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Cover Page Footnote

Professor of Law and Mildred Van Voorhis Jones Faculty Scholar, the University of Illinois College of Law. A number of other people deserve recognition for their intellectual contributions to the underlying work upon which this Symposium essay relies. Collaborative work I have done with John Conley, William Rand Kenan, Jr., Professor of Law at the University of North Carolina, particularly informed the observations about the meaning of the corporate social responsibility trend in business. Margaret Blair, Professor of Law at Vanderbilt University, has recently begun developing a theory about the economic importance of third-party assurance in global commerce, a project to which I have contributed as well. The description of corporate social responsibility initiatives in this paper was first undertaken as background for the collaboration with Professor Blair. Of course I take full responsibility for the conclusions here, including all matters of interpretation where my views may differ from those of these colleagues.

A TALE OF TWO TRAJECTORIES

*Cynthia A. Williams**

INTRODUCTION

I will begin this essay with a personal reflection. I became interested in the questions motivating this Symposium issue of the *Fordham Law Review* over ten years ago while in practice at Cravath, Swaine & Moore in New York City. One of Cravath's long-time clients is the Lawyers' Committee for Civil Rights. In 1993, Cravath was asked by the Lawyers' Committee to represent Barbara Landgraf in the U.S. Supreme Court in a case involving the potentially retroactive application of the damages provisions added in 1991 to Title VII of the Civil Rights Act of 1964. Prior to 1991, damages for a violation of Title VII, which prohibits employment discrimination, were limited to the equitable remedies of two years' back pay and possible reinstatement. After the amendments, a successful plaintiff can also seek compensatory and punitive damages, albeit subject to fairly stringent limits.[1] Although Mrs. Landgraf was found to have been the victim of intentional (and egregious) sexual harassment by her supervisor, she quit her job under circumstances that the district court did not find to constitute constructive discharge. As a result, she was entitled to no monetary relief unless the newly enacted damages provisions of the Civil Rights Act of 1991 (the Act) were available in her case, which was in litigation when the Act became law. (I must admit, we lost the case brilliantly, in an 8-1 opinion in which only Justice Harry Blackmun agreed with our position.)[2]

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1. For a discussion of these limits, see Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. Rev. 1265, 1343 n.296 (1998).

2. *See* Landgraf v. USI Film Prods., 511 U.S. 244, 296-97 (1994) (Blackmun J., dissenting) ("The well-established presumption against retroactive legislation, which serves

In typical Cravath style, while working on the case we first collected and read all of the lower court opinions that had been issued on the retroactivity issue—and there had been a blizzard of them in the two years since the amendments were enacted. In that review, *Luddington v. Indiana Bell Telephone Co.*, a decision authored by Judge Richard Posner of the Seventh Circuit, stood out.[3] While recognizing that the Act did not "prohibit any conduct not already prohibited by Title VII," Judge Posner still thought it would be unfair to allow the new damages provisions to apply to conduct that had occurred prior to the effective date of the Act.[4] In locating the source of that unfairness, Judge Posner seemed to rely on an approach to law that H.L.A. Hart (and this Symposium's organizers) would call the external perspective, stating,

> The amount of care that individuals and firms take to avoid subjecting themselves to liability whether civil or criminal is a function of the severity of the sanction, and when the severity is increased they are entitled to an opportunity to readjust their level of care in light of the new environment created by the change.[5]

This rationale thoroughly mystified the partners working on the case, attorneys with decades of collective experience advising clients. Where did this notion come from that a party could have a settled expectation of a certain level of damages? No one was arguing that the underlying substantive conduct necessary to conform to law had been changed by the amendments, and no one was arguing that the amount that the potential damages had been increased was enough to be characterized as a due process violation. So where was the unfairness? Rather, to the older generation of Cravath partners, Judge Thomas Ellis of the U.S. District Court for the Eastern District of Virginia had gotten it right in his rejoinder to Judge Posner:

> Judge Posner's view seems valid in the context of negligent conduct, but not in the context of intentional conduct. Congress surely did not intend for employers to perform a cost-benefit analysis to decide whether to engage in or permit illegal discriminatory conduct. Rather, Congress plainly meant that no cost-benefit ratio could justify unlawful discrimination.[6]

To those of us newly graduated from law school in the late 1980s, the derivation of Judge Posner's notion was clear: It had come from law and economics and "unreconstructed" rational actor models of human behavior. We had been schooled in efficient breach of contract, the Learned Hand Formula for determining the amount of care to take to avoid accidents, and

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to protect settled expectations, . . . need not be applied to remedial legislation, such as §102, that does not proscribe any conduct that was previously legal.").

3. Luddington v. Ind. Bell Tel. Co., 966 F.2d 225 (7th Cir. 1992).

4. *Id.* at 229.

5. *Id.*

6. *See* Jaekel v. Equifax Mktg. Decision Sys., Inc., 797 F. Supp. 486, 493 n.14 (E.D. Va. 1992).

Richard Posner's *A Theory of Negligence*, written while he was a law professor.[7] As a result, the *Luddington* provenance was not a mystery. This was an extension of Judge Posner's views on negligence. It was Holmes's "bad man," who cared only for the consequence of potential sanctions in thinking of law, cast by Professor Gary Becker in a central role in law and economics' views of law compliance.[8] Yet it struck me then, as it has in subsequent thinking about this issue, that there is something deeply ironic about academics and judges expressing such a calculating view about the meaning of law, while practicing attorneys, whom one might expect to be rather less idealistic often express a robust sense of law's obligation.[9]

Given the work we did on *Landgraf*, and the jurisprudential debates in the lower courts about this "cost-benefit approach to law," examining that approach in the context of a corporation's obligation to comply with the law became the subject of my first law review article after I became a law professor. Thus, I attempted to chart the extent to which the calculative view of law had started to influence courts, academic commentators, and even some law reform projects such as the American Law Institute (ALI) in its *Principles of Corporate Governance*, issued in 1992, and the American Bar Association Committee on Corporate Law's revisions in 1984 to the Model Business Corporation Act (MBCA).[10] The picture I drew by the end of that law review article was a bit bleak. The calculative, "law as price" view seemed ascendant, with the American Bar Association going so far as to provide in the MBCA that a company could exculpate its directors (release them from liability to the shareholders) for even deliberate violations of civil law, and the ALI suggesting exculpation of knowing, "non-culpable" violations of law.[11]

My conclusion was perhaps more pessimistic than the situation warranted. As Donald Langevoort points out in his essay for this Symposium, we ought not lose sight of the fact that the ALI *Principles of Corporate Governance* do state that a corporation "'is obliged, to the same extent as a natural person, to act within the boundaries set by law' regardless of whether or not such conduct enhances shareholder wealth."[12] Thus, the ALI did reject the starkest versions of the "bad man" view of corporate law that had been articulated by Frank Easterbrook and Daniel Fischel contemporaneously with the ALI debates: that corporate "managers

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7. *See* Richard A. Posner, *A Theory of Negligence*, 1 J. Legal Stud. 29 (1972).

8. *See* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. Polit. Econ. 169 (1968).

9. I have been an "accidental empiricist" on this topic ever since 1995, asking many a lawyer how they counsel corporate clients about law compliance. I cannot (and do not) claim anything conclusive about these conversations, other than as just stated.

10. *See* Williams, *supra* note 1, at 1347-52.

11. *See id.* at 1310-14.

12. *See* Donald C. Langevoort, *Someplace Between Philosophy and Economics: Legitimacy and Good Corporate Lawyering*, 75 Fordham L. Rev. 1615, 1620 (2006) (quoting Principles of Corporate Governance § 2.01 cmt. G (1994)).

not only may but also should violate the rules when it is profitable to do so."[13]

Still, the phrase about a corporation being obliged "to the same extent as a natural person" is not self-defining.[14] Well-articulated conceptions of a distinction between the obligation to malum prohibitum versus malum in se laws would give a company substantial freedom to choose to avoid the reach of a vast swath of regulation if those conceptions were generally accepted.[15] Accordingly, my prior work in this area was a criticism of the Easterbrook and Fischel view that there is a right to efficient breach of statutory or regulatory law, and more generally was an argument for a general corporate obligation towards even malum prohibitum law.[16]

I came to this Symposium, then, asking the question, What has happened with respect to these questions in the ten years that have passed since I worked on that article? One could say that the answer to that question is a resounding "not much." There are no decided cases where a company exculpated its directors for knowing violations of law, under either the MBCA standard or the more restrictive ALI approach, nor even decided cases where the question was litigated. The stark Easterbrook and Fischel view that there is a duty for corporate managers to engage in profitable violations of law now seems extreme, and law and economics has

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13. Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 Mich. L. Rev. 1155, 1177 n.57 (1982). That the members of the American Law Institute (ALI) were aware of Easterbrook and Fischel's argument is explicit in Mel Eisenberg's commentary as the Reporter for the First Draft of the *Principles* section 2.01 concerning the obligations to comply with the law. Thus, he stated,

> It is sometimes maintained that whether a corporation should adhere to a given legal rule may properly depend on a kind of cost-benefit analysis.... This argument is premised on a false view of the citizen's duty in a democratic state. With few exceptions, dollar liability is not a "price" that can ethically be paid for the privilege of engaging in legally wrongful conduct.

Principles of Corporate Governance § 2.01 cmt. f (Tentative Draft No. 1, 1982), *quoted in* Williams, *supra* note 1, at 1271-72.

14. H.L.A. Hart draws a distinction between being "obliged" to do an act and having an "obligation" to do so, with the latter conveying the sense of an internal perspective on law and the former of acting from compulsion while not subject to a claim of right, as in being obliged to hand over money to a gunman. *See* H.L.A. Hart, The Concept of Law 82 (2d ed. 1994). It is intriguing that the drafters of the *Principles* used the word "obliged" instead of "has an obligation to," but this may have been simply a stylistic preference.

15. *See, e.g.*, Stephen L. Pepper, *Counseling at the Limits of the Law: An Exercise in Jurisprudence and Ethics of Lawyering*, 104 Yale L.J. 1545, 1576-80 (1995).

16. *See* Williams, *supra* note 1. I do acknowledge that there is a range of blameworthiness in a deliberate choice not to follow the law, and the level of blameworthiness will be dependent on a number of factors that will often make violation of malum in se law more blameworthy than violation of malum prohibitum law, such as whether there was harm caused by the violation, the extent of the harm that is caused, and the type of harm (economic or an injury to health, safety, or the environment). But I would also say that a deliberate choice not to follow the law is itself inherently blameworthy whether one can identify harm to others or the environment or not, because that choice is a harm to the concept of law itself. *See* Hart, *supra* note 14, at 6 ("The most prominent general feature of law at all times and places is that its existence means that certain kinds of human conduct are no longer optional, but in *some* sense obligatory.").

broadened its conception of human rationality and cognitive behavior in ways that make it, at least in theory, amenable to much more nuanced understandings of law compliance.[17]

Yet, we can look at the corporate world today and see two trends in the last decade that would seem to have much to say about concepts of corporate obligation to law. It is here that the "tale of two trajectories" begins. One trajectory is the one that Langevoort implicitly relies upon in his exploration of corporate legitimacy in this Symposium issue, and that is the dramatic corporate social responsibility (CSR) trend in global business. In this realm, a company's social legitimacy increasingly requires attention to "corporate citizenship," not at all narrowly construed.[18] Companies are committing themselves to substantive standards of conduct and to social and environmental disclosure that are well beyond those required by law. The other trajectory is the Enron trajectory—using the name "Enron" as emblematic of the entire genre of corporate governance problems that plagued a seemingly disproportionate number of American businesses in 2001-02 and beyond.

Since lawyers have a primary role in transmitting norms of legal obligation, it is logical to look at the involvement of lawyers in these two diametrically opposed trajectories as some evidence of the place of either the internal or external perspective on law in the legal profession. Here, there is another irony. The first trajectory, showing an expansive view of corporate social obligation, has almost no involvement by lawyers, except in some instances in the United States as sources of resistance, advising companies not to sign onto various voluntary codes of conduct because of the "fear of liability."[19] The second trajectory, showing a narrow view of

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17. *See generally* Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 Cal. L. Rev. 1053 (2000) (providing a cogent overview of cognitive psychology and its implications for standard assumptions about the meaning of rationality).

18. *See* Dirk Matten & Andrew Crane, *Corporate Citizenship: Toward an Extended Theoretical Conceptualization*, 30 Acad. Mgmt. Rev. 166 (2005). In that article, Professors Matten and Crane review the definitions of corporate social responsibility (CSR) that have been put forth in the management literature, and then note dryly that "[t]o some extent, however, these concepts have attained a wider and more enthusiastic acceptance in the academic literature than in corporate thinking and practice. [Corporate citizenship], meanwhile, has been introduced into the CSR discourse in the last few years, mainly at the instigation of corporate actors." *Id.* at 167 (citations omitted). I think there are important differences in the connotations of "corporate social responsibility" versus "corporate citizenship," with the latter having more connotations of privileges, including of political involvement, rather than duties, as connoted by the term "corporate social *responsibility*." Thus, I continue to prefer the term corporate social responsibility.

19. *See* John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. Corp. L. 1 (2005) (reporting on an ongoing business ethnography project investigating the corporate social responsibility trend). This project has involved interviews of people in companies, here and in the United Kingdom, as well as interviews with institutional investors and nongovernmental organizations (NGOs), and attending CSR conferences, again both here and in the United Kingdom, to get a sense of the internal meaning of CSR to the participants in the field. It was in the course of those interviews that we heard of the "fear of liability"

corporate legal obligation, has implicated lawyers substantially, among other gatekeepers who failed to protect company shareholders or promote capital market integrity.[20]

Should we assume from this contrast that lawyers advising companies generally exercise a negative influence, undermining any preexisting sense of corporate social obligation, even to the "minimal" concept of the citizen as obligated to follow the law? Although this is ultimately an empirical question, I think that we should not presume such a negative role for lawyers. The Enron types of corporate governance failings quite often involved either alleged violations of corporate law, such as violations of the fiduciary duties of directors or violations of securities law by misstatements or omissions of material facts. As I will discuss below, "following the law" in corporate law is often a highly formalistic exercise. The Delaware courts will, under the "doctrine of independent significance," allow boards of directors to take deliberate actions that undermine shareholders' key economic rights and corporate governance powers. And what "following the law" requires in securities law can be epistemologically challenging in the extreme, since the key concept that structures compliance, the "materiality" of information, can be extraordinarily difficult to apply to specific facts in context. Moreover, the institutional context of the capital markets, which react harshly when companies miss securities analysts' consensus estimates about quarterly results, cause many well-meaning managers to try, within the range of accuracy permitted by Generally Accepted Accounting Principles (GAAP), to manage earnings to meet the consensus estimates. This, too, undermines a clear sense of what "following the law" obligates one to do. So it is too brash to suggest that the failings of lawyers in the Enron era had all to do with lawyers adopting Holmes's "bad man" view of the law as a normative ideal, calculating the odds of detection and the probability of liability for securities violations as low, compared to the benefits of puffing up securities prices, for instance.

Yet, in evaluating these trends, I will be frankly speculative, and suggest that the Enron-era problems may well have been fueled *in part* by the thin concept of social obligation that is promoted by unreconstructed law and economics, the jurisprudential development that also adopted Holmes and nurtured the external, "bad man" perspective on law. There are other, stronger influences that created the maelstrom. But given uncertain edges to the law, a practice environment that permits a certain amount of manipulation of the rules to advance the client's ends (corporate law), an open-textured body of primary law (securities) and an institutional context

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concern having been expressed by U.S. lawyers as a reason for companies not to embrace either CSR standards or disclosure.

20. *See, e.g.*, Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 Bus. Law. 143 (2002) (discussing the role of lawyers in Enron and other "massive corporate frauds"); Milton C. Regan, Jr., *Teaching Enron*, 74 Fordham L. Rev. 1139 (2005) (discussing the role of lawyers in advising Enron in various of its off-balance sheet structured-finance transactions).

that seemingly demands a certain amount of manipulation, a theory of law that drains human interaction of much of its sense of social obligation does not bode well for interpretations of this open-textured law according to robust norms of social obligation. In contrast, the corporate social responsibility trend, which is most advanced in the United Kingdom and European Union, has taken root in countries with a generally deeper skepticism for the individualistic and self-interested premises of much of law and economics and "external" perspectives on law.[21]

My comments will not entirely be a screed for the "internal" perspective, however. I conclude with the view that the external perspective, when applied to corporations, may lead in a quite different direction than when it is applied to individuals, simply because the range of consequences that matter go far beyond potential legal liability. So if the question that a company executive asks her lawyer is, "Will I be likely to be found liable for doing X and have to pay a fine or damages?" the well-counseled answer should be, "Maybe, but the more important question is what other consequences there will be for potential violations." As a theory of law, I am not personally indifferent to the internal and external perspective.[22] But as a theory of corporate motivation, I am becoming almost agnostic, for reasons to be explained below.

I. CORPORATE SOCIAL RESPONSIBILITY AND TRANSPARENCY

I start here with a somewhat extended description of ways in which participants in the business world have begun to put a much greater emphasis on a company's social responsibilities. I begin with this description as a response to skeptics who might think that "corporate social responsibility" is the exclusive province of niche firms such as the Body Shop or Ben & Jerry's. In fact, major global companies are increasingly

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21. *See generally* David Campbell & Sol Picciotto, *Exploring the Interaction Between Law and Economics: The Limits of Formalism*, 18 J. Legal Stud. 249 (1998) (setting out an extremely critical perspective on law and economics as developed by Posner and Becker in the United States, and contrasting it with British institutionalist theories that evaluate the interactions of firms, markets and the state as social phenomena that cannot be properly understood outside of their social context); *cf.* Brian R. Cheffins, The Trajectory of (Corporate Law) Scholarship 34 (Nov. 2003), *available at* http://www.ssrn.com/abstract=429624 (noting that the law and economics approach to corporate law scholarship is disfavored and criticized in British corporate law as compared to a more explicitly stakeholder oriented view); Nuno Garoupa & Thomas S. Ulen, *The Market for Legal Innovation: Law and Economics in Europe and the United States* (Ill. Program in Law and Econ. Working Paper Series, Aug. 2006) (evaluating various theories for why law and economics has not been taken up in Europe to anywhere near the extent it has been taken up in the United States).

22. Of course it would be useful to define these terms more specifically. I hope I am using the terms in the sense that the conference organizers have set them out—that an external perspective looks primarily to the sanctions that would be applied were one not to comply with law, while an internal perspective, as defined by H.L.A. Hart, looks to the internal sense of obligation to law experienced by a well-meaning citizen of a well-functioning legal system unrelated to potential sanctions. *See* Benjamin C. Zipursky, *Legal Obligation and the Internal Aspect of Rules*, 75 Fordham L. Review 1229 (2006).

involved in various CSR initiatives that suggest a burgeoning sense of social obligation that goes well beyond "mere" law compliance.

Thus, over the past five years, initiatives have proliferated that aim to increase corporate social and environmental transparency, accountability, and adherence to particularized standards of substantive social and environmental conduct. These initiatives have been promulgated by states, public/private partnerships, multi-stakeholder negotiation processes, industries and companies, institutional investors, functional groups such as accountancy associations and social assurance institutions (which did not exist much more than five years ago), nongovernmental organizations, business institutions, and nonfinancial ratings agencies. The implications for our theories of corporate governance, corporate regulation, and what counts as "law" are profound, some of which I have explored in prior work with Professor John Conley, an anthropologist and law professor.[23] Here, I will describe some of these initiatives, and then discuss a number of the implications for the "internal" versus "external" discussion at the heart of this Symposium.

A. *Overview of CSR Initiatives*

To bring order to this description of the proliferating welter of CSR initiatives, I will organize the discussion by the source of the initiative. Further, I will distinguish between initiatives that provide standards for companies' substantive conduct with respect to environmental, social, and governance issues, and those that provide metrics for collecting and disclosing information about the results of companies' actions with respect to those issues. The former I will refer to as "conduct initiatives," and the latter as "transparency initiatives." The following overview does not purport to describe every accountability initiative, but does seek to emphasize many of the most important or widely adopted. My expertise concerns developments concentrated in or developed in the United States and Europe, and so this overview focuses on those developments.

1. Governments' Mandatory Transparency Initiatives

For the most part, the initiatives described in this essay are voluntary and are generated by private actors, rather than states, but in a few instances countries within the European Union, and the European Union itself, have promulgated nonfinancial disclosure requirements. In 2003, the European Union adopted the Modernization Directive, as part of its process of harmonizing financial reporting within Europe and of incorporating International Accounting Standards into European financial reporting. The

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23. *See* Conley & Williams, *supra* note 19; Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 Cornell Int'l L.J. 493 (2005) [hereinafter Williams & Conley, *Third Way*]; Cynthia A. Williams, *Civil Society Initiatives and "Soft Law" in the Oil and Gas Industry*, 36 N.Y.U. J. Int'l. L. & Pol. 457 (2004) [hereinafter Williams, *Civil Society*].

Modernization Directive includes a requirement that, as of 2005, companies present "a fair review of the development and performance of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces" in their annual reports.[24] The Modernization Directive further requires that "[t]o the extent necessary for an understanding of the company's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters."[25]

Denmark, the Netherlands, Norway, and Sweden have all passed laws requiring companies to provide expanded environmental information in their annual reports, starting with Denmark in 1999.[26] France has been the most ambitious country in the European Union in requiring nonfinancial disclosure, requiring each publicly traded French company to disclose extremely detailed information about its environmental, labor, community involvement, health, and safety records on an annual basis, both for the company's locations in France and its sites abroad.[27]

A number of European countries have sought to affect company behavior and disclosure indirectly by requiring pension funds to publish annual statements indicating the extent to which they take ethical, environmental, and social information into account in constructing their investment portfolios. Such pension-fund requirements have been promulgated in France, Belgium, Germany, and the United Kingdom.[28]

2. Governments' Voluntary Conduct and Transparency Initiatives

In 2002, the European Commission established a multi-stakeholder forum on CSR in order to allow a structured discussion amongst the business community, trade unions, and civil society concerning CSR and expanded social transparency. The overall aim was to "promote innovation, transparency and convergence of CSR practices and [reporting]

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24. Council Directive 2003/51, art. 1, 14(a), 2003 O.J. (L 178) 18.

25. *Id.* After an extensive consultation process that lasted approximately seven years, the United Kingdom passed a law in early 2005 for its companies to produce an annual Operating and Financial Review (OFR). The OFR would have required substantially increased disclosure about companies' strategic choices and challenges, and about their risks and opportunities from social and environmental matters, including labor and community relationships. See Williams & Conley, *Third Way*, *supra* note 23, for an extensive discussion about this development and the consultation process. On November 28, 2005, Chancellor Gordon Brown announced that the government was withdrawing the regulations since U.K. companies are covered by the European Union's Modernization Directive, and there was no need to "gold plate" the E.U. requirements (i.e., go beyond what the European Union was requiring). Chancellor Brown's actions have resulted in a huge outcry among investors, accountants, and environmentalists, and so may well not be the last chapter of the OFR saga.

26. Statutory citations and further information concerning governments' nonfinancial disclosure requirements can be found in Williams & Conley, *Third Way*, *supra* note 23.

27. *See id.* at 505, nn. 53-57.

28. *See id.* at 504, nn. 43-46.

instruments" by highlighting best practices among companies, with a particular emphasis on small and medium enterprise.[29] The forum issued a final report in 2004, emphasizing the contributions of CSR to sustainable development and to reducing business risk. The report also emphasized that, because it is voluntary, CSR does not replace regulation or important tripartite obligations, such as those set out in the International Labor Organization Tripartite Declaration of Principles concerning Multinational Enterprises (MNEs) and Social Policy (1977, revised 2000); the Organisation for Economic Co-operation and Development (OECD) Guidelines for MNEs (1976, revised 2000); and the United Nations Global Compact (2000). More recently, the European Commission has established the European Alliance on CSR, which is an organization of businesses to further improve the "uptake, implementation and strategic integration of CSR by European enterprises."[30]

The OECD, which is a membership organization including thirty member countries, primarily from Europe and the United States, has promulgated two documents which include discussions of companies' social responsibilities: the OECD Guidelines for MNEs and the OECD Principles for Corporate Governance (2004). The OECD Guidelines for MNEs "are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. They provide voluntary principles and standards for responsible business conduct in a variety of areas including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation."[31] On September 21, 2005, thirty-nine member governments "reaffirmed their commitment to making them an even more useful instrument for promoting corporate social responsibility among multinational enterprises."[32]

The United Nations, a multilateral organization comprised of member states, has promoted a corporate social responsibility initiative, the Global Compact, which is a special project established by U.N. Secretary-General Kofi Annan, without a ratification process by the member states. The Global Compact is a set of ten principles based on U.N. or International

29. European Multistakeholder Forum on CSR, Final Results & Recommendations 2 (June 29, 2004), *available at* http://europa.eu.int/comm/enterprise/csr/documents/29062004/EMSF_final_report.pdf.

30. *Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: Implementing the Partnership for Growth and Jobs: Making Europe a Pole of Excellence on Corporate Social Responsibility*, COM (2006) 136 final (Mar. 22, 2006), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0136:FIN:EN:HTML.

31. Organisation for Economic Co-operation and Development, Guidelines for Multinational Enterprises, http://www.oecd.org/topic/0,2686,en_2649_34889_1_1_1_1_37439,00.html (last visited Oct. 29, 2006).

32. Organisation for Economic Co-operation and Development, OECD, Partner Governments Commit to Enhance Value of Multinational Guidelines (Sept. 9, 2005), http://www.oecd.org/document/45/0,2340,en_2649_201185_35389869_1_1_1_1,00.html.

Labor Organisation (ILO) treaties regarding human rights, labor, the environment, and anticorruption that companies agree to follow, and on which they will report annually (in a limited way) to the United Nations.[33]

3. Mixed Public/Private Conduct and Transparency Initiatives

There are numerous conduct and disclosure standards that have been developed in multi-stakeholder processes including government, but conducted outside of the parameters of formal multilateral organizations such as the OECD or the ILO. One example of such a conduct initiative is the Voluntary Principles on Security and Human Rights for the extractive industry (oil and gas and mining).[34] The Voluntary Principles were developed in a process convened by the U.K. and U.S. governments, and included major oil companies such as British Petroleum, Shell, Chevron, and Texaco, and human rights organizations such as Amnesty International. In the Principles, companies agree to incorporate U.N. human rights standards in their relationships with public and private security forces, and to establish procedures for training security personnel to avoid human rights infractions, for monitoring their activities, and for responding to complaints.

An example of a public/private transparency initiative is the Extractive Industry Transparency Initiative (EITI), established under the auspices of the U.K. government in a multi-stakeholder process including BP and Shell Oil, nongovernmental organizations (NGOs) such as Transparency International and Christian Aid, and British institutional investors such as ISIS Asset Management.[35] The EITI is aimed at limiting emerging-market government corruption by seeking commitments from companies to "publish what they pay" to host governments for the right to extract natural resources, and by seeking commitments from host governments to adopt laws to permit such revenue transparency.

4. Private Multi-stakeholder Conduct and Transparency Initiatives

There are even more numerous conduct and transparency initiatives that have been developed over a period of years using an inclusive, multi-stakeholder process that involves various parties, such as companies, NGOs, labor, accounting firms, and, in some cases, offices of the U.N. such as the U.N. Environment Programme. One example, among many, of such a conduct initiative is Social Accountability 8000 (SA 8000), a project of Social Accountability International.[36] This initiative's standard is a voluntary standard for companies interested in auditing and certifying labor

33. *See generally* The Global Compact, http://www.globalcompact.org (last visited Oct. 29, 2006).

34. *See* Williams, *Civil Society*, *supra* note 23, at 477-84 (describing the Principles).

35. *See id.* at 484-92 (describing Extractive Industry Transparency Initiative).

36. *See generally* Social Accountability International, http://www.sa-intl.org/ (last visited Oct. 29, 2006).

practices in their facilities (in any industry or in agriculture) and in those of their suppliers and vendors. It is designed to be a standard against which facilities can be certified by independent, third-party certifiers. It is based on the principles of international human rights norms as described in ILO conventions, the United Nations Convention on the Rights of the Child, and the Universal Declaration of Human Rights. It measures the performance of companies in eight key areas: child labor, forced labor, health and safety, free association and collective bargaining, antidiscrimination, disciplinary practices, working hours, and compensation. SA 8000 also provides for a social accountability management system so that companies can demonstrate their ongoing conformance with the standard.

An example of a transparency initiative that has been developed in a multi-stakeholder process is the Global Reporting Initiative (GRI), originally developed as a project of the U.N. Environment Programme and CERES (Coalition for Environmentally Responsible Economies), a U.S. NGO using shareholder activism to get commitments from companies to measure and report on their environmental "footprint."[37] The GRI is becoming the world's most widely adopted framework for "triple-bottom line" reporting, which is reporting on the economic, environmental, and social effects of company action. The charter group that endorsed GRI in 2002 included Baxter International, the Ford Motor Co., General Motors (GM), KPMG, Nike, PricewaterhouseCoopers, and Royal Dutch Shell. As of May 2006, 846 international companies and institutions have agreed to use the GRI reporting format and guidelines, in whole or in part. In addition to the charter group, these companies now include such global companies as BASF AG, Bayer AG, British Petroleum, British Telecom, Deutsche Bank, Hewlett Packard Co., McDonald's Corp., Microsoft Corp., Newmont Mining Corp., Novo Nordisk, Philips International, Suncor Energy, and the China Water Company, Ltd.

5. Industry Self-regulation

Many industries are in the process of developing standards for responsible conduct that reflect the particular social responsibility challenges in their industry. The chemical industry was one of the earliest adopters of voluntary, self-regulatory standards, by creating the Responsible Care Initiative,[38] adopted in 1987 to try to improve the industry's reputation after the 1984 explosion of a Union Carbide plant in Bhopal, India. The initiative originally included standards for best practice in safe chemical production, transport, and control. It has recently been amended to include procedures for internal monitoring of those standards

37. *See generally* Global Reporting Initiative, http://www.globalreporting.org (last visited Oct. 29, 2006).

38. *See generally* Responsible Care: The Chemical Industry's Performance, http://www.chemicalguide.com/ (last visited Oct. 29, 2006).

and external verification.[39] A more recent industry self-regulatory initiative is the banking industry's Equator Principles, which provides standards for assessing and managing environmental and social issues within project finance in order to promote "sustainable development."[40] To date, forty banks have agreed to implement the Equator Principles, including such banks as ABN AMRO, Bank of America, Barclays, Citigroup, Credit Suisse, Dresdner Bank, ING Group, JP Morgan/Chase, Royal Bank of Scotland, and Wells Fargo. Other industries promulgating self-regulatory conduct initiatives include agriculture, apparel, fisheries, forestry, and extractives (oil, gas, and mining).

In addition, thousands of companies have adopted voluntary codes of conduct establishing their standards for responsible business behavior. Business groups such as the World Economic Forum (Davros) and the World Business Council on Sustainable Development have developed corporate citizenship projects and technical assistance partnerships with the United Nations and NGOs to promote sustainable development according to standards of responsible conduct. Even the U.S.-based Business Roundtable, which is an organization of the CEOs of the U.S. Fortune 500 companies, has a group of twenty-one members that announced on September 21, 2005 that it has established an initiative called the SEE (society, environment, economy) Change Initiative. This initiative asks companies to adopt sustainability goals and to measure the results.

6. Shareholder Initiatives Concerning Transparency

A number of institutional investor networks have recently begun articulating their expectations about the nonfinancial transparency that they expect from companies in order to be able to evaluate the business risks from social, environmental, and governance aspects of a company's operations. In 2001, and then reiterated again in 2005, the Association of British Insurers (ABI), which represents about fifty percent of institutional funds under management in the United Kingdom, issued its Disclosure Guidelines on Socially-Responsible Investment.[41] In these guidelines, the ABI sought on an annual basis information concerning the board's approach to taking regular account of social, environmental, and ethical matters, and it sought disclosure of companies' analyses of short- and long-term risks from these matters. More recently, the International Corporate Governance Network, an organization with membership from financial institutions and their advisors that claims $10 trillion under management,

39. *See id.*

40. *See* The Equator Principles: A Benchmark for the Financial Industry to Manage Social and Environmental Issues in Project Financing, http://www.equator-principles.com/ (last visited Oct. 29, 2006).

41. Press Release, Ass'n of British Insurers, Socially Responsible Investment (Sri)—ABI Leads the Way with New Guidelines (Oct. 23, 2001), *available at* http://www.abi.org.uk/Newsreleases/viewNewsRelease.asp?nrid=3676.

began a new project to assess the role of nonfinancial reporting in financial institutions' risk assessment of portfolio companies.

Climate change has become a particularly salient environmental risk that a number of investor networks target in their disclosure requests. Every year over the past three years, the Carbon Disclosure Project (CDP), based in the United Kingdom and now claiming $21 trillion under management, has requested information from the Global 500 companies about the financial risks to their company from the physical effects of climate change or from regulatory efforts to mitigate those physical changes. In 2004, seventy percent of the companies responded, providing information that Innovest analyzed. (Innovest is a specialized investment research and advisement firm that analyzes firm-specific risk from social, environmental, and strategic governance issues.) In the United States, the Investors' Network on Climate Change, a network of public pension funds and socially responsible investment mutual funds, is working to persuade the Securities and Exchange Commission to provide more specific requirements for companies to disclose risks to their companies from climate change.

7. Monitoring and Assessment of the Information

Given the rapid proliferation and diffusion of these transparency initiatives and efforts to encourage further nonfinancial transparency, "social accountancy" firms have also proliferated to audit the quality of the nonfinancial information being produced. Some major accounting firms, such as KPMG and PricewaterhouseCoopers, have established global sustainability practice groups with the specialized expertise necessary to audit environmental and social data. Other specialized nonfinancial auditing firms have been established, such as AccountAbility and Trucost in the United Kingdom, and Verite in the United States.

Nonfinancial ratings firms have also been established to advise investors that take environmental, social, and specialized governance information into account. Such firms use the data provided by companies in their GRI reports, for instance, as a starting point, but develop extensive proprietary databases of additional information on which to base nonfinancial ratings. Firms such as Innovest, CoreRatings, and SustainAbility in the United Kingdom or Investors' Responsibility Research Center (IRRC) in the United States play this role. Other specialized databases have been developed to advise specific socially responsible investment funds, such as KLD (Kinder, Lydenberg, Domini) in the United States, which advises Domini Social Equity, LLC, and that in turn maintains the SRI "bell-weather" Domini 400 Social Index, against which SRI funds are compared.

B. *Implications of These Developments*

As Professors Dirk Matten and Andrew Crane have emphasized, the concept of "corporate citizenship" has been introduced into the lexicon "in the last few years, mainly at the instigation of corporate actors."[42] So, one might ask, what kind of citizens are companies? Using the involvement of companies in CSR initiatives and the production of social and environmental reports as an indicator of a company's commitment to "citizenship," we can see at least four, nonexclusive explanations for these phenomena: the law compliance explanation, the market-driven explanation, the politically motivated explanation, and the intrinsically motivated explanation.

To set out my bias in advance, I doubt that companies' participation in these efforts necessarily conveys an unmitigated sense of corporate social obligation.[43] A number of the most public devotees of CSR are companies that have been the target of CSR campaigns or human rights litigation. The GRI is a good example of this point. It includes a charter group of organizations and companies that publicly endorsed the project at its inaugural event at the United Nations on April 4, 2002. Of the twenty-seven organizations comprising the charter group, only five were companies: Baxter International, Ford Motor Co., General Motors, Nike, and Royal Dutch Shell. Four of those five companies have pretty clear public relations reasons to want to be associated with a corporate accountability initiative: Ford and General Motors produce products that are a major contributor to global warming and thus are always concerned with the risk of stricter regulation; Nike, Inc. had become the poster child for corporate irresponsibility by 2002; and Royal Dutch/Shell had been targeted by 2002 for insufficient environmental awareness (for its plan to dump an old oil platform, the Brent Spar, into the North Sea), political repression, and gross human rights violations in Nigeria. Thus, as a group, the GRI's Charter Members were hardly obvious candidates for being corporate accountability standard-bearers. There is a concern, then, that the GRI process was being used primarily as part of a public relations strategy by at least some participants, and that concern is certainly relevant to others of the actions described above.

At the same time, NGO and civil society participants in the process are acutely, and some might say excessively, aware of that risk, and, to date, have not allowed the financial support or companies' participation to blur their diverging interests.[44] Indeed, Robert Kinlock Massie of CERES, who was one of the leading spokespeople for GRI in its initial years, has been

42. *See* Matten & Crane, *supra* note 18, at 167.

43. *See* Conley & Williams, *supra* note 19. I do maintain some optimism that producing and publicizing Global Reporting Initiative (GRI) reports might eventually have some positive impact upon companies' social and environmental actions. *See* Sharon M. Livesey, *The Discourse of the Middle Ground: Citizen Shell Commits to Sustainable Development*, 15 Mgmt. Comm. Q. 313 (2002) (evaluating the effects of companies' communications strategies, and asserting that as companies make palliative statements to one constituency, for instance environmentalists, this can create pressures by other constituencies (such as employees) on the company to actuate the values inherent in the statements).

44. *See* Conley & Williams, *supra* note 19, at 18-21 (discussing the impact on NGOs of establishing partnership projects with businesses).

quite outspoken on the front pages of the *Wall Street Journal* in his criticism of GM for the active part GM took in lobbying against a Senate proposal to raise federal fuel-economy standards for SUVs.[45] A similarly critical news report appeared in the *New York Times* about Ford, specifically identifying its delay in issuing its 2002 GRI report as a problem, and questioning Ford's commitment to advancing environmental goals, notwithstanding statements by William C. Ford, Jr., about the importance of those goals.[46] Two points are worth noting here: While the companies' motivations might be to use their social reports as public relations efforts, having produced these reports sets up a dynamic where companies are potentially more susceptible to environmental or social political pressures.[47] Moreover, if co-opting the GRI process is the goal, it seems not to have been effective, at least to date. That says nothing about whether the entire GRI process will ultimately succeed in forestalling mandatory regulation requiring social and environmental disclosure, however.

With that, looking through the lens of my own skepticism, I can posit four possible reasons why companies might be producing social reports and engaging in corporate social responsibility initiatives:

(1) *Law compliance*: In some instances greater environmental disclosure is required by law, as discussed above. While "mere" law compliance would seem to be a narrow theory of corporate citizenship, it is at least a theory of citizenship that recognizes the importance of social obligations and does not presume that a company's self-interest can properly outweigh those social obligations. In that sense, law compliance is an important foundation of citizenship.

(2) *Market driven*: There are a number of converging market trends that motivate companies. The first is globalization and the skepticism it has fueled about whether business, left to its own devices, can solve the problems of growing global economic inequality and environmental degradation. Many businesses recognize that they need to "manage" the globalization backlash, and "engagement" with corporate accountability issues may be one way to do so.[48]

Moreover, many consumers, students, and NGOs in Europe, the United Kingdom, and the United States are demanding transparency by global companies about their economic, environmental, and social impacts, and are calling for more corporate attention to CSR issues such as sustainability and growing global inequality. Indeed, the particular issues of concern can be seen by which companies are participating in the GRI. In the United Kingdom, food safety has been an issue of intense public concern. Two

45. *See* Jeffrey Ball, *After Long Detente, GM, Green Group Are at Odds Again*, Wall St. J., July 30, 2002, at A1.

46. *See* Danny Hakim, *Ford Stresses Business, but Disappoints Environmentalists*, N.Y. Times, Aug. 20, 2002, at C4.

47. *See* Livesey, *supra* note 43, at 330.

48. *See* Conley & Williams, *supra* note 19, at 35-36.

grocery store chains in the United Kingdom, J. Sainsbury and Safeway, are participating in GRI. These are the only countries in which grocery store chains are participating. In the United States, environmental issues and concerns over sweatshops have been predominant; most of the participating U.S. companies are from industries likely to have a high environmental impact (chemicals, cars, energy production), or that have been identified with sweatshops (e.g., Nike).

Another market trend affecting companies' participation in CSR initiatives and GRI is the growth of socially responsible investors (SRI), whose information needs are broader than those of typical "financial" investors. In addition, various SRI indices such as the Dow Jones Sustainability Group Index (U.S.) or the FTSE4Good Index (U.K.) publicize lists of "sustainability" leaders in various industry groups, which give companies incentives to publicize any actions they have taken as a result of a commitment to sustainability. Moreover, given the evidence that "sustainable" firms can outperform unsustainable firms,[49] market leaders may see sustainability as a management tool that is potentially useful to enhance financial results. If a company has made a commitment to sustainability for financial reasons, it then makes sense to publicize that fact so that the capital markets can reflect that information in higher stock prices. Finally, a number of accounting firms have recognized that social auditing, sustainability auditing, and risk assessment and management are business opportunities, and are therefore promoting these ideas and communicating to businesses what "best practice" is in this area.

These market motivations may be evidence that the market can work to bring about more social accountability, at least among market leaders, companies with a retail presence, or in large, global companies for whom reputations are important assets. Yet, this evidence does not lead to a particularly robust theory of corporate citizenship. Rather, it emphasizes the economic (and reactive) nature of corporations.

(3) *Politically motivated*: Given some of the market trends identified above, particularly globalization and its contestation, given the recognition by civil society that individual countries are unable to regulate multinational corporate activity, and given the growing recognition among business leaders, civil society, NGOs, SRI shareholder activists, and consumers that environmental issues and global economic inequality (at least) pose fundamental challenges in the world that need to be addressed, at some point there will come pressures for more global regulation of business. There already have been hortatory efforts to define multinational corporations' social responsibilities, such as in the OECD's *Guidelines for Multinational Enterprises*, and questions about the need for either mandatory regulation of corporations' social responsibilities (considered and defeated in Europe) or an international treaty concerning corporations'

49. *See generally* Marc Orlitzky, Frank L. Schmidt & Sara L. Rynes, *Corporate Social and Financial Performance: A Meta-Analysis*, 24 Org. Stud. 403 (2003).

social responsibilities such as that being contemplated under the auspices of the United Nations.[50] If companies can credibly demonstrate that their voluntary initiatives are sufficient to address the problems of globalization, they can try to forestall mandatory regulation. Thus, one possible explanation for why companies are participating in CSR initiatives is that they want to slow efforts for mandatory regulation.

While one could describe this corporate motivation as depicting an engaged citizen, it is citizenship not obviously directed towards the public good, but rather is self-interested citizenship.[51] Thus, this is the public choice conception of the corporate citizen.

(4) *Intrinsic motivations*: It could be that companies are volunteering to raise the standards of their conduct and disclosure for more intrinsic reasons and not in reaction to legal mandates, market conditions, or political exigencies. It could be that some companies are acting in this regard because these actions facilitate a more comprehensive relationship between the corporation and society, properly account to society for the exercise of corporate power in an era of global reach, and provide (in some cases) mechanisms for structured interactions between companies and members of civil society. I would suggest that this would be a more robust view of corporate citizenship than others set out above, in that according to this view companies would seek to identify the social and environmental impacts of their actions, to engage in "self-reflection," and to permit greater transparency, which allows or even invites greater input, including criticism, from those outside the corporation. In becoming self-reflective, companies would demonstrate at least one essential attribute of responsibility to society.[52]

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50. *See* Williams, *Civil Society*, *supra* note 23, at 498-501 (discussing the U.N. process to define the human rights obligations of multinational companies and other business entities).

51. I recognize that this statement contains an implicit empirical premise with which many people would disagree: that failing to regulate companies vigorously is not consistent with the public good. Of course many academics and company executives think that it is best to let markets work to "regulate" companies, and so acting to avoid global regulation is in the public good. Leaving this thorny debate aside, I am comfortable with suggesting that this is a public choice conception of the corporate citizen, since it shows the actions of organized interest groups (business) achieving political goals (staving off regulation) at the expense of the policy preferences that may well be preferred by a diffuse, disorganized majority of global citizens.

52. This is not a new definition of corporate social responsibility, by any means, much like these questions about the nature of the corporation and its relationship to society are not new. *See, e.g.*, Christopher D. Stone, *Corporate Social Responsibility: What It Might Mean, If It Were Really to Matter*, 71 Iowa L. Rev. 557 (1986) (asserting that corporate social responsibility must at least mean that companies create organizational structures that permit them to get information on the effects of their actions and "reflect" upon it). For more recent discussions of the potential importance of laws that require such reflection, see David W. Case, *The Law and Economics of Environmental Information as Regulation*, 31 Envtl. L. Rep. 10,773 (2001); David Hess, *Social Reporting and New Governance Regulation: The Prospects of Achieving Corporate Accountability Through Transparency*, Bus. Ethics Q. (forthcoming 2006), *available at*

Distinguishing between these explanations is difficult without access to information about companies' internal decision-making processes, which will require more in-depth interviews and case studies; there are undoubtedly multiple explanations for this relatively new phenomenon. Yet, from examining the reports, reading the research to date about these trends, and conducting interviews with participants in companies and activists in NGOs in collaboration with my coauthor, Professor Conley, my preliminary conclusion is that very few companies are engaging in CSR initiatives or producing social reports because they are intrinsically motivated to actuate mechanisms of social accountability or because of an expansive conception of corporate citizenship.[53] These are not, primarily, actions motivated by an "internal" sense of social obligation. According to many theories of the firm, there could be serious agency problems if public-company managers *were* actuating their own sense of social obligation through the resources of the firm.

Rather, companies take these actions for some of the narrower reasons identified above. Companies are acting out of various instrumental motivations, such as responding to consumers' demands in the market or NGOs' demands in the political market for more transparency and more corporate social responsibility, seeking to protect their reputations by positioning themselves as responsible corporate actors, seeking to "capture" and define the corporate social responsibility issue, or using voluntary disclosure initiatives as a means to forestall mandatory regulation. In other words, as citizens, companies seem overwhelmingly to be utilitarians and not Kantians. What this means is that we ought not read too much about companies' "self-concepts as citizens" from their voluntary participation in CSR initiatives and reporting. Regulators, consumers, some investors, and NGOs are increasingly requiring or calling for higher social standards and disclosure, and some companies are responding—particularly large companies with global reach, for whom reputation matters a great deal.

And yet, what this might mean is that the external perspective, while not ideal, is working in the corporate context to start to produce actions that may ultimately minimize harm and improve standards of human relationships. On any theory of the corporation and social responsibility, companies have an economic responsibility to be profitable or they will demonstrably not be able to fulfill any other social goals.[54] As the social

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http://papers.ssrn.com/sol3/papers.cfm?abstract_id=818544; Eric W. Orts, *Reflexive Environmental Law*, 89 Nw. U. L. Rev. 1227 (1995).

53. *See* Conley & Williams, *supra* note 19.

54. Legal academics have struggled to produce useful definitions of CSR, and in that effort may be well advised to look to the management literature. In that literature, one widely used definition is that of Professor Archie B. Carroll. Matten and Crane summarize Carroll's definition of CSR as comprised of four types of responsibilities: "(1) the *economic* responsibility to be profitable; (2) the *legal* responsibility to abide by the laws of society; (3) the *ethical* responsibility to do what is right, just, and fair; and (4) the *philanthropic* responsibility to contribute to various kinds of social, educational, recreational, or cultural purposes." Matten & Crane, *supra* note 18, at 167 (referring to Archie B. Carroll, *A Three-*

expectations of companies are raised, firms need to raise their standards of behavior to continue to be successful in the market.[55] Moreover firms recognize that their social license to operate increasingly requires more regard to social and environmental issues. This is the point that Donald Langevoort emphasizes for the Symposium, based on the work of sociologist Robert Kagan: "[I]f conduct inexcusably falls short of societal demands, the firm will lose access to important resources and be disadvantaged. This is so regardless of whether the conduct is law-abiding or not; something can be lawful but still illegitimate."[56]

It is because of firms' need to maintain market position and a "sustainable" reputation and license to operate that the external point of view may work fairly well in many circumstances to produce corporate behavior with a sufficient sense of social obligation, including obligation to law. When an individual is calculative about law, at least in the "bad man" view, it is the risk of potential legal liability that typically comprises the full ambit of concern. With a company, however, much broader potential costs need to be calculated, as Robert Kagan emphasizes: costs to reputation, increased risk of a regulatory response, institutional investor reactions (particularly, I would add, in the United Kingdom where institutional investors have become active scouts of corporate social performance), and ultimately consumer and community responses.[57] Thus, the risk of legal liability is just one of the predictive risks to be considered, and probably not the most serious.[58]

Many lawyers I ask about these questions say that with respect to privately negotiated contracts between sophisticated market players, they may well counsel aggressive exploitation of legal ambiguity, but with respect to external regulation they counsel strict compliance. Why? Because the risks to a company's long-term reputation are not worth the short-term gain from shirking. The recent effort by Wal-Mart to improve its community reputation with well-publicized environmental initiatives, such as sourcing all of the fresh fish that it sells in North America (excluding farm-raised fish) from waters certified by the Marine

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Dimensional Conceptual Model of Corporate Performance, 4 Acad. of Mgmt. Rev. 497 (1979)).

55. There are obviously limits to this: ExxonMobil is consistently one of the world's most profitable companies notwithstanding having no demonstrated commitments to "social responsibility," refusing to participate in industry initiatives with respect to revenue transparency or security arrangements, and funding various think tanks to dispute the evidence of climate change. Since it sells a product that is necessary to life as we now know it, with high barriers to entry, it is (apparently) unconcerned with the views of many institutional investors, NGOs, or consumers, and has not suffered in the market.

56. *See* Langevoort, *supra* note 12, at 1625 (footnote omitted).

57. *See* Robert A. Kagan, Neil Gunningham, & Dorothy Thornton, *Explaining Corporate Environmental Performance: How Does Regulation Matter?*, 37 Law & Soc'y Rev. 51 (2003).

58. The sociologist Robert Kagan has suggested this relative emphasis based on an empirical study he conducted with colleagues about firms' varying approaches to environmental law compliance. *See id.* at 78-82.

Stewardship Council as sustainable, is just the most recent, and perhaps most ironic, demonstration of this point.[59] There are limits to the power of the external approach: Companies without a retail presence or brand to maintain may not be reached (although here the branded companies are imposing demands on their suppliers, so this concern is in part ameliorated), and companies like ExxonMobil will be recalcitrant, I predict, until the last drop of oil is extracted. Yet, as an approach to corporate law compliance, the external perspective is increasingly powerful as the social expectations of companies become more demanding.

II. BUT WHAT ABOUT ENRON?

Given all that companies are doing in response to the social expectations of global business, how, then, are we to understand the Enron phenomenon in the United States, particularly given the role of lawyers as among the failed gatekeepers? In Part II.A, I will suggest that for even the most well meaning of corporate lawyers and actors, the substance of corporate and securities law, and the institutional context within which public companies act, can create difficulties either knowing, specifically, what the law requires, or having a strong sense of an "internal position" to actuate. These interpretive difficulties then give rise to opportunities that the not-so-well-meaning lawyers and actors can readily exploit. I will discuss this problem in Part II.B, and then conclude by speculating that the law-and-economics-infused view of obligation helped fuel the exploitation of ambiguity that led to the Enron and WorldCom era. Stronger influences undoubtedly existed. The academic literature is rich concerning the conflicts of interests of securities analysts, accountants, and lawyers that encouraged ethical lapses; and concerning the self-interest of executives, fueled by stock-option compensation, which encouraged exaggeration and ultimately lies about companies' financial performance.[60] Yet, I will conclude with the speculation that Enron and others can be understood in part by the place in this country (and in particular in the legal academy) of the unproblematic acceptance by many law students, lawyers, and law professors of the premise that social welfare will be increased by individuals simply pursuing their own self-interest. I cannot presume to take on the central premise of neoclassical economics in the concluding pages of this essay. Yet, if my speculation is correct that unmitigated self-

59. *See* Jonathan Birchall & Fiona Harvey, *Wal-Mart Vows to Sell Only Sustainable Fish*, Fin. Times, Jan. 29, 2006, at 7. According to the same article, Wal-Mart will also establish "sustainability networks" to bring together its suppliers, buyers, and concerned NGOs to discuss standards in agriculture, seafood, gold, and jewelry. Notably missing is apparel, where Wal-Mart's record in its factories in China has been recently criticized in the movie *Wal-Mart* and in the Wal-Mart Watch citizen action campaign. For more on this, see Wal-Mart Watch, http://walmartwatch.com/ (last visited Nov. 22, 2006).

60. For a general discussion of these influences, including the role of mergers and acquisitions in relaxing the guard of numerous gatekeepers, see David Skeel, Icarus in the Boardroom (2005); *see also* John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 Cornell L. Rev. 269 (2004).

interest helped fuel the Enron scandal, it does suggest that we need to be cautious about accepting the modern neoclassical economist's story of social alchemy, that flourishing self-interest is transformed by the magic of the market into social welfare, and equally cautious of letting unrestrained self-interest loose from the constraints of a careful, Hartian approach to law.

A. *Formalism, Uncertainty, and Pressure*

I have suggested that a number of aspects of corporate and securities law, and the institutional context of the public capital markets, can undermine a capacious view of what the law requires, and can, indeed, lead even well-meaning lawyers into a muddle.

Take corporate law first. Unlike related bodies of commercial law such as securities and tax, which focus on the substance of transactions rather than the form, corporate law is famously formalistic. Certainly the rhetoric of corporate law is rich with language of enveloping fiduciary duties, not "mere morals of the marketplace," but "a punctilio of honor the most sensitive," and so forth.[61] As a general matter, the Delaware courts do expect directors and officers to act carefully, to put the company's interests before their own, and to act in good faith. Yet these general standards can permit, and are intended to permit, great flexibility in application to specific facts. In many cases, then, managers and directors can take actions specifically to undermine shareholders' voting rights,[62] or bargained-for preferences,[63] so long as the formalities of Delaware law are observed. If a majority shareholder of a company wants to take over the entire company, for instance, it can use a merger format, under state corporate law, in which challenges to its actions will be evaluated under a stringent entire fairness standard, or it can use a self-tender format under federal securities law, at which point entire fairness drops out and the only question is whether there was full disclosure.[64] As Professor Gordon Smith has argued, the Delaware courts can "appear[] to be elevating form over substance in a most dramatic way," with the ultimate effect being that highly manipulative behavior is

61. The quoted language is from Justice Benjamin Cardozo in one of his most famous opinions in business law, written when he was Chief Justice of the New York Court of Appeals. *See* Meinhard v. Salmon, 164 N.E. 545, 545-46 (N.Y. 1928).

62. *See, e.g.*, Paramount Comm., Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1990) (holding that the doctrine of independent legal significance applied to permit a merger, which would have required a shareholder vote to be recast as an acquisition, but which did not, where it was unlikely the shareholders would have voted for the merger).

63. *See, e.g.*, Benchmark Capital Partners IV, L.P. v. Vague, No. CV. A. 19719, 2002 WL 1732423 (Del. Ch. July 15, 2002) (applying the doctrine of independent legal significance to permit a merger for the primary purpose of stripping one class of preferred shareholders of its preferences).

64. *See In re* Pure Resources, Inc., 808 A.2d 421, 433-35 (Del. Ch. 2002) (discussing the different standards that are used depending only on whether a merger or a self-tender is used).

permissible, even in instances where it strains credulity to say companies' actions were fair and were what parties bargained for.[65]

This formalism is often due to the "doctrine of independent legal significance," which has been described by Vice Chancellor Leo E. Strine, Jr., as follows:

> [Delaware law] provides transactional planners with multiple routes to accomplish identical ends. Under the doctrine of independent legal significance, a board of directors is permitted to effect a transaction through whatever means it chooses in good faith. Thus, if one method would require a stockholder vote, and another would not, the board may choose the less complicated and more certain transactional method.[66]

While there are equitable, good faith limits to the manipulation that the doctrine will permit, rarely, in fact, do transactional lawyers run up against those limits outside of the context of taking defensive actions in a contest for control.[67] Lawyers in the corporate law practice environment do not get strong signals demanding that they think about the fairness of clients' goals (such as when a company engages in a de facto merger, but uses a reorganization framework to avoid appraisal rights)[68] or the broader implications of transactions. Rather, the emphasis is on whether lawyers have complied with the formal, technical requirements of the company's certificate of incorporation, its by-laws, and Delaware law in structuring transactions to meet their clients' goals.

Securities law presents a different challenge to the well-meaning lawyer. "Materiality" is the central concept in securities law that distinguishes information that needs to be publicly disclosed from that which does not,[69]

65. D. Gordon Smith, *Independent Legal Significance, Good Faith, and the Interpretation of Venture Capital Contracts*, 40 Willamette L. Rev. 825, 828 (2004). While recognizing the value of formalism in producing clarity and certainty for transactional planners, Professor Smith also uses comparative institutional analysis to suggest that the courts should engage in a more searching inquiry of the good faith of corporate actors when the doctrine of independent legal significance is used to permit egregious preference stripping.

66. Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 Del. J. Corp. L. 673, 675 (2005).

67. *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988), is one case where a board of directors followed all the proper formalities under the company's certificate of incorporation and by-laws to expand the board and appoint new directors, but the Delaware Supreme Court found the action inequitable because it interfered with the potential efficacy of a shareholder vote in the midst of a contest for control of the company. While *Blasius* is still referred to on occasion, the Delaware Supreme Court has acknowledged that the burden it imposes "is quite onerous, and is therefore applied rarely." Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996). Rather, defensive measures are typically evaluated using the more management-friendly standard of *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

68. *See* Smith, *supra* note 65, at 833-34 (discussing Hariton v. Arco Electronics, Inc., 188 A.2d 123 (Del. 1963)).

69. Regulation S-K is the omnibus regulation that defines specifically what needs to be disclosed in complying with the various securities laws, but many of the specific items defined therein only need to be disclosed "to the extent material." *See* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 Harv. L.

and yet locating this distinguishing border ex ante can often seem to require the services of a Talmudic scholar, not a securities lawyer.

The controlling Supreme Court precedent that defines material information is *Basic, Inc. v. Levinson*: An omitted fact is material if "'there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote,'" or, put another way, if there is a "'substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information available.'"[70] As is readily apparent from the definition, materiality determinations are inherently fact-specific and must always be viewed in light of the "total mix" of information already available about a company. The difficulty of determining whether information is material is compounded where what is being evaluated is the potential impact of a contingent or speculative event, since then "it is difficult to ascertain whether the 'reasonable investor' would have considered the omitted [speculative] information significant at the time."[71] With respect to such speculative or contingent information, the Supreme Court adopted the Second Circuit's "probability/magnitude" mode of analysis, such that the greater the potential magnitude of the impact of an event on a company, the lower its probability of occurring must be in order to find the information material.[72] And yet the range of contingent or speculative events that might affect a company is vast, from the potential impact of interest rate movements or currency fluctuations on projected sales, revenues, or profits,[73] to the impact of climate change on a company's profitability,[74] and everything in between. Moreover, these estimates of "magnitudes" and "probabilities" are just that: estimates, and darned hard ones to make in many cases.

The difficulty of translating these general standards into specific materiality determinations can be seen in the facts of *Basic* itself, which

Rev. 1197, 1208-09 (1999) (discussing the relationship of the "materiality" concept to specific disclosure requirements of Reg. S-K).

70. Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976) (defining materiality for purposes of Section 14a claims)).

71. *Id.* at 232.

72. *Id.* at 238 (citing SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc)).

73. *See In re* Caterpillar, Inc., Exchange Act Release No. 30532, 51 SEC Docket 197 (Mar. 31, 1992) (describing an SEC action against Caterpillar where the potential impact of South American currency fluctuations on future profits had not been adequately described).

74. *See, e.g.*, Douglas G. Cogan, Coal. for Environmentally Responsive Econs. (CERES), Corporate Governance and Climate Change: Making the Connection (Mar. 2006), *available at* http://www.ceres.org/pub/docs/Ceres_corp_gov_and_climate_change_0306.pdf (discussing the potential impacts of climate change on a wide range of industries).

74. *Basic* involved misstatements of facts, as managers of the Basic Combustion Company denied allegations that merger talks were occurring at a time when they were in fact occurring—and denied such talks even in answer to a specific question by the New York Stock Exchange, which is a particularly obtuse disclosure strategy. *See Basic*, 485 U.S. at n.4.

involved the question of when the existence of merger discussions at Basic became "material facts."[75] The Third Circuit had adopted a test that held that the fact of merger discussions becomes material when an agreement-in-principle is reached. The Supreme Court rejected this bright-line rule, while recognizing the virtue of such rules in guiding lawyers as they advise clients:

> A bright-line rule indeed is easier to follow than a standard that requires the exercise of judgment in the light of all the circumstances. But ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive.[76]

Rather, the Court adopted the probability/magnitude mode of analysis, while recognizing that "[t]he determination [of materiality] requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him."[77] So then when do discussions of a potential business combination become material? If talks are disclosed that are too preliminary, the stock market values of the target company may go up, and of the acquiring company go down, affecting whether the deal will go through or not, but—more to the point—potentially giving rise to liability for a material misstatement of fact if the talks collapse, and disappointed buyers of the target stock think they were misled about the potential merger. If talks are not disclosed until the agreement-in-principle, disappointed sellers of the target stock, who presumably sold at too low a price, may call foul. This is just one example among many of the difficulties judging the materiality of contingent events.

That these "delicate assessments" can be difficult to make is compounded by the SEC's own guidance on materiality, particularly Staff Accounting Bulletin (SAB) 99. In SAB 99 the SEC rejected the use of numerical guidelines in determining materiality, reiterating that materiality has both a quantitative and a qualitative aspect.[78] It emphasized that even a misstatement of a quantitatively small amount, such as less than one percent of a relevant financial statement item, could be material if it, for instance, masks a change in earnings or other trends, masks a failure to meet analysts' consensus expectations, affects regulatory compliance, relates to an important business sector, bears on the quality of management, and so on. In other words, just about any quantitative information could be material, depending on the circumstances, and just about any qualitative information could be material, depending on the circumstances. That the guidance of the Court and of the SEC amounts to no guidance at all was

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76. *Id.* at 236.

77. *Id.* at 238 (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976)).

78. *See* SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150 (1999), *available at* http://www.sec.gov/interps/account/sab99.htm.

brought home to me in practice, where I became aware of vigorous arguments that lasted hours, and in one case days, amongst some of New York City's most respected and knowledgeable securities lawyers over whether specific information was material or not.

If Hart's internal perspective on jurisprudence views the person as being under an internal sense of "an obligation to engage [or not] in certain conduct [and] . . . as being held up to a standard of what one is really *supposed to do*," as Professor Benjamin Zipursky has written,[79] then the interpretive morass of materiality in securities law is potentially problematic. While the well-meaning securities lawyer can certainly feel obligated to meet disclosure obligations because that is what one is supposed to do, she can still feel rather unsure of what, specifically, that injunction actually requires her to do in any given circumstance. The former sense of obligation may be all that is required to speak intelligently of a securities lawyer adopting an internal point of view. After all, Hart was clearly aware that law requires interpretation, and discussed the jurisprudential implications of the interpretive process at some length.[80] Still, this extraordinarily open-textured aspect of securities law, in conjunction with the formalistic nature of deal structuring, produces a practice environment in which even the most well-meaning lawyer can lose the sense that there are hard edges to what the law requires or enjoins, a point to which I will return below.

The third aspect of the business environment that reinforces the open-textured feel of much business law, and that can undermine a robust internal perspective, is the pressure that public company managers are under to meet Wall Street's consensus estimates of their company's quarterly results. This pressure was identified by then-SEC Chairman Arthur Levitt as the results of a "market that is unforgiving of companies that miss their estimates," recounting the story of a company that lost six percent of its stock market value in one day when it missed "its so-called 'numbers' by one penny."[81] In such an environment, the fiduciary duties of managers to their shareholders can be understood to require that the company make accounting adjustments to meet Wall Street's estimates, so long as that can be done within the acceptable range of accuracy that Generally Accepted Accounting Practices permits. Otherwise the shareholders may suffer a dramatic loss in the value of their shares that is unrelated to any fundamental changes in the underlying value of the company. This is not to suggest that the company should ship boxes of bricks and book revenues as

79. Zipursky, *supra* note 22, at 1229.

80. *See* Hart, *supra* note 14, at 124-41.

81. *See* Arthur Levitt, Chairman, SEC, The "Numbers Game," Speech Before the New York University Center for Law and Business (Sept. 28, 1998), *available at* http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt.

if it were shipping boxes of computers, as did the Miniscribe Company,[82] or any such outright fraud. I am suggesting, though, that a well-meaning, careful fiduciary, aware of the over-reaction of Wall Street to even small misses, may well look to the discretion that GAAP permits to manage the accounting process to try to meet Wall Street's expectations.[83] This, too, can undermine the sense that the law has "hard shoals as well as shifting sands."[84]

B. *Exploiting Interpretive Freedom*

The above sketch has suggested that the inherent formalism of corporate law and the indeterminacy of securities law with respect to the central concept of material information, in the context of the pressures of Wall Street's earnings expectations, can create an epistemological and ethical morass for even the most well meaning of lawyers. I entirely agree with Professor Zipursky that "legal obligations are their own kind of 'ought,'" separate from moral oughts (and happily leave it to him to prove that in a philosophically sophisticated way).[85] Those legal "oughts" are essential to what Hart defined as the law's principal function:

> The principal functions of the law as a means of social control are not to be seen in private litigation or prosecutions, which represent vital but still ancillary provisions for the failures of the system. It is to be seen in the diverse ways in which the law is used to control, to guide, and to plan life out of court.[86]

Unfortunately, though, our well-meaning corporate or securities lawyer can occupy an internal position with respect to the obligations of corporate and securities law without knowing what, for example, securities law

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82. *See* United States v. Wiles, 102 F.3d 1043, 1050 (10th Cir. 1996) (describing efforts to hide a $15,000,000 inventory overstatement with "an extensive cover-up which included recording the shipment of bricks as in-transit inventory").

83. I recognize that this is an iconoclastic view, but it is supported by a number of articles in the finance literature that suggest that analysts on Wall Street are better able to interpret smooth earnings than volatile earnings, and therefore do a better job of valuing the stocks of companies in which earnings are smoothed. *See* Anil Arya, Jonathan C. Glover & Shyam Sunder, *Are Unmanaged Earnings Always Better for Shareholders?*, Acct. Horizons, supp. 2003, at 111-12 (a managed earnings stream ("income smoothing") can convey more information than an unmanaged earnings stream since it permits managers to convey their best assessment of private information); Paul K. Chaney & Craig M. Lewis, *Income Smoothing and Underperformance in Initial Public Offerings*, 4 J. Corp. Fin. 1, 1 (1998) (finding a positive association between a proxy for income smoothing and firm performance in a sample of 489 firms that made initial public offerings between 1975 and 1984, and stating that "[t]his result is consistent with a hypothesis that the market makes better assessments of the information content of earnings for firms with smoother earnings").

84. I am grateful to my colleague at the University of Illinois, Emeritus Professor John E. Cribbet, for bringing this saying about the law to my attention (and to the attention of Illinois law students for the over fifty years that he taught students not only about the law, but about the highest standards of professionalism and ethics).

85. Zipursky, *supra* note 22, at 1247.

86. Hart, *supra* note 14, at 40.

requires with respect to a novel disclosure issue, and without advancing any particularly robust view of fairness to a company's shareholders, let alone fairness or concern for a concept of broader social welfare. So that even occupying the internal perspective, a lawyer's work in these fields seems unmoored from clear external guidance and drained of moral consequence—and I write that as someone who practiced in that field for many years in a law firm with very high ethical standards and a great deal of integrity. Deal structure manipulation will become derivatives manipulation that is difficult, time-consuming, and expensive, but that increases attorneys' fees and investment banks' income; or deal structure manipulation becomes reincorporation of a company in Bermuda to reduce its U.S. tax obligations without moral alarm bells going off (perhaps about the impact on the United States if every company did that). Still, the well-meaning lawyer will struggle in good faith to actuate the spirit of securities disclosure requirements when faced with a novel question, and will search in good faith to identify the acceptable outer limits of GAAP flexibility and counsel her client to stay within them, even given the pressures of the Wall Street consensus estimate. She may even counsel deal structures that permit shareholders to have appraisal rights to protect their interests, or suggest that reincorporation elsewhere is shirking the company's obligation as a corporate citizen, although, I must admit, these both seem unlikely given the prevailing norms.[87]

But what of the lawyer who is occupying a "bad man" view, and who cares primarily about the possible sanctions for his client for violations? Nothing in the field will pull him back from such a Holmesian perspective (or, perhaps it is more accurate to say that prior to Sarbanes-Oxley nothing would have). The formalism of corporate law produces no strong moral signals about the consequences of a client's actions, and the indeterminacy of securities law can be exploited by this lawyer to produce exaggerated degrees of freedom. Hart recognized that all law involves interpretation, and that individual citizens (and regulated entities) have a primary role in that interpretation.[88] In fact, the example Hart uses of such interpretive issues is the "reasonableness" standard in tort law, which is of just the sort of open-textured law as is the "materiality" standard in securities law, and includes the same fact-specific, all-things-considered aspect. Precisely because of the open-textured nature of law in the securities field, then, we need lawyers who will engage in the well-meaning lawyer's good faith struggle to define his client's legal obligations with a fair measure of honesty and integrity, rather than exploiting the ambiguities to advance his client's perceived short-term self-interest. The need for companies to

87. Deal structures are hugely affected by tax considerations, so the well-meaning, internally guided Hartian lawyer may really have much less freedom to act in this area to protect shareholders or actuate a sense of fairness, as compared to the freedom to structure the client's disclosure under securities law.

88. *See* Hart, *supra* note 14, at 124-36.

maintain social legitimacy, as Langevoort has articulated it, may be one important way to engage clients in adopting this interpretive posture.[89]

Important trends in legal education and legal theory, however, complicate the goal of producing lawyers who will take a Hartian perspective and who will understand companies' need for social legitimacy. Chief among those trends, in my view, is the teaching of "primitive" law and economics, which has taken the neoclassical economist's stylized picture of the person, *homo economicus*, a self-interested utility maximizer, and has assumed that this two-dimensional person occupies the real world, subjecting every aspect of life to a cost-benefit analysis, including decisions about law compliance.[90] As David Campbell and Sol Picciotto have stated, in a "process of intellectual imperialism," leading law and economics writers such as Richard Posner have advocated "market-based solutions to a wide range of issues not only legal but also merely tangential to law, including adoption, AIDS, aging, and art; and this is just to stay within 'a.'"[91] Thus, complex situations with social, cultural, political, and moral dimensions are reduced to the cost-benefit calculations of self-interested market actors. In relentlessly exposing law students to law and economics (more so, in my experience, than we have exposed them to law and sociology, law and psychology, critical race theory, law and history, or many other intellectual traditions), we also can reinforce some quite troubling perspectives.

One such perspective is that the individual pursuit of self-interest is natural and good and that if people simply pursue their individual self-interest through isolated market transactions, this will lead to enhanced social welfare.[92] Competing human characteristics and values, such as capacities for altruism, trust, cooperation, and fairness do not feature prominently in this worldview, if they appear at all.[93] Since many of the corporate governance problems that epitomized the Enron era had to do with senior executives within companies and various gatekeepers outside it

89. *See* Langevoort, *supra* note 12, at 1616-18.

90. I am using the term "primitive" law and economics in recognition that the field has developed well beyond its earliest articulations, such as those of Judge Richard Posner, and that more recent work incorporates a fuller picture of human rationality and interests. *See* Korobkin & Ulen, *supra* note 17. Yet, as with much of the more sophisticated work law professors do, these elaborations are often not communicated as clearly to students as are the simpler foundational ideas, such as the idea that the promotion of "economic efficiency" is the major goal of law, swamping fairness or redistribution as competing goals.

91. Campbell & Picciotto, *supra* note 21, at 253. Campbell and Picciotto's article is a critique of American-style law and economics, including a thoughtful analysis of the ways in which that intellectual juggernaut has misread Coase, and is a good starting point for references to the European institutional economics tradition.

92. The corporate variation of this theory is that social welfare is enhanced by individual companies acting solely to maximize shareholder wealth. See Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 Geo. L.J. 439 (2001), for what has become the iconic, short expression of this view.

93. *See* Lynn A. Stout, *On the Proper Motives of Corporate Directors (Or, Why You Don't Want to Invite* Homo Economicus *to Join Your Board)*, 28 Del. J. Corp. L. 1, 9 (2003) (asserting that "[e]conomic analysis has little use for such concepts as honor, trustworthiness, or duty").

privileging their self-interest over other values, including social responsibilities, the good of the corporation, or the importance of the integrity of the capital markets,[94] a legal philosophy that reinforces self-interest as a moral polestar is demonstrably of concern.

This is not just a matter of academic concern, however. Nor is law and economics the only influence encouraging self-interest in our culture. One of the most disturbing scenes in the documentary *Enron: The Smartest Guys in the Room*,[95] in my opinion, consisted of tape recordings of energy traders at Enron who were thrilled when wild fires were burning out of control underneath some of their power distribution lines in California, because that meant they could legitimately shut down those lines and increase the cost of power. While looking at footage of the roaring fire, one hears one of the traders happily chortling "Burn, baby, burn," to raucous laughter from his cohorts. Given the extraordinary disruptions in people's lives that were being caused by the energy "shortage" that Enron had already manufactured in California, including automobile accidents caused by traffic lights that were not working, people trapped in elevators for hours, hospitals struggling to provide care to seriously ill patients, and so forth, the young traders' veneration of the money they would make from others' misfortunes is a chilling reminder of how much social dislocation can be caused by promoting this morally neutral view of self-interest.

It is not only that the view of humans as simple self-interested calculators is descriptively incomplete that causes difficulties. As Professor Lynn Stout has discussed, experiments in social psychology have consistently shown that the level of people's altruistic or cooperative behavior is affected by the social clues they receive about whether cooperation and altruism are expected.[96] By giving law students social clues that suggest self-interest is at the core of all human interaction, as does primitive law and economics, we are not only shaping our students' views of themselves and of the world, but we are also potentially shaping our students' behavior as well, including their ultimate behavior as lawyers. Given the empirical evidence demonstrating the impact of such social cues, we really ought not feel sanguine about law school in the twenty-first century being an ongoing social experiment in telling young people that it is perfectly acceptable to be self-interested utility maximizers.

Another troubling perspective that law and economics conveys is that promises do not matter, and have no moral content, even when reflected in

94. *See supra* note 40; *see also* Cynthia A. Williams, *Icarus on Steroids*, 94 Geo. L.J. 1197, 1202-07 (2006) (reviewing David Steel, Icarus in the Boardroom (2005)) (providing an overview of the academic writing on Enron and related problems, and a discussion of the kinds of conflicts of interest that produced the Enron era).

95. Enron: The Smartest Guys in the Room (Magnolia Pictures 2005).

96. *See* Stout, *supra* note 91, at 13-16.

a contract, the perspective animating "efficient breach" scholarship.[97] Indeed, Richard Posner in a judicial opinion has stated as much:

> Even if the breach is deliberate, it is not necessarily blameworthy. The promisor may simply have discovered that his performance is worth more to someone else. If so, efficiency is promoted by allowing him to break his promise, provided he makes good the promisee's actual losses. If he is forced to pay more than that, an efficient breach may be deterred, and the law doesn't want to bring about such a result.[98]

Note the central moral premise: that deliberate breach of a contract (which is, at its core, a promise) is not necessarily blameworthy. Certainly there are many instances in which breaking a promise is not morally blameworthy when obligations to others that most people in society would consider more important intervene. For instance, you promise to take a neighbor's child to the movies and cancel when it turns out your own daughter is sick and needs care. Yet, much of society and many religious and philosophical traditions would disagree with Judge Posner's view, arguing that breaking a promise simply because one has later realized it is to one's personal advantage to do so is morally blameworthy in most instances.[99]

Both of these perspectives—that self-interest is good and that promises do not matter very much—reinforce attitudes that undermine Hart's internal perspective of legal obligation because they undermine notions of social obligation. A person adopting this perspective would interpret legal obligations in a miserly fashion, and only adopt those interpretations that advance her perceived interests. Such a principle of interpretation cannot be the basis of the types of social constraint that Hart seems to propose for law. Rather, one must have a concept of social obligation even where it pinches to arrive at an internal perspective on law in areas of legal ambiguity and interpretive freedom—and it is this concept of social obligation that is undermined by much of the law and economics that we teach our students.[100]

CONCLUSION

Looking at the corporate governance events of the last few years, the worst of which is typified by Enron and its ilk, one can think that Hart's internal perspective on law is important as an ideal, but far distant from the

97. For an excellent critique of the "efficient" breach theory, see Joseph M. Perillo, *Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference*, 68 Fordham L. Rev. 1085 (2000).

98. Patton v. Mid-Continent Sys., Inc., 841 F.2d 742, 750 (7th Cir. 1988).

99. See Perillo, *supra* note 94, at 1041-93, for further elaboration of this point.

100. One of the joys of writing a symposium essay is that one can take it as an opportunity to romp through tangled legal thickets that one would normally feel an obligation to tease apart with painstaking care. I have clearly taken this opportunity in this essay, while hoping that my former writing in this area will lend some measure of *gravitas* to my perambulations here.

actual practice of corporate and securities law. As this essay has discussed, the situation is not so clear. Companies throughout the world, but in particular in Europe, the United Kingdom and the United States, are expressing and demonstrating a greater sense of social obligation than that required by law. So it is not the case that companies as a whole have a miserly sense of social obligation. One can assume that an expansive sense of social obligation will, in many instances, incorporate an internal perspective on one important aspect of social obligation, which is the obligation to law that Hart so thoughtfully discussed.

How much is this conclusion undermined, though, by the Enron events? Some, of course, since it is impossible to look on those events without concern that lawyers, among others, have not advanced a Hartian perspective to their clients. The practice environment is difficult for even the well-meaning lawyer, for the reasons advanced above, and those difficulties can be used to rationalize departures from an internal perspective for lawyers who are not so well meaning. To the extent that we law professors have communicated unrefined versions of law and economics to our students, and thereby allowed them to conclude that of course advancing one's self-interest is the natural order of things, and all that can be expected of human nature, then we bear some responsibility for these departures. Perhaps it is time for a new generation of law students to be asked to read H.L.A. Hart along with their Posner and Becker, and contemplate well the wisdom contained in that Oxford professor's views.