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

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

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

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

[166] *See* KEYS, *supra* note 146, at 121-23.

[167] *Id.* at 123.

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

[169] *Id.* at 94.

[170] *Id.* at 94-95.

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

[172] SUÁREZ, *supra* note 70, at 95.

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

[174] *Id.* at 97 (using the example of a prince decreeing a perpetual subsidy for himself).

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

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

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

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

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[175] *Id.*

[176] SUÁREZ, *supra* note 70, at 98.

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

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

[179] *Id.* at 99.

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

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

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

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

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

[182]*See supra* notes 6, 47-48 and accompanying text.

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

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

[185]Helen Alford & Michael J. Naughton, *supra* note 183, at 33.

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

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

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

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

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

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hands of the economist.").

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

[189]PETER F. DRUCKER, MANAGEMENT 97 (Harper Collins ed. 2008).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[196]Koslowski, *supra* note 188, at 107.

[197]*See id.*

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

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

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

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

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

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

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

[202]*See* DRUCKER, *supra* note 189, at 98.

[203]PETER F. DRUCKER, MANAGEMENT: TASKS, RESPONSIBILITIES, PRACTICES 60 (1974).

[204]DRUCKER, *supra* note 189, at 110-11.

[205]*Id.* at 111.

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

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

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[206] 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1994).

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

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

[209] Valsan & Yahya, *supra* note 207, at 4 (emphasis added).

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

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

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

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

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

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

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

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[212] *See supra* note 211 and accompanying text.

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

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

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

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

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

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

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[217]Avi-Yonah, *supra* note 24, at 815.

[218]*See supra* note 14 and accompanying text.

[219]Bainbridge, *supra* note 17, at 9 (emphasis added).

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

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

[222]Distributive justice deals with the just allocation of common resources. *Id.*

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

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

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

1. First Constraint: The Good of the Perfect Community

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

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

[224] *Id.* at 8 (emphasis added).

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

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

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

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

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

[227] MICKLETHWAIT & WOOLDRIDGE, *supra* note 5, at 182 (quoting President Theodore Roosevelt).

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

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

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

[231] *See* Sheehy, *supra* note 230, at 4.

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

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

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

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

[234]*See* BAKAN, *supra* note 4, at 153.

[235]Allen, *supra* note 6, at 280.

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

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

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

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

> Owen Young, the President of General Electric, for example, stated in a public address during the 1920s as follows:
>
> > [M]anagers [are] no longer attorneys for stockholders; they [are] becoming trustees of an institution. If you will pardon me for being personal, it makes a great deal of difference in my attitude toward my job as an executive officer of the General Electric Company whether I am a

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[238] *See supra* note 130 and accompanying text.

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

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

[241] Allen, *supra* note 6, at 265.

[242] *Id.*

[243] *Id.* at 271.

[244] *Id.*

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

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

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

2. The Second Constraint on Corporate Decisions

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

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

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[245] Allen, *supra* note 6, at 271 (alteration in original) (citation omitted).
[246] BAKAN, *supra* note 4, at 108.
[247] *See supra* notes 144-205 and accompanying text.
[248] *See supra* note 153 and accompanying text.
[249] *See supra* note 154 and accompanying text.

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

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

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

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

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[250]Jensen, *supra* note 198, at 16.

[251]*See supra* notes 159-63 and accompanying text.

[252]BAKAN, *supra* note 4, at 31 (statement of Samir Gibara) (omission in original).

[253]BAKAN, *supra* note 4, at 48 (statement of Henry A. McKinnell) (emphasis added).

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

Thus far this Article argues for a metaphysical explanation of the nature of corporations. They are imperfect communities subject to the requirement of the common good. Yet, the thesis of this Article goes beyond arguing that we should understand the corporate entity from this perspective. The next part will argue that not only should theorists and commentators adopt this Aristotelian conception of the corporation, it argues that this metaphysics is already a part of American corporate law.

V. CONSTITUTIONAL METAPHYSICS ARE CONSISTENT WITH EXISTING CORPORATE LAW

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

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

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

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

[255]Lawrence E. Mitchell, *Preface* to PROGRESSIVE CORPORATE LAW, at xiii (Lawrence E. Mitchell ed., 1995).

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

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

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

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

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

[258] *See* cases cited *supra* note 256.

[259] Leslie v. Lorillard, 18 N.E. 363, 365-66 (1888).

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

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

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

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

Id. at 646 (footnote omitted).

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

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

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

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

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

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

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

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

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[264] *Id.* at 91.

[265] *See* Subramanian, *supra* note 260, at 1827, 1828 tbl.3.

[266] First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 782 n.18 (1978).

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

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

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

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

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

[269]*See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985).

[270]*See supra* notes 153-56 and accompanying text.

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

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

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

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

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

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

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

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

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

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

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

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

[278] *See* DEL. CODE ANN. tit. 8, § 242(b)(1) (West Supp. 2011).

[279] *See id.* § 242(c).

[280] *See id.* §§ 251(a) & (d), 252(c), 263(c).

[281] *See id.* § 275.

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

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

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

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

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

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[283] DEL. CODE ANN. tit. 8, § 351 (2006).

[284] 488 A.2d 858 (Del. 1985).

[285] *Id.* at 889-90.

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

[287] *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1989); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

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

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

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

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

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

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

[291] *Paramount*, 571 A.2d. at 1152. The court states:

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

Id. at 1152-53 (citations omitted).

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

[293] *Paramount*, 571 A.2d. at 1152 (emphasis added).

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

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

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

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

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

> shareholder value in the short term, even in the context of a takeover.[296]

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

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

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

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

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[296] *Paramount*, 571 A.2d. at 1150 (citations omitted).

[297] *Id.*

[298] *Id.* at 1149.

[299] *Id.* at 1143 n.4.

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

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

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

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

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

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

[302]*Credit Lyonnais Bank Nederland, N.V.*, 1991 WL 277613, at n.55.

[303]*Id.* at *33.

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

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

> [A]cting merely for the shareholder-as-residual claimant would be inappropriate, as it would "expos[e] creditors to risks of opportunistic behavior and creat[e] complexities for directors." Better to give directors a wide berth, to "conceiv[e] of the corporation as a legal and economic entity." If directors act for the corporation "as entity" then the competing economic interests of the various stakeholders—including their priority—become secondary.[307]

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

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

[305] *Id.* stating that:

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

(footnotes omitted).

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

[307] *Id.* at 253-54 (footnotes omitted).

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

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself . . . .[310]

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

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

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

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[308] 170 N.W. 668 (Mich. 1919).
[309] *See* Allen, *supra* note 6, at 267-68.
[310] *Dodge*, 170 N.W. at 684.
[311] *See id.* at 671.
[312] *Id.*

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

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

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[313]Allen, *supra* note 6, at 267-68.
[314]*Dodge*, 170 N.W. at 672-73.
[315]*Id.* at 673-74.
[316]*Id.* at 674.
[317]*Id.* at 677.
[318]*Dodge*, 170 N.W. at 676-77.
[319]*Id.* at 678.
[320]*See id.* at 685.
[321]*Id.* at 681.

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

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

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

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

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[322] *See Dodge*, 170 N.W. at 684.
[323] *See id.* at 682.
[324] *Id.* at 682-83.
[325] *Id.* at 684.

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

VI. CONCLUSION

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

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

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

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