Chapman Law Review

Volume 17 | Issue 2

Article 7

2014

Afterword

Tom Campbell
tcampbell@chapman.edu

Afterword

Tom Campbell[*]

Three articles in this symposium (Donald Kochan, Jonathan Macey, and Robert Miller) search for a coherent place for corporate social responsibility (CSR) in today's jurisprudential and economic thought space and fail to find it. One article (Andrew Spalding) claims to have done so.

Professor Kochan's is the first article skeptical about CSR. Professor Kochan uses the Alien Tort Statute (ATS) to demonstrate his position that CSR-oriented plaintiffs, and their lawyers, can best be understood as "rent-seekers." It bears emphasis, however, that Kochan identifies the "rent" being sought as of a different nature than that in the usual law-and-economics example. The telltale is that the ATS plaintiffs' attorneys appear to seek declaratory judgments, creating precedent for future announcements of what the "law of nations" requires; rather than monetary damages for their clients—when the two are in conflict. One can imagine a private settlement with non-disclosed terms being perfectly acceptable to the more traditional rent-seeking litigant, but wholly unacceptable to the ATS plaintiff, because no "messaging" (Kochan's term) would be accomplished by a non-disclosed settlement.

Kochan's article thus points toward an interesting area for future research: How often, prior to *Kiobel*, did an ATS suit settle for terms that were not disclosed, as compared with a measure of any other kind of CSR case? His argument would suggest a statistically significant difference.

In recognizing this likely difference, Kochan raises one other point worthy of discussion: In what sense is rent-seeking to establish international norms of decency by governments different from rent-seeking to transfer influence over corporate behavior to employees, members of the community around the plant, or a broader environmental community? Kochan treats them all the same. Yet, they are different in an important sense:

[*] Dean and Donald P. Kennedy Chair in Law, Dale E. Fowler School of Law, and Professor of Economics, Chapman University.

the CSR plaintiff wants to obtain a role in the direction of on-going corporate behavior. The ATS plaintiff wants to change governmental behavior, and uses the corporation only as a means to that end. One might call them both rent-seeking, but in the sense that one might (in an extreme example) call a religious missionary curing sick people in a third-world country rent-seeking because such behavior is pleasing to the missionary or will earn her or him a place in heaven. Wanting to change the world is different from wanting to take control of a corporation, even if the CSR actor believes the latter can lead to the former.

Professor Kochan's skepticism about the claims of CSR to moral superiority is found as well in Professors Macey and Miller's articles.

In *Corporate Social Responsibility: A Law & Economics Perspective*, Professor Macey makes two fundamental points. The fiduciary duty owed by a corporation to someone diminishes in value if it is owed to more than one person; and shareholders value a fiduciary duty owed to them more than any other claimant because they are residual claimants on what flows from a corporation's activities. As a result, corporate social responsibility should not replace shareholders' monetary interests in a corporation's exercise of its fiduciary duty.

In *Coasean Social Responsibility*, Professor Miller makes one fundamental point. All corporate social responsibility claims are indistinguishable from claims to economic benefit; and, in a Coasean world with low bargaining costs, the efficient outcome will be reached. All else, to Miller, is moral posturing.

Let me turn to Macey's second claim first: that shareholders value a fiduciary duty more than other claimants do. We can apply Miller's thinking to this proposition. In the presence of low bargaining costs, Macey should not need to posit that shareholders value fiduciary duties more than others; because, if others valued them more, they could bargain with shareholders to purchase them. Hence, Macey is either saying he knows all such bargaining would lead to shareholders winning the rights (perhaps at a price), or that bargaining is so expensive, the Coase Theorem cannot apply; and, as a first approximation, according the rights to shareholders is more often a correct expression of how bargaining would result if it were possible.

If the former is what he is saying, then there is no need for corporate law to award fiduciary rights to shareholders; private ordering would do so.

If the latter is what Macey is saying, Miller's analysis challenges it factually. In each instance of a non-shareholder asserted interest, there is a well-defined group presenting claims against the corporation; and in many instances, there are third-party intermediaries who, lacking a claim on the corporation of sufficient monetary importance to compel the corporation's attention, nevertheless serve as monitors for those who do. Accordingly, Macey's entire second claim fits within Miller's conceptual outline.

However, Miller might be wrong. Let us posit very high transactions costs. Then, the law must allocate the fiduciary duty to some group since the groups cannot bid for it among themselves. The origin of Macey's claim, that the shareholders are the right group to possess the benefit of fiduciary duty, stems from a proposition for which he cites Easterbrook and Fischel: that the shareholders, as residual claimants, should have the right to fiduciary duty since they alone have an interest in the entire performance of the corporation, not simply in some part of its performance (such as environmental impact, or working conditions). Environmentalists can specify some level of global-warming gas emissions; labor rights activists can pressure the company to follow the modern day equivalent of the Sullivan principles; but shareholders' interests are by their nature incapable of being so clearly defined. Their interest is for the company to make money; how it does so is not subject to any easy (and thus contractually enforceable) measurement.

There is some circularity to this argument, which runs: shareholders are residual claimants; residual claimants should be the ones to benefit from fiduciary duties; therefore, shareholders should be owed fiduciary duties.

Suppose, however, that the law made environmentalists residual claimants. Then, it would follow, that they should have the benefit of fiduciary duties. Just by speaking of some level of greenhouse gases as a measurable goal, we have not exhausted all the interests of the environmentalist claimants any more than by saying a certain level of earnings per share exhausts all the interests of the shareholders. Companies strive to do more—for their residual claimants. If we were to reverse, by law, the position of environmentalists and shareholders, making the former the residual claimants, and the latter entitled to some level of measured earnings, then a fiduciary duty would be owed to the environmentalists. The way this would be expressed is: a company should manage the reasonable expectations of its financial investors for a return, and then do everything in its power with what is left to improve the environment.

To this I can anticipate the response that I have not really described shareholders, then, but bond-holders, or preferred shareholders, who have some upside cap on their potential earnings. I would agree. But it is in like manner, by describing labor and environmental advocates as having narrow, more easily defined claims, that Macey has by definition excluded them from being residual claimants. Suppose, by contrast, that government structures allowed financial interests in a company to be only of the bond-holder, or preferred stock kind. Suppose, further, the law gave to environmentalist interests the residual right that the company must behave in a way that hurts the environment to the minimal extent possible, consistent with the other claimants' rights, including the specified interest or appreciation of shares owned by those with a financial claim. Macey's logic would proceed to the conclusion that the environmentalists, then, as residual claimants, would have the right to fiduciary duty.

So, the syllogism that the residual claimant has the benefit of fiduciary rights tells us nothing about who that residual claimant should be.

My hypothetical reversal of environmentalists with shareholders is not completely fanciful. In regulated utilities, rate-payers hold a position close to my hypothetical. Shareholders anticipate a reliable dividend but a lower capital appreciation than shareholders in companies not subject to public utility regulation. The public utility commission sets strictures on the company that incidentally limit profit, in furtherance of a goal of providing dependable water, gas, or electricity service. Provided the shareholders receive a reasonable rate of return, the commission might very well say that the public utility's managers must spend residual earnings on improving reliability of service. Who, then, is the residual claimant on the activities of a public utility?

The conclusion I draw is that Miller provides a helpful description of how the Coase Theorem makes claims of corporate social responsibility quite ordinary, expectable, and efficient. Where transaction costs are so high that the Coase Theorem does not apply, Macey provides a helpful description of why the residual claimant should benefit from fiduciary duties. What has not been proven, however, is who that residual claimant should be. This is where the normative aspects of this debate enter. Miller introduces time-honored notions of morality from Kant and Aquinas, to ask whether a corporation reflecting as much corporate social responsibility as the claimants urging it are willing to pay for, is behaving morally. He reaches an agnostic conclusion. Corporations have no souls; they merely facilitate collective action by individuals who do. If consumers, employees, and environmentalists want X amount of corporate social responsibility, and convey to the company the Y dollars needed to bring about X, there is no issue of morality.

Resort to the political world to vindicate corporate social responsibility goals is briefly alluded to by Macey and Miller. I believe the treatment of that aspect of corporate social responsibility should have been more central in the analysis of each author. Laws can, by themselves, make bargaining costs extremely high so as to prevent the Coase-like solution Miller favors.

For example, political groups urge laws to compel corporations not to pay employees an amount below a certain minimum wage. Many individuals are willing to work for a lower wage, but it is forbidden. Some then go without jobs because they lack the skills necessary to command a wage above the minimum. Yet, we have enacted minimum wage laws for a long time—because, it is claimed, they are just. There is nothing logically different between this historic fact and the same politicians enacting laws to make employees the residual claimants on a company's earnings—because it would be just. The American labor movement is replete with claims that a job is owned by the person who works it, and European land reform with the claim that land is owned by the person who tills it. What are each of these claims other than an assertion of residual claimant status?

The answer for both Miller and Macey, and for me, has to be positive rather than normative. CSR is to be rejected if society will have less total output, of everything it values, when residual claimants are other than investors. We might still prefer to sacrifice some total output, to achieve what many consider a more just society; but we should do so in an informed way. The advocates for redistribution of income through steeply progressing income taxes appear willing to accept less total output for what they would consider more justice. Occasionally, some try to argue that a lower Gini coefficient (more evenly distributed income) induces more economic growth, and, once on that ground, I am content to allow application of unbiased statistical research decide the outcome. What is intractable, however, is that a concept of one person's (or a majority of voting persons') sense of what is fair is worth sacrificing a greater pie for all. The virtue of articles like Macey's and Miller's is to force to the front the reality that that is, indeed, the fundamental question of corporate social responsibility. If that explicit trade-off is not at issue, corporate social responsibility holds no different place than an interesting, and occasionally difficult to measure, element of profit maximization.

Up to this point, the articles I have reviewed present a universal treatment of CSR as being entitled to no special intellectual or moral standing. Professor Spalding tries to even that out.

In *The Problem of Deterring Extraterritorial White-Collar Crime*, Professor Spalding suggests a new role for corporate social responsibility. He suggests appeals to CSR could solve a failure he sees in neo-classical economic analysis to prescribe effective deterrence in the case of extraterritorial white-collar crime statutes.

The problem Spalding takes on is, indeed, interesting and timely. The United States has, since at least the Lockheed scandal of the 1970s, been attempting to limit bribery by companies subject to American jurisdiction in overseas markets. The 1977 Foreign Corrupt Practices Act represents the statutory enshrining of that effort. American firms have long complained that application of such rules to their activities in foreign markets simply hands contracts to their competitors from other countries, which do not have an equivalent of the Foreign Corrupt Practices Act. American firms lose out and less "ethical" foreign firms win, while the amount of evil activity in the foreign (host) country stays the same.

The foregoing dilemma is described by Spalding as "investor substitution." The investors (or contractors) from the less ethical country substitute for the investors from the country trying to impose a moral code on its own nationals' behavior. Spalding also offers the concept of a "discretionary investment forum"—companies under the jurisdiction of the country attempting to impose an ethical code can choose simply not to make their investment or sales activities in the countries where ethical risks exist. This is the self-selection component of the first phenomenon Spalding describes, and it leads to the same result. Whether because companies from countries that do not impose ethical standards outbid them in the host country, or whether the risk of incurring legal liability by even entering the host country is costly, either way, there is less activity by the companies of the country trying to impose an extraterritorial moral code.

This situation is troublesome. It stems in each case from the absence of a single governmental regime: one country prohibits unethical behavior in a host country, and another does not, a characteristic Spalding calls "selective criminalization." If all countries followed the same rules, or, more simply, if the host country set a standard of behavior at least as high as the most demanding foreign country, the problem Spalding identifies would not occur.

There is a prisoner's dilemma operating here. The companies of the country setting the highest standard on its own nationals will lose out the most, unless a single regime obtains for all companies. One can expect political resistance, accordingly, to any effort to adopt an equivalent of the Foreign Sovereign Corrupt Practices Act in any country that currently lacks a counterpart of it.

In this, Spalding sees a new role for corporate social responsibility, which he argues can create international pressure for uniformity of rules. I do not see this as novel. It is the standard reply to the prisoner's dilemma problem. Where each country would benefit from eliminating bribery by its national firms that carry on business in foreign countries (Spalding's consistent example), but the first country to try to do so will lose business, all governments have an incentive to reach a treaty to eliminate bribery, and enforce the ban. Bribery distorts productive efficiency. The best briber, not the best manufacturer, wins in the exporting country. And in the host country, bribery denies consumers the benefits of market rents, directing them instead to those who have won non-market contests (by getting into political power).

Analogously, this is why countries apply diplomatic efforts to arrive at tax treaties, and why they have succeeded in doing so. At first, it might seem that a country sacrifices revenue by not taxing all international earnings of a transnational company with some tie to that country; but if all countries asserted such authority, international commerce would be depressed. So, countries work out neutral and transparent rules for allocating international earnings to be taxed among the several countries that could claim to tax the transnational company's operations, so that companies are not subject to multiple taxation exceeding 100%, or, ideally, the marginal rate of the highest taxing jurisdiction.

The same is true with most corporate social responsibility goals; and we can recur to Miller's article to make the case that such goals can be fit within a Coasean framework. It is certainly the case with eliminating bribery.

Other corporate social responsibility goals might fit less readily, such as the desire to enforce an international minimum wage. There, the host country would suffer a loss of its comparative advantage (a cheaper workforce), and so, along with other third world countries, might not agree to the universal rule. Solving the prisoner's dilemma problem for social goals not economically beneficial to all countries (even if universally adopted) might call on an extra-market effort to change perceived national self-interests. But that is not the example Spalding has chosen. Economic crime by corporations, bribery in particular, is his example, and it fits comfortably in the law and economics modality.

In one part of his article, Spalding attempts to prove too much. This is his attempt to prove the theoretical possibility that over-deterrence will actually lead to more law breaking in the host country. To reach this result, Spalding needs a critical assumption: that for country A attempting such laws, there is also a country B, whose companies are willing and able to sell into the host country, and replace country A's nationals. If there is no such country B, then the desire of country A to diminish bribery by its own nationals in the host country would succeed. In several highly sophisticated industries, military aircraft, for instance, there is often no country B to America's country A, or one with only limited capacity and reliability. American-made F-16's compete with French Mirages in the market to sell fighters to the third world, but there is no other supplier in a practical sense; and in the eyes of those more expert than I, the Mirage might no longer compete. In that situation, the U.S. Foreign Corrupt Practices Act could, indeed, have the desired effect of reducing bribes. If Lockheed Martin, the F-16's manufacturer, will not pay bribes, and the Mirage is not considered a close substitute, there will be fewer bribes with more enforcement of the Foreign Corrupt Practices Act than with less. Spalding's case could not apply.

Where it could apply, however, Spalding needs a second critical assumption, which he does not make explicit. Further, I believe it to be an implausible assumption.

For illustrative purposes, Spalding posits an iterative process. The world starts with no extraterritorial ethics laws, and a certain amount of bribery exists in a particular host country. In the second time period, one exporter's country develops such laws, and the amount of bribery drops. In a third time period, that exporter's country stiffens its law, and the amount of bribery increases—though to a level still less than the original level. To make that interesting result work, Spalding needs to have the firm subject to the extraterritorial law continue to make bids, some with bribes, and some without. As it loses market share to firms from the other exporting country, all of whose companies pay bribes, the entire amount of bribery in the host country rises.

A bundle of bids with and without bribes is supplanted by a bundle of bids entirely with bribes.

However, it is not logical to assume that the companies subject to the extraterritorial law will make some bids with and some without bribes. More likely is the outcome that every bid will always carry a bribe, but that the companies who are nationals of the country attempting to apply extraterritorial ethics laws will make fewer bids—hoping not to get caught. It would be striking if any company would choose to compete with another company where the other paid bribes and it did not. So, if that is the case, the stiffening of sanctions for extraterritorial bribery will shift market share to the companies from a country without such laws, but the overall number of bribes will stay the same.[2]

Spalding does not need to prove this point for his main conclusion. He need not prove that bribery will go up with more law enforcement of the extraterritorial kind. He need only prove it will not go down. To prove the latter, he is on much safer ground.

However, he still has not proven any claim to CSR's moral superiority. The role for corporate social responsibility Spalding champions has validity wherever collective goods theory would apply: where a regime is better for all, but harmful to a sole adapter. Existing law and economics analysis is well able to handle that case. International efforts to universalize prohibitions against bribery can lead to an efficient outcome by solving the prisoner's dilemma. There is nothing "CSR" about that conclusion. Like duplicate taxation of earnings, allocating contracts by personal bribes is economically inefficient. Suppressing bribery is in the general interest, not because it is socially responsible, but because it is economically efficient.

The articles in this symposium focus on whether there is any intellectually coherent content to a claim of corporate social responsibility. Spalding attempts to claim so, but his case is one of economic efficiency, not CSR moral superiority. Miller and Kochan defend the view that CSR has no superior claim to shareholders' interests. Macey attempts to go further: to prove that CSR is always a wrong way to allocate corporate rights, but his argument contains circularity about the residual claimant being the shareholder. It thus devolves into a claim that the shareholder is most often the efficient residual claimholder in the

2 I assume that there is no increasing cost function to making offers for contracts, so that shifting market share from one kind of bidder to another will not increase the overall cost of making offers.

presence of high transactions costs. That may be true, but was not proven.

To take wealth from others to increase one's own wealth is rent-seeking. To do so at the cost of overall efficiency is rent-seeking and wasteful. To do so because one claims a higher morality than another is judgmental in the highest degree. Nevertheless, on occasion, that is what law is called upon to do. What else is the "law of nations," to take Kochan's example, but a code of behavior that purports to be morally superior to the behavior of uncivilized peoples? The import of the articles in this symposium is that we should be quite cautious before granting such a claim of moral superiority to overcome what a reasonably free market might otherwise order.