The Shareholder's Role in Corporate Social Responsibility

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THE SHAREHOLDER'S ROLE IN CORPORATE SOCIAL RESPONSIBILITY

I. INTRODUCTION

In The Modern Corporation and Private Property, Professors Berle and Means concluded that the corporation should serve the interests of all society and not solely the interests of its shareholders. This concept was a break from traditional corporate theory and the beginning of the theory of corporate social responsibility. The purpose of this article is to assess the modern shareholder's role in the implementation of this doctrine.

Because Berle was one of the first to consider the role of the shareholder in enforcing the corporation's responsibility to society, this article will begin with a brief review of his ideas with respect to this problem. The writings of other scholars in the corporate area will then be examined to discover their assumptions regarding the shareholder's interest in the modern corporation and their conclusions regarding the shareholder's role in enforcing corporate social responsibility. Finally, the validity of these assumptions and conclusions will be analyzed in the light of recent developments in the area.

II. BERLE: THE EARLY DOCTRINE

In 1932 Berle and Means proclaimed the separation of ownership and control in the modern corporation. From this premise the authors reached two related conclusions. First, because of the wide dispersion of stock ownership shareholders could no longer be certain that the corporation would run primarily in their interest. Because the shareholder was now unable to enforce his

1 A. Berle & G. Means, The Modern Corporation and Private Property (1932) [hereinafter cited as The Modern Corporation].

2 This article is not primarily concerned with the economics of the corporate system; rather, its primary focus is the social and political power of large corporations. Although some authors have been critical of corporate reformers who ignore economic considerations in their discussions of corporate power [See Manne, The 'Higher Criticism' of the Modern Corporation, 62 Colum. L. Rev. 399, 430 (1962)], the better view is that the social and political powers of corporations, although perhaps the results of economic power, are problems in themselves and should be addressed as such. See Adelman, The Two Faces of Economic Concentration, 21 The Public Interest 117, 126 (1970):

Perhaps bigness is much more important, sociologically or politically, than is revealed by measuring economic quantities to understand market facts. If that is the case, it should be studied directly, and not be confused with economic concentration, a market phenomenon.

3 The Modern Corporation 4.
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demands, management had assumed a position of absolute power. Second, the separation of ownership and control changed the concept of property. Berle believed that in the past ownership of a business enterprise had always involved both risk-taking and management responsibilities. However, in the modern corporation the shareholder had become solely a risk-taker, leaving the management of the enterprise to the directors and/or officers.4 The shareholder was now the owner of what Berle termed "passive property."5 When the shareholder lost control and responsibility over his property, he also lost the right to demand that the corporation be operated in his sole interest. Having been released from shareholder control, the corporation was now free to serve the public interest.6

This was clearly a break from traditional corporate theory under which management was required to seek maximum profits for the benefit of the corporation's shareholders.7 This expectation of maximum profit had served not only as the unifying interest between corporate investors and managers but also as a legal standard against which courts could measure management performance.8

Although Berle was certain that the profit-maximization theory could be abandoned because the shareholders were no longer entitled to be the sole beneficiaries of the corporate trust, he was uncertain about the abandonment of profit maximization as a legal norm. Thus, when Professor Dodd asserted that management should act as a trustee for both the shareholder and the public,9

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4 Id. at 338.
5 Id. at 346-347.
6 Id. at 355-356.
7 For a discussion of the traditional theory see Manne, Current Views On The 'Modern Corporation,' 38 U. DET. L.J. 559 (1961). In Manning, Book Review, 67 YALE L.J. 1477 (1958) the author asserts that the proper function of managers is to maximize the economic position of shareholders and nothing else." In terms of modern corporate literature, Manne admits that his position "approaches the radical." Manne, note 7, at 573.
8 For a strong argument in favor of the retention of profit maximization as a legal norm see, Rosiow, To Whom and for What Ends Is Corporate Management Responsible?, in The Corporation in Modern Society 46 (Mason ed. 1960).
9 Professor Dodd had advanced the view that corporations have a social responsibility as well as a profit-making function. See Dodd, For Whom Are Corporate Managers Trustees?, 45 HARV. L. REV. 1145 (1932). He had also found that management was "free from any substantial supervision by shareholders . . .," and that managers, in fact, did not act as though maximum stockholder profit was the sole object of their activities. Id. at 1147. Thus, with management and public opinion recognizing a corporate social responsibility, Dodd concluded that management should be the trustee not only of the shareholders but also of the public. Id. at 1148. In asserting this view, he criticized Berle's earlier position, expressed in Corporate Powers as Powers In Trust, 44 HARV. L. REV. 1049 (1931), that management should act in the sole interest of the shareholders, and declared that management instead should be freed of the traditional profit-maximization norm. 45 HARV. L. REV. at 1148.
Berle responded that Dodd's assertion was based upon abstract theory, admitting, however, that he had previously subscribed to that view. Berle had now concluded that the traditional legal norm of profit maximization could not be abandoned until a clear and enforceable scheme of responsibility to someone else developed.

Nevertheless, in 1954, Berle discovered that corporate management has assumed a social responsibility. Citing *A.P. Smith Mfg. Co. v. Barlow*, where the New Jersey Supreme Court held that the Company directors' $1,500 contribution to Princeton University constituted legitimate corporate action, Berle declared that management was no longer bound to the legal norm of profit maximization and conceded that Dodd had won the debate. Berle later stated that by 1954 he had realized that because of the threat of government intervention management was forced to take a business statesmanship position and that the focus of public opinion had led management to become more trustworthy and develop higher standards of conduct.

Berle knew that this was a departure from the traditional theory of profit maximization. But in supporting his business statesmanship position against attack by traditional theorists, Berle claimed that by being forced into the social statesmanship position, management was concomitantly forced to deviate from the profit-maximization norm. That management might be unfaithful to its shareholders in assuming its new position did not alarm Berle, for, as he had earlier suggested, stock was merely passive property with no responsibility of, or right to, ownership.

Probably one of the most widely accepted explanations for

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13 The court stated that "corporations acknowledge and discharge social as well as private responsibilities as members of the communities in which they operate." 13 N.J. 145, 154, 98 A.2d 581, 586.
14 BERLE, supra note 11, at 169.
16 Id. at 437.
17 As Berle stated:

In assuming responsibility for certain aspects of community life, in making gifts to charity, in playing any role in economic statesmanship not dictated by market considerations, the corporate management traitorously departs from the discipline of seeking the highest possible profit, regarded by classicists as the motive driving all into court of the "free market"—the supreme and beneficient arbitrator.

18 Id. at 442.
19 Id. The Modern Corporation 346–347.
Berle's change of position begins with his concern over the absence of machinery, legal or otherwise, for enforcing a legitimate community demand determinative.\(^{20}\) In replying to Dodd in 1932, Berle had expressed his fear that if management were no longer controlled by the legal norm of profit maximization, it would attain a position of absolute power, especially since there was no alternative scheme of effective control. However, one of the predominant themes of \textit{The Modern Corporation} was that through the dispersion of stock ownership shareholders had become so impotent that managers had attained a position of absolute power. Thus, if Berle believed that management was in economic fact no longer subject to shareholder demands for profit maximization, he had little ground to assert that the loss of the legal norm of profit maximization would result in any further loss of control.

Nor can it be said that Berle's change of position resulted from the development by 1954 of an alternative scheme of control. Public opinion can hardly be called a clear and enforceable scheme of responsibility to community demands.\(^{21}\) However, apart from the threat of government interference, Berle suggested no other enforcement machinery.\(^{22}\)

To this writer, the key point of dispute between Berle and Dodd appears to have been over what corporate managers in fact did. Because Dodd believed that managers assumed a social responsibility position and that public opinion supported that position, he concluded that management should be freed of the profit-maximization norm in order to pursue it. Berle, on the other hand, while believing that corporations owed a duty to the public interest, found that management had not assumed such a role and therefore concluded that the traditional norm would have to be applied until either the courts or the community forced management to assume such a role. When in 1954 Berle found that


\(^{21}\) In responding to Berle's belief in the "higher standards" of managers as a means of social control, Professor Kaysen notes:

\begin{quote}
It is sufficient to remark that there is, at least as yet, neither visible mechanism of uniform training to inculcate, nor visible organization to maintain and enforce, such standards. \ldots
\end{quote}


\begin{quote}
This is not to suggest that we have reached first-rate solutions. Planning, stabilization, continuity, and provision for the future can be better taken care of than they are now.
\end{quote}

Berle, \textit{supra} note 15, at 443.

\(^{22}\) Berle later stated that he opposed Dodd simply because he thought management was not qualified to assume a social responsibility in 1932. Berle, \textit{supra} note 15, at 443.
managers had assumed the business statesmanship position, the debate ended.

Thus, Berle's change in position may have been merely an admission that managers do make decisions affecting the public interest, that corporate directors do make decisions on social and moral grounds,\(^2\) and that the only effective means of controlling these persons is public opinion.

To assert that the main dispute between Berle and Dodd was whether managers in fact assumed a business statesmanship position is not to reduce a great legal debate into a sophomoric squabble. One of the key aspects of the current debate over the means of enforcing corporate social responsibility concerns the nature of the shareholder's interest. Depending upon whether the shareholder is in fact solely interested in profits or is also concerned with the social power of corporate management, the shareholder's role in a scheme of corporate social responsibility will be radically different.

III. THE SHAREHOLDER'S ROLE IN CORPORATE POLICY-MAKING

In 1932, when Berle recognized only the legal norm of profit maximization, the shareholder was not included in any proposed scheme of social responsibility. Believing that management had not yet assumed a business statesmanship position and finding managers to be untrustworthy and unqualified, Berle was willing to wait until a group outside the corporate framework could effectively present their claims and have them enforced.

When Berle later recognized that management had assumed a business statesmanship position, he acquiesced in its assumption of this role. In so doing, he changed many of his earlier assumptions. Managers were now more trustworthy, more qualified, and were legally freed of the profit-maximization norm.\(^2\) Implicit in

\(^{23}\) Berle, *supra* note 15, at 444:

The fact is that boards of directors or corporation executives are often faced with situations in which quite humanly and simply they consider that such is the decent thing to do and ought to be done. . . . They apply the potential profits or public relations tests later on, a sort of lefthanded jursification in this curious free-market world where an obviously moral or decent or humane action has to be apologized for on the ground that, conceivably you may somehow make money by it.

\(^{24}\) The fact that managers were capable of assuming the role and were legally free to do so did not answer Berle's question: "Why do these men have decision making power rather than someone else?" Berle, *supra* note 15, at 444. Berle could only answer that managers have assumed this role, and it works fairly well. Thus, he concedes that Manne correctly asserted that "Berle has legitimized them on the firing line, so to speak, by finding that they are performing their social function well and that that is sufficient." Manne, *supra* note 2, at 418.
Berle’s acquiescence must have been the belief that there was still no method by which a group outside the corporation could present its claims. A “clear and enforceable scheme of responsibilities to someone else” never materialized.

In retrospect, Berle is probably more correctly characterized as a “managerialist.” His concern over the uncontrolled power of management and his fear of freeing management from the profit-maximization norm were replaced by the knowledge that managers had become business statesmen and that their power to act in the public interest had been realized. At the same time, the shareholder had become unimportant, for he no longer assumed responsibility for or control of the corporate enterprise, his only risk was that his shares would make or lose money, he was no longer relied on for a supply of capital, and the corporate elections in which he participated had become a mere ritual. It is not surprising that the shareholder should have no role in a scheme of social responsibility, when it is doubtful that he has any impact on the corporation at all.

Since the shareholders were thought to be the owners of the corporation, Berle’s assessment of their role was reached through the application of traditional property concepts. Under this approach the shareholders failed miserably, and Berle concluded that they no longer deserved to be the sole beneficiaries of the corporate trust. His conclusion was, in effect, that shareholders were not owners of the corporation but merely owners of shares.

It is here that Berle’s logic breaks down. The shareholder’s interest in the corporation cannot be determined by applying property concepts. If shareholders are not the owners of the corporation they cannot be condemned for failure to assume the risks of operating the enterprise. If they are merely owners of

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25 See Eisenberg, Legal Roles of Stockholders and Management in Modern Corporate Decision-Making, 57 CALIF. L. REV. 1, 21 (1969). In discussing those who are concerned with the political and social power of corporate managers, Eisenberg has classified their reform programs, including their proposals regarding the shareholder’s role, into three schools of thought: shareholder democracy, client-group participation, and managerialism. Id. at 15-27.

26 In THE MODERN CORPORATION, Berle found that although the large corporations reinvested their earnings, such reinvestment only furnished a quarter of their growth, while the “bulk of their growth came almost entirely from new issues of stock or other securities.” THE MODERN CORPORATION 280. However, later Berle noted that out of an aggregate of 150 billions of dollars spent for capital expenditures between 1946 and 1953, only 6 percent was raised by the issuance of stock. Berle, supra note 11, at 39. Indeed, Berle subsequently stated:

In fact, if the stock market shut down completely (as it did in 1914), or if all of their stock were miraculously wiped out, it would not have a great effect on their operations, though it might have tangible effect on the number of buyers ready, willing, and able to buy their cars or washing machines.

Berle, supra note 15, at 446.
shares they have fulfilled the ownership function by assuming the risk of loss of their capital investment.27

Nevertheless, the shareholders' rights and interests, not as owners of the corporation, but as the owners of shares, have received legal sanction. When a person buys a share he is given certain rights which are set out by the corporate charter, the statutes of the state of incorporation, and the federal securities acts and regulations. Thus, to conclude that under property theory shareholders have no rights or interests in the corporation as owners does not necessitate the conclusion that they have no interest in the corporation at all.

Whether the shareholder should be allowed to participate in a scheme of corporate social responsibility is another matter. Under a property theory there is no justification for such participation—the shareholder has no interest in the corporation. Berle at one time argued that the general community should be able to present their demands to the corporation; and there are those who continue to claim that consumers, workers, and other such groups should be allowed to participate in corporate decision-making.28 Again, this cannot be justified on a property theory. This is not to say that there is no means available for presenting certain types of claims and of having them enforced, for it would seem an obvious point, especially to one believing in a wide dispersion of stock ownership, that a group of consumers or workers could purchase a single share and use the available statutory machinery to present their claims.

Berle, however, failed to consider this point because he assumed that shareholders were only interested in profits. In The Modern Corporation he stated that the shareholder had only two interests: the return on his capital, and the return of his capital.29 While Berle was willing to allow the consumer to participate in enforcing corporate responsibility, once the consumer purchased a share he was disqualified, for then he became a shareholder who was only interested in profits. The roles of manager, shareholder, and non-shareholder were mutually exclusive.

Berle is not alone in his definition of the shareholder's interest and his conclusion as to his limited role in enforcing corporate responsibility. Professor Manning, by adhering to the same definition, has reached the same conclusion.30 Manning begins by stat-

29 The Modern Corporation 121.
30 In advancing his position that the corporate constituency should be expanded to
ing the problem as one of uncontrolled power in the hands of managers. However, he does not believe that the solution rests in increasing shareholder power and control. Noting that in 1932 Berle and Means reported an unchecked management and impotent shareholder, Manning claims that after twenty-five years of "reform" by the Securities and Exchange Commission nothing has changed. Thus, shareholder democracy is not the answer because it hasn't worked, and one of the reasons it hasn't worked, Manning believes, is because the shareholder's sole interest is profit maximization and not good management. The disenfranchised shareholder is relevant to the issue of corporate responsibility only if one can assume that once shareholders regain power they will control management for the benefit of all society. However, since shareholders and the rest of society have different interests regarding the operation of the corporation, Manning finds no grounds upon which to make this assumption. He therefore criticizes the shareholder democrats for diverting attention from the real problem of holding business managers to a desirable standard of responsibility and at the same time perpetrating a fraud upon the public by leading them to believe that management is responsible to the shareholders when, in fact, it is responsible to no one.

Although Manning concludes that shareholders should play no role in enforcing corporate social responsibility, he does not share Berle's faith in management's assumption of the role. Instead, Manning takes a cautious view of the Barlow case and the concept of non-business charitable contributions. Viewing the problem as how to control an uncontrolled management, he does not find the solution in allowing managers to assume a business statesmanship position, because he believes that "[t]he new enthusiasm for the concept of corporate good citizenship is likely to increase this power further." Therefore, management should be held to a

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include groups other than the shareholders, Chayes does not assert that such groups are entitled to representation as owners or under a theory of property interests. Instead, they have a right to participate in corporate decision-making because they have a "significant common relation to the corporation and its power." Chayes, supra note 28, at 41.

32 Id.
33 Id.; As with other shareholders, the primary interest of the investment fund must be income and profit-taking—not the abstraction of good business management.
35 In this regard, Manning is not alone. See Eisenberg, supra note 25, at 180 - 181: There is no reason to believe that present-day management would use in-
clear and enforceable standard of responsibility like the traditional norm of profit maximization.

The shareholder democrats whom Manning so vigorously attacked also assume that the shareholder's sole interest is profit maximization. Professors Emerson and Latcham, two of the most fervent supporters of shareholder democracy, state that the shareholder's interest is purely economic and conclude that the SEC regulations do a fairly good job in protecting this interest. They concede that the social consequences of corporate policies are beyond the scope of the proxy machinery and the shareholder's interest but contend that a "liberal view" should be taken to allow shareholders to consider the social effects of corporate decisions and policies. This seemingly conflicting position is in part due to the shareholder democrat's great concern with keeping control within the corporate structure. Thus, Emerson and Latcham state:

A liberal view of the issues which stockholders may consider does mean that these problems may receive attention from a group with a much broader social background and objectives and, yet, a group which is still within the corporate context. Otherwise, some group outside the corporation—notably a governmental agency—may be called upon to supply the broader outlook.

Therefore, even if the shareholder's interest is purely economic, he should still be allowed to participate in non-economic decisions rather than allowing the government or someone else to exercise the control. This position is also in line with one of the basic tenets of shareholder democracy, that is, shareholder participation is in accord with the goals of a democratic society—a belief which Manning expressly rejects.


Manning, supra note 31, at 1494.

Manning also proposed an extension of the business judgment rule to provide managers with the broadest latitude in making business decisions and full disclosure to aid the shareholders in deciding whether to sell their shares or sue for breach of management's profit-maximization responsibility. As a further safeguard, he suggested an administrative board to protect the shareholder's interests, and a system providing shareholders with an easy means of withdrawing their shares. Manning, supra note 31, at 1490-91.

F. Emerson and F. Latcham, Shareholder Democracy 149 (1954):

Shareholders are, of course, interested in their problems as shareholders, that is, in dividends, the value of their securities, and the protection of their proprietary interest.

Id. at 150.

Manning, The Shareholder's Appraisal Remedy: An Essay For Frank Coker, 72
However, Emerson and Latcham run into further difficulties with their assumption of the shareholder's interest. The authors conclude that the "Wall Street Rule," which provides that the shareholder can best influence corporate policies by selling his shares if he becomes dissatisfied with management's policies, is an effective method of shareholder control.\textsuperscript{41} They recognize that there are many flaws in the rule, such as the limitations on the ease of withdrawal, but fail to state the greatest and most apparent flaw. That is, assuming that the shareholder is only interested in pecuniary gain, he will never sell his shares despite his opposition to management policies if they are making a profit.

In any event, the shareholder democrats conclude that shareholders should have a role in a scheme of corporate social responsibility, regardless of whether their interest is solely economic. They believe that the proxy regulations, although presently too limited, can be used as a proper and useful means of representing the interests of consumers and the general public.

Perhaps the corporate reformers who are most disadvantaged by their assumption of the shareholder's interest are those whom Eisenberg characterizes as expounders of "client-group participation."\textsuperscript{42} This group of reformers, led by Professor Chayes,\textsuperscript{43} claims that shareholder democracy is a sham, because the shareholders are not under the control of the corporation to the same degree as other groups, such as consumers and suppliers. Like Manning, they argue that if corporate goals conflict with national and public goals, increasing shareholder power will not resolve the conflict, because shareholders, \textit{qua} shareholders, are not concerned with national goals but only with profits. Therefore, they contend that an effort should be made to "democratize" other groups to allow them to participate directly in business decisions affecting the public interest.

As Eisenberg had conceded, the greatest problem facing these "corporate democrats" is how to achieve the direct participation

\textsuperscript{41} F. Emerson and F. Latcham, \textit{ supra} note 38, at 151.

\textsuperscript{42} Eisenberg, \textit{ supra} note 25, at 16.

\textsuperscript{43} Chayes, \textit{The Modern Corporation and the Rule of Law}, in \textit{The Corporation in Modern Society} 25, 42-45 (Mason ed. 1960).
of social groups in business decisions.\textsuperscript{44} One of the many obstacles in setting up such a plan involves determining the constituency of each group. As an example, Eisenberg notes that General Motors would vote in Greyhound as a supplier and in United States Steel as a customer. A related problem is the fact that many of the groups are interrelated. Thus, one individual or institution could be both a supplier and consumer of the same corporation.\textsuperscript{45}

Most importantly, however, the corporate democrats are handicapped in the implementation of their theory by their assumption that shareholders are solely concerned with making profits. If they did not assume that a consumer of supplier lost his identity as such upon becoming a shareholder, the greatest obstacle—the lack of a scheme of implementation—could have been circumvented by directing attention to the SEC proxy machinery and regulations and the legal norms regulating shareholder participation.

By assuming that shareholders are only interested in profits, all corporate reformers have been hindered in their efforts to control the social and political power of managers. The assumption has led them either to acquiesce in a more powerful management, to reject the theory of corporate social responsibility entirely, or to continue to search for an alternative scheme of presenting community demands. With the exception of the shareholder democrats, all have concluded that the shareholder has no role to play in enforcing the corporation's social responsibility.

IV. REASSESSMENT OF THE SHAREHOLDER'S INTEREST

A. The Factual Assumption

Recent efforts of certain shareholders have made it clear that not all shareholders are solely concerned with profit maximization. An example is the dispute between the Medical Com-

\textsuperscript{44} Eisenberg, \textit{supra} note 25, at 18.

\textsuperscript{45} \textit{Id.} The question arises, why divide into groups at all; if all society is affected why not let all society participate? In this regard the state, as the entity best able to define the goals of the public interest, could select the appropriate representatives. Vagts has made an extensive study of the experiences of foreign governments in trying to extend the corporate constituency. Vagts, \textit{Reforming the 'Modern' Corporations: Perspectives from the German}, 80 HARV. L. REV. 23, 64-87 (1966). His conclusions concerning Germany's experience in allowing public participation in corporate management is that the government representatives have failed to produce any substantial changes in corporate policy. \textit{Id.} at 85. The government representatives, instead of regulating the corporation, have become regulated by it. Thus, Vagts declares that:

On the whole, one is inclined to believe that a more rational and orderly
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The Committee became a shareholder through a gift of a number of shares in Dow Chemical Company. At that time, the company had a defense contract to manufacture napalm for use in the Vietnam War. Because the manufacture and use of such a product conflicted with its ethical goals, the Committee submitted a proposal requesting the board of directors to propose an amendment to the corporate charter prohibiting the company from further production of napalm.

The efforts of the Committee to have its proposal included in the company's proxy material cannot be squared with the assumption that the shareholder is only concerned with dividends and profits, for the Committee was not motivated by a purely economic interest. In a letter addressed to the Secretary of Dow Chemical Company, the national chairman of the Committee stated that "our objections to the sale of this product are primarily based on the concerns for human life inherent in our organization's credo." He went on to state that the organization also believed that the manufacture of napalm was bad for the company's business and was adversely affecting its public image; however, these were merely secondary reasons for urging the adoption of the proposal. Regardless of whether the Committee expected to make a profit on their shares, it did not lose its identity as a human rights organization upon becoming a shareholder.

Another example of shareholders whose sole concern was not with profit maximization is the Project on Corporate Responsibility. The Project, referring to it as "[a] newly formed organization which will explore methods by which corporations can be made more responsive to public and social needs. . . ." sought to have nine proposals included in General Motors' proxy materials at the annual shareholders meeting in 1970. The proposals con-

development of economic law is apt to be achieved by pursuing the American pattern of open regulation rather than the German form of operating through undisclosed negotiations between private and public representatives.

Id. at 87.


47 Id. at 432 F.2d 662.

48 Id.


51 The proposals were submitted by the Project pursuant to Rule 14a-8 of the proxy
cerned such matters as amending the corporate charter so that none of the purposes could be implemented "in a manner which is detrimental to the public health, safety, or welfare," expanding the board of directors to permit the addition of "public representatives," and creating a "Special Committee for Corporate Responsibility" to study the manner in which corporate decisions are made and assess the possible adverse social impact of corporate activities. Six other proposals relating to specific areas, such as mass transportation and air pollution, were not included in the proxy materials because they were not proper subjects under state law for action by security holders.

In light of the goals of the Project and the substantive impact of the proposals, it is clear that the Project was not chiefly concerned with either the corporation's or its own economic position. Instead, the Project, as a shareholder of General Motors, was concerned with the social responsibility of that corporation. In submitting its first three proposals, the Project stated:

Both as shareholders and as members of the public we have been concerned about the myriad ways in which General Motors' decisions affect the lives of virtually all Americans—in areas ranging from auto safety to repair bills, environmental pollution, minority employment, and worker health and safety.

The Medical Committee for Human Rights and the Project on Corporate Responsibility are only two groups of shareholders who have demonstrated an interest in the social consequences of corporate decisions. Another such group is a coalition of black,

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rules of the SEC which requires management, subject to certain exceptions, to include such proposals in its proxy materials along with a supporting statement by the shareholder of one hundred words or less. 17 C.F.R. § 240.14a-8 (1969).

52 Proxy Statement, Campaign To Make General Motors Responsible (March 25, 1970).

53 General Motors decided not to include these proposals in its proxy materials on the grounds that they were submitted "primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes" and were not "proper subjects" under state law for action by security holders, and were thus excludable under Rule 14a-8(c)(1)(2). This decision was supported by the SEC when it advised General Motors that it would take no action if the proposals were omitted from management's proxy materials. Letter from Charles R. Shreve, Director, SEC to George Wm. Coombe, Jr., Secretary General Motors Corp. (March 10, 1970).

54 Letter from Mr. Geoffrey Cowan to Mr. Edward B. Wallace, Feb. 6, 1970, reprinted in 116 CONG. REC. E1267 (daily ed. Feb. 24, 1970). A further indication of the Project's motives can be taken from the proxy statement of the Campaign to Make General Motors Responsible. Here, the purpose of the solicitation was declared to be to provide shareholders with the opportunity to consider various proposals "designed to make the Corporation more responsible to the community as a whole." Proxy Statement, Campaign To Make General Motors Responsible 2 (March 25, 1970). Campaign GM also noted that "It is possible that adoption of these proposals could cause a reduction in the corporation's profits." Id.
Mexican-American, and women's groups in California calling themselves Responsible Corporate Action. Upon conducting a survey of the decision-making structures of the sixty-seven largest California corporations, the coalition discovered that none of the corporations' 1,008 directors were either black or Mexican-American. And, although six of the 1,008 directors were female, three were married to the president of chairman of the company, and one was the daughter of the company's founder. Responsible Corporate Action has announced that it will avail itself of shareholder movements, such as Campaign G.M. to achieve its goal of persuading the "California-based corporations that 25 percent of their directors should represent blacks, Mexican-Americans and women—who, when combined, make up 61 percent of the state's population."\textsuperscript{55}

Although it is perhaps too early to state that there is a trend toward a greater social concern among shareholders regarding the consequences of corporate decisions, it is at least clear that many groups, concerned with the uncontrolled social and political power of managers, are turning toward the shareholder's position as a possible solution.\textsuperscript{56} For those who are unwilling to acquiesce in management's assumption of the business statesmanship position, who are unwilling to rely on governmental regulation, and who cannot wait until an alternative method of enforcement is established, the shareholder's position and the SEC regulations are the only realistic means of presenting their claims.\textsuperscript{57}

It has been contended that the Committee and the Project submitted their proposals not because they were concerned with such issues as shareholders, but because they were concerned primarily as citizens or members of certain groups. In arguing against the inclusion of the Project's proposals before the SEC, the attorneys for General Motors asserted that the Project became a shareholder solely "for the purpose of making the Proposals and for the primary purpose of promoting its public goals."\textsuperscript{58}

\textsuperscript{56} For a list of the larger corporations which have been confronted by "[d]issident shareholders who questioned not profit performance but the social impact of the company's activities," see Schwartz, \textit{supra} note 49, at 422.
\textsuperscript{57} As Schwartz states:

\begin{quote}
To affect national policy, the dissenters concluded, required them to influence economic policy, and this in turn meant that they had to work within the organizations that make such policies. Therefore, the plan evolved to oppose corporate policies not as outsiders, but as participants in the process.
\end{quote}

\textit{Id.} at 422. The shareholder proposal rules under the SEC regulations were the means adopted by Campaign GM and other dissenters to present their claims to the corporate body.

\textsuperscript{58} Letter from Davis, Polk & Wardell to Ross L. Malone, General Counsel of General Motors Corp., February 27, 1970.
Such an allegation may indeed be factually true. Undoubtedly the Medical Committee for Human Rights, as an organization, was concerned with the use of napalm as an instrument of war. Likewise, the members of the Project on Corporate Responsibility were concerned with the social consequences of corporate decisions before they became stockholders of General Motors. However, it cannot be contended that because the Committee and the Project were concerned with similar issues before they became shareholders they were not acting as shareholders in submitting their proposals. Such a conclusion is merely a reassertion of the assumption that when a shareholder submits a proposal concerning primarily social or ethical issues, he cannot be acting as a shareholder, because shareholders are only concerned with profit maximization. However, both the Committee and the Project were shareholders, and as such, were more concerned with the corporation’s social responsibilities than its economic responsibilities. The question is not whether the shareholders were acting as shareholders in submitting their proposals, but whether shareholders should be allowed to submit such proposals.

B. The Legal Assumption

It is insufficient to assert that the assumption that shareholders are solely interested in profit maximization is no longer valid factually, for this assumption is also based in law. By applying the standard of profit maximization the courts have vitalized the assumption.

First contact with the theory of profit maximization usually occurs in the study of economics and not in the study of corporate law. In most introductions to the economic system, the student will find the statement that "[e]ntrepreneurs aim at the maximization of their firms' profits. . ."[59] By applying this basic assumption to others regarding supply and demand, the economist is able to predict market behavior in a capitalist economy. Thus, profit maximization is basically an economic predictive used to determine and assess the behavior of industries within the market system.

With economists reporting that corporations seek to maximize their profits, it was not illogical for the courts to adopt the predictive as a legal norm, especially in light of the assumption that shareholders were solely concerned with receiving the greatest return on their capital. Thus, when the Michigan Supreme Court

held in *Dodge v. Ford Motor Co.* that Ford could not pursue a policy of reducing the price of cars for the purpose of sharing its profits with the public because it would violate the profit-maximization norm, it did so on the ground that it was protecting the shareholders’ interest as well as upholding the goals of the capitalist system. As the courts began to assume that corporations acted in a manner so as to maximize their profits, the legal norm became a bar to shareholder participation in corporate decision-making. As long as the managers were, in good faith, making decisions designed to maximize the corporation’s profits, the courts reasoned that the shareholder had little cause for concern, since his interest was being fully protected.

One manifestation of the courts’ thinking was their adoption of the “business judgment rule” under which they refused to hear cases disputing business decisions. The rule was, in part, an expression of the idea that in a competitive free-enterprise system business managers should be relatively free of governmental regulation, and was based upon the belief that corporate managers should be protected from liability in the event that a good faith decision resulted in economic disaster. To be valid, the rule must also have been based on the assumption that in pursuing profit maximization, the corporation was fulfilling its responsibility to its shareholders. As Manne states:

> Since the corporate system is premised on some coincidence of interest between managers and shareholders, the decision-making process must be one which on its face can be presumed to be in the interest of shareholders.

However, if the shareholder is no longer solely concerned with maximizing his return, a decision based upon profit maximization will not necessarily be in the shareholder’s interest. Further, if, as Berle thought, managers are no longer making decisions on a profit-maximization basis, the premise of some coincidence of interest between managers and shareholders is undermined, and the rule loses its validity. By applying the rule in such a case, a court would be refusing to review a non-profit-maximizing decision on the ground that it was a profit-maximizing decision protecting an interest which, in fact, the shareholder had disclaimed.

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61 As Vagts stated:
   It is quite evident... that, with the prevalence of a benign judicial attitude towards the disinterested business judgment of management, many actions by directors not in fact based on profit motives have gone unchecked.
Vagts, *supra* note 45, at 36-37.
The court in the *Dow* case was faced with such a situation, except instead of deciding whether to apply the business judgment rule, the court was faced with construing the scope of the "ordinary business" limitation of 17 C.F.R. § 240, 14a-8(c)(5). There the shareholders sought judicial review of the company's refusal to include their proposal requesting that the company cease the manufacture of napalm in its proxy material. The company refused to include the proposal on the ground that it was not a "proper subject" for shareholder action under section 14a of the Securities Exchange Act of 1934. Specifically, it urged that the proposal was excludable as motivated by general political and moral concerns under rule 14a-8(c)(2) and as relating to ordinary business operations under rule 14a-8(c)(5).

Under the traditional norm of profit maximization the determination of the products which a corporation shall manufacture would be considered a business decision in which the managers would be entitled to the protection of the business judgment rule. This is, in effect, what Dow managers were asserting. However, in the *Dow* case, the court was faced with a situation in which the managers declared that the decision to manufacture napalm was not an economic decision but was one based on morality. As the court noted:

The management of Dow Chemical Company is repeatedly quoted in sources which include that company's own publications as proclaiming that the decision to continue manufacturing and marketing napalm was made not because of business considerations, but in spite of them; that management in essence decided to pursue a course of activity which generated little profit for the shareholders and actively impaired the company's public relations and recruitment activities because management considered this action morally and politically desirable.\(^6^3\)

Under the traditional norm of profit maximization the court would have been justified in declaring, as in the *Dodge* case, that management, by making such a decision, had violated the norm and their responsibility to the shareholders. However, in *Dow* the shareholders had expressly disclaimed a profit-maximization motive. Instead, they contended that the proposal was submitted because of their moral and ethical beliefs concerning the use of napalm. Thus, the legal norm of profit maximization was not applicable. The court, therefore, declared that management was

not "more qualified or more entitled to make these kinds of decisions than the shareholders..." and remanded the case to the Securities and Exchange Commission for a redetermination of the shareholder's claims.

It is unlikely that many managers will now contend that a particular business decision was based primarily on social or moral grounds. However, most business decisions probably contain some elements of a social or moral belief. Thus, there may be many cases, like Dow, where the traditional norm can no longer be used to decide the issue.

Finally, the validity of profit maximization as an economic predictive has also come under an increasing wave of attack. Many economists now contend that corporations do not pursue a profit-maximization policy, but, instead, proceed on a theory of sales or growth maximization or a satisficing policy. Thus, the validity of profit maximization as a legal norm is being severely challenged. Its validity as an economic predictive is being questioned, and it can no longer be assumed that profit maximization is in accord with the interests of the shareholders.

V. CONCLUSION

Most corporate reformers have addressed themselves to the problem of the uncontrolled power of corporate managers. Generally, they have expressed concern over the political and social power of management and the vast social consequences of business decisions. Believing that managers owe a duty to society as a whole, they have sought to find the best method of implementing the theory of corporate social responsibility. In this quest they have indulged in certain assumptions regarding corporate behavior. As has been shown, the most prevalent assumption is that the shareholder is only interested in profit maximization.

The profit-maximization assumption has led many corporate reformers to conclude that the shareholder has no role to play in enforcing a scheme of corporate social responsibility. This, in turn, has led them either to acquiesce in management’s position of power by calling it business statesmanship or to reject the entire theory of corporate social responsibility and advocate a strict adherence to the legal norm of profit maximization. Those who cannot accept either position continue to search for an enforce-

64 Id.
65 See J. Baumol, BUSINESS BEHAVIOR, VALUE AND GROWTH (1967); and H. Liebenstein, ECONOMIC THEORY AND ORGANIZATIONAL ANALYSIS(1960).
able method by which society can assert its demands. It is time that the reformers reassess their assumptions.

If the modern shareholder is willing to assert non-economic claims on the corporation, and if various community groups are willing to become shareholders to assert these claims, more attention should be directed toward the means by which they can do so. A recent example in this regard is provided by a bill, introduced by Senator Muskie, designed to amend section 14(a) of the Securities and Exchange Act of 1934 to allow shareholders to submit proposals on political or social matters within the control of the corporation. As Senator Muskie has stated:

One way to increase the effectiveness with which corporations serve society is to increase the voice of shareholders on issues which affect them both as owners of corporations and as citizens in their everyday lives. By providing another channel for shareholders to direct their corporations to advance the general welfare, this bill attempts to improve corporate responsiveness to social and environmental issues.

If the shareholders are willing to play a role in enforcing corporate responsibility, it is the duty of corporate reformers to insure that they are able to do so. The scheme of shareholder enforcement established by the SEC regulations should, therefore, be asserted in relation to corporate norms in order to allow these shareholders to actively participate in enforcing management's social responsibility. If management has been legally freed of the profit-maximization norm, it is time to assert that shareholders should also be freed.

—Thomas H. Hay*

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