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THE RESPONSIBLE CORPORATION: ITS HISTORICAL ROOTS AND CONTINUING PROMISE

LARRY D. THOMPSON*

During corporate America's Gilded Age, satirist Ambrose Bierce defined a corporation as "[a]n ingenious device for obtaining individual profit without individual responsibility."¹ One need not accept that definition to recognize that it captures a debate about corporations that has preoccupied America for more than a century: Does a corporation have any responsibility to society? Or, is its only obligation to maximize profits for its shareholders? Nobel Laureate Milton Friedman famously stated that a corporation has "one and only one social responsibility"—"to increase its profits" ² "Few trends," he wrote, "could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."³ "This," we are told, "is a fundamentally subversive doctrine."⁴

I have thought a lot about this formulation of corporate responsibility since I left the government to join PepsiCo a few years ago. My law school mentor, Professor Joseph Vining, has written that it is incumbent upon us lawyers to contemplate our role in the world, in our profession, and in the institutions of which we choose to become a part. We must explore "the connection between a larger sense of things—a sense of the nature of what is and the way the world works—and what we ourselves do and what our contribution is to the way the world will be."⁵ There are also such connections between great corporate enterprises and the societies in which they thrive and from which they derive their support. I do not believe that a corporation must don blinders

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1. AMBROSE BIERCE, *THE DEVIL'S DICTIONARY* 28 (1957). Today, corporate leadership is so pervasively distrusted that big business actually ranks below Congress on the list of institutions in which the American public has confidence. See Lydia Saad, *Americans' Confidence in Military Up, Banks Down*, GALLUP (June 24, 2009), <http://www.gallup.com/poll/121214/Americans-Confidence-Military-Banks-Down.aspx>.

2. MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 133 (40th ed. 2002). The book was originally published in 1962.

3. *Id.*

4. *Id.*

5. Joseph Vining, *Propter Honoris Respectum: The Gift of Language*, 73 *NOTRE DAME L. REV.* 1581, 1597 (1998).

and restrict its vision to the narrow, short-term economic interests of some of those who happen to be its stockholders at any given moment. Our past financial turmoil demonstrates that this approach—slavish devotion to short-term profit maximization—is economic poison. And history shows that this cramped vision of corporate purpose is not inevitable. It is not now, and never has been, a corporation's only option.

In the end, Milton Friedman's exclusively economic understanding of a corporation's mission and responsibilities fails because it is one-dimensional. That vision is arbitrarily and historically truncated along two axes: it is far too *narrow* and it is far too *shortsighted*. I believe that a responsible and prudent corporation of the twenty-first century must broaden its horizons beyond the economic interests of its shareholders to include the interests of the wider community that gave it birth and in which it would prosper. And it must look past the short-term desire to maximize earnings in the next quarter to contemplate, instead, sustainable corporate performance extending through—and past—a more distant horizon.⁶

This Article examines the shortcomings of Friedman's cramped vision of a corporation's purpose, while highlighting the historical and legal bases and institutions that support a long-term, sustainable approach to corporate responsibility. First, this Article reviews the origins, definitions, legal impact, and early history of the corporation. It argues that traditional theories and definitions of corporations as having purely economic objectives, specifically "profit maximization," serve as only a portion of the equation management should consider in today's legal environment. This Article examines the role law plays in shaping corporate duties and behavior, especially in an increasingly globalized market. From a historical perspective, this Article focuses on the origin of the corporation in ancient Rome and the idea that corporations were formed to further public purposes, as well as the Middle Age emergence of responsibility and ownership division among multiple parties.

Second, this Article focuses on the history and the evolving characteristics of American corporations from the colonization period through the industrial period and examines the impact private corporations had on the colonization of America, including venture capitalism and corporate emphasis on public projects and welfare. This Article describes the significance early American laws had on corporations, forcing them to fulfill a public service and cooperate with government entities before pursuing private goals. A shift in corporate focus, from public purpose to private capital emerged during the Industrial Age, causing a shift of focus to traditional profit maximization. However, this Article argues that the underlying reasons for continued social investment by corporations during the Industrial Age were the direct

6. The Chairman and CEO of PepsiCo, Indra Nooyi, has formulated an alternative approach that she calls "Performance with Purpose," which is discussed later in this article.

result of a positive financial impact on the company when social initiatives were taken.

Third, this Article focuses on traditional legal concepts, such as the Business Judgment Rule, that allow managers and boards of directors to look beyond the short-term. It discusses cases where the courts refuse to interfere with management's long-term decision making, though short-term shareholder profits were not maximized. Also, this Article examines empirical studies showing corporations that act socially responsible in the long run. Comparisons of successful "American theory" business models and unsuccessful American and foreign strategies highlight the devastating effect excessive dividend payments and shareholder focus can have, as well as the importance of reinvesting gains into long-term company needs.

Finally, this Article concludes by suggesting ways corporations can overcome management's urge to focus primarily on current quarter results. Corporations need to shift management and investor focus beyond the current financial cycle due to the impact corporations have on global economies and resources. Sustainability reporting, which analyzes financial and non-financial factors in determining a corporation's health, is one such method of shifting to a long-term focus. Companies should prioritize sustainability reporting and ensure the reliability of the reported data. Further, this Article argues that corporations should alter the structure of executive compensation to prevent managerial shortsightedness, and incorporate sustainability as a critical factor for managerial success. Ultimately, corporations must take it upon themselves to shift away from a short-term, bottom-line culture to a forward-looking culture in order to ensure long-term economic success for shareholders while also encouraging environmental and social progress to secure a brighter future for the entity itself and its shareholders.

I. THE CORPORATION AS A LEGAL PHENOMENON

Rather than jumping straight into the middle of the debate about the nature and extent of a corporation's responsibilities, and to whom they are owed, we might first step back and ask, as Professor Vining has, why corporate responsibility should ever be a question at all:

We do not ask such a question about you or me. You might say of me that I'm not a responsible person or I'm being irresponsible in the circumstances, but your assumption is that I should be responsible or try to be. You and I . . . care about the consequences of our actions. There is tort law out there with its threat of damages, and we pay premiums for insurance against liability. . . . But that is not the reason why we are careful if we are responsible people. We actually don't want someone else to be hurt, and if we really don't care, and really are indifferent to the consequences of our

actions, we are viewed as a bit of a psychiatric case and a threat—certainly not someone who can be dealt with in ordinary affairs.⁷

Thus we—you and I—are not purely economic actors who have only financial motives and who respond only to market signals; so why would we ever assume that our corporations, which human beings created to serve human needs, are purely economic actors?⁸ Yet we are told that “business” is different and that otherwise universally-applicable norms of responsibility are an invidious interference with business and an insidious corruption of its central institution, the business corporation.⁹ Friedman’s formulation of corporate purpose is so familiar that it has almost become a cliché, and this may obscure just how radical it truly is. “Profit maximization,” under the finance theory taught in business schools, or the theory of the firm taught in economics departments, “does not mean . . . a *primarily* monetary interest, a *primary* concern for economic growth, more income, fewer costs. It means truly ‘maximization,’ a sole concern for profit.”¹⁰ Under this view, corporate responsibility for *any* other value is denied: “all substantive value is external, none is internalized, and all mental activity is calculation.”¹¹ For example, Enron hewed tightly to the Friedman approach and had a state-of-the-art corporate code of conduct, which led only to “the ascendance of *unenlightened* self-interest—winning for yourself; I win, you lose. The Enron . . . rationalization was, ‘We didn’t do anything wrong, because we didn’t break the law.’”¹² Of course, Enron did break the law—but that was merely where the carnage of the wreck finally landed. The corporate vehicle had left the track and lost its bearings much earlier when it decided to steer with an exclusive focus on the immediate profits of its shareholders.

However familiar it may be to our ears, Friedman’s view of the corporation is necessarily incomplete because he saw the corporation exclusively through the lens of an economist—although one of our greatest economists, to be sure. The shortcoming of this view is that the corporation is not solely an economic phenomenon—it is a legal phenomenon as well. A business corporation does not rise spontaneously from the intersection of contracts among private parties in the marketplace. A corporation is a legal fiction—an artificial person “existing only in intendment and consideration of law,”¹³ and we create these

7. Joseph Vining, *Competition, Corporate Responsibility, and the China Question*, 45 L. QUADRANGLE NOTES 83, 83 (2003).

8. *See id.* at 88 (“‘Business’ is not a set of value-free machines. ‘Business’ is a set of living human organizations allowing us as individuals to live in a way we can stand to live—to have lives as individuals we can justify to ourselves and each other.”).

9. *Id.* at 83.

10. Joseph Vining, *The Effect of Economic Integration with China on the Future of American Corporate Law* 1 (Law & Econ. Working Papers Paper No. 11).

11. Vining, *supra* note 7, at 88.

12. Interview by Lenny T. Mendonca & Matt Miller with Daniel Yankelovich, Public Opinion Analyst & Social Scientist, in La Jolla, Cal. (2007), in 2 MCKINSEY Q. 65, 69 (2007).

13. 1 WILLIAM BLACKSTONE, COMMENTARIES *464. Sir Edward Coke opined that a corporation’s creation “rests only in intendment and consideration of the law.” Case of

artificial persons in our own image. We are social and moral actors with responsibilities to our community—why should we assume that our corporations are not? They have whatever characteristics we endow them with and whatever responsibilities we choose to impose on them. A corporation has perpetual life; it governs itself through by-laws of its own choosing, it can buy and sell property and can sue and be sued in its own name—and, in law, its liability is limited to the assets that it holds in its own name. A corporation possesses these attributes only because the state has willed that it be so. It is therefore more than a little strange to suppose that a body corporate owes nothing to the body politic that created it as an act of legislative grace.

Little, if anything, in American law endorses such a wholly calculating, single-minded pursuit of profit as an acceptable basis for corporate behavior. “It is not the case that American law commands or even allows you, if you are doing your duty to the corporation, to think that in your social role as a business decision-maker you are to play a game with everything and everybody, the law included”¹⁴ Both the American Law Institute (ALI) and the Business Roundtable spurn this narrow and cynical approach to corporate governance. The Business Roundtable recognizes that corporations must serve the interests of society as well as their shareholders,¹⁵ and the ALI’s Principles of Corporate Governance provide that, “[e]ven if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business . . . [m]ay devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.”¹⁶ Indeed, the ALI has specifically refused to define a corporation’s mandate as “profit maximization,” embracing instead the position that company decisions should be made merely “with a view to enhancing corporate profit.”¹⁷

To give you an idea of just how far the ALI standard is removed from unbridled laissez-faire, the ALI’s formulation of corporate purpose parallels that of the Company Law enacted in 1999 by the People’s Republic of China: corporate decisions are to be made “with a view to improving economic return.”¹⁸ The ALI position is not an aberration. Other components of American corporation law, including securities laws, constituency statutes in most states, the common law of Delaware (when closely read), rules of professional responsibility for lawyers and accountants, and the very applicability of criminal law to corporations

Sutton’s Hospital, 77 Eng. Rep. 960, 973 (K.B. 1612); *see also* Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 518, 636 (1819) (Marshall, C.J.) (stating that “[a] corporation is an artificial being, invisible, intangible, and existing only in contemplation of law”).

14. Vining, *supra* note 10, at 3.

15. The Business Roundtable, *Corporate Governance and American Competitiveness*, 46 BUS. LAW. 241, 244 (1990).

16. A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(b) (1994).

17. Vining, *supra* note 7, at 87 (internal quotation marks omitted).

18. *Id.* (internal quotation marks omitted).

as such (not merely to their officers and agents) all reject an exclusive focus on profit as the sole standard for making business decisions.¹⁹

This and other legal restraints on a company's single-minded pursuit of profit are not unique to American law. A global perspective is warranted not as some sort of academic nod to comparative law but as part of the cold, practical reality of a multinational corporation operating in dozens of countries. A company may be incorporated in only one state or nation, but if it ventures beyond those borders to do business or run facilities in other jurisdictions around the planet, it should expect to be held accountable by the rules that those jurisdictions have adopted, not by whatever standards apply to the company in its home town. In Japan, which is the world's third-largest economy, the courts held the Chisso Chemical Company on Minimata Bay liable for the horrific birth defects caused by the company's discharge of mercury-laden water. It mattered not that the discharged water met every statutory and regulatory environmental standard, nor that Chisso's treatment methods were superior to those of any other member of its industry.²⁰ In China, which is now the world's second-largest economy,²¹ the corporation law has recently been amended and no longer speaks of "strengthening socialist spiritual civilization."²² If this suggests a degree of convergence with Western capitalist definitions of corporate purpose, it should be tempered both with the observation that Chinese law still contains explicit mandates that a corporation "respect" and "undertake" "social responsibility"²³ and with the reminder that the ALI's own formulation of corporate purpose, even if not that of China, still describes the pursuit of profit as merely one element of business decision-making.²⁴

Undoubtedly, there is a major gap between the commands of the law and the actual conduct of corporations in response to the law, and this is surely at least as true in China as in the United States. But my point is that any corporation that would operate in both China and the United States must attend to the social-responsibility standards of both nations. A global corporation will inevitably be affected by the gravitational pull of each of these economic giants—and by the smaller influence of a dozen (or more) other nations. The concept of corporate

19. See, e.g., The Business Roundtable, *supra* note 15, at 244 (stating that corporations serve social interests); Reuven S. Avi-Yonah, *The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility*, 30 DEL. J. CORP. L. 767, 770, 810 (2005) (stating that standard formulations of managerial success include managerial latitude to serve non-corporate public welfare, and corporate boards may consider other "stakeholders" besides shareholders); Vining, *supra* note 10, at 3–4.

20. See Vining, *supra* note 7, at 85–86.

21. In the last year China displaced Germany for the number three spot. In 2009, Chinese GDP was forecast to grow eight percent; this, while the American economy was contracting at an annual rate of six percent (according to figures for the second quarter of 2009).

22. Vining, *supra* note 10, at 6 (internal quotation marks omitted); cf. Vining, *supra* note 7, at 87 (discussing the earlier 1993 and 1999 Companies Laws of the People's Republic of China).

23. Vining, *supra* note 10, at 6 (internal quotation marks omitted).

24. See *supra* notes 17–18 and accompanying text.

social responsibility in any one country will thus be shaped by other nations' views of the primacy of profit as the corporation's *raison d'être*.²⁵

To be sure, business corporations, both East and West, often appear to *act* as if they acknowledge no value other than profit, and therefore a theory of the corporation that posits that exclusive end will sometimes be sufficient in itself to account for, *to explain*, corporate behavior.²⁶ But this confuses the descriptive with the prescriptive, the "is" with the "ought." Law is a normative enterprise that seeks to regulate and change the world, not merely to understand it. Law is therefore tuned to answering questions that economics, by itself, can merely beg.

For example, the normative legal inquiry into corporate social responsibility considers the consequences of business decisions on such groups as employees, retirees, customers, suppliers, and communities. "In economic theory these effects are called 'externalities' but," as Professor Vining has observed, "that assumes an answer to the question of what is internal and what is external to a business corporation, an answer that economics itself cannot give and only the law can provide."²⁷

II. THE CORPORATION AS A HISTORICAL ARTIFACT: ROMAN ORIGINS

Friedman's narrow view of corporate obligations contemplates the business company as an idealized economic construct, ignoring its actual historical origins.²⁸ When first conceived in Roman law two mil-

25. See Vining, *supra* note 10, at 7.

[W]ill the development of China's economic institutions and China's integration into the world economy, and our own, be a special challenge in an unexpected way? Not competitively, but internally, in what *we* come to project? Will it have the perhaps surprising effect of blunting the late-twentieth century pressure in the United States to see profit as the sole concern of business decision-making, and ultimately make the way we think fifty years hence more humane than it might otherwise have been?

Id.

26. *Id.* at 4–5.

[T]his pressure reflects an increasingly serious claim on Western thought in general. 'Ideology' does not quite describe what can be observed. A widespread project of 'naturalizing' captures it better. Exclusive interest in profit, biological or economic, is what evolutionary biologists and many political and social scientists assume in their work of prediction and explanation of the human world, and it has been a useful and productive assumption. But moving from assuming it for predictive purposes, to asserting and teaching it, and, beyond that, to enforcing it as a norm, is a difficult thing to resist, by those who work with it or by others, because it fits a much wider thrust in Western thought that positively wants to see and understand each of us, and each of our institutions, as only self-seeking systems responding to the actions of other self-seeking systems.

Id.

27. Vining, *supra* note 7, at 84.

28. This mutual reinforcement between the legal and historical perspectives on any given subject is unsurprising given Holmes' famous dictum that a page of history is worth a volume of logic. Legal discourse is usually about—and, if it wishes to avoid obscurity, is *always* about—the actual and the concrete rather than the abstract. "Law . . . turns away

lennia ago, the corporation was a legal entity licensed by the state to further *public* purposes.²⁹ Corporations are artificial bodies existing only in public law, organizations born of, and owing responsibilities to, the broader community.

Roman jurists pioneered the fundamental concept of an association licensed by the state and thereby endowed with a collective identity apart from its human members.³⁰ As late as the eighteenth and nineteenth centuries, English and American lawyers were routinely employing the precedents and vocabulary of Roman civil law in describing and defining corporations.³¹ The Roman nobility created tax-farming *societates* in which they held shares with the corporate entity, rather than each individual noble, being responsible to Rome for collecting the taxes.³² The corporation also prospered in Rome's plebian social strata, where guilds known as *collegia*, *corporata*, and *universitates* organized tradesmen and specialized laborers.³³ The Roman *collegia* also provided services to the government and to their communities, including distributing grain to the needy, keeping the peace, and lending money to families for special expenses such as funerals and marriages. A *collegium* could own property, had perpetual existence through the succession of its members, could sue and be sued, and made by-laws for its own governance.³⁴ Whether *societates* of aristocrats or *collegia* of tradesmen, these corporations could exist only if permitted by the state, and the state, ever jealous of its authority, allowed them to exist only if they served the state's purposes as well as their own.

III. BREAKING BREAD TOGETHER: COMPANIES AND GUILDS

During the Middle Ages, the Roman *corporata* provided ready precedents for jurists wishing to recognize collective entities distinct from their individual members.³⁵ "Bodies corporate" facilitated associations

from accepted forms of academic discourse—away from proposition isolated and stated first, its establishment as truth and its linkage to other propositions by bonds of incontestable logic." Vining, *supra* note 5, at 1581. Ultimately, "law is a story. [It is] the particular and the concrete, in constant tension with the statistical and the generalizing in those various and highly developed modes of thought that cannot admit the importance of what is only an individual instance." *Id.*

29. See, e.g., 1 WILLIAM BLACKSTONE, *supra* note 13, at *455–62; NATHAN ROSENBERG & L. E. BIRDZELL, JR., *HOW THE WEST GREW RICH: THE ECONOMIC TRANSFORMATION OF THE INDUSTRIAL WORLD 196* (1986); Douglas Arner, *Development of the American Law of Corporations to 1832*, 55 SMU L. REV. 23, 25, nn.9–11 (2002); Avi-Yonah, *supra* note 19, at 773–74; FERNAND BRAUDEL, *THE WHEELS OF COMMERCE: CIVILIZATION & CAPITALISM 15TH-18TH CENTURY 440* (1979) (English translation 1982).

30. JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, *THE COMPANY—A SHORT HISTORY OF A REVOLUTIONARY IDEA 4* (2003).

31. See BRAUDEL, *supra* note 29, at 434; JOSEPH K. ANGELL & SAMUEL AMES, *TREATISE ON THE LAW OF PRIVATE CORPORATIONS AGGREGATE 27–28* (1832) (reprint, N.Y. Arno Press 1972).

32. The tax farming *societates* were among the most prominent and effective early Roman corporations. See MICKLETHWAIT & WOOLDRIDGE, *supra* note 30, at 4.

33. *Id.* at 4–5.

34. ROSENBERG & BIRDZELL, *supra* note 29, at 192.

35. MICKLETHWAIT & WOOLDRIDGE, *supra* note 30, at 12.

as varied as the mayor and common people of a city, the dean and chapter of a cathedral, or the head and fellows of a college.³⁶ Corporations, whether of ecclesiastics or lay tradesmen, municipalities or universities, enabled groups to transmit their wealth, their learning and their traditions from one generation to the next.³⁷

The business entities that took form in medieval Europe were generally family firms whose members shared everything: capital, labor, bread—and liability.³⁸ The family firms grew in size and complexity and, because trade was usually their business, they also grew across political borders, acquiring investors not just from outside the family but from outside the realm. The time-tested arrangement of dividing ownership into shares served these expanding enterprises well, and corporations in politically weak medieval city-states thrived in direct proportion to their utility to the state. The share companies even “handled tasks properly those of the state,” such as financing the public debt or paying for military expeditions.³⁹ The boundaries between public and private life that modern minds take for granted were blurred.⁴⁰

IV. EXPLORING THE WORLD: THE GREAT CHARTERED MERCHANT COMPANIES

Merchants involved in foreign trade also formed corporate guilds known by the title “Merchant Adventurers,” because they risked their money on ventures in foreign lands. This is the origin of the modern term “venture capitalist.” The only way to raise money for trade and colonization was to share the risk through joint stock companies, and the only way to induce private capital to invest was to award a royal charter giving a company of adventurers a monopoly on trade with that portion of the globe: hence the East India Company, the Hudson’s Bay Company, the Virginia Company.⁴¹ These chartered companies “bestraddled the public and private sectors,”⁴² and the adventurers represented the sovereign that granted their charters: for example, the Muscovy Company paid the expenses of the embassy that King Edward sent to the court of the Russian Czar.⁴³

36. 1 WILLIAM BLACKSTONE, *supra* note 13, at *455–59.

37. MICKLETHWAIT & WOOLDRIDGE, *supra* note 30, at 12–13.

38. The word “company” came to English from the Old French word *compaignon*—companion—literally, “one who breaks bread with another.” The French word in turn is derived from the Latin words *cum* and *panis*—“together with bread.” Thus “company”—the noun denoting a commercial enterprise, a business organization—arose from words used to describe a relationship among individuals formed *not* at arms’ length, but elbow to elbow, side by side around a common table while breaking bread.

39. BRAUDEL, *supra* note 29, at 440; *see also* JONATHAN BARRON BASKIN & PAUL J. MIRANTI, JR., A HISTORY OF CORPORATE FINANCE 60 (1997).

40. *See* BASKIN & MIRANTI, *supra* note 39, at 58.

41. *See* BRAUDEL, *supra* note 29, at 439; MICKLETHWAIT & WOOLDRIDGE, *supra* note 30, at 17–18.

42. MICKLETHWAIT & WOOLDRIDGE, *supra* note 30, at 17.

43. ROSENBERG & BIRDZELL, *supra* note 29, at 193.

It is little wonder that Blackstone referred to corporations as “little republic[s].”⁴⁴ Indeed, “empires” might be a more appropriate label. The Hudson’s Bay Company, chartered in 1670 and still the oldest surviving commercial corporation in North America, was once the largest landholder on the planet, controlling 1.5 million square miles of territory and even issuing its own currency.⁴⁵

The public responsibilities of these corporations were spelled out in their charters, which required the company’s management to attend to the interests of stakeholders in addition to those who owned the company’s stock. The charter of the Virginia Company directed the Company’s Council to govern the colony not just “for the Good of the Adventurers” who owned its stock, but also for all “the inhabitants” in Virginia.⁴⁶

Some of the good that came from English colonial expansion is attributable in significant part to the corporation. In 1619, the Virginia Company introduced representative government to America by convening its first General Assembly.⁴⁷ This body, selected by colonists who were rarely shareholders, was equal in stature to the Company’s own board of directors: acts of the General Assembly became law in Virginia once confirmed by the Company’s management in London, and Company orders did not bind the colonists in Virginia “unless they be ratified in like Manner in the General Assembly.”⁴⁸ The Virginia Company’s rules made the interests of the colonists paramount—even though most of the colonists were not shareholders.⁴⁹ Thus the history of the corporation in America began with the most dramatic and most consequential form of corporate social responsibility that can be imagined.

V. PUBLIC SERVICE: THE CORPORATION IN THE NEW REPUBLIC

Given that the first American corporations gave birth to the first American colonies, it is little surprise that American law in the seventeenth and eighteenth centuries did not draw sharp distinctions between the corporation and the state. Public service and private profit

44. 1 WILLIAM BLACKSTONE, *supra* note 13, at *456.

45. The company now runs department stores and other retail establishments in Canada.

46. Second Charter of The Treasurer and Company of Adventurers and Planters of the City of London for the First Colony in Virginia (May 23, 1609), *reprinted in* 1 HENRY STEELE COMMAGER & MILTON CANTOR, DOCUMENTS OF AMERICAN HISTORY 11 (10th ed. 1988).

47. Ordinance for Virginia (July 24, 1621), *reprinted in* COMMAGER & CANTOR, *supra* note 46, at 13–14. The discrepancy in dates is due to the loss of the original Ordinance of 1619; the one enacted in 1621, on which this discussion is based, is believed to be virtually identical to the original enactment.

48. *Id.* at 14.

49. The overriding corporate purpose was “to settle such a Form of Government there as may be the greatest Benefit and Comfort of the People, and whereby all Injustice, Grievances, and Oppression may be prevented, [and to provide] a Remedy of all Inconveniences [and to ensure the] advancing of Increase, Strength, Stability, and Prosperity of the said Colony[.]” *Id.* at 13.

were not incompatible—indeed, the corporate form was available to pursue the latter only insofar as it contributed to the former. The corporation was the means by which a state could channel private capital to achieve public ends such as the building of a bridge, turnpike or canal. Governments employed the corporate form “to do things that rational businessmen would not do because they were too risky, too expensive, too unprofitable, or too public, that is, to perform tasks that would not have gotten done if left to the efficient operation of markets.”⁵⁰

These eighteenth-century corporations needed much more from the state than a charter—a mere license to exist. Businessmen whom the government wished to entice into building bridges across rivers would usually invest only if the government offered a monopoly: if nobody else would be allowed to build a bridge or to operate a ferry nearby, you knew that your bridge was assured enough business to pay a good return. Other endeavors were not merely risky without government concessions—they were wholly impractical or even impossible. A bank needed the right to issue currency on its own credit—only the government could grant that privilege. Would-be builders of canals, turnpikes and railroads needed the power of eminent domain to ensure availability of the land along the planned route—only the government could delegate such authority.⁵¹ As one court put it, such concessions would be conferred only,

[I]n consideration of services to be rendered to the public. . . . It may often be convenient for a set of associated individuals, to have the privileges of a corporation bestowed upon them; but if their object is merely *private* or selfish; if it is detrimental to, or not promotive of, the public good, they have no adequate claim upon the legislature for the privileges.⁵²

This dual concept of corporate purpose helps to explain the extraordinary popularity of the corporation as a business form in the early United States. Although the joint-stock company (other than the great exploratory charter companies) was moribund in England in the eighteenth and early-nineteenth centuries, corporations proliferated in America as the young nation built out its infrastructure.⁵³ American states chartered corporations for business purposes—albeit businesses with a public purpose, such as turnpikes or canals—far more than other nations, where corporations continued to be primarily the province of non-profit endeavors such as municipalities or universities.⁵⁴

50. WILLIAM G. ROY, *SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA* 41 (1997).

51. MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1780–1860*, at 116–18, 125–26 (1977); ROSENBERG & BIRDZELL, *supra* note 29, at 194.

52. HORWITZ, *supra* note 51, at 112 (quoting *Currie’s Adm’ts v. Mutual Assurance Soc’y*, 14 Va. 315, 347–48 (1809) (emphasis in original)) .

53. MICKLETHWAIT & WOOLDRIDGE, *supra* note 30, at 43.

54. Pauline Maier, *The Revolutionary Origins of the American Corporation*, 50 WM. & MARY Q. 51, 55–56 (1993).

Part of the corporation's appeal was that, in a country without an aristocracy, it enabled the concentration of capital necessary for economic development. John Quincy Adams, among many others, advocated the joint-stock company "as a 'truly republican institution' that allowed investment by 'the poor, . . . females and children, . . . the widow and the orphan.'"⁵⁵ Promoting ownership of vital internal improvements by the general public, as an alternative to leaving them in the hands of a few wealthy individuals or, worse still, in the hands of indolent (or even corrupt) government bureaucrats grasping for a sinecure, was not only good business—it was a positive civic virtue.⁵⁶

The popularity and effectiveness of the corporate form exploded in the decades following American independence. When the Constitution was ratified in 1789, there were only six non-bank business corporations in the entire United States. Within a decade that number had multiplied by a factor of forty-five.⁵⁷ Three-fourths of those corporations were formed to accomplish internal improvements: canals, turnpikes, bridges, water supplies. The public obligations of business corporations were, accordingly, taken very seriously. Lack of a sufficient public purpose was grounds for denying a corporate charter; failure to fulfill public responsibilities was grounds for revocation of a charter.⁵⁸ Government action short of outright revocation was also visited upon early American corporations to ensure their contribution to the public good. Towns and legislatures regulated the tolls charged by turnpike corporations and the rates charged by grist mills.⁵⁹ A mill owner might be forbidden to put the mill to uses other than those for which the proprietors had originally obtained its corporate charter from the legislature or its water privileges from the town.⁶⁰ In particular, the state did not part with its power of eminent domain lightly, and the measures employed to ensure its responsible exercise by a corporation could be extreme. In an 1823 opinion, New York's Chancellor Kent explained that:

55. Note, *Incorporating the Republic: The Corporation in Antebellum Political Culture*, 102 HARV. L. REV. 1883, 1894 (1989) (quoting a speech on manufacturing that Adams gave in 1832) [hereinafter *Incorporating the Republic*].

56. See *id.* at 1894–95.

57. ROY, *supra* note 50, at 49.

58. *Id.* at 48. Sometimes the enforcement mechanism was judicial, in the form of a *quo warranto* hearing, where the public inquired by what right has this entity presumed to take a challenged action. See, e.g., *Wadsworth Land Co. v. Piedmont Traction Co.*, 78 S.E. 297, 298 (N.C. 1913) (*quo warranto* remedy if a transportation company abuses its eminent domain power); D. Mark Jackson, Note, *The Corporate Defamation Plaintiff in the Era of SLAPPS: Revisiting New York Times v. Sullivan*, 9 WM. & MARY BILL RTS. J. 491, 517 (2001); Richard Grossman, *Revoking the Corporation*, 11 J. ENVTL. L. & LITIG. 141, 145 (1996); ROBERT BENSON, CHALLENGING CORPORATE RULE 41–42 (1999).

59. HORWITZ, *supra* note 51, at 118, 125; see also *San Diego Land & Town Co. v. National City*, 174 U.S. 739, 755 (1899) (explaining that a railroad cannot fix rates to maximize its profits while ignoring the rights of the public because "such a corporation was created for public purposes, and performed a function of the state, and . . . its right to exercise the power of eminent domain, and to charge tolls, was given primarily for the benefit of the public [. . .]").

60. HORWITZ, *supra* note 51, at 118.

Turnpike roads are, in point of fact, the most public roads or highways that are known to exist, and, in point of law, they are made entirely for public use, and the community have a deep interest in their construction and preservation. They are under legislative regulations, and the gates are subject to be thrown open, and the company indicted and fined, if the road is not made and kept easy and safe for the public use.⁶¹

Seventy years later, the United States Supreme Court held that railways are likewise “public corporations organized for public purposes” that have been given “valuable franchises and privileges,” and they therefore “primarily owe duties to the public of a higher nature even than that of earning large dividends for their shareholders.”⁶² Such transportation companies were granted a public franchise, and one condition of their public service was the legal obligation to serve all comers without discrimination⁶³—a principle that lives on in the modern common-carrier doctrine.

VI. THE CORPORATION IN INDUSTRIAL AMERICA: SELF-INTEREST, RIGHTLY UNDERSTOOD

As America’s infrastructure was constructed, the center of gravity for corporations shifted gradually from public dedication of private capital, to public purposes, to private direction of how and where capital should be invested. This movement, like so much in the history of American corporations, began in New England. In 1830, the Massachusetts legislature declared that petitioners for corporate charters no longer had to be engaged in public works to be awarded the privilege of limited liability. In 1837, Connecticut took the next step and permitted most business enterprises to become incorporated by a registration procedure that no longer required a special legislative charter.⁶⁴ But it is a measure of the abiding power of the principle of corporate public purpose that such statutes did not spread quickly. When Delaware, the modern mother of corporation law, enacted a general incorporation statute in 1899, it was only the twelfth state to do so.⁶⁵

61. ROY, *supra* note 50, at 51.

62. *United States v. Trans-Missouri Freight Ass’n*, 166 U.S. 290, 332–33 (1897).

63. ROSENBERG & BIRDZELL, *supra* note 29, at 194.

64. MICKLETHWAIT & WOOLDRIDGE, *supra* note 30, at 46; *see also* CHARLES PERROW, *ORGANIZING AMERICA: WEALTH, POWER, AND THE ORIGINS OF CORPORATE CAPITALISM* 36–37 (2002). In part, this relaxation of incorporation requirements was a reform movement aimed at the political favoritism—and sometimes outright corruption—that had attended incorporation so long as it required a special legislative grant for each applicant company. ROSENBERG & BIRDZELL, *supra* note 29, at 199.

65. ROSENBERG & BIRDZELL, *supra* note 29, at 199. The exceptions to this general trend—even today—are public utility companies. Whether streetcar lines, water companies, electric companies, telephone companies or cable television companies, such concerns require the grant of a specific government franchise, even if they no longer need a special act of the legislature merely to incorporate. *Id.* at 194–95. At the outset, such enterprises were understood to be “natural monopolies” and therefore, they required a government grant of monopoly privileges to be viable. And, of course, the power of eminent domain was often essential to the success of such companies. Technological

The substitution of simple registration procedures for petitions for individual legislative enactment of corporate charters has been criticized as fatally diluting the requirement of corporate public service: “On the practical level, [general incorporation laws] made the corporate form more widely available than it had previously been; on the ideological level, they abandoned the implication that corporate privileges should only be granted for special, public purposes.”⁶⁶ But this interpretation misses the point: unlike other business forms such as partnerships, a corporation requires the approval of the state *simply to exist*. It is an artificial person, not a natural being. If you fail to get a license for your dog, your dog still exists; this is not true for a corporation. A corporation is a political creation, not an automatic, inevitable result of economic change or technological development. The corporation and its special features—limited liability, perpetual existence, the power to sue and be sued in its name—are not attributes that private actors could, without the assistance of the state, recreate by themselves through the mechanisms of private contract.⁶⁷

Even during the heyday of the robber-barons, the Supreme Court recognized that the law remained within the gravitational influence of the original concept of the corporation:

[T]he corporation is a creature of the state. It is presumed to be incorporated for the benefit of the public. It receives certain special privileges and franchises, and holds them subject to the laws of the state and the limitations of its charter. Its powers are limited by law. It can make no contract not authorized by its charter. Its rights to act as a corporation are only preserved to it so long as it obeys the laws of its creation. There is a reserved right in the legislature to investigate its contracts and find out whether it has exceeded its powers. It would be a strange anomaly to hold that a state, having chartered a corporation to make use of certain franchises, could not, in the exercise of its sovereignty, inquire how these franchises had been employed, and whether they had been abused.⁶⁸

advances have recently diminished the claims of natural-monopoly status but transportation and utility companies remained the archetype of the huge American corporation until well into the twentieth century. As late as 1929, half of the two hundred largest corporations in America were in the transportation or utility industries. *Id.* at 194.

66. *Incorporating the Republic*, *supra* note 55, at 1883.

67. Limiting the corporation’s liability to its creditors to the assets it holds in its own name (distinct from the assets owned by its shareholders) may actually be less important to corporate vitality than the mirror-image concept of “entity-shielding”—the protecting of corporate assets from the claims of the personal creditors of the corporation’s myriad shareholders. See Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 394 (2000); Henry Hansmann et al., *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333, 1337 (2006).

68. *Wilson v. United States*, 221 U.S. 361, 383–84 (1911) (holding that a corporation, a creature of state law, must submit its books to examination by the state) (citation and quotation marks omitted); see also *Santa Clara Cnty. v. S. Pac. R.R. Co.*, 18 F. 385, 389 (C.C.D. Cal. 1883), *aff’d* 118 U.S. 394 (1886).

Perpetual, institutionalized antagonism between management and labor, corporation and community, manufacturer and consumer is not good for business. It is not a sound basis for sustainable corporate growth, and it is therefore not in the corporation's best interests.

Henry Mills, a Unitarian preacher who ministered to the factory workers of Lowell, Massachusetts, described companies who recognized this principle as imbued with "the sagacity of self-interest."⁶⁹ Company towns were built across America because corporations understood that "[w]ell-housed and well-educated workers would be more efficient than their slum-dwelling, feckless contemporaries."⁷⁰ In the early years of the twentieth century, Proctor & Gamble pioneered disability pensions, Sears established a retirement plan, U.S. Steel contributed ten million dollars a year to employee welfare programs, and International Harvester instituted profit-sharing.⁷¹ All of these programs were established not just because they were good for the employees, but because they were good for business.

VII. THE BUSINESS JUDGMENT RULE: SHIELDING MANAGERIAL DISCRETION TO LOOK AT THE BIG PICTURE AND THE LONG TERM

Even when corporate strategies to address social concerns arguably redound to the shareholders' injury, the "business judgment rule" protects managers who aim at sustainable, responsible business growth.⁷² The courts "will not disturb the judgments of a board of directors 'if they can be attributed to any rational business purpose.'"⁷³ Henry Ford stated that it was his ambition "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."⁷⁴ Ford proposed to achieve this goal by two measures: first, reinvesting

69. MICKLETHWAIT & WOOLDRIDGE, *supra* note 30, at 75.

70. *Id.*

71. *Id.* at 75, 111.

72. In the U.S. Supreme Court's majority opinion in *Burwell v. Hobby Lobby Stores, Inc.*, Justice Alito dismisses the argument that the purpose of for-profit corporations is simply to make money, stating that

[w]hile it is certainly true that a central objective of for-profit corporations is to make money, modern corporate law does not require for-profit corporations to pursue profit at the expense of everything else, and many do not do so. For-profit corporations, with ownership approval, support a wide variety of charitable causes, and it is not at all uncommon for such corporations to further humanitarian and other altruistic objectives. Many examples come readily to mind. So long as its owners agree, a for-profit corporation may take costly pollution-control and energy conservation measures that go beyond what the law requires. A for-profit corporation that operates facilities in other countries may exceed the requirements of local law regarding working conditions and benefits.

Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751, 2771 (2014).

73. *In re Reading Co.*, 711 F.2d 509, 517 (3d Cir. 1983) (citation omitted) (applying Delaware law).

74. *Dodge v. Ford Motor Co.*, 170 N.W. 668, 671 (Mich. 1919) (quoting Henry Ford's testimony).

profits to acquire an iron smelting business that would reduce his steel costs and second, cutting the price of his cars by about twenty percent.⁷⁵ The latter effort was part of Ford's plan to make his cars available to a wider market; the former revealed his zeal for vertical integration to minimize costs—it was said he wanted to own the grassy pastures that grazed the sheep whose wool was gathered to manufacture the upholstery in his Model-Ts.

The Dodge brothers, who were among the company's shareholders, sued Ford to block the expansion into the steel business and to compel the company to distribute the accumulated profits as dividends. The court compelled a greater dividend than Ford wished and seemed to have done so largely because Ford's own testimony was tantamount to a declaration (1) that the "the Ford Motor Company has made too much money . . ." and (2) that Ford would "continue the corporation henceforth as a semi-eleemosynary institution . . ."⁷⁶ The court deemed this an abuse of discretion and held that "it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefitting others . . ."⁷⁷ However, the court flatly refused to interfere with Ford's expansion into the steel business: directors' "power over [profits] is absolute so long as they act in the exercise of their honest judgment. They may reserve of them whatever their judgment approves as necessary or judicious for repairs or improvements, and to meet contingencies, both present and prospective."⁷⁸ The facts of *Dodge*—and Ford's testimony in particular—were extreme and have rendered it a curiosity. It is now generally cited for the rule that courts will not second-guess corporate management and that "plans must often be made for a long future, for expected competition, for a continuing as well as an immediately profitable venture."⁷⁹

The modern business judgment rule is better represented by *Shlenky v. Wrigley*,⁸⁰ in which stockholders brought a derivative suit against the principal owner of the Chicago Cubs to force him to install lights so that games could be played at Wrigley Field at night, to remedy the disappointing attendance at home games and the Cubs' consequent multi-year operating losses.⁸¹ The court was unmoved by plaintiff's alle-

75. *Id.* at 683.

76. *Id.* at 683–84.

77. *Id.* at 684.

78. *Id.* at 682 (citation and quotation marks omitted).

79. *Id.* at 684. *See, e.g.,* Lytle v. Malady, 566 N.W.2d 582, 593 n.25 (Mich. 1997) (citing *Dodge* for the proposition that courts should not second-guess corporate management); Levin v. Miss. River Corp., 59 F.R.D. 353, 365 (S.D.N.Y. 1973) (describing *Dodge* as having adopted a general rule against judicial interference with corporate management and distinguishing facts in *Dodge* as anomalous); Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 98 (2004) (describing the *Dodge* decision as "famously refus[ing] to interfere with Henry Ford's decision to expand Ford Motor Company's manufacturing facilities" and "explaining that 'judges are not business experts'").

80. 237 N.E.2d 776 (Ill. App. Ct. 1968).

81. *Id.* at 777.

gations that Wrigley was ignoring the shareholders' interest and imposing his personal view "that baseball is a 'daytime sport' and that the installation of lights and night baseball games [would] have a deteriorating effect upon the surrounding neighborhood."⁸² The court opined that "the effect on the surrounding neighborhood might well be considered by a director" and that "the long run interest" of the company "might demand" consideration of the impact of night games on the community.⁸³ The court held that second-guessing the company's management was "beyond [its] jurisdiction and ability"⁸⁴ and that the allegations of the complaint therefore could not survive a motion to dismiss—"the court did not even permit Shlensky to come to bat."⁸⁵

The business judgment rule thus shields—and thereby promotes—managerial discretion to serve the corporation's long-term prospects. In *Paramount Communications, Inc. v. Time, Inc.*,⁸⁶ the Supreme Court of Delaware refused to enjoin the Time-Warner merger at the behest of Paramount, a disappointed corporate suitor. The Time board's objection to a merger with Paramount focused on intangible, long-term considerations:

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. . . . [The directors] feared that a merger with an entertainment company would divert Time's focus from news journalism and threaten the Time Culture.⁸⁷

The court held that "precepts underlying the business judgment rule militate against a court's engaging in the process of attempting to appraise and evaluate the relative merits of a long-term versus a short-term investment goal for shareholders."⁸⁸ Such matters are best left to the corporation's managers, because their broad mandate to direct a company's affairs 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."⁸⁹

82. *Id.* at 778 (some interior quotations omitted).

83. *Id.* at 780.

84. *Id.*

85. Bainbridge, *supra* note 79, at 97 (citation and internal quotation marks omitted).

86. 571 A.2d 1140 (Del. 1990).

87. *Id.* at 1143 n.4; *see also id.* at 1149 ("The Time board maintained that the Warner transaction offered a greater long-term value for the stockholders and, unlike Paramount's offer, did not pose a threat to Time's survival and its 'culture.'").

88. *Id.* at 1153.

89. *Id.* at 1150; *see also id.* ("[A] board of directors, while always required to act in an informed manner, is not under any *per se* duty to maximize shareholder value in the short term, even in the context of a takeover.").

VIII. EXTENDING CORPORATE HORIZONS: WHY SHOULD AN ENTITY
 ENDOWED WITH PERPETUAL LIFE OBSESS ABOUT
 THE NEXT QUARTER'S EARNINGS?

Corporate discretion to look past the short-term economic interests of shareholders and consider additional stakeholders, such as employees, suppliers, and the community, was expanded in the 1980s when a host of states enacted laws—generally known as “constituency statutes”—explicitly authorizing such consideration, largely as a means of enabling local companies to fend off unwelcome takeover attempts.⁹⁰ Aside from the abstention rationale supporting the business judgment rule—the recognition that courts are ill-suited to substitute their judgment for that of corporate managers—there is a substantive justification for the rule as well: long-term study has demonstrated that corporate social responsibility is good for business. Careful review of more than fifty quantitative studies reveals that such principled corporate performance pays off and that “portraying managers’ choices with respect to [social responsibility and financial performance] as an either/or tradeoff is not justified in light of [thirty] years of empirical data.”⁹¹ Aiming for economic performance imbued with ethical purpose does not entail sacrificing the bottom line.

The CEO of PepsiCo, Indra Nooyi, has formulated an approach that she calls “Performance with Purpose”: a program of sustainable growth that combines robust financial returns with giving back to the communities that the company serves, by meeting consumer needs for a spectrum of convenient foods and beverages while reducing the company’s impact on the environment through water, energy and packaging initiatives, and supporting the company’s employees with a diverse and inclusive global corporate culture. Thus, during the company’s October 8, 2009 earnings call, Ms. Nooyi described PepsiCo’s research and development focus on

[T]rue science based differentiation [that] will enable us to accelerate our health and wellness transformation. We have put in place an outstanding R&D team with complementary skills and experience and we have married them with our insights organization, which we are continually upgrading. While we are already seeing benefits from some of the work in our 2010 pipeline, we

90. MICKLETHWAIT & WOOLDRIDGE, *supra* note 30, at 150. Connecticut’s statute actually mandates that a corporation consider such interests. *See id.* In the United Kingdom, the 1985 Companies Act likewise forced directors to consider the interests of employees as well as shareholders. *Id.*; *see generally* Jonathan D. Springer, *Corporate Constituency Statutes: Hollow Hopes and False Fears*, 1999 ANN. SURV. AM. L. 85 (1999).

91. Marc Orlitzky et al., *Corporate Social and Financial Performance: A Meta-Analysis*, 24 ORG. STUD. 403, 427 (2003), available at http://community-wealth.org/_pdfs/articles-publications/sri/article-orlitzky-et-al.pdf; *see also id.* at 426 (“First and foremost, market forces generally do not penalize companies that are high in corporate social performance; thus, managers can afford to be socially responsible.”).

don't expect immediate major breakthroughs. This is an area where sustained investment is critical.⁹²

Economic performance and ethical practices ultimately merge and reinforce each other synergistically. Across a broad spectrum of quantitative inquiries, "corporate social performance is positively correlated with [corporate financial performance] . . ." and, as statistical analysts are wont to say, "the relationship tends to be bidirectional and simultaneous . . ." ⁹³ In layman's terms, "[c]orporate virtue . . . is rewarding in more ways than one."⁹⁴

The "Performance with Purpose" agenda is not radical. It is simply the conviction that there is more to business than the earnings cycle. Some corporations have pursued similar ends with different formulations for at least the last half-century. Hewlett-Packard, the original resident of Silicon Valley, has been saying for more than fifty years that profits are not the principal goal of its business.⁹⁵ In 1951 the CEO of Standard Oil of New Jersey argued that corporate management's job is "to maintain an equitable and working balance among the claims of . . . stockholders, employees, customers, and the public at large."⁹⁶ The American heritage of this idea is much older still: de Tocqueville identified the "principle of self-interest rightly understood" as the engine that drives corporations and other associations to that place where "private interest and public interest meet and amalgamate."⁹⁷

This is not a call for corporations to compromise, let alone to abandon, their commercial mission to pursue opportunities aggressively and to maximize return on capital. Whatever one may think of Adam Smith's famous "invisible hand," he clearly got this part right: the greatest contribution any company can make to society will always be increasing the pie on the table at which we all dine.⁹⁸ For all the universities and libraries built by the robber-barons and all the good works financed by Boeing, Google, and Microsoft do not equal the good they have done humanity through the jobs they have provided, the products they have manufactured, and the wealth they have generated. All that is required is recognition that "shareholder value is a result, not a strat-

92. *PepsiCo Earnings Conference Call* (Oct. 8, 2009), transcript at 4 (available from Thompson Reuters Streetevents, www.streetevents.com).

93. Orlitzky, *supra* note 91, at 427.

94. *Id.*

95. MICKLETHWAIT & WOOLRIDGE, *supra* note 30, at 189.

96. *Id.* at 118 (citation and internal quotation marks omitted).

97. 2 ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* (Henry Reeve trans., Colonial Press ed.) (1838).

98. See ADAM SMITH, *THE WEALTH OF NATIONS* bk. IV, at 32 (Andrew Skinner ed., Penguin Classics 1999) (1776) (In a capitalist system, an individual "neither intends to promote the public interest, nor knows how much he is promoting it. . . . [H]e intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good.").

egy,” and that a corporate manager’s “main constituencies are [her] employees, [her] customers and [her] products.”⁹⁹

A responsible corporation must both broaden and extend its horizons. Not only should it widen its view beyond its shareholders to include the interests of the community that gave it birth, it should also look past the next quarterly report to envision sustainable performance. Even when considered solely in the economic terms he used to frame it, Milton Friedman’s argument that a corporation’s only social responsibility is “maximum profits for stockholders” begs the question: *which* stockholders is he talking about? Does he mean buy-and-hold equity investors who are with the company for the long haul? If so, the corporation maximizes its return by adopting long-term strategies that anticipate changes in the marketplace and that aim for sustainable performance, even if that means lower earnings now. Or does he mean day-traders and other stock speculators who are gambling on the market and desire large, rapid movements in stock price? The corporation would have to behave in radically different ways to maximize their profits.¹⁰⁰

Analysts of western stock exchanges estimate that about eighty percent of stock market value “depends on expectations of corporate cash flows beyond the next three years.”¹⁰¹ One study concluded that ninety-five percent of a company’s value “comes not from existing contracts reflected in financial statements but from expectations of future sales and purchase contracts.”¹⁰² It therefore seems to follow that responsible corporate leadership, even if viewed exclusively in financial terms, *mandates* planning for the long term even at the cost of not meeting the earnings projections for the next quarter. In a fairly recent interview, Unilever chief Paul Polman explained:

I do not work for the shareholder, to be honest; I work for the consumer, the customer. I discovered a long time ago that if I focus on . . . the long term to improve the lives of consumers and customers all over the world, the business results will come.¹⁰³

Indeed, I would argue that a longer-term perspective is dictated by a fundamental aspect of a corporation’s nature: it is endowed by law

99. Michael Skapinker, *Replacing the ‘Dumbest Idea in the World,’* FIN. TIMES, Apr. 12, 2010, available at www.ft.com/comment/columnists/michaelskapinker (quoting former General Electric CEO Jack Welch).

100. See Judith F. Samuelson & Lynn A. Stout, *Are Executives Paid Too Much?*, WALL ST. J., Feb. 26, 2009, <http://online.wsj.com/news/articles/SB123561746955678771> (“[Corporations] pursue complex, uncertain projects that take years or decades to reach fruition: developing brand names, building specialized manufacturing facilities, exploring and drilling for oil and gas fields, or developing new drugs, products and technologies.”).

101. Ian Davis, *What is the Business of Business?*, MCKINSEY Q. (Aug. 2005), available at http://www.asq-qm.org/resourcesmodule/download_resource/id/415/src/@random4b253ffcd/fcd/.

102. RESEARCH & POLICY COMM. FOR ECON. DEV., *BUILT TO LAST: FOCUSING CORPORATIONS ON LONG-TERM PERFORMANCE* 19 (2007) (footnote omitted) [hereinafter COMM. FOR ECON. DEV., *BUILT TO LAST*].

103. Skapinker, *supra* note 99.

with perpetual existence—a life of its own not constrained by the lives of its mortal shareholders. It can convey its traditions, its learning, and its wealth from one generation to the next. To posit a corporate duty to maximize the next quarter's earnings at the expense of next year's (or the next decade's), is to squander the opportunity conferred on a corporation by one of its defining features.

IX. RESURRECTING THE “AMERICAN THEORY” OF BUSINESS PLANNING

Given that the current global economic meltdown was ignited by heedless and toxic short-term thinking in America's financial markets, it is ironic that a presumption in favor of long-term corporate planning was largely an American invention. Well into the twentieth century, British corporations routinely distributed as dividends more than three-fourths of their profits.¹⁰⁴ In contrast, in the late nineteenth century, some American corporations began to retain and devote a growing portion of their earnings to capital equipment and internal investment opportunities. This difference in perspectives was vividly illustrated in 1881, when a representative of British shareholders in the Pennsylvania Railroad arrived in Philadelphia to demand (unsuccessfully) that all earnings be distributed as dividends.¹⁰⁵ The policy of sacrificing short-term stockholder gains in order to reinvest and grow the business was denounced by the British as the “American theory” of business planning.¹⁰⁶ Given how much the American industrial revolution eclipsed that of Europe, it is hard to quarrel with the philosophy. The most successful American industrial enterprises at the start of the twentieth century were those that relied primarily on retained earnings to finance their operations.¹⁰⁷ This was especially true with respect to huge companies that tried to expand by means of consolidating many smaller entities. Eighteen huge consolidated enterprises—including Westinghouse and United States Leather—spiraled into insolvency and had to be reorganized because of a rush to pay high dividends at the expense of reinvestment.¹⁰⁸

Often the two forms of corporate myopia—viewing only a narrow constituency of shareholders and looking only at the short-term—induce parallel, simultaneous errors. An example of the opposite approach demonstrates the point. After 9/11, every American airline laid off employees—except Southwest Airlines. It alone bucked the

104. BASKIN & MIRANTI, *supra* note 39, at 192.

105. *Id.* at 193.

106. *Id.*; see also BENJAMIN GRAHAM & DAVID L. DODD, SECURITY ANALYSIS 379 (2d ed. 1940).

107. BASKIN & MIRANTI, *supra* note 39, at 205.

108. *Id.* at 194; see also *id.*

The haste with which these early dividends were declared was at a variance with the principles of sound finance. . . . Why was such lack of conservatism shown by these corporations? Able financiers were on the directorates of nearly every case. . . . One motive that often prompted declaration of dividends was a desire to make a market for the stock.

(citation omitted).

rush to cut short-term costs and looked instead to husbanding the resource that was its workforce. This paid off in terms of confident and secure and loyal employees who continue to give Southwest the highest customer-satisfaction ratings in the industry. It also gave Southwest an edge in competing with other airlines for talent: when the company announced 3,000 new jobs, it received 120,000 applications.¹⁰⁹ Southwest has also benefited from making long-term commitments to its suppliers. Early in this decade, it undertook a multi-year contract for aviation fuel and was consequently unperturbed by the shockwave that rocked other airlines when oil prices skyrocketed in 2008.

We therefore need not break new ground to reject the obsession with meeting the next quarter's earnings projection that has tyrannized Wall Street and helped spawn the financial crisis that currently plagues us. Prudent corporations, like prudent households, take heed of the common-sense maxims that one does not burn the furniture to heat the house tonight and one does not gorge oneself on tomorrow's seed corn.¹¹⁰ Recognizing these truths is particularly important in a world with an expanding population and diminishing resources. Some years ago Stuart Hart articulated the challenge of developing a "sustainable global economy" this way:

Although we may be approaching ecological recovery in the developed world, the planet as a whole remains on an unsustainable course. . . . [T]he scourges of the late twentieth century—depleted farmland, fisheries and forests; choking urban pollution; poverty; infectious disease; and migration—are spilling over geopolitical borders. The simple fact is this: in meeting our needs, we are destroying the ability of future generations to meet theirs. . . . [C]orporations are the only organizations with the resources, the technology, the global reach, and, ultimately, the motivation to achieve sustainability.¹¹¹

What the present circumstances call for is the revival of another ancient, common-law concept: stewardship—the responsible management of the estate of another. In this case, on a global scale, the "estate" is the planet and the "other" is the generation yet to come. As Professor Vining has observed, such stewardship is both "alternative and supplement to democracy"¹¹²—including corporate democracy. It is "trusteeship for those to be born in the future who do not yet have a voice."¹¹³

109. MICKLETHWAIT & WOOLDRIDGE, *supra* note 30, at 189.

110. During a quarterly earnings conference call in 2008, Indra Nooyi rhetorically asked whether "it is prudent to do something radical to deliver [forecast performance] numbers in [periods of] extreme volatility, and the answer is no because we're running the company for the long term. You never run a company where you burn the furniture for the short term." *PepsiCo Q3 Earnings Conference Call* (Oct. 14, 2008), transcript at 11 (available from Factset: callstreet, www.callstreet.com).

111. Stuart L. Hart, *Beyond Greening: Strategies for a Sustainable World*, HARV. BUS. REV. 67, 67 (Jan.–Feb. 1997).

112. Vining, *supra* note 5, at 1598.

113. *Id.*

A rapidly-growing part of the investor community understands this stewardship. Socially-responsible investing is growing at a pace faster than the broader universe of all professionally-managed investments. Nearly one out of every nine dollars under professional investment management in the United States—a sum that comes to \$2.7 trillion—is managed according to “socially responsible” criteria.¹¹⁴ Although some socially responsible investors are focused on a single issue, others push corporations to adopt long-term outlooks and to recognize and deal with long-term risks.

X. SOME SUGGESTED TREATMENTS FOR WALL STREET’S ADDICTION TO SHORT-TERM RESULTS

Corporate America’s fixation on short-term thinking presents a paradox: a legal entity designed to transcend the mortal limits of human lifetimes is managed with a myopic focus on what happens in the next three months. The term “paradox” comes from the combination of the Greek words *para* —“beyond”—and *doxa*—“opinion.” Therefore, to address—to transcend—a paradox, one must look beyond the apparent contradiction that is embodied in conventional thinking, and the conventional thinking at issue here is some of Wall Street’s obsession with the immediate earnings cycle. We must induce both investors and managers to shift their perspectives to consider more than just the immediate bottom line of the next quarterly earnings report, to envision socially responsible, sustainable corporate performance, and to work toward it. Investors need to be shown the financial advantages of sustainability, and managers need to be given financial incentives to overcome their addiction to short-term results. The former requires the promotion of metrics that measure sustainable performance and thereby reveal to investors the value of companies that pursue performance with purpose; the latter requires changing the formula for compensating company executives to relieve them of a perverse incentive structure.¹¹⁵

A. *Sustainability Reporting*

Sustainability metrics attempt to quantify the value in a company that is not always fully represented by its financial report. These metrics are sometimes referred to generally as non-financial reporting. Significant market value derives from intangible assets such as reputation, the capacity to innovate, and a commitment to social well-being that almost always redounds to the benefit of global corporations in many ways.¹¹⁶ “Corporate Sustainability is a business approach that creates long-term

114. See SOCIAL INVESTMENT FORUM, 2007 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES, at ii (2007), available at http://www.ussif.org/files/Publications/07_Trends_%20Report.pdf.

115. As explained below, The Aspen Institute has been a leader in focusing attention on the ills of short-term business planning.

116. See *About Sustainability Reporting*, GLOBAL REPORTING INITIATIVE, <https://www.globalreporting.org/information/sustainability-reporting/Pages/default.aspx>.

shareholder value by embracing opportunities and managing risks deriving from economic, environmental, and social developments.”¹¹⁷ The creation of measures to report and compare the sustainability of different companies serves not only companies that adopt this business approach but also the growing number of investors who “‘perceive sustainability as a catalyst for enlightened and disciplined management’” and therefore as a crucial element of enduring corporate success.¹¹⁸ The leading sustainability reporting institutions are the Global Reporting Initiative (“GRI”), created by the Ceres organization in 1997¹¹⁹ and the Dow Jones Sustainability Index (“DJSI”), first published in 1999.¹²⁰

The DJSI comprises the top ten percent of the 2,500 largest companies in the world based on an assessment of long-term environmental, economic and social criteria, such as corporate governance and plans for responding to global climate change. Dow Jones has defined a set of criteria (and associated weightings) to assess the opportunities and risks presented to companies.¹²¹ Generally applicable economic criteria include, for example, a corporation’s regime of corporate governance, code of conduct, regulatory compliance programs, and risk and crisis management; environmental criteria include the company’s environmental reporting; and social criteria include the company’s philanthropy, labor practices and recruiting and personnel policies for attracting and retaining talented employees.¹²² A company is also assessed with respect to criteria specific to particular industries; for example, assessments for food or product-manufacturing companies might include consideration of their brand management, marketing practices, and research and development programs.¹²³

The shortcomings of current sustainability reporting regimes, including GRI and DJSI, are that they are not embraced by all corporations and the information on which they are based lacks a degree of standardization that makes apples-to-apples comparisons somewhat problematic. The entire point of sustainability reporting is to provide a

117. See *Corporate Sustainability*, DOW JONES SUSTAINABILITY INDICES, <http://www.sustainability-indices.com/sustainability-assessment/corporate-sustainability.jsp>.

118. See *Dow Jones Sustainability Indexes Reveal Tech Winners and Losers*, SILICON REPUBLIC (Sept. 14, 2011), <http://www.siliconrepublic.com/clean-tech/item/23580-dow-jones-sustainability-in> (quoting Dow Jones Sustainability Index).

119. See *What is GRI?*, GLOBAL REPORTING INITIATIVE, <https://www.globalreporting.org/information/about-gri/what-is-GRI/Pages/default.aspx>. GRI became an independent entity and relocated to the Netherlands in 2002. See *id.*

120. See *Dow Jones Sustainability World Enlarged Index Guide Book*, at 7 (Jan. 2008), available at http://www.sustentabilidad.uai.edu.ar/pdf/negocios/djsi/djsi_world_guide_book_91.pdf.

121. See ROBECO/SAM, DJSI 2014 REVIEW RESULTS, at 3 (Sept. 2014), available at http://www.sustainability-indices.com/images/DJSI_Review_Presentation_09_2014_final.pdf

122. See *Dow Jones Sustainability Indexes*, at 2 (Nov. 2010), available at https://www.djindexes.com/mdsidx/downloads/brochure_info/Dow_Jones_Sustainability_Indexes_Brochure.pdf.

123. The Dow Jones Sustainability Index actually comprises several indices for different regions, including World, North America, Euro STOXX, Asia-Pacific, Korea and Japan. *Id.* at 4.

standard of information that is credible, comparable, and consistent across all companies. These goals cannot be achieved if companies can effectively rate themselves and disclose only the information that they wish. For example, under GRI Guidelines, corporations decide for themselves which of the two reporting options (known as “Core” and “Comprehensive”) they wish to declare that they have met.¹²⁴ Furthermore, it is entirely optional for a company to have either an external auditor or GRI itself check the company’s self-declaration of the reliability of its sustainability report.¹²⁵ The corporation may also choose whether to prepare its sustainability report “in accordance” with the [GRI] Guidelines”—that is, to actually adhere to them—or to take an “incremental approach” that requires mere “partial adherence to the reporting principles.”¹²⁶ GRI explains that it “encourages” external or independent assurance of data reporting because such verification will naturally enhance the “credibility and quality of sustainability reports,” but it hastens to add that “[i]ndependent assurance of a sustainability report is not a requirement” even for reporting declared to be formally “in accordance” with GRI’s Guidelines.¹²⁷

Thus, there are opportunities for improvement in sustainability reporting. No matter how good a process is, no matter how sound its methodology, its results have little meaning if the data that are put into the process are unreliable or incomplete.¹²⁸ To be fair, any shortcomings in the GRI regime are certainly not due to lack of care or a shortage of intellectual acumen on the part of those who created and support the GRI. The Global Reporting Initiative is, as its name reveals, a first attempt—an effort from the bottom up to achieve some order and comparability in systematic quantification and reporting of sustainability. GRI by itself has no means of imposing its Guidelines from the top down, and while this limits their impact, the GRI framework is nonetheless a laudable, groundbreaking step on the path to a world in which corporate sustainability will be an essential element of planning by both investors and corporate managers.

The Dow Jones Sustainability Index has an additional carrot to encourage companies to meet its reporting requirements—inclusion as a member of an economic index created by one of the world’s most venerated financial reporting institutions. The DJSI process is different from that of the GRI Guidelines, because the former not only has a daily monitoring program that compares a company’s actual behavior

124. See *Global Reporting Initiative FAQs*, at 15 (Dec. 2014), available at <https://www.globalreporting.org/resourcelibrary/G4-FAQ.pdf>.

125. *Id.*

126. *Id.* at 3.

127. *Id.*

128. Charles Babbage, the nineteenth-century English mathematician and engineer who first conceived of a programmable computer, despaired of those who failed to grasp this inherent problem: “On two occasions I have been asked, ‘Pray, Mr. Babbage, if you put into the machine wrong figures, will the right answers come out?’ . . . I am not able rightly to apprehend the kind of confusion of ideas that could provoke such a question.” CHARLES BABBAGE, *PASSAGES FROM THE LIFE OF A PHILOSOPHER* 49 (Martin Campbell-Kelly ed., 1994).

with the sustainability policies it proclaims, it also provides a measure of independent review through an outside accounting firm (Deloitte AG). However, Deloitte examines and verifies only the methodology applied by DJSI's research arm (SAM Research AG), and (at least to a limited extent) the accuracy of that agency's compilation of sustainability scores. Neither Deloitte nor any other independent body verifies, nor even reviews, "the data, data collection, collation, and validation processes used by the individual companies submitting information to [DJSI]."¹²⁹

It does not have to be this way. Sustainability reporting can be more than an exercise in "happy" corporate communications. Even if we assume that sustainability reporting may inevitably be less rigorous than the financial data presented in a company's 10-K, due to the play in the joints inherent in assigning a numerical value to such things as corporate governance structures or crisis management protocols, this does not mean that sustainability reporting cannot be made more exacting and reliable.¹³⁰ For example, although PepsiCo's participation in the DJSI, like that of many companies, began largely as a communications initiative, all of the information submitted to DJSI must now be verified through the company's Disclosure Committee, consisting of the general counsel, the chief internal auditor, the head of investor relations, the controller, and the head of financial planning and analysis.¹³¹ Even if the numbers assigned to sustainability criteria cannot be crunched quite as rigorously as budget figures or market-share statistics, the fact remains that many companies report such data and trumpet their ranking on the DJSI in order to influence the decisions of investors, and in the end that means that sustainability reporting should be considered subject to the standards that the securities laws already

129. Deloitte, *Independent Assurance Report by Deloitte AG to SAM Research AG*, at 1 (Sept. 2014), available at <http://www.sustainability-indices.com/images/independent-assurance-report-by-deloitte-AG-to-robecosam-ag-2014.pdf>.

130. That said, one should take care not to overrate the meaningfulness of the supposedly "hard numbers" set forth in a 10-K statement. It is worth remembering that there is far more latitude for judgment and interpretation in financial data than we are often willing to admit. As the Committee for Economic Development has noted, the "apparent, but false, precision of financial statements feeds the narrow focus of managers, investors, directors, and analysts on the earnings-per-share number." COMM. FOR ECON. DEV., *BUILT TO LAST*, *supra* note 102, at 19. "[S]tock analysts, the investing public, and regulators must recognize the inherently judgmental character of accounting statements and financial information. Ranges of values rather than precise numbers should be explained and understood as such. In addition, financial statements should be supplemented with non-financial indicators of value." *Id.* (citation omitted).

131. Processing sustainability information through a Disclosure Committee may not be enough. Companies also need rigorously defined metrics and data collection protocols, centralized reporting on sustainability initiatives, dedicated resources for data collection, and an audit process to verify the results. Finally, responsibility within the company for the ultimate sustainability reporting effort should be clearly defined, for example through designation of a chief sustainability officer or the designation of a committee of high-level executives.

impose on other “‘material’ information . . . that would be important to a reasonable investor in making his or her investment decision.”¹³²

It has been said that, just as a corporation has no soul, so “[a] corporation cannot blush.”¹³³ But as a practical matter this is simply not so. Even if a corporate logo cannot display embarrassment or chagrin, the human beings who manage a corporation can be profoundly embarrassed, even shamed, by revelations about the company’s misconduct, by its refusal to acknowledge responsibility for harms it has caused, by its slowness to provide relief measures, or by its failure to live up to the principles that it espouses in corporate filings and press releases. The very existence of the Dow Jones Sustainability Index and the Global Reporting Initiative confirm that both investors and corporate directors care about whether a company is perceived as socially responsible, and a company’s reputation in such matters can be either an asset or a liability in the marketplace.¹³⁴

Perhaps it is time for Congress and the SEC to undertake inquiry and invite public comments further defining the “materiality” of a company’s sustainability reporting, and consider whether social, environmental and governance risks (and a company’s performance in dealing with them) should be addressed in a company’s official public filings. And perhaps we even need an international organization of business enterprises to make the case for this proposal (and others) even to international regulators.¹³⁵ This role is filled in the United States by such organizations as the Aspen Institute’s Business and Society Program,¹³⁶ the Ceres corporate network,¹³⁷ and the Committee for Economic Development.¹³⁸ But perhaps, in addition to these country-

132. In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997) (defining “material information”); see also *Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1084 (1991); *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 445–49 (1976).

133. Joseph Auerbach, *Speech: Corporate Ethics: An Elusive Euphemism*, 5 TULSA J. COMP. & INT’L L. 169, 178 (1997) (quoting an English corporation case from 1837) (quotation marks omitted).

134. See *Global Reporting Initiative FAQs* at 3 (“Significant market value derives from intangible assets such as reputation, the capacity to innovate, and a commitment to social well-being.”), available at <http://www.globalreporting.org/AboutGRI/FAQs/FAQSustainabilityReporting.htm>; see also *Dow Jones Sustainability World Enlarged Index Guide Book*, *supra* note 120, at 13 (“[A] company’s involvement and management of critical environmental, economic and social crisis situations . . . can have a highly damaging effect on its reputation and its core business.”).

135. See Indra K. Nooyi, *Leading to the Future: Capitalism Is Great For Economic Recovery*, in 525 VITAL SPEECHES OF THE DAY 406 (2009) (proposing such an organization and explaining need for “metrics, communications, policies and executive remuneration all towards this objective of creating long-term value.”).

136. See ASPEN INST., www.aspeninstitute.org; DIRS. & BDS., www.directorsandboards.com.

137. See CERES, www.ceres.org.

138. See COMM. FOR ECON. DEV., www.ced.org. For example, the CED has recommended that the “relevance, transparency, and utility of company-reported information” be improved by “redesigning business reports to include useful non-financial indicators of value, such as those proposed by the Enhanced Business Reporting Consortium, and dropping the use of quarterly earnings guidance.” COMM. FOR ECON. DEV., *BUILT TO LAST* *supra* note 102, at 19.

specific business organizations and their analogs around the world, we need a G50 group of global corporations to facilitate discussion with the G20 nations. In the meantime, we who act in the marketplace can demand greater rigor. I therefore issue the following challenge to all publicly traded corporations: All of the sustainability information that a company submits to DJSI or any other body, and all sustainability claims and programs that a company announces to the public, must first undergo systematic and methodical review by the company's own disclosure committee.¹³⁹ It is time for sustainability to be more than communications hype; it is time for corporations to "walk the talk."¹⁴⁰

B. *Executive Compensation*

Diagnosing the causes of the recent economic crisis has become something of a parlor game similar to discussions among historians about what caused the fall of the Roman Empire. But to my mind the greatest contributing factor was the willingness of business leaders to take on excessive risk in order to improve on last quarter's earnings or to satisfy Wall Street's expectations for next quarter's profits. As Judith Samuelson of the Aspen Institute and Lynn Stout of the UCLA Law School memorably put it: "Our economy didn't get into this mess

139. Although there is no legal requirement that a company maintain a disclosure committee, the SEC recommends that corporations establish committees to consider the materiality of information about the company and to manage the company's disclosure obligations. Those obligations are imposed by the Sarbanes-Oxley Act, which mandates that companies required to report financial information to the SEC establish (and vouch for) internal procedures and controls for disclosing information material to the company's performance. See 15 U.S.C. §§ 7241(a)(4), 7262 (2006). And, under Section 409 of the Act, such material information must be publicly disclosed on a real-time basis. See 15 U.S.C. § 78m(a)(1) (2006). At a minimum, such disclosure committees review all reports made to the SEC and the guidance and press releases the company issues about its expected earnings. Some companies have their committees also review the information presented on the company's website and presentations the company makes to rating agencies. My proposal is that every company should subject the sustainability information it discloses to the same rigorous process of review that its disclosure committee applies to other company information of a material nature.

140. In addition to the Global Reporting Initiative discussed above, two other organizations—the Sustainability Accounting Standards Board ("SASB"), a U.S.-based, non-profit organization that recently appointed Michael Bloomberg and former SEC Chairman Mary Schapiro as its board chair and vice chair, and the International Integrated Reporting Council ("IIRC"), a global coalition of regulators and investors—have emerged as leaders in developing sustainability reporting standards. SASB's mission is to develop sustainability accounting standards to complement financial accounting standards that help public companies "disclose material factors in accordance with SEC standards" in periodic filings with the SEC, such as annual reports, and they are working with corporations to identify, industry by industry, a minimum set of sustainability issues that may have a significant impact on most, if not all, corporations in that industry. See SUSTAINABILITY ACCOUNTING STANDARDS Bd., www.sasb.org. IIRC developed a framework of "integrated thinking" focused on enabling companies to communicate in an integrated report how a range of financial and non-financial factors may materially affect their ability to create value over time. See THE INTERNATIONAL INTEGRATED REPORTING COUNCIL, www.theiirc.org. In addition, several countries and exchanges, including Denmark, France and South Africa, have begun requiring companies to report or explain certain sustainability-related initiatives.

because executives were paid too much. Rather, they were paid too much for doing the wrong things.”¹⁴¹ Meanwhile, outside investors—with little ready access to the data needed to assess whether the company is making decisions that will promote sustainable growth by investing in employees, communities, innovation, and supplier and customer relationships—all too often take the easy route of simply checking whether the share price was up or down today.¹⁴²

The latter problem can be addressed, in part, by promoting credible and consistent metrics of relating to policies that promote sustainable growth, as discussed above. Part of the solution to the first problem could be infusing sustainability into corporate planning by expressly basing executive pay on the company’s performance in addressing sustainability, especially when many objectives are immediately accretive to a company’s bottom line and others clearly support growth of long-term shareholder value. Instead of relying exclusively on share price or other short-term financial metrics, directors should thoughtfully design executive compensation programs that motivate executives to accomplish the right long-term and sustainable growth goals. Emphasizing these, rather than short-term financial results, will push executives to make choices promoting long-term goals instead of making the sort of risky bets that contributed to the recent economic crisis. For example, at Dutch chemical company Akzo Nobel, executive pay depends in part on the company’s position on the Dow Jones Sustainability Index.¹⁴³ Service to particular constituencies, such as suppliers, customers, or business partners, can be incentivized, too. For example, executive compensation at Marriott is tied in part to ratings by the company’s franchise holders.¹⁴⁴

PepsiCo announced in its 2009 annual report specific numeric goals in the areas of human, environmental, and talent sustainability, such as improving its water-use efficiency and increasing healthful eating options in its global product portfolio.¹⁴⁵ PepsiCo integrates these same sustainability goals into executive performance targets that determine incentive compensation.

Recent legislative proposals in Washington—grouped generally under the rubric of “say-on-pay”—would require all public companies to give shareholders an opportunity to cast a non-binding advisory vote to approve the executive compensation disclosed in annual proxy state-

141. See Samuelson & Stout, *supra* note 100, at A13.

142. *Id.*

143. See Skapinker, *supra* note 99 .

144. *Id.*

145. See 2009 Annual Report – Performance with Purpose, PEPSICO, http://www.pepsico.com/annual09/performance_with_purpose.html. Specifically, PepsiCo pledged to improve water and electricity efficiency by 20% per unit of production by 2015; to reduce fuel-use intensity by 25% per unit of production by 2015; to provide access to safe water to three million people in developing countries by 2015; to create partnerships to increase U.S. beverage recycling rates to 50% by 2018; to reduce packaging weight by 350 million pounds by 2012 (avoiding the creation of a billion pounds of landfill waste); and to reduce added sugar per serving in key global food brands by 25%, sodium per serving by 25%, and saturated fat per serving by 15%.

ments.¹⁴⁶ This step is welcome, and in fact many companies, including PepsiCo, have voluntarily committed to implement such votes. However, my principal concern is less about *who* sets executive pay than about *how* it is set. A say-on-pay vote changes the players but does not address the substantive criteria used to set management's pay. The perverse incentive structure of executive compensation will persist so long as the input for compensation calculations—even those made by independent committees and reviewed by shareholders—is limited to supposedly objective financial data that too often emphasizes short-term earnings and ignores long-term sustainability.¹⁴⁷

Indeed, increasing the input of shareholders—many of whom are just as likely as managers to respond principally, perhaps exclusively, to short-term swings in stock value—may in some instances exacerbate the problem. Professor Stephen Bainbridge¹⁴⁸ argues that the basic premise behind the say-on-pay mandate will fail to prevent future economic crises and may further crises because “shareholders and society do not have matching goals when it comes to executive pay.”¹⁴⁹ Society wants managers to be more risk adverse, while many shareholders will encourage managers to take “higher risks in the search for higher returns to shareholders.”¹⁵⁰ Although Dodd-Frank's say-on-pay man-

146. See *Treasury Department Fact Sheet: Ensuring Investors Have a “Say on Pay”* (June 10, 2009), available at http://www.treasury.gov/press-center/press-releases/Documents/fact_sheet_say%20on%20pay.pdf. Initiatives to bring shareholders into the executive-compensation process are also among the key features of bills proposed by Senator Charles Schumer and Representative Gary Peters. See Ronald D. Orol, *Bills Splitting Role of Chairman and CEO Shifting in Capitol Legislation Would Limit Efforts to Throw Out Rules Empowering Shareholders*, MARKETWATCH (Oct. 7, 2009), <http://www.marketwatch.com/story/story/print?guid=404BF3D3-C2DF-46CF-9F71-747F9E36A0DB>; Press Release, Rep. Peters, Author of Shareholder Empowerment Act, Says Strengthening Shareholder Rights Key to Reining in Executive Pay, Reckless Investments (Oct. 22, 2009), available at <http://peters.house.gov/index.cfm?sectionid=22&parentid=21§iontree=21,22&itemid=193>; Press Release, Legislation Includes “Say-on-Pay” Measure to Give Shareholders a Vote on Lavish Executive Compensation Packages (May 19, 2009), available at http://schumer.senate.gov/new_website/record.cfm?id=313468.

147. The movement to de-emphasize quarterly earnings is gaining momentum. In recent years, over 200 companies have discontinued earnings guidance and the percentage of listed companies offering guidance has fallen. . . . A membership survey taken by the CFA Institute, a prominent organization of investment analysts, showed that three-quarters of respondents preferred that companies move away from quarterly earnings guidance and towards providing more information on a company's long-term prospects. A key obstacle to change is the close link between short-term performance and incentive pay for company managers, fund managers, and analysts.

COMM. FOR ECON. DEV., BUILT TO LAST *supra* note 102, at 25; see also Samuelson & Stout, *supra* note 100, at A13 (“Top executives who receive equity-based compensation should be prohibited from using derivatives and other hedging techniques to offload the risk that goes along with equity compensation, and instead be required to continue holding a significant portion of their equity for a period beyond their tenure.”).

148. Stephen M. Bainbridge is the William D. Warren Professor of Law at UCLA School of Law.

149. Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1819 (2011).

150. *Id.* at 1819.

date¹⁵¹ seeks to align management and shareholder interests, the result many times is continued short-term focus by management.¹⁵² To ensure shareholder support for their compensation packages, directors may be influenced to standardize executive compensation packages and focus on well-established short-term financial metrics rather than more long-term sustainability goals unique to their organization.¹⁵³

The directors of a company, who are in the best position to be informed of and to understand the company's long-term strategic interests, should be allowed to base executive compensation in part on the company's long-term sustainability, even if that characteristic is hard to quantify in the traditional—albeit sometimes specious—form of “hard” numerical data. In the say-on-pay environment, directors rightfully will also have the task of persuading shareholders that these sustainability objectives are the right yardstick for determining executive compensation and are good for the company.¹⁵⁴

CONCLUSION

Pauline Maier, one of the most perceptive students of the corporation's history in this country, describes Americans of our Revolutionary era as “salvag[ing] from a rejected past those English legal traditions and practices that suited their republic”¹⁵⁵ “They rescued the corporation,” a moribund institution in eighteenth-century England, “recreate[d] it as an agent of opportunity rather than a recipient of privilege,” “harness[ed] it more firmly to the public good,” and employed it “to empower individuals whose resources were unequal to their imaginations.”¹⁵⁶ It is my hope that, in this contemporary period of transformation, we might find that our corporations can once again

151. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899–1900 (2010).

152. Bainbridge, *supra* note 149, at 1818–19.

153. *See id.* at 1810–11 (explaining how power essentially shifts to a small number of controlling institutional investors and advisory firms, who will likely require a standardized package that may not properly or automatically suit all of the roughly 10,000 U.S. reporting companies' needs).

154. In *The Shareholder Value Myth*, Lynn Stout posits that “[t]he widespread perception that corporate directors and executives have a legal duty to maximize shareholder wealth plays a large role in explaining how shareholder value thinking has become so endemic in the business world today.” LYNN STOUT, *THE SHAREHOLDER VALUE MYTH* 24 (2012). However, “the business judgment rule holds that, so long as a board of directors is not tainted by personal conflicts of interest and makes a reasonable effort to become informed, courts will not second-guess the board's decisions about what is best for the company—even when those decisions seem to harm shareholder value.” *Id.* at 29. Lynn Stout maintains that “[t]o build enduring value, managers must focus on the long term as well as tomorrow's stock quotes, and must sometimes make credible if informal commitments to customers, suppliers, employees, and other stakeholders whose specific investments contribute to the firm's success” and that “gauging the performance of the American corporate sector solely by the share price performance” ignores “the diverse interests and values of different shareholders to focus only on those of a very narrow subset that is particularly short-sighted, opportunistic, indifferent to external costs, and lacking in conscience.” *Id.* at 109–11.

155. Maier, *supra* note 54, at 83.

156. *Id.*

marshal resources equal to our imaginations. Our corporations are no longer the “little republics” that Blackstone described centuries ago: fifty-one of the 100 largest economies in the world (as measured by gross domestic product) are American corporations.¹⁵⁷ Of the top 150 economies, 69 are corporations.¹⁵⁸ To put this in even more concrete terms, General Electric’s annual revenues eclipse the GDP of such nations as Romania, the Philippines, New Zealand and Egypt.¹⁵⁹

The world’s problems are the corporation’s problems because we are all in this together. Society needs corporations and corporations need society, at least if they wish to continue to have consumers for their products and services. Therefore, a proper representation of the needs of society, the environment and the corporation is not the classic Venn diagram of three overlapping circles with a sweet spot where they intersect. It is instead three concentric rings, with the business—which cannot exist except within the society that created and sustains it—in the middle, surrounded by the society, which in turn is imbedded in the environment, apart from which it cannot exist.¹⁶⁰ Our problems will not be solved in any one person’s lifetime. A generation comes, a generation goes, but the Earth abides forever.¹⁶¹ We are therefore most fortunate to have institutions that straddle national borders, that span generations of humankind, that possess the wherewithal and the expertise to make a difference, and that have the advantage—and the *responsibility*—of taking a long perspective.

157. Janet E. Kerr, *Sustainability Meets Profitability: The Convenient Truth of How the Business Judgment Rule Protects a Board’s Decision to Engage in Social Entrepreneurship*, 29 CARDOZO L. REV. 623, 666, 666 n.237 (2007).

158. *Countries’ Gross Domestic Product in US Dollars*, WORLD BANK, http://data.worldbank.org/indicator/NY.GDP.MKTP.CD/countries?order=wbapi_data_value_2011%20wbapi_data_value%20wbapi_data_value_last&sort=desc&display=default (last visited Aug. 16, 2012); *Our Annual Ranking of America’s Largest Corporations*, FORTUNE MAG., May 23, 2011, at F1.

159. *Compare* GENERAL ELECTRIC, 2008 ANNUAL REPORT 26, available at http://www.ge.com/ar2008/pdf/ge_ar_2008.pdf, with *National Accounts Main Aggregates Database*, UNITED NATIONS STATISTICS DIV., <http://unstats.un.org/unsd/snaama/selbasicFast.asp> (data for 2007); see also KERR, *supra* note 157, at 660 n. 201 (offering additional comparisons). Of course, such comparative status is always subject to change and has been particularly volatile in this century during the current recession. Thus, as recently as May of 2001, only the economies of the G8 nations were larger than that of General Motors, a company that has more recently fallen on hard times. See *Comparison of Revenues among States and TNCs*, GLOBAL POLICY FORUM, <https://www.globalpolicy.org/social-and-economic-policy/tables-and-charts-on-social-and-economic-policy.html>. Whatever the rankings at any given moment and whatever the fortunes of any given company, the dominance of corporations among the world’s economies will endure.

160. Rajkumar S. Adukia, *An Insight into Sustainability Reporting/Triple Bottom Line Reporting* 6, <http://xa.yimg.com/kq/groups/12982260/665041536/name/hbsrpro.pdf> (last visited Aug. 20, 2012).

161. *Cf. Ecclesiastes* 1:4.