

REMARKS

CORPORATE LAW PROFESSORS AS GATEKEEPERS

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Like Professor Rakesh Khurana, I will address the critical role of graduate and professional education in shaping beliefs about corporate purpose and healthy corporate activity. But I will discuss law school education; specifically, I contend that what corporate law professors do (and do not) teach may contribute to a faulty outlook on certain baseline issues in the minds of future lawyers who advise corporate directors and officers. Wrongheaded ideas picked up in law school can critically shape how lawyers discharge their all-important role as legal counselors to business people. In the current business environment—where trust is in short supply—we legal educators must ask ourselves whether we are doing all we can to instill right thinking and right conduct in those who will counsel key decision-makers in the corporate setting.

First, I share two striking statistics: fifty-six percent of MBA students admitted in a recent survey that they had cheated at least once in the prior year,¹ and forty-five percent of law students reported that they had done so.² Evidently, something is wrong in the educational culture as well as in the business and professional cultures into which we send our students. Law school is the “gate” through which students must pass if they wish to become lawyers. Consequently, we who teach them are “gatekeepers” into the profession. Likewise, those of us who teach corporate law are the gatekeepers into a corporate law practice, and we must be mindful of the social role entrusted to us and must endeavor to discharge that role responsibly.

Graduate education, in the business law area as elsewhere, can broaden (or narrow) a student’s intellectual and ethical horizons.³ Corporate law,

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1. Lucia Graves, *Which Types of Students Cheat Most?*, U.S. NEWS & WORLD REP., Oct. 3, 2008, <http://www.usnews.com/articles/education/2008/10/03/which-types-of-students-cheat-most.html> (citing research by Professor Donald McCabe).

2. *Id.*

3. As James Hunter has observed, “Language itself provides horizons for our moral imaginations.” JAMES DAVISON HUNTER, *THE DEATH OF CHARACTER* 24 (2000).

like other disciplines, asks certain questions and does not ask others. In other words, it begins with a paradigm and that paradigm frames the ensuing inquiry by including and excluding certain topics. Students quickly pick up what we think matters, both by what we professors discuss and highlight and—equally powerfully—by what we do not discuss and thereby ignore. There are many facets to our role as educational gatekeepers, but I will highlight just a couple of them.

Beginning about twenty-five years ago—and for a variety of reasons, not the least of which was the dramatic upsurge of wide-scale hostile takeover activity⁴—two related, discipline-shaping phenomena took hold in corporate law scholarship and corporate law teaching. These paradigm-shifting developments were imported from graduate business schools and economics departments. First, the role of markets in disciplining corporate directors and officers was heavily emphasized.⁵ The influence of these markets, of course, included the usual competitive pressures found in relevant product and services markets. Other markets, though, also were emphasized.⁶ With respect to the market for executive talent, for example, it was argued that the desire to land a better job and to move up the corporate ladder would motivate managers to perform well, deliver value, and thereby win plaudits and advance their careers.⁷

The capital markets were also said to be severe disciplinarians in at least two ways.⁸ First, to successfully access equity markets, a company had to have a compelling, credible story to tell prospective investors. Recent evidence, however, suggests that internal cash flows and debt may be more significant sources of funds than equity, at least for many firms.⁹ Second, once traded on a public market, the share price of a company's common stock was said to be a shorthand report card on management—a low share price supposedly indicated managerial shortcomings that would make a company vulnerable to an outside bid by an investor (or “raider,” to use the pejorative parlance of the day) who would pay current shareholders a premium to gain a controlling interest and then, in theory, spiff up the company and run it in such a way as to produce wealth for the new owners.¹⁰ Reality did not always match theory, however, as many companies faltered

4. See Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 867–78 (1990) (describing responses to takeover activity in the 1980s).

5. See Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215, 2223 (1992).

6. *Id.*

7. See generally Mark J. Roe, *Can Culture Constrain the Economic Model of Corporate Law?*, 69 U. CHI. L. REV. 1251, 1254 (2002).

8. See Ronald Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 841 (1981).

9. Lawrence Mitchell, *The Legitimate Interests of Public Shareholders*, 66 WASH. & LEE L. REV. (forthcoming 2009).

10. See Gilson, *supra* note 8, at 841–42.

or outright collapsed under the burdensome debt financing often used to fund an acquisition.

This broad embracing of market solutions to corporate activity was, at bottom, an argument for a libertarian, deregulatory policy approach to business matters, generally, and to corporate law and securities regulation, specifically.¹¹ If markets worked as efficiently as theorized, the oversight role of courts and other corporate regulators could, it was argued, be reduced and the possibility of regulatory error curtailed.¹² Harmonious markets would also supposedly lead to the overall well-being of both shareholders and society at large. If markets sometimes fail, however, as Professor Coffee argues was the case in the subprime market meltdown, then a deregulatory stance is far harder to justify. We probably witnessed the high water mark of this outlook in early 2007 when private equity funds and hedge funds still reigned supreme. This likely is not what the U.S. or global financial and corporate world will look like for the next few years.¹³ Corporate law, as a field of study, will not merely be a sub-category of contract law or economics.

The second ground-shifting phenomenon that took hold in corporate law over the last quarter century was wide-scale adoption of a shareholder primacy conception of corporate purpose.¹⁴ Within law schools, although there were a few dissenters and some variations on the theme,¹⁵ it was widely *assumed* (that is, it was not discussed in class or at academic conferences) that the overall purpose of corporate activity was, of course, singularly to maximize shareholder wealth. The corporation was simplistically regarded as a financing vehicle or a “nexus of contracts;”¹⁶ any sense of the corporation as an important social institution wielding vast influence on countless lives was marginalized or lost altogether.¹⁷ In this regard, what happened in corporate law education since the 1980s resembles the developments in graduate business education outlined by Professor Khurana. Educators who are not careful will wrongly convey, in law schools as in business schools, that business activity has one chief and undisputed end: make as much money as possible. Instilling that belief in young law students can lead them, like students in graduate business schools, to think that they too should act so as to maximize their own financial position. In this

11. See Johnson, *supra* note 5, at 2237–40.

12. *Id.*

13. See GEORGE A. AKERLOF & ROBERT J. SHILLER, ANIMAL SPIRITS: HOW HUMAN PSYCHOLOGY DRIVES THE ECONOMY, AND WHY IT MATTERS FOR GLOBAL CAPITALISM 167–76 (2009).

14. See Johnson, *supra* note 4, at 878–88.

15. Symposium, *New Directions in Corporate Law*, 50 WASH. & LEE L. REV. 1373 (1993).

16. Johnson, *supra* note 5, at 2215–16, 2219–22 (describing this view, popularized by Frank Easterbrook and Daniel Fischel in corporate law but imported wholesale from financial economics).

17. *Id.* at 2226–29 (describing the more organic, institutional view of sociologist Robert Bellah).

way, what supposedly is intended as a *descriptive* account of institutional and individual goals can be wrongly understood as a *prescriptive* endorsement of self-serving conduct. Calls for adherence to notions of “professionalism” and the supposed steadying influence of professional rules may prove to be weak counterforces to a rampant wealth-primacy norm in the cultures of business and business-advising to which our students are heading.

Shareholder primacy as a normative goal was embraced as canonical in corporate law;¹⁸ the scholarly debate was not over ends, it was over means. I could say several things about this, but my overall point is this: there are widespread misunderstandings in the business world—as well as in business education and in legal education—with respect to what the law does (and does not) require on the question of corporate purpose. In short, outside unusual circumstances—the so-called “*Revlon*” mode under Delaware law¹⁹—no law requires that businesses pursue only the goal of corporate profit or the goal of investor wealth maximization.²⁰ As with other myths, this one dies hard, but it remains as legally mythical as tales of Jack Frost or Paul Bunyan. Lawyers and law students who do not properly appreciate this point may wrongly believe that factors other than wealth maximization cannot, and therefore should not, be considered in charting corporate strategy. Heedless wealth maximization, at the expense of prudence, played a key role in recent financial problems. The public’s continuing perception that businesses have wrongly pressed to maximize profits at the expense of other considerations is impeding the restoration of trust in the business sector.

Although various markets certainly constrain managerial discretion to varying degrees in the relevant industry, and although shareholders have voting rights and could oust boards they consider to be *too* socially or morally responsible,²¹ the widespread pursuit of shareholder wealth maximization as a corporate objective largely stems not from law but from social norms and business lore that can powerfully influence managerial belief and conduct. There are, to be sure, normative and policy arguments supporting—and disfavoring—this convention,²² but there is no legal obliga-

18. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 Nw. U. L. REV. 547, 563 (2003).

19. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). The degree of judicial scrutiny brought to bear on whether and how directors actually discharge their *Revlon* duties was substantially reduced in the recent case of *Lyondell Chemical Co. v. Ryan*, No. 401-2008, 2009 WL 1024764 (Del. Mar. 25, 2009).

20. This theme is more fully developed in Lyman Johnson, *A Role for Law and Lawyers in Educating (Christian) Business Managers About Corporate Purpose* (Univ. of St. Thomas Sch. of Law Legal Studies, Working Paper No. 08-22, 2008), available at <http://ssrn.com/abstract=1260979>.

21. *Id.*

22. Lynn Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189 (2002).

tion to follow it. Certainly, shareholder primacy outside *Revlon* is not a judicial standard of review for assessing director or officer behavior when challenged in court. In fact, were this not true, the ongoing normative debates about corporate social responsibility and business ethics would be meaningless: in ethical discourse, a moral “ought” necessarily implies “can.” Only if they genuinely possess legal latitude can we meaningfully discuss what managers “should” and should not do in various business settings. Nor is there a historically or culturally immutable or “fixed” position on this basic matter of corporate purpose. Rather, a study of our own country’s history reveals that beliefs as to appropriate corporate goals can change over time. Moreover, they can vary from country to country and even from company to company. There is, consequently, no *a priori* reason for insisting on a corporate monism in which all companies pursue the same ultimate goal, as opposed to a more institutionally pluralistic approach whereby businesses vary in the degree to which they single-mindedly pursue investor wealth. We should not mislead students by teaching them otherwise.

Probably the most famous assertion as to the proper purpose of business activity came from renowned economist Milton Friedman. He stated as follows:

A corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom.²³

Friedman cites no positive law authority for his position. His is strictly a normative position that, as noted earlier, is nowhere mandated. In fact, many positive law authorities permit a contrary view.²⁴ Friedman’s position, moreover, when closely examined proves to be quite tolerant of socially-responsible conduct under certain conditions. He suggests acting in accordance with shareholder desires. Today, different segments of investors appear to have some appetite for responsible conduct, and not simply a desire to make as much money as quickly as possible.²⁵ This represents a market solution to the issue of corporate purpose, of the kind Friedman, as a free market advocate, would seem to support. Indeed, he qualifies his admonition to maximize profits by using the word “generally,”²⁶ thereby recognizing that certain investors likely will have different preferences. In fact,

23. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, § 6, at 32.

24. See Johnson, *supra* note 20.

25. Einer Elhange, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 779–91 (2005).

26. Friedman, *supra* note 23.

the very next (and little-quoted) sentence following the popular Friedman quotation noted above goes on to capture just this point: “Of course, in some cases his employers may have different objectives.”²⁷ This recognizes, as well, that human motivation is more complex than neo-classical economics theory posits; many people, perhaps most, at least occasionally sacrifice their own maximum well-being for the good of others.

Moreover, Friedman recognizes that executives must also conform not only to the law but also to rules “embodied in ethical custom.”²⁸ As ethical principles evolve in a society—whether they be greater attentiveness to environmental concerns, employee job security and benefits, product safety, or other considerations, such as better risk management—executives, in Friedman’s view, must conform to them. Business practices in a democracy—like law itself—eventually must reflect underlying social norms and, as with other customs, those practices may change. In 2009 we may be entering a period of fundamental rethinking as to society’s expectations of for-profit businesses. We should invite our students to reflect on and discuss these baseline issues in our corporate law classes. Those students will be key participants in shaping business behavior in the private sector, and perhaps in the public sector, in the years ahead.

The simple point for corporate law professors in law schools, then, is this: We have a responsibility to help our students, who are training to be business lawyers, understand what the law does (and does not) really say about corporate purpose and what new scholarly work has to say about human motivation that challenges the simplistic self-interest view of neo-classical economics,²⁹ and we should identify for them the host of factors shaping current thinking about these key subjects. Only then can they be best-positioned to have both a broad understanding of the corporation’s legal *and* social role, and to provide genuinely sound counsel to future clients. One reason to be optimistic that corporate law professors once again are starting to realize the enduring value of examining corporate purpose is seen in the American Association of Law School’s 2009 Mid-Year Meeting on Business Associations. A plenary session is titled “What Are the Objectives of Public Companies and Who Decides?”³⁰ That is a great and time-

27. *Id.*

28. *Id.*

29. Several articles in a recent collection of works develop this theme in various ways. *See, e.g.*, Robert C. Solomon, *Free Enterprise, Sympathy, and Virtue*, in *MORAL MARKETS: THE CRITICAL ROLE OF VALUES IN THE ECONOMY* 16, 17, 34 (Paul J. Zak ed., 2008); Peter J. Richerson & Robert Boyd, *The Evolution of Free Enterprise Values*, in *MORAL MARKETS, supra*, at 107, 111, 118 (describing a “moral hidden hand” inducing cooperation among humans); Lynn A. Stout, *Taking Conscience Seriously*, in *MORAL MARKETS, supra*, at 157; Herbert Gintis & Rakesh Khurana, *Corporate Honesty and Business Education*, in *MORAL MARKETS, supra*, at 300, 304–06.

30. Conference on Business Associations: Taking Stock of the Field and Corporate Social Accountability, <http://www.aals.org/midyear2009/> (last visited May 22, 2009).

less question—notwithstanding those in corporate law who sought in recent years to marginalize this vital query—and one we should also pose to our students before they pass through the law school “gate.”