interests, such a community would surely disintegrate unless there were one of its number to have a care for the common good.

*Id.*

<sup>88</sup>*See id.* at 9 ("The head of a household . . . is not called king but father. Even so there is a certain similarity about the two[.]); *see also* AQUINAS, ARISTOTLE'S *POLITICS*, *supra* note 69, bk. I, ch. I, at 5 (comparing and demonstrating the connections between the rule of a father over a family, a senior clansman over a neighborhood, and a king over a city and quoting Homer: "[e]ach man lays down laws for his wife and children," just as kings lay down laws in political communities).

<sup>89</sup>*See* AQUINAS, ARISTOTLE'S *POLITICS*, *supra* note 69, bk. I, ch. I, at 5-6.

<sup>90</sup>*See* Aroney, *supra* note 73, at 184-85 (discussing the Guild as an example).

<sup>91</sup>*See* AQUINAS, NICOMACHEAN, *supra* note 85, bk. I, Lecture I, cmt. 5.

<sup>92</sup>1 ST. THOMAS AQUINAS, SUMMA THEOLOGICA, pt. I-II, Q. 90, Reply Obj. 3.

As one man is a part of the household, so a household is a part of the state: and the state is a perfect community, according to *Polit.* i. 1. And therefore, as the good of one man is not the last end, but is ordained to the common good; so too the good of one household is ordained to the good of a single state, which is a perfect community. Consequently he that governs a family, can indeed make certain commands or ordinances, but not such as to have properly the force of law.

*Id.*

### 1. The Corporation Has Been Understood as a Community Oriented to an End

In ancient Rome, in addition to the Republic or the Empire, there were different types of human association on a smaller scale. The *universitas*<sup>93</sup> and the *societas* were groups of people gathered together for a purpose.<sup>94</sup> But the nature of the relationship formed differed between the two. *Universitas* is defined as "[a] number of persons associated into one body, a society, company, community, guild, corporation, etc."<sup>95</sup> As the definition implies, this legal form included a sense of something coming into existence, a community, beyond the partnership of individuals. The term *universitas* and *corpus* (body) are used interchangeably to refer to a collective body other than an explicitly political community, such as a city.<sup>96</sup> A wide variety of associations took on the form of a *universitas* in Roman times: religious organizations, burial clubs, political clubs, guilds of craftsmen or traders, orphanages, and asylums.<sup>97</sup> What these groups share is a common purpose and a sense of an organizational unit greater than a partnership of particular individuals.

Members of a *universitas* did not have direct ownership interests in the assets of the *universitas* since assets were owned by the corporate body for use in its stated field of action, and not the members.<sup>98</sup> For example, the Digest contains this passage:

Things in *civitates* such as theaters and stadiums and such like,  
and anything else which belongs communally to the *civitates*

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<sup>93</sup>In addition to *universitas*, the corporation was also referred to by the words, *corpus* (body) and *collegium* (college). See HAROLD J. BERMAN, LAW AND REVOLUTION: THE FORMATION OF THE WESTERN LEGAL TRADITION 215 (1983).

<sup>94</sup>Roger Scruton & John Finnis, *Corporate Persons*, in 63 PROCEEDINGS OF THE ARISTOTELIAN SOCIETY 239, 242 (1989).

<sup>95</sup>CHARLTON T. LEWIS & CHARLES SHORT, *A LATIN DICTIONARY* 1933 (1975).

<sup>96</sup>See, e.g., 2 THE DIGEST OF JUSTINIAN, bk. 2.4, no. 10.4 (Theodor Mommsen & Paul Krueger eds., Alan Watson trans., 1985) [hereinafter DIGEST OF JUSTINIAN] stating:

One who is manumitted by some guild [*corpore*] or corporation [*collegio*] or city [*civitate*], may summon the members as individuals; for he is not their freedman. But he ought to consider the honor of the municipality, and, if he wishes to bring an action against a municipality [*rem publicam*] or a corporation [*universitatem*], he ought to seek permission under the edict although he intends to summon a person who has been appointed their agent.

<sup>97</sup>BERMAN, *supra* note 93, at 215-16.

<sup>98</sup>The later Medieval canonists claimed that the property of a *universitas* was owned by nobody and the managers acted as mere guardians of this property. See Scruton & Finnis, *supra* note 94, at 242.

are property of the community [*universitatis*] corporately not of separate individuals [*singlorum*]. Thus, even the communal slave of the *civitas* is considered to belong not to the individuals in undivided shares but to the community [*universitatis*] corporately.<sup>99</sup>

Observe the connection between *universitas* (the body corporate) and *civitas* (the political community of the city). The term describes the nature of a political community, a people taken as a whole. The Roman jurist Ulpian also makes the connection between a communal body and *universitas* when he says:

If members of a municipality [*municipes*], or any corporate body [*universitas*] appoint an attorney for legal business, it should not be said that he is in the position of a man appointed by several people; for he comes in on behalf of a public [*republica*] authority or corporate body [*universitas*], not on behalf of individuals.<sup>100</sup>

The words "municipality" and "corporation" are used in parallel, identifying similar types of groups. Yet, ownership by a *universitas* is distinguished in Roman legal thinking from ownership by the whole political community, even if the two are of a similar nature. Justinian's Institutes distinguishes between public ownership (by all citizens) and ownership by a *universitas*. To Justinian, some things are by natural law common to all persons (*omnium*), some are public (*publica*), some belong to a corporate body (*universitatis*), some to no one, with the greater part being the property of individuals.<sup>101</sup> Although not an exhaustive study of the uses of the word, it is interesting to note that it is in all these instances, *universitas* denotes a community which comprises some sort of body or identity which is equated or analogous to a political community, a city, or municipality.

The *universitas* was not limited to the lives or agreement of a particular set of individuals. Its identity and ability to sue and be sued remained despite changes in, or even a complete turnover of, its original

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<sup>99</sup>DIGEST OF JUSTINIAN, *supra* note 96, bk. 1.8, no. 6.

<sup>100</sup>DIGEST OF JUSTINIAN, *supra* note 96, bk. 3.4, no 2. ("Si municipes uel aliqua universitas ad agendum det actorem, non erit dicendum quasi a pluribus datum sic haberi: hic enim pro re publica uel universitate interuenit, non pro singulis.")

<sup>101</sup>*See, e.g.,* J. INST. 2.1 (Peter Birks & Grant McLeod, ed. & trans., 1987) ("Things can be: everybody's by the law of nature; the state's; a corporation's; or nobody's. But most things belong to individuals, who acquire them in a variety of ways . . .").

membership.<sup>102</sup> Again this quality is similar to a *civitas*. A new city is not formed as citizens are born and die. The same city or corporate body continues. The similarity between the larger political community and a corporation as well as their difference was established by the time of Justinian. The Roman Empire was itself considered to be a corporation having attributes similar to the smaller corporate bodies yet it was still referred to as the People of Rome (*populous Romanus*) signaling it was greater than any individual *universitas*.<sup>103</sup>

In contrast to a *universitas*, there were other associations with less permanence. A *societas* is defined as a "copartnership, association for trading purposes."<sup>104</sup> In Roman law, the *societas* was a "pooling of resources (money, property, expertise or labor, or a combination of them) for a *common purpose*."<sup>105</sup> Roman law recognized various forms of partnership, ranging from a pooling of all assets to the pooling of specific assets for a single transaction.<sup>106</sup> The emphasis is not on a body of people coming together but a pooling of assets. Significantly, the partnership provided virtually no asset shielding as each partner was liable *pro rata* for the liabilities of the partnership, and the law made no distinction between the obligations and assets of the partnership and that of the partners.<sup>107</sup> Unlike ownership of the *universitas*, the partners were also seen as having a form of direct ownership of the assets of the *societas*. Although the nature of the partners' ownership of contributed assets changed (the two partners became joint owners of the money contractually agreeing to limit the use of their joint property in accordance with their specific common purpose),<sup>108</sup> they still retained an ownership interest directly in the joint assets.

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<sup>102</sup>See, e.g., DIGEST OF JUSTINIAN, *supra* note 96, bk. 3.4, no. 7 ("As regards decurions or other corporate bodies [universitas], it does not matter whether all the members remain the same or only some or whether all have changed.").

<sup>103</sup>BERMAN, *supra* note 93, at 215.

<sup>104</sup>LEWIS & SHORT, *supra* note 95, at 1715.

<sup>105</sup>REINHARD ZIMMERMANN, THE LAW OF OBLIGATIONS: ROMAN FOUNDATIONS OF THE CIVILIAN TRADITION 451 (1990); see also Henry Hansmann, Reinier Kraakman, & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333, 1356 (2006).

<sup>106</sup>See ZIMMERMANN, *supra* note 105, at 452-54; see also DIGEST OF JUSTINIAN, *supra* note 96, bk. 17.2, no. 5 ("Partnerships are formed in all goods, or in some business, or for the collection of a tax, or even one thing.").

<sup>107</sup>See ZIMMERMANN, *supra* note 105, at 454-56.

<sup>108</sup>See *id.* at 465-66 ("[E]ach of them having 'totius corporis pro indiviso pro parte dominium' . . ."); see also DIGEST OF JUSTINIAN, *supra* note 96, bk. 17.2, no. 1 (describing all of the assets of the partnership being held in common).

Finally, a *societas* was limited in duration to, at most, the lives of the partners.<sup>109</sup> Unlike a corporate body, events affecting members of a *societas*—such as death, bankruptcy, and loss of freedom—dissolved the partnership.<sup>110</sup>

Although for-profit business was conducted in the period following antiquity through contractual arrangements,<sup>111</sup> the jurists of the Middle Ages discerned another form of association, in addition to the contractual forms of business arrangements.<sup>112</sup> The jurists discussed this form of association as if it had its own legal identity, independent of the identities of the members, its own corporate personality.<sup>113</sup> A corporation (coming from the Latin "*corpus, corporis*" meaning a body) survived the life of its members.<sup>114</sup> The jurists were drawing on the Roman law discussion of a *universitas*, which term was appropriated to describe the new centers of learning emerging in the twelfth century. Bartolus of Sassoferrato describes a university in a way that recognizes that something exists beyond the particular members and scholars of the university at a particular place and time. He says:

A corporate body [*universitas*] is a legal name, and it does not have a soul or an intellect. Therefore it cannot commit crimes. . . . Others say, that corporate bodies [*universitas*] can commit crimes. . . . We must consider first, whether a corporate body [*universitas*] differs from its members [*hominess universitatis*]?<sup>115</sup> Some say no, like the philosophers and canonists, who hold that the whole does not really differ from its parts. The truth is, that if we speak about reality proper, those say the truth. For a university of scholars [*universitas scholars*] is nothing other than the scholars. But according to legal fiction they err. For a university [*universitas*] represents a person, which is different than the scholars, or its members [*hominibus universitatis*]. . . . Thus, if some scholars leave and others return, nevertheless the

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<sup>109</sup>DIGEST OF JUSTINIAN, *supra* note 96, bk. 17.2, no. 1 ("A partnership [*societas*] can be formed either for all time, *that is, as long as the contracting partners live* or for a limited period of time or from a particular moment in time or under a condition.") (emphasis added).

<sup>110</sup>*Id.* bk. 17.2., no. 4.

<sup>111</sup>Particularly the *societas*; however, other contractual forms such as the *census* and the *commenda* were used. See Brian M. McCall, *It's Just Secured Credit! The Natural Law Case in Defense of Some Forms of Secured Credit*, 43 IND. L. REV. 7, 22-23 (2009).

<sup>112</sup>See MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 12.

<sup>113</sup>*Id.*

<sup>114</sup>*Id.* at 12-13.

<sup>115</sup>Literally, "the men of the corporate body."



university [*universitas*] stays the same. Similarly if all members of a people [*omnibus de populo*] die and others take their place, the people [*populus*] is the same . . . and thus a corporate body [*universitas*] is different from its members [*persone*], by legal fiction, because it is a represented person.<sup>116</sup>

Bartolus is clearly commenting on the Roman law concept of the *universitas*, which still had a broader meaning than an institution of learning. When speaking about a university, in the modern sense, he needs to qualify it as a *universitas scholares*. Putting aside the debate about the development of the particular conception of the nature of the legal fiction of the corporate form,<sup>117</sup> it is clear that the *universitas* differs from a mere partnership of members (*societas*) as it survives the complete replacement of all members. The parallel to a political community is present. The *universitas* is related to its particular members ("[f]or a university of scholars [*universitas scholares*] is nothing other than the scholars") but it transcends those particular members.<sup>118</sup> Likewise, a city cannot exist without particular citizens but its survival transcends any particular person. The comparison to a political community can be seen in his comparison of the changeover in the members of a university to that of a people (*populus*). The American people are a political community, which is dependent upon particular members at the present time, but also transcends them. The person (*persona*) that the legal fiction makes out of a *universitas*, but not a *societas*, is a type of transcendent political community.

The Medieval jurists made a significant contribution to the Roman concept of a corporation; they added the concept of jurisdiction.<sup>119</sup> The canonists recognized a quasi-political nature of a corporation in that it had the ability to make law for its members.<sup>120</sup> The corporate authorities possessed a form of jurisdiction over the members of the corporate community, albeit a limited jurisdiction.<sup>121</sup> This recognition of a form of jurisdiction places a corporation as a form of imperfect political community within the broader perfect political community.

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<sup>116</sup>Avi-Yonah, *supra* note 24, at 781 (quoting BARTOLUS OF SASSOFERATO, *Commentary* on Dig. 3.4.1.1 (1653)) (alteration to original).

<sup>117</sup>*See id.* at 776-77 (tracing the development of the history of three views of the corporate form: (1) the real entity view; (2) the artificial entity view; and (3) the aggregate view).

<sup>118</sup>*See supra* note 116 and accompanying text.

<sup>119</sup>BERMAN, *supra* note 93, at 219.

<sup>120</sup>*Id.* at 218-219.

<sup>121</sup>*Id.* at 219.

In the period of the Medieval jurists (as in Roman times), the types of human association recognized as a corporate body (*universitas*) were generally of a non-profit nature: towns, universities, religious communities, and guilds.<sup>122</sup> These bodies were not formed for profit making activities and no distributions of income could be made to the members (although salaries could be paid to employees).<sup>123</sup> Since the law did not preclude the use of the corporate form to undertake for-profit business, eventually profit making businesses began adopting this form, with the first arguably being the Aberdeen Harbour Board in 1136.<sup>124</sup> By the eighteenth century, some for-profit commercial corporations were established.<sup>125</sup> The guild represents a good example of the combined public/private nature of these early corporate entities. Although guilds had focused on trade and business, their interests and activities surpassed mere commercial activity.<sup>126</sup> By the early modern period, in the age of mercantilism, corporations possessed an admixture of characteristics of a private business association and a public institution, possessing elements of government: standing armies and democratic elections.<sup>127</sup> Employees of the great mercantile corporations in England and Germany referred to themselves as "civil servants."<sup>128</sup>

From the time of the Middle Ages, governments were skeptical of use of these perpetual entities for profit making activities since they could be used to evade regulation and taxation by their perpetuity.<sup>129</sup> In the eighteenth century, corporations were subject to inspection by a committee of visitors, "which represented the interests of the founder and of the wider community."<sup>130</sup> This skepticism, combined with a financial collapse, led to restriction of the corporate form (*universitas*) in business.<sup>131</sup> After the passage of the Bubble Act in England, business companies, in an effort to escape the restrictions it imposed, had to be formed as creatures of contract

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<sup>122</sup>MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 12; *see also* Reuven S. Avi-Yonah, *supra* note 24, at 783.

<sup>123</sup>David A. Skeel, Jr., *Christianity and the Large Scale Corporation*, 4 (scholarship at Penn Law, Paper No. 188, 2007), *available at* [http://lsr.nellco.org/upenn\\_wps/index.3.html](http://lsr.nellco.org/upenn_wps/index.3.html).

<sup>124</sup>MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 12-13.

<sup>125</sup>Avi-Yonah, *supra* note 24, at 783.

<sup>126</sup>*See* MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 13; *see also* EAMON DUFFY, *THE STRIPPING OF THE ALTARS* 141-54 (1992) (discussing guild involvement in the parish).

<sup>127</sup>MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 21, 33-36.

<sup>128</sup>*Id.* at 35, 95.

<sup>129</sup>*Id.* at 13.

<sup>130</sup>Avi-Yonah, *supra* note 24, at 783.

<sup>131</sup>MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 28-32 (describing the financial bubbles of the Mississippi Company and the South Sea Company).

through a deed of settlement signed by all shareholders.<sup>132</sup> Corporate law in this phase had to rely on contract (particularly partnership contracts) and trust law. With the advent of the English Companies Act of 1844, and later the English Joint Stock Companies Act of 1856, registration—rather than contractual execution—became the method for forming companies.<sup>133</sup> The law of the corporate form (*universitas*) rather than mere contract (*societas*) became accessible again by business ventures. A positive act of the government was necessary to create a corporate body; in England this was an Act of Parliament, and in the United States, of state legislatures.<sup>134</sup> These bodies also had to be constrained to exist for a limited stated public purpose (i.e. fulfilling some aspect of the common good such as exploration of new lands, building of railroads, etc.).<sup>135</sup> The public aspect of corporate law began to break down by the mid-nineteenth century. In the 1830s, Massachusetts and Connecticut removed the requirement that a corporation be engaged in some form of public work to obtain limited liability.<sup>136</sup> The modern corporation is thus a political creation of governments fused out of the Roman concept of the *universitas* married to the profit-making purpose of the *societas*.<sup>137</sup>

Throughout this varied history, we see that the *universitas*, or body corporate, has been seen as a community directed to a particular end or purpose. Clearly, the corporate body has been discussed as a community and even one analogous to the wider, perfect, political community. It was larger than the mere contractual association of transient partners. It was smaller than, and thus subject to, the jurisdiction of the larger political community.

## 2. Corporations Possess the Attribute of Authority

As the texts of the Roman jurists discussed above note, a corporate body cannot act for itself. It must act through an agent or person managing its affairs. A partnership acts by consensus of its private members,<sup>138</sup> a

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<sup>132</sup>Bottomley, *supra* note 1, at 282.

<sup>133</sup>*Id.*

<sup>134</sup>See MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 40-44.

<sup>135</sup>*Id.*; see also Avi-Yonah, *supra* note 24, at 784 (noting that "only corporations that were clearly vested with a public purpose and benefited the public fisc, like the East India and Hudson Bay Companies, received royal approval").

<sup>136</sup>MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 46. By the end of the nineteenth century, regulation of corporate bodies changed to do away with specially defined purposes and gave way to broader, more general purposes. See Bakan, *supra* note 4, at 13-14; see also MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 45-46.

<sup>137</sup>See MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 53-54.

<sup>138</sup>See Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 466-

community acts through identified decision makers. This attribute, a defined hierarchy of decision making, is a defining attribute of a corporation.<sup>139</sup> Steven Bainbridge persuasively argues that this fiat governing authority is centered in the board of directors,<sup>140</sup> by or under whom, in the words of Delaware's corporation law, "[t]he business and affairs of every corporation . . . shall be managed."<sup>141</sup>

The Model Business Corporation Act's language more clearly identifies the authoritative power of a corporate board of directors: "All corporate powers shall be exercised by or under the authority of the board of directors . . . and the business and affairs of the corporation shall be managed by or under the direction . . . of its board of directors."<sup>142</sup> Certainly the board does not have to make all the decisions personally, it can exercise its authority through a hierarchy of delegation.<sup>143</sup> In the words of the Model Business Corporation Act, the authority is to be exercised *by or under* the board of directors. That authority, even if exercised by others, traces its legitimacy back to the board. Unlike contractual decision making characterized by negotiation and bargaining, corporate decision making is authoritarian.

#### IV. THE NATURE OF THE COMMON GOOD OF THE CORPORATION

The previous part established that a corporation is an imperfect community distinct from, but analogous to, the perfect community of the nation. This section will consider the implications of the concept of the common good for an imperfect community like a corporation. The common good serves two primary purposes within an imperfect community. First, the common good is the principle which harmonizes the autonomy of the imperfect community with the unity of the end of the perfect community of which it is a part. Second, the common good has implications for the way the imperfect community governs itself within its sphere of autonomy from the perfect community.

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67 (1992) (describing partnership decision making as generally dominated by consensus rather than fiat).

<sup>139</sup>Bainbridge, *supra* note 17, at 17 ("[T]he defining characteristic of a firm is the existence of a central decision maker vested with the power of fiat.")

<sup>140</sup>*See id.* at 25-29. Although Bainbridge sees the political "sovereignty" of the board of directors, he does not see this sovereignty governing an entity, a community, but a mere amalgamation of contracts, a *societas of societates*. *See id.* at 8. This Article argues that boards have real sovereignty over a community not the mere private amalgamation of contracts.

<sup>141</sup>DEL. CODE ANN. tit. 8, §141(a) (2006).

<sup>142</sup>MODEL BUS. CORP. ACT § 8.01(b) (2008).

<sup>143</sup>*See* Bainbridge, *supra* note 17, at 27.

### A. *The Concept of the Common Good*

A consequence of seeing a corporation as a type of political community is that corporate decision making is seen in a different light. The nature of personal economic decision making differs from political decision making by an authority for a community. In making a political decision, the authorities are meant to put aside purely private interests and to make decisions that support the common good of the political community.<sup>144</sup> The political process is characterized by a process where parties "are blocked, if only by the sanction of social disapproval, from arguing by reference to special as distinct from common concerns."<sup>145</sup> The concept, which embodies the nature of political decision making, is the common good.

The definition of the common good is a vast subject. For purposes of this Article, I will note that it involves the relationship of two concepts. Something which is a common good must be both a *good* and *common*, as opposed to private.<sup>146</sup> What is the definition of "good" in this context?

The "good" is none other than the end or purpose of something. In the Aristotelian tradition, "end" and "good" refer to that toward which something aims, its purpose: "every agent acts for an end under the aspect of good."<sup>147</sup> Good and end are also related to a third concept, being. The end of something is the correspondence of that thing to what it is designed to be. Aquinas explains: "the good or evil of an action, as of other things, depends on its fulness of being or its lack of that fulness."<sup>148</sup> To make the logic explicit, the end of something is defined as the "good" of that thing, and something is judged as good to the extent it achieves the fullness of its own being. Hence, by substitution, the end of something is to achieve the fullness of what it is, which is "good."<sup>149</sup>

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<sup>144</sup>See Bottomley, *supra* note 1, at 288 (quoting KUKATHAS & PETTIT, *supra* note 40, at 32-33) ("The political way [of decision making] is for the parties to put aside their own particular interests and to debate about the arrangement that best answers to such considerations – usually considerations in some sense to do with the common good – as all can equally countenance as relevant.").

<sup>145</sup>See KUKATHAS & PETTIT, *supra* note 40, at 32-33.

<sup>146</sup>See MARY M. KEYS, AQUINAS, ARISTOTLE, AND THE PROMISE OF THE COMMON GOOD 4 (2006) (examining Aquinas's account of the "common" and the "good" aspects of the Aristotelian political telos).

<sup>147</sup>1 ST. THOMAS AQUINAS, SUMMA THEOLOGICA pt. I-II, Q. 94, art. 2., at 1009 (Fathers of the English Dominican Province trans., Benzinger Bros. 1947) [hereinafter AQUINAS, SUMMA THEOLOGICA].

<sup>148</sup>*Id.* Q. 18, art. 2, at 664.

<sup>149</sup>See JOHN RZIHA, PERFECTING HUMAN ACTIONS: ST. THOMAS AQUINAS ON HUMAN PARTICIPATION IN ETERNAL LAW 36 (2009) ("Thomas argues that although humans make a distinction between goodness and being in their knowledge, they are the same in reality.").

But how is this end (this fullness of being, the good) known? Aquinas says: "Consequently the first principle in the practical reason is one founded on the notion of good, viz., that good is that which all things seek after."<sup>150</sup> All things seek after their natural type, exemplar, or idea.<sup>151</sup> The definition of the nature of something contains the definition of that thing's end or good. As Professor Maria T. Carl states:

St. Thomas holds that good and being are really the same, although they differ in their concept or notion [*secundum rationem*] or in thought in that they are not predicated of a thing in the same way. Being signifies that something is, either absolutely [*per se*] as a substance is, or relatively [*per aliud*] as an accident is. Goodness expresses actuality and perfection, and ultimate goodness expresses the complete actuality of a being.<sup>152</sup>

Goodness is the perfection (fullness) of something's very existence. The common good of a community is thus that common end, which is the purpose of the community itself.

Since a community is formed by a commitment to a common purpose, something that is for the common good of a community is established for the common advantage of all in the community.<sup>153</sup> Decisions made for a political community, or laws, "should be framed, not for any private benefit, but for the common good of all the citizens."<sup>154</sup> The ends would be inverted if those in charge of a community pursue the private good of individuals in contravention of the common good.<sup>155</sup> Tyranny occurs when a ruler pursues

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<sup>150</sup>AQUINAS, *SUMMA THEOLOGICA*, *supra* note 147, pt. I-II, Q. 94, art. 2., at 1009 (emphasis omitted).

<sup>151</sup>See Brian M. McCall, *The Architecture of Law: Building Law on a Solid Foundation—The Eternal and Natural Laws*, 10 *VERA LEX* 47, 57-65 (2010) (describing principles of eternal law).

<sup>152</sup>Maria T. Carl, *The First Principles of Natural Law: A Study of the Moral Theories of Aristotle and Saint Thomas Aquinas*, 149-50 (Dec. 1989) (unpublished Doctoral Dissertation, Marquette University) (footnote omitted).

<sup>153</sup>See SUÁREZ, *supra* note 70, at 90, 92; *see also supra* Part III.A (explaining the definition of community).

<sup>154</sup>AQUINAS, *SUMMA THEOLOGICA*, *supra* note 147, pt. I-II, Q. 96, art. 1, at 1017; *see also* SUÁREZ, *supra* note 70, at 90 (stating that "it is inherent in the nature and essence of law, that it shall be enacted for the sake of the common good"); AQUINAS, *SUMMA THEOLOGICA*, *supra* note 147, pt. I-II, Q.90, art. 2, at 994 (explaining that every law is ordained for the public good).

<sup>155</sup>See SUÁREZ, *supra* note 70, at 92; *see also* AQUINAS, *SUMMA THEOLOGICA*, *supra* note 147, pt I-II, q. 96, art. 1 ("Whatever is for an end should be proportionate to that end. Now the end of law is the common good . . .").

private advantage in lieu of the common good.<sup>156</sup> The common good does not exclude the good of individual members of the community. Individual good is compatible with the common good, however, only when it is not inconsistent with the common good. Suárez explains:

[T]he good of private individuals . . . forms a part of the common good, when the former is not of a nature to exclude the latter good; being rather such that it is a necessary requisite in individuals . . . in order that the common good may result from this good enjoyed by private persons.<sup>157</sup>

Thus, pursuing the common good does not exclude pursuing something which is advantageous to an individual member as long as the contemplated action benefits the common good as well as the private good of that individual. As Mary M. Keys explains:

But to be fully just, these ordinances [which advantage a particular person or group] must be made with a view to the overarching welfare of the entire political community and reflect a reasonably equitable allocation of benefits and burdens. Likewise, any exception made to the law must conduce in some respect to the public welfare, lest it constitute an act of arbitrary privileging of one part of civil society over another.<sup>158</sup>

The good of individuals and the community at large need not be considered in opposition to one another. The good of the individual is related to and a part of the good of the whole community. As Aquinas says:

He that seeks the good of the many, seeks in consequence his own good, for two reasons. First, because the individual good is impossible without the common good of the family, state, or kingdom. Hence Valerius Maximus says of the ancient Romans that 'they would rather be poor in a rich empire than rich in a poor empire.' Secondly, because, since man is a part

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<sup>156</sup>See SUÁREZ, *supra* note 70, at 93; *see also* AQUINAS, POLITICAL WRITINGS, *supra* note 73, bk. 1, ch. 3, at 15 (describing a tyrant as one who "substitutes his private interest for the common welfare of the citizens").

<sup>157</sup>SUÁREZ, *supra* note 70, at 91.

<sup>158</sup>KEYS, *supra* note 146, at 213 (internal citations omitted).

of the home and state, he must need[] [to] consider what is good for him by being prudent about the good of the many. For the good disposition of parts depends on their relation to the whole . . . .<sup>159</sup>

Since man is a social and political animal,<sup>160</sup> it is not in his nature to pursue his individual good separately from the good of the communities of which he is a part. Note, the individual good is not subordinated to the good of the many, as in a form of utilitarianism. The common good should not be advanced by unduly harming an individual. As a Roman law maxim states: "[b]y the law of nature it is fair that no one become richer by the loss and injury of another."<sup>161</sup> Aquinas restated this principle, stating: "[n]ow whatever is established for the common advantage, should not be more of a burden to one party than to another."<sup>162</sup> The good of the individual is not a mere means to an end to be sacrificed to the common good. The individual good is still an end, even if it is to be coordinated with the common good. Pursuing the common good may mean that the ultimate individual good is not maximized, but the individual good cannot be sacrificed for the sake of the common good.

Both the individual and common good are ends to be pursued in tandem. As the twelfth century philosopher John of Salisbury stated: "The public welfare is therefore that which fosters a secure life both universally and in each particular person."<sup>163</sup> Even the individual good is not attainable in a community not pursuing that individual good along with the common good of the community. A task of the ruler of a community is to work to harmonize the individual and common good. Even the individual good is not attainable in a community that is not pursuing that individual good along with the common good of the community.<sup>164</sup> A task of the ruler of a community is to work to harmonize the individual and the common good.<sup>165</sup>

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<sup>159</sup>AQUINAS, *SUMMA THEOLOGICA*, *supra* note 147, pt. II-II, Q. 47, art. 10, at 1395 *see also id.* pt. II-II, Q. 50, art. 1-4, at 1406-09 (explaining that through political prudence an individual directs himself in relation to the common good).

<sup>160</sup>AQUINAS, *ARISTOTLE'S POLITICS*, *supra* note 69, at 6-7.

<sup>161</sup>DIGEST OF JUSTINIAN, *supra* note 96, bk. 50, ch. 17, no. 206 ("Iure naturae aequum est neminem cum alterius detrimento et iniuria fieri locupletiores").

<sup>162</sup>AQUINAS, *SUMMA THEOLOGICA*, *supra* note 147, pt. II-II, Q. 77 art. 1, at 1513.

<sup>163</sup>JOHN OF SALISBURY, *POLICRATICUS* bk. III, ch. 1, at 14 (Cary J. Nederman ed. & trans., Cambridge Univ. Press 1990) (1159).

<sup>164</sup>SUÁREZ, *supra* note 70, at 95 (stating that the subject matter of laws may deal directly with the common good or the individual good, "but the reason why law deals with either kind of subject-matter is the common good, which therefore should always be the primary aim of law").

<sup>165</sup>*Id.* at 94 (stating that "a law which is useful to one kingdom often is harmful to



Mary M. Keys gives an excellent example of the difficult task of harmonizing the individual and common good.<sup>166</sup> A student is kidnapped abroad by terrorists demanding the release of justly held prisoners in the student's home country. The parents of the student rightly seek to pursue the good particular to their family of persuading the government to attempt to attain the release of the student. Yet, the requirement of the common good restricts the government's actions in attaining that good. To merely release justly held prisoners would foster neither the common good of deterring future terrorist kidnapping, nor the common good of justice. Thus, the government should work to satisfy the rightly ordered familial good of freeing the student, but within the constraints of promoting the common good of the entire country.<sup>167</sup>

The art of making laws for a community that have the common good of the community as their subject<sup>168</sup> involves reconciling individual goods and the common good of the community. To understand this process better, a distinction must be drawn when analyzing a particular decision of the community's authority.<sup>169</sup> There are two senses in which a law can refer to the common good.<sup>170</sup> First, its direct subject matter can be something that is common to all members of the community.<sup>171</sup> For example, laws relating to public property, such as a park, would have as their subject the common good of the community.

Second, a law may deal directly with an individual, by either conferring a benefit or a burden on that individual.<sup>172</sup> Such a law having a direct bearing on an individual or other subset of the community must, to be just, redound to the common good as well.<sup>173</sup> For example, a law might award a salary or stream of payments to the ruler of a community. This law's direct effect is to confer a benefit on an individual (the ruler), but if the amount of the payment is just, the whole community benefits from its leader being justly compensated for the care of the community.<sup>174</sup> Thus, even

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another . . . [and] that which seems advantageous to the community is onerous and troublesome to a great number of private person").

<sup>166</sup>See KEYS, *supra* note 146, at 121-23.

<sup>167</sup>*Id.* at 123.

<sup>168</sup>SUÁREZ, *supra* note 70, at 95 (stating that the subject of laws "ought of itself to be referable to the common good").

<sup>169</sup>*Id.* at 94.

<sup>170</sup>*Id.* at 94-95.

<sup>171</sup>*Id.* at 94 (providing as examples of laws treating the common good directly, laws concerning the use of things such as public buildings, courts, and common pastures).

<sup>172</sup>SUÁREZ, *supra* note 70, at 95.

<sup>173</sup>*Id.* at 94 ("[b]ut the other form is a common good only in a secondary sense and because it redounds [to the general welfare], so to speak").

<sup>174</sup>*Id.* at 97 (using the example of a prince decreeing a perpetual subsidy for himself).

though this law directly benefits a private individual, it is still a just law if the amount of the payments are not excessive and the community as a whole derives a good from the leader being compensated.<sup>175</sup> Laws that have the effect of privileging individuals are justified if the private benefit granted "be of so rational a nature, that it will work to the common advantage if [other, and] similar privileges are granted for similar causes."<sup>176</sup>

Conversely, some laws are detrimental with respect to individuals, yet they are just, if they benefit the common good.<sup>177</sup> For example, a law prescribing a certain punishment for the commission of a crime, inflicts a private detriment (the punishment) on the criminal, but it is justified if such law benefits the entire community (by, for example, reducing the incidents of crime).<sup>178</sup> In this case, even the one harmed by the punishment benefits by the law; the community in which he lives is made safer for him as well as everyone else. Yet, the harm caused to the individual is subject to limits. "[T]he harm to private individuals should not be so multiplied as to outweigh the advantages accruing to other persons."<sup>179</sup> Thus, individual sections of a community should not bear a disproportionate burden of costs to achieve common benefits in which all will share.<sup>180</sup>

### B. *Applying the Common Good to the Corporate Community*

Having established that the corporation is a type of political community, the prior section explained to some extent the requirement to pursue the common good of a community. This part explores the question: "What is the common good of a corporation?"<sup>181</sup>

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<sup>175</sup>*Id.*

<sup>176</sup>SUÁREZ, *supra* note 70, at 98.

<sup>177</sup>*Id.* at 99 (stating that "it frequently happens that what is expedient for the whole community, will be harmful to this or that individual").

<sup>178</sup>*Id.* at 100 (noting that although peace is an objective of the common good, punitive laws are necessary to reach that goal, and are often ends sought by legislation).

<sup>179</sup>*Id.* at 99.

<sup>180</sup>AQUINAS, *SUMMA THEOLOGICA*, *supra* note 147 pt. II-II, Q. 77, art. 1., at 318 ("Now whatever is established for the common advantage, should not be more of a burden to one party than to another").

<sup>181</sup>As will be evident from the analysis in this part, to answer this question completely, one needs to establish which groups are part of the corporate community and which are external to it. The constraints of this Article's length, however, do not permit an exhaustive examination of this complex inquiry. This Article will accept the assumption that the corporate community is larger than mere shareholders without delineating the exact lines of inclusion and exclusion. The argument in this section will proceed on the basis that holders of debt securities, managers, and employees are within the community and that some customers and suppliers might be considered within the community (although room for argument exists with respect to this latter group). Steven Bainbridge

Many scholars, both of the contract and property school, would argue that maximizing shareholder wealth is the common good or end of the corporation.<sup>182</sup> This section will demonstrate that shareholder wealth is only a private good of one group, the shareholders (or perhaps more accurately, groups of shareholders) within the corporate community. As this section will demonstrate, taking actions that increase shareholder wealth are not precluded by the concept of the common good so long as the actions to increase shareholder wealth are also consistent with the common good of the corporation. What then is the common good shared by the various groups that comprise the corporate community? Shareholder wealth maximization is clearly inadequate to capture the overall end of a particular corporation. Both concepts of "wealth" and "shareholder" are insufficient to capture the common good.

First, wealth is clearly not a complete end in itself, but can only be used to obtain other goods.<sup>183</sup> The normative position of wealth is thus determined by the use to which that wealth is put, i.e., the end it serves.<sup>184</sup> Modern finance theory acts as if wealth were a complete end in itself.<sup>185</sup> Intuitively, most people would admit that there is more to society than wealth; otherwise this is all our political leaders would regulate. Such a realization led Aristotle to place economics in a subordinate position to politics.<sup>186</sup> Aquinas echoed this conclusion when he quipped: if abundance of riches were the final end, an economist would be king of the people.<sup>187</sup>

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has provided a methodology for drawing this line by distinguishing the "existence of a boundary within which the firm's decision maker has power to exercise fiat." Bainbridge, *supra* note 17, at 13. Thus, the interests of those to be considered in the common good are those constituencies over whom the governing authority can exercise decision making power in contrast to those with whom the governing body can only transact.

<sup>182</sup>See *supra* notes 6, 47-48 and accompanying text.

<sup>183</sup>Helen Alford & Michael J. Naughton, *Beyond the Shareholder Model of the Firm: Working Toward the Common Good of a Business*, in RETHINKING THE PURPOSE OF BUSINESS 27, 36 (S.A. Cortright & Michael J. Naughton eds., 2002) (explaining that money and capital goods are foundational or instrument goods, the authors' terminology for imperfect ends).

<sup>184</sup>James Gordley, *Virtue and the Ethics of Profit Seeking*, in RETHINKING THE PURPOSE OF BUSINESS 65, 68 (S.A. Cortright & Michael J. Naughton eds., 2002) ("On a normative level, whether efficiency or wealth maximization is valuable depends on whether it is a good thing for people to satisfy their preferences. . . . [I]t all depends on whether the preferences in question are normatively good.")

<sup>185</sup>Helen Alford & Michael J. Naughton, *supra* note 183, at 33.

<sup>186</sup>ARISTOTLE, *Politica*, in THE BASIC WORKS OF ARISTOTLE, 1127, 1127 (Benjamin Jowett trans., Richard Mckeon ed., Random House 1941); ARISTOTLE, *Ethica Nicomachea*, in THE BASIC WORKS OF ARISTOTLE 935, 936 ("[W]e see even the most highly esteemed of capacities to fall under this [referring to politics], e.g. strategy, economics, rhetoric").

<sup>187</sup>See ST. THOMAS AQUINAS, *De Regimine Principum*, bk. I, ch. 14, in AQUINAS: SELECTED POLITICAL WRITINGS (A. P. d'Entrèves ed., J. G. Dawson trans., 1948) (translating "Si autem ultimus finis esset divitiarum affluentia, oeconomus rex quidam multitudinis esset," into "If . . . it were abundance of riches, the government of the community could safely be left in the

As Peter Drucker explains, defining the purpose of a business as making profits tells us nothing about what any particular corporation actually does:<sup>188</sup>

That Jim Smith is in business to make a profit concerns only him and the Recording Angel. *It does not tell us what Jim Smith does and how he performs.* We do not learn anything about the work of a prospector hunting for uranium in the Nevada desert by being told that he is trying to make his fortune. We do not learn anything about the work of a heart specialist by being told that he is trying to make a livelihood, or even that he is trying to benefit humanity. The profit motive and its offspring maximization of profits are just as irrelevant to the function of a business, the purpose of a business, and the job of managing a business.<sup>189</sup>

The shareholders may have as an objective, the return of profit, yet such an end is a good identified by only one part of the community, the shareholders. It certainly must be pursued, but within the framework of the common good or end of the corporation. As Frank Abrams, chairman of Standard Oil, noted over a half a century ago, "[t]he job of management . . . is to maintain an equitable and working balance among the claims of the various directly interested groups . . . stockholders, employees, customers, and the public at large," and not to pursue the good of only one group.<sup>190</sup> A need to recognize the broader common good in corporate decision making can be discerned in the tendency—encouraged by the Delaware Supreme Court and the NYSE and NASDAQ—for publicly traded companies to have a majority of their directors be independent.<sup>191</sup> Although

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hands of the economist.").

<sup>188</sup>Peter Koslowski observes that the one exception proving this rule is a financial holding or investment company. It is formed for the end of investing capital in other businesses to make a profit. Drucker explores the consequences of substituting this particular purpose of this specific species of corporation for the purpose of all corporations, generally. See Peter Koslowski, *The Shareholder Value Principle and the Purpose of the Firm: Limits to Shareholder Value*, in RETHINKING THE PURPOSE OF BUSINESS 102, 109 (S.A. Cortright & Michael J. Naughton eds., 2002).

<sup>189</sup>PETER F. DRUCKER, *MANAGEMENT* 97 (Harper Collins ed. 2008).

<sup>190</sup>MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 118 (quoting a 1951 speech by Frank Abrams, chairman of Standard Oil).

<sup>191</sup>See Douglas M. Branson, *The Death of Contractarianism and the Vindication of Structure and Authority in Corporate Governance and Corporate Law*, in PROGRESSIVE CORPORATE LAW 93, 99 (Lawrence E. Mitchell, ed. 1995) (discussing the Delaware Supreme Court's "*de facto*, if not *de jure*, requirement that publicly held corporations have a majority of independent directors"); Eric M. Fogel & Andrew M. Geier, *Strangers in the House: Rethinking*

one can differ over what constitutes independence, the general point is that courts and corporate executives are recognizing that corporate decision making is benefited by having a majority of decision makers who are not financially connected to the managers they monitor.<sup>192</sup> Independence can be seen as encouraging a stepping back from individual goods so as to see the common good.

Yet, profit is still a good, albeit one within the larger community of the corporation. It acts as a restraint on management and prevents shirking.<sup>193</sup> Yet, this demonstrates that profit growth is merely a means to an end, or an instrumental good. The profit principle prevents shirking rather than pursuing the common end in and of itself. Shareholder wealth increase is an individual good which if pursued consistently with the common good of the corporation is a legitimate good. Yet, it is obvious that the shareholders cannot pursue this good without the other constituent parts of the corporate community (otherwise there would be no need for the corporation; shareholders would use their wealth directly to increase their wealth). Hence, the particular good of the shareholders is inseparable from the common good of the corporation.

Secondly, the qualifier "shareholder" is also inadequate. Advocates of shareholder wealth maximization speak about this term as if shareholders necessarily constitute a homogeneous class whose definitions of "wealth" or "value" neatly coincide. Many scholars have called this assumption into question.<sup>194</sup> As Chancellor Leo Strine has observed, various types of

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*Sarbanes-Oxley and the Independent Board of Directors*, 32 DEL. J. CORP. L. 33, 41-42 (2007) (noting that shortly after the Sarbanes-Oxley Act was passed, both Stock Exchanges modified their standards to require that companies have a majority of independent directors).

<sup>192</sup>See 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 3A.01, 106-07 (1992) (noting that the rationale for having a majority of independent directors flows from the oversight function of the board, which is effective if the board can objectively evaluate the performance of the executives, and if the directors can obtain an accurate and reliable flow of information regarding the executives).

<sup>193</sup>Koslowski, *supra* note 188, at 105 ("The demand for profitability is the means to prevent shirking in the operations of all members of a firm.").

<sup>194</sup>See, e.g., Walton, *supra* note 62, at 40 (reaching the conclusion that shareholder heterogeneity as to goals is not a necessary assumption in her model for optimal voting rules); Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1283 (2008) (describing as "inaccurate" the view that minority investors share "a common economic goal"); Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 744-46 (2007) (arguing (1) that a corporation's shareholder base often includes special interest shareholders who have economic interests broader than the performance of the companies in which they invest; and (2) shareholders often have different time horizons for maximization); Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 579-93 (2006) (cataloguing a host of reasons why shareholders' interests may conflict); Marleen O'Connor, *Labor's Role in the American Corporate Governance Structure*, 22 COMP. LAB. L. & POL'Y J. 97, 109-15 (2000) (describing how labor unions are beginning to use corporate law and governance

shareholders, such as "investors [who] are associated with state governments and labor unions . . . often appear to be driven by concerns other than a desire to increase the economic performance of the companies in which they invest."<sup>195</sup> How can shareholder wealth maximization serve as a definition of a common good if even its term lacks commonality? Shareholders' goals may not only conflict with the goals of other constituencies, but also with other shareholders.

If shareholder wealth maximization cannot qualify as the common good of the corporation, what concept can unify the ends of all shareholders and other constituencies into a common good of the corporation? What end or teleology binds together the individual goods or ends of the constituent parts? They are all united to the end of efficiently producing economically useful products. Peter Koslowski described this end as such:

If one wants to single out the first purpose or final teleology of the firm, it is clear that the goal of no one group among those constituting the firm can qualify as the purpose of the firm, since the other groups also have the right to pursue their purposes via the firm. If there is one overriding purpose of the firm, it must be a purpose that could be accepted as such by all groups connected with the firm; it must be a purpose common to all members of the firm and to the public.<sup>196</sup>

Each individual group within the corporation will have its own private good: labor seeks wages, customers seek optimal products, the community seeks tax revenue, debt holders seek timely repayment of principal and interest, and shareholders seek profits.<sup>197</sup> Pursuing the common good involves seeking a unifying end that integrates these individual goods into a common good sought by the whole corporate community. Michael Jensen rightly points out that the flaw in stakeholder theory is that it requires managers to pursue the individual interest of conflicting stakeholder groups without providing a principle for reconciling conflicts.<sup>198</sup> The result is that

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through their related pension fund investments to accomplish labor objectives historically sought within the framework of labor laws).

<sup>195</sup>Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response To Bebchuk's Solution For Improving Corporate America*, 119 HARV. L. REV. 1759, 1765 (2006).

<sup>196</sup>Koslowski, *supra* note 188, at 107.

<sup>197</sup>*See id.*

<sup>198</sup>Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, J. APPLIED CORP. FIN. 8, 9-10 (2001). Ronald Colombo also demonstrates that reliance on non-shareholder enforcement of corporate social responsibility can fall into a similar trap of merely promoting special interests which disregard a common good (such as environmental responsibility). *See* Colombo, *supra* note 28, at 285.

there is no common purpose or means of evaluating performance, and thus, all stakeholder groups are shortchanged since an organization needs a single purpose in order to pursue rational behavior.<sup>199</sup> This common good provides the objective reconciling principle Jensen recognizes as necessary since it requires the integration of the individual goods of stakeholders into a common end.<sup>200</sup> What is this common purpose which unites all groups of the corporation? Peter Drucker argues: "[i]t is the customer who determines what a business is. It is the customer alone whose willingness to pay for a good or for a service converts economic resources into wealth, things into goods."<sup>201</sup>

Shareholder profit, like employee wages, is part of the common good, but not the whole common good of the corporation. Without paying employees or returning profit to shareholders, the corporation could not exist. But the ability to do both is contingent upon serving the customer. Just as the pursuit of shareholder profit cannot be achieved without the common good of the other members of the community, so too the pursuit of the common good, the satisfaction of customer need,<sup>202</sup> cannot be achieved without shareholder profit. As Peter Drucker argues, profit for the shareholders "is not the purpose of[,] but a limiting factor on[,] business enterprise and business activity."<sup>203</sup> To attain its common good, the corporation will encounter risks, and hence costs; profit is necessary to pay those costs.<sup>204</sup> "Profit is a condition of survival. It is the cost of the future, the cost of staying in business."<sup>205</sup> Staying in business for what purpose?

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<sup>199</sup>Jensen, *supra* note 198, at 9-10 ("[W]hen there are many masters, all end up being shortchanged.").

<sup>200</sup>Unlike the theory of the customer or the product advanced in this section of the Article, Jensen argues the common purpose is "firm value" but limits its definition to the value of financial claims on the firm. *See id.* at 8-9.

<sup>201</sup>DRUCKER, *supra* note 189, at 98. Drucker's contention is similar to Michael Jensen's definition of value centered on efficiently producing goods that people desire. *See* Jensen, *supra* note 198, at 11 stating:

[S]ocial welfare is maximized when all firms in an economy attempt to maximize their own total firm value. The intuition behind this criterion is simple: that value is created—and when I say "value" I mean "social" value—whenever a firm produces an output, or set of outputs, that is valued by its customers at more than the value of the inputs it consumes (as valued by their suppliers) in the production of the outputs. Firm value is simply the long-term market value of this expected stream of benefits.

<sup>202</sup>*See* DRUCKER, *supra* note 189, at 98.

<sup>203</sup>PETER F. DRUCKER, *MANAGEMENT: TASKS, RESPONSIBILITIES, PRACTICES* 60 (1974).

<sup>204</sup>DRUCKER, *supra* note 189, at 110-11.

<sup>205</sup>*Id.* at 111.

The answer is the end that all aspects of a business (labor, management, capital) are oriented towards: producing particular products that customers want to purchase. This common good is to be pursued consistently with the individual or instrumental good of profitability for shareholders. Such an understanding can assist in interpreting the objective of the corporation, as stated by the American Law Institute's Principles of Corporate Governance: "a corporation . . . should have as its objective the conduct of business activities [common good] with a view to enhancing corporate profit [still part of common good] and shareholder gain [individual good]."<sup>206</sup>

In addition to the American Law Institute, several scholars have advocated a re-orientation of the understanding of fiduciary duties which is consistent with this view of the common good. Rather than owing duties to shareholders, these scholars advocate that the duty should run to the corporation as a whole.<sup>207</sup> Remus D. Valsan and Moin A. Yahya, have advocated that directors should have a duty to increase the corporation's overall value, which means making decisions and choosing projects that have a positive net present value.<sup>208</sup> Choosing net present value projects and maximizing corporate value that "effectively serves the interests of *all corporate constituencies*."<sup>209</sup> This appears to be another way of stating that

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<sup>206</sup>1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1994).

<sup>207</sup>Remus D. Valsan & Moin A. Yahya, *Shareholders, Creditors, and Directors' Fiduciary Duties: A Law and Finance Approach*, 2 VA. L. & BUS. REV. 1, 51 (2007) (advocating that directors have a duty to pursue positive net present value projects); *see also* Thomas A. Smith, *The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty*, 98 MICH. L. REV. 214, 268 (1999) (arguing economic efficiency suggests that the duty of directors should be owed to the corporation as a whole and that the corporation should be considered as the sum of all the financial claims against it); Alon Chaver & Jesse M. Fried, *Managers' Fiduciary Duty Upon the Firm's Insolvency: Accounting for Performance Creditors*, 55 VAND. L. REV. 1813, 1817 (2002) (suggesting that "an insolvent firm's managers should have as their objective the maximization of the sum of the value of *all* claims—both financial and performance—against the firm"); Gregory Scott Crespi, *Rethinking Corporate Fiduciary Duties: The Inefficiency of the Shareholder Primacy Norm*, 55 SMU L. REV. 141, 153 (2002) (arguing that economic efficiency would be improved in a regime where fiduciary duties were owed to the company and not only the shareholders); Laura Lin, *Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485, 1524 (1993) (exploring the argument that directors should be obligated to maximize firm value when in distress even if the actions would not be in the individual interests of shareholders or creditors but ultimately rejecting the conclusion as unenforceable).

<sup>208</sup>Valsan & Yahya, *supra* note 207, at 3 ("In order to reach the [firm] maximization goal, the directors must undertake the projects that have the highest expected net present value . . . ."); Jensen, *supra* note 198, at 8 ("[F]irm value . . . means not just the value of the equity, but the sum of the values of *all* financial claims on the firm—debt, warrants, and preferred stock, as well as equity.").

<sup>209</sup>Valsan & Yahya, *supra* note 207, at 4 (emphasis added).



directors have to pursue the common—and not merely individual—good. If the corporation's value is increased, all of those members of the corporate community are benefited. Yet, although similar to the common good analysis, the net present value approach to duties lacks an important element in the understanding of the common good. The good advanced must be common to all, and not merely a personal good. One person or group should not disproportionately bear the cost of attaining that good.

A consideration of how corporate managers and directors actually act indicates at least an implicit recognition that some product, rather than shareholder profit, is the common good of the corporation. A review of the mission statements of the Fortune 100 companies in July of 2009 revealed that very few companies have shareholder profit maximization as their primary or sole goal.<sup>210</sup> Of the sixty companies who have issued active mission statements, only five (FedEx, Berkshire Hathaway, Emerson Electric, AmerisourceBergen, and CHS) listed shareholder wealth as the primary or sole goal.<sup>211</sup> Only sixteen of the other fifty-five companies with mission statements mentioned this goal explicitly in the mission statement. Five other mission statements make reference to shareholders or shareholder value indirectly. Of the forty corporations without mission statements, sixteen made explicit reference to shareholder wealth, profit, or value in either a vision statement or list of company values. An additional seven

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<sup>210</sup>See *Fortune 500*, CNNMONEY.COM, [http://money.cnn.com/magazines/fortune/fortune500/2009/full\\_list/](http://money.cnn.com/magazines/fortune/fortune500/2009/full_list/) (last visited Apr. 4, 2011) (listing the Fortune 500 companies, the top 100 of which, are termed the Fortune 100); *Company Statements and Slogans*, <http://www.company-statements-slogans.info/> (last visited Apr. 4, 2011) (providing links to each of the Fortune 500 companies' mission, vision, and values statements).

<sup>211</sup>See *Mission Statement*, FEDEX, <http://ir.fedex.com/documentdisplay.cfm?DocumentID=125> (last visited Apr. 4, 2011) ("FedEx Corporation will produce superior financial returns for its shareowners by providing high value-added logistics, transportation and related business services through focused operating companies."); *Mission Statement*, BERKSHIRE HATHAWAY HOMESTATE COMPANIES, [http://www.bhbc.com/wc\\_mission\\_statement.php](http://www.bhbc.com/wc_mission_statement.php) (last visited Apr. 4, 2011) ("We strive to be the premier insurance carrier in our chosen markets . . . while consistently delivering industry-leading returns to our shareholders."); *Mission & Values*, EMERSON, <http://www.emerson.com/en-US/about/overview/mission-values/Pages/default.aspx> (last visited Apr. 4, 2011) ("Our mission as a company is to create long-term value for our shareholders, customers, and employees . . . Emerson's disciplined management process enables the company to focus on creating shareholder value while anticipating changing economic and industry environments."); *Mission*, AMERISOURCEBERGEN, <http://www.amerisourcebergen.com/abc/Mission/index.jsp> (last visited Apr. 4, 2011) ("To build shareholder value by delivering pharmaceutical and healthcare products, services and solutions in innovative and cost effective ways."); *CHS Mission Statement and/or Vision Statement*, <http://www.company-statements-slogans-info/list-of-companies-c/chs.htm> (last visited Apr. 4, 2011) ("The vision and mission of CHS is to be an integrated energy and grain-based foods system innovatively linking producers to consumers while growing company profitability and stakeholder value.").

corporations have language that supports this value implicitly. Of these forty corporations, however, the reference to shareholder wealth was somewhere in a list of other values and could not be said to be the sole or primary goal of the corporation.

Altogether, out of the hundred corporations, only five had shareholder profit as the primary goal.<sup>212</sup> In fact, only forty-nine of the hundred companies made a reference to this goal explicitly or implicitly. The most common themes in the mission statements, vision statements, and company value statements were customer service or satisfaction<sup>213</sup> and some form of being the best business in the field. Fifty-two had the customer as the predominant focus and twenty-nine had some sort of operational excellence. The remaining sixteen corporations had a variety of themes such as integrity, safety, and employees, among others, but no clear patterns emerged among this group.

Conceding that mission statements are made public at least in part for public relations purposes,<sup>214</sup> it is still striking that shareholder wealth maximization finds such a small place in these statements.<sup>215</sup> To utterly disregard the way a corporation publicly describes itself is akin to accusing the company of making a fraudulent statement. If the law really requires the directors to act solely in the interest of shareholders, are not the directors of the vast majority of the Fortune 100 publicly traded companies flaunting this legal requirement? A more accurate inference would seem to be that corporations do not see themselves as having the same mission as the shareholder wealth advocates suggest. Even if the mission statements overstate or exaggerate, to an extent, the other values and goals articulated, can they really be dismissed out of hand as having no bearing on the way corporations see themselves or at least want the public to see them?<sup>216</sup>

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<sup>212</sup>See *supra* note 211 and accompanying text.

<sup>213</sup>This supports Drucker's contention that the common goal of a corporation is found in the customer. See DRUCKER, *supra* note 189, at 98 ("It is the customer who determines what a business is. It is the customer alone whose willingness to pay for a good or for a service converts economic resources into wealth, things into goods.")

<sup>214</sup>*Mission Statement*, INC., <http://www.inc.com/encyclopedia/mission-statement.html#> (last visited Apr. 4, 2011) (stating that a mission statement's "content[] [is] often . . . used both to enhance performance and to serve a public relations purpose").

<sup>215</sup>See Lisa M. Fairfax, *Easier Said Than Done? A Corporate Law Theory for Actualizing Social Responsibility Rhetoric*, 59 FLA. L. REV. 771, 774 (2007) ("[R]hetoric emphasizing a corporate commitment to other concerns appears to have increased, and in some cases it has even eclipsed corporate discourse on shareholders and wealth-maximization.")

<sup>216</sup>*Id.* at 775-76 (arguing based on empirical information and theories from social psychology that corporate rhetoric cannot be simply dismissed as irrelevant to corporate behavior).

The rise of diversified institutional shareholders also says something about whether shareholders are really investing to achieve maximum return from individual companies. Professor Avi-Yonah argues that "the majority of current shareholders, namely those who invest through mutual funds and pension funds, invest primarily to obtain a secure return and not for maximum, but risky, gains. . . . For those shareholders, firms that promise a secure, reasonably high return are a good investment. . . ."217 With institutional holdings accounting for approximately two-thirds of the equity markets,218 it would seem that for the majority of shareholders, profit maximization is not supreme.

Even law and economics scholars, advocating the nexus of contracts model of corporations, cannot avoid alluding to this mission of corporations which transcends shareholder wealth: "[b]uilding on Coase's work, modern law and economics scholars view the corporation. . . as an aggregate of various inputs *acting together to produce goods or services*."<sup>219</sup> The end, or good—towards which all of these inputs work—is the production of economic goods. Thus, the ultimate common good of the corporation is to produce high-quality economic goods and services which are useful or desired by customers and that further, or at least do not detract from, the common good of the wider community.<sup>220</sup> An important instrumental end of the corporation, or one of the means to the ultimate good, is to produce those goods and services efficiently and profitably for all members of the community and in a manner which does not detract from the common good of the larger society. How the profits resulting from the corporation pursuing its end are allocated among the members of the community is not a fixed requirement by its nature.<sup>221</sup> Different systems of allocation are possible under distributive justice.<sup>222</sup> Two constraints exist on this analysis, however. Those having care of the community must respect the principle of distribution governing that corporation and not randomly redistribute it. Secondly, the cost of producing the end good of the corporation cannot be borne by only one aspect of the community.

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<sup>217</sup>Avi-Yonah, *supra* note 24, at 815.

<sup>218</sup>*See supra* note 14 and accompanying text.

<sup>219</sup>Bainbridge, *supra* note 17, at 9 (emphasis added).

<sup>220</sup>Peter Koslowski reaches a similar conclusion that the purpose of the firm is to produce products. *See* Koslowski, *supra* note 188, at 107 ("[T]he purpose of the firm is the production of optimal products, or of optimal inputs for other products, under the constraints that meeting the goals of the major groups within the firm or touched by the firm's operation supposes.")

<sup>221</sup>*See* 2 ST. THOMAS AQUINAS, SUMMA THEOLOGICA, pt. II-II, Q. 61, art. 2 (differentiating between distribution done according to distributive justice and commutative justice).

<sup>222</sup>Distributive justice deals with the just allocation of common resources. *Id.*

C. *Corporate Decision Making in Light of the Common Good of an Imperfect Community*

A corporation is an imperfect community formed for the common good of efficiently assembling and coordinating resources to produce specific economic goods for its customers. What does this conception of the corporation mean for practical corporate decision making? This section explores a few general conclusions about the limitations placed on corporate decisions by this corporate metaphysics.

Even a law and economics scholar like Steven Bainbridge, who argues for plenary power for a board of directors, recognizes limits to the governing authority of the board of directors.<sup>223</sup> Yet, he can only allude to a vague constraint on the exercise of such plenary power. He argues that the "board ought to have *virtually* unconstrained freedom to exercise business judgment," and that this "*largely* unfettered discretion" should be preserved.<sup>224</sup> Yet, his theory lacks a coherent definition of what makes the discretion largely unfettered and the freedom virtually unconstrained. The concept of the common good within an imperfect community provides content to this constraint.

1. First Constraint: The Good of the Perfect Community

Part III of this Article explained the nature of an imperfect community such as a corporation. The end of an imperfect community is an incomplete end which must be harmonized with the common good of the perfect community of which the corporation is a part. Corporations only pursue a partial good, some particular economic product. Decisions made in light of this imperfect end can and do have implications and consequences for the larger common good of the perfect community.<sup>225</sup> This imperfect end cannot be inverted to be considered as the ultimate end of the perfect community in which the corporation exists. Corporate decisions made with respect to the common good of the corporation cannot be made without some consideration of their effect on the common good of the perfect community.

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<sup>223</sup>See Bainbridge, *supra* note 17, at 7-8 (stating that although board accountability is necessary, it should not trump board authority so as to make the decision making process less efficient).

<sup>224</sup>*Id.* at 8 (emphasis added).

<sup>225</sup>See Greenwood, *supra* note 2, at 43 ("Wealth maximization inevitably conflicts with other environmental, aesthetic, cultural or economic goals, as well as freedom, liberty, equality and justice.").

Otherwise, the part would not harmonize with the whole.<sup>226</sup> President Theodore Roosevelt expressed this conclusion over a hundred years ago when he observed that corporations are "indispensible instruments of our modern civilization; but I believe that they should be so supervised and so regulated that they shall act for the interests of the community as a whole."<sup>227</sup>

The primary responsibility for harmonizing the imperfect communities with the perfect community which they constitute rests with the governing authority of the perfect community.<sup>228</sup> Two implications flow from this conclusion. First, the nation has the competence and the right to restrain corporations when, in pursuit of their imperfect end, they harm the common good of the nation.<sup>229</sup> In reconciling the particular good of the corporation to the common good of the nation, the national authorities need to allow for the pursuit of the corporation's end—its products—but can restrain its activity only to the extent necessary to harmonize with the common good. Since a corporation is created to pursue its own particular end, profitably producing goods and services, it will produce externalities affecting the common good of the larger political community.<sup>230</sup> The creation of externalities requires coordination.<sup>231</sup> Clearly the activity of a corporation must be subject to coordination by the authority governing the larger perfect community of which it is a part. This analysis provides a normative basis for the regulation of corporate activity that affects the community such as plant closures, environmental consequences, and systemic effects on the economy as a whole. As recognized throughout the history of the corporation, they act within the community and affect the public good, and thus are subject to coordination with that public good.

Recognizing that a corporation is an imperfect and not perfect community precludes the conclusion of certain advocates of pure

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<sup>226</sup>See AQUINAS, *SUMMA THEOLOGICA*, *supra* note 147, pt. II-II, Q. 61, art. 1 (noting that a private individual, or corporation in this case, is compared to the community as a part to the whole).

<sup>227</sup>MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 182 (quoting President Theodore Roosevelt).

<sup>228</sup>See Greenwood, *supra* note 2, at 50-51 (arguing that corporate law and decision making should not cut off political debate about the resolution of conflicts between share price maximization and other important considerations of the larger political community by leaving these issues within the sole domain of corporate managers).

<sup>229</sup>See Ernest Grumbles III, *Is Government the Enemy of Business? No*, STARTRIBUNE.COM, (Apr. 1, 2011), <http://www.startribune.com/local/yourvoices/119055039.html>.

<sup>230</sup>See Benedict Sheehy, *Corporations and Social Costs: The Wal-Mart Case Study*, 4 (bepress Legal Repository, Working Paper No. 1735, 2006), <http://law.bepress.com/expresso/eps/1735>; Jensen, *supra* note 198, at 16.

<sup>231</sup>See Sheehy, *supra* note 230, at 4.

shareholder wealth maximization that even the duty to obey the law is subject to profit maximization. Scholars such as Frank Easterbrook and Daniel Fischel have "suggested that the duty to obey the law is simply a constituent part of the duty to maximize the firm's value."<sup>232</sup> These scholars have argued that "managers not only may but also should violate the [economic regulatory laws] when it is profitable to do so."<sup>233</sup> When the corporation is seen as an imperfect society, which is a part of the perfect society, such an assertion is impossible. The means and end of an imperfect society must be integrated into the greater end of the perfect society. Although corporations are created to profitably engage in economic activities, they were created by governments to play a role in serving the public good.<sup>234</sup> As Chancellor Allen has observed, corporate decision making cannot lose sight of the fact that "while these entities are surely economic and financial instruments, they are, as well, institutions of social and political significance."<sup>235</sup> The governing authority of the perfect community has the obligation to correct corporate behavior that ignores this reality.

Beyond the right of the larger community to pass laws harmonizing corporate activity with the common good, it is legitimate for corporate directors to consider this larger common good in their own decisions. Although the primary responsibility for coordinating particular and common goods rests with the government of the perfect community, managers who recognize the nature of a corporation as an imperfect community can and should take into account the externalities the decisions made for the community will have on the larger community.<sup>236</sup> This is particularly so since the managers of corporations are both members of the larger and smaller community simultaneously.<sup>237</sup> A theme running through the brief

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<sup>232</sup>Kent Greenfield, *Corporate Ethics in a Devilish System*, 3 J. BUS. & TECH. L. 427, 427-28 (2008) (citing Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155, 1177 (1982))

<sup>233</sup>Easterbrook & Fischel, *supra* note 232, at 1177 n.57. *See also id.* at 1168 n.36 ("Managers have no general obligation to avoid violating regulatory laws, when violations are profitable . . .").

<sup>234</sup>*See* BAKAN, *supra* note 4, at 153.

<sup>235</sup>Allen, *supra* note 6, at 280.

<sup>236</sup>*See* Easterbrook & Fischel, *supra* note 232, at 1176 (stating that social responsibility entails that "managers not only have a duty to avoid acting unlawfully themselves but also may act, in the corporation's name and at shareholders' expense, to prevent others from acting unlawfully").

<sup>237</sup>Aroney, *supra* note 73, at 187 ("An individual may therefore belong, simultaneously, to a private and a public association, but where the private association is a part of a public association, that individual is not in fact a member of two different associations, because membership in the former necessarily entails membership in the latter.").

history of the corporate form discussed in Part II.B is the relationship between the corporate body and the wider community. From the English board of visitors<sup>238</sup> to several provisions previously within the German Stock Corporation Act,<sup>239</sup> corporate managers have been directed to have an eye towards the common good of the wider community.

In this vein, the American Law Institute recognizes that the primary focus of business managers is the profitability of their corporate community, yet in pursuing this end, corporate managers may take into account the common good of the wider community even if doing so does not increase shareholder wealth.<sup>240</sup> Chancellor Allen describes this notion of corporate governance as the "social entity conception."<sup>241</sup> A corporation is a "social institution . . . tinged with a public purpose."<sup>242</sup> The board of directors must manage the business to provide a rate of return "sufficient to induce them to contribute their capital."<sup>243</sup> Yet, under this view boards ought to pay attention to "the making of a contribution to the public life of its communities."<sup>244</sup> Such an approach involves striking a balance between shareholder good and the common good. Chancellor Allen explains:

Owen Young, the President of General Electric, for example, stated in a public address during the 1920s as follows:

[M]anagers [are] no longer attorneys for stockholders; they [are] becoming trustees of an institution. If you will pardon me for being personal, it makes a great deal of difference in my attitude toward my job as an executive officer of the General Electric Company whether I am a

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<sup>238</sup>See *supra* note 130 and accompanying text.

<sup>239</sup>See Detlev F. Vagts, *Reforming the "Modern" Corporation: Perspectives from the German*, 80 HARV. L. REV. 23, 40-41 (1966) (describing the history of Section 70 of the former German Stock Corporation Act which provided that managers were to manage the corporation "as the good of the enterprise . . . and the common weal . . . demand," and the subsequent act which, although deleted, this section provided that a corporation could be dissolved for failure to heed the public interest).

<sup>240</sup>1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(b) (1994) ("Even if corporate profit and shareholder gain are not thereby enhanced, the corporation . . . [m]ay devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.").

<sup>241</sup>Allen, *supra* note 6, at 265.

<sup>242</sup>*Id.*

<sup>243</sup>*Id.* at 271.

<sup>244</sup>*Id.*

trustee of the institution or an attorney for the investor. If I am a trustee, who are the beneficiaries of the trust? To whom do I owe my obligations?

Mr. Young went on to give his answer: As the chief officer of General Electric, he acknowledged an obligation to stockholders to pay "a fair rate of return"; but he also bore an obligation to labor, to customers, and lastly to the public, to whom he saw a duty to make sure the corporation functioned "in the public interest . . . as a great and good citizen should."<sup>245</sup>

Mr. Young is not alone in this recognition that the corporation does not function in a social vacuum but is part of a larger community. Professor Bakan observes: "The notion that business and government are and should be partners is ubiquitous, unremarkable, and repeated like a mantra by leaders in both domains."<sup>246</sup>

## 2. The Second Constraint on Corporate Decisions

The first constraint on corporate decision making considered the relationship between the corporation and the common good of the perfect community. The second constraint considers the common good of the corporation itself. As sections A and B of this part establish, the common good of the corporation requires decisions be made for the good of the entire corporate community.<sup>247</sup> Decisions may have the effect of positively or negatively affecting the particular good of members of the corporate community, but the hallmark of decisions for the common good is that those effects are coordinated to the common good.<sup>248</sup> No decision should merely advance the particular good or harm of a group.<sup>249</sup>

Also, costs should not be disproportionately inflicted out of proportion to the common good on one group in particular. The requirement that pursuit of the common good must be harmonized with individual good helps explain Michael Jensen's claim that "we cannot maximize the long-term market value of an organization if we ignore or mistreat any important

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<sup>245</sup>Allen, *supra* note 6, at 271 (alteration in original) (citation omitted).

<sup>246</sup>BAKAN, *supra* note 4, at 108.

<sup>247</sup>See *supra* notes 144-205 and accompanying text.

<sup>248</sup>See *supra* note 153 and accompanying text.

<sup>249</sup>See *supra* note 154 and accompanying text.



constituency."<sup>250</sup> Decisions to pursue the common good necessarily involve consideration of effects on individual good.<sup>251</sup> Corporate managers seem aware of this larger view of corporate decision making. Goodyear Tire's Samir Gibara alluded to the nature of corporate decisions transcending the individual shareholder good when he said: "[T]he corporation is much broader than just its shareholders. . . . The corporation has many more constituencies and needs to address all these needs."<sup>252</sup> Shareholder profit is certainly a necessary part of the common good of the corporation, but only a part. The CEO of the major pharmaceutical company, Pfizer, recognized the relationship between shareholder profit and the larger good of the corporate enterprise when he commented: "Our primary mission . . . is to *sustain the enterprise*, and that, of course, requires profit."<sup>253</sup>

How does such a consciousness affect particular corporate decisions? A few hypothetical examples may be helpful. A board of directors may consider paying a dividend to shareholders. How would a common good heuristic affect this decision? This will have the direct effect of benefiting shareholders over other members of the corporate community as they will receive a benefit others will not. Yet, if the dividend is reasonably necessary to retain and attract the investment of equity capital, it benefits the entire corporation which obtains the equity capital necessary to function. If, however, the amount of the dividend were clearly in excess of what is reasonably necessary to achieve this common advantage, it would not be consistent with the common good.

Secondly, a board may consider—in light of financial difficulties—that it needs to reduce costs to survive. As a result, some workers may lose their jobs or all workers may have to receive lower salaries. Even though this decision directly confers a detriment on part of the community, if necessary to preserve the corporation's survival, it benefits the common good so long as the burden to the affected group is not disproportionate to the good of preserving the corporation. If a board reduced wages by 20% in order to pay an additional dividend to shareholders, such a decision would not benefit the common good.

The two constraints which flow logically from a corporation being an imperfect community can be summarized in this definition of the corporation: A corporation is "a common good of both management [and

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<sup>250</sup>Jensen, *supra* note 198, at 16.

<sup>251</sup>See *supra* notes 159-63 and accompanying text.

<sup>252</sup>BAKAN, *supra* note 4, at 31 (statement of Samir Gibara) (omission in original).

<sup>253</sup>BAKAN, *supra* note 4, at 48 (statement of Henry A. McKinnell) (emphasis added).

capital] and labor, at the service of the common good of society."<sup>254</sup> As Lawrence E. Mitchell has observed: "It is time that the corporation be recognized as what it is: a public institution with public obligations."<sup>255</sup>

Thus far this Article argues for a metaphysical explanation of the nature of corporations. They are imperfect communities subject to the requirement of the common good. Yet, the thesis of this Article goes beyond arguing that we should understand the corporate entity from this perspective.

The next part will argue that not only should theorists and commentators adopt this Aristotelian conception of the corporation, it argues that this metaphysics is already a part of American corporate law.

#### V. CONSTITUTIONAL METAPHYSICS ARE CONSISTENT WITH EXISTING CORPORATE LAW

A comprehensive argument that corporate law, as it exists today, accepts the premises and implications of understanding corporations as imperfect societies committed to the common good is beyond the scope of the final part of this Article. This part cannot present a comprehensive examination of the details of corporate law to support this claim. Rather, it will present an overview of such an argument and will conclude by suggesting that this hypothesis is plausible.

##### A. *Corporate Law Treats Corporations as Imperfect Societies Subject to the More Perfect Society*

Woven throughout the judiciary's corporate decisions is a recurring reminder that corporations are not supreme; they are imperfect communities subject to some level of control by the larger political community in light of the public interest.<sup>256</sup> Although the extent of constraint deemed appropriate

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<sup>254</sup>John Paul II, Pope of the Catholic Church, To the World of Labour: Primacy of the Common Good, Speech to Italian Managers and Workers in Verona (April 17, 1988), in L'OSSERVATORE ROMANO, May 2, 1988, at 7-8 (emphasis omitted).

<sup>255</sup>Lawrence E. Mitchell, *Preface* to PROGRESSIVE CORPORATE LAW, at xiii (Lawrence E. Mitchell ed., 1995).

<sup>256</sup>*See, e.g.*, *Citizens United v. Fed. Election Comm'n*, 130 S. Ct. 876, 930 (2010) (Stevens, J., dissenting) ("[L]awmakers have a compelling constitutional basis, if not also a democratic duty, to take measures designed to guard against the potentially deleterious effects of corporate spending in local and national races."); *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89 (1987) ("No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations . . ."); *Edgar v. MITE Corp.*, 457 U.S. 624, 646 (1982) (Powell, J., concurring) (noting that certain adverse consequences to general public interest support a Commerce Clause reasoning that allows for state regulation of certain corporate formations); *Hale v. Henkel*,

by the state and the implications of this constraint have varied over the centuries in corporate jurisprudence, the courts have repeatedly acknowledged at some level (if only in a dissenting opinion and even when striking down corporate regulation)<sup>257</sup> that the corporation is a part of a larger society and thus to at least some extent subject to that larger society's political institutions.<sup>258</sup> A strong version of this argument was made by the New York Court of Appeals at the end of the nineteenth century:

In the granting of charters the legislature is presumed to have had in view the public interest, and public policy is (as the interest of stockholders ought to be) concerned in the restriction of corporations within chartered limits, and a departure there from is only deemed excusable when it cannot result in prejudice to the public or to the stockholders. . . . Corporations are great engines for the promotion of the public convenience, and for the development of public wealth, and so long as they are conducted for the purposes for which organized they are a public benefit; but if allowed to engage without supervision . . . or if permitted unrestrainedly to control and monopolize the avenues to that industry in which they are engaged, they become a public menace, against which public policy and statutes design protection.<sup>259</sup>

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201 U.S. 43, 74-75 (1906) ("[T]he corporation is a creature of the state . . . presumed to be incorporated for the benefit of the public."); *Or. Ry. & Nav. Co. v. Oregonian Ry. Co.*, 130 U.S. 1, 20 (1889) (noting that corporations only have such powers given to them by State legislatures and urging law makers to pay "serious attention and consideration" to the regulation of these entities); *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519, 586-87 (1839) (rejecting an understanding of the corporation which would "deprive every state of all control over the extent of corporate franchises proper to be granted in the state . . ."); *Trs. of Dartmouth Coll. v. Woodward*, 17 U.S. (4 Wheat.) 518, 636 (1819) ("Being the mere creature of law, [a corporation] possesses only those properties which the charter of its creation confers upon it . . .").

<sup>257</sup>*See, e.g., Edgar*, 457 U.S. at 646 (Powell, J., concurring) (striking down an Illinois anti-takeover act).

<sup>258</sup>*See* cases cited *supra* note 256.

<sup>259</sup>*Leslie v. Lorillard*, 18 N.E. 363, 365-66 (1888).

The adoption of anti-takeover statutes in various states<sup>260</sup> presents an example of the larger perfect community placing a restraint on corporate action which conflicts with the common good of the larger community. Although the United States Supreme Court has rightly recognized that the scope of such statutes has limits,<sup>261</sup> the state governments are not precluded from frustrating takeover activity which may be in the best economic interest of shareholders when another public good is implicated.<sup>262</sup> In *CTS Corp. v. Dynamics Corp. of America*, the Supreme Court recognized the right of states to regulate the corporations they charter even if the effect would be to hinder or interfere with some corporate transactions.<sup>263</sup> The Supreme Court

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<sup>260</sup>By 2000, all but seven states (Alabama, Alaska, Arkansas, California, Montana, New Hampshire, and West Virginia) had enacted some form of antitakeover statute. See Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1828 tbl.3 (2002). Of these, twenty-seven had control share acquisition statutes, defined as "prevent[ing] a bidder from voting its shares beyond a specified threshold . . . unless a majority of disinterested shareholders vote to allow the bidder to exercise the voting rights of its control stake." *Id.* at 1827. Thirty-three states had business combination statutes, which "prevent a bidder from engaging in a wide range of transactions with an acquired company . . . , typically for either three or five years after the bidder acquires its controlling stake, unless the target board approves the acquisition." *Id.* Twenty-seven states had fair price statutes, allowing shareholders to receive the same consideration as other shareholders within a time period unless certain approval requirements are met. *Id.* Twenty-five states had pill validation statutes, endorsing the ability of a board to use a rights plan. *Id.*

<sup>261</sup>See *Edgar v. MITE Corp.*, 457 U.S. 624, 646-47 (1982) (holding that an Illinois statute was unconstitutional because it was so broadly drafted that it could apply to takeovers which did not affect a single Illinois shareholder). Justice Powell, although concurring in part with the majority decision to strike down the statute at issue, was careful to signal that the decision in his view did not preclude all state action limiting takeovers. He explained that he joined part of the opinion:

because its Commerce Clause reasoning leaves some room for state regulation of tender offers. This period in our history is marked by conglomerate corporate formations essentially unrestricted by the antitrust laws. Often the offeror possesses resources, in terms of professional personnel experienced in takeovers as well as of capital, that vastly exceed those of the takeover target. This disparity in resources may seriously disadvantage a relatively small or regional target corporation. Inevitably there are certain adverse consequences in terms of general public interest when corporate headquarters are moved away from a city and State. The Williams Act provisions, implementing a policy of neutrality, seem to assume corporate entities of substantially equal resources. I agree with Justice Stevens that the Williams Act's neutrality policy does not necessarily imply a congressional intent to prohibit state legislation designed to assure—at least in some circumstances—greater protection to interests that include but often are broader than those of incumbent management.

*Id.* at 646 (footnote omitted).

<sup>262</sup>See *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 94 (1987) (upholding an Indiana antitakeover statute).

<sup>263</sup>*Id.* at 89-90 ("No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations . . . . These regulatory laws may affect directly a variety of corporate transactions.").

described this accepted right of the chartering state to influence the conduct of the internal affairs of a corporate community thus:

It thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in the corporations it charters . . . .<sup>264</sup>

Notice the Supreme Court speaks of a corporation as composed of parties, not just shareholders and recognizes the state has an interest in promoting stability among them. As of 2000, forty-three states had enacted some form of anti-takeover statute which in some way regulates the process of a corporate takeover in light of larger public concerns.<sup>265</sup>

American jurisprudence has recognized that the corporate purpose is to be seen within the larger context. Thirty years ago, Justice Powell rejected the claim that shareholder wealth maximization was the sole determinant of the end of the corporation when he argued: "Thus corporate activities that are widely viewed as educational and socially constructive could be prohibited. Corporations no longer would be able safely to support—by contributions or public service advertising—educational, charitable, cultural, or even human rights causes."<sup>266</sup>

*B. Corporate Law is Consistent with Managers Exercising Authority for the Common Good of the Corporate Community and Not Just Shareholders*

Corporate law also can be seen as adhering to the requirement that directors manage a corporation for the common good of the corporation and not just shareholders. Defining fiduciary duties of directors comprises a significant aspect, if not the substantial part, of corporate law. The management of a corporation is entrusted not to the shareholders but to the board of directors.<sup>267</sup> What is the role of these directors? Although the

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<sup>264</sup>*Id.* at 91.

<sup>265</sup>*See* Subramanian, *supra* note 260, at 1827, 1828 tbl.3.

<sup>266</sup>*First Nat'l Bank of Boston v. Bellotti*, 435 U.S. 765, 782 n.18 (1978).

<sup>267</sup>*See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2006) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . .").

Delaware courts have referred to the directors as "representatives" of the shareholders, the directors are not mere agents or delegates and their decisions are not usually subject to challenge or reversal by shareholders.<sup>268</sup>

Delaware law has recognized two distinct fiduciary duties of directors, one of exercising care in making business decisions and the other a duty of loyalty obliging one not to act in a self-dealing manner.<sup>269</sup> These duties are consistent with the understanding of a corporation as an imperfect society. The concept of the common good requires those in authority to make decisions for the common good and not their own self-interest.<sup>270</sup> Risk of self-interested decision making is why the duty of loyalty requires courts to more carefully scrutinize directors' decisions in a context suggesting possible self-dealing.<sup>271</sup>

Beyond the definition of the duties, the question is to whom do these duties run? In whose interests are the directors to act with care and loyalty? Generally, courts have spoken of directors having a duty to act in the best interests of the corporation and its shareholders, not just solely the shareholders.<sup>272</sup> Delaware courts have explained this hallowed phrase of corporate law as embodying a duty to the corporate entity itself and not just its shareholders.<sup>273</sup> Clearly, directors should not act against shareholder

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<sup>268</sup>*See, e.g.,* *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 42 (Del. 1994) ("Under normal circumstances, neither the courts nor the stockholders should interfere with the managerial decisions of the directors. The business judgment rule embodies the deference to which such decisions are entitled.").

<sup>269</sup>*See, e.g.,* *Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985).

<sup>270</sup>*See supra* notes 153-56 and accompanying text.

<sup>271</sup>*Paramount Commc'ns*, 637 A.2d at 42 n.9 ("Where actual self-interest is present and affects a majority of the directors approving a transaction, a court will apply even more exacting scrutiny to determine whether the transaction is entirely fair to the stockholders."); *see also* *Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 954 (Del. 1985) (explaining that the "omnipresent specter" of board self-interest in the takeover context requires enhanced judicial examination of board actions).

<sup>272</sup>*See, e.g.,* *CA Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 238 (Del. 2008) (invalidating a bylaw which would preclude the board from discharging fiduciary duties to the corporation and its shareholders); *N. Am. Catholic Educ. Programming Found. Inc. v. Gheewalla*, 930 A.2d 92, 99 (Del. 2007) ("It is well established that the directors owe their fiduciary obligations to the corporation and its shareholders."); *McMullin v. Beran*, 765 A.2d 910, 916 (Del. 2000) ("The business judgment rule . . . [encompasses] a judicial recognition that the directors are acting as fiduciaries in discharging their statutory responsibilities to the corporation and its shareholders."); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) ("[T]he duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder . . ."); *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1280 (Del. 1989) ("[D]irectors owe fiduciary duties of care and loyalty to the corporation and its shareholders . . ."); *Van Gorkom*, 488 A.2d at 872 ("[D]irectors are charged with an unyielding fiduciary duty to the corporation and its shareholders.").

<sup>273</sup>*See, e.g.,* *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998) ("The directors of Delaware

interests but it is a conjunctive phrase, the corporation *and* its shareholders. The concept of the common good which integrates shareholder interest within the common good of the corporate community as a whole can explain the meaning of this phrase. The directors are to act in a way that harmonizes the common good of the entire corporation with the individual good of the shareholders. To date, thirty states had adopted some form of "constituency" statutes.<sup>274</sup> Delaware, though lacking a similar statute, did adopt a common law rule permitting directors to consider other interests in very circumscribed scenarios.<sup>275</sup> Such statutes reinforce this common law conception of acting in the interest of both the whole (the corporation) and the part (the shareholders). In general, the statutes confirm that in exercising this authority boards *may* consider all the interests that comprise the common good of the corporation and not just those of shareholders.<sup>276</sup>

The law requires the directors to act in the corporation's interests. This requirement is greater than merely acting in the interest, or in accordance with the desires, of particular shareholders, majority

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corporations stand in a fiduciary relationship not only to the stockholders but also to the corporations upon whose boards they serve."); *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 200 (Del. Ch. 2006) (describing fiduciary duties as being owed to *Trenwick* "as an entity"); *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.*, 1991 WL 277613, at \*34 & n.55 (Del. Ch. Dec. 30, 1991) ("[A] board of directors . . . owes its duty to the corporate enterprise."), *reprinted in* 17 DEL. J. CORP. L. 1099, 1155 & n.55 (1992).

<sup>274</sup>Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 463 n.293 (2006) (stating that, at the time this article was written, only twenty-nine states had constituency statutes). In 2007, Nebraska enacted a constituency statute to replace the one that had been repealed in 1995. NEB. REV. STAT. § 21-2095 (2010) (effective March 7, 2007).

<sup>275</sup>Velasco, *supra* note 274, at 464-65. This Delaware common law arose in *Unocal Corp. v. Mesa Petroleum Co.*, where the Delaware Supreme Court stated that in a hostile takeover attempt the directors can balance concerns which may "include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of securities being offered in the exchange." 493 A.2d 946, 955 (Del. 1985). Less than a year later, in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, the Delaware Supreme Court narrowed the scope that *Unocal* had introduced. In *Revlon*, the court stated that "while concern for various corporate constituencies is proper when addressing a takeover threat, that principle is *limited by the requirement that there be some rationally related benefit accruing to the stockholders.*" 506 A.2d 173, 176 (Del. 1986) (emphasis added).

<sup>276</sup>*See* Subramanian, *supra* note 260, at 1827. Prior to 2010, Connecticut was the only state whose constituency statute made these interests a mandatory consideration on directors. *See* CONN. J. FAV. COMM. REP., H.B. 5530, AN ACT CONCERNING THE CONNECTICUT BUSINESS CORPORATION ACT (2010). In 2010, the legislature, noticing that changes to the statute would "make Connecticut more attractive for public corporations considering whether to organize under Connecticut Law . . . . Connecticut is the only state that requires rather than permits directors to consider . . . other constituencies . . . . [which] imposes a burden on directors of Connecticut corporations that directors of corporations . . . under other state laws do not face." *Id.*; *see also* CONN. GEN. STAT. § 33-756(d) (West, Westlaw through the Gen. St. Rev. 2011) (changing the word "shall" to "may").

shareholders, or even the shareholders as a whole.<sup>277</sup> The amendment of a corporation's charter presents an example where the law recognizes that directors must act in accordance with a good that transcends shareholders' interests. In order to amend a certificate of incorporation, the board of directors must pass a resolution declaring the "advisability" of the amendment.<sup>278</sup> Even after a requisite majority of shareholders have approved an amendment, the board is permitted to abandon the approved amendment prior to its filing.<sup>279</sup>

A similar bifurcated procedure is required for mergers<sup>280</sup> and dissolution of the corporation.<sup>281</sup> In deciding to approve amendments to constitutional documents, Delaware courts have required directors to consider the best interests of the corporation and not just the approval of the amendment by the majority of stockholders.<sup>282</sup> These bifurcated processes

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<sup>277</sup>*See* *Hollinger, Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342, 387 (Del. Ch. 2004) (excluding majority shareholder from voting on a major transaction); *Mendel v. Carroll*, 651 A.2d 297, 304 (Del. Ch. 1994) (conceding that there may be circumstances where a board could grant an option to buy stock to effect a shareholder vote); *Phillips v. Insituform of N. Am., Inc.*, 1987 WL 16285, at \*6 (Del. Ch. Aug. 27, 1987) (explaining a board's need to justify its actions when expressly depriving shareholder rights), *reprinted in* 13 DEL. J. CORP. L. 774, 785 (1988); *see also* Andrew R. Brownstein & Igor Kirman, *Can a Board Say No When Shareholders Say Yes? Responding to Majority Vote Resolutions*, 60 BUS. LAW. 23, 42-45 (2004) (arguing that the board has a fiduciary duty to make an independent determination of whether proposals are in the company's best interest notwithstanding the proposal having received majority shareholder approval); Victor Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CALIF. L. REV. 1072, 1074 n.4 (1983) (noting that the law imposes duties on directors, which are owed to the corporation and not particular stockholders); Paula J. Dalley, *Shareholder (and Director) Fiduciary Duties and Shareholder Activism*, 8 HOUS. BUS. & TAX L.J. 301, 317 (2008) (explaining that a director acting in best interest of the corporation as whole, even if contrary to the wishes of particular shareholders, is consistent with a director's fiduciary obligations); Robert L. Knauss, *Corporate Governance—A Moving Target*, 79 MICH. L. REV. 478, 488 (1981) ("Directors of large publicly traded corporations, small corporations, and nonprofit corporations all owe fiduciary duties to their corporation, and not to any particular corporate constituency."); Strine, *supra* note 195, at 1764-66 (contrasting directors who owe fiduciary duties to the corporations they manage to institutional investors who do not); *see generally* WILLIAM L. CARY & MELVIN A. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 150-53 (5th ed. 1980) (covering the limitations of inherent shareholder authority over the managerial actions of directors); HARRY G. HENN, LAW OF CORPORATIONS §§ 232, 235, 240 (2d ed. 1970) (covering duties relating to corporate directors); ROBERT S. STEVENS, HANDBOOK ON THE LAW OF PRIVATE CORPORATIONS § 143 (2d ed. 1949) (covering directors as shareholder representatives).

<sup>278</sup>*See* DEL. CODE ANN. tit. 8, § 242(b)(1) (West Supp. 2011).

<sup>279</sup>*See id.* § 242(c).

<sup>280</sup>*See id.* §§ 251(a) & (d), 252(c), 263(c).

<sup>281</sup>*See id.* § 275.

<sup>282</sup>*See* *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 42 (Del. 1994); *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1378-79 (Del. 1995); *see also* Brownstein & Kirman, *supra* note 277, at 42-45 (discussing fiduciary duties under Delaware law); Dalley, *supra* note 277, at 322-23 (discussing the different loyalties of shareholders and board members).



indicate that the directors and shareholders are meant to be acting on different considerations—shareholders on their individual good, the directors the good of the corporation as a whole.

Closely held corporations present another example. Even when the shareholders elect to govern a close corporation directly, Delaware law says they are still subject to the liabilities (presumably including fiduciary duties) of directors.<sup>283</sup> If directors were required to look only to shareholder interest, then when the directors and shareholders merge, such a requirement would seem redundant. How can managing shareholders be said to have breached duties to themselves? An answer can only exist if a shareholder takes on some additional responsibility when acting as a manager of the corporate community.

In the case of *Smith v. Van Gorkom*,<sup>284</sup> the court did not permit the directors to defend against a claim that the board breached its fiduciary duty to the corporation by arguing that the shareholders approved the board's decision because the shareholders were not fully informed.<sup>285</sup> In a later case, the court clarified that even when a shareholder vote has been fully informed, the effect of shareholder ratification of a board's decisions, which did not legally require shareholder approval, is to subject the board action to business judgment review and not to extinguish the claim.<sup>286</sup> If directors were just meant to follow shareholder good and not the common good, shareholder ratification should extinguish the claim. Again, such cases imply that directors are considering something larger than, but encompassing, shareholder good.

In one circumstance the Delaware courts have explicitly recognized a particular requirement to act to maximize shareholder value. When a decision has been made to put a corporation up for sale or break-up the enterprise, or facilitate a change of control, then the directors have an obligation to secure the best price for the shareholders.<sup>287</sup> Since there is a danger of managers exercising their authority for their own self-interest by entrenching their position, the Delaware Supreme Court has subjected decisions that are found to be defensive to a different level of analysis than a

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<sup>283</sup>DEL. CODE ANN. tit. 8, § 351 (2006).

<sup>284</sup>488 A.2d 858 (Del. 1985).

<sup>285</sup>*Id.* at 889-90.

<sup>286</sup>*Gantler v. Stephens*, 965 A.2d 695, 713 (Del. 2009) ("With one exception, the 'cleansing' effect of such a ratifying shareholder vote is to subject the challenged director action to business judgment review, as opposed to 'extinguishing' the claim altogether (i.e., obviating all judicial review of the challenged action.)").

<sup>287</sup>*See Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989); *Reylon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

regular decision.<sup>288</sup> The fact that this test is used in exceptional circumstances suggests that such strict duties owed to shareholders are not the baseline or normal conception of director duties.

As part of this line of cases, the Delaware courts have adopted the so-called *Unocal* test<sup>289</sup> to evaluate defensive measures which could be used to entrench management. Yet, implicit in the two prongs of the test is an assumption that managers act for the interest of the enterprise, not just the shareholders. Under *Unocal*, directors can take defensive measures (as long as they satisfy the second prong of the test) in order to preserve "corporate policy and effectiveness," against a danger which the board reasonably perceives.<sup>290</sup> The Delaware Supreme Court rejected limiting what is defined as a threat "to corporate policy and effectiveness" necessary to pass the first prong of the *Unocal* test, to situations where only shareholder interest is threatened.<sup>291</sup> Rather, the court held that legitimate dangers included things like the impact of the transaction on constituencies other than shareholders.<sup>292</sup>

In so holding, the Delaware Supreme Court disapproved of several prior Chancery Court opinions, which failed to find a sufficient threat to justify defensive measures because "[i]n those cases, the Court of Chancery determined that whatever threat existed related *only to the shareholders and only to price and not to the corporation*."<sup>293</sup> In correcting the Chancery

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<sup>288</sup>*See Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 955-58 (Del. 1985) (announcing an enhanced test before applying the business judgment rule when directors purchase shareholders' shares with corporate funds).

<sup>289</sup>*See, e.g., Omnicare, Inc., v. NCS Healthcare, Inc.*, 818 A.2d 914, 935, (Del. 2003); *Kahn v. Roberts*, 679 A.2d 460, 465-66 (Del. 1996); *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373-74 (Del. 1995); *Stroud v. Grace*, 606 A.2d 75, 92 (Del. 1992); *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1151-52 (Del. 1990); *Selectica, Inc. v. Versata Enter., Inc.*, 2010 WL 703062, at \*12 (Del. Ch. Feb. 26, 2010); *Hills Stores Co. v. Bozic*, 769 A.2d 88, 107 (Del. Ch. 2000).

<sup>290</sup>*Omnicare*, 818 A.2d at 928; *Kahn*, 679 A.2d at 465-66; *Unitrin*, 651 A.2d at 1372-73; *Stroud*, 606 A.2d at 82-83; *Paramount*, 571 A.2d at 1149; *Selectica*, 2010 WL 703062, at \*12; *Hills Stores*, 769 A.2d at 106.

<sup>291</sup>*Paramount*, 571 A.2d. at 1152. The court states:

Implicit in the plaintiffs' argument is the view that a hostile tender offer can pose only two types of threats: the threat of coercion that results from a two-tier offer promising unequal treatment for non-tendering shareholders; and the threat of inadequate value from an all-shares, all-cash offer at a price below what a target board in good faith deems to be the present value of its shares. Since Paramount's offer was all-cash, the only conceivable 'threat,' plaintiffs argue, was inadequate value. We disapprove of such a narrow and rigid construction of *Unocal*.

*Id.* at 1152-53 (citations omitted).

<sup>292</sup>*Unocal*, 493 A.2d at 955 (including the "impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)" within the list of legitimate threats that could justify reasonable defenses).

<sup>293</sup>*Paramount*, 571 A.2d. at 1152 (emphasis added).

Court, the Supreme Court acknowledged that the corporation's interests are something distinct from the shareholders' interest (price) and a threat to the former is sufficient to proceed to the second prong of the *Unocal* test, whether the response to the threat is reasonable. Throughout the cases dealing with the *Unocal* test, the Delaware Supreme Court seems to acknowledge a unified collective purpose similar to the common good which harmonizes the goods of various constituencies as an appropriate object of director decision making.

Beyond the *Unocal* analysis, other aspects of the decision in *Paramount Communications, Inc. v. Time, Inc.* represent a clear endorsement of the notion that directors may make decisions in light of what is best for the entire corporate venture and not just shareholder wealth maximization.<sup>294</sup> In *Paramount*, the court decided that the board was justified in frustrating an offer to buy the company at a premium (which would have been in the individual best interest of the then existing shareholders) in order to preserve the corporate culture and business strategy of the target company.<sup>295</sup> The court described the fiduciary duties of directors in terms of a corporate purpose that, although acknowledging shareholder short-term interests, transcends them. The court stated:

First, Delaware law imposes on a board of directors the duty to manage the business and affairs of the corporation. This broad mandate includes a conferred authority to set a corporate course of action, including time frame, designed to enhance corporate profitability. Thus, the question of "long-term" versus "short-term" values is largely irrelevant because directors, generally, are obliged to chart a course for a corporation which is in its best interests without regard to a fixed investment horizon. Second, absent a limited set of circumstances as defined under *Revlon*, a board of directors, while always required to act in an informed manner, is not under any *per se* duty to maximize

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<sup>294</sup>See Allen, *supra* note 6, at 276 (arguing that the court in *Paramount* "seems to have expressed the view that corporate directors, if they act in pursuit of some vision of the corporation's long-term welfare, may take action that precludes shareholders from accepting an immediate high-premium offer for their shares").

<sup>295</sup>See *Paramount*, 571 A.2d. at 1149-55; see also Reuven S. Avi-Yonah, *To Be or Not To Be? Citizens United and the Corporate Form*, 22-23 (Univ. of Mich. Legal Working Paper Series, Working Paper No. 4, 2010), available at <http://law.bepress.com/umichlwps/empirical/art4> (characterizing the court's holding in *Paramount* as permitting the preservation of Time's culture).

shareholder value in the short term, even in the context of a takeover.<sup>296</sup>

Shareholder wealth maximization is not irrelevant to the court's analysis but it is clearly not the sole criterion for judging corporate decisions. The board cannot disregard shareholder returns but its responsibility lies in an obligation "to chart a course for a corporation which is in its best interests."<sup>297</sup> The Court of Chancery had framed the question presented in a way that clearly shows a choice between pure shareholder interest and the common good of the Time community: "Under what circumstances must a board of directors abandon an in-place plan of corporate development in order to provide its shareholders with the option to elect and realize an immediate control premium?"<sup>298</sup>

Beyond the decision reached in *Paramount*, the description in the opinion of the board discussions throughout the process of considering the combinations with Time and Paramount is enlightening. The court recounts, without rebuke, that the directors were considering interests beyond shareholder profits. They were considering the interests of the organization as a whole, its "culture," as well as the larger community (particularly with respect to Time's journalism business). The court notes with respect to some directors' objections to owning and creating programming:

The primary concern of Time's outside directors was the preservation of the "Time Culture." They believed that Time had become recognized in this country as an institution built upon a foundation of journalistic integrity. . . . Several of Time's outside directors feared that a merger with an entertainment company would divert Time's focus from news journalism and threaten the Time Culture.<sup>299</sup>

In considering the stock for stock merger with Warner, the Time directors recognized that they might have to pay "a premium to protect the 'Time Culture.'"<sup>300</sup> Paying a premium in a stock for stock merger is *not* in the best financial interest of the Time shareholders. It means that Warner

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<sup>296</sup>*Paramount*, 571 A.2d. at 1150 (citations omitted).

<sup>297</sup>*Id.*

<sup>298</sup>*Id.* at 1149.

<sup>299</sup>*Id.* at 1143 n.4.

<sup>300</sup>*Paramount*, 571 A.2d. at 1146. In fact, Warner's financial advisors described the premium ultimately agreed to as not only fair but "one hell of a deal." *Id.*

shareholders would receive a higher percentage ownership in the new company than without the premium. Yet, again the court notes, without objection, that the directors justified doing so not to maximize shareholder wealth but to "protect Time Culture." The *Paramount* case, in its opinion and in the actual discussions of the directors involved, presents a clear example of a corporation being managed as a community, with a common good transcending shareholder value maximization.

Another subset of fiduciary duty cases clearly illustrate the notion of managing for the common good of the corporation; cases considering duties to creditors. Chancellor Allen stated in his famous *Credit Lyonnais Bank Nederland N.V. v. Pathe Communications Corp.* decision: "At least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise."<sup>301</sup> Chancellor Allen explained the duties of directors as transcending the individual interests of various constituencies, including shareholders, thus:

[I]n managing the business affairs of a solvent corporation in the vicinity of insolvency, circumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act.<sup>302</sup>

In other words, at the very time when individual constituency interests may be in conflict (creditors and shareholders) directors have an obligation to act in the corporation's interest. Chancellor Allen explained that the directors did not breach a duty to Parretti, the controlling shareholder, but "acted prudently . . . from the point of view of MGM [the company]."<sup>303</sup> Although this decision is qualified by its potential limitation to some period

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<sup>301</sup>*Credit Lyonnais Bank Nederland, N.V., v. Pathe Comm'ns Corp.*, 1991 WL 277613, at \*34 (Del. Ch. Dec. 30, 1991), *reprinted in* 17 DEL. J. CORP. L. 1099, 1155 (1992). Subsequently, the Delaware Supreme Court clarified that creditors may not bring direct claims for breach of fiduciary duties while a corporation is insolvent, but may bring such claims derivatively on behalf of the corporation. *See* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101-02, 103. (Del. 2007); *see also* Michael R. Patrone, *Directors' Fiduciary Duties in the Zone of Insolvency and Actual Insolvency: To Whom, What, and When?* (May 23, 2011) (unpublished comment), <http://ssrn.com/abstract=1851103>.

<sup>302</sup>*Credit Lyonnais Bank Nederland, N.V.*, 1991 WL 277613, at n.55.

<sup>303</sup>*Id.* at \*33.

prior to insolvency, the rationale of the analysis is rooted in an understanding of directors as decision makers for an enterprise not just its shareholders.

In a subsequent case, Chancellor Strine suggested that being in this hazy "zone of insolvency" is not determinative for breach of duty claims regardless of whether brought by shareholders or creditors.<sup>304</sup> The directors owe duties directly to the corporation, not merely its residual risk bearer, be they shareholders or creditors, and breach of this duty harms the corporation who is the actual plaintiff in a derivative suit.<sup>305</sup> Such a reading of fiduciary duty cases as involving a duty to a corporate entity rather than a particular constituency has led Professor Jonathan C. Lipson to interpret the *Credit Lyonnais* progeny as cases involving a choice between which constituency has standing to bring the corporate entity's claim—creditors or shareholders—rather than establishing separate duties to creditors.<sup>306</sup> Professor Lipson interprets Chancellor Allen as arguing, at least in the context of a troubled company, that:

[A]cting merely for the shareholder-as-residual claimant would be inappropriate, as it would "expos[e] creditors to risks of opportunistic behavior and creat[e] complexities for directors."

Better to give directors a wide berth, to "conceiv[e] of the corporation as a legal and economic entity." If directors act for the corporation "as entity" then the competing economic interests of the various stakeholders—including their priority—become secondary.<sup>307</sup>

Notwithstanding these types of cases which call into question the primacy of shareholder wealth maximization as the object of director duties,

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<sup>304</sup>See *Production Res. Grp. L.L.C., v. NCT Grp., Inc.*, 863 A.2d 772, 789 n.56, 791-92 (Del. Ch. 2004).

<sup>305</sup>*Id.* stating that:

[E]ven in the case of an insolvent firm, poor decisions by directors that lead to a loss of corporate assets and are alleged to be a breaches of equitable fiduciary duties remain harms to the corporate entity itself. Thus, regardless of whether they are brought by creditors when a company is insolvent, these claims remain derivative, with either shareholders or creditors suing to recover for a harm done to the corporation as an economic entity and any recovery logically flows to the corporation and benefits the derivative plaintiffs indirectly to the extent of their claim on the firm's assets.

(footnotes omitted).

<sup>306</sup>Jonathan C. Lipson, *The Expressive Function of Directors' Duties to Creditors*, 12 STAN. J.L. BUS. & FIN. 224, 279-80 (2007).

<sup>307</sup>*Id.* at 253-54 (footnotes omitted).

the perception persists that this norm has a long history in corporate law. To address this perception, the classic case of *Dodge v. Ford Motor Co.*<sup>308</sup> needs to be addressed. *Dodge* might seem to stand for principles contrary to those articulated in this Article. This case has been seen as the classic support for the proposition that the directors must act for the shareholder's profit maximization.<sup>309</sup> The decision in this case described the obligations of directors as follows:

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 . . . .<sup>310</sup>

Such language would seem to support the vision of the corporation as directed solely to the end of shareholder wealth. Despite such general language, the facts and outcome of the case tell a different story. The Ford Motor Company, after having grown to a very profitable company with substantial cash reserves, announced that no special dividends would be paid in the future other than the regular dividend equal to five percent of the capital stock of the company.<sup>311</sup> Henry Ford explained that the shareholders had received back all of their invested capital and would be receiving a five percent dividend going forward and the remaining profits were to be reinvested in the business. Mr. Ford explained:

My ambition . . . is to employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this, we are putting the greatest share of our profits back into the business.<sup>312</sup>

Henry Ford's vision of the corporation was a critical issue in the case. "Mr. Ford was quoted in the press as saying that the purpose of the corporation was to produce good products cheaply and to provide increasing

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<sup>308</sup>170 N.W. 668 (Mich. 1919).

<sup>309</sup>See Allen, *supra* note 6, at 267-68.

<sup>310</sup>*Dodge*, 170 N.W. at 684.

<sup>311</sup>See *id.* at 671.

<sup>312</sup>*Id.*

employment at good wages and only incidentally to make money."<sup>313</sup> The plaintiffs complained that Ford proposed to use the large amounts of retained earnings to expand production facilities (including building plants to produce raw materials used in car manufacturing) and to fund a reduction in the price of automobiles (despite rising labor and material costs).<sup>314</sup> The company defended its decisions on the grounds that it did not "jeopardize the interests of the plaintiffs and . . . are in accordance with the best interests of the company."<sup>315</sup> The company argued that the use of the cash was in the common good of the company in its purpose of building a car producing company and that the shareholders' interests were thus furthered.<sup>316</sup> Henry Ford defended the company's policy of not raising prices on cars to the highest level the market would bear, but rather lowering them from time to time to a level that the "safety and welfare" of the company would permit.<sup>317</sup> Mr. Ford argued that a large cash surplus should be retained, among other reasons, so that if difficult economic times arrived large numbers of workers would not have to be discharged from work.<sup>318</sup> The trial court ordered the company to pay out fifty percent of its cash surplus as a special dividend, as well as effectively enjoining the planned expansion of the business and prohibiting the building up of cash surpluses in the future.<sup>319</sup> The Michigan Supreme Court affirmed the order to pay the special dividend but overturned the other aspects of the order.<sup>320</sup> After dismissing several of the plaintiff's allegations, the court narrowed the issues to whether:

the proposed expansion of the business of the corporation, involving the further use of profits as capital, ought to be enjoined because inimical to the best interests of the company and its shareholders, and upon the further claim that in any event the withholding of the special dividend asked for by plaintiffs is arbitrary action of the directors requiring judicial interference.<sup>321</sup>

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<sup>313</sup> Allen, *supra* note 6, at 267-68.

<sup>314</sup> Dodge, 170 N.W. at 672-73.

<sup>315</sup> *Id.* at 673-74.

<sup>316</sup> *Id.* at 674.

<sup>317</sup> *Id.* at 677.

<sup>318</sup> Dodge, 170 N.W. at 676-77.

<sup>319</sup> *Id.* at 678.

<sup>320</sup> *See id.* at 685.

<sup>321</sup> *Id.* at 681.



In answering this question, the court explained that it could not object to the validity of the propositions put forward by the defendant:

[T]he fact that it [a corporation] is organized for profit does not prevent the existence of implied powers to carry on with humanitarian motives such charitable works as are incidental to the main business of the corporation. . . . [S]uch expenditures are [not] rendered illegal because influenced to some extent by humanitarian motives and purposes on the part of the members of the board of directors.<sup>322</sup>

Essentially, the court said that the decisions of the board to undertake actions which benefited the employees and reduced prices for customers were within their scope of authority and could not be enjoined.<sup>323</sup> The decision to deny any distribution of the vast cash profits of the business to shareholders, however, was arbitrary and an abuse of discretion.<sup>324</sup> The court does note that although the shareholders are being asked to forego a dividend to fund the expansion, "the very considerable salaries paid to Mr. Ford and to certain executive officers and employes [sic] were not diminished."<sup>325</sup> The concept of the common good explains the result the Supreme Court of Michigan reached. The Ford Motor Company has as its common good the production of automobiles and their parts. The directors have the authority to make decisions consistent with that good. In doing so they can choose means that benefit to varying degrees some groups and disadvantage others (by investing in capital assets, lowering prices, and raising employee compensation).

Yet these means must still be directed to the common good and not become ends in themselves. The Ford Motor Company cannot be operated for the ultimate end of raising employee living conditions. A decision which does so must be connected to its ultimate common good. Likewise, no group within the corporation should disproportionately bear the cost of employing means to achieve the common good. In this case the shareholders were being denied a meaningful share in the considerable profits of the corporation while the customers, managers, and employees were not bearing a share of this cost but obtaining only benefit. Since shareholder interest comprises and must be considered as part of the common good, shareholders

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<sup>322</sup>See *Dodge*, 170 N.W. at 684.

<sup>323</sup>See *id.* at 682.

<sup>324</sup>*Id.* at 682-83.

<sup>325</sup>*Id.* at 684.

must be treated fairly while pursuing the declared policy of the board as to expansion. Thus, the court revokes the injunction of the lower court with respect to the board decisions and merely requires the company to share one half of the accumulated profit with the shareholders. This may have the effect of delaying the achievement of the board's objectives but it does not preclude them. The means of obtaining the common good declared by the directors are permissible but must be harmonized with the legitimate interests of shareholders.

## VI. CONCLUSION

The conception of a corporation as an imperfect society committed to the common good has been presented as a better metaphysical understanding of the corporation than either the contract or property based theories. This Article argues that it is better in the sense of more accurately describing the reality of a corporation consistently, not only with its history as a legal form, but with the way business people act and think. The corporation as an imperfect society can be used to explain the relationship between the corporation and the larger community in which it is formed and the relationship among its members. Specifically, this constitutional understanding places the objective of maximizing shareholder profits within the context of a shared common good of the community. The constitutional nature of an imperfect society requires respect for the autonomy of its selected common good, but also coordination with the common good of the nation.

The role and duties of directors of a corporation involve tension and balancing the common good with the individual goods of the members of the corporate community. Interests of the members of the community comprising a corporation, as well as the corporation's external effects on the perfect community, must be harmonized in a way that advances the common good of the corporation with the common good of the larger society. This conception appears consistent with and may explain the broad themes running through corporate law better than a shareholder maximization requirement rooted in contract or property.

This Article is not arguing for a major change in the outcomes of most corporate law decisions. Rather, it argues that this constitutional understanding of the nature of a corporation better explains those results. The rhetoric of directors having the primary duty of maximizing shareholder profit (either as a result of contract or property law) is inconsistent with the results in many corporate law cases and with the way managers and directors actually think and act. Yet, the persistence of this rhetoric creates confusion for managers and courts, who may sense the inconsistency between the law

and their experience on one hand, and the theoretical explanations of both. Corporate managers as well as the future development of corporate law doctrines will be aided more by a corporate theory that better explains with consistency how corporations act and how the law requires managers to act. Hopefully, this political understanding of the corporation can provide a connection between law as theory and law as enacted in the corporate realm, thereby better assisting directors and their counsel in understanding the use of the corporate authority conferred unto them.