Corporate Social Responsibility: A Law & Economics Perspective

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INTRODUCTION

The law and economics of corporate social responsibility are simple. Assets are worth more to their owners if they are held exclusively by those owners rather than shared. This simple fact explains why shareholders prefer to be the exclusive beneficiaries of corporate fiduciary duties. If, however, the rules of the game were changed and corporations were deemed to have responsibilities to society in general, instead of exclusively to their shareholders, the shareholders would be harmed because the economic value of their shares would decline. Of course, shareholders would agree to a change such that corporations owed duties to society rather than to the shareholders exclusively if they were *compensated* for this diminution in rights. Thus, if non-shareholder constituencies such as local communities, workers, suppliers, or customers valued these rights sufficiently, they would have them because they would buy them from the shareholders. The fact that this does not happen is strong evidence that it is efficient to organize corporations such that they are run so as to maximize value for shareholders.

From a law and economics perspective, the corporate social responsibility debate is really a debate about how to interpret the contracts and understandings that allocate rights and responsibilities within corporations and other forms of business organizations (hereinafter "corporations"), and between corporations and those located outside of the corporation, such as local communities. The ineluctable reality is that when shareholders make investments in a corporation, they do not think that they are giving their money away. Rather, they invest

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on the premise that they have the right to receive something in exchange for their investments. To say that corporations are supposed to be managed to maximize shareholder value is simply to recognize that part of the reciprocal promise made by the corporation in exchange for the investment is an agreement that the corporation will be managed for the benefit of the shareholders.

From this very basic perspective comes the insight that the fiduciary duties that officers and directors owe to shareholders simply reflect a central term of the standard form contract created when a corporation issues shares: the corporation is promising that the business will be run to maximize returns for shareholders. While there is some confusion on this subject, this basic contract is entirely mutable in every detail. In other words, it is the default rule that is in place unless the corporation, at its inception, chooses to make a different set of commitments to investors.

It is not entirely clear that fiduciary duties are particularly valuable assets. The fervor of the corporate social responsibility debate suggests that having the shareholders' right to have the corporation managed for their exclusive benefit, as opposed to the benefit of all stakeholders, including non-shareholder constituencies, must be worth something. Otherwise, it would not be worth fighting over.

The interests of the widely variegated groups of claimants on firms' assets conflict in numerous ways. By strengthening the bargaining position of one group, the law inevitably weakens the bargaining position of the other competing groups.

Building on the axiom that the corporation is a nexus of contracts,[1] fiduciary duties are simply corporate assets that are bargained for and auctioned off among the various groups of stakeholders. The bargaining process theoretically could lead to a wide variety of outcomes.

As long as the parties engaged in the bargaining process are rational, however, they will agree to stipulate that fiduciary duties will be exclusively enjoyed by one constituency, if the value of such duties is greater when enjoyed exclusively than when shared with other groups. Thus, the allocation of fiduciary duties exclusively to one group of claimants does not reflect any lack of bargaining power on the part of the groups that do not enjoy the privilege of being the beneficiary of such duties. Rather,

1 *See* R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 393 (1937) ("A firm, therefore, consists of the system of relationships which comes into existence when the direction of resources is dependent on an entrepreneur.").

I argue that these other groups *benefit* by giving up any claims they might have on such rights by more than they lose.

The benefits will vary depending on the nature of the non-shareholder constituency at issue. They may take the form of higher interest rates for bondholders, higher wages or greater job security for workers, or higher taxes for local communities. Thus, the notion of forbidding companies from offering a standard form contract in which shareholders are the exclusive beneficiaries of fiduciary duties and requiring firms to allow directors to serve broad societal interests will not only make shareholders worse off, they make other constituencies worse off as well.

For over a century, state corporate law doctrine provided that the directors of both public and closely held firms owe fiduciary duties to shareholders and to shareholders alone. The applicable legal norm required directors to manage a corporation for the exclusive benefit of its shareholders. Protection for other sorts of claimants existed only to the extent provided by contract. This principle has been subjected to sustained attack.[2]

I argue that fiduciary duties should flow to residual claimants and to residual claimants alone. This conclusion stems from a contractual analysis, under which residual claimants receive the benefits of fiduciary duties, not because other groups do not value them, but rather because (1) the aggregate value of fiduciary duties to any group within a firm diminishes as those rights are shared with other groups; and (2) the shareholders value these rights more than any other group.

Non-shareholder constituencies also value these rights. It would be surprising indeed if rights were of value to one group but not to another group, just as it would be surprising if the rights were of exactly the same value to every group. The very nature of the interests and contractual claims of non-shareholder constituencies makes it easier for these constituencies to protect themselves from post-contractual opportunism by the firm. In addition, non-shareholder constituencies already enjoy the protection provided by judicial gap-filling and do not need the additional gap-filling protections afforded by fiduciary duties. All groups ultimately benefit from a legal regime that makes shareholders the exclusive beneficiaries of fiduciary duties.

A valid criticism leveled at other constituency statutes is that they require corporate agents to serve so

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2 *See, e.g.*, Comm. on Corporate Laws, Am. Bar Ass'n, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2253 (1990) (criticizing other constituencies statutes for carrying the potential to change basic premises of corporate law).

many masters—employees, communities, bondholders, customers, suppliers—that the costs in terms of confusion and misunderstanding on the part of courts and litigants vastly outweigh any potential benefits that such statutes might provide. But this argument is not dispositive of the debate because it ignores the fact that corporations have long been able to issue multiple classes of shares with different economic and political rights, and corporate management has owed fiduciary duties to each of these classes. Thus, it simply cannot be said that corporate
law is incapable of reconciling the claims of a variety of competing interests. The argument that other constituency statutes will cause confusion also neglects the fact that most managers' actions are insulated from judicial second-guessing by the business judgment rule. Accordingly, as a practical matter, the rights being taken away from shareholders by other constituency statutes were not rights that provided much in the way of concrete benefits for shareholders in the first place.

Interestingly, over a significant range of important corporate decisions, other constituencies such as fixed claimants or workers may actually have the greatest stake in the decisions being made. For example, shareholders may well benefit by a corporate decision to close a particular plant, but the workers who would lose their jobs in that plant closing likely would suffer to a much greater extent.

Similarly, other constituency statutes cannot be condemned on the grounds that they upset a system of legal rules that present a pre-existing set of clearly defined behavioral guidelines for officers and directors. No such set of guidelines exists.

Rather, the critical problem with other constituency statutes is that they fail to recognize that fiduciary duties are owed solely to residual claimants because they are the group that faces the most severe set of contracting problems with respect to defining the nature and extent of the obligations owed to them by officers and directors. Fiduciary duties should properly be seen as a method of gap-filling in incomplete contracts. And shareholders place a far greater value on the protection provided by this gap-filling than do the other constituencies of a corporation.

This observation, of course, raises an obvious follow-up question: if gap-filling is a useful device from the shareholders' perspective, why not from the perspective of these other constituencies as well? Here I argue that under modern principles of contract law, courts *do* fill in gaps for these other constituencies, but they do so against the background of the pre-

existing contracts that these groups have with the firm. Thus, gap-filling on behalf of such other constituencies as employees and bondholders is done in the context of interpreting the employment contracts, collective bargaining agreements, bond indentures, and covenants that these other groups have with the corporation. Necessary gap-filling is achieved in this context.

The obvious exception to this general rule comes from the local communities in which large corporations operate. Unlike the rest of the constituencies with which a firm deals, the local community has no preexisting agreement with the firm. As such, there simply is no gap for a court to fill. However, the local community is, or should be, well represented in the political process. Any grievance felt by the local community is best addressed to local political officials.

Finally, this paper considers—and rejects—the argument that other constituency statutes are worthwhile because they prevent inefficient wealth transfers from other constituencies, particularly bondholders and employees, to shareholders. The question is not whether such wealth transfers are theoretically *possible*, because they clearly are. Rather, the relevant issues are (1) whether the dangers associated with such wealth transfers can be avoided by contractually negotiated covenants between the fixed claimants and the firm; and (2) whether the social costs of attempting to mitigate this wealth transfer problem through the promulgation of other constituency statutes are greater than the social benefits. The answer to both of these questions is yes. It seems patently clear that the actual purpose and effect of these statutes is to benefit a single non-shareholder constituency, namely the top managers of publicly held corporations who want still another weapon in their arsenal of anti-takeover protective devices. In other words, like many other legislative initiatives, other constituency statutes do not benefit the interests or groups that they ostensibly are intended to benefit. Rather, such statutes benefit a well-organized, highly influential special-interest group, namely the top managers of large, publicly held corporations who wish to terminate the market for corporate control.

I. CORPORATE SOCIAL RESPONSIBILITY AND RESIDUAL CLAIMANTS

Other constituency statutes and other efforts to require corporations to shift their focus from shareholders to society are inconsistent with the fact that shareholders' expectations of being the exclusive beneficiaries of fiduciary duties are legitimate because this is what they have contracted and paid for. This argument derives from the insight of modern financial theory

that "shareholders retain plenary authority to guide the fate of the corporate enterprise because . . . they have the greatest stake in the outcome of corporate decision-making . . . ."[3] Despite the fact that corporations are merely complex webs of contractual relations—and despite the fact that shareholders do not "own" the modern, publicly held firm in any meaningful sense—the ultimate right to guide the firm (or, more precisely, to have it guided on their behalf) is retained by the shareholders because they are the group that values it most highly.[4]

The implication of this analysis for the allocation of fiduciary responsibilities within the firm is not entirely clear. To say that shareholders place the highest value on the rights protected by fiduciary duties is not the same as saying that shareholders are the only group that values such rights. Clearly, many discretionary decisions within the corporation harm the rights of other claimants. For example, in recent years corporations have: (1) "[r]edeem[ed] refunding-protected debt with proceeds of an equity offering, while at the same time borrowing for other corporate purposes at" lower interest rates;[5] (2) "[d]eliberately engineer[ed] a technical default in a private debt covenant, in order to be 'forced' to retire a high coupon issue that was otherwise fully call-protected";[6] (3) "[b]orrow[ed] heavily in the short-term market, [and] then offer[ed] bondholders a choice between amending a covenant limitation on funded debt or leaving the issuer severely exposed to interest rate fluctuations and burdened with large near-term maturities";[7] and (4) "[l]everag[ed] . . . [their capital structure] to avoid a hostile takeover, thereby triggering a decline in the company's bond rating . . . , notwithstanding the bondholders' longstanding assumption that the issuer desired to maintain the highest possible rating in order to minimize its borrowing costs."[8]

Thus, the interesting question is not why shareholders receive the benefits of fiduciary duties, but why they should be the *exclusive* beneficiaries of fiduciary duties, given that other constituencies would benefit if they had the rights created by the imposition of such duties. But why would shareholders, as residual claimants, place the highest value on fiduciary duties?

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3 Jonathan R. Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173, 175 (1989).

4 *Id.*

5 Martin S. Fridson, *Bondholder Rights: A Survey of Current Issues*, EXTRA CREDIT: THE JOURNAL OF HIGH YIELD BOND RESEARCH, Jan.–Feb. 1992, at 33.

6 *Id.*

7 *Id.* at 34.

8 *Id.*

After all, once we accept the view that the firm is not an entity at all but a set of contracts or series of bargains:

> [The organization] . . . decomposes . . . into a group of identifiable participants—e.g., investors, managers, creditors, employees and suppliers—who negotiate an equilibrium position among themselves. An implication of this perspective is to deny that any one class of participants (i.e., the shareholders) have a natural right to view themselves as owners of the firm. Rather, shareholders are seen not as the firm's owners, but as suppliers of equity capital; they are the 'residual claimants,' who bring to the firm their special ability at risk-bearing, which creditors, managers, and employees tend to lack.[9]

Of course, "[o]nce we view the shareholders as simply the residual claimants who have agreed to accept a more uncertain . . . return because of their superior risk-bearing capacity, it is far from self-evident that they are necessarily entitled to control the firm,"[10] that is, to have managers' and directors' fiduciary duties flow exclusively to them.

The rationale for why shareholders place the highest value on such rights is said to be that,

> [u]niquely, the residual claimants . . . are interested in the firm's overall profitability, whereas creditors and managers [and presumably other constituents as well] are essentially fixed claimants who wish only to see their claims repaid and who will logically tend to resist risky activities. Having less interest in the overall economic performance of the firm, creditors can bargain through contract and do not need representation on the board to monitor all aspects of the firm's performance.[11]

Thus, fiduciary duties exist because the decisions that face officers and directors of corporations are sufficiently complex and difficult to predict. It would therefore not be feasible to specify, in advance, how such officers and directors should respond to a wide range of future contingencies. Fiduciary duties are the mechanism invented by the legal system for filling in the unspecified terms of shareholders' contingent contacts. It has been argued that these duties run exclusively to shareholders because, as residual claimants, "[t]he gains and losses from abnormally good or bad performance are the lot of the shareholders, whose claims stand last in line."[12] As Easterbrook and Fischel have observed:

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9 JESSE H. CHOPER, JOHN C. COFFEE, JR. & C. ROBERT MORRIS, JR., CASES AND MATERIALS ON CORPORATIONS 28 (3d ed. 1989).

10 *Id.* at 29.

11 *Id.*

12 Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 403 (1983), *available at* http://www.jstor.org/stable/725097.

> As the residual claimants, the shareholders are the group with the appropriate incentives . . . to make discretionary decisions. The firm should invest in new products, plants, etc., until the gains and costs are identical at the margin. Yet all of the actors, except the shareholders, lack the appropriate incentives. Those with fixed claims on the income stream may receive only a tiny benefit (in increased security) from the undertaking of a new project. The shareholders receive most of the marginal gains and incur most of the marginal costs. They therefore have the right incentives to exercise discretion [or to have it exercised on their behalf].[13]

A simple illustration can be used to demonstrate this point. Suppose that a firm has two classes of claimants: fixed and residual. The firm will owe $1 million to the fixed claimants at the end of period one. Suppose further that the firm has to choose between two projects: A and B. Both of these projects will require the firm to allocate one hundred percent of its resources to that project for the relevant period. Project A has a 0.5 chance of producing a pay-off with a present value of $1 million, and a 0.5 chance of producing a pay-off with a present value of $5 million at the end of period one. Thus, the expected present value of project A is $3 million.[14] Project B, on the other hand, has a pay-off matrix in which there is a 0.5 chance of a pay-off with a present value of $6 million, and a 0.5 chance of a pay-off with a present value of $1 million. Thus, while project A has an expected value of $3 million, project B has an expected value of $3.5 million.

The shareholders will prefer project B, since they are better off by $500,000 if they select that project.[15] The fixed claimants, by contrast, are indifferent as to whether the firm selects project A or project B because under either outcome available under either project, the fixed claimants are absolutely certain to obtain the $1 million that is owed to them by the firm. Where a firm is making a decision like this, the fixed claimants clearly do not deserve a role in the decision-making process. The firm, and society, are better off if the firm selects project B, because that is

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13 *Id.*

14 (0.5 x $1 million) + (0.5 x $5 million) = $3 million.

15 Project A has an expected value to the shareholders of $2 million. If the project only makes $1 million, the fixed claimants will get all of the gains from the project, and there will be nothing left over for the shareholders. If the project makes $5 million, the shareholders will get $4 million, because the first million goes to satisfy the firm's obligations to the fixed claimants. Thus, project A has an expected value to the shareholders of $2 million (0.5 x $4 million = $2 million). Project B has an expected value of $2.5 million. As before, if the project only makes $1 million, the shareholders get nothing. If the project makes $6 million, the shareholders will get $5 million, because the first million will go to the fixed claimants of the firm. Thus, project B has an expected value to the shareholders of $2.5 million (0.5 x $5 million = $2.5 million).

the one that maximizes the firm's and society's stock of wealth. No purpose is served by giving the firm's fixed claimants any stake in the decision-making process. The only possible result from involving them would be to permit them to threaten to obstruct the firm's efforts to undertake project B in order to extract a side payment of some kind.

The sort of decision described in the above example lies behind the intuition that fiduciary duties should flow exclusively to a firm's shareholders because they are residual claimants. Because the relevant decision in this example, like so many decisions made by corporations, is infra-marginal with respect to all constituencies other than shareholders, the shareholders should be the only party with legal rights in the process leading to that decision. And, as Easterbrook and Fischel suggest, the shareholders' position within the firm is unique because shareholders are the only group with a meaningful stake in *every* decision made by a solvent firm.

But not all decisions made by a firm resemble the decision suggested in the above example. Suppose that the decision was between project A as described above and a third project, C. Project C has a 0.5 chance of producing a pay-off at the end of period one with a present value of $500,000, and a 0.5 chance of producing a pay-off at the end of period one with a present value of $10 million. The shareholders would prefer project C to project A (or project B, for that matter). Project C has an expected return to shareholders of $4.25 million, which compares favorably with project A's expected return to shareholders of $2 million, and project B's expected return to shareholders of $2.5 million. However, unlike project A and project B, the firm's fixed claimants are not indifferent with respect to the decision to select project C. Under project C, there is a 0.5 chance that the fixed claimants will be paid only half of the full $1 million that is owed to them. Indeed, the fixed claimants would be willing to pay for the right to block project C.

It is simply incorrect to say that the shareholders are the only group with the correct incentives to decide whether to adopt project C or project A or B. Nor is it the case that the society benefits by allocating the fiduciary duties within the firm exclusively to the shareholders on the grounds that the shareholders have the greatest incentives to maximize the value of the firm. It is possible to manipulate the numbers in the above examples—and the actual projects selected in the real world—to transfer wealth from the fixed claimants to the residual claimants while *reducing* rather than increasing the overall value of the firm.

Imagine, for example, that the firm is selecting between two projects: D and E. Project D presents a 0.5 chance of producing absolutely nothing, and a 0.5 chance of producing a present value pay-off of $1.5 million at the end of period one. Project E presents a one hundred percent chance of producing a present value pay-off at the end of period one of $1 million. Ex ante, the overall value of the firm is maximized by selecting project E, since that produces a present expected value of $1 million, while project D produces a present expected value of only $750,000. The shareholders, however, would prefer project D to project E, since under project E there is no chance that the shareholders will realize any pay-off at all, while under project D there is a 0.5 chance that the shareholders will realize something (that is, $500,000 after repaying the $1 million owed to fixed claimants). Thus, if the shareholders are left in complete control, they will have incentives "to adopt various strategies with the effect of transferring wealth from bondholders to shareholders, such as choosing risky investment projects and withdrawing assets from the firm."[16] This example strongly suggests that some of the strategies that shareholders can adopt to transfer wealth from the fixed claimants and other constituencies to themselves reduce the value of the firm, and overall societal wealth as well. The point of this discussion is that simply describing shareholders as residual claimants to the cash flow of the modern corporation does not fully explain why fiduciary duties flow exclusively to shareholders.

The shareholders' status as residual claimants provides a persuasive rationale for why their interests should trump with respect to a wide range of transactions. However, it is also clearly the case that other claimants have a strong interest in having their preferences taken into account, at least to some extent, in decisions about how to allocate corporate resources, because these claimants face the realistic prospect of tangible loss if their interests are neglected. Thus, the argument that shareholders, as residual claimants, have the greatest incentive to maximize the value of the firm, and therefore should be the beneficiaries of the legal protection afforded by fiduciary duties, is incomplete. It does not explain why the interests of other claimants should not be respected, at least as regards those decisions that have the potential to affect their interests directly.

The reason that shareholders should be the exclusive beneficiaries of fiduciary duties does not lie in the fact that the shareholders are residual claimants, but rather in the fact that

16 Easterbrook & Fischel, *supra* note 12, at 404.

fiduciary duties are not public goods. Because fiduciary duties are not public goods, the enjoyment by one group of the rights associated with such duties necessarily diminishes other groups' ability to enjoy those benefits. This is particularly true in the case of corporate fiduciary duties where the interests of the various stakeholders' groups actually conflict.

It is well understood that a discretionary decision by directors that increases the wealth of one stakeholder group often will diminish the wealth of another group. For example, just as a decision by a corporate board of directors to increase the overall riskiness of a firm above the expected level transfers wealth from fixed claimants to residual claimants, so too does a decision by the board to reduce the riskiness of the firm transfers wealth to fixed claimants from residual claimants. But the implication of this basic point has been lost on those who have supported statutes that expand the rights of non-shareholder constituencies to include fiduciary duties.

Another example illustrates this point. Suppose that there are only two groups of stakeholders: bondholders and stockholders. The bondholders value the right to be the exclusive beneficiaries of fiduciary duties at $50, while the shareholders value the right to be the exclusive beneficiaries of fiduciary duties at $75. If fiduciary duties are shared by both groups, however, the aggregate value of the corporate fiduciary duties declines to $40 ($20 for each group). If both groups have equal bargaining power and are rational, the parties will agree that the shareholders should be the exclusive beneficiaries of the directors' fiduciary duties. The bondholders would accept some amount greater than $20 in exchange for agreeing that the shareholders will be the exclusive beneficiaries of the directors' fiduciary duties. The shareholders would pay some amount less than $55 to obtain the right to be the exclusive beneficiaries of the directors' fiduciary duties. Within this range, both groups would be better off than if fiduciary duties were shared with the other group. In other words, in this example, as long as the shareholders pay the bondholders an amount greater than $20 but less than $55, both will be better off than if the fiduciary duties are shared and no exchange is made. Thus, corporate shareholders will *pay* other corporate constituencies for the right to have these duties inure to their sole benefit.

Suppose, for example, the shareholders place an aggregate value of $10 million on the legal protection provided by a corporate governance system that allocates fiduciary duties exclusively to shareholders, while other constituents place a value of $2 million on the protection afforded by such duties.

Under these assumptions, both parties will be better off if the shareholders are permitted to compensate these other constituencies—in the form of higher interest on bonds, higher wages to workers and managers, and better prices for suppliers and customers—to acquire the right to have fiduciary duties flow exclusively to them.

Thus, *all* constituencies will be better off by allocating fiduciary duties within the firm exclusively to shareholders because: (1) fiduciary duties are not a public good; and (2) shareholders are the group within the firm that places the highest value on such duties.

II. THE TOO MANY MASTERS ARGUMENT

Another criticism of embracing corporate social responsibility is that, to the extent that doing so effects any change in firm behavior or existing law, it complicates corporate governance immeasurably. Specifically, embracing corporate social responsibility requires directors to attempt the impossible: pleasing a multitude of masters with competing and conflicting interests. As the Committee on Corporate Laws of the American Bar Association's Section on Business Law has argued in its position paper on other constituency statutes:

> The confusion of directors in trying to comply with such statutes, if interpreted to require directors to balance the interests of various constituencies without according primacy to shareholder interests, would be profoundly troubling. Even under existing law, particularly where directors must act quickly, it is often difficult for directors acting in good faith to divine what is in the best interests of shareholders and the corporation. If directors are required to consider other interests as well, the decision-making process will become a balancing act or search for compromise. When directors must not only decide what their duty of loyalty mandates, but also to whom their duty of loyalty runs (and in what proportions), poorer decisions can be expected.[17]

On one view, the "too many masters" argument is that other constituency statutes make life more difficult for corporate managers and boards of directors. In fact, the better view is that such statutes make life easier rather than harder for incumbent management of the large, public corporation. After all, these statutes enable management to justify virtually *any* decision on the grounds that it benefits *some* constituency of the corporation or other.

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17 Comm. on Corporate Laws, *supra* note 2, at 2269.

To illustrate the point that other constituency statutes increase rather than decrease the degree of freedom enjoyed by incumbent managers, one has only to imagine virtually any decision or transaction contemplated by a corporation. Take, for example, the issue of whether a firm should relocate its headquarters from the large metropolis that has served as its base for several years to a small town with better schools, lower labor costs, and lower taxes. While shareholders might benefit by this move, the community in which the firm is currently located clearly would suffer. Some employees might benefit by the move, while others might suffer. The firm could justify virtually any decision as serving the interests of one or more of the firm's constituencies. Imagine now that the proposal to relocate the company comes not from incumbent management, but from an outside bidder who is launching a hostile tender offer for the company at a substantial premium over the current market price of the firm's shares. Now the other constituency statute can be used to justify resisting an outside offer that may be in the best interests of the firm's shareholders. This is an additional reason why other constituency statutes diminish in value when they are shared by more than one group of stakeholders.

Thus, the primary beneficiaries of other constituency statutes are incumbent managers who can justify virtually any decision they make on the grounds that it benefits some constituency of the firm. Strong support for this assertion lies in the fact that not only are these statutes (with a single exception) permissive, they do not afford standing to sue to any of the other constituencies that they purportedly are designed to benefit.[18] A similar sentiment was expressed by Dean Robert Clark, who has observed that it is socially optimal for corporate law to promote the interests of shareholders in profit maximization in a rather single-minded fashion:

> A single objective goal like profit maximization is more easily monitored than a multiple, vaguely defined goal like the fair and reasonable accommodation of all . . . interests. Assuming shareholders have some control mechanisms, better monitoring means that corporate managers will be kept more accountable. They are more likely to do what they are supposed to do and do it efficiently.[19]

Like the argument that other constituency statutes are ill-advised because they ignore the special status of shareholders as residual claimants, the "too many masters" argument is not without merit. Indeed, this argument provides what is a logical

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18 Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163, 165 (1991).

19 ROBERT C. CLARK, CORPORATE LAW 20 (1986).

explanation of state legislatures' eagerness to enact these statutes. As has been pointed out, "Nonshareholder constituency statutes . . . are intended to permit consideration of stakeholder interests, and, at the same time make hostile takeovers more difficult . . . . [I]t is clear that the corporate managers who supported these statutes expected them to help protect incumbent target management."[20] Of course the winners of the takeover battles of the 1980s were corporate shareholders, while the losers were incumbent managers. Other constituency statutes give such managers the ability to obtain politically what they were unable to obtain in the marketplace—meaningful job security regardless of the quality of their performance.

The problem with the "too many masters" argument is that it is overstated. Corporations traditionally have been able to issue multiple classes of common and preferred stock, and corporate managers and directors have owed fiduciary duties to all of these various classes of claimants simultaneously. Moreover, just as the interests of common shareholders can conflict with the interests of non-shareholder constituencies, so too can the interests of one class of equity claimant conflict with the interests of another class of equity claimant. In particular, certain preferred shareholders may have interests that more closely resemble the interests of fixed claimants than the interests of common shareholders. Such preferred shareholders may seek to discourage the firm from engaging in certain risky projects while the shareholders would support the firm's decision to undertake such projects.

With respect to corporate law jurisprudence, as the Committee on Corporate Law has observed, in no case has the all-important Delaware Supreme Court held that directors will be permitted to prefer the interests of other constituencies over shareholders or that they ought, as a normative matter, to take such interests into account.[21] The Committee has reformulated the position of the Delaware Supreme Court to be that

> directors have fiduciary responsibilities to shareholders which, while allowing directors to give consideration to the interests of others, compel them to find some reasonable relationship to the long-term interests of shareholders when so doing. In Delaware, this principle is modified when the decision is made to sell the company, at which time the directors may consider only the interests of shareholders.[22]

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20 Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 996 (1992).

21 *See* Comm. on Corporate Laws, *supra* note 2, at 2260.

22 *Id.* at 2261.

Another noteworthy facet of the Delaware approach is its recognition of the important point that over a wide range of issues, no conflict exists between the interests of other constituencies and those of shareholders. Acting to improve worker morale is good for workers and good for shareholders. Taking steps to improve relations with the local community has the same effect. Similarly, drafting strong bond covenants or developing a reputation for dealing fairly with bondholders or other constituencies benefits the shareholders in the form of lower interest costs for debt and a lower cost of doing business generally. However, as a corporation approaches insolvency, the shareholders' interests become less relevant, and non-shareholder constituencies take on all of the characteristics of residual claimants.

Delaware's approach recognizes the Hayekian argument that it generally is not possible to identify precisely which actions are in shareholders' interests and which are not.[23] Experimentation and after-the-fact observation is required. As such, managers require plenty of latitude for experimentation. In addition, many technological or managerial improvements to a firm's operations may well result from pure happenstance and fortuity, rather than careful strategic planning. Consequently, judicial efforts to hold managers to a strict profit-maximization standard through the palliative of ex post judicial review of corporate decisions and operations is not likely to benefit anyone other than the legal community. The obvious exception to this general rule occurs in the case where there is a palpable conflict of interest between the actions of managers and the interests of shareholders. Where this is the case, there is, of course, an important role played by judicial enforcement of corporate law norms.

In competitive markets, if managers act in ways that are sub-optimal from the shareholders' perspective, they will be disciplined, if at all, by the various markets in which such managers must operate.[24] Because of the problems of ignorance and uncertainty in the world of business, managers often base their actions on custom, tradition, force of habit, imitating the actions of more successful competitors, or a complex set of conflicting motivations. Courts are likely to be even more inept

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23 A basic tenet of Austrian economic thought, as exemplified by the work of Friedrich A. Hayek, is that "there is an unpredictability and indeterminacy with regard to human preferences, expectations and knowledge." Israel M. Kirzner, *On the Method of Austrian Economics*, *in* THE FOUNDATIONS OF MODERN AUSTRIAN ECONOMICS, 48 (Edwin G. Dolan ed., Sheed & Ward, Inc. 1976); *see also* FRIEDRICH A. HAYEK, INDIVIDUALISM AND ECONOMIC ORDER 46 (1948).

24 These markets include the market for corporate control, the internal and external managerial labor markets, and the markets for the products offered by the firm.

than managers and directors in determining with any certainty which actions are in the best interests of shareholders and which actions are not. As noted above, over a wide range of issues, allowing managers to take the interests of a variety of constituencies into account simply recognizes the fact that ex post second-guessing of managerial decisions probably does more harm than good. Generally, it is best for all parties concerned if courts decline to second-guess managers' decisions. Only when such decisions are clearly being made self-interestedly should courts intrude on the internal process of corporate governance.

To the extent that other constituency statutes are interpreted in ways that are consistent with this general norm in corporate law, they will be efficient and will benefit societal interests, not harm them. Consistent with the approach taken by the Delaware Supreme Court, the fact that such statutes give incumbent managers more freedom is worrisome only if managers can use that freedom in ways that are inconsistent with shareholder welfare.

Thus, the problem with other constituency statutes is not that they require managers and directors to serve too many masters. Under current law, corporate officials must serve a shifting and highly variegated set of masters. Rather, the problem is that these statutes potentially permit such managers and directors to serve no one but themselves.

III. SHAREHOLDERS AS THE GROUP WITH THE MOST ACUTE NEED FOR FIDUCIARY DUTIES

The real reason why shareholders value fiduciary duties more than other groups, and why non-shareholder constituency statutes are unproductive, is that such statutes ignore the severe contracting problems faced by residual claimants. These acute contracting problems, coupled with the fact that the value of being made the beneficiary of corporate fiduciary duties is not in the nature of a public good, provide the basic justification for the traditional common law rule that managers and directors owe their primary fiduciary responsibilities to shareholders.

Outside of insolvency, non-shareholder constituencies can protect themselves against virtually any kind of managerial opportunism by retaining negative control over the firm's operations. Workers, bondholders, even local communities, can protect their interests by contracting for the right to veto future proposed actions by management. By contrast, the shareholders must retain positive control over the actions of the firm in order to realize the full potential value of their shares.

Merely because non-shareholder constituencies decline to contract for the right to veto certain corporate transactions does not mean that they were *unable* to do so. Rather, the absence of contractual protection for other constituencies may simply reflect the fact that such other constituencies were unwilling to *pay* for such protection in the form of lower wages or lower interest rates on debt.

Workers are perhaps the group with which one sympathizes most when thinking about the possible benefits associated with other constituency statutes. Unlike shareholders, who are concerned with the overall profitability of the firm in which they have invested, workers are concerned with wages, hours, and working conditions. From a contracting perspective, wages and hours present few, if any, problems. Workers potentially could protect their expectations concerning wages with pension guarantees, severance agreement (golden parachute) contracts, stipulated cost-of-living adjustments, and other straightforward provisions. Similarly, workers can obtain credible assurances against being forced to work undesirable hours simply by stipulating the precise length of the workday. Employees can achieve guaranteed working conditions by making reference to a well-known status quo, and requiring the employer to maintain working conditions at that level or above.

The point here is not to suggest that workers have the contracting power to protect their wages, hours, and working conditions. Rather, the point is simply that, unlike the situation that pertains to the shareholders, it is at least *technologically* possible for workers to protect themselves contractually by drafting strong contractual provisions in their favor. Moreover, to the extent that future, unforeseen contingencies arise that cast doubt on the efficacy of contractual protection, courts can protect workers by construing their employment contracts in the light of the original purposes behind the agreement. Thus, the gap-filling functions provided by modern judges in interpreting contracts provides workers with the same sorts of protection that fiduciary duties provide for shareholders.

The above arguments apply with even more force to bondholders. First, bondholders can and do draft elaborately detailed contracts to protect themselves from transactions that upset the original understanding between bondholders and the firm regarding the sorts of transactions that are appropriate for the firm.[25] For example, bond indentures often contain provisions

25 Clifford W. Smith Jr. & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117, 118–19 (1979).

that impose limitations on an issuer's ability to pay dividends, acquire stock, acquire debt or issue preferred stock, either directly or through a subsidiary, to sell assets, or to engage in transactions with affiliate companies. While these provisions would not provide much protection to shareholders (and indeed might be harmful to their interests), they do much to protect bondholders and other fixed claimants against wealth transfers by other corporate interests.

Again, it is worth emphasizing that, for the purposes of the arguments presented in this paper, the issue is not whether bondholders have the bargaining power to obtain every contractual protection they desire when covenants and indentures are drafted. After all, bondholders, like other constituencies, are free to decline to invest in the firm if they are not satisfied with the risk-return trade-off being offered. Instead, the relevant issue is whether it is technologically possible for the bondholders to protect themselves via contract.

As such, the only reason we do not observe the use of such contractual provisions in the real world is that they are prohibitively expensive. Unlike shareholders who, absent the gap-filling protection afforded by fiduciary duties, cannot obtain contractual assurances that a firm will maximize profits, bondholders can protect the present value of their fixed claims by drafting "put" provisions that give them the legal right to force the firm to repurchase the bonds at a pre-determined price upon the occurrence of certain contingencies. Put provisions may also require the firm to adjust the payments to fixed claimants to compensate them for the increased risks associated with certain transactions or with downgrades in the firm's credit rating.

The put provisions accompanying bond sales generally are triggered by a merger or transfer of a substantial number of assets to another firm, a change in the ownership of the firm, a significant share repurchase by the firm, or similar transaction.[26] Of course it would be possible to draft even more comprehensive protection for bondholders. The right to put the bonds back to the firm might be triggered any time the market price of the bonds reached a certain level in the open market. Such a broad provision would be easy to monitor and enforce, and would provide virtually complete protection for bondholders against unforeseen contingencies. Thus, to repeat, the issue is not whether other constituencies can protect themselves via contract, but whether they are willing to *pay* for such protection.

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26 *See* Matthew Winkler, *Harris, Williams Cos. Unit Are First to Offer Super 'Poison Puts,'* WALL ST. J., Nov. 16, 1988 at C1, C23.

IV. GAP-FILLING FOR NON-SHAREHOLDER CONSTITUENCIES

The familiar retort to the argument made in the preceding section is that shareholders and the corporate managers who serve them are endlessly creative. As such, no matter how elaborate the guarantees, non-shareholder constituencies will be unable to protect themselves without the broad-based gap-filling provided by fiduciary duties because new strategies will be devised to undermine whatever contractual protection other constituencies can devise.

An interesting variant on this argument has been made in an important article by Columbia's Professor John Coffee. He argues that the hostile takeover itself is best viewed as a shareholder strategy for reneging on the original bargain between non-shareholder constituencies (particularly managers) and the firm:

> [T]he hostile takeover can be seen not simply as a mechanism that compels a management to accept that level of business risk that shareholders deem appropriate, but as a means by which shareholders outflank the safeguards managers obtained to protect the promises of deferred compensation and job security [that shareholders have given to managers]. Thus, what appears from the bidder's perspective to be a process of purging organizational slack looks from the manager's viewpoint more like deceptive reneging on the original understanding.[27]

The ex post reneging argument seems flawed for two reasons. First, as noted above, non-shareholder constituencies can draft contracts that protect them against the consequences of future, unforeseen contingencies. Foreseeable contingencies, such as hostile takeovers and corporate restructuring are even easier for non-shareholder constituencies to deal with contractually. As discussed in the preceding section, poison puts for bondholders and golden parachutes for workers potentially provide virtually complete protection for non-shareholder constituencies.

Second, it is inaccurate to suggest that absent other constituency statutes, only shareholders enjoy the protection afforded by judicial gap-filling. An impressive literature on relational contracts indicates that modern judges should and do go a long way towards filling in unstated terms and conditions in long-term relational contracts such as those forged between non-shareholder constituencies and public corporations.[28]

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27 John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 24 (1986).

28 *See generally* Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261 (1985).

Modern courts will examine the nature of the understanding between two contracting parties and interpret legal disputes between them in the light of this understanding. Thus, non-shareholder constituencies (with the exception of local communities) *already enjoy* a substantial degree of protection of the gap-filling sort.

For non-shareholder constituencies, the starting point for this judicial gap-filling process must be the contract itself. The contract that constitutes the starting point can take a variety of forms. It may be an employment agreement, a collective bargaining agreement, a bond indenture, or a standard form contract between a firm and its suppliers or customers. For shareholders, it is widely recognized that the contract between managers and shareholders establishes that managers have a duty "to make corporate decisions so as to maximize the value of [their] shares."[29]

Fiduciary duties are a corporate governance device uniquely crafted to fill in the massive gap in this open-ended bargain between shareholders and corporate officers and directors. On the basis of the preceding analysis, it should be clear that recent attempts to expand the scope of managements' fiduciary duties to non-shareholder constituencies are misguided for two reasons that previously have gone unrecognized. First, to the extent that such duties are legally enforceable, they shift the focal point of the legal analysis of the relationship between the non-shareholder constituency and the firm away from the actual contract between the parties. In other words, allocating fiduciary obligations to non-shareholder constituencies takes the judicial gap-filling process out of its proper framework, which lies in the actual contract that exists between the constituency and the firm, and puts it on some other dimension. Removing this gap-filling from its proper framework deprives judges of any coherent basis for allocating rights and responsibilities within the firm.

Inevitably, removing the gap-filling done by judges for non-shareholder constituencies from a contractual framework to a fiduciary duty framework creates potential conflicts between the express and implied terms of the actual bargains and the new "rights" being created by corporate constituency statutes. To the extent that these new rights are allowed to trump the terms contained in a contract between a non-shareholder constituency and the firm, such statutes simply transfer wealth from

29 CLARK, *supra* note 19, at 17–18; Jonathan R. Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173, 186 (1989).

shareholders to these other constituencies. The specter of such wealth transfers deprives investors of incentives to invest in public corporations and reduces societal wealth generally. Thus, to the extent that other constituency statutes create rights for non-shareholder groups that are not expressly or impliedly contained in the actual agreements between these groups and the firm, they will impede the process of capital formation and wealth creation in the economy.

V. THE LOCAL COMMUNITY

Local communities constitute a possible exception to the analysis presented above. Unlike other non-shareholder constituencies, local communities may have no pre-existing contractual relationship with the firm on which to base a reconstruction of the original understanding between the parties in the event of future conflict. Of course, it often will be the case that a local community will in fact enter into express negotiations with a particular firm and agree to provide certain services and infrastructure support in exchange for a decision by the firm to locate in that community. In such cases, for the reasons presented above, layering on a set of fiduciary duties to the local community in addition to express contracts between the firm and the community will only hinder the ultimate resolution of future disputes.

But often there will be no express or implied understanding between a firm and its community.[30] Where there is no agreement, it seems clear, at least to me, that creating an amorphous, open-ended fiduciary duty running from the firm to the "local community" in which the firm operates is a singularly bad idea. Creating such a duty transforms the role of top managers of public companies from that of private businessmen into that of unelected and unaccountable public servants. A decision to elevate the interests of a local community above the interests of a firm's shareholders is nothing less than a decision about how to allocate wealth within society. There seems to be a broad consensus that "the reallocation of wealth is a function for which directors are not especially suited and one beyond the general pale of their perceived mandate from society."[31]

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30 *See* John William Singer, *The Reliance Interest in Property*, 40 STAN. L. REV. 611, 618 (1988) (describing the disruptions caused to the community of Youngstown, Ohio, when the United States Steel Company closed two plants there).

31 Comm. on Corporate Laws, *supra* note 2, at 2270; *see also* Christopher J. Smart, *Takeover Dangers and Non-Shareholders: Who Should Be My Brothers' Keeper?*, 1988 COLUM. BUS. L. REV. 301, 326–39 (1988).

As with other non-shareholder constituencies, expanding the scope of a firm's fiduciary duties to include local communities is simply unnecessary. This is because local communities have unique access to the political process. To the extent that the actions of a firm are genuinely harmful to a local community, the members of that community can appeal to their elected representatives in state and local government for redress. Regardless of whether one has a pluralism or a republican perspective on the governmental process,[32] local communities should be able to mobilize into an effective political coalition to press for protection from actions by corporations that are truly harmful to such communities. Indeed, upon reflection, the better argument seems to be that corporations need protection from local communities' abuse of the political process at least as much as local communities need protection from opportunistic behavior by corporations. The political capital being made by local politicians over the strike at the *New York Daily News* illustrates this point nicely. There, politicians have been falling all over themselves to demonstrate solidarity with the striking *Daily News* employees with little or no regard for the substantive merits of the dispute.

The Worker Adjustment and Retraining Notification Act[33] illustrates the point that local communities are able to protect themselves in the political process and hardly need any additional protection that might be afforded by a plant closing law. The statute requires that, under virtually all conditions, firms with 100 or more workers give workers and communities sixty days notice prior to closing a plant. The bill requires that workers be paid for every day that they are deprived of notice.[34]

CONCLUSION

The argument that the fiduciary duties of officers and directors in public corporations should run exclusively to shareholders and not to other constituencies is an uneasy one. As shown above, the shareholders' unique status as residual claimants provides a persuasive rationale for allocating fiduciary duties to shareholders in some but by no means all situations. In simple terms, in those situations in which other constituencies have no meaningful stake in a particular decision, they have no

32 For a republican perspective on government, see Cass R. Sunstein, *Beyond the Republican Revival*, 97 YALE L.J. 1539 (1988). For a pluralism critique, see Jonathan R. Macey, *The Missing Element in the Republican Revival*, 97 YALE L.J. 1673 (1988).

33 29 U.S.C. § 2102 (2012).

34 The statute provides exceptions for businesses struck by unforeseen circumstances and businesses in dire financial straits. *See* Elizabeth Wehr, *Reagan Bows to Politics on Plant Closing Bill*, CONG. Q. WEEKLY REP., AUG. 6, 1988, at 2216.

constructive role to play in the decision-making process. Including them in such decisions would lead to opportunism and to a diminution in societal wealth. On the other hand, non-shareholder constituencies plainly have a significant interest in a wide range of decisions that a firm may be called upon to make. Thus the special role of shareholders as residual claimants does not provide a complete explanation for why shareholders should be the exclusive beneficiaries of corporate fiduciary duties.

It is desirable to maintain a system of corporate governance in which fiduciary duties are owed exclusively to shareholders because no suitable alternative means of protecting shareholders' claims exist other than by way of a judicially enforced regime of fiduciary duties. By contrast, the obligations owed to other claimants can be enforced by contract because they are more precisely defined than the obligations to shareholders.

Moreover, in this article I have stressed that the fiduciary duties owed to shareholders are a device that serves to fill in the implied terms of the contract that exists between shareholders and the firm. This contract requires officers and directors of corporations to maximize overall firm value for shareholders. The fiduciary duties owed to shareholders are the only gap-filling device available to protect shareholders' investments, whereas other claimants enjoy the gap-filling that courts routinely supply when interpreting the terms of their contracts with the firm. Allocating fiduciary duties to shareholders does not really give shareholders a level of protection not enjoyed by non-shareholder constituencies. Instead, the fiduciary duties owed to shareholders simply provide the residual claimants with a level of judicial protection commensurate with the nature of the firm's contractual obligations to them. Ironically, the ostensible reason for passage of non-shareholder constituency statutes is to provide such non-shareholder constituents with the enhanced legal protections that shareholders enjoy. In fact, in the light of the pervasive conflicts of interest that exist between shareholders and managers, it seems clear that if any group within the firm is in need of additional legal protection it is the shareholders. Instead, the recent wave of non-shareholder constituency statutes has enhanced the ability of incumbent management to justify corporate strategies that reduce the overall value of the firm on the grounds that such strategies benefit some non-shareholder constituency or other.

The Problem of Deterring Extraterritorial White-Collar Crime

Andrew Spalding[*]

INTRODUCTION

Recent reports of egregious labor practices in China and Bangladesh have called public attention to the potential harms of foreign direct investment (FDI) in developing countries. The best, or at least most obvious, tool for reducing destructive overseas business practices would seem to be the extraterritorial application of white-collar criminal law.[1] The "holy grail" of contemporary criminal law is deterrence,[2] and the deterrence literature is largely shaped by the paradigm of law and economics. Prominent within that literature is Polinsky and Shavell's "enforcement authority," which seeks to maximize social utility through the efficient deterrence of crime.[3] Guided by the principles of law and economics, the enforcement authority wields four enforcement tools: enforcement expenditures, the level of the fine, the length of imprisonment, and the standard for imposing liability.[4] By manipulating these variables, it can presumably achieve the optimal combination of minimizing crime while also minimizing public expense.[5]

But this essay argues that, in international business law specifically, that enforcement authority will tend to fail. The traditional methods of criminal deterrence, when applied rigorously and in good faith, will ultimately create the very conditions in which extraterritorial white-collar crime proliferates. As the enforcement authority utilizes its tools to

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1 *See, e.g.*, Jodie Gummow, *In Bangladesh, Workers Escalate Demands for Better Working Conditions*, TRUTHOUT (May 26, 2013, 9:52), http://www.truth-out.org/news/item/16594-in-bangladesh-workers-escalate-demands-for-better-working-conditions.

2 Patrick J. Keenan, *The New Deterrence: Crime and Policy in the Age of Globalization*, 91 IOWA L. REV. 505, 515 (2006).

3 A. Mitchell Polinsky & Steven Shavell, *The Economic Theory of Public Enforcement of Law*, 38 J. ECON. LITERATURE 45, 72 (2000).

4 *Id.* at 49.

5 *See id.* at 70.

pursue the optimally low level of such crime, unique legal and economic conditions will too often produce an increase in overall rates of criminality. Deterrence's goal—namely, the reduction in crime—can only be achieved by utilizing tools and theories that are not part of the contemporary deterrence logic.

Section I briefly describes the law and economics approach to deterrence, and explains why scholars have not been particularly concerned with whether deterrence could lead to an increase, rather than a decrease, in crime. Section II then explains how international business, particularly foreign direct investment in developing countries, creates a set of conditions in which this possibility arises. It constructs a model, using bribery prohibitions as an example, which illustrates that beyond a given level of enforcement, heightened enforcement will produce a net increase in crime in the host country. Section III explores the possibility that corporate social responsibility (CSR) may be able to pick up where law and economics leaves off. That is, though crime reduction ultimately proves beyond the reach of the law and economics enforcement authority, it may be within the reach of socially responsible corporations. But inducing these corporations to more than mere compliance requires a reexamination of the basic assumptions on the relationship between CSR and globalization.

I. THE LOGIC OF DETERRENCE

This section briefly discusses both the theoretical and empirical scholarship on how deterrence works. It then shows how little attention deterrence scholars have paid to the problem of overdeterrence.

A. The Downside of Deterrence's Upside

Within the law and economics scholarship, the watershed work on public law enforcement was Polinsky and Shavell's *The Economic Theory of the Public Enforcement of Law*.[6] They explain that to the law and economics way of thinking, "social welfare generally is presumed to equal the sum of individuals' expected utilities."[7] An individual's expected utility essentially depends on four variables: whether she commits a harmful act, whether she is sanctioned (by fine, imprisonment, or both), whether she is a victim of someone else's harmful act, and on her tax payment

6 *See generally id.*
7 *Id.* at 48.

(which will reflect the costs of law enforcement, less any fine revenue collected).[8]

The individual thus wears two hats in the utility calculation: as potential wrongdoer, and as potential victim. The potential victim's two variables—whether she is a victim, and the extent of her taxes—are of course closely interconnected. Recognizing her potential victimization, she pays taxes to prevent it. The purpose of paying taxes, then, is to prevent the disutility of victimization. The paradigm thus assumes that we pay taxes to increase our individual utility; were there no threat of victimization, the individual would have no reason to pay taxes. There would be no utility in it; not faced with the threatened disutility of falling victim, her utility would not be maximized by paying taxes to finance public criminal law enforcement. The potential victims are taxpayers; the taxpayers are potential victims.

The "enforcement authority's problem" then is to maximize social welfare by finding the most efficient combination of the four key enforcement variables mentioned above: enforcement expenditures, the level of the fine, the length of imprisonment, and the standard for imposing liability.[9] The disutility of crime is weighed against the cost of prevention, and the aim is to reduce crime with maximal cost-efficiency. The enforcement authority should expend only so much on enforcement as is necessary to reduce the disutility for the taxpayer.

Following Beccaria's admonition that "[i]t is better to prevent crimes than to punish them,"[10] law and economics seeks to deter crime by ensuring that the cost of punishment to a potential wrongdoer exceeds the rewards.[11] The core assumption of deterrence is that potential wrongdoers will decide against the commission of a criminal act based on the fear of sanctions or punishment. [12] It assumes that the potential (and perhaps hypothetical) wrongdoer calculates the utility of crime based on the benefits and costs of the criminal act as well as the benefits and costs of abstaining.[13] The attributes of punishment that can be manipulated to maintain the proper cost-benefit ratio are its certainty, severity, and celerity (or swiftness). [14] If set

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8 *Id.*

9 *Id.* at 49.

10 CESARE BECCARIA, ON CRIMES AND PUNISHMENTS 93 (Henry Paolucci trans., 6th prtg. 1977) (1764).

11 GEORGE B. VOLD, THOMAS J. BERNARD & JEFFREY B. SNIPES, THEORETICAL CRIMINOLOGY 196 (5th ed. 2002).

12 Raymond Paternoster, *How Much Do We Really Know About Criminal Deterrence?*, 100 J. CRIM. L. & CRIMINOLOGY 765, 766 (2010).

13 *Id.*

14 *Id.* at 783.

appropriately, the potential violator will succumb to deterrence because a rational choice would never result in the commission of a crime; the cost would prove too high in comparison to the perceived benefit. [15] Thus, "[p]unishment is said to have a deterrent effect when the fear or actual imposition of punishment leads to conformity."[16]

This core theory has given rise to a number of hypotheses that empiricists continue to test. Questions remain concerning to what extent an increase in the objective costs of punishment to a potential wrongdoer, particularly length of sentence, will decrease the incidence of crime; to what extent increasing enforcement resources will increase certainty and celerity; whether objective increases in certainty, severity, or celerity will produce a proportional increase in the subjective perceptions of those attributes among wrongdoers and therefore exert a downward push on crime; etc.[17]

But note that these are questions of degree. While we do not know whether deterrence "works very well,"[18] we know it works. The empirical evidence indeed demonstrates that deterrence measures succeed—however imperfectly—in reducing crime. [19] Actors subject to the jurisdiction of a law that penalizes a given form of conduct with the requisite degree of certainty, severity, and celerity will engage in less of that conduct. We know this, and we might call it the upside of deterrence.

But notice the corollary. If we know that actors subject to a criminal prohibition will engage in less of that conduct, we also know that actors not so subject will engage in more of it. Applied to white-collar enforcement, companies subject to the criminal prohibition on a particular form of profitable but socially undesirable conduct will engage in less of that conduct than companies that are not so subject; companies not subject to that prohibition will engage, relatively speaking, in more of that conduct. This is the downside of deterrence's upside. To clarify, what I am here calling the downside is not a consequence of its upside; it is merely a logical corollary that will prove important in the analysis below. And in international business, governed by the extraterritorial application of criminal laws, where the law's

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15 *See* VOLD ET AL., *supra* note 11, at 196.

16 TERANCE D. MIETHE & HONG LU, PUNISHMENT: A COMPARATIVE HISTORICAL PERSPECTIVE 20 (2005). Deterrence need not be complete; partial deterrence is still successful. *Id.* at 21.

17 *See* Paternoster, *supra* note 12, at 787–818.

18 *Id.* at 766; *see also* DAVID M. KENNEDY, DETERRENCE AND CRIME PREVENTION: RECONSIDERING THE PROSPECT OF SANCTION 9 (2009).

19 KENNEDY, *supra* note 18, at 10–11.

stated object is to deter overseas crime, the downside proves to be a tricky problem.

B. The Nonissue of Criminal Overdeterrence

Despite the robust theoretical and empirical deterrence literature, scholars have given little attention to the issue of criminal overdeterrence. In civil law, by contrast, the cost of overdeterrence is well recognized:[20] if punishment for causing a car accident were $1 million, people would likely cease driving.[21] But for the kinds of intentional acts generally proscribed by criminal law, the risk of discouraging socially productive behavior, or of encouraging constructive behavior, is negligible. Because the goal is to achieve effective deterrence by setting punishment at a sufficiently high level to dissuade potential offenders, the "temptation to impose increasingly harsher penalties is strong."[22] The optimal level of intentional (as opposed to negligent) criminal conduct, generally speaking, is therefore zero.

But scholars have, perhaps somewhat indirectly, addressed the problem of overdeterrence in two ways. These concern the risk that deterring a particular crime might increase the incidence of other crimes. The first is the problem of marginal deterrence: setting equally high penalties for crimes of unequal severity will tend to encourage the more severe crime. As George Stigler famously put it, "If the thief has his hand cut off for taking five dollars, he had just as well take $5,000."[23] Where the overall level of criminality might be understood as the number of crimes committed multiplied by their severity, disproportionate penalties for relatively mild criminal acts will remove the disincentive to engage in more serious crimes and thus increase overall levels of criminality.

The second is based on Neal Katyal's research on substitution. Katyal held that the public enforcement agency must consider how penalizing a given crime may increase the appeal of alternative, or substitute, crimes. An increase in the

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20 *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 213–17 (8th ed. 2011) (describing the theory of optimal tort damages).

21 John Bronsteen, Christopher Buccafusco & Jonathan Masur, *Happiness and Punishment*, 76 U. CHI. L. REV. 1037, 1056 n.100 (2009).

22 *Id.* at 1055–56. The overdeterrence problem can arise with negligence crimes; negligent vehicular homicide would raise the same overdeterrence problems as the civil example above, such that the optimal level of such homicides may be greater than zero. *Id.* at 1056 (stating in the civil tort context "the possibility of overdeterrence is a persistent problem"); *see also* POSNER, *supra* note 20.

23 George J. Stigler, *The Optimum Enforcement of Laws*, 78 J. POL. ECON. 526, 527 (1970).

"price" of one crime may cause potential wrongdoers to substitute criminal act X with criminal act Y or Z.[24] Accordingly, though enforcing the prohibition on X may well deter X, it may also increase the incidence of Y or Z.[25] For both of these problems, the effort to deter a given crime has produced the collateral harm of an increase in another form of crime.

But for these costs, scholars have not seemed particularly concerned about the collateral economic harm of deterring criminal behavior. But contemporary international white-collar enforcement may present new challenges to the logic of deterrence. Despite deterrence's relatively long history, originating in the eighteenth-century works of Montesquieu,[26] Beccaria,[27] and Bentham,[28] the concept fell out of fashion and was largely neglected[29] until the seminal work of Gary Becker in the 1960s.[30] And owing largely to Cold War ideological divisions, international business—and particularly the flow of capital from developed to developing countries—would not increase significantly until after the collapse of communism. As will be shown below, this new economic order raises significant theoretical and practical problems for deterrence.

II. THE CRIMOGENICS OF EXTRATERRITORIAL WHITE-COLLAR ENFORCEMENT

Extraterritorial conduct of any sort raises formidable law enforcement challenges: evidence is difficult to collect, foreign enforcement authorities may not be cooperative or well resourced, and cultural sensitivities must be navigated. But this article argues that the challenges of extraterritorial white-collar

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24 Neal Kumar Katyal, *Deterrence's Difficulty*, 95 MICH. L. REV. 2385, 2387 (1997).

25 The enforcement authority's inclination to inflict an increasingly severe punishment may be further restrained in two ways. Bronsteen et al., *supra* note 21, at 1056. First, the enforcement costs must be no greater than is necessary to achieve the optimal level of deterrence. *Id.* These costs would take two forms. *Id.* Most obvious are the costs of "detecting, trying, and imprisoning a criminal," which are of course substantial. *Id.* Under the logic of deterrence they cannot become excessively so, lest the taxpayers' disutility exceeds the risk of victimization. *Id.* But additionally, society incurs the opportunity cost of removing potentially productive individuals from society through imprisonment, a factor that is (from a narrowly economic perspective) especially pronounced in white-collar crime. *Id.* In addition to these social costs, utilitarianism would value the welfare (though not the rights) of the defendant; he need not suffer any greater a punishment than is necessary for deterrence purposes. *Id.* at 1056–57.

26 BARON DE MONTESQUIEU, THE SPIRIT OF THE LAWS (Thomas Nugent trans., Hafner Publ'g Co. 1949) (1748).

27 *See* BECCARIA, *supra* note 10, at 58.

28 JEREMY BENTHAM, AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION (J. H. Burns & H. L. A. Hart eds., 1996) (1789).

29 Paternoster, *supra* note 12, at 772–73.

30 *See, e.g.*, Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968).

deterrence run far deeper. By definition, many or most actors committing crimes in foreign jurisdictions are not subject to the same set of disincentives: companies seeking to extract Nigeria's oil will hail from the United States, the EU, Russia, China, and elsewhere, and these countries will have substantially different white-collar crime regimes in place. The United States, for example, may be able to deter socially destructive behavior among U.S. companies and other companies subject to U.S. jurisdiction, but it cannot readily alter the behavior of those companies that lie beyond its jurisdiction. To the extent that a country wishes to reduce criminal conduct in overseas locations where only a portion of all actors is subject to its jurisdiction, this becomes problematic.

Of course, it may well be true that in certain areas of law the aim is not to reduce the overall levels of a given sort of extraterritorial crime. We may wish only to deter the conduct among our own citizens, perhaps untroubled by the impact our own deterrence efforts may have on overall levels of criminality in those foreign locations. But other areas of law, such as anti-bribery law, prohibit the overseas conduct categorically, without regard to whether the conduct has any harmful impact whatsoever on U.S. markets or persons.

This section shows just how problematic that goal will prove to be. It develops a model that illustrates how, given current and foreseeable future legal and economic conditions, extraterritorial deterrence has pronounced crimogenic[31] tendencies. That is, in attempting to reduce crime overseas, wielding the tools of deterrence will often create the conditions in which the conduct we seek to deter actually proliferates.

A. Three Unique Conditions of International Business

Foreign direct investment, particularly in developing countries, has three inherent characteristics that distinguish it from the domestic conduct that deterrence scholarship generally assumes. In combination, they create a kind of perfect storm in which deterrence will often prove self-defeating.

The first I will call "selective criminalization." A given form of extraterritorial conduct may well be criminalized by a particular home jurisdiction: think of express statutory prohibitions on overseas bribery or monopolistic conduct in the

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31 For a discussion of crimogenics in deterrence, see Paul H. Robinson & John M. Darley, *The Role of Deterrence in the Formulation of Criminal Law Rules: At Its Worst When Doing Its Best*, 91 GEO. L.J. 949, 985–89 (2003); *see also* KENNEDY, *supra* note 18, at 54–72.

United States, and the dedication of substantial resources to their enforcement. But other countries may fall into either of two alternative categories: those that do not enforce their prohibitions, and those that have not enacted such prohibitions. In other words, among all actors in a given foreign jurisdiction, the conduct is only selectively criminalized: the criminal prohibition applies to some of the companies pursuing Nigerian oil, but not to others. The United States may wish to deter bribery there, but lacks jurisdiction over many of the actors.

The second characteristic I will call the "discretionary investment forum." A typical U.S.-based company will be doing business in the United States. The enforcement authority thus need not worry whether that company will choose to continue doing business there (unless, of course, a given criminal prohibition threatens to drive a company out of business altogether, but this is rare and probably confined to highly dubious business models). But overseas investment forums are inherently discretionary: a U.S.-based company may choose to focus its efforts in the United States, or to enter overseas markets, and if the latter, to focus on the developed or developing world, and to invest in particular countries. These countries will vary in their legal, economic, and cultural environments, potentially creating varying levels of risk that a U.S.-based company will engage in conduct that its home jurisdiction criminalizes. Accordingly, the enforcement authority must consider whether its companies will do business in these jurisdictions at all. When the enforcement authority uses the tools of deterrence to raise the costs of a particular behavior, the costs may rise to a level where, in certain contexts, the risk becomes too great. Companies may then use their discretion not to invest in particular projects, sectors, or countries. The effort to deter crime has thus deterred investment.

Should the enforcement authority care? The question goes to the very heart of the law and economics methodology. Richard Posner has characterized law as "a system for maximizing the wealth of society."[32] The aim of enforcement is thus to increase wealth, for individual persons and for society generally. The deterrence of investment in foreign countries has implications for both. Companies may forego relatively efficient investment opportunities for safer, but less efficient (and profitable) opportunities. This, in turn, impacts the wealth of both the capital-exporting and the capital-importing nation: the exporter's GDP is negatively impacted by the diminished profits of its

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32 *See* POSNER, *supra* note 20, at 32.

companies; and the importer's GDP is negatively impacted by the loss of foreign direct investment. If deterrence is understood as one of many mechanisms for increasing social wealth, deterring investment in particular discretionary investment forums is problematic. This becomes especially true in developing countries where the need to maximize wealth is most pressing.

The third characteristic I will call "investor substitution." Assume, for purposes of this theory, that the companies from diverse jurisdictions are interchangeable—that companies from the United States, Germany, and China are equally capable of providing the given good or service. This is of course not true in all industries; highly technologically sophisticated sectors, for example, will tend to favor companies from more developed countries. But the gap is narrowing as developing countries like China progress, and the gap does not exist at all for many or most industries. Further assume that the host country's need for FDI is constant, such that if companies originating from one jurisdiction are disinclined to do business in the manner expected by the host country, that host country will seek the investment from other jurisdictions. Given these assumptions, quasi-criminalization and the discretionary investment forum will result in investor substitution. Companies from a country that enforces a given criminal prohibition—again, think of the United States enforcing a bribery prohibition—may find the risk (say, of paying bribes in Nigeria) too high. Those companies may choose not to invest in countries like Nigeria (as ample empirical evidence demonstrates).[33] The host country, which remains in need of the FDI, will seek it from companies that are from jurisdictions that do not enforce the prohibition. Because these companies can provide roughly the same good or service—in other words, the substitution costs to the host country are negligible—they will become substitute foreign investors.

This analysis is related to, but significantly different from, the previous work on substitution. That body of scholarship, as noted above, has focused on a given actor substituting criminal acts Y and Z for criminal act X. It assumed a given set of actors, choosing among alternative forms of criminality. The principle of investor substitution is quite different. It assumes alternative actors are all deciding whether to engage in the same form of criminality (or, to be clear, conduct that one jurisdiction deems criminal, though others do not). It is a variation on the

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33 For a summary of the empirical literature, see Andrew Brady Spalding, *Corruption, Corporations, and the New Human Right*, 89 WASH. L. REV. (forthcoming Jan. 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2232670.

substitution thesis that applies uniquely to the realm of extraterritorial enforcement.

B. The Net Impact on Crime: An Illustration

The impact of investor substitution on the net levels of crime in the host country will depend on the level of enforcement. This section illustrates how a relatively low level of enforcement can reduce overall crime, but increases in enforcement will, ironically, increase levels of criminality. This model uses anti-bribery law to illustrate this dynamic.

This paper does not assume the existence of a perfectly rational enforcement authority. Rather than exploring what a hypothetical authority should do, it explores the implications of what actual governments would do or have done. It posits a number of conditions that closely resemble the actual world of anti-bribery enforcement, and which would likely be typical of other areas of extraterritorial white-collar criminal enforcement as well. Such an enforcement authority is, predictably, economically subrational in several important respects.

First, the enforcement authority assumes that the optimal level of bribery is zero, and does not engage in sophisticated arguments about whether some amount of bribery may actually be efficient. This assumption holds true both for bribery among companies subject to its jurisdiction, and for overall levels of bribery in the host countries as well. Alternatively, one might assume that the enforcement authority is guided by a deontological argument—that bribery is inherently wrong—rather than an assumption about the relationship between bribery and economic efficiency. Either way, the authority is determined to reduce bribery as far as possible.

Second, and relatedly, the agencies of the enforcement authority that enforce the bribery prohibition will actually take measures to deter bribery without regard for their impact on economic efficiency. Whatever they may have assumed about the relationship between bribery and efficiency, the statute charges the agencies with reducing bribery and makes no mention of its economic implications.

Third, the enforcement authority is unwilling or unable to impose a combination of enforcement expenditures and level of penalty that would immediately reduce bribery to zero. It is faced with limited enforcement resources, uncertain political support, and imperfect empirical knowledge about the effects of enforcement on crime. Similarly, it likely subscribes to notions of fairness that will prevent it from imposing the exorbitant

penalties that could deter bribery where the probability of detection was more limited. Thus constrained, the enforcement authority experiments with varying levels of enforcement over time (which is precisely what has occurred in the United States).[34] Accordingly, the illustration below posits a recognizably subrational enforcement authority, and uses law and economics principles to trace out the implications of that authority's enforcement decisions.

Assume, then, a developing country (the "host country") that solicits foreign direct investment in its infrastructure sector. In this country and sector, bribery is quite common. Further assume that companies from two jurisdictions—Jurisdiction A and Jurisdiction B—have historically invested in this sector.[35] All firms competing in the host country's infrastructure sector are from one of these jurisdictions; no companies from jurisdictions other than A or B are investing there.

The host country will regularly issue Requests For Proposals (RFPs) and companies will submit bids in an effort to win contracts. Each contract involves a variety of transactions in which bribes would typically be paid: some would be paid during the bidding process (preparing and submitting the bid, then winning the contract) and others would be paid in the course of performing the contract (visas, permits, inspections, etc.). Further assume that the number of transactions per contract is fixed, resulting in a fixed number of total transactions. For purposes of this argument, assume that 100% of all business transactions in the host country government have involved bribes.

At a time that we shall call Time 1, neither Jurisdiction A nor Jurisdiction B is enforcing an extraterritorial bribery prohibition. Firms from both A and B therefore pay bribes freely. But Jurisdiction A firms are more efficient than Jurisdiction B firms, such that A firms in Time 1 win 60% of the contracts and B firms win 40%. The chart below captures these numbers.

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34 *Id.* at 7–10.

35 I use "jurisdiction" rather than "country" because often the jurisdiction of a given country will extend to companies from other countries as well. For example, certain foreign companies are subject to the jurisdiction of the U.S. extraterritorial anti-bribery statute, such that even though they do not reside in the United States, they are nevertheless "from" the U.S. jurisdiction. *See* U.S. DEPARTMENT OF JUSTICE & U.S. SECURITIES AND EXCHANGE COMMISSION, FCPA: A RESOURCE GUIDE TO THE FOREIGN CORRUPT PRACTICES ACT 11 (2012), *available at* http://www.justice.gov/criminal/fraud/fcpa/guide.pdf.

Time	Enforcement Level	% Market Share for Firms from Jurisdiction A	% Bribes that A Firms Pay in Their Transactions	Overall Rate of Bribery in Host Country
T1	None	60	100	100

Firms from Jurisdiction A win 60% of the contracts, but pay bribes in 100% of the transactions. Jurisdiction B firms thus have a 40% market share, and likewise bribe 100% of the time. The overall rate of bribery in the infrastructure sector of the host country is therefore 100% in Time 1.

However, at Time 2, Jurisdiction A announces that it will begin enforcing an extraterritorial criminal bribery prohibition. The enforcement agencies are, again, subrational actors, so they are unable to implement an enforcement regime that would reduce bribery to zero: they cannot dedicate the resources necessary to raise the probability of detection to the requisite level, and fairness principles do not allow them to impose exorbitant penalties that would compensate for the low level of detection. Constrained as they are by limited resources and by fairness, they commence what we will call a low level of enforcement. Jurisdiction B does not follow suit and does not implement any kind of extraterritorial bribery prohibition, so B firms continue to bribe freely.

The host country issues a new set of RFPs and awards all available contracts to firms from Jurisdictions A and B. Jurisdiction A firms now become what we will call reluctant bribe payers. They do not stop paying bribes altogether, but they begin searching for ways to avoid paying bribes where possible while remaining present in the sector and profitable. While they may have previously paid a small bribe to expedite a visa approval, they are now willing to wait; instead of paying a bribe to send their goods immediately through customs, their ships wait in line for days in the harbor. Similarly, the government of Jurisdiction A begins working on behalf of its companies to reduce the demand for bribery in the host country (as the U.S. and UK governments do today).

The reluctant bribe payers (companies from Jurisdiction A) recognize that avoiding bribes will often reduce their efficiency—waiting in the harbor for customs approval is not without cost to the company. But they are willing to absorb these costs to reduce the risk of penalty for violating the prohibition. Although the risk of penalty is high enough to deter a certain amount of bribery, it

is not high enough to completely stop paying bribes. For reluctant bribe payers, the benefits of continuing to invest in the host country remain high enough that the company can pay some bribes and accept the risk that it will be caught and penalized for violating the bribery prohibition.

In the course of continuing to do business in the host country, the reluctant bribe payer will therefore encounter three kinds of transactions. The first is where the risk of detection is sufficiently high (or the firm is sufficiently principled) that it refuses to pay the bribe but can still find ways to complete the transaction. These may entail increased costs for the firm (such as waiting in line at port) but owing to the firm's efficiency (or the less than perfectly competitive market conditions) the firm can absorb these costs while remaining profitable. Alternatively, the firm may seek the diplomatic assistance of the governments (in the United States, these would be the Departments of Commerce or State). This is the kind of conduct that anti-bribery advocates seek to incentivize and may generally assume occurs. However, the firm will encounter a second kind of bribe, in which it will likewise refuse to pay but cannot complete the transaction without it. The firm must therefore knowingly forego the transaction; the best example would be a lost bid in a RFP. For the third kind of bribe, the risk of detection may be sufficiently low, or the costs of foregoing the transaction are sufficiently high (the company really needs this particular bid, or cannot afford to wait three days in port) that the firm will pay the bribe and accept the risk of detection.[36]

Given the three types of bribes the firm will encounter and Jurisdiction A's new but still low-level of enforcement, assume that A firms reduce their bribery by half. They are now willing to pay bribes in 50% of all transactions. Assume further that as a result, the percentage of contracts they will be able to win also drops by half, from 60% of all contracts to 30% of all contracts. Investor substitution occurs, and B firms win the extra 30% of the contracts. Now A firms have 30% of the market and B firms have 70%. Owing to the downside of deterrence's upside, B firms

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36 The ability of companies from Jurisdiction A to absorb a degree of lost profits but remain competitive assumes that the market is not what economists would consider perfectly competitive. Were it so, the companies would have no margin to absorb the losses because competitors would have already been selling at the lower cost. But foreign direct investment is not perfectly competitive, in at least two respects. First, often a sort of oligopoly exists where only select companies from select countries are positioned to compete. Second, some companies might have a competitive advantage by virtue of their access to capital, technological, or various forms of government support. Accordingly, this illustration assumes that Jurisdiction A firms are operating at a level of profitability that permits them to absorb limited losses to comply with the statute.

continue to bribe in 100% of all their transactions, and therefore will bribe on the extra 30% of the contracts they will win. But because A firms were paying bribes on those contracts in Time 1, investor substitution has not resulted in a net increase in bribery in the host country.

Rather, A's low level of enforcement has thus succeeded in two respects. Of the 30% of the contracts that A firms win, they will only pay bribes in 50% of these transactions. For half of this 30%, or 15%, no bribes are being paid; this portion of the host country's infrastructure sector is now clean. Jurisdiction A's enforcement has thus reduced bribery among its own firms by 50%, and has reduced net bribery levels in the host country by 15%.

Time	Enforcement Level	% Market Share for Firms from Jurisdiction A	% Bribes that A Firms Pay in Their Transactions	Overall Rate of Bribery in Host Country
T1	None	60	100	100
T2	Low	30	50	85

Again, overall levels of bribery have gone down from 100% to 85% because A firms have a 30% market share and are not paying bribes on half of the related transactions. This is the outcome that anti-bribery advocates take for granted, and for those who accept the normative premise that federal law should deter overseas bribery, it is the reason to continue enforcement.

But now assume a subsequent point in time, called Time 3. The enforcement authorities in Jurisdiction A, perhaps encouraged from the successes of Time 2, have decided to ramp up enforcement through the dedication of new resources. We will call this mid-level enforcement, and it significantly increases the likelihood of detecting violations. In Time 3, the host country issues a new set of RFPs. The other assumptions still hold: the total number of transactions is again fixed, companies from Jurisdictions A and B will again compete, and companies from Jurisdiction B still bribe without fear of punishment.

Companies from Jurisdiction A now engage in a new cost-benefit analysis. They conclude that because the risk of detection and therefore penalty is higher, they must pay even fewer bribes than they did in Time 2. Say that mid-level

enforcement induces A firms to reduce their bribery percentage from 50% to 25% of all transactions.

The mid-level enforcement regime has thus succeeded in reducing bribery among companies subject to its jurisdiction. But consider the impact that investor substitution will now have on the change in overall bribery levels from Time 2 to Time 3. Although A firms won 60% of all contracts when bribing 100% of the time, they can now win only one-fourth of those contracts.[37] They now have only a 15% market share, down from 30% in Time 2. The 15% market share that A firms have lost since Time 2 will now go to B firms, which continue to bribe 100% of the time. In other words, 15% of the transactions have shifted from reluctant bribe payers to free bribe payers. Jurisdiction A firms remain engaged in only 15% of all transactions in the host country's infrastructure sector, and they will pay bribes in one-fourth of that 15%. Accordingly, A firms are bribe-free in 11% of all transactions. Because all other transactions are paid with bribes, the overall bribery level in the host country is now at 89%.

Time	Enforcement Level	% Market Share for Firms from Jurisdiction A	% Bribes that A Firms Pay in Their Transactions	Overall Rate of Bribery in Host Country
T1	None	60	100	100
T2	Low	30	50	85
T3	Mid	15	25	89

From Time 2, overall bribery has increased by 4%, and the increase is entirely due to Jurisdiction A's increased enforcement effort.

Consider a further period in time, Time 4, in which Jurisdiction A has finally resolved to dedicate the enforcement resources necessary to achieve what it deems the optimal rate of bribery among its firms—0%. And suppose it succeeds, such that now A firms pay absolutely no bribes. Further assume that all other conditions remain the same, and the host country issues a new set of RFPs. Jurisdiction A firms can no longer win contracts

37 This exercise assumes that the percentage of contracts it can win will drop precisely in the same amount as the percentage of bribes it can pay. In practice, the relationship between these two figures would be more complicated.

in this host country's infrastructure sector. Jurisdiction B firms now win 100% of the contracts, engage in 100% of the transactions, and pay bribes 100% of the time. While the rate of bribery among A firms is now 0%, the overall rate of bribery in the host country is 100%.

Time	Enforcement Level	% Market Share for Firms from Jurisdiction A	% Bribes that A Firms Pay in Their Transactions	Overall Rate of Bribery in Host Country
T1	None	60	100	100
T2	Low	30	50	85
T3	Mid	15	25	89
T4	High	0	0	100

Notice the pattern. At Time 2, its efforts to deter bribery were effective in reducing the overall level of bribery in the host country. The success was due to raising the risk of detection and penalty to the point that its companies would make an effort to bribe less, but could still do business. Companies from Jurisdiction A indeed lost business as a result of the decision to enforce the bribery prohibition. But in Time 1, companies from Jurisdiction A were bribing as freely as companies from Jurisdiction B, so losing business to companies from Jurisdiction B at Time 2 did not result in an increase in bribery for the host country. The enforcement authority from Jurisdiction A thus continues to believe that increasing enforcement will decrease bribery. But at Time 3, the second increase in enforcement has reduced bribery only among companies subject to A's jurisdiction. Those companies are indeed bribing less. But owing to investor substitution, the impact on overall levels of bribery in the host country is a net increase. And we saw at Time 4 that raising penalty risks further can produce a scenario in which the rates of bribery in the host country return to 100%, a level not seen since before the enforcement effort began. In sum, after Time 1, the overall rate of bribery in the host country correlates inversely with Jurisdiction A's enforcement. Likewise, it correlates inversely with the percentage of bribes that A firms are paying. As Jurisdiction A attempts, and succeeds, in decreasing bribery among its own companies, it increases overall bribery in the developing country.

This illustration is of course artificially simplified. In reality, a number of additional variables would influence the net impact of increased enforcement: the number of transactions, the number of agencies or persons soliciting bribes, changes in the level of penalty, changes in the effectiveness of the reluctant bribe payer's tools for avoiding bribes, and perhaps most importantly, a decrease in the percentage of transactions in developing countries that require bribes. Developing a model that considers each of these variables is a project for another day. But this thought experiment nevertheless illustrates limitations inherent in the effort to deter extraterritorial white-collar crime, given current global economic and legal conditions.

C. Deterrence's Double Disutility

Though the enforcement authority's aim is to maximize utility, extraterritorial white-collar deterrence will tend to produce two distinct forms of disutility.

The first is, quite simply, that it often will not work. As explained above, overseas business environments will often lead to an increase, rather than a decrease, in the conduct we seek to deter. This will be true as long as capital-exporting jurisdictions vary in their enactment and enforcement of criminal prohibitions. The answer, one might think, is to tinker with the variables available to the enforcement authority: enforcement expenditures, fine levels, the length of imprisonment, and the standard for imposing liability. The problem, however, is that once into Time 2, decreasing the cost of the penalty through any of these four variables will necessarily decrease the disincentive to engage in the act: reducing enforcement expenditures, fines, or prison terms, or raising the standard for imposing liability, will decrease the costs of crime and increase its frequency.

In Times 2 and 3, the enforcement authority is trapped. By not increasing the risk of detection, it tolerates a measure of criminality among persons subject to its jurisdiction. But by raising the risk of detection, it produces the concurrent decrease in criminality among its companies, and an increase in that same behavior in the host country among all actors. These are the Scylla and Charybdis of extraterritorial white-collar criminal enforcement. The enforcement authority must choose between the harm of knowingly tolerating preventable criminality among its own companies, and knowingly increasing levels of criminality in vulnerable developing countries. It cannot avoid both.

But even if the first problem were resolved, and overseas deterrence efforts were to effectively reduce crime, the law and economics enforcement authority would be left with a second

problem. Consider again the assumption behind the economic theory of public enforcement: the taxpayer is the potential victim, and she pays taxes to prevent her victimization. That works in domestic enforcement, where all potential victims are taxpayers and all taxpayers are potential victims. But what if the victims are not taxpayers, and the taxpayers are not victims? What if the victims lie beyond the jurisdiction that is enforcing the criminal prohibition, and are therefore not paying the taxes that fund enforcement? Again using the anti-bribery example, we devote substantial public resources to protecting those overseas victims through the DOJ, SEC, FBI, offices in Commerce and State, and the federal judiciary. And various economic benefits might very well accrue to U.S. taxpayers, including the improvement of overseas markets and the resulting potential for economic and political alliances. But stakeholders to anti-bribery enforcement generally agree that the principal victims of extraterritorial bribery are the citizens of the overseas governments. And they are not paying for enforcement. That is, Congress enacted a statute in which U.S. taxpayers would pay to protect non-taxpayers from the harms of bribery. To the utility-maximizing taxpayer typically associated with law and economics, this is the second disutility of deterrence.

The enforcement authority thus seeks the Golden Mean or, if one prefers, the Goldilocks theory, of enforcement: to enforce its prohibition only to the point that it deters overall levels of bribery, and not further. The law and economics enforcement authority is trapped in this dilemma, unable to achieve what it considers the optimal level of criminality among its own actors without raising levels of the same conduct in the host country.

To the extent that the extraterritorial prohibition seeks both to deter criminality among the jurisdiction's own actors and to reduce overall levels of crime, the traditional mechanisms of deterrence may not be the most effective tools available. That is, the means typically employed by deterrence advocates may not be best suited to achieve deterrence's goals. Rather, the achievement of deterrence goals may require using non-deterrence, or extra-deterrence, means.

As the above illustration shows, extraterritorial crime reduction requires reaching two sets of actors who lie beyond the reach of the enforcement authority. The first is the host country: to the extent that a capital-importing country can enforce its own prohibitions (on bribery, for instance) no investor substitution can occur. All companies investing in that country would (in theory) be subject to the same risks and costs, and would engage in crime at roughly similar levels. If the host country sought to

reduce a given form of conduct to zero, it could do so, and differences among the capital-exporting jurisdictions would become irrelevant. But a developing country, almost by definition, is ill-equipped to do so; its state is not yet sufficiently resourced to deter the conduct of powerful foreign firms. This is thus a long-term project. Accordingly, the capital-exporting jurisdiction seeking to deter destructive conduct in foreign countries can also seek to influence the behavior of competing capital-exporting jurisdictions that do not enforce comparable prohibitions (the B Jurisdictions). The problem, of course, is that the enforcing jurisdictions (the A Jurisdictions) generally have no authority over either the capital-importing or capital-exporting governments.

III. RETHINKING CORPORATE SOCIAL RESPONSIBILITY

The challenge of extraterritorial crime reduction is to promote better overseas conduct using tools other than, or in addition to, the coercive power of the state. The above illustration shows how mere compliance by firms subject to an enforcing jurisdiction will tend to create an environment in which those firms cannot compete: eventually, high levels of enforcement combined with investor substitution will chase them out of the market. From the company's own standpoint, then, compliance proves self-defeating. But where the risk of detection is sufficiently high, noncompliance is not the remedy; this too will prove self-defeating. The remedy lies in doing that which law does not, and perhaps could not, require: firms subject to such extraterritorial prohibitions must seek to change the behavior of competitor firms, and push for reforms in capital-importing governments.

Enter corporate social responsibility, which generally encourages firms to engage in socially beneficial conduct beyond the minimal requirements of compliance.[38] This is especially true in the face of globalization, where "the capacity of the state to regulate economic behavior and to set the conditions for market exchange is in decline."[39] CSR scholars have argued that globalization requires corporations to "go beyond what is

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38 Given the mind-boggling array of proffered definitions of CSR, this article attempts none. For a sample, see Doreen McBarnet, *Corporate Social Responsibility Beyond Law, Through Law, for Law: The New Corporate Accountability*, *in* THE NEW CORPORATE ACCOUNTABILITY: CORPORATE SOCIAL RESPONSIBILITY AND THE LAW 9, 9 (Doreen McBarnet et al. eds., 2007).

39 Andreas Georg Scherer & Guido Palazzo, *Globalization and Corporate Social Responsibility*, *in* THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY 413, 426 (Andrew Crane et al. eds., 2008).

required by law, when the legal system is imperfect or legal rules are incomplete."[40]

But the CSR literature "has only begun to discuss the consequences of globalization," [41] and has yet to tackle the difficult problems of extraterritorial deterrence given the reality of selective criminalization and investor substitution. While some scholars have suggested that "creative compliance" is the "most intractable" of "obstacles to effective legal control of business,"[42] the above deterrence analysis shows that the problem of corporate misbehavior is far greater than merely ensuring that firms obey the law to which they are subject. Jurisdiction A may draft a perfect statute, utterly devoid of loopholes and sufficiently expansive to include all conceivable forms of socially destructive behavior, and yet still fail to deter. Indeed, it may actually cause an increase in the proscribed conduct. CSR, accordingly, must do more than encourage firms to fully comply with the law in both its letter and "spirit." It must provide firms with a paradigm that induces them to systematically work toward altering the conduct of actors other than themselves. It is an other-regarding form of CSR that focuses not on the victims, but on potential wrongdoers whose home jurisdictions are unwilling or unable to deter destructive behavior. It must further persuade firms that the socially responsible thing is closely aligned with their interests and motivations.

The existing literature on CSR and globalization has not provided this paradigm. That literature has generally envisioned any or all of three forms of socially responsible corporate conduct with respect to developing countries. The first appeals to the firm's profit motive. It argues that various forms of socially beneficial conduct, while not immediately profitable, will tend to prove profitable in the long term. Indeed, it may have become "conventional wisdom for management texts and CSR advocates" to claim that considering "a broad range of stakeholders is in a firm's best long-term interests."[43] This is sometimes called the "business case" for CSR, holding that companies can "do well by

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40 *Id.* at 414.

41 *Id.* at 422.

42 *See* McBarnet, *supra* note 38, at 48.

43 David L. Levy & Rami Kaplan, *Corporate Social Responsibility and Theories of Global Governance: Strategic Contestation in Global Issue Arenas, in* THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY 433, 435 (Andrew Crane et al. eds., 2008) (citing ANNE T. LAWRENCE & JAMES WEBER, BUSINESS AND SOCIETY: STAKEHOLDERS, ETHICS, PUBLIC POLICY 21 (13th ed. 2004)).

doing good."[44] The business case hypothesis has been subject to rigorous empirical tests over the years, but the results have proven unpersuasive.[45] Some have thus concluded that "a solid business case cannot be built by depending solely on locating an irrefutably established causal connection" between CSR and financial performance.[46] The link is simply too remote and tenuous.

Accordingly, other forms of CSR in the globalization context appeal to other corporate motives and modes of operation. The second form of CSR is philanthropy, whereby the firm functions as a charitable donor. In developing countries, CSR frequently takes the form of investment in education, health, the environment, or other community services.[47] While a firm may well have mixed motives in its charitable undertakings, this form of CSR seeks to move beyond the short-term profit motive in encouraging socially responsible behavior.

Yet a third form of CSR frames the corporation not as a self-interested profit seeker but as a citizen, as a responsible contributing member of the polity. It holds that particularly in developing countries, where the host state is less effective and the regime of transnational rules is "fragile and incomplete," firms have a "political responsibility to contribute to the development and proper working of global governance."[48] These scholars argue that corporations must become "politicized" through an "enlarged understanding of responsibility" to "solve political problems in cooperation with state actors and civil society actors."[49] They should adopt more "cosmopolitan or higher-order interests."[50] These scholars envision CSR as part of a process in which "political solutions for societal challenges are no longer limited to the political system but have become

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44 Elizabeth C. Kurucz, Barry A. Colbert & David Wheeler, *The Business Case for Corporate Social Responsibility*, *in* THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY 83, 84 (Andrew Crane et al. eds., 2008).

45 *See, e.g.*, Philip L. Cochran & Robert A. Wood, *Corporate Social Responsibility and Financial Performance*, 27 ACAD. OF MGMT. J. 42, 42–56 (1984); Samuel B. Graves & Sandra A. Waddock, *Institutional Owners and Corporate Social Performance*, 37 ACAD. OF MGMT. J. 1034, 1042–44 (1994); James E. Mattingly & Shawn L. Berman, *Measurement of Corporate Social Action: Discovering Taxonomy in the Kinder Lydenburg Domini Ratings Data*, 45 BUS. & SOC'Y 20, 40–42 (2006).

46 Kurucz et al., *supra* note 44, at 85.

47 Wayne Visser, *Corporate Social Responsibility in Developing Countries*, *in* THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY 473, 493 (Andrew Crane et al. eds., 2008).

48 Scherer & Palazzo, *supra* note 39, at 414.

49 *Id.* at 426.

50 *Id.* at 427 (citing Hildy Teegan, Jonathan P. Doh & Sushil Vachani, *The Importance of Nongovernmental Organizations (NGOs) in Global Governance and Value*, 35 J. OF INT'L BUS. STUD. 463, 471 (2004)).

embedded in decentralized processes that include non-state actors such as NGOs and corporations."[51] Ultimately, by this view, corporations must be understood as both "economic and political actors."[52]

Note the relationship here between economic and political action. This model expressly makes a distinction between the conventional economic motives of a multinational corporation, and the "higher-order" political motives. This form of CSR asks firms to transcend profit seeking in the name of citizenship. It posits a sharp dichotomy between the firm's short-term economic interests and society's longer-term interests.[53]

Notably, so too does the charity model rest on this distinction. It calls upon firms to build social infrastructure through donations that, with the possible exception of tax benefits, are generally a chink to the bottom line. Finally, notice that even the so-called business case concedes the tension between foreseeable profits and socially responsible conduct. It has historically built its case not on foreseeable profits, but on long-term profit, and asked (or hoped) that the empiricists could prove the connection. This empirical proof was sought, of course, because the connection between CSR and profit was not immediately apparent. Like the charity and political actor models, the business case asks the firm to set aside short-term interests in the name of a longer-term—and, it seems, elusive—financial benefit.

But this distinction—between short-term economic interests and long-term social interests—is precisely the reason that so many doubt whether CSR can ever do much work. To the extent that corporations are asked to suspend or compromise their pursuit of profits, we wonder whether CSR's impact will expand beyond the fringes. CSR's prospects would indeed be far greater in a set of legal and economic conditions that made the connection between socially beneficial conduct and immediate profits more apparent.

Those circumstances now exist in the arena of foreign direct investment in developing countries. The above analysis has shown that only up to a point will developed countries' efforts to reduce overall levels of extraterritorial crime actually work. Given the unique conditions of selective criminality and investor substitution, strict compliance with an ever-increasing

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51 *Id.* at 427.

52 *Id.*

53 *See* Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705, 707 (2002).

enforcement effort poses an immediate threat to the profitability of companies from enforcing jurisdictions. Companies from non-enforcing jurisdictions will eventually chase them out of the market. Companies will see—and indeed, in the bribery space they increasingly report[54]—that enforcement and compliance significantly compromise their profitability.

In this space arises the need for a new kind of CSR. Like the third model above, it would call on corporations to work toward political reforms in the countries in which they do business. It would indeed ask them to assume the role of a responsible citizen, and help to ensure that not just they, but others as well, are subject to meaningful laws that are effectively enforced. It would help to create the conditions that give rise to a broad-based culture of compliance. But in acting as citizen, this form of CSR would not ask the corporation to suspend its pursuit of profit, even of foreseeable and relatively short-term profit. It would not ask firms to alternately wear either of two hats—one as profit-seeker, the other as responsible citizen. It would collapse the dichotomies that are so pervasive in CSR literature—between private and public, between profit and charity, between the demands of business and the aspirations of politics.

Corporations might engage in any number of such activities in developing countries. They might finance studies on the causes of particular forms of criminal conduct and develop innovative solutions. They might lobby for reforms in the host country that would increase, rather than decrease, enforcement. So too might they lobby their own jurisdiction to use the levers of international diplomacy to force other capital-exporting jurisdictions to enforce their extraterritorial prohibitions. All of these can be justified by a CSR model that recognizes corporations as responsible citizens. And all can be justified by an appeal to immediate profitability. A compliant U.S.-based multinational corporation doing business in Nigeria does not need a host of empirical studies to understand that if Nigeria enforced its own domestic bribery prohibitions, or China enforced its extraterritorial prohibition, the U.S. company would become more profitable.

CSR is typically understood as a critique, either explicit or implicit, of neoclassical economics. It has sought to move beyond the Friedmanesque view of the firm, which has "one and only one social responsibility of business—to use its resources and engage

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54 *See* Spalding, *supra* note 33, at 10–15.

in activities designed to increase its profits so long as it stays within the rules of the game."[55] So too has the bulk of CSR literature asked firms to move beyond the motives typically attributed to the *homo economicus* of law and economics. Though it may well remain true that business engagement with social issues is "generally attributed to two broad motivations, financial and political-institutional," [56] these need not be mutually exclusive. To the extent that the CSR literature can collapse this dichotomy, it will do far more to command the attention of the corporations whose voluntary conduct the advocates wish to direct. And contemporary international business, where companies from diverse jurisdictions are competing in developing countries for business, now provides the catalyst.

CONCLUSION

The above model has shown how efforts to decrease overseas bribery may very well have the opposite result and increase levels of criminality. It has used bribery precisely because it is perhaps the best example today of U.S. law pursuing overseas deterrence. But the model would apply to any area of law in which overall deterrence was the policy goal but where global legal and economic conditions give rise to investor substitution. Though the U.S. Supreme Court has recently taken measures to restrict the extraterritorial application of federal law governing corporate conduct, [57] the trajectory of increasing globalization would suggest that efforts to regulate extraterritorial business conduct will tend to expand rather than retract. Should this happen, regulators and advocates alike will increasingly contend with these unique conditions.

Ultimately, the deterrence theory of law and economics identifies a problem that it cannot solve. It must hand off the problem to another literature, with a different set of assumptions and goals, in the hopes that it may fashion a new remedy. CSR may very well be that literature. This essay calls upon it to move beyond the dichotomies that have simultaneously made CSR scholarship seem so inspiring to some and yet so futile to others. Indeed, applied to contemporary international business, CSR's

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55 MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962).

56 Levy & Kaplan, *supra* note 43, at 435.

57 *See* Morrison v. Nat'l Australia Bank Ltd., 130 S. Ct. 2869, 2887–88 (2010) (restricting the application of Rule 10b-5 to domestic transactions); Kiobel v. Royal Dutch Petroleum Co., 133 S. Ct. 1659, 1669 (2013) (restricting the application of the Alien Tort Statute to conduct that "touch[es] and concern[s] the territory of the United States . . . with sufficient force.").

goal may very well be to collapse the dichotomy between law and economics and CSR itself.

The Coasean Dissolution of Corporate Social Responsibility

*Robert T. Miller**

INTRODUCTION

Assertions that corporations should be socially responsible[1] commonly elicit either of two quite different reactions.[2] On the one hand, there is an enthusiastic affirmative response, generally grounded in moral views and often associated with the liberal end of the political spectrum.[3] This response, which is usually coupled with the idea that big business is malevolent and dangerous, holds that corporate managers are too often concerned only with profits and that, unless guided by the values of corporate social responsibility (CSR), corporations cause great harm to society. On this view, corporations are generally not sufficiently socially responsible and ought (in a moral sense of

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1 For recent scholarship, see generally ARCHIE B. CARROLL ET AL., CORPORATE RESPONSIBILITY: THE AMERICAN EXPERIENCE (Kenneth E. Goodpaster ed., 2012); DANIEL E. BRENNAN ET AL., CORPORATE SOCIAL RESPONSIBILITY: THE CORPORATE GOVERNANCE OF THE 21ST CENTURY (Ramon Mullerat ed., 2d ed. 2011); BRYAN HORRIGAN, CORPORATE SOCIAL RESPONSIBILITY IN THE 21ST CENTURY: DEBATES, MODELS AND PRACTICES ACROSS GOVERNMENT, LAW AND BUSINESS (2010); Peter Dobers & Delyse Springett, *Corporate Social Responsibility: Discourse, Narratives and Communication*, 17 CORP. SOC. RESP. AND ENVTL. MGMT. 63 (2010).

2 Abagail McWilliams & Donald Siegel, *Corporate Social Responsibility: A Theory of the Firm Perspective*, 26 ACAD. OF MGMT. REV. 117, 117 (2001); Abagail McWilliams & Donald Siegel, *Corporate Social Responsibility and Financial Performance: Correlation or Misspecification?*, 21 STRATEGIC MGMT. J. 603, 603 (2000).

3 CARROLL ET AL., *supra* note 1, at 91; BRENNAN ET AL., *supra* note 1, at 35; HORRIGAN, *supra* note 1, at 73; Dobers & Springett, *supra* note 1, at 65; KENT GREENFIELD, THE FAILURE OF CORPORATE LAW 154 (2006). As Herbert Hovenkamp has pointed out to me, however, some CSR concerns are championed more by persons and organizations on the political right, such as Evangelical Christians and traditional Roman Catholics. For example, businesses owned and managed by such groups have resisted the Health and Human Services (HHS) mandate related to insurance coverage for abortifacient drugs under the Affordable Care Act. *See, e.g.*, Hobby Lobby Stores, Inc. v. Sebelius, 723 F.3d 1114 (10th Cir. 2013).

ought) to do more to promote socially desirable ends, regardless of how this affects the profits of the firm.[4] On the other hand, there is also a negative and hostile response to the assertion that corporations ought to be socially responsible.[5] This view is generally grounded in economic norms concerning efficiency and is often associated with the conservative end of the political spectrum. Usually coupled with the idea that big business has a generally positive effect on society, this response holds that CSR activities reduce corporate profits and usually fail to achieve their intended ends, which implies that corporate managers ought to eschew such activities and seek only to maximize profits within the law.[6] In this way, businesses benefit society in the only way they reasonably can, and attempts by corporations to do more or otherwise generally destroy value and are socially harmful. Typifying this view is Milton Friedman, who famously said that the only social responsibility of corporations is to increase their profits.[7]

Both of these responses to CSR have some truth in them, but both are also somewhat confused. In particular, I shall argue in this Article that, based on conventional views in the economic analysis of law, we should expect that corporations will engage in an efficient amount of CSR activities.[8] In fact, it turns out that the conflicts generated by CSR concerns generate a classic Coasean incompatible use problem, albeit in an especially complex context. For firms are engaged in operating their businesses in a manner that maximizes profits, but other people wish that they would modify their activities in various ways that would result in the firm's having lower profits. The question is therefore how businesses are going to operate. In accordance

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4 CARROLL ET AL., *supra* note 1, at 114; BRENNAN ET AL., *supra* note 1, at 129; HORRIGAN, *supra* note 1, at 5; Dobers & Springett, *supra* note 1, at 65. Similarly, compare the differing reactions to Citizens United v. Fed. Election Comm'n, 558 U.S. 310 (2010) of Ronald Dworkin, *The "Devastating" Decision*, N.Y. REV. BOOKS, Feb. 25, 2010, *available at* http://www.nybooks.com/articles/archives/2010/feb/25/the-devastating-decision/, and Richard A. Epstein, *Citizens United v. FEC: The Constitutional Right That Big Corporations Should Have but Do Not Want*, 34 HARV. J.L. & PUB. POL'Y 639 (2011).

5 *See generally* DAVID HENDERSON, MISGUIDED VIRTUE: FALSE NOTIONS OF CORPORATE SOCIAL RESPONSIBILITY (2001).

6 *Id.*

7 Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 33.

8 In connection with a firm's dealings with its customers, Abagail McWilliams and Donald Siegel have argued for an identical conclusion based on a neo-classical supply and demand model of CSR. McWilliams & Siegel, *supra* note 2, at 125. My conclusions in this Article are consistent with theirs, to which I am very much indebted. McWilliams and Siegel, however, do not reach their conclusions and do not understand them in terms of the Coase theorem, and, more generally, do not consider the problem of CSR in the more realistic terms of costly markets. It is in exploring the issues in those terms that this Article seeks to make an original contribution.

with the Coase theorem,[9] when transaction costs are low, parties to mutually beneficial exchanges will generally engage in such exchanges. Since most large firms are already in contractual relationships with various parties that value certain CSR activities (and thus have low transaction costs with respect to those parties), the positive values that these parties place on CSR activities and the low transaction costs involved create the possibility for modifications of the contractual terms between the firm and such parties, such that the firm will engage in the CSR activities that the parties desire to the extent that the parties are willing to pay the costs incurred by the firm in doing so. For example, if the firm's customers value products made from recycled materials more than otherwise similar products, we should expect the firm to sell products made from recycled materials to the extent that the customers' willingness to pay for such products exceeds the incremental cost to the firm of producing such products, with the price of the products increasing to reflect this incremental cost. In short, the preference on the part of persons contracting with the firm for the firm to engage in CSR activities is no different from any other preference that a party may bring to a contractual situation: to the extent that a party's willingness to pay a contractual counterparty to do something exceeds the cost to the counterparty of doing what the party wishes, the agreement between the parties will generally require the counterparty to comply with the party's wishes, the price to the party rising accordingly and the exchange being efficient.

Part I of this article sets out in detail this Coasean understanding of CSR and examines how it will generally play out in a variety of CSR contexts, including in the firm's relationships with its customers, employees, suppliers and manufacturers, and investors, as well as the implications for situations in which the CSR concerns at issue are not generally represented by a constituency already in a contractual relationship with the firm—that is, in situations in which the key assumptions of Part I, that there is a party willing to pay for the firm's CSR activities and that the transaction costs between such party and the firm are low, fails. Part II considers some moral concerns that the foregoing analysis raises, including (a) whether the corporation is really serving the moral ends of CSR if it

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9 *See* Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15–16 (1960). For general overviews of the immense literature on the Coase theorem, see 1 Steven G. Medema & Richard O. Zerbe, Jr., *The Coase Theorem*, *in* ENCYCLOPEDIA OF LAW AND ECONOMICS 836 (Boudewijn Bouckaert & Gerrit De Geest, eds. 2000); Francesco Parisi, *Coase Theorem and Transaction Cost Economics in the Law*, *in* THE ELGAR COMPANION TO LAW AND ECONOMICS 7 (Jürgen Backhaus ed., 2005).

merely takes money to perform CSR activities from people who wish to pay for them, and (b) whether it is morally defensible that parties other than the corporation itself pay the costs of CSR activities, i.e., whether it is morally right that parties other than the firm have to pay the firm to do what is morally right. Part II is followed by some concluding remarks.

I. THE COASEAN UNDERSTANDING OF CORPORATE SOCIAL RESPONSIBILITY

In this Part, I consider transactions between the firm on one side and its various contractual counterparties on the other, including customers, employees, suppliers and manufacturers, and investors.[10] The primary assumption, as is standard in the economic analysis of law, is that human beings are rational actors who, in general, take actions reasonably calculated to satisfy their preferences. In Section I.A, I discuss this assumption in connection with the idea that such actors often have among their preferences such altruistic or moral preferences as manifest themselves in CSR concerns. In Section I.B, I elaborate a Coasean analysis of transactions between the firm and its counterparties on the assumptions that the parties involved have incompatible desires in that (1) the firm's managers seek to maximize its profits and (2) many of the firm's counterparties have preferences related to some standard CSR concerns to effect which they are willing to pay. The primary conclusion of this section will be that we should expect firms to modify the terms of their transactions with such counterparties to reflect the CSR concerns of such parties to the extent that such parties are willing to pay to see such concerns addressed, the incremental costs to the firm being reflected in upwards adjustments to the price paid by such parties in their transactions with the firm.[11] In the various subsections of Section I.B, I will apply the general conclusion to the special contexts of

10 I adopt the view common in the law and economics literature that we should view the relation between a corporation and its shareholders as contractual even though the relationship is in part defined by statutory law. As used in the text, investors include corporate shareholders and the equity holders of other kinds of business entities. The analysis in the text could be extended to include creditors as well, but CSR concerns seem to arise in the creditor-debtor context only rarely.

11 In referring to the price paid by counterparties animated by CSR concerns, I mean not just the financial price a party might pay in a transaction but the entire economic price to the party: that is, the firm may respond to the added cost it bears by addressing the counterparty's CSR concern by raising the financial price or by some other adjustment of the contract terms favorable to it but unfavorable to the counterparty, whatever is more efficient. In the vast majority of cases, the adjustment would be to the financial price, and so I shall refer simply to the price in the text unless a particular context requires otherwise.

the firm's relations with its customers, employees, suppliers and manufacturers, and investors.

A. Including CSR Preferences in Economic Analysis

The positive economic analysis of law is based on rational choice theory,[12] which in turn begins with the assumption (usually called the rationality assumption)[13] that human beings have preferences[14] and in general take actions reasonably calculated to satisfy those preferences, subject to whatever constraints happen to exist.[15] Sometimes economists express this assumption by saying that human beings seek to maximize their own utility or welfare. Although the intended meaning is the same, this latter formulation tends to give rise to the most persistent and pernicious misunderstanding of economic analysis, namely that it presupposes that human beings are exclusively self-interested in the most venal and base sense of the term.[16] This is simply a mistake. It is to confuse the assertion that human beings tend to act rationally to satisfy their preferences with an assertion about what those preferences tend to be. The rationality assumption makes no claims of any kind on this latter issue. On the contrary, to apply the rationality assumption correctly, we must take the preferences of human beings as we find them actually to be in the world. Economic analysis, Gary Becker writes, "does not assume that individuals are motivated solely by selfishness or gain. It is a *method* of analysis, not an assumption about particular motivations . . . . The analysis assumes that individuals maximize welfare *as they conceive it*, whether they be selfish, altruistic, loyal, spiteful, or masochistic."[17]

The reason for beginning with a realistic understanding of human preferences is straightforward. For the whole point of making the rationality assumption is to predict actual human behavior by starting with people's preferences and determining which actions they are likely to take to satisfy those preferences;

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12 On rational choice theory in the economic analysis of law, see generally 1 Thomas S. Ulen, *Rational Choice Theory in Law and Economics*, *in* ENCYCLOPEDIA OF LAW AND ECONOMICS 790 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000).

13 *Id.* at 792.

14 More accurately, human beings have transitive preferences, but the question of transitivity introduces complications not here relevant. *See generally id.* and sources cited therein.

15 Such constraints include income, time, imperfect knowledge, imperfect memory and calculating capacities, and even just the limited nature of the set of opportunities and actions physically available to the person. Gary S. Becker, *Nobel Lecture: The Economic Way of Looking at Behavior*, 101 J. POL. ECON. 385, 386 (1993).

16 *E.g.*, DAN ARIELY, THE (HONEST) TRUTH ABOUT DISHONESTY 3–9 (2012).

17 Becker, *supra* note 15, at 385–86.

if we have an unrealistic understanding of people's preferences, this method is not likely to yield true predictions.[18] Rather, applying the rationality assumption in a way likely to yield true predictions requires that we start with a realistic understanding of the preferences of the group of people whose behavior we are trying to predict. If people in fact have preferences for certain moral concerns, we should expect that they will generally take action to effect those concerns, always subject to whatever constraints may exist on their ability to act. When, as is usually the case in the real world, people have preferences both for material gain and for moral concerns, and in certain situations these preferences tend to conflict, applying the rationality assumption becomes more difficult. The solution, however, is not to ignore one set of preferences entirely. Rather, we need an understanding of how people engineer compromises among their competing preferences when satisfying both preferences is impossible. We can obtain such an understanding in the same way and to the same extent that we obtain information about all other preferences that people have: by observing their overt behavior.[19]

Now, some people may think that moral preferences, including those manifested in CSR concerns, are not on a par with other preferences. For moral purposes, this may perhaps be correct.[20] For economic purposes, however, moral preferences ought to be treated just like any other preference. The reason is that it is very hard to see how any good for which people have a willingness to pay is anything other than an economic good,[21] and certainly many people are willing to pay to realize CSR concerns, as, for example, when they pay more for fair-trade coffee or for goods made from recycled materials or even for goods *not* made from conflict minerals.[22] Given that moral preferences obviously influence human behavior, and given that such preferences, when backed by a willingness to pay, *can* be included on a par with other preferences for economic goods in positive economic analysis, there is no reason to exclude such goods from attempts to predict human behavior based on the rationality assumption.

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18 *See* MILTON FRIEDMAN, *The Methodology of Positive Economics*, *in* ESSAYS IN POSITIVE ECONOMICS 3, 7–41 (1953).

19 *See* DANIEL M. HAUSMAN & MICHAEL S. MCPHERSON, ECONOMIC ANALYSIS, MORAL PHILOSOPHY, AND PUBLIC POLICY 44–94 (2d ed. 2006).

20 For the general problem of moral motivation, see Connie S. Rosati, *Moral Motivation*, STAN. ENCYCLOPEDIA PHIL., Fall 2008, *available at* http://plato.stanford.edu/entries/moral-motivation/.

21 Richard O. Zerbe, Jr., *The Legal Foundation of Cost-Benefit Analysis*, 2 CHARLESTON L. REV. 93, 127 (2007).

22 *See generally* Karen E. Woody, *Conflicts Minerals Legislation: The SEC's New Role as Diplomatic and Humanitarian Watchdog*, 81 FORDHAM L. REV. 1315 (2012).

All this also applies to the normative question of whether a transaction or an outcome is economically efficient. Kaldor-Hicks efficiency[23] (or, better, Pareto Relevance)[24] takes the actual preferences of human beings as given, whatever those preferences may be.[25] Any good for which there is a willingness to pay counts. Hence, moral preferences for which there is a willingness to pay count like all other preferences in the normative calculus of determining which transactions or outcomes are efficient and which are not. As Zerbe argues, "Moral sentiments are properly economic goods in so far as there is a willingness to pay to obtain their realizations and so in determining efficiency moral claims are properly included directly."[26] Assuming, as seems clear, that some people are willing to pay to realize moral preferences related to CSR concerns, these preferences should be treated on a par with all other preferences, not only in applying the rationality assumption in positive economic analysis but also in calculating efficiency in normative economic analysis.

B. Coasean CSR Transactions

Suppose that two parties who have low transaction costs[27] and who, because they each have many alternative transacting partners, are unlikely to engage in strategic behavior,[28] are negotiating a commercial transaction, by which I mean one in which one party (the buyer) will exchange money for the performance of the other (the seller), which performance would typically be some obviously economic good or service. Say further that, in addition to his other preferences related to the good or service, the buyer has a moral concern, for which he has a willingness to pay, of a typical CSR type related to the

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23 For the original papers, see generally Nicholas Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 ECON. J. 549, 550 (1939); J.R. Hicks, *The Foundations of Welfare Economics*, 49 ECON. J. 696, 706, 711 (1939); Nicholas Kaldor, *A Note on Tariffs and the Terms of Trade*, 7 ECONOMICA 377, 377–78 (1940); T. De Scitovszky, *A Note on Welfare Propositions in Economics*, 9 REV. OF ECON. STUD. 77, 78, 86–88 (1941).

24 *See generally* Zerbe, *supra* note 21, at 103–04.

25 For example, in discussing the inefficiency of rape, Posner counts the rapist's preferences on a par with the victim's. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 274 (8th ed. 2011).

26 RICHARD O. ZERBE, JR., ECONOMIC EFFICIENCY IN LAW AND ECONOMICS (2001).

27 Transaction costs are notoriously difficult to define, a problem exacerbated by the fact that the correctness and practical relevance of the Coase theorem often turn on the point. *See generally* Medema & Zerbe, *supra* note 9, at 855. Coase himself apparently generally understood transaction costs to include what we today would call search costs, bargaining costs, and monitoring costs. As Medema and Zerbe point out, however, a better definition may be any costs arising from uncertainty about the ownership of property rights. *Id.* at 856, 875.

28 DOUGLAS G. BAIRD ET AL., GAME THEORY AND THE LAW 269 (1994).

transaction: for example, for purely moral reasons, he may want to buy products made from recycled materials, or may wish to deal only with sellers who maintain certain high standards in dealing with their employees or suppliers, or may desire to patronize businesses that contribute to philanthropic or charitable causes in the buyer's local community. Crucially, the right related to the buyer's concern is one that the law assigns to the seller: the seller has no legal duty to satisfy the buyer's concern.[29] We then have a typical Coasean situation: because the transaction costs between the parties are low (they are already negotiating a transaction), we should expect that the right related to the buyer's CSR concern will be assigned to the party who values it most highly.[30] For the seller, parting with the right, which amounts to complying with the buyer's CSR preferences, generally involves some cost (for instance, using more expensive recycled materials in its production processes or paying its employees or suppliers at higher rates). The seller will thus generally have some minimum willingness to accept a transfer of the right: that is, a minimum price he will demand to part with the right. The buyer, by hypothesis, has some positive maximum willingness to pay: that is, a maximum price he will pay to obtain the right. If the latter exceeds the former,[31] we should expect the transfer to occur (the right is assigned to its higher-value user), with the buyer paying the seller for the right, and the overall result being efficient.[32] In other words, the buyer's CSR preferences will be realized in the terms of the transaction to the extent that the buyer is willing to pay to realize them, the price being appropriately adjusted upwards.

In the subsections below, I explain how this general result works out in the most common kinds of CSR concerns: that is, between firms and their (1) customers, (2) suppliers and manufacturers, (3) employees, and (4) investors.

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29 McWilliams & Siegel, *supra* note 2, at 117 (defining CSR as "actions that appear to further some social good, beyond the interests of the firm and that which is required by law" and noting that "[t]his definition underscores that . . . CSR means going *beyond* obeying the law").

30 This is the central point of the Coase theorem. Coase, *supra* note 9, at 9. For general overviews of the immense literature on the Coase theorem, see MEDEMA & ZERBE, *supra* note 9.

31 If the buyer's willingness to pay is less than the seller's willingness to accept, no transaction related to the right will occur, and the right will remain with the buyer, who in this scenario is the highest-value user of the right, producing an efficient result. The argument in this section implies that such inefficient CSR transactions do not occur.

32 The conclusion that the result is efficient depends on the assumption that any negative externalities of the transfer are less than the gains to the parties (or, better, that any other party affected by the transfer has transaction costs low enough to participate in the transaction). In most transactions in which CSR concerns are in play, it seems that this additional assumption would generally be fulfilled.

1. Customers

The general explanation above is immediately applicable to transactions between a firm and its customers in its product markets: some customers are willing to pay for products that reflect CSR concerns, either because the product embeds a CSR attribute (such as being made from recycled materials), or because it was produced by means of a process reflecting CSR concerns (such as being made by unionized workers, by workers in America, or by workers in foreign jurisdictions who are paid super-market wages),[33] or because the firm producing it donates some of the profits from the sale of the product to a CSR cause.[34] In each case, there is a CSR concern for which customers are willing to pay, but the right relative to those concerns has been assigned by law to the firm. The firm, we assume, has no preference but to maximize its profits[35] within the law.[36] Therefore, in accordance with the general argument above, to the extent that customers are willing to pay to see their CSR concerns realized, the firm will sell them the right and realize the concern by modifying its products accordingly.

This result should be unsurprising, for it merely replicates in the moral context exactly what occurs with respect to undeniably economic terms in contracts between firms selling consumer goods and their customers. Most obviously, this applies to the

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33 McWilliams & Siegel, *supra* note 2, at 119.

34 For example (RED), which was founded in 2006 by Bono and Bobby Shriver, licenses certain trademarks to famous brands, which then contribute up to fifty percent of the profits from (RED)-branded goods and services to the Global Fund. The Global Fund, *(RED)*, THEGLOBALFUND.ORG (Sept. 16, 2013, 9:44 AM), http://www.theglobalfund.org/en/donors/private/red/. The Global Fund uses the proceeds to finance HIV/AIDS programs in Africa. *Id.*; *see also* Ron Nixon, *Bottom Line for (RED): How Much Trickles Down to Charitable Mission*, N.Y. TIMES, Feb. 6, 2008, at C1. *See generally* M. Todd Henderson & Anup Malani, *Corporate Philanthropy and the Market for Altruism*, (John M. Olin L. & Econ. Working Paper No. 399, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1116797.

35 It is also possible that there is a distinct agency problem related to CSR. As Warren Buffett has argued, some managers may derive private benefits from causing the firm to engage in CSR activities, whether the benefit is typically materialistic (if the firm donates enough to the Metropolitan Opera, the chief executive officer and his or her spouse may be invited to the gala ball with the cast), or merely the satisfaction of the manager's moral preferences. *See* KNIGHTS, RAIDERS & TARGETS: THE IMPACT OF THE HOSTILE TAKEOVER 14 (John C. Coffee, Jr., Louis Lowenstein & Susan Rose-Ackerman eds., 1988); *see also* Hollinger, Inc. v. Hollinger Int'l, Inc., 858 A.2d 342, 383–84 (Del. Ch. 2004) (noting that whoever owns the *Telegraph* can have dinner with the Queen of England). In the latter case, policing the agency problem is likely to be extremely difficult, as the agent by hypothesis believes that the company ought (in a moral sense) to undertake the CSR activity and so is very unlikely either to realize that he is imposing an agency cost on the firm's investors or to respond favorably to attempts by others to dissuade him from doing so.

36 *See* In re Massey Energy Co., C.A. No. 5430-VCS, 2011 WL 2176479, at *20 (Del. Ch. 2011) (stating that directors always violate their fiduciary duties if they cause the corporation to do something illegal, even if such actions are profit-maximizing).

physical features of the firm's products. For example, if customers are willing to pay for a product feature like air conditioning in cars or meals on airplane flights, then sellers will include these features in their products, adjusting the price to the buyer accordingly. Similarly, the principle applies to the non-price terms of a contract designed to confer additional legal rights on the buyer, such as contractual representations and warranties, indemnification provisions, or generous return or cancellation rights. With return rights, for example, at issue is the right of the buyer to rescind the contract after the purchase and sale is complete. Initially, the law assigns this right to the seller; that is, the buyer has no such right under the common law of contracts or the Uniform Commercial Code.[37] But many sellers, such as large department stores, transfer this right to their customers by incorporating into the terms of the contract of sale their return policies, which allow the customer, subject to certain conditions, to return the product and receive back the purchase price. Because such sellers value their long-term relationships with their customers (that is, expect to profit in the long run by repeat business) and because, for many goods, the customer cannot effectively evaluate their quality before the point of sale,[38] the customer values the right to return the goods more than the seller does, and so customers are willing to pay higher prices to cover the costs to the seller of allowing a certain percentage of goods to be returned. This is a straightforward Coasean situation in which, because transaction costs are low, rights migrate to the party who values them more highly, thus producing an efficient outcome.

The CSR concerns of buyers differ from these examples only in that CSR concerns are moral preferences, not the palpably self-interested, materialistic kinds of preferences that parties typically bring to commercial transactions. But if, as we saw above, moral concerns should be treated like any other economic good to the extent that people who have such concerns are willing to pay to effect them, then we should expect that such concerns will be reflected in the terms of commercial transactions just like any others, and, moreover, the results of such transactions will be efficient just as they are with the non-moral concerns parties bring to such transactions.

A nice case intermediate between buyers' typical self-interested, materialistic preferences and their CSR

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37 *See generally* E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS (3d ed. 2004).

38 Such goods are usually called experience goods, in contrast to search goods, whose characteristics can be easily ascertained before purchase. Phillip Nelson, *Information and Consumer Behavior*, 78 J. POL. ECON. 311, 312 (1970).

preferences relates to the safety features of products. On the one hand, such features can be understood as being the subject of customers' self-interested preferences for their own health and safety, for which customers are generally willing to pay. Hence, even a firm not concerned with CSR will tend to incorporate safety features into its products, increasing the price of the product to the extent that customers remain willing to pay. Moreover, if the firm's products harm its customers, the firm's reputation and its profits will likely suffer, and so satisfying the customers' preferences related to safety is clearly tied to the firm's maximizing its profits. On the other hand, the physical safety of products can also be understood as the kind of moral concern reflected in CSR: companies have a moral duty to protect the health and safety of those who use their products.[39] When the absence of such safety features would expose the firm to legal liability,[40] the feature would not generally be thought of as relating to CSR.[41] But even when it is clear under existing law that a certain safety feature is not legally required, firms sometimes incorporate such features into their products. For instance, before 1998, there was no legal requirement in the United States that cars be equipped with airbags,[42] but General Motors had introduced airbags on some of its American models in 1973,[43] presumably advertising the fact and claiming that its vehicles were safer for the improvement.[44] This is just what we should expect, however, with safety features that, like airbags, protect the customers themselves and not third parties.[45] For, the customers are already contracting with the seller and so have low transactions costs related to transacting for such safety features, and thus, to the extent that customers are willing to pay for such safety features, firms can be expected to incorporate them into their products. Thus, Posner argues that when "the danger is to the industry's customers, the customary level of precautions taken by sellers is . . . likely to be efficient" because customers

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39 CARROLL ET AL., *supra* note 1, at 350.

40 W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 677 (W. Page Keeton ed., 5th ed. 1984).

41 *See* McWilliams & Siegel, *supra* note 2, at 117 (referring to the relation of CSR and legal obligation).

42 *See* 49 C.F.R. § 571.208.

43 Lisa Wade McCormick, *A Short History of the Airbag*, CONSUMERAFFAIRS (Sept. 25, 2006), http://www.consumeraffairs.com/news04/2006/airbags/airbags_invented.html.

44 General Motors, *1974 Air Cushion Restraint System*, OLD CAR MANUAL PROJECTS, http://www.oldcarbrochures.com/static/NA/Oldsmobile/1974_Oldsmobile/1974_Oldsmobile_Air_Cushion_Folder/dirindex.html (last visited Sept. 21, 2013).

45 To my knowledge, no car company makes cars designed to protect the safety of pedestrians, though some technological means probably exist for doing this. The reason, presumably, is that high transaction costs prevent pedestrians from contracting either with the car companies or with drivers to install such devices. *See infra* Part I.C.

"should be willing to pay a higher price for the industry's product or service up to the point that the last dollar spent buys just one dollar in reduced accident costs."[46] This is true whether we view safety features as reflecting the self-interested preferences of consumers for self-preservation or their moral preferences about what a car manufacturer owes them. In either case, the firm will provide such features up to the consumers' willingness to pay for them.

2. Suppliers and Manufacturers

For many people, another major CSR concern relates to the conditions and wages of the workers who produce (or are otherwise involved in the distribution and sale of) the goods they buy.[47] When these workers are in the United States, the concern is usually with their wage levels,[48] whether they receive health insurance benefits,[49] or whether they are unionized.[50] When the workers are outside the United States and in developing countries, the concerns are usually about their wage levels,[51] the number of hours they work,[52] the health and safety conditions of the factories in which they work,[53] and, in extreme cases, whether the workers are children, prisoners, or even slaves.[54] Dramatic recent examples concerned manufacturers in Bangladesh that operated factories in extremely dangerous conditions; in one instance, a fire in such a factory killed 120 workers,[55] and in another, a building collapse killed more than

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46 POSNER, *supra* note 25, at 219. Posner is here discussing the famous *T.J. Hooper* case. *See* The T.J. Hooper, 60 F.2d 737 (2d Cir. 1932).

47 CARROLL ET AL., *supra* note 1, at 362; María Prandi & Josep M. Lozano, *Corporate Social Responsibility and Human Rights*, *in* CORPORATE SOCIAL RESPONSIBILITY: THE CORPORATE GOVERNANCE OF THE 21ST CENTURY 209, 210 (Ramon Mullerat ed., 2d ed. 2011); HORRIGAN, *supra* note 1, at 302; Dobers & Springett, *supra* note 1, at 67.

48 CARROLL ET AL., *supra* note 1, at 410.

49 *Id.*

50 *Id.* at 409.

51 *Id.* at 396–97 (discussing accusations that Nike products were manufactured in sweatshops and Nike's response).

52 *See* Michael Hopkins & Ivor Hopkins, *Labour Standards and Corporate Social Responsibility: The Need for a Planetary Bargain*, *in* CORPORATE SOCIAL RESPONSIBILITY: THE CORPORATE GOVERNANCE OF THE 21ST CENTURY 157, 169–70 (Ramon Mullerat ed., 2d ed. 2011) (detailing the International Labour Organization's core labor standards, which establish a maximum number of weekly hours and designated rest days).

53 *See* HORRIGAN, *supra* note 1, at 317–18 (detailing the provisions of the Draft United Nations Norms on Human Rights Responsibilities of Companies, which provide in part for the right to a safe and healthy workplace).

54 *See* CARROLL ET AL., *supra* note 1, at 395–96 (detailing the United Nations Global Compact's (UNGC) prohibition of compulsory labor and child labor).

55 Syed Zain Al-Mahmood, *Bangladesh Factory Fire Kills 120*, WALL ST. J., Nov. 25, 2012, *available at* http://online.wsj.com/article/SB10001424127887323330604578140871172985126.html; Vikas Bajaj, *Fatal Fire in Bangladesh Highlights the Dangers Facing Garment Workers*, N.Y. TIMES, Nov. 25, 2012, *available at* http://www.nytimes.com/2012/11/26/world/asia/bangladesh-fire-kills-more-than-100-and-injures-many.html.

1,100 workers.[56] Some of the goods manufactured in the factory that suffered the fire were ultimately sold to consumers in the United States, including by such leading retailers as Walmart.[57] In other cases, the concern has been not about the workers in foreign factories, but about the pollution emitted by such factories or the sources of physical inputs processed in such factories, as when the concern has been to eschew the use of conflict diamonds or conflict minerals.[58]

In the usual case, we have a retailer operating in a developed nation (the retailer) that contracts with another firm based in the developed nation that specializes in producing certain consumer goods (a supplier), often under licenses for trademarks owned by yet other parties. The supplier usually subcontracts the physical manufacturing of the products to a firm located in the developing world (the manufacturer).[59] For example, in the case of the Bangladesh fire, Walmart had contracted with a private company based in the United States to produce clothing under Walmart's own Faded Glory label, and that company had contracted with the Bangladeshi firm to manufacture the goods. The ultimate consumer, therefore, is at three removes from the firm that operates the morally obnoxious business: the consumer contracts with the retailer, who contracts with the supplier in its domestic market, who contracts with the foreign firm that is directly responsible for the facts or circumstances that the consumer concerned with CSR finds morally offensive.

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56 Syed Zain Al-Mahmood & Shelly Banjo, *Deadly Collapse in Bangladesh*, WALL ST. J., Apr. 24, 2013, *available at* http://online.wsj.com/article/SB10001424127887324874204578441912031665482.html; *Death Toll in Bangladesh Passes 1,100*, N.Y. TIMES, May 11, 2013, *available at* http://www.nytimes.com/2013/05/12/world/asia/death-toll-in-bangladesh-collapse.html; *see also* Richard A. Epstein, *The Way Forward in Bangladesh*, DEFINING IDEAS (May 7, 2013), http://www.hoover.org/publications/defining-ideas/article/146431 (advocating increased building code enforcement to improve Bangladeshi garment industry).

57 Syed Zain Al-Mahmood, Tripti Lahiri & Dana Mattioli, *Bangladesh Fire: What Wal-Mart's Supplier Network Missed*, WALL ST. J., Dec. 10, 2012, *available at* http://online.wsj.com/article/SB10001424127887324024004578169400995615618.html; Shelly Banjo, *Wal-Mart to Brief Shareholders on Bangladesh*, WALL ST. J., Aug. 28, 2013, *available at* http://online.wsj.com/article/SB10001424127887324009304579040973222049280.html.

58 Tom Zeller, Jr., *Clothes Makers Join to Set 'Green Score,'* N.Y. TIMES, Mar. 1, 2011, *available at* http://www.nytimes.com/2011/03/01/business/01apparel.html (Chinese factory pollution); Mireya Navarro, *Diamonds Are for Never?*, N.Y. TIMES, Dec. 14, 2006, *available at* http://www.nytimes.com/2006/12/14/fashion/14diamonds.html; Edward Wyatt, *Use of 'Conflict Minerals' Gets More Scrutiny from U.S.*, N.Y. TIMES, Mar. 19, 2012, *available at* http://www.nytimes.com/2012/03/20/business/use-of-conflict-minerals-gets-more-scrutiny.html.

59 In practice, there are often several levels of subcontracting between the supplier, who deals directly with the retailer, and the ultimate manufacturer, who operates the factory. For simplicity, I assume throughout that there is only one level of subcontracting and the supply chain thus runs from retailer to supplier to manufacturer.

Nevertheless, every step in this chain is contractual, and so the transaction costs faced by the parties related to negotiating additional terms reflecting CSR concerns are relatively low. If the ultimate consumers are morally concerned with the conditions of the workers who manufacture goods that they buy, then we should expect that, all along the supply chain, contractual terms will be modified to reflect these concerns, and prices between buyers and sellers should increase accordingly. There will be Coasean solutions related to these rights first between consumers and the retailer, then between the retailer and the supplier, and then between the supplier and the manufacturer in the developing nation.

And this is exactly what we do in fact find. Large retailers typically require their suppliers and manufacturers to contractually agree that neither they nor any of their suppliers and manufacturers will engage in the kinds of practices that consumers with the relevant CSR preferences would find morally objectionable. For example, Walmart, which has for a long time maintained a whole department for ethical sourcing, requires its suppliers not only to comply with all relevant laws in the jurisdictions in which they operate, but also to maintain certain standards regarding labor hours, hiring and employment practices, compensation levels, freedom to engage in collective bargaining, health and safety conditions, and sanitation levels in workplaces, dormitories, and canteens.[60] Other provisions of Walmart's standard agreement prohibit suppliers from using child, slave, or indentured labor, from engaging in human trafficking, from giving gratuities to Walmart employees, and from engaging in corrupt practices.[61] Yet other provisions require suppliers to meet certain environmental standards and to keep accurate business and financial records.[62] Under Walmart's standard agreement, all of these requirements flow through from the supplier to the manufacturer: that is, Walmart requires its suppliers to impose these obligations on their manufacturers.[63]

From an economic point of view, the most interesting feature of this situation is how consumers' moral preferences are so efficiently transmitted down the supply chain across numerous contractual relationships. Once again, however, if we remember to view moral preferences for which there is a willingness to pay

60 *Standards for Suppliers Manual*, WALMART STORES, INC., 7–16 (Jan. 2012), *available at* http://corporate.walmart.com/global-responsibility/ethical-sourcing/standards-for-suppliers.

61 *Id.* at 5–6, 20.

62 *Id.* at 16–19, 21.

63 *Id.* at 22.

as being on a par with all other preferences for which there is a willingness to pay, this result is not at all surprising. That is, consumers obviously have self-interested, materialistic preferences related to the goods they buy (for instance, as to quality and durability), and no one is surprised that these preferences are reliably transmitted from consumer to retailer to supplier to manufacturer, in each case through contractual relationships. The reason for this, of course, is that consumers are willing to pay to see these preferences realized, and so their direct and indirect contractual counterparties respond appropriately, charging the consumers accordingly. Exactly the same thing happens, and for exactly the same Coasean reasons, when the consumers' preferences are moral ones reflecting CSR concerns.

3. Employees

Firms also encounter contractual counterparties with CSR concerns in dealing with their employees. Some people prefer to work for firms they believe are morally responsible. This seems to be especially true of better-educated and higher-earning employees,[64] who are, of course, the employees with the highest marginal productivity and so are of the greatest value to the firm. To respond to the preferences of such employees, firms adjust their policies and practices. Google, for example, tries to maintain a corporate culture typified by its slogan, "Don't be evil,"[65] and many of Google's employees have, among their reasons for working for Google, a desire to participate in a business that has such a corporate culture.[66] Similarly, other firms provide matching financial donations to charitable organizations that their employees support,[67] organize community service events in which their employees volunteer their time,[68] and donate their goods or services to needy

64 *See* Heather Schmidt Albinger & Sarah J. Freeman, *Corporate Social Performance and Attractiveness as an Employer to Different Job Seeking Populations*, 28 J. BUS. ETHICS 243, 245–52 (2000), *available at* http://link.springer.com/article/10.1023/A:1006289817941 (finding that companies with high levels of corporate social performance (CSP) are better able to attract employees with high levels of job choice—that is, better educated, more competitive candidates).

65 *Code of Conduct*, GOOGLE INVESTOR RELATIONS (2012), *available at* http://investor.google.com/corporate/code-of-conduct.html.

66 *Id.*

67 *See, e.g.*, *Microsoft Corporate Citizenship: Serving Communities: Employee Giving*, MICROSOFT, http://www.microsoft.com/about/corporatecitizenship/en-us/serving-communities/employee-giving/ (last visited Sept. 15, 2013) ("Microsoft matches employee nonprofit donations and volunteering year round up to $12,000.00 per employee.").

68 *See, e.g.*, *GoogleServe 2013: Giving Back on a Global Scale*, GOOGLE OFFICIAL BLOG (June 28, 2013), http://googleblog.blogspot.com/2013/06/googleserve-2013-giving-back-on-global.html (describing GoogleServe 2013, in which "more than 8,500 Googlers from 75+ offices participated in 500 projects").

individuals.[69] Often, the CSR concerns that arise primarily from the firm's customers concerning the attributes of products or processes by which products are made are shared by employees as well: for moral reasons, some employees want to be associated with certain products, such as ones produced by fair trade arrangements, and do not want to be associated with others, such as products manufactured under conditions unsafe for the workers involved or that incorporate conflict minerals.

Now, many employees with such CSR concerns are also willing to pay to realize such concerns. In such cases, in accordance with the general argument given above, since the employees are already negotiating terms with the employer, the parties face low transaction costs, and so we should expect that the relevant rights will be transferred to the highest value user. Of course, the law initially assigns the right to the firm: absent some contractual obligation, the firm has no legal duty to provide such CSR benefits to its employees. We should thus expect the firm to transfer the right to employees willing to pay for it in exchange for an appropriate payment. Here, however, two complications arise. The first and simpler is that, because of the nature of the employer-employee relationship, the employee is selling services to the employer in exchange primarily for cash: in other words, the employer is the buyer, not the seller. The result, therefore, is not that the employee pays the employer for the CSR benefit as we see with customers, but that the employer pays the employee with a combination of cash, traditional fringe benefits, and CSR benefits, with the cash component of the package being reduced by the cost to the firm of providing the CSR benefit.[70] In

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69 *See, e.g.*, *PPA Celebrates Fourth Anniversary Has Helped More Than 5.7 Million Uninsured Patients*, PHRMA (Apr. 6, 2009), http://www.phrma.org/media/releases/ppa-celebrates-fourth-anniversary-has-helped-more-57-million-uninsured-patients (describing how the pharmaceutical industry sponsors the Partnership for Prescription Assistance, which provides prescription drugs either for free or at reduced prices to millions of patients); *see also* Michael Barbaro & Justin Gillis, *Wal-Mart at Forefront of Hurricane Relief*, WASH. POST (Sept. 6, 2005), http://www.washingtonpost.com/wp-dyn/content/article/2005/09/05/AR2005090501598.html (discussing Wal-Mart's donations of large quantities of goods to Hurricane Katrina victims).

70 CSR benefits provided to employees thus depress cash wages, and the more thoroughly companies adopt CSR policies, the lower cash wages will be—a result that CSR advocates would no doubt find very inconvenient. Compare Posner's point that bribery reduces the cost to the government of hiring employees. *See generally* Richard Posner, *Economics of Corruption*, THE BECKER-POSNER BLOG (Aug. 28, 2005), http://www.becker-posner-blog.com/2005/08/economics-of-corruption--posner.html ("In effect, bribes shift the financing of public services from taxes to a combination of taxes and fees for service. By injecting a market element into public services, bribes can actually improve efficiency when used to get around rigid or inefficient rules."). Of course, the lower wages do not represent any economic loss to the employees: the firm provides CSR benefits only to the extent that the employees are willing to pay for them, and so the employees are benefited, not harmed, by CSR benefits, given the employees preferences and their willingness to pay for them.

other words, employees pay for CSR benefits in the form of reduced traditional forms of compensation.

The second complication is more serious. For, firms generally do not enter into written employment agreements except with their most senior and most highly compensated employees. For the vast majority of employees, the terms are agreed upon orally and are governed by default rules deriving from the common law of contracts, as modified by the few relevant statutes, including most importantly the antidiscrimination laws,[71] certain health-and-safety laws and regulations,[72] ERISA,[73] and a few others, none of which deal with the CSR concerns of employees. Even when a firm does enter into an elaborate written employment agreement with an employee, the terms rarely require the company to engage in any particular CSR activities that the employee may support. Hence, the right to engage in CSR activities is not in general transferred from the firm to its employees as the general argument above would suggest; although the company may consistently and energetically respond to the CSR concerns of its employees (and indeed have explicit policies of doing so), the employees do not generally obtain a right against the company related to such concerns. Given the general argument above, why should this be?[74]

Assuming the correctness of the Coase theorem, the answer has to be that, despite the willingness of the employees to pay to realize their CSR concerns, the firm nevertheless values the right more highly than do the employees. Here, a comparison between a firm's relationship with its customers and its relationship with its employees is instructive. The customers buy from time to time; they do not have long-term contractual relationships with the firm, even when the firm hopes to obtain their repeat business. Provided that the product that the customer purchases embeds the CSR attribute or was produced in accordance with

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71 *E.g.*, Age Discrimination in Employment Act of 1967, 29 U.S.C. §§ 621–634 (prohibiting employment discrimination against individuals forty years of age or older); Rehabilitation Act of 1973, 29 U.S.C. §§ 701–796l (2012) (prohibiting discrimination on the basis of disability).

72 *E.g.*, Occupational Safety and Health Act of 1970, 29 U.S.C. §§ 651–678 (2012) (ensuring employers provide safe and healthful working conditions for its employees).

73 Employee Retirement Income Security Act, 29 U.S.C. §§ 1001–1461 (2012).

74 Since employees without employment agreements are at-will, meaning that either the employer or the employee may terminate the relationship at any time, employees have no continuing right to any form of compensation they receive from the employer, whether it be cash, traditional fringe benefits, or anything else. Hence, any CSR benefits that the employer supplies are being treated exactly like all other forms of compensation—and presumably for exactly the same reason, which is basically that the employer values the right to terminate the relationship more than the employee values job security. *See generally* POSNER, *supra* note 25, at 436–38 (discussing the economics of at-will employment). The argument in the text is really just an elaboration of this point.

the CSR processes that the customer values, the firm's CSR obligations to the customer are complete at the time of sale; the firm has no ongoing CSR obligations, the future costs of which could be difficult to ascertain in the present. With employees, the matter is quite different. Employees are hired for the medium to long term, and if a right to CSR benefits were transferred to the employee in the employment agreement, the company would remain legally bound to provide the benefit as long as the relationship continued (or at least until the agreement was renegotiated). Even if the company's current costs of providing CSR benefits are below the employee's willingness to pay for them, there is no guarantee that this will remain the case for the term of the employment relationship. Hence, besides the right to CSR benefits, there is in this contractual relationship between the firm and the employee a risk to be allocated—the risk that the cost of the relevant CSR benefits will rise in the future above the employee's willingness to pay. If the employee received a legal right to these CSR benefits, this risk would rest with the company; if the employee does not receive such a right, even if the company provides CSR benefits in the present and intends to continue to do so in the future, the risk rests with the employee. So the question as to why the company values the right related to providing CSR benefits more than does the employee reduces to the question as to why the employee is the superior risk bearer of this risk.[75]

In general, a party is a superior risk bearer if that party can either (a) evaluate the expected cost of the risk more accurately than can other parties, generally because the party has superior factual information or expertise, or (b) the party can pool the risk with other risks, achieving a reduction in uncertainty through diversification or the application of the law of large numbers.[76] In this instance, since it is clear that the employee cannot pool and

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75 In some contractual situations, a risk is allocated to a party because the party is the cheapest cost avoider related to the risk. *See* Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2008 (2008). That is, the party can take action, albeit at a cost, to prevent the risk from materializing, and the cost of prevention is less than the expected cost of the risk, making prevention efficient (of course, if both parties can prevent the risk from materializing at a cost less than the expected cost of the risk, then the risk is allocated to the party whose costs of preventing it are least). *See id.* In the case discussed in the text, however, no party is likely to be a cheaper cost avoider: if the cost of providing CSR benefits to employees rises, this is likely beyond the control of both the firm and the employees. The question, therefore, concerns not cheaper cost avoiders but superior risk bearers.

76 *See* Richard Posner & Steven Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83, 90–91 (1977). Sometimes, there are yet other reasons why one party to an agreement will be the superior risk bearer. *See* Miller, *supra* note 75, at 2008–09.

diversify risks (indeed, if this is possible at all, it would be the firm that could do so), the driving rationale must be related to the evaluation of the risk: that is, the employee knows better than the firm (indeed, better than anyone else) his or her willingness to pay for CSR benefits. Moreover, this amount no doubt varies widely from employee to employee. Hence, the employee, not the firm, is the superior bearer of the risk that, in the future, the cost of CSR benefits provided by the firm could rise above the employee's willingness to pay for such benefits in the form of reduced cash compensation. Relatedly, if the costs of providing CSR benefits rise above the willingness of the employee to pay for them, it will likely be cheaper for the employee to change jobs (or simply accept alternative forms of compensation in lieu of the CSR benefit) than it would be for the company to continue to provide the benefit.

Once again, this is not a surprising result if we compare CSR benefits to other forms of employment benefits for which employees have preferences. For example, employees generally prefer, and are willing to pay for, health insurance, disability insurance, and vacation benefits, as well as such terms of employment as titles, reporting responsibilities, expense accounts, commodious office space, and similar perquisites. But aside from the few employees senior enough to receive written employment agreements, employees who receive such perquisites generally do not have a contractual right to such benefits under their agreements with the employer. The employer retains the freedom to modify or abolish such benefits as it sees fit. As with CSR benefits, the Coasean question in such cases is which party values the right in question more highly—or, more accurately in this case, which party is the superior bearer of the risk that the costs of providing such benefits will come to exceed the employee's willingness to pay for them in the form of reduced cash compensation. For the reasons given above, the employee is the superior risk bearer, and so the risk is allocated to the employee, the right to the employer. Once again, the key point is to see that preferences for CSR benefits for which there is a willingness to pay are economically indistinguishable from all other preferences for which there is a willingness to pay.

4. Investors

Some investors want to invest only in firms that reflect the investors' CSR preferences.[77] For example, some investors

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77 *See* CARROLL ET AL., *supra* note 1, at 394; *see also* CLAES CRONSTEDT, *Some Legal Dimensions of Corporate Codes of Conduct*, *in* CORPORATE SOCIAL RESPONSIBILITY: THE CORPORATE GOVERNANCE OF THE 21ST CENTURY 454 (Ramon Mullerat ed., 2d ed. 2011);

eschew investments in defense contractors, gun manufacturers, or firms that derive revenues from nuclear power, alcohol or tobacco products, or pornography.[78] Like some consumers, other investors want to invest only in firms that make products that embed CSR attributes or are made using CSR processes, or that treat their employees or suppliers and manufacturers according to certain high standards.[79] Of course, determining which firms meet an investor's CSR preferences is difficult and costly, and so, not surprisingly, there are firms that specialize in this task and intermediate between investors and the firms in which they can invest: the socially-responsible mutual fund.[80] Such funds have stated policies of investing only in companies that meet the fund's CSR criteria.[81] Investors who share these criteria can invest in the firms they prefer for moral reasons by investing in the socially responsible mutual fund, thus indirectly investing in only those firms that meet their CSR preferences.

The situation here is in some ways similar and in some ways different from those that we have analyzed in connection with the CSR preferences of customers, suppliers and manufacturers, and employees. Here, we assume again that the investor is willing to pay to effect his CSR preferences, but here the payment is made by the investors being willing to accept a lower return on his or her investment. Indeed, to the extent that investors are willing to pay to effect their CSR preferences in investments and assuming that capital markets are reasonably efficient, this result is inevitable: investors willing to pay to effect their CSR preferences will buy certain stocks and sell others in part on the basis of their CSR preferences (and not just on the basis of their views about the fundamental value of the securities at issue), and this will cause the stock prices of CSR-friendly companies to rise and the prices of CSR-unfriendly companies to fall, meaning that the return on the former will be lower and return on the latter higher.[82]

HORRIGAN, *supra* note 1, at 187. *See generally* Dobers & Springett, *supra* note 1.

78 James Roselle, *The Triple Bottom Line: Building Shareholder Value*, *in* CORPORATE SOCIAL RESPONSIBILITY: THE CORPORATE GOVERNANCE OF THE 21ST CENTURY 129, 136 (Ramon Mullerat ed., 2d. ed. 2011).

79 *Id.* at 136–37.

80 CARROLL ET AL., *supra* note 1, at 394.

81 *Id.*

82 Thus, just as a company's responding to employees' CSR preferences lowers wages, so its responding to investors' CSR preferences lowers the return on its stock. Again, we have a seemingly inconvenient result for CSR advocates, but again the inconvenience is not really troubling: when the investor's total return is computed, including the financial return and the satisfaction of his CSR preferences, the return will equal the market return on a risk-adjusted basis (assuming the efficiency of capital markets and a diversified investment portfolio).

But, although investors may be able to negotiate about CSR concerns when purchasing securities from a firm in a primary offering,[83] in general, CSR-conscious investors, like most investors, purchase securities on the secondary market and not directly from the issuer. Indeed, if investors in the secondary market attempted to negotiate with the issuer concerning CSR issues, the transaction costs involved would be very high, mostly because the number of investors is very great and because these investors likely have quite different levels of willingness to pay for CSR concerns. All that said, however, the relationship between a shareholder and the company is still contractual, and because shareholders can always sell their shares into the market, thus depressing the share price, companies will care about the CSR concerns of their shareholder base. Thus, following the factory fire in Bangladesh, Walmart has moved repeatedly to reassure not only its customers about its sourcing practices but also its investors.[84] Of course, shareholders who have no CSR concerns of their own will care about the financial effect on the firm in which they are invested if the customers of that firm have CSR concerns and the firm is publicly perceived as not meeting them. At this point, the CSR concerns of the investors and their self-interested financial concerns tend to merge.

But, although the firm will generally respond to the CSR concerns of its investors to the extent that the investors are willing to pay to realize them, nevertheless, just as in the relationship of the firm with its employees, the firm will not transfer to the counterparty the right to change or discontinue CSR policies in the future. It would, of course, be legally possible for the firm to do so: the firm's obligation to address CSR concerns could be included in its certificate of incorporation with whatever degree of particularity the parties happened to desire.[85] The firm does not do this for the same reason that it does not

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83 Even this is highly unusual in the initial public offering context: the shares are sold by the issuer or its existing shareholders to one or more underwriters, who in turn sell them to a large number of investors in the market. Genuine negotiations occur only between the sellers and underwriters, who presumably do not generally reflect the heightened CSR concerns of particularly socially-conscious investors.

84 Shelly Banjo, *Wal-Mart to Brief Investors on Bangladesh*, WALL ST. J., Aug. 29, 2013, at B2.

85 Title 8, section 102(b) of the Delaware Code provides that a Delaware corporation's certification of incorporation "may . . . contain . . . any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders . . . if such provisions are not contrary to the laws of this State." DEL. CODE ANN. tit. 8, § 102(b) (2012). *But see* CA, Inc. v. ASFCME Emps. Pension Plan, 953 A.2d 227, 234 (Del. 2008) (regarding corporate governance provisions that may not be included in the corporation's bylaws).

transfer away an analogous right to its employees: the firm remains the highest-value user of the right to change its CSR policies because the counterparty (in this case the shareholders) are the superior risk bearer of the risk that the costs of CSR activities will rise above the shareholders' willingness to pay for such activities. The shareholders are the superior risk bearer of this risk because they, much better than the firm, can evaluate the risk because they, and not the firm, know their own willingness to pay for such activities.

Furthermore, if the cost of engaging in CSR activities rose sharply and was well above the shareholders' aggregate willingness to pay, and if further the right was vested in the shareholders, then the parties would face high costs of rectifying the situation, for the company would need to call a shareholders meeting to amend its certificate of incorporation, a process that would typically cost a public company several million dollars in professional and other fees. If, in otherwise similar circumstances, the right is vested in the company, however, the cost of adjusting the level of the company's CSR activities is quite low: management simply decides to modify or discontinue them.

If, as seems intuitively plausible, the shareholders' demand for CSR activities is fairly elastic relative to price, then it would be especially important for the company to be able to vary the level of CSR activities and not be contractually bound to maintain them at a given level. If it were so bound, then there could result the highly inefficient situation in which the company, bound to maintain the activities, continued to perform them, primarily under threat from the relatively small number of shareholders who would continue to value them above their new cost, while a larger number of shareholders, who did not value the activities so highly, would also have to continue to pay them. It is thus in the interest of the average shareholder, even the average shareholder with significant CSR preferences, to allow the company to modify the level of CSR activity over time as the cost of such activity varies.

C. CSR Preferences of Third Parties

In arguing that the CSR preferences of customers, employees, and investors will be reflected in the activities of the firm to the extent that such parties are willing to pay for them, I have conspicuously noted that, in each case, the party is already in a contractual relationship with the firm and thus the transaction costs of incorporating the parties' CSR preferences into their relationship are low. The presence of low transaction costs is crucial to the argument because it tends to show that, in

accordance with the Coase theorem, the relevant rights will migrate to their highest value users—that is, the CSR preferences of the firm's contractual counterparties will be effected to the extent that such parties are willing to pay for them. If, however, transaction costs between a party and the firm are high, then, even if that party has CSR preferences and is willing to pay to effect them, it could well happen that the firm will not respond to these preferences because the high transaction costs prevent the party and the firm from entering into an agreement under which the firm would effect the CSR activities that the party prefers.

Such high-transaction-cost situations typically arise when a third party not in a contractual relationship with the firm has CSR preferences regarding the firm's behavior. For example, the Sierra Club undoubtedly has preferences about the environmental policies of large petroleum companies, but it is not in any contractual relationship with such companies that would easily admit of incorporating terms regarding environmental policies that the Sierra Club would desire. Moreover, even if such a contractual relationship did exist, the Sierra Club certainly lacks the financial capacity to pay, say, Exxon Mobil, to do all the environmentally friendly things that the Sierra Club would prefer. In such cases, since the party's willingness to pay falls below the cost to the firm of effecting its preferences, there is no inefficiency; the relevant rights are already, and remain, with their highest-value user. But when the party's willingness to pay does exceed the cost of effecting its CSR preferences, but a transaction related to these preferences is thwarted by high transaction costs, the result will indeed be inefficient.

Happily, however, it is difficult to think of many real-world cases that would fit this pattern. The reason is that, since the costs of effecting typical CSR preferences are generally high in a business of any considerable size, if there were a party that both had the relevant CSR preferences and had the willingness to pay to effect them, it would presumably also have the means to enter into negotiations with the firm to pay it to give effect to its CSR preferences. Real world instances of such arrangements, if there are any, must be very rare. The danger of inefficiency on this score is thus remote.

More common, however, are cases in which a third-party organization with CSR preferences strongly held in a psychological sense but with little willingness to pay (because of the organization's limited financial capacity) attempts to influence the behavior of a firm through quasi-political means: that is, by calling attention to the firm's policies that it regards

as immoral and by attempting to enlist parties that are already in a contractual relationship with the firm, generally customers and shareholders, to pressure the firm to adjust its behavior to comply with the relevant CSR preferences. Here, the outside organization is relying on the willingness to pay of the insiders, the parties already dealing with the firm. Curiously, such campaigns appear to target the firm, but if they are to succeed, they will do so by relying on payments to be made by others to the firm targeted (in the case of customers) or by reductions in returns to shareholders (in the case of investors).

It is important to see how the groups who organize such campaigns fit into the Coasean analysis of the relationship between the firm and the parties that are already in contractual relationships with the firm. Such parties do indeed have low transaction costs in dealing with the firm, but they will often have high transaction costs with respect to detecting activities by the firm of which they would disapprove for CSR reasons and with respect to monitoring the firm's compliance with its CSR commitments (for which the firm has presumably charged the parties with CSR preferences). The outside advocacy organization, which has developed expertise in detection and monitoring, acts as an informal agent for the firm's customers or investors with CSR preferences, informing them of the firm's activities and looking for violations of the firm's commitments. Also, since the customers and investors are numerous and dispersed, they would face high costs of organizing and possible collective action problems in dealing with the firm. The advocacy organization reduces these costs and helps overcome these problems by informally coordinating the actions of the firm's customers and shareholders by proposing the CSR actions that it thinks the firm should take and then relying on customers and shareholders to demonstrate a willingness to pay for such actions (e.g., by withholding their business or selling their shares if the company does not comply). But if the advocacy organization oversteps, demanding more CSR action than the customers and shareholders are willing to pay for, it will fail in its efforts to change the firm's behavior. Its verbal demands will not be backed up by real economic demand. There is thus a kind of market discipline on such activism. Furthermore, quite appropriately from an economic point of view, the customers and investors may also pay the costs of the advocacy organization's activities, for people with CSR preferences and a willingness to pay to effect them will often use some of that willingness to pay to make financial donations to the appropriate advocacy organizations.

All that said, there will still be some cases in which parties with CSR preferences and a willingness to pay in excess of the costs to the firm of realizing their preferences will be prevented from contracting with the firm to effect those preferences. In the Sierra Club example above, it was crucial that the Sierra Club was in effect coordinating the activities of parties, generally customers, who were already in contractual relationships with the firm and had low transaction costs in dealing with the firm. In some cases, this will not be true: it could happen that there are third parties, not already dealing with the firm, who, because they are numerous and not easily organized, will face very high transaction costs in contracting with the firm to realize their CSR preferences. When in the aggregate the parties' willingness to pay exceeds the cost to the firm of realizing their CSR preferences but no transaction occurs because of the high transaction costs, then the result is indeed inefficient. This, of course, is exactly what Coase has always told us: that high transaction costs can prevent efficient transactions. These are the cases when we should look not to the market but to regulation to solve the problem: although exceptions may be possible, in general in such cases, the obligation to comply with the third parties' CSR preferences should be imposed on the firm by law, for this will produce the efficient result.

II. MORAL CONCERNS ARISING FROM THE COASEAN ANALYSIS

The analysis in the preceding Part is entirely economic. As a matter of positive economics, it argues that, when customers, suppliers and manufacturers, employees, or investors have CSR preferences and are willing to pay to realize them, the firm will respond, affecting these preferences and charging the other parties accordingly. As a matter of normative economics, it argues that the resulting transactions are efficient. Assuming the positive argument is correct and this is how CSR concerns are actually realized in the world, some important moral questions remain. In particular, in this Part, I shall inquire (a) whether the firm is really serving the moral ends of CSR if it merely takes money to perform CSR activities from people who wish to pay for them, and (b) whether it is morally defensible that parties other than the firm itself pay the costs of CSR activities, i.e., whether it is morally right that parties other than the firm have to pay for the firm to do what it is morally obligated to do.

A. Corporate Actions Related to CSR but Not Motivated by CSR Concerns

If the firm engages in CSR activities only because its customers or other contractual counterparties have CSR preferences and are willing to pay the firm to effect those preferences, then it may seem that the firm is not truly engaged in CSR activities: it is merely maximizing its profits by catering to the preferences (albeit the moral preferences) of those with whom it deals. Such activities, someone may say, can hardly be praised as *socially responsible*, for they are motivated not by commitments to any normative values but merely by a selfish desire for profits. In other words, although the firm may be doing the right things, it is doing them for the wrong reasons, and so it deserves no moral credit.

This argument raises a familiar issue in moral philosophy. Kant distinguished actions that are in accordance with duty from actions that are done for the sake of duty, and his key example is actually directly relevant to CSR concerns: he says that a tradesman who is careful never to overcharge his customers acts in accordance with duty, but if he does this simply from motives of prudence because he believes that a reputation for honesty will be best for his business in the long term, then he does not act for the sake of duty.[86] Famously, or perhaps infamously, Kant held that actions performed in accordance with duty but not for the sake of duty have no moral worth; only actions performed for the sake of duty have such worth.[87] Long before Kant, Thomas Aquinas had a similar but less radical position. He taught that an otherwise good action may be done from a bad motive (curiously, his example is close to CSR concerns too: a man who gives alms not out of concern for the poor but in order to obtain a reputation for generosity), and he said that such actions are not good simply speaking, but good in some respects and bad in others.[88] Other moralists in the western tradition have had similar concerns.

Without attempting to resolve the difficult philosophical issues involved, I think we can dispose of the objection as it relates to the CSR activities of business firms on the basis of

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86 IMMANUEL KANT, GROUNDWORK OF THE METAPHYSICS OF MORALS 11 (Mary Gregor ed., trans., 1997).

87 *Id.* For elementary discussions of this point in Kant, see 6 Frederic Copleston, S.J., A HISTORY OF PHILOSOPHY, at 108–10 (1964); J.B. Schneewind, *Autonomy, Obligation, and Virtue: An Overview of Kant's Moral Philosophy*, *in* THE CAMBRIDGE COMPANION TO KANT 309, 325 (Paul Guyer ed., 1992); VERNON J. BOURKE, HISTORY OF ETHICS 169 (1968); 3 TERENCE IRWIN, THE DEVELOPMENT OF ETHICS 27–28 (2009).

88 THOMAS AQUINAS, SUMMA THEOLOGIAE Ia–IIae.18.4 in c. et ad 3.

features peculiar to that context. That is, when a person has a CSR preference, there are usually many different reasons that might underlie that preference. For example, if a person favors products with certain environmentally friendly attributes, the reason most likely is that the person is concerned with the well-being of current or future generations of human beings who will have to live in the environment affected by those products. Or maybe the person is concerned about the environment as an end in itself, quite apart from the adverse effects that that environment may have on human beings. Perhaps there are other reasons as well, but these reasons will generally be independent of the motives of the firm responding to the person's CSR preferences; in other words, a person with a CSR preference is characteristically concerned with producing certain states of affairs in the world, not with the moral improvement of corporations and the people who run them (in the way, for example, that parents generally care about the moral improvement of their children). Hence, even if a firm complies with a person's CSR preferences only because the firm is being paid to do so, the person's CSR preferences would normally be fulfilled in every relevant way because, for example, the environment is in fact being protected in the way the person wants. His preference would be unfulfilled only in the unusual case when the preference is primarily about the moral development of the human beings managing the firm and not really about the environment at all—that is, if the preference were that the managers of the firm become more moral. That people's CSR preferences are not generally about the moral development of corporations and their managers can be shown with a simple thought experiment. For example, suppose that a person had a preference that the firm's managers behave morally in environmental matters, and suppose further that these managers sincerely tried to operate the firm in an environmentally sound manner out of a moral concern for the environment, but that through incompetence or bad luck they in fact caused the firm to perpetrate an environmental catastrophe. It would be beyond strange to say in such circumstances that the CSR preferences of the person in question were in fact fulfilled because the managers behaved morally. But that is exactly what would follow if we interpret the person's preferences as being about the moral development of the corporation and its managers. Thus, since most people with CSR concerns are not primarily concerned with the moral worth of the actions of firms and their managers but about the actual consequences of the firm's activities, it seems clear that we should count such people's preferences as being satisfied, provided that the firm acts in

accordance with them, regardless of the firm's or its managers' motivations for doing so. Perhaps Kant is right that the managers' actions have no moral worth, but for CSR purposes what matters is that the actions be, as Kant would have said, in accordance with duty, not that they be done for the sake of duty.

B. Morality of Shifting Costs to Parties Willing to Pay for CSR Concerns

Another possible moral issue arising out of the Coasean analysis of CSR transactions presented above concerns whether it is morally defensible that parties other than the firm itself pay the costs of the firm's CSR activities, that is, whether it is morally right that parties other than the firm have to pay for the firm to do what it is morally obligated to do. In contradistinction to the issue discussed immediately above in Section II.A, the issue here is not whether the firm deserves any moral credit for doing the right thing for less than the right reason, but whether the firm is still behaving immorally by effectively charging other parties to do things that it itself already has a moral obligation to do. It may seem, for example, that the firm is no better than a highway robber who accepts a bribe not to rob travelers whom he has waylaid on the road. If the firm has a moral obligation to behave in certain ways, surely, some people may say, it is behaving immorally if it extracts payments from third parties in order to live up to its moral obligations. A firm whose CSR activities are the product of Coasean transactions is no better, from a moral point of view, than a firm that entirely eschews such activities. The form of immorality may change, but the immorality remains.

This argument, in my view, turns on the assumption that, for moral purposes, firms are relevantly like individuals. That is, if an individual performs his moral obligations only because someone else is paying him to do so, then the individual would likely be behaving immorally. But it is quite otherwise with firms, for, despite the views of some scholars,[89] the firm is not a moral agent in any normal sense of the term. It exists only in the contemplation of the law[90] and amounts to a nexus of contractual relationships,[91] ultimately among individual human beings.[92] It is not a person but a form of organizing activity by persons. If the

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89 *E.g.*, Albert W. Alschuler, *Two Ways to Think About the Punishment of Corporations*, 46 AM. CRIM. L. REV. 1359, 1369 (2009); Sara Sun Beale, *Is Corporate Criminal Liability Unique?* 44 AM. CRIM. L. REV. 1503, 1532–33 (2007).

90 M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 316, 340 (1819).

91 Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310 (1976).

92 *Id.*

firm engages in costly activities, some individuals or others will ultimately bear those costs. There is no such thing as the firm itself bearing the cost; at most, this means that the cost is borne by the firm's equity investors. The argument thus reduces to the proposition that all the costs of CSR activities ought to be borne by investors. In accordance with the argument in Section I.B.4, this is already the case with respect to the satisfaction of the investors' own CSR preferences. But why should it be the case with respect to CSR costs in general?

The answer is that there is no reason why it should, and any sense that this result is counterintuitive probably comes from failing to appreciate that firms merely intermediate the relationships among the various parties with whom they contract. For example, a firm that produces and sells consumer goods has certain non-CSR costs, such as for physical inputs, labor, intellectual property, and equity capital. The firm has not only a legal but also a moral obligation to pay these costs. No one would suggest that there is the slightest moral impropriety if the firm builds these costs into the price for which it sells its goods, thus effectively passing these costs along to consumers. Indeed, it has no other source of funds with which to pay these costs. If the firm's costs go up—for example, because wage rates are rising and the firm must now pay higher salaries—then these added costs will also, with all moral propriety, be passed along to customers. Now suppose that morality, but not market conditions, requires that the firm pay higher wages. I see no reason why these costs, unlike all others, may not morally be passed along to customers, but should rather reduce the return to equity investors. If consumers have a taste for a certain kind of product, and morality requires that certain costs be incurred in making the product, a consumer who is unwilling to pay those costs is as unreasonable as the consumer who thinks that any other costs incurred by the firm in producing the product ought to be absorbed by the investors and not passed on to the consumer. Once again, there is no basis for distinguishing between costs arising from moral preferences and costs arising from any other kind of preferences.

CONCLUSION

The Coasean analysis of corporate social responsibility presented in this Article is driven primarily by the assumption that people's moral preferences, to the extent that they are backed by a willingness to pay to realize them, should be treated on a par with all other preferences for economic goods, whether in positive or normative economic analysis. Once this assumption

is made, all the rest follows from a straightforward application of the Coase theorem. To the extent that scholars, corporate executives, and CSR advocates have not generally appreciated this point, the reasons are twofold. First, they have too often thought that economic analysis ought to be confined to preferences that are more obviously economic in the colloquial sense—that is, to preferences for self-interested, material gain. This is just a mistake, a caricature of true economic analysis of law. Second, such people have mistakenly taken the firm with more moral seriousness than it deserves; it is not a genuine moral agent, just a convenient way to intermediate contractual relationships among large numbers of individuals.

A final consideration pertains to those CSR preferences people may have that are not backed by a willingness to pay in excess of the cost to the firm of realizing these preferences, as, for instance, might happen when consumers prefer products made from recycled materials but are not willing to pay the added costs such materials would create. The analysis in this Article predicts, of course, that such preferences will not be effected by the firms involved and, moreover, that this result is nevertheless efficient. If there really is a moral imperative to use recycled materials in making such products, then the moral and the efficient would diverge in such cases. We would have an apparent failure of CSR, though the failure would really lie with the consumers who were unwilling to pay to realize their moral preferences. But whether this is really the case seems doubtful. In reality, what is probably happening in such cases is that, although many people have the relevant CSR preferences, their willingness to pay to realize these preferences varies. Most of them would say that, in determining whether there is a moral obligation to use recycled materials in given products in fact depends on, among other things, the costs of doing so. If the costs become too high, the moral obligation lapses. This is emphatically not to say that our morals are for sale. It is just to admit, as all reasonable people do, that very often whether we have a moral obligation to do something depends on what we have to sacrifice to accomplish it. A man may have a duty to attempt to save his drowning neighbor, but not if that means abandoning his own drowning child. Thus, when the costs of effecting their CSR preferences exceed consumers' aggregate willingness to pay, for most consumers the preference ceases to have the character of moral obligation and becomes a mere velleity. Such consumers no longer regard using non-recycled materials as immoral in the circumstances. For those few consumers who continue to see the result as immoral, however, the picture looks rather different: they may be willing to pay their proportionate share of the cost,

but their judgment that the overall result is immoral actually reflects a demand that their fellow citizens agree with their views on this matter—a demand that they have every right to make and probably have made, albeit to no effect. That is the way of democracies. Those imbued with a truly liberal spirit, or at least a philosophical one, are not surprised to find themselves in this position from time to time. Some people, however, when placed in this position, evince an undue insistence on their own moral judgments and a failure to tolerate the differing moral judgments of others. And that, I would say, is socially irresponsible.

Corporate Social Responsibility in a Remedy-Seeking Society: A Public Choice Perspective

Donald J. Kochan[*]

ABSTRACT

This Article applies the lessons of public choice theory to examine corporate social responsibility. The Article adopts a broad definition of corporate social responsibility activism to include both (1) those efforts that seek to convince corporations to *voluntarily* take into account corporate social responsibility in their own decision-making, and (2) the efforts to alter the legal landscape and *expand legal obligations* of corporations beyond traditional notions of harm and duty so as to *force* corporations to invest in interests other than shareholders and profits because they must comply with these new laws.

After surveying the corporate social responsibility debate, this Article examines public interest-labeled groups (including corporate social responsibility groups) under a public choice lens and determines that they seek to maximize their budgets, maximize influence, maximize membership, secure their jobs, and in the case of corporate social responsibility sometimes directly effectuate wealth transfers into their organizations or constituencies (e.g., from shareholders to stakeholders). When rent-seeking for legal change is the more efficient use of corporate social responsibility advocates' limited resources, those groups will invest in the creation of law.

This Article pays special attention to a broad definition of rent-seeking that includes the investments made, through precedent-building litigation models, in the creation of legal liability regimes or realistic new threats of legal liability in an effort to obtain leverage over corporations in settlements or other negotiations designed to convince corporations to change behavior. According to studies on settlement dynamics, when novel new litigation theories start to survive motions to dismiss, corporate defendants have more incentives to settle to avoid harm to reputation or brand, in addition to avoiding adverse judgments. The Article concludes using the Alien Tort Statute (ATS) as a case study illustrating how the interest-group dynamic can play out in the development of a corporate social responsibility-driven liability regime.

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INTRODUCTION

Advocates for some corporate "socially responsible" role and the imposition of some duties upon corporate boards greater than maximizing wealth often cast themselves as society's champions for the greater public interest or public good. This is too simple a story. A primary goal of this Article will be to demonstrate that corporate social responsibility (CSR) advocates are interest groups too. Thus, law and economics can teach us a bit about the behaviors we can expect from corporate social responsibility advocates, depending on the available legal architecture which can be deployed to advance the advocates' interests and preferences in an effort to gain leverage against their adversaries—the profit-seeking corporations. Corporate social responsibility advocates will engage in rent-seeking behavior, investing in legal outcomes when it is beneficial to their cause. Thus, how the law of corporate social responsibility is shaped and how advocates operate to shape the law can each be explained in part by reference to interest-group behaviors and public choice theory. While corporate social responsibility reverberates with sounds of the wonderful, it has rent-seeking undertones like any other effort to use the law to shape social policy through controls on private behavior.

After centuries of academics weighing in on the debate over corporate social responsibility, there exists almost a required four-part checklist of introductory disclaimers in any article that will soon ink yet more pages on the already swollen corporate social responsibility bookshelf. There are, at least, some predictable, seemingly obligatory categories of observation in most article introductions and I will provide my due compliance before proceeding.

First, an author should acknowledge that they are cautiously, indeed nervously and with some hesitation, entering a field already well tread. Professor Cynthia Williams, for example, in one of her lengthy explorations of corporate social responsibility stated that "[i]t is with some trepidation that this author undertakes a rather extended venture into the contested arena of corporate social responsibility."[1] I hereby incorporate that statement and thereby check off the first box on the list.

Second, the author should alert readers that the academic material on corporate social responsibility is massive and overwhelming and acknowledge that it is hard to imagine why

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1 Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705, 706 (2002).

someone would want to read yet another article in this seemingly saturated area of law, economics, and public policy. Professors Henry Butler and Fred McChesney captured this sentiment well when they exclaimed while writing on corporate social responsibility that "[f]or centuries legal, political, social, and economic commentators have debated corporate social responsibility *ad nauseam*."[2]

Third, it is obligatory to mention something about the definition of corporate social responsibility. Quite frequently this will involve some explanation that there is no one, definitive definition of corporate social responsibility, and this cautionary note will sometimes include a statement that the author will not attempt a singular definition. Usually it will also follow with some statement that the author will focus on one or more particular meanings of the phrase captured within the broader concept of corporate social responsibility. Consider Professor Peter Madsen's comment in the opening to an article that "[d]efining CSR is, as the saying goes, like trying to nail Jell-O to the wall."[3] Or, as Williams explains as another example, "[o]ver the past decades . . . it has been difficult to define what one means, in any fully specified way, by the concept of corporate social responsibility, and thus it has been difficult to discuss except at a high level of generality."[4] There is no doubt that corporate social responsibility is tough to define and means different things to different people. As this Article proceeds, I will attempt to make clear the meaning of the phrase as I intend to use it when possible or helpful, but I will also write with some of the necessary generalities.[5]

In this Article, I will be defining corporate social responsibility activism broadly as related to both (1) those efforts that seek to convince corporations to *voluntarily* take into account corporate social responsibility in their own decision-making, willingly launch corporate initiatives based on concerns beyond profit, and sometimes specifically and intentionally address social and stakeholder values; and (2) the efforts to alter the legal landscape and *expand legal obligations* of corporations beyond traditional notions of harm and duty so as to

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2 Henry N. Butler & Fred S. McChesney, *Why They Give at the Office: Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation*, 84 CORNELL L. REV. 1195, 1195 (1999).

3 Peter Madsen, *Professionals, Business Practitioners, and Prudential Justice*, 39 MCGEORGE L. REV. 835, 836 (2008).

4 Williams, *supra* note 1, at 775.

5 David Millon, *Shareholder Social Responsibility*, 36 SEATTLE U. L. REV. 911, 919 (2013) ("There is no single, generally accepted definition of CSR," but "it is possible to sketch the concept's meaning in broad outlines.").

force corporations to invest in interests other than shareholders and profits because it must comply with these new laws. Throughout this Article, I will also use terms like activism, advocacy, and expansionism interchangeably to capture the nature of those interest groups that seek to engraft new social welfare-oriented obligations, and impose higher standards, on corporations. These interest groups see businesses as their opposition or competition.

Finally, within the four obligatory components of a corporate social responsibility article introduction, the author should make some claim that there is something new and unique in the article at hand that makes it worthy of some attention. This is particularly important because the corporate social responsibility field is already so substantially plowed. Sometimes, the claim will be about something truly new. At other times, the author might need to admit that the work is partly new just in the sense that this particular author has never said it before and not yet thrown his perspective into the mix. Professor Stephen Bainbridge provided an insight on this phenomena when he observed in an article focused on corporate social responsibility that, usually, every current corporate social responsibility "debate is not being driven by any crisis in corporate law,"[6] but instead "[i]t is just a perennial problem on which each new generation of corporate law scholars feels obliged to put its stamp."[7]

While there will be a bit of that "first time in print by my pen" newness in this article and some articulations will be made for the first time *by this* author, yet not the first time such ideas have ever been uttered, my aim is to provide a few insights that have not yet been articulated in the literature with any sense of clarity. Principal among these will be why it is useful to look at corporate social responsibility advocates as classic interest groups seeking to obtain wealth transfers that they would be incapable of receiving absent their manipulation of the legal process to achieve changes in legal doctrine in order to obtain advantage in advancing their goals. In particular, this Article will focus on the investments corporate social responsibility advocates make in the creation of legal liability regimes or realistic new threats of legal liability in an effort to obtain

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6 Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1435 n.40 (1993) [hereinafter Bainbridge, *In Defense*].

7 *Id.* Bainbridge followed this claim directly with the statement, "[h]erewith my spin." *Id.*

leverage over corporations in settlements or other negotiations designed to convince corporations to change behavior.

Part I will survey the corporate social responsibility debate, briefly describing the spectrum along which the arguments regarding wealth-maximization and other more expansive social responsibilities exist. Part I will conclude with an introduction to the means by which law can provide benefits to those seeking acceptance for greater, more expansive notions of corporate social responsibility. Part II will introduce public choice and interest-group theory. It will explain the process of rent-seeking for legal advantage and explain why corporate social responsibility activists should be received with the skepticism afforded all interest groups in the political process. It will conclude that, like other interest groups, corporate social responsibility activists try to use the law to obtain advantages for their cause at a lower cost than they could obtain these benefits by bargaining for these things in the open marketplace. The law and economics literature does not discuss often enough the separate public choice and rent-seeking phenomena distinctively seen in the development of liabilities through litigation.[8] Part II will also discuss this process of rent-seeking as being broader than the pursuit of legislation. Any concept of rent-seeking should include interest group investment in changing the law to create liability regimes that benefit the group (here, corporate social responsibility advocates) and expand the duties and compensatory obligations of their competitors (here, corporations).

Despite the fact that the literature is saturated with articles on almost every aspect of corporate social responsibility, there is surprisingly little attention paid to the interest group dynamics in the contest between corporations and advocates for a more expansive type of corporate social responsibility above and beyond what might occur as a natural consequence of seeking wealth-maximization. Although there are a number of examples of rent-seeking behaviors by corporate social responsibility advocates that could be discussed, given the limited space for this symposium article, Part III will examine only one type of behavior with one case study—liability-seeking efforts under the Alien Tort Statute (ATS).[9] The ATS provides a recent example where we saw the interest-group dynamic play out in the

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8 Paul H. Rubin, Christopher Curran & John F. Curran, *Litigation Versus Legislation: Forum Shopping by Rent Seekers*, 107 PUB. CHOICE 295, 295–96 (2001) (discussing the relatively fewer works devoted to public choice implications in litigation for rent-seeking ends vis-à-vis the number of similar analyses of legislative processes).

9 28 U.S.C. § 1350 (2012).

development of a liability regime for human rights and other international law abuses. Part III examines the evolution of the ATS as a liability-imposing corporate social responsibility tool. The corporate social responsibility advocates' investment in the development of an ATS liability doctrine (for a time with some substantial success) will demonstrate how interest groups operate in what might be called "rent-seeking" through judicially based "remedy-seeking" behavior.

In the end, through general analysis and the ATS case study, this Article seeks to unveil the public interest curtain that often shields corporate social responsibility activists from the scrutiny their efforts should receive. When it comes to corporations, a remedy-seeking society is often too quick to presume that more socially desirable outcomes require restraining corporate shareholder wealth. At the very least, it should be understood that any efforts to do so will advantage another self-interested group rather than somehow serving primarily the true public interest.

I. THE CONTOURS OF THE CORPORATE SOCIAL RESPONSIBILITY DEBATE

A. A Ubiquitous Contest Between Two Competing Visions of Responsibility and Duty

Corporate social responsibility has no single, accepted definition, yet it stirs the passions of many behind their own conception of the term.[10] As a result, issues regarding the social responsibility of corporations—including whether there are any such obligations at all—have generated substantial debate over the years.[11]

Within the debate over the scope of corporate social responsibility there are two poles with varying positions in between.[12] On one side of the spectrum are those who believe that corporations have social responsibilities of some kind or degree beyond the bottom line and beyond compliance with existing laws. The opposite side of the spectrum believes that the social responsibility of corporations cannot be judged outside of the obligation of a corporation to achieve wealth-maximization in the corporate management's fiduciary duties to its shareholders

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10 Williams, *supra* note 1, at 775.

11 Millon, *supra* note 5, at 921 ("Given the lack of an agreed definition of CSR, it comes as no surprise that there are several different models or theories of CSR.").

12 Williams, *supra* note 1, at 711–20 (summarizing the corporate social responsibility literature and the varying legal and policy positions).

or obligations in compliance with its web of contracts. Of course, nuanced definitional issues and middle ground positions appear within the discussion as well—including questions regarding what counts as "law," what is our definition of "duty" and "harm," and what is the meaning of "wealth-" or "profit-maximization." This section will briefly discuss the presence and growth of the debate within corporate law followed by a brief discussion of the substantive claims behind the wealth-maximization theories juxtaposed with the more expansive theories of corporate social responsibility.

While it is true that this is an age-old debate,[13] there is no doubt that the issue of corporate social responsibility—especially the rise of camps arguing for an enlarged sense of corporate duty to social interests and stakeholders outside of the corporate form—has received steadily increasing attention across the past several decades. One insight into this evolution of the corporate social responsibility conversation can be gleaned from a survey of the use of the phrase "corporate social responsibility" across time. For that task, I will turn briefly to the results from Google's Ngram function[14]—which has been described as "the first tool of its kind, capable of precisely and rapidly quantifying cultural trends based on massive quantities of data. It is a gateway to culturomics!"[15] This unique Google product enables users "to examine the frequency of words . . . or phrases . . . in books over time."[16] The database permits searching "through over 5.2 million books: ~4% of all books ever published!"[17] The creators proclaim that this tool will have "profound consequences for the study of language, lexicography, and grammar."[18] The Ngram

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13 Butler & McChesney, *supra* note 2, at 1195.

14 GOOGLE BOOKS NGRAM VIEWER, http://books.google.com/ngrams (last visited Oct. 4, 2013) [hereinafter *Google Labs Ngram Viewer*] (based on the model and database developed by Jean-Baptiste Michel, Yuan Kui Shen, Aviva Presser Aiden, Adrian Veres, Matthew K. Gray, William Brockman, The Google Books Team, Joseph P. Pickett, Dale Hoiberg, Dan Clancy, Peter Norvig, Jon Orwant, Steven Pinker, Martin A. Nowak, and Erez Lieberman Aiden. *See* Jean-Baptiste Michel, Yuan Kui Shen, Aviva Presser Aiden, Adrian Veres, Matthew K. Gray, William Brockman, The Google Books Team, Joseph P. Pickett, Dale Hoiberg, Dan Clancy, Peter Norvig, Jon Orwant, Steven Pinker, Martin A. Nowak, & Erez Lieberman Aiden, *Quantitative Analysis of Culture Using Millions of Digitized Books*, SCIENCE, Jan. 14, 2011, at 176, *available at* http://www.sciencemag.org/content/early/2010/12/15/science.1199644).

15 *Google Ngram Viewer*, CULTUROMICS, http://www.culturomics.org/Resources/A-users-guide-to-culturomics (last visited Oct. 3, 2013); *see also* Michel et al., *supra* note 14, at 176 (describing the database and related data collection tool).

16 *Google Ngram Viewer*, *supra* note 15.

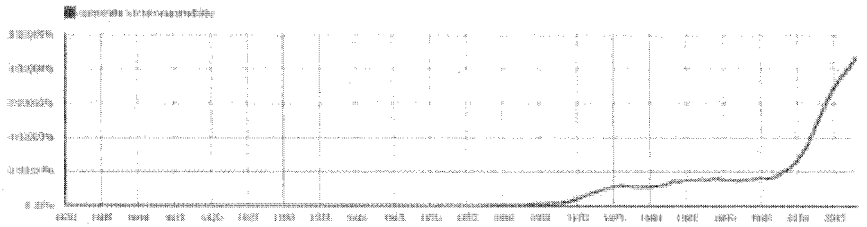
17 *Id.*

18 Michel et al., *supra* note 14, at 178, Figure 2; *see also id.* at 177 ("Our results suggest that culturomic tools will aid lexicographers in at least two ways: (i) finding low-frequency words that they do not list, and (ii) providing accurate estimates of current

Viewer undoubtedly provides an interesting picture for discussion of the usage of words and phrases, although it admittedly has some inherent limitations and some recognized criticisms of its scientific value.[19]

The Ngram for the phrase "corporate social responsibility" shows the phrase's increased usage over time, and an especially interesting rate of increase since 2000, likely as a result of our increased scrutiny of corporations following a series of financial crises:

TABLE 1:
GOOGLE LABS BOOKS NGRAM VIEWER
GRAPH *CORPORATE SOCIAL RESPONSIBILITY* FROM 1900 TO 2008
FROM THE CORPUS OF ENGLISH WITH A SMOOTHING OF 3



Source: GOOGLE BOOKS NGRAM VIEWER, http://books.google.com/ngrams (last visited Oct. 4, 2013) (based on the model and database developed by Jean-Baptiste Michel, Yuan Kui Shen, Aviva Presser Aiden, Adrian Veres, Matthew K. Gray, William Brockman, The Google Books Team, Joseph P. Pickett, Dale Hoiberg, Dan Clancy, Peter Norvig, Jon Orwant, Steven Pinker, Martin A. Nowak, and Erez Lieberman Aiden, *Quantitative Analysis of Culture Using Millions of Digitized Books*, SCIENCE, Jan. 14, 2011, at 176).

Table 1 shows trends from 1900 to 2008 (the latest available date) for the unigram "corporate social responsibility." The y-axis shows what percentage of all the unigrams contained in Google's sample of books written in English include the phrase "corporate social responsibility." "Usage frequency is computed by dividing the number of instances of the n-gram in a given year by the

frequency trends to reduce the lag between changes in the lexicon and changes in the dictionary.").

19 John Bohannon, *Google Opens Books to New Cultural Studies*, 330 SCIENCE 1600, 1600 (2010) (describing the Ngram project and its initial critics). Peer review is as of yet limited on this relatively new tool, yet even the creators warn, "[b]asically, if you're going to use this corpus for scientific purposes, you'll need to do careful controls to make sure it can support your application. Like with any other piece of evidence about the human past, the challenge with culturomic trajectories lie in their interpretation." Google Ngram Viewer, *supra* note 15. Suggestions for controls are available in the main paper supporting the application. *See also* Michel et al., *supra* note 14, at 181. "Culturomic results are a new type of evidence in the humanities. As with fossils of ancient creatures, the challenge of culturomics lies in the interpretation of this evidence." *Id.* (giving a few example searches with interpretations).

total number of words in the corpus in that year."[20] Smoothing allows for a consideration of the trends as a moving average and can be adjusted for any search.[21] When one runs the search on Google, hyperlinks appear underneath the graph, allowing one to browse through the books available that contributed to the data set.[22]

Although the Ngram reveals "corporate social responsibility" appears in an extremely small percentage of the overall books in Google's digitized collection, it certainly shows both a notable frequency and a significant upward trend in its usage. This is, admittedly, only a collection of raw data. But the usage and trend are both apparent.

With an increased discussion of expanded corporate social responsibilities, the academic, legal, and policy discussions have also increasingly debated both the existence and meaning of "stakeholders"—some constituency, larger than the shareholders of corporations and those with whom the corporation holds contracts, to which the corporation nonetheless owes some duty on which to expend corporate resources. As Williams explains, "the current corporate social responsibility debate often involves a competition between shareholder versus stakeholder conceptions of the corporation."[23]

According to Professor David Millon, for example, "the pragmatic definition [of 'stakeholder'] advanced by business ethics expert R. Edward Freeman has intuitive appeal, is reasonably workable, and has proved to be durable: a stakeholder of a particular corporation is anyone who 'can affect or is affected by the achievement of an organization's objectives.'"[24] Millon

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20 Michel et al., *supra* note 14, at 176. The Google Ngram data is "normalize[d] by the number of books published in each year." *What Does the Ngram Viewer Do?*, GOOGLE BOOKS, http://books.google.com/ngrams/info (last visited Oct. 4, 2013).

21 Google Books describes "smoothing" as follows:

> Often trends become more apparent when data is viewed as a moving average. A smoothing of 1 means that the data shown for 1950 will be an average of the raw count for 1950 plus 1 value on either side: ("count for 1949" + "count for 1950" + "count for 1951"), divided by 3. So a smoothing of 10 means that 21 values will be averaged: 10 on either side, plus the target value in the center of them. At the left and right edges of the graph, fewer values are averaged. With a smoothing of 3, the leftmost value (pretend it's the year 1950) will be calculated as ("count for 1950" + "count for 1951" + "count for 1952" + "count for 1953"), divided by 4.

What Does the Ngram Viewer Do?, *supra* note 20.

22 *Id.* ("Below the graph, we show 'interesting' year ranges for your query terms. Clicking on those will submit your query directly to Google Books.").

23 Williams, *supra* note 1, at 707.

24 Millon, *supra* note 5, at 920 (quoting R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 46 (1984)).

adequately explains these persons affected (and thereby defined as "stakeholders") as including "workers, creditors, local communities, suppliers, consumers, and those affected by the corporation's impact on the environment."[25] Freeman and Millon's definition captures the essence of what most people mean by the term. But the "anyone who can affect or is affected by" language should be sufficient for the reader to understand the potentially unlimited breadth of possible stakeholder constituencies.

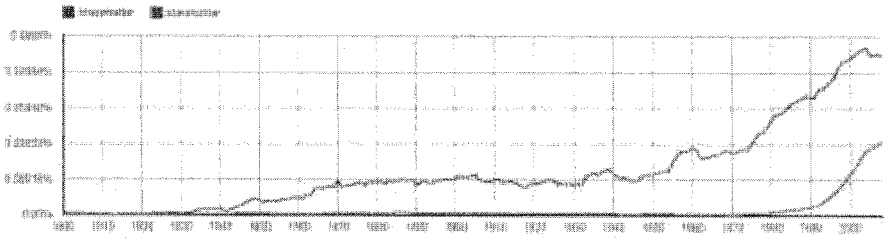
Tracking the rise of the usage of the word "stakeholder" over time is another interesting way to illustrate the injection of corporate social responsibility into our vocabulary and usage. The Ngram tool allows the researcher to compare two terms or phrases, thus Table 2 provides the Ngrams for both "shareholder" and "stakeholder."

TABLE 2:

GOOGLE LABS BOOKS NGRAM VIEWER

GRAPH *SHAREHOLDER* (UPPER LINE) V. *STAKEHOLDER* (LOWER LINE)

FROM 1800 TO 2008 FROM THE CORPUS OF ENGLISH WITH A SMOOTHING OF 3



Source: GOOGLE BOOKS NGRAM VIEWER, http://books.google.com/ngrams (last visited Oct. 4, 2013) (based on the model and database developed by Jean-Baptiste Michel, Yuan Kui Shen, Aviva Presser Aiden, Adrian Veres, Matthew K. Gray, William Brockman, The Google Books Team, Joseph P. Pickett, Dale Hoiberg, Dan Clancy, Peter Norvig, Jon Orwant, Steven Pinker, Martin A. Nowak, and Erez Lieberman Aiden, *Quantitative Analysis of Culture Using Millions of Digitized Books*, SCIENCE, Jan. 14, 2011, at 176).

Table 2 shows trends from 1800 to 2008 (the latest available date) for the unigrams "stockholder" as the upper line and "stakeholder" as the lower line. As Table 2 shows, the usage of "shareholder" has seen a rather steady increase from the mid-1800s to the mid-1970s, with a heightened rate of increase in frequency of usage since the late 1970s and early 1980s. "Stakeholder" barely registers on the graph before the late 1970s and has since shown a steadily sharp rise across the past three decades. This data regarding the use of the term in books stands

25 *Id.*

as a possible proxy for its overall importance in the corporate law discussion. The rise in usage illustrated here coincides with an increasing importance given to the stakeholder concept in corporate law discussions.

It is clear that corporate social responsibility is a continuingly important part of the current corporate law discourse. As noted at the outset of this Part, there are two extremes involved in this debate that see the duty of a corporation quite differently. For those with a wealth-maximization view, corporate social responsibility has little meaning beyond maximizing the wealth of the shareholders and complying with contracts and the law.[26] Any benefits to the rest of society are happy benefits of the corporation's focus on profits.[27] Occupying the other pole in the spectrum, another view might be described as the progressive or expansive side, oriented toward advocating for broad-based duties for the corporation—both morally and legally. For this side, there is a greater constituency other than shareholders (even including at times all of "society") with whom profits must be shared, for the protection of whom profits may need to be sacrificed, or for the benefit of whom expenditures must be made.[28]

I have described the conflict in previous work as requiring us to decide what guidance we suggest and what requirements we impose (as a matter of law or policy) to define "proper" corporate decision-making:

> The spectrum between these extremes resembles the classic debate over the negative and positive rights of man as they relate to obligation and the justification for intervention by institutions of power. The corporate social responsibility discussion raises three principal issues about how a moral corporation lives its life: how a corporation chooses its self-interest versus the interests of others, when and how it should help others if control decisions may harm the shareholder owners, and how far the corporation must affirmatively

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26 *See* MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962); *see also* Milton Friedman, *The Social Responsibility of Business Is To Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 32.

27 Elsewhere I have described this side of the spectrum as viewing "the concept of corporate social responsibility as essentially nonexistent, unless it happens to be an accidental and spontaneous outcome of otherwise self-interested financial motives of a profit-maximizing corporation." Donald J. Kochan, *Legal Mechanization of Corporate Social Responsibility Through Alien Tort Statute Litigation: A Response to Professor Branson with Some Supplemental Thoughts*, 9 SANTA CLARA J. INT'L L. 251, 254 (2011) [hereinafter Kochan, *Mechanization*].

28 In previous work, I have described this extreme as one that advances the notion that "corporations should become governmental surrogates, conscripted philanthropists, or otherwise constrained with affirmative perceived-moral obligations that can be compelled by coercive force." *Id.*

> go to help right the perceived wrongs in the world in which it operates.[29]

These issues go to the heart of the debate about the meaning of corporate social responsibility. The remaining sections in this Part will further examine in more detail the sides of the spectrum in this corporate social responsibility debate and will take a look at each side's expectations for the law's role in protecting or advancing its positions.

B. The Shareholder Wealth- or Profit-Maximization Camp

Regardless of whether one adopts a separation of ownership and control conception of the corporation or a nexus of contracts conception, both accept a wealth-maximization model of corporate social responsibility (even if for slightly different reasons).[30] The primary constraint on corporate behavior is not the advancement of some vague social interest but instead is the advancement of profits within the bounds of the law, which includes compliance with contracts and compliance with otherwise generally applicable legal rules and regulations.[31] Despite extensive efforts to dislodge it, this traditional view also remains the predominantly accepted legal view of a corporation's social responsibility.[32]

Proponents of the wealth-maximization view claim that these more certain and limited metrics are not only substantively superior, but they are also better defined—making them more manageable and more susceptible to monitoring. As Clark explains, "[a] single, objective goal like profit-maximization is

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29 *Id.* (citing CHARLES FRIED, RIGHT AND WRONG 1 (1978) (writing generally on the obligations of man and his relation to the state using an analogous set of choices)).

30 *See* Bainbridge, *In Defense*, *supra* note 6, at 1427–28 (some reach a preference for the wealth-maximization norm but as a result of a nexus of contracts theory of corporate law rather than focusing on the separation of ownership and control).

31 Clark explains the idea that profit is conditioned upon compliance with applicable law as follows:

> [T]he profit-maximizing norm does *not* imply that corporations and their managers have only minimal legal obligations to persons other than shareholders. Quite the contrary is true. Every major relationship between the corporation and persons or groups it affects is subject to vast and intricate bodies of legal doctrine and to legal enforcement mechanisms. These legal controls are ineffective in some instances and suboptimal in others, but they exist.

ROBERT CHARLES CLARK, CORPORATE LAW § 16.2 (1986).

32 *See* Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001) ("Shareholder wealth maximization is usually accepted as the appropriate goal in American business circles."); Williams, *supra* note 1, at 714 (describing profit-maximization and that the "predominant academic view in the United States about corporate social responsibility is directly derived from the shareholder theory of the corporation").

more easily monitored than a multiple, vaguely defined goal like fair and reasonable accommodation of all affected interests."[33]

The work of Milton Friedman is often associated as the standard bearer for this "wealth-maximizing" or "profit-maximizing" view of corporate social responsibility.[34] As Friedman states:

> The view . . . that corporate officials and labor leaders have a 'social responsibility' that goes beyond serving the interest of their stockholders or their members . . . shows a fundamental misconception of the character and nature of a free economy. In such an economy, there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.[35]

This wealth-maximization view also famously finds support in the 1919 Michigan Supreme Court decision in *Dodge v. Ford Motor Company* where the court denounced Henry Ford's plan to share profits with employees at the expense of shareholders.[36] There the court explicated clear limits on the discretion of corporations to take into account broader social interests in its expenditures of profits:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.[37]

Dodge remains a dominant force in defining the prevailing view of corporate social responsibility within corporate law.[38]

This view as expressed by Friedman and in *Dodge* is largely based on the traditional notion of the corporation as involving the separation of ownership and control. This position rejects any

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33 CLARK, *supra* note 31, § 16.2.

34 Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 564 (2003) ("Milton Friedman's famous essay on corporate responsibility remains the classic statement of the shareholder primacy model."); *see also* Roe, *supra* note 32, at 2065 n.2 (2001) ("Although aggressive when it appeared, Friedman's perspective is now mainstream in American business circles . . . .").

35 FRIEDMAN, *supra* note 26, at 133; *see also* Friedman, *supra* note 26, at 124.

36 Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

37 *Id.*

38 *See* Bainbridge, *In Defense*, *supra* note 6, at 1423–24 ("[T]he mainstream of corporate law remains committed to the principles espoused by the *Dodge* court.").

and all duties to those other than the shareholders.[39] It contends that corporate decisions to spend shareholder profits on societal needs or goods imposes a tax on, or constitutes a wealth transfer from, those shareholders and that it illegitimately does so without shareholder consent.[40] Others reach the same conclusion regarding wealth-maximization as the optimal restraint on corporate decisions, although adopting a nexus of contracts conception of the corporation whereby the corporation's scope of duty is itself constrained in a manner that does not directly take into account outside stakeholder constituencies.[41]

Importantly, as Ribstein notes, "the legal issue is not whether the corporation or any of the individuals who manage it *should* care about society."[42] The better question is "*whether the law should mandate such governance*, given lawmakers' inherent limitations, the potential costs of legal rules, and disagreements about appropriate social objectives."[43] The wealth-maximization view does not mean that corporate managers are heartless or that corporations will fail to contribute to social welfare. As previously mentioned, the economic growth spurred by corporations pursuing profits helps all of society. And specifically, those in the wealth-maximization camp point to the jobs created, the contracting engaged in that consumes goods and services, the goods produced and services provided, and the taxes paid by corporations, for example, as evidence that corporations are

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39 As Macey explains:

> Under traditional state and corporate law doctrine, officers and directors of both public and closely held firms owe fiduciary duties to shareholders and to shareholders alone. Directors and officers are legally required to manage a corporation for the exclusive benefit of its shareholders, and protection for other sorts of claimants exists only to the extent provided by contract.

Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 23 (1991) [hereinafter Macey, *An Economic Analysis*]; *see also* THE AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1994) ("[A] corporation . . . should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.").

40 Aneel Karnani, *The Case Against Corporate Social Responsibility*, WALL ST. J., Aug. 23, 2010, at R1 ("Managers who sacrifice profit for the common good also are in effect imposing a tax on their shareholders and arbitrarily deciding how that money should be spent.").

41 Bainbridge, *In Defense*, *supra* note 6, at 1429–30 (under the nexus of contracts, wealth-maximization and fiduciary duties exclusive to shareholders is set as the efficient default rule away from which rational investors will not likely deviate).

42 *See* Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1432 (2006).

43 *Id.* at 1432–33 (emphasis added).

helping others when pursuing their own profit-maximizing ends.[44]

One of the most important constraints on wealth-maximization is that a corporation is duty-bound to comply with the law. As Clark explains, the view holds that "[p]rofits should be made as large as possible, within the [limited legitimate] constraints," which first and foremost includes compliance with the law.[45]

There is yet another important limitation that deserves special mention as well. It is an obvious but too often ignored sub-constraint within the wealth-maximization constraint—the power of consumer demand and the price system. As Ludwig von Mises has explained, corporate power is only as good as the orders given by the captains of the market—the consumers:

> The direction of all economic affairs is in the market society a task of the entrepreneurs. Theirs is the control of production. They are at the helm and steer the ship. A superficial observer would believe that they are supreme. But they are not. They are bound to obey unconditionally the captain's orders. The captain is the consumer.[46]

Consumers have the ability to "pay" for their own preferred social responsibility of corporations. If they truly value it and desire it, then any rational profit-maximizing corporation will provide it.[47] Consumers and shareholders alike have the power to purchase corporate social responsibility outcomes. That is a cause and consequence quite distinct from coercively dictating those results. As Friedman added, "The stockholders or the customers or the employes [sic] could separately spend their own money on the particular action if they wished to do so."[48] Corporations will supply a product that naturally arises in a market where consumers demand products that are socially responsible and are willing to pay for any additional cost for the

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44 Williams, *supra* note 1, at 714 (explaining the wealth-maximization view and its claims regarding ways that "corporations meet their proper social responsibilities by excelling in their economic activities, which then contributes to a well-functioning economy . . . .").

45 CLARK, *supra* note 31, § 16.2.

46 LUDWIG VON MISES, HUMAN ACTION: A TREATISE ON ECONOMICS 270 (3d rev. ed. 1963).

47 *Id.* at 648–49. Mises explains:

> All market phenomena are ultimately determined by the choices of the consumers. If one wants to apply the notion of power to phenomena of the market, one ought to say: in the market all power is vested in the consumers. The entrepreneurs are forced, by the necessity of earning profits and avoiding losses, to consider in every regard . . . the best possible and cheapest satisfaction of the consumers as their supreme directive.

Id. at 649.

48 Friedman, *supra* note 26, at 33.

production of that demanded product. If adding a corporate social responsibility element to a product makes the production of the corporation's goods or the provision of the corporation's services more expensive, presumably those additional costs can be captured by an increased price that a willing consumer base will pay because they value the additional efforts made by the corporation.[49]

Thus, consumers themselves absorb the costs to the corporation for the provision of that socially beneficial good. A socially responsible ingredient is added to a product, proactively or reactively, and that ingredient meets consumer demand. Whether it is a demand for "green" and recycled toilet paper, non-GMO corn, fuel-efficient vehicles, energy-conserving appliances, or similar products, if purchasers exist, then the corporations will label, market, and supply these products.[50] Elsewhere, I have described this corporate reaction as achieving socially responsible outcomes as a result of internally induced, profit-driven, and voluntary behavior.[51]

So long as demand is the sole reason for the provision of the good and the consumer market is willing to bear the costs of production through higher prices, such corporate actions are justified within the wealth-maximization norm. In that case, if demand disappears, the corporation is under no compulsion to continue providing that good.

It then becomes the individual responsibility of consumers to apply pressure with their own resources, pocketbooks, and buying power—rather than the law—to alter corporate behavior. Mises explains that the consumers run the show and dictate what is made and how it is made. "Their buying and their abstention from buying decides who should own and run the plants and the farms. They make poor people rich and rich people poor. They determine precisely what should be produced, in what quality, and in what quantities."[52]

The expansive corporate social responsibility advocates would rather, however, push for top-down imposition of corporate social responsibility standards forcing corporations and their shareholders to accept losses by bankrolling the social programs rather than those advocates themselves paying directly for the

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49 *See generally* Karnani, *supra* note 40.

50 *Id.* (describing new markets for fuel-efficient cars, energy-conserving products, and healthier foods as examples, explaining that "in cases where private profits and public interests are aligned, the idea of corporate social responsibility is irrelevant . . . .").

51 Kochan, *Mechanization*, *supra* note 27, at 255.

52 *Id.*

desired behavior and social outcomes. As usual, instead of accessing market mechanisms to satisfy their preferences, these activist interest groups engage in rent-seeking behavior to obtain these social "gains" for some cost less than what they would have to pay if bargained for in a free and fair open market exchange.[53]

Finally, seemingly altruistic or charitable actions may be taken voluntarily by corporations where the impetus for the donation or other action is the calculated benefit to profits from the action due to an ability to capitalize on marketing, branding, or other means of increasing the consumer base or attracting additional investors. Reputation enhancing efforts based on these criteria of self-interest should be considered internally induced and voluntary. These efforts will cease when they are no longer profitable for the corporation. If the decision is made in order to maximize profits, it falls into this category of voluntary behavior that nonetheless leads to concurrently meeting both profit-based and social concerns.

Often, however, as discussed in more detail below, neither the wealth-maximization norm and its constraints on corporate behavior nor the beneficial effects of corporate profits on society are enough to achieve the remedies and results sought by those usually advocating for greater social responsibilities. Those advocates claim that existing conditions and allocations of profits leave other so-called stakeholders or otherwise "affected" individuals in unsatisfactory positions.[54] They contend that this deficiency should be met with more law to constrain the operations of the corporations, including an altered definition of legal duties owed.

C. The Expansive, Remedy-Seeking Notion of Corporate Social Responsibility and Its Broader Vision of Corporate Duties and Obligations

Advocates for a broad or progressive notion of corporate social responsibility argue that there is, or should be, some broader constituency to which a duty is owed beyond shareholders,[55] those involved in contractual relationships with

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53 *See infra* Part II.

54 Adefolake Adeyeye, *The Role of Global Governance in CSR*, 9 SANTA CLARA J. INT'L L. 147, 149 (2011) ("CSR focuses on the attempt to regulate corporate behavior in order to ensure that corporations carry out their activities in consideration to multi-stakeholder interests.").

55 Williams, *supra* note 1, at 716 ("[P]rogressive scholars contend that directors ought to consider the impact of their decisions on a wider range of constituents than shareholders, and thus ought to consider the implications of their actions on employees, consumers, suppliers (in some cases), the community, and the environment.").

the corporation, or those harmed by corporate behavior under traditional notions of harm.[56] On the latter, corporate social responsibility theories sometimes rest on an expanded and different kind of definition of harm.[57]

As mentioned before, corporate social responsibility has many definitions and manifestations. Even among the progressive or expansionist advocates of corporate social responsibility, there is little agreement as to the goals or mechanisms for achieving corporate social responsibility or advancing broader stakeholder interests vis-à-vis corporate power.[58] Professor Larry Ribstein, for example, has explained that "[t]he debate over corporate social responsibility is often vague or unrealistic or both."[59] He continued that those participants seeking greater responsibilities for corporations "speak in terms of how corporations ought to be run, without specifying the legal changes that will produce these results."[60] Friedman noted that "[t]he discussions of the 'social responsibilities of business' are notable for their analytical looseness and lack of rigor."[61] Although many expansionist corporate social responsibility advocates are united in their desire to restrict the universe of acceptable corporate behaviors, they are not necessarily in agreement on all positions within that broader framework.[62]

Despite the sometimes less than cohesive message, corporate social responsibility activism, whatever its iteration, has strength in its optics. "'Corporate social responsibility' is a term that sounds difficult to quibble with as a goal. It exudes a sense of 'the good' or 'the proper.'"[63] After all, it is hard to defend the opposite—"irresponsibility." Much like other terms for

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56 *See* Millon, *supra* note 5, at 919 ("The 'social' element of CSR is the idea that corporations have responsibilities to the broader society.").

57 *See* Bainbridge, *In Defense*, *supra* note 6, at 1432 (corporate social responsibility advocates are worried about the costs that corporate actors supposedly impose upon nonshareholder "constituencies").

58 Williams, *supra* note 1, at 775 ("While many advocates of more corporate social responsibility share a concern that managing global corporations to maximize shareholder wealth has the potential to lead to harmful social effects, including exacerbating persistent income inequalities, there is much less agreement about how to suggest reforming corporate law to address that concern.").

59 Ribstein, *supra* note 42, at 1432; *see also* Williams, *supra* note 1, at 706 (expressing similar difficulties with the definition).

60 Ribstein, *supra* note 42, at 1432.

61 Friedman, *supra* note 26, at 33.

62 Millon, *supra* note 5, at 919 ("Even among sympathetic analysts, key questions generate controversy. There is disagreement about the role of business in society, the persons to whom a business should be responsible, the responsibility that should entail, and so on.").

63 Kochan, *Mechanization*, *supra* note 27, at 254.

movements, corporate social responsibility as captured by the expansionist view exudes an image of purity and virtue. At the same time, much of the corporate social responsibility advocacy paints a very nasty picture of corporate behavior and a very myopic view of the (un)worthiness of profit. Profit motive is seen as merely (and unseemly) greedy and the contributions of economic growth to the betterment of society[64] become ignored. Moreover, within the advocacy or scholarship on the expansive view of corporate social responsibility, there is minimal discussion of negative rights, economic liberty, or laissez faire philosophy as part of the rubric of what constitutes, or contributes to, human rights and freedom.[65] Nor is there much discussion of the general improvements on the human condition that derive from development and investment.[66] Those with an expansive definition of corporate social responsibility exploit every avenue to create a negative image of corporations and downplay their positive contributions to society. Either through demonization of wealth or simply a fear of the "large," corporate behavior is seen as requiring some external check or control especially when we are told that it contributes to the awful conditions for many in areas where corporations operate.[67] These informational and perceptual imbalances further disadvantage those forwarding wealth-maximization as the better view.

In fact, the messaging becomes so powerful and difficult to rebut that Friedman warned corporations that they endanger themselves when they even enter the fray of a corporate social responsibility discussion, because they risk legitimizing the terms of the debate as being based in a battle between good and

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64 *See, e.g.*, CLARK, *supra* note 31, § 16.2 (large organizations like corporations, "increase social welfare, because without them certain large-scale business ventures would be impossible or would be carried out in a wasteful way").

65 On these concepts and their contribution to social welfare, see 3 FRIEDRICH A. HAYEK, LAW, LEGISLATION, AND LIBERTY (1979); MISES, *supra* note 46, at 257–326; *see also generally* FRIEDMAN, *supra* note 26.

66 As Adam Smith described:

> Every individual is continually exerting himself to find out the most advantageous employment for whatever capital he can command. It is his own advantage, indeed, and not that of society, which he has in view. But the study of his own advantage naturally, or rather necessarily leads him to prefer employment which is most advantageous to the society . . . . [H]e intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.

ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, 421, 423 (Edwin Cannan ed., 1937) (1776); *see also* Jan Narveson, *The "Invisible Hand,"* 46 J. BUS. ETHICS 201, 201 (2003).

67 Adeyeye, *supra* note 54, at 149.

evil.[68] He cautioned that corporate managers engaging in corporate social responsibility talk are legitimizing the "already too prevalent view that the pursuit of profits is wicked and immoral and must be curbed and controlled by external forces."[69] There is little doubt that the jargon painting those directly or indirectly (and, often, tenuously at best) affected by corporate action as the oppressed, and corporations as their oppressors, provides powerful marketing for the social responsibility cause.[70]

The expansionist corporate social responsibility view tends to be one partly grounded in entitlement and a poorly conceived concept of justice and blame.[71] When bad things happen in the world, people search for someone to blame and expect someone to pay.[72] Advocates of increased corporate social responsibility—as they are searching to find somebody to blame and get compensation from—seem to tout the claim that the law must provide a "remedy for every wrong."[73]

Not every perceived wrong, financial hardship, disparity, inequality, or other perceived hardship can find relief from the law and the legal system.[74] "While it may seem that there should be a remedy for every wrong, this is an ideal limited perforce by

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68 Friedman, *supra* note 26, at 32.

69 *Id.*

70 As I have previously described:

> The marketing of law or ideas is advanced by the terms used to define the goals of expanded limitations on corporate behavior: rights, responsibilities, duties, human rights, morality, ethics, virtue, equality, accountability, and the like. It is against the backdrop of stories of genocide, killings, abuse, oppression, despair, poverty, inequality, slavery, starvation, arms, unjust imprisonment, apartheid, the Holocaust, greed, [and] selfishness . . . . It is easy to "sell" the ideas and projects that seek to solve or remedy these problems.

Kochan, *Mechanization*, *supra* note 27, at 254.

71 *See* Sonja B. Starr, *Rethinking "Effective Remedies": Remedial Deterrence in International Courts*, 83 N.Y.U. L. REV. 693, 698 (2008) ("International courts and scholars habitually invoke the principle of *ubi ius ibi remedium*—'where there is a right, there is a remedy.'").

72 Millon, *supra* note 5, at 919 (quoting Joel Bakan categorizing corporations as the "externalizing machine" because of corporate potential to ignore adverse third-party effects) (quoting JOEL BAKAN, THE CORPORATION: PATHOLOGICAL PURSUIT OF PROFIT AND POWER 60–84 (2005)).

73 For example, calling on the maxim *ubi ius ibi remedium*, one author in favor of expansive corporate social responsibility and promoting human rights litigation concluded that

> [a]llowing corporations and State officials to escape liability for their acts simply because they occurred in countries without adequate legal structures to address them does damage to the concept of Rule of Law and defeats the whole idea that where there is a breach of a legal right, a remedy must attach.

Emeka Duruigbo, *The Economic Cost of Alien Tort Litigation: A Response to* Awakening Monster: The Alien Tort Statute of 1789, 14 MINN. J. GLOBAL TRADE 1, 40 & n.235 (2004).

74 *See, e.g.*, Bush v. Lucas, 462 U.S. 367, 373 (1983) (recognizing that the court will not fashion a remedy without a right and even then only when determining congressional intent and considering broader policy concerns).

the realities of this world."[75] The legal system is not intended to provide a legal remedy for every wrong, harm, injury, or unfortunate social condition.[76] Nor is the legal system responsible for constructing itself to deliver a private party to blame and force that party to somehow make perceived wrongs right. Emotions and tragic stories aside, legal doctrines cannot mold themselves to such situations.[77]

Before any remedy can be applied or the law constructed in a manner to require a payment from one (like a corporation) to another (some segment of society benefitted by CSR-based investment), there must be a "right" recognized by law. The proposed beneficiaries of corporate philanthropy have earned no such right.

That limitation—that only rights are protected—explains why the maxim *ubi ius ibi remedium* loosely translates as establishing triggering conditions: *for every right*, there is a remedy. Even that phrase has further limits. Blackstone has explained that "it is a general and indisputable rule, that where there is a legal right, there is also a legal remedy, by suit or action at law, whenever that right is invaded . . . . [I]t is a settled and invariable principle in the laws of England, that every right when with-held must have a remedy, and every injury it's [sic] proper redress."[78] This concept, as explained by Blackstone and when understood in context, makes clear that there is only a right with a corresponding remedy if we also identify a duty (and afterward of course also find some violation of that duty which directly causes harm that is traceable to such a violation).

Every right must have a corresponding duty before one can claim any entitlement to action by another. This often-projected maxim that "there must be a right for every wrong" is improperly invoked if there is not a rights/duty analysis.[79] And only those who have that duty or obligation can be sued or otherwise held responsible for a wrong (not to mention all of the other hurdles

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75 Tobin v. Grossman, 249 N.E.2d 419, 424 (N.Y. 1969) (explaining the facts of our system that the limits of the law mean that there are "limit[s] to attaining essential justice").

76 Hall v. Trisun, No. CIVA SA05CA0984 OG, 2005 WL 3348956 (W.D. Tex. Nov. 16, 2005) ("Plaintiff is advised that the law does not provide a remedy for every injury suffered. Moreover, the jurisdiction of a federal court to resolve disputes is inherently limited.").

77 *See* Howard v. Lecher, 366 N.E.2d 64, 66 (N.Y. 1977) (discussing that even where the "temptation is great to offer . . . some form of relief," it is "not the function of the law" to provide a remedy for every wrong).

78 3 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 23, 109 (Univ. of Chicago Press 2002) (1765).

79 *See* Perodeau v. City of Hartford, 792 A.2d 752, 768 (Conn. 2002).

like causation that must then be proved). Many attempts to increase the scope of corporate liability face these hurdles. The reality is that reform cannot always be accomplished through the imposition of new legal rules, although that fact may be unsatisfactory to those looking for their concept of justice.[80] Despite all the ills of the world, we must maintain the limits of the law, and we should appreciate what the law can and cannot do effectively.[81]

The rhetoric of corporate social responsibility sometimes ignores these bedrock principles and necessary prerequisites to the identification of legitimate legal obligations. At other times, expansionist advocates seek to redefine human relations and expand the concept of duty far beyond any meaningful constraint. They begin to invest in the creation of law or legal liability regimes to advance their interests. Corporate social responsibility activism illustrates that segments of society believe that cures for all things that are seemingly wrong in society may be found in the creation of law or the imposition of new legal liabilities. We live in a remedy-seeking society that often embraces these ideas of liability hunting. And, in the sense that these activists push for an alteration in corporate duties to obtain the remedies they seek, those groups are remedy-seeking through rent-seeking, as will be discussed in the next Part. Yet, there must be limits to the capacity of the law to accomplish these ends.

In the end, modern expansionist notions of corporate social responsibility can be seen as seeking an alteration in behavior—a new ethic in corporate conduct based on the desire to alter corporate behavior to achieve certain socially desirable outcomes. It seeks to identify harms, isolate causes of such harms, control negative externalities from doing business, and concomitantly induce or force corporations to internalize the purported larger costs and broader range of impacts from their actions.[82] The proliferation of expansive corporate social responsibility efforts has been effective at inducing changes in corporate behavior—leaving aside whether or not such changes are wise.

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80 James R. Adams, *From Babel to Reason: An Examination of the Duty Issue*, 31 MCGEORGE L. REV. 25, 53 (1999) ("Tort law does not provide a remedy for every harm. We cannot solve every social problem by simply 'passing a law.' There are many ways to control conduct; tort law is but one.").

81 Tobin v. Grossman, 249 N.E.2d 419, 424 (N.Y. 1969) ("The problem for the law is to limit the legal consequences of wrongs to a controllable degree," and therefore attenuated causation cannot be actionable).

82 Millon, *supra* note 5, at 919 (discussing the "social costs" that a profitable corporation can impose).

Just as the measure and the meaning of corporate social responsibility are varied, the mechanisms for achieving the aims of those favoring an expanded notion of corporate social responsibility can equally take a number of different forms. Some of these involve bottom-up private market forces while others seek to alter the legal landscape top-down with fundamental changes in statutes, judicially recognized common law or statutory liabilities, or other legal outlets for reform.

D. The Tactical Basics for Reformers: What Can Law Do to Affect Greater Corporate Social Responsibility?

In past work, I characterized some of the mechanisms that could accomplish corporate social responsibility objectives along a spectrum of increasing levels of coercive rules—from non-coercive, voluntary decisions by corporations aligned with their own interests in wealth-maximization all the way to the highest levels of coercively induced mechanisms of command and control over the decision-making of corporations and their distributions of profits.[83] In this section, I want to focus on just a few of the more specific efforts that can be taken to try to achieve one's corporate social responsibility objectives.

As explained above, the first (and most legitimate) option for achieving one's desired corporate social responsibility results is through purchasing the outcome. If, indeed, consumers demand a particular corporate effort that they deem socially desirable, then the consumer demand is enough incentive for a profit-maximizing corporation to provide that corporate social responsibility "product." Despite all the talk about the big bad powerful "corporations" in expansive corporate social responsibility and other progressive rhetoric, it is the consumers, after all, that have the power.[84] Mises again explains that, "[o]wnership of material factors of production as well as entrepreneurial or technological skill *do not*—in the market economy—bestow power in the coercive sense. All they grant is the privilege to serve the real masters of the market, the consumers, in a more exalted position than other people."[85] The price of the goods or services will be adjusted upward if they have added costs from social responsibility efforts included in the production of goods or provision of services. But, presumably, if

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83 Kochan, *Mechanization*, *supra* note 27, at 255–57.

84 MISES, *supra* note 46, at 649 ("It is customary nowadays to signify the position which the owners of property and the entrepreneurs occupy on the market as economic power or market power. This terminology is misleading when applied to the conditions of the market.").

85 *Id.* (emphasis added).

consumers desire that extra "CSR ingredient" in the product, then they will be willing to pay the higher price. It will be an incident (or an accident) of the corporation making wealth-maximization decisions.

Corporate social responsibility advocates can also try to work within existing law to compel corporate decisions that are socially responsible in the advocates' minds. Advocates can become shareholders and try to change things from the inside—through, for example, voting their shares, proxy solicitations, hostile takeovers, direct lawsuits, derivative lawsuits, and other means. Admittedly these options will be constrained so long as the legal definitions of duty remain aligned with the wealth-maximization model. Thus, the more effective technique for these interest groups is to use these avenues as a way to attempt change regarding the contours of board of directors' duties and the vision of the corporate role. There is a part of the corporate social responsibility movement that tries to change the governing rules or metrics of corporate decision-making—to limit the range of acceptable corporate profit decisions and allow more room or even mandate so-called socially responsible choices or stakeholder concerns to be taken into account. The advocates would need to overcome the default rules and convince a corporation to structure itself with different standards and duties, or they would need to convince the judiciary to amend traditional notions of fiduciary duties. Again, these are difficult tasks but it may be worthwhile for advocates to invest in these efforts to cause legal change.

When unable to achieve their corporate social responsibility objectives within corporate law or through a change in the rules of traditional corporate governance, the corporate social responsibility lobby diverts its attention and resources elsewhere. Corporate social responsibility advocates may seek legislation that imposes new duties on corporations and their boards of directors that align with the social interests of the advocates. So-called "stakeholder statutes" or "constituency statutes" allowing or requiring corporations to take stakeholders into account in decision-making are obvious examples of these efforts.[86]

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86 *See generally* Kathleen Hale, Note, *Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes*, 45 ARIZ. L. REV. 823, 833 (2003) (describing stakeholder statutes); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1992) (discussing the constituency statute approach). More recently, we have also seen "social enterprise" statutes and "benefit corporation" regimes emerge that attempt to further similar goals. *See, e.g.*, Brian D. Galle, *Social Enterprise: Who Needs It?*, 54 B.C. L. REV. (forthcoming 2013), *available*

The corporate social responsibility lobby can also seek to change the substantive law—to regulate the conduct of business activities or to create new duties or liabilities for certain entities and certain behaviors. The expansion of the operating liabilities of businesses and the narrowing of acceptable practices by creating substantive prohibitions or tort liabilities for corporate actions can be accomplished by changing the contents of legislative or regulatory standards. And, these substantive rules can also be changed in the courts through the development of new liability schemes, identification of new harms, or creation of new duties.

Rather than convincing corporations to change their decision-making calculus or transforming their concept of duty, and rather than seeking legislation or judicial standards generally altering the definition of a corporation's fiduciary duties to include secondary stakeholders, corporate social responsibility advocates often seek to manipulate the substantive law to force corporations into making corporate social responsibility investments—to the detriment of shareholder interests—through means of pressure quite apart from truly voluntary decision-making choice. This is accomplished, in part, by creating an atmosphere of threatened liability that changes the respective bargaining power of the corporate social responsibility lobby and arms them with substantial leverage which it can deploy against corporations in efforts to "convince" corporations to change behaviors.[87] The effects are no less damaging than outright legislatively demanded changes in corporate law. Corporations shift resources into suboptimal investments in secondary stakeholder concerns at the expense of distributing profits to their primary shareholders. It diverts resources and misallocates profits into non-shareholder investments. The beauty of such efforts for the corporate social responsibility lobby is that even if they are not entirely successful in creating law (or even when any such efforts have not yet been completed), the corporate social responsibility lobby can start to use the threat of law and the threat of completing a legal regime to change the power dynamics.[88] The corporate social responsibility lobby can leverage the possible creation of law or

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at http://ssrn.com/abstract=2302658 (discussing the political economy of social enterprise statutes and questioning the motives and effectiveness of such legislation).

87 Robert S. Adler & Elliot M. Silverstein, *When David Meets Goliath: Dealing with Power Differentials in Negotiation*, 5 HARV. NEGOT. L. REV. 1, 5 (2000) ("The degree of power that each party brings to the negotiation affects the room for maneuver that each feels is available in bargaining situations.").

88 *Id.* at 20 (discussing power dynamics between litigating parties).

the risk of adverse judgments in a manner that paints corporations into a corner, stimulating changes in behavior to stave off the threatened legal maneuver.[89]

Whatever the means—or at least those means outside of engaging, as consumers or otherwise, in truly voluntary contracts with corporations—used to seek a remedy for the harms expansive corporate social responsibility advocates believe are the fault of corporate behavior and attributable to the traditional corporate wealth-maximization model, these advocates are acting in a manner consistent with public choice models of interest group behavior. Whether through seeking legislation, litigation advancing novel theories of liability for corporate behaviors such as for "aiding and abetting" nasty foreign regimes, shareholder activism, derivative suits, or other means, corporate social responsibility advocacy operatives meet the classic definition of interest groups and should be treated with the same skepticism as we might give anyone attempting to manipulate the law for private gain. These advocates are advancing their own agendas and the wealth and power of their own organizations in the process of seeking special treatment from the law.

While expansive corporate social responsibility advocates may claim that their efforts to change the law are for "the public interest" or the overall "social good," they are asking for a wealth transfer from the corporations and their shareholders to those who will supposedly benefit from the corporate social responsibility efforts demanded. Expansive corporate social responsibility efforts are redistributive in nature. The concentrated corporate social responsibility interest groups seek payments in the form of corporate social responsibility reforms or measures by the corporation, and the costs of complying are borne by the shareholders in the form of sacrificed profits.

There is no reason to believe that corporate social responsibility advocates are any less inclined to tap into the law as a means of serving their ends. The next Part will explain how these efforts by corporate social responsibility activists dangerously conscript the law for inappropriate means. Legal rules should not be fitted through manipulation as outcome-based vehicles for social reform.

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89 *Id.*

II. CORPORATE SOCIAL RESPONSIBILITY ADVOCATES AND LITIGANTS AS INTEREST GROUPS IN A PUBLIC CHOICE PERSPECTIVE

This Part introduces public choice theory to set forth the primary lesson of this Article—expansive corporate social responsibility advocacy should be viewed in light of what we know about interest group politics. We should not pay any special deference to the aims of these seemingly beneficial groups simply because their names and cause sound in the public interest. Corporate social responsibility advocacy is still private interest advocacy and any attempt to use the law to reposition one's status within the bargaining market is, indeed, still rent-seeking, despite the "social responsibility" labels.

Rent-seeking and private advantage are often behind legislation, regulation, and the creation of law generally.[90] Corporate social responsibility lawmaking efforts may sound like they are in the "public interest,"[91] and for a long time the dominant theory in political science presumed that legislation was and could be crafted with social welfare enhancing effects and intent.[92] This concept that laws can be created for some common good isolated from interest group influence has been challenged by public choice theory,[93] exposing the public interest model to the real world operations and effects of interest group influence in legal and political decision-making.[94] Public choice theory "burst[s] the bubble" of the public interest model and attempts to recast our critique of legislation and other law creation with an understanding that even those with benign or inherently good sounding motives or causes are nonetheless seeking private interest gains.[95]

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90 MAXWELL L. STEARNS & TODD J. ZYWICKI, PUBLIC CHOICE CONCEPTS AND APPLICATIONS IN LAW 46 (2009) (explaining rents and rent-seeking).

91 Andrew P. Morriss, Bruce Yandle & Andrew Dorchak, *Choosing How to Regulate*, 29 HARV. ENVTL. L. REV. 179, 214 (2005) [hereinafter Morriss et al., *Choosing*] (discussing the history of public interest theory).

92 *Id.* at 215.

93 James Buchanan, *Politics Without Romance: A Sketch of Positive Public Choice Theory and Its Normative Implications*, *in* THE THEORY OF PUBLIC CHOICE-II 11 (James Buchanan & Gordon Tullock eds., 1984) (explaining that the truths exposed by public choice destroyed the romance of public interest theory).

94 STEARNS & ZYWICKI, *supra* note 90, at 44–45 (contrasting the public interest and public choice models).

95 Paul Boudreaux, *Eminent Domain, Property Rights, and the Solution of Representation Reinforcement*, 83 DENV. U. L. REV. 1, 18 (2005) (public choice theory "burst the bubble" of the civic republic model by explaining that "[l]aws adopted ostensibly to help the public are in reality the masked use of government to help one group at the expense of others – be it business interests who are helped by regulation of their competitors or outdoor enthusiasts aided by laws restricting private development in parklands").

Public choice theory looks at the world of legislation and other avenues of law creation as marketplaces for the production of goods desired by interest groups. The law suppliers—usually legislators but also including courts—have the ability to produce such goods[96] upon demand from interest groups and the interest groups will pay to acquire the goods (so long as it is more efficient than paying for the same result in an open marketplace without the legislation).[97]

In corporate social responsibility, the expansionist interest groups see their opposition, or competition, as the businesses upon which they seek to impose higher standards. While the expansionist lobby could negotiate in the private market with businesses to encourage changes in behavior, such bargaining would be costly. It may often be less expensive for advocacy groups to obtain the same result—changes in corporate behavior—by spending their budget on changing legal rules to their advantage. This includes seeking legislation to advance their interests, developing litigation strategies to create liabilities for corporations, and the like.[98] We should expect the expansionist corporate social responsibility lobby's resources will be directed to the law making realm when achieving gains there is less costly than bargaining for such gains.

Interest-group consumers of the laws supplied usually benefit quite separate and apart from any concern over the greater social welfare (even if that legislation is given a general welfare spin in order to market to the public that legislation or other legal outcome as a positive for the public good).[99] When it comes to information, interest groups have a leg up. Interest groups are more savvy and experienced at controlling the flow of information than individual citizens, and thus those interest groups are able to manage the message so that the public and its legislators have reason to support the legislation or other changes in law that the interest group favors.[100]

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96 Robert D. Tollison, *The Economic Theory of Rent Seeking*, 152 PUB. CHOICE 73, 80 (2012) [hereinafter Tollison, *Economic Theory*] (discussing the supply and demand of legislation).

97 *See, e.g.*, George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971); Robert D. Tollison, *Public Choice and Legislation*, 74 VA. L. REV. 339 (1988).

98 *See* Rubin et al., *supra* note 8, at 295–96.

99 Jonathan R. Macey, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223, 227 (1986) [hereinafter Macey, *Public-Regarding*] ("Interest group theory treats statutes as commodities that are purchased by particular interest groups or coalitions of interest groups that outbid and outmaneuver competing interest groups.").

100 *See* NORMAN J. ORNSTEIN & SHIRLEY ELDER, INTERESTS GROUPS, LOBBYING AND POLICYMAKING 75–76 (Robert L. Peabody ed., 1978).

The idea is to obtain something of value by spending less on the lobbying, litigating, and other payments needed to get that something from the government than one would need to spend in a free and openly competitive marketplace where they would have to negotiate with other private parties to obtain that same something of value.[101] This process of "rent-seeking"[102] is the expenditure of resources to obtain this something of value—often an alteration in legal status that directly props up the seeker's bargaining position but at other times some alteration that simply knocks down a competitor's status.[103] A rational interest group will invest in the cheapest alternative mechanism to achieve their desired results.[104] When working for legal change becomes more expensive than seeking a private market resolution, interest group behavior is channeled back again to that private market.[105] When one can obtain a rent—the positive savings differential between the high cost of obtaining something in the market and the lower cost of obtaining the same thing through legal institutions—then the rational investor will seek that rent.

For rent-seeking deals to succeed the public needs to be left with the perception that the actions of legislators are public minded and that the actions of courts are independent and free from outside manipulation for private gains; and, the public must be left with little reason to suspect the existence of private-advantage deals that transfer wealth from individual taxpayers.[106] Quite often due to the concept of "masking," despite legislation or other alterations of legal rules having the effect of promoting a specific interest group's agenda (often at the expense of the public), the face of the legislation or legal rule is designed to make the public believe that it, the public, is the true beneficiary of the law. As a result of such a belief, the public is

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101 *See generally* Daniel A. Farber & Philip Frickey, *The Jurisprudence of Public Choice*, 65 TEX L. REV. 873 (1987).

102 *Id.*; *see also generally* Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 W. ECON. J. 224, 232 (1967); Tollison, *Economic Theory*, *supra* note 96, at 80 (describing rent-seeking).

103 STEARNS & ZYWICKI, *supra* note 90, at 50 (defining rent-seeking as "meaning affirmative lobbying efforts to secure beneficial legal protections against competition").

104 Tollison, *Economic Theory*, *supra* note 96, at 80 ("[G]roups who can organize for less than a dollar in order to obtain a dollar of benefits from legislation will be the effective demanders of transfers.").

105 STEARNS & ZYWICKI, *supra* note 90, at 46 ("[A]n economic rent arises when an economic activity, for example labor, earns a return that exceeds the opportunity cost of the income-producing asset.").

106 Morriss et al., *Choosing*, *supra* note 91, at 225 ("Politicians . . . seek to minimize their own costs when acting on behalf of interest groups or the general public.").

less likely to question the law and light never shines on the less scrupulous interest group bargain behind the mask.[107]

This masking concept is also sometimes referred to as a curtain, cloak, or veil of legitimacy.[108] Masking works to shield interest group-motivated changes in the law from scrutiny because it hides the costs of the activity behind a veil of a seemingly positive goal. Masking plays a critical role in rent-seeking's successes,[109] and corporate social responsibility advocates are in a strong starting position given the comparative "good versus evil" optics discussed in Part I.[110] As Professor Harry Hutchison has explained, "Properly understood, the corporate social responsibility model allows some to exercise their preferences at the expense of others while couching that exercise in wonderful sounding language."[111]

When such a mask is effective, of course, it diminishes opposition and makes the rent-seeking successful because there is little resistance to the legal movement or the change achieved.[112] In the end, rent-seeking processes are damaging and dangerous because they result in misallocation of resources in

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107 John O. McGinnis, *The Bar Against Challenges to Employment Discrimination Consent Decrees: A Public Choice Perspective*, 54 LA. L. REV. 1507, 1530–31 (1994) (explaining the means by which politicians can raise the information costs for those opposing their actions by disguising the true objectives of their actions); Todd J. Zywicki, *Environmental Externalities and Political Externalities: The Political Economy of Environmental Regulation and Reform*, 73 TUL. L. REV. 845, 890 (1999) [hereinafter Zywicki, *Externalities*] (discussing why the rational voter will have no incentive to spend time or money to discover illegitimate wealth transfers and interest group deals).

108 *See* Rebecca M. Kysar, *Listening to Congress: Earmark Rules and Statutory Interpretation*, 94 CORNELL L. REV. 519, 580 (2009) (discussing masking special interest legislation); POLITICAL ENVIRONMENTALISM: GOING BEHIND THE GREEN CURTAIN (Terry L. Anderson ed., 2000) (discussing the curtain behind which private interest deals hide); Jonathan H. Adler, *Rent Seeking Behind the Green Curtain*, REG., Fall 1996, at 26–34 (1996) (curtain concept); Scott Baker & Kimberly D. Krawiec, *The Penalty Default Canon*, 72 GEO. WASH. L. REV. 663, 678 (2004) (discussing a legislative public interest "cloak"); Gregory C. Shaffer, *How Business Shapes Law: A Socio-Legal Framework*, 42 CONN. L. REV. 147, 155 (2009) ("In some cases, 'public interest' statutes may serve as a facade, providing a symbol of government concern while masking government inaction."); Michael Abramowicz & Thomas B. Colby, *Notice-and-Comment Judicial Decisionmaking*, 76 U. CHI. L. REV. 965, 1013 (2009) (discussing rulemaking "charades").

109 Macey, *Public-Regarding*, *supra* note 99, at 251.

110 *See supra* notes 63–82 and accompanying text.

111 Harry G. Hutchison, *Director Primacy and Corporate Governance: Shareholder Voting Rights Captured by the Accountability/Authority Paradigm*, 36 LOY. U. CHI. L.J. 1111, 1135 n.141 (2005). Hutchison further explains that "[a]s thus understood, the corporate social responsibility model is merely one of many conventional models of corporate governance in which actors often exercise their own self-interest and as such, the claim that this model exists in some counter-hegemonic sense remains highly speculative." *Id.*

112 Macey, *Public-Regarding*, *supra* note 99, at 232.

society,[113] forcing individuals to waste money seeking these "law" goods and forcing their competitors to spend money opposing the same. All the while wealth is being coercively transferred in unnatural and unproductive ways.[114]

Lessons can be learned for the corporate social responsibility mask from other seemingly wonderful terms like social justice, environmental sustainability, or others infused with a sense of the public good. Such terms readily attach themselves to lawmaking efforts as part of the masking effort.[115] Whether it is labor unions, the plaintiffs' bar, human rights organizations, corporate social responsibility activists, or the like, these groups are advancing a cause that appears as though it is in the "public interest," but public choice teaches us that is seldom the full dynamic.

This Article started with the promise to make the case that corporate social responsibility advocates are interest groups too, and that is precisely the point here. While many people associate interest groups or "special interests" only with businesses or other overtly profit-driven enterprises, "social" or "public

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113 Richard L. Hasen, *Lobbying, Rent-Seeking, and the Constitution*, 64 STAN. L. REV. 191, 232 (2012) (explaining the likely billions lost and other inefficiencies each year from rent-seeking legislation); Tollison, *Economic Theory*, *supra* note 96, at 74 (explaining why spending to obtain rent-seeking legislation produces nothing of value and diverts resources from more important investments); *see also* Nicolas Loris, *The Wind Production Tax Credit and the Case for Ending All Energy Subsidies*, 23 DUKE ENVTL. L. & POL'Y F. 323, 327–28 (2013). Loris explains, by example, that "[t]he resources a banana producer used for lobbying for banana tariffs or an extension of the banana tax credit could have been spent actually growing and selling bananas. Rather than engaging in profit-seeking behavior in the marketplace, the producer is engaging in rent-seeking behavior in the political process." *Id.* at 327.

114 Hasen, *supra* note 113, at 197 (discussing the diversion of funds by rent-seeking and interest group legislation into nonproductive uses); Macey, *Public-Regarding*, *supra* note 99, at 230 (explaining that most laws obtained through rent-seeking "enrich the few at the expense of the many"). Empirical study reveals that these opportunity costs, diverted resources, and negative effects on economic growth and entrepreneurship are real:

> Economist Russell Sobel of West Virginia University defines rent-seeking as unproductive entrepreneurship. Political efforts made by rent-seeking companies could have been channeled toward productive uses instead of distorting economic activity. Sobel found that states that provide more political preferences have higher levels of unproductive entrepreneurship and lower levels of productive entrepreneurship, and therefore have slower economic growth.

Loris, *supra* note 113, at 328 (citing Russell Sobel, *Testing Baumol: Institutional Quality and the Productivity of Entrepreneurship*, 23 J. BUS. VENTURING 641, 646 (2008)).

115 Georgette Chapman Poindexter, *Land Hungry*, 21 J.L. & POL. 293, 319 (2005) (providing examples of when public interest-looking groups are often "purely self interested actors" that rely on concepts like the "environment," "social justice," and "preservation" as cover); *see also, e.g.*, Donald J. Kochan, *"Public Use" and the Independent Judiciary: Condemnation in an Interest-Group Perspective*, 3 TEX. REV. L. & POL. 49 (1998) (discussing interest group influences and masking in eminent domain).

interest" organizations seek to profit from the manipulation of legal standards in much the same way as any other groups.

For example, Sheehan explains why non-governmental organizations (NGOs)—the same groups that often appear as the public face for corporate social responsibility initiatives—are often perceived as public-interested but have the same *self-interested* agenda as any other interest group:

> NGOs have a political ideology. Most believe that the private sector cannot solve environmental problems and that governments must control economic decision-making to protect the environment. This belief may be quite sincere, but it is also rooted in self-interest. Many NGOs depend on governments for jobs, money and power. They seek out grants and contracts from national governments and international agencies. They also bask in the recognition they receive from public agencies, which adds authority to their pronouncements and brings their leaders prestige.[116]

NGOs get more funding if they have successes to market to their membership, and with more funding comes greater job security and growth of the organization.[117] As I have described in past work, the same motivations exist within human rights and international law advocacy organizations, sometimes being the very same groups that put corporate social responsibility at the top of their agendas or at least align themselves with other expansive corporate social responsibility groups.[118]

Environmentalism is a theme sometimes incorporated in social responsibility, and, even when not cast directly as a corporate social responsibility issue, it often has a very similar tone as corporate social responsibility activism does in public discussions. Professor Todd Zywicki has analyzed how environmental public interest groups try to dominate the public debate with high-sounding ideals when in fact they are seeking private interest legal outcomes.[119] The mask provided by such

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116 JAMES M. SHEEHAN, GLOBAL GREENS 2 (1998). *See also generally* JEREMY RABKIN & JAMES SHEEHAN, GLOBAL GREENS, GLOBAL GOVERNANCE (1999).

117 Todd J. Zywicki, *Baptists?: The Political Economy of Environmental Interest Groups*, 53 CASE W. RES. L. REV. 315, 316–18 (2002) [hereinafter Zywicki, *Baptists*] ("Their activities can be understood as being identical to those of any other interest group – namely, the desire to use the coercive power of government to subsidize their personal desires for greater environmental protection and to redistribute wealth and power to themselves.").

118 *See* Donald J. Kochan, *The Political Economy of the Production of Customary International Law: The Role of Non-governmental Organizations in U.S Courts*, 22 BERKELEY J. INT'L L. 240 (2004) [hereinafter Kochan, *Political Economy*].

119 Zywicki explains:

> Environmentalists often claim that environmental activist groups and environmental regulation is animated by the "public interest," i.e., an outpouring of "civic republicanism" that causes individuals to overcome their

environmental groups and their seemingly noble intentions provide a very effective diversion.[120] Environmental groups—like most corporate social responsibility advocates—claim that their cause is bigger and better, more humane, and more basic than profit. Yet, there is little cause to believe that they are using the law in any more noble or just way than any business-based interest group.[121]

These "public interest" groups have characteristics that qualify them for scrutiny as interest groups no different from corporate interest groups, military-industrial interest groups, or others that often have that "special interest" label slapped on them as a pejorative. Sargent explains that "[a]ssertions of fairness, 'the public interest,' social justice, and equality thus are often perceived within the law and economics tradition as masks for the self-interest, as rhetorical dodges deflecting attention from the play of conflicting interests."[122] These public interest-labeled groups (including corporate social responsibility groups) seek to maximize their budgets, maximize influence, maximize membership, secure their jobs, and in the case of corporate social responsibility sometimes directly effectuate wealth transfers into their organizations or constituencies (e.g., from shareholders to stakeholders).

Such wealth transfers can occur through projects or programs designed to provide aid and assistance to corporate social responsibility stakeholders, payments of increased wages, settlements in lawsuits, or other goods provided by the corporations at the expense of their shareholders and in favor of

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> narrow self-interest and to support wide-ranging environmental regulatory policies . . . . [A] brief review of the evidence suggests that the public interest model has little descriptive accuracy with respect to the behavior of environmental interest groups.

Zywicki, *Baptists*, *supra* note 117, at 325–26; *see also* Zywicki, *Externalities*, *supra* note 107, at 856–88 (explaining empirically the political economy of environmental interests groups); POLITICAL ENVIRONMENTALISM, *supra* note 108; Adler, *supra* note 108, at 26; Macey, *Public-Regarding*, *supra* note 99, at 232 n.46 ("Even regulations that have long been thought to accomplish such worthy goals as improving the environment recently have been shown to benefit special interests.").

120 Zywicki, *Baptists*, *supra* note 117, at 336 ("[T]he stranglehold that environmental lobbyists exercise over environmental policy-making is the result of the public perception that these groups are, in fact, acting according to the public interest.").

121 *Id.* at 349 (finding "little obvious difference between environmental activists who want more for their projects, and farmers, defense contractors, or thousands of others who use the political process to redistribute money from the public to the goals preferred by their well-organized and influential interest groups").

122 Mark A. Sargent, *Utility, the Good and Civic Happiness: A Catholic Critique of Law and Economics*, 44 J. CATH. LEG. STUD. 35, 42 (2005); *see also* Stephen M. Bainbridge, *Law and Economics: An Apologia*, *in* CHRISTIAN PERSPECTIVES ON LEGAL THOUGHT 208, 209 (Michael W. McConnell et al. eds., 2001).

these outside stakeholders. Despite their public interest exterior, there is no reason to treat corporate social responsibility groups as anything different. They are trying to maximize their own self-interest at the expense of others and will take advantage of rent-seeking opportunities that are available to them.

In addition to having their own institutional interests as advocacy groups in mind and profiting from lawmaking successes by support and funding, these social policy groups engage in remedy-seeking through rent-seeking. They see ills in the world and believe that transfers of wealth accomplished through the creation of legal rules are necessary to create a remedy for those ills. They seek to impose new duties well beyond the limits that would otherwise be imposed under our traditional notions of liability for direct actions with proof of causation of harms themselves traditionally defined and limited. Such groups would rather obtain a benefit at a lower cost than these groups would be required to pay if they were forced to bargain in a free market for their preferred outcomes.[123] Again, so long as the public believes that their activities are public spirited, then their efforts at making law will often move forward relatively unimpeded.

As discussed in the previous Part, corporate social responsibility advocates can use market mechanisms, acquire stock and try to influence corporations and effect change from the inside through voting and corporate governance techniques, bargain as an outsider for corporate change, seek legislation or regulation to advance their interests, create liability schemes in the courts, use derivative and direct shareholder lawsuits to alter corporate behavior or to discipline corporate "misbehavior," or use other shareholder activism techniques. Within the mechanisms listed, in all but the most benign voluntary exchanges for, and purchases of, corporate social responsibility outcomes where no changes in law would be necessary to accomplish the ends, corporate social responsibility advocates stand to benefit if they can achieve an alteration of law in favor of their interests. Corporate social responsibility groups engage in rent-seeking behavior to alter legal rules. They invest in outcomes like stakeholder legislation, for example, in the same way that a corporation looks to Congress for a tax advantage or other corporate subsidy.

Where possible (and less expensive than private bargaining), these corporate social responsibility groups will want to tip the

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123 Zywicki, *Baptists*, *supra* note 117, at 349 (environmental rent-seeking helps groups avoid costlier marketplace alternatives).

law in their favor. There are incentives to make an investment in the creation of law that will put the investor—here, the corporate social responsibility advocates—in a strategically advantaged position vis-à-vis competitors or others in the marketplace—here, principally corporations—where transactions would otherwise be free, on equal footing, and at arm's length.

As mentioned earlier, public choice typically focuses on the incentives for interest groups to invest in the production of *legislation* beneficial to its interests and giving it a strategic advantage—the creation of rents—not available in the private marketplace.[124] Similar analysis, however, can be applied to the production of law generally. Public choice theory construed broadly includes a description of rent-seeking investments in law creation in any form to accomplish changes in legal status.[125]

Most specifically for purposes of this Article's analysis, interest groups will invest in the production of liability regimes within the judicial system that similarly advantage the interest group or disadvantage their competitors.[126] So liability here focuses less on altering firm governance standards than it does on limiting the scope of acceptable/legal firm decisions.[127] The first success lies in creating the new duty with a corresponding liability. The secondary benefit lies in the mere threat and leverage that comes from having a new doctrine to wield against an adversary. Where the mere existence of the threat of liability regime can disadvantage the corporation at the bargaining table, it is worthwhile for the interest group seeking to alter the corporate behavior to invest in early stage developing of novel liability theories.[128] Seeking legal change to obtain valuable

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124 *See, e.g.*, Gordon Tullock, *Rent Seeking*, *in* 7 THE NEW PALGRAVE DICTIONARY OF ECONOMICS 95 (Steven N. Durlauf & Lawrence E. Blume eds., 2d ed. 2008).

125 Rubin et al., *supra* note 8, at 295–97 (noting that "[m]ost public choice analyses stop with the passage of interest group legislation" but, drawing on empirical examples, stressing the relevance of applying the same principles to incentives in using litigation for rent-seeking ends).

126 *Id.* at 295 ("[I]nterest groups can sometimes use the common law litigation process for benefit seeking. We provide a model of the decision by an interest group as to whether to use the litigation process or traditional lobbying for the purpose of obtaining benefits from government, and show that the model has empirical relevance.").

127 *See, e.g.*, ANDREW P. MORRISS ET AL., REGULATION BY LITIGATION (2009) (describing several case studies where interest group outcomes were sought and achieved through civil litigation models).

128 *See* Emanuela Carbonara & Francesco Parisi, *Rent-Seeking and Litigation: The Hidden Virtues of the Loser-Pays Rule* 3 (Minn. Legal Studies Research Paper Series, Research Paper No. 12-39, 2012), *available at* http://ssrn.com/abstract=2144800 ("When parties litigate, they normally expend resources to improve their odds of winning . . . . Economists describe such situations, where parties expend resources to improve their share of (or probability of winning) fixed stake as 'rent-seeking,' which is how the law and economics literature has predominantly analyzed litigation costs.").

leverage above and beyond their bargaining position without the law provides rents to the corporate social responsibility interest groups.[129] The existence or nonexistence of a liability regime for the behavior targeted for change affects the relative power of expansionist interest groups to extract promises from corporation to change behavior.[130] Even if it is just in the investment in law in order to create a threat of liability, it will make sense for an interest group to invest in shifting the legal rules if the existence of that threat can thereby alter the bargaining power—i.e., create leverage.[131]

As civil litigation emerges to promote corporate social responsibility through liability regimes, the remedy the plaintiffs' attorneys and advocates are seeking often extends beyond relief for the particular plaintiff in a case. The goal is bigger.[132] Additional goals include changing corporate behavior,[133] promoting public policy,[134] obtaining declarations of public norms,[135] sparking "institutional reform,"[136] and the like.[137] In the ATS situation, for example, it involves the transformation of

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129 *See, e.g.*, Kal Raustiala, *Commentary: Density and Conflict in International Intellectual Property Law*, 40 U.C. DAVIS L. REV. 1021, 1034 (2007) (discussing as an example the phenomena in intellectual property law involving "rent-seeking efforts by producers, who try to use the lawmaking process to leverage their political strength in an effort to segment and protect markets against increasing competition").

130 Adler & Silverstein, *supra* note 87, at 20.

131 Rubin et al., *supra* note 8, at 303–08 (explaining the use of tort litigation, for example, as interest-group motivated rent-seeking and the empirically proven comparative advantages and successes of plaintiffs in this forum vis-à-vis business interests).

132 Beth Stephens, *Translating* Filártiga*: A Comparative and International Law Analysis of Domestic Remedies for International Human Rights Violations*, 27 YALE J. INT'L L. 1, 14 (2002) ("This trend of public interest litigation predisposes the U.S. public, judiciary, and legal advocates to view civil litigation as a potential means to realize large-scale policy goals and hold accountable perpetrators of egregious abuses, whether or not such litigation results in an enforceable judgment.").

133 Chimène I. Keitner, *Conceptualizing Complicity in Alien Tort Cases*, 60 HASTINGS L.J. 61, 64 (2008) ("ATS cases against corporate defendants involve high stakes on both sides. For victims, these cases offer an unusual chance to receive monetary compensation for human rights violations, in addition to providing symbolic vindication and deterring corporate involvement in internationally wrongful conduct.").

134 Stephens, *supra* note 132, at 13 ("[I]n some public interest cases, 'the subject matter of the lawsuit is not a dispute between private individuals about private rights, but a grievance about the operation of public policy.'").

135 Harold Hongju Koh, *Transnational Public Law Litigation*, 100 YALE L.J. 2347, 2349 (1991).

136 *Id.* at 2347–48 ("[T]ransnational public law litigation seeks to vindicate public rights and values through judicial remedies. In both settings, parties bring 'public actions,' asking courts to declare and explicate public norms, often with the goal of provoking institutional reform.").

137 Stephens, *supra* note 132, at 14 ("[C]ivil litigation may lead to a full investigation of the facts of an incident, identify the persons responsible, produce a public judgment of that responsibility, and generate compensation for those harmed and punitive damages as a sanction for the accused.").

a simple torts case into a case with a larger message and meaning.[138] Judgments can operate to negotiate issues in larger public ideological conflicts.[139] And the threats of liability can operate to induce settlement—on both monetary and action-based terms.

Corporations are motivated to negotiate with corporate social responsibility advocates when there is a perceived risk to the corporate brand or reputation.[140] The interest groups are savvy at focusing on what the corporations have to lose.[141] Those negotiations take on a much more serious character when the advocates for social responsibility can legitimately threaten a lawsuit with a real risk of liability if the corporation does not change its behavior or otherwise settle with the advocacy group.[142] The corporations are willing to bargain as a self-protection measure, trying to minimize the harm that could be inflicted upon them if they do not bargain with the interest group.[143]

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138 *See, e.g.*, Donald E. Childress III, *The Alien Tort Statute, Federalism, and the Next Wave of Transnational Litigation*, 100 GEO. L.J. 709, 725 (2012) (stating that "it seems that the real value of an ATS case is that it transforms a tort case into a human-rights case," although concluding it is not clear how effective this strategy has been for activist plaintiffs).

139 Koh, *supra* note 135, at 2349 ("Even a judgment that the plaintiff cannot enforce against the defendant in the rendering forum empowers the plaintiff by creating a bargaining chip for use in other political fora.").

140 Lisa M. Fairfax, *Easier Said Than Done? A Corporate Law Theory for Actualizing Social Responsibility Rhetoric*, 59 FLA. L. REV. 771, 805–06 (2007) ("Recent literature regarding corporate brands reveals that corporations . . . spend considerable effort creating and protecting the corporate identity through the use of such techniques as brands and slogans.").

141 G. RICHARD SHELL, BARGAINING FOR ADVANTAGE: NEGOTIATION STRATEGIES FOR REASONABLE PEOPLE 98 (2006) (discussing the strength of leverage when there is a concrete risk of loss).

142 Richard A. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEGAL STUD. 399, 418–19 (1973) [hereinafter Posner, *Economic Approach to Legal Procedure*] (discussing subjective probability of prevailing and stakes as elements in settlement calculus).

143 Fairfax, *supra* note 140, at 806–07. Fairfax explains that, "[r]eputation represents a key component of corporate identity, and corporations aim to build a reputation of trustworthiness . . . . The crux of recent literature is that once a corporation constructs an identity, people within the corporation feel a responsibility to engage in actions that protect and preserve that identity, thus fostering a quality reputation." *Id.* (citing, *inter alia*, KEVIN LANE KELLER, STRATEGIC BRAND MANAGEMENT: BUILDING, MEASURING, AND MANAGING BRAND EQUITY 546 (2d ed. 2003) (discussing the "Science of Branding")); *see also* George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 24–25 (1984) ("[T]he loss of the case may damage the defendant's public reputation . . . . In situations of this nature, the dollar judgment sought by the plaintiff may reflect only a small portion of the defendant's total loss if the plaintiff wins."); Shaun Mulreed, Comment, *Private Securities Litigation Reform Failure: How Scienter Has Prevented the Private Securities Litigation Reform Act of 1995 from Achieving Its Goals*, 42 SAN DIEGO L. REV. 779, 781 n.2 (2005) ("In considering whether to settle or litigate, a corporation must weigh both the costs of settlement and potential brand injury against expected results at trial.").

When faced with a lawsuit or the threat of a viable liability claim, it is entirely possible that the judgment value is far exceeded by the external effects of the litigation on the corporation and the corporation's own interests in preserving its brand, image, reputation, customer base, investor interest, and the like. Thus, corporations will often even settle when they could win the substantive lawsuit but do not wish to incur the incidental expense of the litigation and collateral damage along the way. Moreover, if there is an ambiguous or uncertain risk, which may very well be the case in newly developing liability regimes, then the corporation may want to be risk averse—again motivating settlement.

Interest groups will change course or divert their strategy based on where their investment can return the greatest result. The relative availability of liability mechanisms will have an effect on resource allocation. Interest groups will invest in litigation so long as the litigation (or cause of action) is viable. If attractive causes of action exist, we can expect that an expansionist interest group will invest more in litigation and less in other avenues of attack. If courts are receptive to innovative liability ideas, then too we should expect interest groups to invest in developing a favorable liability doctrine complete with bankrolling litigation efforts for the purpose of developing precedent and dicta that constantly adds growing value to the new scheme.

Because the viable cause of action is a very valuable and powerful tool, we should expect that such groups will invest in the development and expansion of liability doctrines that have a high likelihood of becoming recognized as providing for legitimate new claims. According to studies on settlement dynamics, there is a dramatic shift in leverage between litigation competitors as soon as a doctrine develops to the point that claims begin to survive motions to dismiss.[144] Soon thereafter the incentives for corporate defendants to settle in corporate social responsibility-driven litigation will increase.[145] Consequently, even an investment in a liability regime that only takes it just

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144 Hillary A. Sale, *Judges Who Settle*, 89 WASH. U. L. REV. 377, 386 (2011) ("Avoiding damages and reputational harm and gaining preclusion all provide an incentive to settle . . . . Even if the defendants believe that the allegations lack merit, when the plaintiffs' claims survive a motion to dismiss, the risk of a trial and the possibility of a bad outcome increase.").

145 *Id.*; *see also* A.C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 952–53 (1999) ("If the plaintiffs can withstand a motion to dismiss, defendants generally will find settlement cheaper than litigation . . . . Any case plausible on the pleadings will have a positive settlement value if only to avoid the costs of discovery and attorneys' fees . . . .").

that far—to the point that the once novel theory is now accepted, viable, and capable of surviving a motion to dismiss or summary judgment—may be a very valuable use of an interest group's budget. Sometimes, the change in the *status* of the parties and their positioning in negotiations are far more important than the relative merits of the claims.

As the next Part will explain, the Alien Tort Statute is an example of such an interest-group motivated development of a liability doctrine. Lawsuits and their potential for monetary awards were attractive to ATS expansionists, but they were not the most advantageous outcome of the seeming acceptance of corporate liability under the ATS. The doctrine that developed provided leverage in negotiations with corporations and an invigorated position when demanding behavioral change from the corporation.[146] The mere ability of corporate social responsibility-minded plaintiffs to survive a motion to dismiss in ATS suits against corporate defendants tipped the scales in a manner that substantially increased the bargaining power of the corporate social responsibility advocates. When causes of action cannot be developed or where they are taken off the table—such as with a Supreme Court case like *Kiobel*[147] that essentially now removes most of the ATS cases from the list of viable litigation routes for gaining leverage against multinational corporations for their activities outside the United States—we should expect such interest groups to shift their resources to alternative points of attack.

Despite the consequences of *Kiobel* narrowing to near nil the effective and available ATS claims designed to alter corporate behavior, the history of the ATS provides a useful study for (1) examining the broad concept of rent-seeking beyond legislation; (2) analyzing the effects of investment in lawmaking outcomes including liability doctrines; and (3) demonstrating that corporate social responsibility advocacy groups act like other interest groups when seeking their preferred outcomes. Investments in liability doctrines can be helpful in obtaining valuable leverage for use in trying to change corporate behavior, as one will see in the example that follows in the next Part. The ATS corporate liability regime was designed, constructed, and the product of investment by coalitions of interest groups aligned by expansive corporate social responsibility preferences. The ATS

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146 Beth Van Schaack, *With All Deliberate Speed: Civil Human Rights Litigation as a Tool for Social Change*, 57 VAND. L. REV. 2305, 2329 (2004) ("As jurisprudence under the ATCA has become more robust, the genuine threat of legal entitlement increasingly presents the necessary predicate for settlement negotiations.").

147 Kiobel v. Royal Dutch Petroleum Co., 133 S. Ct. 1659 (2013).

worked its way into becoming a major mechanization for using litigation to affect changes in corporate conduct.

III. THE ALIEN TORT STATUTE AS A CASE STUDY IN CORPORATE SOCIAL RESPONSIBILITY ADVOCATE-INVESTMENT IN THE CREATION OF LIABILITY DOCTRINES

To illustrate some of this Article's contentions regarding interest group investment in corporate social responsibility law, I will use the investments made in developing a liability regime for multinational corporate operations through the vehicle of the Alien Tort Statute (ATS) as a case study.[148] The ATS grants the federal district courts subject-matter jurisdiction over "any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States."[149]

The ATS liability revolution emerged around 1980, before which almost no litigation had been brought under that statute.[150] After being "discovered," the Alien Tort Statute became one of the most important and controversial mechanisms by which federal courts wrestled with and sometimes entertained international law and human rights issues. Across the years, most of the cases alleged that nation-states, state actors, and even private individuals or corporations had actually committed, or in complicity or conspiracy had been responsible for, violations of international law.

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148 28 U.S.C. § 1350 (2012). For more complete discussions of the Alien Tort Statute, its history, and its implications for law and policy, several other works by this Author may be instructive. *See generally* Kochan, *Mechanization*, *supra* note 27; Donald J. Kochan, *Sovereignty and the American Courts at the Cocktail Party of International Law: The Dangers of Domestic Judicial Invocations of Foreign and International Law*, 29 FORDHAM INT'L L.J. 507 (2006); Donald J. Kochan, *Boyakasha, Fist to Fist: Respect and the Philosophical Link with Reciprocity in International Law and Human Rights*, 38 GEO. WASH. INT'L. L. REV. 349 (2006); Donald J. Kochan, *No Longer Little Known But Now a Door Ajar: An Overview of the Evolving and Dangerous Role of the Alien Tort Statute in Human Rights and International Law Jurisprudence*, 8 CHAPMAN L. REV. 103 (2005) [hereinafter Kochan, *No Longer Little Known*]; Kochan, *Political Economy*, *supra* note 118; Donald J. Kochan, Note, *Constitutional Structure as a Limitation on the Scope of the "Law of Nations" in the Alien Tort Claims Act*, 31 CORNELL INT'L L.J. 153 (1998) [hereinafter Kochan, *Constitutional Structure*]; *see also* Donald J. Kochan, *After Burma: Like the Massachusetts Law, the Alien Tort Claims Act Allows Improper Interference in U.S. Foreign Policy*, LEGAL TIMES, Aug. 21, 2000, at 54.

149 28 U.S.C. § 1350 (2012). For annotation based histories of ATS litigation, see Russell G. Donaldson, Annotation, *Construction and Application of Alien Tort Statute (28 U.S.C.A. § 1350), Providing for Federal Jurisdiction Over Alien's Action for Tort Committed in Violation of Law of Nations or Treaty of the United States*, 116 A.L.R. FED. 387 (2005); CHARLES ALAN WRIGHT, ARTHUR R. MILLER, & EDWARD H. COOPER, 14A FEDERAL PRACTICE AND PROCEDURE § 3661.1 (Pocket Part 2005).

150 Judge Friendly has described the Act as an "old but little used section [that] is a kind of legal Lohengrin; although it has been with us since the first Judiciary Act, no one seems to know whence it came." IIT v. Vencap, Ltd., 519 F.2d 1001, 1015 (2d Cir. 1975) (citation omitted) (holding fraud not a violation of international law).

While ATS corporate social responsibility-based liability and the reform-through-litigation strategy that led to its creation were largely put to a stop when the U.S. Supreme Court decided the 2013 case of *Kiobel v. Royal Dutch Petroleum Co.*,[151] the evolution of the ATS—including the investment in the development of the liability regime by broad-minded corporate social responsibility advocates and the leverage that those advocates obtained during the years while the ATS seemed a viable threat to corporations—is nonetheless instructive regarding how investments in liability regimes operate effectively for interest groups.

A quotation from a 2003 article in the *Financial Times* helps illustrate the suitability of choosing the ATS as a case study for an examination of the mechanics of corporate social responsibility-based interest groups: "US plaintiffs' lawyers have revived a dormant 18th-century law and made it their chief weapon in a 21st-century battle over corporate responsibility in an age of globalisation."[152] That was undoubtedly true.[153] From 1980 to 2013, the scope of ATS litigation grew extensively in large part due to investments made in its creation. As it grew, there was an ever-increasing risk that major liabilities could attach for corporate business decisions and behaviors accompanied by the expansion of enforceable duties corporations owed to diverse groups of stakeholders worldwide.[154] As one author put it, the doctrine evolved "[i]n the best traditions of American legal creativity,"[155] as spurred by corporate social

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151 133 S. Ct. 1659 (2013).

152 Patti Waldmeir, *An Abuse of Power: US Courts Should Not Punish Companies for Human Rights Violations Committed Overseas*, FIN. TIMES, Mar. 14, 2003, at 12.

153 Williams, *supra* note 1, at 724–66 (discussing problems and possibilities of using the ATS to achieve corporate social responsibility).

154 John B. Bellinger, III, *The U.S. Can't Be the World's Court*, WALL ST. J., May 27, 2009, at A19 (op-ed by attorney in Washington, D.C. and former legal advisor to the U.S. Department of State) ("We may be on the verge of a new wave of legal actions against U.S. and foreign corporations in American courts . . . . Litigation under the Alien Tort Statute may force companies to modify their international activities in some cases, although it rarely produces monetary awards for plaintiffs.").

155 Waldmeir, *supra* note 152, at 12. As analysts watched the ATS evolution, commentary was rich. For example, in commenting on the then-ongoing ATS suit against Unocal, *The Economist* in its April 24, 1999 issue described the potential implications of this new trend in tort litigation: "The next big test will be whether the Alien Tort Claims Act can be used against companies as well as individuals." *Human-Rights Trials: To Sue a Dictator*, THE ECONOMIST, Apr. 24, 1999, at 26. And, the authors prognosticated that if companies began losing under the ATS, it could "provide a major headache for many American companies operating abroad." *Id.* When discussing an award against Serbian leader Karadzic, an August 2000 *Washington Post* editorial called the new line of ATS human rights' cases "troubling" as "proceed[ing] under an ill-conceived but now well-accepted reading of a 1789 law that . . . is a modern graft on a largely moribund statute; international human rights law did not exist in the 18th century." *Lawsuits and Foreign Policy*, WASH. POST, Aug. 12, 2000, at A20. In November 2002, it was opined in

responsibility advocates generally along with human rights groups, labor organizations, the plaintiffs' bar as a strong supporter with its own financial interests,[156] and others aligned with interests in developing new liability schemes.

Signs of the synergies between the causes favoring expanding ATS liability doctrines and those seeking greater corporate social responsibility were readily apparent as the law progressed to accept an ever-growing role for the ATS. One labor activist explained that the ATS was viewed within these groups as a "vital tool for preventing corporations from violating fundamental human rights."[157] A *Corporate Legal Times* headline in 2002 put the reputational leverage issue front and center, reading "No Longer Satisfied With Destroying the Reputations of Corporations That Get Entangled in Human Rights Abuses Overseas, Activist Groups are Seeking Retribution in U.S. Courts."[158] One scholar opined that the ATS "cases should be regarded as one element in a wide spectrum of attempts to tame corporate behavior by inventing new global regulatory regimes."[159] There was active investment by corporate social responsibility-aligned advocacy groups in the creation of a legal

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the *Financial Times* that the ATS jurisprudential trend presented a "danger that the US judicial system will become the world's civil court of first resort . . . ." Thomas Niles, *The Very Long Arm of American Law*, FIN. TIMES, Nov. 6, 2002, at 15. In yet another article in 2004, the U.S. Chamber of Commerce was quoted as characterizing the emerging ATS suits as "'global forum shopping,' in which foreigners resort to U.S. courts, with their favorable class action and discovery rules, to litigate over alleged human rights abuses overseas by U.S. corporations. 'The U.S. is increasingly becoming the jurisdiction of choice for opportunistic foreign plaintiffs,' says Chamber President Thomas Donohue." Tony Mauro, *Justices Debate Alien Tort Law*, LEGAL TIMES, April 5, 2004, at 8.

156 Van Schaack, *supra* note 146, at 2314 ("As ATCA jurisprudence became more established and courts confirmed that corporations could be sued for human rights abuses, the statute was 'discovered' by plaintiff-side lawyers . . . ."). *Cf.* Richard A. Epstein, *The Political Economy of Product Liability Reform*, 78 AM. ECON. REV. (PAPERS & PROC.) 311, 313 (1988). As Epstein has observed, when lawyers are in the mix in tort suits, both the plaintiffs' and defendants' bar will perpetuate expanded tort liabilities:

> Obviously, the plaintiff's bar has a vital interest in preserving that system of laws which maximizes its own welfare. Less obviously, perhaps, the defendant's bar has closely parallel interests. No defendant lawyer has ever made substantial sums of money by being able to win a summary judgment (i.e., judgment without the need for trial) for its clients.

Id.

157 TERRY COLLINGSWORTH, INT'L LABOR RIGHTS FUND, THE ALIEN TORT CLAIMS ACT – A VITAL TOOL FOR PREVENTING CORPORATIONS FROM VIOLATING FUNDAMENTAL RIGHTS (2003), *available at* http://lrights.igc.org/publications/ATCA.pdf.

158 *See* Robert Vosper, *Conduct Unbecoming; No Longer Satisfied With Destroying the Reputations of Corporations That Get Entangled in Human Rights Abuses Overseas, Activist Groups are Seeking Retribution in U.S. Courts*, CORP. LEGAL TIMES, October 2002, at 35.

159 Ronen Shamir, *Between Self-Regulation and the Alien Tort Claims Act: On the Contested Concept of Corporate Social Responsibility*, 38 LAW & SOC'Y REV. 635, 643 (2004).

liability regime that could be utilized to achieve not just judgments but also substantial leverage through an alteration of the relative legal rights between two competitors—corporations seeking profit-maximization for their shareholders on the one hand and stakeholders on the other side wanting instead for corporate expenditures to be made to advance social interests and desiring corporate profits to be shared with those claiming an entitlement to remedies for some broad concept of harm allegedly visited upon them by corporate behavior.

The ATS provided a means by which the soft ideals of human rights and other international law activists could be transformed into hard legal requirements.[160] As such, they and other corporate social responsibility advocates and like-minded activists invested in the development of ATS litigation.[161] Their investments in early litigation brought returns as broader and broader precedents developed and liability under the ATS started to become more realistic and substantial, or at least was perceived as such.

The remainder of this Part will provide further background on the ATS and explain the ATS evolution as a way of describing the process of interest group investment in new liability doctrines. That analysis will include a description of the economic benefits associated with purchasing, in effect, a stick from the law's liability-creating tort function to gain an advantaged position that can be used to beat down a corporation that, before the creation of the new doctrines, was in a more favorable legal bargaining position with fewer recognized legal duties.

In the case of *Filartiga v. Pena-Irala* in 1980, the ATS emerged from non-use and the evolution of ATS litigation began.[162] There, the U.S. Court of Appeals for the Second Circuit held that suits based on customary international law for human rights abuses could be pursued under the ATS.[163] This opened the door for several cases against numerous state actors from rather oppressive regimes. It was clear that those involved in early ATS litigation were in fact investing in the development of

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160 Van Schaack, *supra* note 146, at 2335 (discussing using the ATS to "transform the abstract and at times hortatory rights in the various international declarations, covenants and treaties into enforceable legal claims" with more concrete status).

161 *Id.* at 2313 ("The first generation of individual ATCA-style actions was initiated by lawyers affiliated with nonprofit human rights organizations, or lawyers working pro bono, who were inspired by the tradition of using legal tools to advance morality-driven goals.").

162 Filartiga v. Pena-Irala, 630 F.2d 876, 878 (2d Cir. 1980).

163 *Id.*

an expansive doctrine, understanding that the effective development of a new liability scheme must take baby steps,[164] establishing precedent that gradually expands.[165] Professor Beth Stephens has described the civil human rights litigation model witnessed in the ATS cases as involving a strategy of precedent creation and expansion:

> Civil litigation in the United States . . . has long been used as a means of promoting social reform . . . . In the United States, we are generally comfortable with the concept that lawsuits seek remedies designed with an eye to the future . . . .
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> . . . .
>
> U.S. commentators have explained at length the benefits that civil litigation offers to the victim, to the human rights movement, and to society—even litigation that does not result in actual payment of the damages awarded. *Where the legal theories are novel or untested, a civil lawsuit may seek first to obtain a judicial recognition of the rule of law, a precedent that can then be used to influence future policies and as a basis for future litigation.*[166]

Similarly, Professor Harold Koh has discussed the strategic importance of transnational public law litigation beyond particular cases and extending to the creation of precedent and other "prospective aim[s] as well."[167] These aims include "to provoke judicial articulation of a *norm* of transnational law, with an eye toward using that declaration to promote a political settlement in which both governmental and nongovernmental entities will participate."[168] Koh has further emphasized, after discussing the early ATS cases, that "transnational public law litigation is characterized by . . . the litigants' strategic awareness of the *transportability of those norms* to other domestic and international fora for use in judicial interpretation or political bargaining . . . ."[169] While relief in a particular case is not irrelevant, the prospective benefits from "building" law for use in, and "transporting" precedent to, future cases and as

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164 Harold Hongju Koh, *Transnational Public Law Litigation*, 100 YALE L.J. 2347, 2366 (1991) (discussing the first major ATS case *Filartiga* and explaining that in that case "transnational public law litigants finally found their *Brown v. Board of Education*").

165 *See, e.g.*, Vincy Fon, Francesco Parisi & Ben Depoorter, *Litigation, Judicial Path-Dependence, and Legal Change*, 20 EUR. J. L. & ECON. 43, 44 (2005) ("The model of path dependence in the law suggests the rate of recognition of legal claims brought by plaintiffs in past cases affects the state of the law in the future.").

166 Stephens, *supra* note 132, at 13–14 (emphasis added).

167 Koh, *supra* note 135, at 2349.

168 *Id.*

169 *Id.* at 2371.

leverage in bargaining often seemed to be a fundamental objective in the ATS cases.[170]

Many of the earliest ATS cases against state actor defendants resulted in default judgments in favor of the plaintiffs. With little party opposition and often gruesome allegations, receptive courts began issuing judgments accompanied by broadly worded interpretations of the scope of the ATS. These cases seemingly served only a symbolic function with limited effect as judgments were seldom collected.[171] In essence, these awards could be characterized as a "judgments as social commentary" approach.[172]

But it was also a well-orchestrated campaign to build up the ATS early on with easy cases followed by later application to new situations and new defendants (with deeper pockets and who were more likely to offer something of value to the plaintiffs to see the litigation go away).[173] As explained above, this playbook is well known in the evolution of tort law and manifest in public international law litigation as well.

These cases were necessary to create a foundation for a bigger target down the road—corporations. Many of the corporate social responsibility-associated interest groups suing corporations toward the end of the ATS evolution were on the ground from the start, remedy-seeking for alleged harms occurring around the world and looking for someone to hold responsible.

Moreover, it is important to note that while the public law litigators were building precedent, there were few forces working against them. In the early years, there was no countervailing interest-group force balancing the zealous expansionist group

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170 Keitner, *supra* note 133, at 64 ("[C]orporate ATS litigation has become a battleground in broader struggles over the role of tort litigation in regulating corporate behavior . . . .").

171 Lauren A. Dellinger, *Corporate Social Responsibility: A Multifaceted Tool to Avoid Alien Tort Claims Act Litigation While Simultaneously Building a Better Business Reputation*, 40 CAL. W. INT'L L.J. 55, 91 (2009) (ATS "litigation has largely been unsuccessful in the sense that no solid judgments against these corporations have been entered. . . . In the past, individuals have used the ATS merely to obtain a sense of justice, realizing that the monetary award may never come.").

172 A *Washington Post* editorial raised concerns about the ATS as it was expanding, especially after seeing judgments pursued solely for symbolic effect. That editorial cautioned that "[y]ou don't have to be indifferent to human rights abuses to have misgivings about this reading [of the ATS], because it creates troubling problems for democratic government and permits the courts to interfere excessively in the conduct of foreign policy." *Old Law, New Questions*, WASH. POST, July 20, 2004, at A16.

173 Van Schaack, *supra* note 146, at 2313 ("At the outset, these legal pioneers sought to establish the ATCA as a tool for the enforcement of human rights norms and to gain judicial elaboration of the scope of those norms.").

investment in ATS litigation. There was no check on the forward progress of the doctrinal evolution. There was, as explained above, little opposition in the lawsuits themselves and few interest groups outside the litigation saw any danger to the doctrinal progress.[174] Corporations did not see the coming threat and did not intervene in the ATS development.[175] Indeed, even the academy was lopsided in favor of the expansion.[176] Academics were in large part the intellectual driving force behind the beginnings of the ATS revolution and, of those that wrote about the ATS at all, the majority of scholars favored its expansion.[177] It was not until the late 1990s that any scholarly works focused on refuting the merits and wisdom of the ATS evolution in any substantial and critical manner.[178]

The development of the new liability doctrines under the ATS was in the finest traditions of rent-seeking too. Activists were seeking to create a law that would place them in a position of dominance over the legal rights of others, ultimately allowing them to obtain outcomes at a lower cost than if they were required to bargain privately for such a reallocation of duties and obligations.

Another major step in the ATS evolution occurred in the 1995 *Kadic v. Karadžic* case, in which the U.S. Court of Appeals for the Second Circuit held that quasi-public and even private actors might be bound by customary international law for certain egregious violations and could be sued under the ATS.[179] This

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174 *See* Kochan, *No Longer Little Known*, *supra* note 148, at 108 n.20 (discussing the lack of corporate interest, for example, even in the late 1990s).

175 *Id.* at 107–08.

176 *See* HAROLD HONGJU KOH, TRANSNATIONAL LITIGATION IN UNITED STATES COURTS 35 (2008) (noting that *Filartiga* "triggered a wave of academic scholarship and more than a quarter-century of human rights litigation in U.S. courts"); *see also* David Fontana, *The Rise and Fall of Comparative Constitutional Law in the Postwar Era*, 36 YALE J. INT'L L. 1, 27–30 (2011) ("The law professors who revitalized international law during this time [in the late 1970s and early 1980s before and after *Filartiga*] came from a profession more and more interested in international law—in particular as a source for American federal litigation.").

177 *See, e.g.*, Robert H. Bork, *Judicial Imperialism*, WALL ST. J., June 17, 2003, at A16 (discussing ATS cases as part of the effort toward "the enactment of world-wide law by an unholy alliance of imperialistic judges and a leftish cadre of international law professors"); *Sosa v. Alvarez-Machain*, 542 U.S. 692, 749–50 (2004) (Scalia, J., dissenting) ("The notion that a law of nations, redefined to mean the consensus of states on *any* subject, can be used by a private citizen to control a sovereign's treatment of *its own citizens* within *its own territory* is a 20th-century invention of internationalist law professors and human-rights advocates.") (emphasis in original).

178 My 1998 student note was one of the very first articles providing any substantial and concentrated critique of the ATS specifically. *See* Kochan, *Constitutional Structure*, *supra* note 148.

179 Kadic v. Karadžic, 70 F.3d 232, 239–44 (2d Cir. 1995), *cert. denied*, 518 U.S. 1005 (1996).

was the next return on the ATS-promoters' investment, expanding the scope of defendants just a little more and creating the necessary precedential prelude to finding corporate liability under the ATS. And that is precisely what came next.

ATS liability expanded next in the late-1990s with successes in bringing suits (and surviving motions to dismiss) against *corporate* defendants. The 1997 *Doe I v. Unocal* case, where the corporate-defendant ATS suit had its first major validation, was trailblazing.[180] A federal district court held that Unocal, a private corporation, was subject to ATS jurisdiction for alleged human rights abuses abroad.[181] After that 1997 decision, it was open season for the use of the ATS against corporations to try to advance the agendas of a variety of corporate social responsibility-minded interest groups.

Between 1997 and 2013, scores of lawsuits were filed against corporations under the ATS.[182] The theories also broadened over time, sometimes alleging corporate liability on aiding-and-abetting or vicarious liability theories in addition to some claiming that international law was broad enough to impose direct liability for corporate actions independent of the acts of the ruling regimes where they operate.[183]

Activists had faced somewhat incomplete and unsatisfactory victories against nation states or foreign leaders in early ATS litigation. Barriers to "success" for plaintiffs in the early ATS suits included sovereign immunity for state actors, forum non conveniens dismissals, cases dismissed on political question or act of state doctrine defenses, and problems obtaining personal jurisdiction over some state actor defendants, along with other prudential rules that insulated many nations or state actors from ATS review. On top of these barriers, even when plaintiffs were successful in proceeding to trial against a state actor ATS defendant, these parties were often judgment proof or their assets were inaccessible for collection.

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180 Doe I v. Unocal Corp., 963 F.Supp. 880 (C.D. Cal. 1997).

181 *Id.* at 892, 898 (upholding subject matter jurisdiction under ATS based on allegations that an American oil company, acting in concert with the Burmese government, committed various civil and human rights abuses), *aff'd in part & rev'd in part*, 395 F.3d 932 (9th Cir. 2002), *and rehearing en banc granted, opinion vacated by* Doe v. Unocal Corp., 395 F.3d 978 (9th Cir. 2003).

182 For a summary of major pre-*Kiobel* ATS cases, see Lee G. Dunst, *Human Rights Overseas: Courts Have Enforced Strict Gatekeeping Function in Dismissing Suits Under the Alien Tort Claims Act*, N.Y. L.J., Oct. 26, 2009, at S6. *See also generally* MICHAEL KOEBELE, CORPORATE RESPONSIBILITY UNDER THE ALIEN TORT STATUTE (2009); RALPH G. STEINHARDT & ANTHONY D'AMATO, THE ALIEN TORT CLAIMS ACT: AN ANALYTICAL ANTHOLOGY (1999).

183 *See generally* KOEBELE, *supra* note 182.

Targeting corporations in ATS suits overcame several problems for plaintiffs. Corporate ATS suits were in part a response to the dissatisfaction regarding the inability to recover either monetary judgments or true justice against state actors in these early cases.[184] Corporations do not enjoy sovereign immunity and have a more difficult time using the other shields mentioned above. Thus, in many cases, jurisdictional obstacles to suit, while keeping foreign nations and leaders out of the defendant's chair, could be avoided when suing a corporation. The next milestone in the ATS evolution came with the 2004 decision in *Sosa v. Alvarez-Machain*.[185] That case marked the first time that the U.S. Supreme Court had discussed the ATS, although even in *Sosa* the Court offered only minimal guidance as to its scope.[186] The *Sosa* decision did little to disrupt the upward liability trend in the ATS cases and did not foreclose corporate ATS suits.[187]

The ATS suits were at first novel and extraordinary. By 2009, however, at least one writer was arguing that "[t]hese lawsuits have become so routine . . . they've barely caused a ripple in the news cycle."[188] Although perhaps overstated, another author even observed in 2009 that ATS suits had become "commonplace for companies with international operations . . . ."[189] ATS suits were clearly aimed at inducing changes in corporate behavior, and the number of cases steadily rose as the corporate ATS suit became perceived as an increasingly legitimate means of grievance, a beneficial means of remedy-seeking, and an acceptable mechanism for holding corporations to a higher standard of care with a broader base of constituent stakeholder interests owed some duties by those corporations.[190]

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184 Nathan Koppel, *Arcane Law Brings Conflicts From Overseas to U.S. Courts*, WALL ST. J., Aug. 27, 2009, at A11 ("Thomas Niles, a former U.S. ambassador to Canada and Greece who is now the vice chairman of the United States Council for International Business, a pro-business group, says corporations are being used unfairly as a surrogate for foreign governments in these cases. 'You can't sue the government of Nigeria or South Africa because of sovereign immunity, so who are you going to sue? Companies, and they are sued essentially for being' in countries where human-rights violations occur.").

185 542 U.S. 692 (2004).

186 *See generally* Kochan, *No Longer Little Known*, *supra* note 148.

187 *Id.*

188 Steven Dudley, *The Trials and Errors of Tort Cases: Lawsuits Against Multinationals for Abuses Abroad may be Losing Steam*, MIAMI HERALD, June 15, 2009, at G12 (recognizing there were "more than 30 [corporate ATS] suits around the country" at the time of his article).

189 *See* Dunst, *supra* note 182, at S6.

190 Koppel, *supra* note 184, at A11. As a *Wall Street Journal* reporter explained, "Victims of human-rights abuses around the world increasingly are *seeking justice American style – by filing lawsuits against deep-pocketed defendants*. Both sides agree on

As the ATS cases had progressed, the ATS activists pushed increasingly expansive theories of the ATS's scope, often with success. The first wave of ATS litigation came in the 1980s with cases that were largely based on sympathetic facts and allegations of unacceptable atrocities with allegations of relatively direct causation by ruthless and despicable defendants. This made these "easy" cases to decide and made the opinions in the cases susceptible to relatively far-reaching statements regarding the purpose and reach of the ATS. Precedent under the ATS was developing, and both precedent and dicta could always be manipulated in the next case to slowly expand the accepted and recognized reach of the ATS and increase the pool of defendants. Every expansion of the liability doctrine was a stepping-stone to yet another stage of expansion.

Corporations eventually recognized the threat, as evidenced by the liability-management techniques engaged in by ATS defense attorneys and public relations managers in the public square in the late 2000s. Several of these reputation managers and liability limiters published articles in the news media regarding the cost of ATS litigation to corporations and the litigation risks involved.[191] Some of these articles and op-eds read with the tone of client development letters, but they are nonetheless an instructive perspective from the front lines reflecting at least the perceived threat. These same defense attorneys later trumpeted the *Kiobel* decision as a glorious end to the dangerous ATS litigation scheme against corporations.[192]

Activist litigators had "seized the opportunity" to begin litigating against corporations under the ATS because corporations were much more attractive targets than early ATS defendants.[193] There was also a higher probability of settling

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one thing: Courts increasingly are willing to consider alien-tort suits and to force companies to answer for their behavior overseas." *Id.* (emphasis added).

191 For a sampling of these articles, see J. Russell Jackson, *Alien Tort Claims Act Cases Keep Coming: Lawsuits by Plaintiffs From All Over the World Present Major Risks for Companies Doing Business Abroad*, NAT'L L.J., Sept. 14, 2009, at 28 (author "a partner in the mass torts group at New York's Skadden, Arps, Slate, Meagher & Flom, which represents defendants in Alien Tort Claims Act cases"); Jordan Cowman, *The Alien Tort Statute – Corporate Social Responsibility Takes On a New Meaning*, MONDAQ, Aug. 11, 2009 (author a partner in the Dallas office of Akin Gump Strauss Hauer & Feld LLP); Jonathan Drimmer & Jennifer Millerwise Dyck, *Human Rights Threat Matrix: Corporate Responsibility Through a Legal Lens*, PR NEWS, Apr. 20, 2009, at 7 (authors are a partner of Steptoe and Johnson L.L.P, and a VP of APCO Worldwide, respectively).

192 *See, e.g.*, Andrew Pincus, *Is the Alien Tort a Zombie Doctrine? Andrew Pincus Responds*, LITIGATION DAILY, April 29, 2013, http://www.americanlawyer.com/digestTAL.jsp?id=1202597980026&Is_the_Alien_Tort_a_Zombie_Doctrine_Andrew_Pincus_Responds (a perspective of the ATS evolution from beginning to end by one of the lawyers for corporate defendants).

193 Kirschner explains:

cases with positive results for the plaintiffs, judged by a variety of metrics (including bargaining for changed behaviors) in addition to monetary relief.[194]

True to corporate social responsibility form, many ATS suits seek more than monetary damages in their demands for relief.[195] For example, "plaintiffs in the corporate cases have increasingly sought judicial directives governing [Multinational Corporations'] foreign investment policies, relations with their host governments, offshore production arrangements, project security measures, environmental policies, and labor relations."[196] It is not surprising then that these same plaintiffs seek more than money in settlement negotiations including reforms in corporate behaviors.[197]

While there is an emphasis in some public civil litigation for obtaining damages for the particular plaintiff in the case, most often these cases are motivated by something more. In transnational tort litigation, for example, Koh explains that, "although transnational public law plaintiffs routinely request retrospective damages or even prospective injunctive relief, their broader strategic goals are often served by a declaratory or default judgment announcing that a transnational norm has been violated."[198] It is the development of precedent that has broader utility in terms of its advancement of a cause and a promoter's position in negotiations with adversaries of the cause. Redressing the plaintiff's injury is often a secondary goal in corporate social responsibility advocacy-generated litigation.[199] This is not universally true for all involved—some plaintiffs'

> Corporations provide easier targets for ATS claims than individuals or repressive regimes, and litigators seized the opportunity. The 2001 *Doe v. Unocal* case offered to charge them with complicity in human rights abuses. Suits against corporations have reached actions taken by many individuals that only collectively amount to illegalities. Sovereign immunity has not protected corporations as it has governments. Most large corporations have maintained permanent presences within the United States, making it possible to establish personal jurisdiction over them. Corporations also have had more substantial recoverable assets and stronger incentives to settle claims to avoid negative publicity than other defendants.

Jodie A. Kirshner, *Why Is the U.S. Abdicating the Policing of Multinational Corporations to Europe?: Extraterritoriality, Sovereignty, and the Alien Tort Statute*, 30 BERKLEY J. INT'L L. 259, 272–73 (2012).

194 *Id.*

195 Van Schaack, supra note 146, at 2328.

196 *Id.*

197 *Id.*

198 Koh, *supra* note 135, at 2349.

199 *See, e.g.*, Van Schaack, *supra* note 146, at 2313 (speaking of the ATS cases and stating that "[a]lthough ostensibly tort disputes seeking retrospective relief, obtaining an executable judgment was often a secondary goal of this litigation.").

lawyers are in it for a payday and want to maximize the monetary judgment to maximize their contingency fee and their demands in corporate social responsibility liability litigation have complicated settlements aimed at achieving more grand reform-based outcomes.[200] Nonetheless, when a reform agenda dominates the litigation strategy, one can expect that the litigation will be aimed at obtaining some concessions from a corporation that could not have been extracted absent the existence of the liability regime.

ATS advocates began to utilize the tool created by their investment in the creation of new law, leveraging the threat of ATS liability to induce corporations to agree to change conduct or pay monetary settlements. Without the ATS, the advocates' legal position was weaker and they would have been required to "pay" the corporations to change. Stated another way, without the duties even just *potentially* imposed by the ATS, the corporations could stand on their then-existing legal position where a payment to the corporate social interest group would feel less compulsory (and, consequently, what the corporation would be willing to pay to avoid action by the advocacy group would have been less as well).[201]

In discussing why, in part, there are so few judicial opinions on the ATS, the Second Circuit in *Kiobel* explained that:

> Such civil lawsuits, alleging heinous crimes condemned by customary international law, often involve a variety of issues unique to ATS litigation, not least the fact that the events took place abroad and in troubled or chaotic circumstances. The resulting complexity and uncertainty—combined with the fact that juries hearing ATS claims are capable of awarding multibillion-dollar verdicts—has led many defendants to settle ATS claims prior to trial.[202]

Simply recognizing the legitimacy of ATS corporate defendant litigation changes the power dynamic between the parties.

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200 *Id.* at 2314–15 (discussing the complexity of motivations in ATS lawsuits especially once the plaintiffs' bar started joining in with more materialistic goals than some of the reform-minded advocates).

201 As Van Schaack explains:

> Even short of a full settlement, the commencement of litigation may make possible discussions between parties that were foreclosed by power inequalities in place prior to the filing of suit. Indeed, the very filing of the suit can provide a "foot in the door" to communicate with a defendant corporation that may have otherwise dismissed the demands of victims and activists.

Van Schaack, *supra* note 146, at 2330.

202 Kiobel v. Royal Dutch Petroleum Co., 621 F.3d 111, 116 (2010) (citations omitted).

Leverage is very powerful.[203] As G. Richard Shell explains, "[l]everage is your power not just to reach agreement, but to obtain an agreement *on your own terms*."[204] Indeed, it changes the stakes.[205] "Research has shown that, with leverage, even an average negotiator will do pretty well while without leverage only highly skilled bargainers achieve their goals. The party with leverage is confident; the party without it is usually nervous and uncertain."[206]

A special report in *The Economist* studied the ATS evolution and concluded that the merits of the cases were almost a side issue, with the remedy-seeking settlement and leverage dynamics at the center of the stage:

> Most of the rhetoric on CSR may be about doing the right thing and trumping competitors, but much of the reality is plain risk management. It involves limiting the damage to the brand and the bottom line that can be inflicted by a bad press and consumer boycotts, as well as dealing with the threat of legal action. In America, the legal instrument of choice . . . is the Alien Tort Claims Act . . . . Even if it does not get as far as a trial, this can be embarrassing and costly for companies.[207]

Williams similarly opined that the merits of these corporate ATS cases were not nearly as important as the power brought by the mere legal legitimacy of the lawsuits—"they represent a form of leverage and a forum for leverage being newly brought to bear on global corporate social responsibility issues."[208] Most ATS suits against corporations were weak on the merits and instead were useful as a mechanism to get corporations to settle, beating the corporations down with the prospect of protracted and expensive litigation, and ultimately obtain something valuable

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203 SHELL, *supra* note 141, at 103 ("Threat leverage gets people's attention because, as astute negotiators have known for centuries and psychologists have repeatedly proven, *potential losses loom larger in the human mind than do equivalent gains*.").

204 *Id.* at 90.

205 *Id.* at 98 ("To gain real leverage, you must eventually persuade the other party that he or she has something concrete to lose in the transaction if the deal falls through.").

206 *Id.* at 90.

207 *A Special Report on Corporate Social Responsibility: A Stitch in Time,* ECONOMIST, January 19, 2008, at 12; *see also* Dudley, *supra* note 188, at G12. In his reporting, Dudley observed that "corporate watchdog groups say the lawsuits have helped usher in a new era of corporate social responsibility . . . ." *Id.* He continued to report the statement from Pam Muckosy, the research manager for the London-based Ethical Corporation Institute, that "'Sometimes companies pursue CSR in order to improve their international reputation and be a good "global citizen," . . . Other times, it's about securing a local "license to operate." Increasingly, it seems to be about minimizing legal risks.'" *Id.*

208 Williams, *supra* note 1, at 772; *see also* Childress, *supra* note 138, at 725–26 (2012) ("[I]t is arguable that modern uses of the ATS against corporations" result in part because of the "signaling value that is offered when bringing suit against a corporation for alleged violations of international law" and "brand damage while gaining significant publicity in hopes of both encouraging policy change and a monetary settlement.").

for the plaintiff advocates (i.e., a share of some of their profits either directly or through forcing corporate expenditures on projects of value to the plaintiff corporate social responsibility group).[209] Despite these often weak claims, the gains from settlement for the plaintiffs and the corporate social responsibility causes they championed were often substantial—either in dollar terms[210] or in costly alterations in behavior agreed to by a corporation to settle a case.[211]

The lawsuit-as-settlement-leverage litigation model was clearly utilized in the ATS corporate defendant suits. Douglas Branson, for example, has claimed that "[t]he ultimate value of ATS lawsuits, or some of them, is not to hold the multinational parent liable, or to force the multinational to undergo a long and complicated trial. The ultimate objective should be to send a message to corporate boardrooms and to obtain a recovery for persons who have suffered very real harms."[212] That messaging process, according to Branson, meant these ATS suits could be used to scare corporations into settlements or otherwise into making decisions that accomplish changes in behavior consistent with meeting the demands of the corporate social responsibility-oriented interest groups represented by the plaintiffs in these cases.[213] As explained in my earlier work:

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209 Gary C. Hufbauer, *Why Shouldn't Corporations Be Liable Under the ATS?*, 43 GEO. J. INT'L L. 1009, 1010 (2012) ("Many ATS suits are class actions that entail years of litigation, extensive discovery of corporate records, and damage to the corporation's reputation. Such suits are mostly an effort by the plaintiffs to force a corporate settlement regardless of the underlying merits."); David Scheffer & Caroline Kaeb, *The Five Levels of CSR Compliance: The Resiliency of Corporate Liability Under the Alien Tort Statute and the Case for a Counterattack Strategy in Compliance Theory*, 29 BERKELEY J. INT'L L. 334, 372 (2011) ("Corporations remain exposed to the risks of diminished reputation and to the costs of legal settlements that offer attractive alternatives to prolonged litigation under the ATS, depending on its current fate before the federal courts.").

210 *See* Dunst, *supra* note 182, at S6 (discussing the fifteen million dollar settlement by Shell in one case and concluding that "the Shell settlement certainly may incentivize plaintiffs to file additional claims under the act in the future"); *Unocal Settles Rights Suits in Myanmar*, N.Y. TIMES, Dec. 14, 2004, at C6; Catherine Rampell, *Yahoo Settles With Chinese Families*, WASH. POST, Nov. 14, 2007, at D4; *see also* Jonathan Drimmer, *Resurrection Ecology and the Evolution of the Corporate Alien Tort Movement*, 43 GEO. J. INT'L L. 989, 998 (2012) ("While for years federal courts routinely dismissed corporate ATS cases, plaintiffs have gained a greater frequency of settlements and victories," and "[s]everal corporate ATS cases have settled for well over ten million dollars."); Van Schaack, *supra* note 146, at 2239 (discussing a variety of settlements induced by ATS suits).

211 Jeffrey A. Van Detta, *Politics and Legal Regulation in the International Business Environment: An FDI Case Study of Alstom, S.A., in Israel*, 21 U. MIAMI BUS. L. REV. 1, 77 (2013) ("the objective of . . . more than a few ATS suits filed against MNEs is to reset the context and terms of activism in opposition to" corporate behaviors).

212 Douglas M. Branson, *Holding Multinational Corporations Accountable? Achilles' Heels in Alien Tort Claims Act Litigation*, 9 SANTA CLARA J. INT'L L. 227, 249 (2011).

213 *Id.*

> The currency by which a corporation may satisfy the pressure imposed against it could involve alterations in behavior, expenditures on public relations campaigns, or contributions to funds or charities of allegedly affected groups. It could take the form of outright monetary payments, ceasing or altering operations to comply with demands or private codes or protocols, enacting codes of conduct, joining compacts, establishing corporate social responsibility departments, instituting training, committing to transparency initiatives like contracting for external audits, and other mechanisms that either alter behavior or otherwise satisfy those interests applying some form of pressure to the corporate operation.[214]

Those investing in ATS liability had succeeded in developing a legal liability regime that frightened corporations.[215]

The threat of liability gave the corporate social responsibility promoters of ATS liability an advantage, particularly for pressuring corporations to settle to make an ATS suit go away or take actions favorable to the advocacy group to avoid the filing of a lawsuit in the first place.[216] The mere acceptance of this liability doctrine and its extension to cover corporate behavior and snag corporations as defendants were alone enough to immediately shift the balance in any negotiations between the advocacy groups and corporations.[217] Settling is sometimes just about hedging risk, similar to a corporation's financial decision to buy insurance.[218] The legal status of, and the weapons available to, the corporate social responsibility activists were strengthened while concomitantly the legal positions of the corporations were weakened. When the law changes, so does the risk calculus,[219]

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214 Kochan, *Mechanization*, *supra* note 27, at 256.

215 Childress, *supra* note 138, at 725 (plaintiffs can "create public-relations problems for corporations, and thus force a settlement, because no corporation wishes to be known as a human-rights abuser or violator of international law"); *see also* SHELL, *supra* note 141, at 101 ("A better way to understand leverage is to think about which side, at any given moment, has the most to lose from a failure to agree."); Adler & Silverstein, *supra* note 87, at 20 ("[T]he essence of determining the relative power of the parties in a negotiation depends less on how powerful each party is in any absolute sense than on how badly each party needs or fears the other.").

216 SHELL, *supra* note 141, at 104 ("Leverage is a complex mixture of ideas," including "opportunities that will be lost if the parties fail to reach a deal, threats to each party's status quo, and possible losses to each side's self-esteem should their actions appear inconsistent (in their own eyes) with a prior or professed standard of conduct or dealing.").

217 *See generally* Dellinger, *supra* note 171 (describing strategies to stay out of court under ATS by enacting preemptive corporate social responsibility measures).

218 J.B. Heaton, *Settlement Pressure*, 25 INT'L REV. L. & ECON. 264, 272 (2005) ("Corporations routinely buy insurance, and engage in a variety of more and less sophisticated hedging activities.").

219 Scheffer & Kaeb, *supra* note 209, at 372 ("The ATS presents a formidable challenge in risk assessments because the liability that arises under ATS litigation, whether or not the plaintiffs are successful, can be significant financially and otherwise.").

and so then does one's willingness to give in to another party now in a superior position.

Expansionist corporate social responsibility advocates clothe their cause in a sense of pure motives and objectives, allowing them to sell their cause to the sympathies of the public. It made it difficult to run an opposition campaign with these optics. Thus, corporations faced with ATS suits or the threat of such suits sought to mute the campaign against them associated with an ATS suit by negotiating away the case or possible filing of a complaint. Preventative intervention is essential because some damage could be done even just by filing an ATS suit.[220]

Risk-averse corporations showed a willingness to settle or change behavior to avoid even the possibility of an ATS suit. Negotiated agreements before suits were filed, settlements, and other defensive tactics were designed to prevent, or at least minimize, potential reputational and other damage to the corporation.[221] Corporations were motivated out of the fear of the ATS and the changed position created by the alteration in legal status accomplished by the creation of the ATS doctrine. When the stakes are high for a defendant, settlement is often a reasonable choice.[222]

The "unknowns" regarding how the courts would treat novel theories of liability against corporations created risks that further made settlement a reasonable option for defendants in the early years of the developing doctrine holding corporations liable under the ATS.[223] Uncertainty itself motivates settlement. The Supreme Court has recognized in a different but relatable context that, when there is "uncertainty of the governing rules, entities subject to secondary liability as aiders and abettors may find it prudent and necessary, as a business judgment, to abandon substantial defenses and to pay settlements in order to avoid the expense and risk of going to trial."[224] The risks of substantial litigation costs and the potential for long trials with

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220 Dellinger, *supra* note 171, at 59 ("Even though cases regarding human rights violations often result in settlement or dismissal, the tarnish to a corporation's reputation remains.").

221 *Id.* at 74–75 (mere ever-present threat of ATS suits encourages companies to change behavior to avoid litigation).

222 Posner, *supra* note 142, at 418–19 (explaining situations where the stakes impact decisions to settle).

223 *See generally id.*; *see also* John P. Gould, *The Economics of Legal Conflicts*, 2 J. LEGAL STUD. 279, 280–81, 296 (1973) (examining "how individuals engaged in civil suits will behave" and finding that "a critical component in the motivation of such individuals to settle out of court is agreement on the probabilities of the court's action").

224 Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 189 (1994).

extended discovery and lawyers' fees made settlement attractive for ATS defendants.[225]

Here again, discovery alone is a high risk for the corporation and a huge gain for the plaintiffs. For example, in discovery there is an ability to uncover information that, whether it establishes liability or not, may not paint a very pretty picture of corporate operations or at least the conditions in the areas where they operate in developing countries.[226] Guilt by operation in certain regimes—a type of guilt by association—could be implied in the eyes of the public that hears about an ATS suit against a corporation and the atrocious allegations in the daily news for too long. The literature on corporate behavior reveals that corporations will go to great lengths to avoid damage to their brand and reputation.[227] Therefore, the potential damaging impacts on a corporation's reputation and brand from a lawsuit, trial publicity, and plaintiffs' promotion of their case in the press often mitigates in favor of settling.[228] Avoiding these damages to reputation and brand may often be more valuable to a corporation than avoidance of a large monetary judgment, explaining why a corporation might settle even those cases that it believes it can win on the merits.[229] When a corporation faces opposing forces that are threatening the corporate image or reputation, it is not surprising that the corporation will be reactive and work to quell the impact of the reputation-damaging

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225 Posner, *supra* note 142, at 417 ("[S]ettlement costs are normally much lower than litigation costs . . . .").

226 Van Detta, *supra* note 211, at 76 (discussing "the considerable transactional costs attendant to American-style discovery and civil practice, the generation of negative public opinion and negative opinion among investors and analysts, and the costs of settlement—which corporate ATS defendants have incurred in more than a few cases").

227 Fairfax, *supra* note 140, at 805–06 (discussing the literature on the importance of brand and reputation protection to corporations).

228 Kevin T. Jackson, *Global Corporate Governance: Soft Law and Reputational Accountability*, 35 BROOK. J. INT'L L. 41, 47 (2010) ("[U]nlike traditional hard law enforcement regimes, today's emerging 'civil regulations' are grounded in the 'rule of reputation,' which ties accountability solely to reputational capital, or lack thereof. Operating internationally and faced with pressure to self-regulate, a company's reputation has become one of its most valuable assets."); Stephens, *supra* note 132, at 14 ("Even absent payment of a judgment, the defendant may be 'punished' by public exposure . . . ."); *see also* Peter T. Hoffman, *Valuation of Cases for Settlement: Theory and Practice*, 1991 J. DISP. RESOL. 1, 35 (1991) ("Settlement also can avoid the unwanted publicity of a trial, a matter particularly important" when there are reputations to maintain.); Jonathan C. Drimmer & Sarah R. Lamoree, *Think Globally, Sue Locally: Trends and Out-of-Court Tactics in Transnational Tort Actions*, 29 BERKELEY J. INT'L L. 456, 489–622 (2011) (using multiple case studies to show the effectiveness of out-of-court tactics coordinated with and accompanying transnational tort litigation).

229 Scheffer & Kaeb, *supra* note 209, at 373 ("[R]eputational risks . . . can do far more to damage corporate profitability and the long-term credibility of the 'brand name' than most court cases could impose upon a corporate defendant.").

possibilities like the initiation of an ATS suit, let alone its filing and progression to trial.[230]

When defendants are placed in untenable litigation positions and the cost of defending against class actions is especially high, for example, some have gone so far as to characterize the plaintiff's position to demand settlement as metaphorically akin to a blackmailer.[231] Moreover, the mere ability to *threaten* a class action suit has been described by some scholars as creating a situation of "legalized blackmail."[232] Whether class actions or not, ATS suits create the same power dynamic as described in that analysis.

In fact, Judge Dennis Jacobs from the U.S. Court of Appeals for the Second Circuit, when concurring in the denial of rehearing in the *Kiobel* case that had held corporations could not be liable under the ATS, explained that the holding halting corporate ATS suits had the "considerable benefit of avoiding abuse of the courts to extort settlements."[233] He discussed the ATS corporate lawsuit as riddled with opportunities for coercively induced settlements by corporations:

> The holding of this case matters nevertheless because, without it, plaintiffs would be able to plead . . . in a way that . . . would delay dismissal of ATS suits against corporations; and the invasive discovery that ensues could coerce settlements that have no relation to the prospect of success on the ultimate merits. American discovery in such cases uncovers corporate strategy and planning, diverts resources and executive time, provokes bad public relations or boycotts, threatens exposure of dubious trade practices, and risks trade secrets. . . . These coercive pressures, combined with pressure to remove contingent reserves from the corporate balance sheet, can

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230 Fairfax, *supra* note 140, at 806–07; Priest & Klein, *supra* note 143, at 24; Mulreed, *supra* note 143, at 781 n.2.

231 *See, e.g.*, *In re* Rhone-Poulenc Rorer, Inc., 51 F.3d 1293, 1298–1300 (7th Cir. 1995) (Posner, J.) (citing HENRY J. FRIENDLY, FEDERAL JURISDICTION: A GENERAL VIEW 120 (1973) (citing Handler while discussing the dynamics in class action cases and the high likelihood that they "produce blackmail settlements")); Milton Handler, *The Shift from Substantive to Procedural Innovations in Antitrust Suits—The Twenty-Third Annual Antitrust Review*, 71 COLUM. L. REV. 1, 9 (1971) ("Any device which is workable only because it utilizes the threat of unmanageable and expensive litigation to compel settlement is not a rule of procedure—it is a form of legalized blackmail."). *See also* Charles Silver, *"We're Scared to Death": Class Certification and Blackmail*, 78 N.Y.U. L. REV. 1357, 1386 (2003) ("It seems safe to conclude that proponents are using the word 'blackmail' metaphorically.").

232 *See, e.g.*, In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation, 55 F.3d 768, 784–85 (3d Cir. 1995) ("Another problem is that class actions create the opportunity for a kind of legalized blackmail: a greedy and unscrupulous plaintiff might use the *threat* of a large class action, which can be costly to the defendant, to extract a settlement far in excess of the individual claims' actual worth.").

233 Kiobel v. Royal Dutch Petroleum Co., 642 F.3d 268, 271 (2d Cir. 2011) (Jacobs, C.J., concurring in denial of rehearing).

> easily coerce the payment of tens of millions of dollars in settlement, even where a plaintiff's likelihood of success on the merits is zero. Courts should take care that they do not become instruments of abuse and extortion.[234]

This extortion-like threat was facilitated by an all-out strategy to use both the in-court threat of ATS liability and out-of-court tactics touting the claimed ATS liability as a means to pressure corporations.[235]

Indeed, what is particularly important with the evolution of the ATS cases against corporations is the power that came from the mere recognition by the courts of the legitimacy of these lawsuits.[236] Once courts started denying motions to dismiss against corporate ATS defendants, the settlement dynamic changed dramatically. Research shows that plaintiffs' ability to survive a motion to dismiss substantially alters corporations' and other defendants' risk assessments regarding non-settlement options (such as going to trial).[237] The chance of settlement is much higher when plaintiff's case can withstand a motion to dismiss because it is usually the cheaper and less risky alternative.[238] It is for this reason that the development of the liability regime under the ATS—including the cases that ultimately used early ATS case precedent to build toward the creation of the corporate liability layer of ATS doctrine—became so important and such a powerful rent-seeking achievement.

For a long time, the threat of ATS liability had a substantial impact on leverage. The power dynamic between corporations and corporate social responsibility advocates substantially changed as a result of the liability regime that was emerging and threatening to emerge. As all of these corporate ATS lawsuits began to pick up steam, debate grew regarding the appropriateness of using U.S. courts to extraterritorially enforce

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234 *Id.*

235 Drimmer, *supra* note 210, at 999 ("[O]ut-of-court tactics, *in conjunction with litigation*, have taken hold. Plaintiffs, their attorneys, and their representatives regularly utilize these strategies to pressure corporate defendants to settle cases or change existing practices, publicize their causes, and for other purposes" (emphasis added)); Drimmer & Lamoree, *supra* note 228, at 472–88 (explaining how in connection with ATS and other "transnational tort cases, parties frequently employ [a variety of] out-of-court tactics in part to publicly advance their cause, pressure their opponents, or initiate corporate change" including media, investment, political, and community organizing tactics).

236 *See generally* Adler & Silverstein, *supra* note 87, at 6 (exploring "the concept of power disparities in negotiation").

237 Sale, *supra* note 144, at 386 (2011) (showing the relationship between survivability of motions to dismiss and defendants motivations to settle to avoid damages and reputational harm).

238 *Id.*; *see also* Pritchard, *supra* note 145, at 952–53 (1999) (stating that if plaintiffs can survive a motion to dismiss, defendants will often settle to minimize further harm).

supposed internationally accepted norms and impose liability for violations of such norms by foreign actors and for actions outside the United States that were otherwise subject to foreign laws and regulations.

The *Kiobel v. Royal Dutch Petroleum Co.* case reached the U.S. Supreme Court after the U.S. Court of Appeals for the Second Circuit held that corporations were not proper defendants under the ATS.[239] The Second Circuit's decision split with several other circuits that had decided ATS suits against corporations could proceed.[240] Although not deciding when, if ever, corporations are proper defendants under the ATS, the 2013 Supreme Court decision in *Kiobel* severely limited ATS suits, including those against corporations, by interpreting the ATS as having no (or some say *almost* no) extraterritorial reach.[241] Because almost all of the available corporate social responsibility stories for ATS cases involved corporate actions outside the United States, the ATS as a corporate social responsibility tool against anyone, including multi-national corporations, was effectively neutralized by *Kiobel*.[242]

If there was any doubt about the ATS as a rent-seeking interest group strategy, one need only look at the press releases immediately following *Kiobel* by many of the activist groups lamenting that the Court "shut their doors" to their causes and the fact that the Court "harshly limited" usage of the ATS.[243] The

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239 Kiobel v. Royal Dutch Petroleum, 621 F.3d 111, 147–48 (2d Cir. 2010) (holding that corporations are not subjects of international law and therefore law of nations does not recognize corporate liability).

240 *See, e.g.*, Doe v. Exxon Mobile Corp., 654 F.3d 11, 15 (D.C. Cir. 2011), *vacated by* Doe v. Exxon Mobil Corp., No. 09-7125, 2013 WL 3970103 (D.C. Cir. July 26, 2013); Flomo v. Firestone Natural Rubber Co., 643 F.3d 1013, 1025 (7th Cir. 2011); Sarei v. Rio Tinto, PLC, 671 F.3d 736, 818 (9th Cir. 2011) (en banc), *cert. granted and judgment vacated by* Rio Tinto PLC v. Sarei, 133 S. Ct. 1995 (2013); Romero v. Drummond Co., Inc., 552 F.3d 1303, 1315 (11th Cir. 2008).

241 *See Kiobel*, 133 S. Ct. at 1669 ("We therefore conclude that the presumption against extraterritoriality applies to claims under the ATS, and that nothing in the statute rebuts that presumption."). *See also, e.g.*, Michael D. Goldhaber, *The Global Lawyer: The Zombification of the Corporate Alien Tort*, THE LITIGATION DAILY, Apr. 21, 2013, http://www.americanlawyer.com/digestTAL.jsp?id=1202596949949 ("Rather than kill the corporate alien tort outright, the Court maimed all forms of alien tort by restricting their territorial reach. The corporate alien tort is therefore doomed to remain a zombie doctrine—not quite alive and not quite dead.").

242 Rich Samp, *Supreme Court Observations: Kiobel v. Royal Dutch Petroleum & the Future of Alien Tort Litigation*, FORBES, Apr. 18, 2013, http://www.forbes.com/sites/wlf/2013/04/18/supreme-court-observations-kiobel-v-royal-dutch-petroleum-the-future-of-alien-tort-litigation/ ("Yesterday's decision . . . will lead to the dismissal of virtually all pending ATS cases.").

243 *See, e.g., Kiobel v. Shell: Supreme Court Limits Courts' Ability to Hear Claims of Human Rights Abuses Committed Abroad*, CENTER FOR CONSTITUTIONAL RIGHTS (Apr. 17, 2013), http://ccrjustice.org/newsroom/press-releases/kiobel-v.-shell%3A-supreme-court-limits-courts%E2%80%99-ability-hear-claims-of-human-rights-abuses-committed-a (quoting

complaints in the press releases sounded like investors who had seen their portfolio (represented by the package of ATS precedents purchased) disappear, holding stocks they could not sell (represented by the fact that the courts were now closed to almost all claims where those precedents could have been valuable), suffering from a metaphorical stock market crash (represented by the devaluation of those precedents as a consequence of the *Kiobel* holding). These groups tried to find a silver lining in the decision and held out hope for some suits against corporations surviving,[244] but realistically there is very little room left in the now-limited ATS for its use as a corporate social responsibility tool. Some groups admitted that they would need to redirect their investments now that the ATS remedy was cut off. For example, one corporate social responsibility group named the Accountability Counsel informed its members in a post-*Kiobel* press release that "[f]or victims of corporate abuse

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lead counsel for the *Kiobel* plaintiffs (who has also been counsel in many ATS cases) as stating, "We are disappointed by today's ruling and the fact that U.S. courts have shut their doors to the human rights violations our clients suffered"); Natalie B. Fields, *What Kiobel Means for Corporate Accountability*, ACCOUNTABILITY COUNSEL (Apr. 17, 2013), http://www.accountabilitycounsel.org/news/what-kiobel-means-to-corporate-accountability/ ("Today, the U.S. Supreme Court harshly limited cases that may be brought in U.S. courts against corporations that commit human rights abuses abroad."); *Kiobel Ruling Undermines U.S. Leadership on Human Rights*, HUMAN RIGHTS FIRST (Apr. 17, 2013), http://www.humanrightsfirst.org/2013/04/17/kiobel-ruling-undermines-u-s-leadership-on-human-rights/ ("Today in its decision in *Kiobel v. Royal Dutch Petroleum*, the Supreme Court gutted the Alien Tort Statute (ATS), a law that has been on the books for more than 200 years and for the last 30 years has been a critical avenue to hold serious human rights violators accountable."); Kate Mitchell, *Kiobel v. Royal Dutch Petroleum and the Future of Corporate Accountability for Human Rights Violations Committed Abroad*, OXFORD HUMAN RIGHTS HUB (Apr. 21, 2013), http://ohrh.law.ox.ac.uk/?p=1579 ("The Court held that the Alien Torts Statute (ATS) did not apply extraterritorially, shutting off an avenue previously embraced by human rights advocates for making corporations accountable for human rights abuses committed abroad."); *Civil and Human Rights Coalition Criticizes Supreme Court Ruling in Kiobel as a Setback for Human Rights*, THE LEADERSHIP CONFERENCE (Apr. 17, 2013), http://www.civilrights.org/press/2013/kiobel-supreme-court.html ("Today's decision in *Kiobel v Royal Dutch Petroleum* undermines the unique and important role of U.S. courts in providing an opportunity for justice for those who have suffered serious human rights violations at the hands of repressive regimes around the world. With this decision, the Supreme Court has closed our courthouse doors . . . .").

244 *See, e.g.*, Alison Frankel, *Human Rights Lawyers Look for Silver Lining in Kiobel Black Cloud*, REUTERS BLOG (Apr. 17, 2013, 10:09 PM), http://blogs.reuters.com/alison-frankel/2013/04/17/human-rights-lawyers-look-for-silver-lining-in-kiobel-black-cloud/ ("When the U.S. Chamber of Commerce rushes out a statement hailing a decision by the U.S. Supreme Court, you can be sure that opinion is a defeat for plaintiffs' lawyers."); Wessen Jazrawi, *Kiobel v Shell: US Supreme Court on corporate accountability for foreign human rights abuses*, UK HUMAN RIGHTS BLOG (Apr. 18, 2013), http://ukhumanrightsblog.com/2013/04/18/kiobel-v-shell-us-supreme-court-on-corporate-accountability-for-foreign-human-rights-abuses/ ("[W]hilst *Kiobel* has been a setback for those seeking stronger accountability of multinationals operating abroad, the decision does not mean that corporations are immune from liability, and ways will continue to be sought to that end.").

that had hoped to use U.S. courts, and now cannot, our work [on non-judicial accountability mechanisms] just became that much more important."[245] Several of these groups in their statements specifically discussed *Kiobel* as a blow to corporate accountability and social responsibility campaigns.[246] A critical weapon in the expansionist corporate social responsibility activists' arsenal was lost.[247] Of course, all sides had an opinion.[248] Immediately following the decision, business-aligned interest groups also had their own press releases applauding the *Kiobel* decision in large part due to the relief it provided for the corporation's legal positioning.[249]

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245 Fields, *supra* note 243.

246 *See, e.g.*, Marjorie Jobson, *South Africa: Unanswered Questions For The South Africa Apartheid Litigation As U.S. Supreme Court April 17 Rules Against The Kiobel Case*, KHULAMANI SUPPORT GROUP (Apr. 24, 2013), http://www.khulumani.net/khulumani/statements/item/780-unanswered-questions-for-the-south-africa-apartheid-litigation-as-us-supreme-court-april-17-rules-against-the-kiobel-case.html?utm_source=Khulumani+News+Alerts&utm_campaign=2ea075167c-Kiobel_case_statement4_24_2013&utm_medium=email ("The Kiobel decision seems to have 'cut a hole into the web of accountability . . . .,' said Elisa Massimino, President of Human Rights First."); *US: Supreme Court Limits Suits Against Rights Abusers Abroad*, HUMAN RIGHTS WATCH (Apr. 29, 2013), http://www.hrw.org/news/2013/04/29/us-supreme-court-limits-suits-against-rights-abusers-abroad ("[*Kiobel*] undercuts case law that had made the US courts a mainstay for redress for victims of serious human rights abuses."); *Analysis: Set-Back for Corporate Accountability on Human Rights*, THE DANISH INSTITUTE FOR HUMAN RIGHTS (Apr. 23, 2013), http://humanrights.dk/news/news?doc=22277 ("Last week, events in the US made it harder to hold multinational companies accountable for contributing to human rights abuses in their global operations . . . . For the past two decades, the ATS has been one of the most visible manifestations of the global need for greater clarity on the human rights responsibility of corporate actors.").

247 Jobson, *supra* note 246. Jobson concludes that "this power to advance corporate accountability has been significantly reduced by the US Supreme Court's decision." *Id.* She quotes Rita Kesselring, a Swiss scholar who wrote that, "[i]n an environment in which few institutions, whether judicial or political, have been able to secure the accountability and liability of corporations, the ATS has served a unique and critical function. It has had the power to enforce liability for compromising the dignity of human beings and (it) has strengthened international human rights against corporate abuse." *Id.*

248 Marcia Coyle, *Justice Limit Reach of Alien Tort Law*, AM. LAWYER, Apr. 17, 2013, *available at* http://www.americanlawyer.com/PubArticleTAL.jsp?id=1202596443758&Justices_Limit_Reach_of_Alien_Tort_Law (describing the reactions from both sides to the *Kiobel* decision).

249 *See, e.g.*, *U.S. Chamber Commends Supreme Court for Reining In Abuses of Alien Tort Statute*, U.S. CHAMBER OF COMMERCE (Apr. 17, 2013), http://www.uschamber.com/press/releases/2013/april/us-chamber-commends-supreme-court-reining-abuses-alien-tort-statute ("U.S. Chamber of Commerce today praised [the Kiobel] decision . . . that limits the global business community's liability under the [ATS]" calling the ATS cases "a scheme by class action trial lawyers" to "expose global businesses to frivolous and costly lawsuits"); Peter Nestor, *The Supreme Court Has Ruled on Kiobel. Now What?*, THE BUSINESS OF A BETTER WORLD (Apr. 17, 2013), http://www.bsr.org/en/our-insights/blog-view/the-supreme-court-has-ruled-on-kiobel.-now-what ("Our initial assessment after today's opinion is that most businesses will not likely face suit in U.S. federal court under this ruling, particularly for allegations of abuse occurring abroad.").

As a result of *Kiobel* and the closing of the ATS mechanization to achieve corporate social responsibility objectives, we should see the expansionist interest groups channel their resources to other avenues. There should be a post-*Kiobel* shift in their investment strategy, perhaps away from law creation or just to other law-production centers. We have seen this shift in part with the rise of state-based tort claims seeking remedies for supposed corporate harms and state-based causes of action with extra-territorial reach, including and sometimes beyond what these groups attempted to push through the mechanism of the ATS.[250] It would be interesting in future work to research where these corporate social responsibility groups divert the funds previously dedicated to their ATS litigation budgets.

Despite the convincing proof of its demise through *Kiobel*, the story of the ATS's life tells an interesting tale about interest group behavior and corporate social responsibility activism. The ATS evolution is instructive about the means and institutional venues for rent-seeking behavior and the real possible returns from investing in the creation of law (including liability doctrines) beneficial to one's self-interest.

CONCLUSION

Public choice, interest group theory, and the economic analysis of law provide methods by which we can better understand the operational aspects of corporate social responsibility advocacy. Like any interest groups, those groups labeling as their mission the advancement of new social responsibilities for corporations will engage in the same cost/benefit analysis as any other interest groups determining where to invest their limited time, money, and other resources. When rent-seeking for legal change is the more efficient use of their limited resources, corporate social responsibility groups will invest in the creation of law to advance their own interests at the expense of others. This Article sought to explain these motivations and position corporate social responsibility activism in the same category of skepticism due any interest-group investment in the creation of laws.

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250 *See generally* Childress III, *supra* note 138; Ziad Haider, *Corporate Liability for Human Rights Abuses: Analyzing* Kiobel *and Alternatives to the Alien Tort Statute*, 43 GEO. J. INT'L L. 1361 (2012); Roger Alford, *Kiobel Insta-Symposium: The Death of the ATS and the Rise of Transnational Tort Litigation*, OPINIO JURIS (Apr. 17, 2013, 5:48 PM), http://opiniojuris.org/2013/04/17/kiobel-instthe-death-of-the-ats-and-the-rise-of-transnational-tort-litigation/.

Finally, both generally and through the case study of the ATS, this Article sought to demonstrate that rent-seeking analysis should have broad application. There is room for increased scrutiny of new rules of liability emerging from the courts that, in all likelihood, have sometimes themselves been the product of interest group investment in the creation of new judicial doctrine. There are lessons to be learned about precedent-building litigation development strategies employed in public law litigation and elsewhere. Moreover, these insights help expand the utility of public choice analysis, and more aggressive use of this mode of analyzing litigation outcomes for rent-seeking origins could provide further valuable insights on how tort laws and other judicially-created legal doctrines come about and whether their content should receive more critical examination as a result of the background processes of their creation.

An Interview with Milton Friedman

*Russ Roberts**

INTRODUCTION

Almost a half century ago, Milton Friedman wrote an article on the social responsibility of business for the *New York Times Sunday Magazine*.[1] In the article, he restated what he had said in his book, *Capitalism and Freedom*,[2] arguing that the social responsibility of business is to earn profits, as long as those profits are earned honestly, without deception or fraud. By publishing his arguments in the *New York Times*, Friedman reached a much wider audience. As a result, he became identified and is identified still as the leading opponent to the idea of the social responsibility of corporations.

Friedman argued that the social responsibility movement misunderstands the role of profit and misunderstands the importance of incentives. If you encourage the CEO to seek goals other than profit, the CEO will essentially be spending other people's money—the money of stockholders and consumers—on an ill-defined goal that those stockholders and consumers could never agree on. One of Friedman's deepest and simplest insights is the idea that you spend your own money more carefully than you spend other people's money. If managers and CEOs are encouraged to spend potential or actual profit on higher wages or lower product prices, there is no reason to think they will do it wisely or carefully. Such a system would allow CEOs to be less responsible—they would have the leeway to pursue their own goals with less accountability.

Friedman feared that once CEOs and managers were seen as guardians of the public good, they would be seen as public figures and there would be pressure to choose them based on their ability to achieve various social goals rather than their ability to make a profit. He saw the social responsibility movement as a

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

2 MILTON FRIEDMAN, CAPITALISM AND FREEDOM (1962).

form of socialism—a way to expropriate private property for ends that would be directed from the top down rather than the bottom up, using the means of the political process rather than the marketplace. He also understood that profit is an important social goal—a way that we human beings transform the world. Profits are a sign that a business is covering its costs. That means providing a product or service that is valued above what it takes to produce it. Achieving that honestly through voluntary exchange is a very good thing.

Ultimately, Friedman's critique of social responsibility came down to the appropriate role for profit in a capitalist system. Many activists see profit as a pie to be carved up and handed out once a business has succeeded. But Friedman and others see profit as an organic part of the market process alongside the potential for losses. The future profitability of an organization can never be known in advance. Requiring firms to pay "responsible" wages that differ from market wages, for example, can jeopardize the existence of the firm in the competitive landscape of a modern economy.

It is important to add that Friedman had no problem with people spending their own money to help the poor or other causes they thought important. A successful firm specializes in making products and providing services for its customers at prices that are able to cover the firm's costs. It has no special expertise in helping the disadvantaged or fighting for other causes. But once workers, investors, and managers take their share of the firm's profits, Friedman thought it fine, indeed laudable, if they chose to give their money voluntarily to people and organizations that were successfully specializing in helping others.

Since Friedman's 1970 article, there has been steady pressure for firms to set wages, prices, and production decisions that take into account something other than the potential for profit. Despite this pressure, most firms have the freedom to pursue profit as their managers see fit. Minimum wage laws are relatively modest. Firms are free to outsource their production overseas if they choose. Price ceilings are relatively rare. Ironically, perhaps, the biggest intervention in the economy since 1970 related to profits has not been the intervention of the state to redirect how corporate investments are made or how corporations treat their workers or their customers. The biggest intervention has been to reduce losses, particularly in the financial sector and particularly for large lenders financing the investments of other financial firms using borrowed money.

The rescue of creditors in the decades before the financial crisis of 2008 and during that crisis was always rationalized by

policy makers as necessary for social reasons—the necessity of intervening in the marketplace to prevent financial chaos in a system where large firms are so interconnected. Firms that lend money for high-risk investments have been shielded from the effects of their poor decisions. The result is a system with a great deal less responsibility. In the name of running the financial system for the good of the people, cronies have been encouraged to feed at the public trough.

I think Milton Friedman would have been appalled at this perversion of incentives resulting from intervening in the incentives of the market place in the name of a higher good. He was always eager to point out that capitalism is not anchored by profits. It is anchored by profits and losses. Profits are the carrot that signal success and encourage innovations. Losses are the stick that punish poor performance and signal failure. Having one without the other is not capitalism, but crony capitalism.

I interviewed Milton Friedman at his home in downtown San Francisco in August of 2006, a few months before his death that November. It was a bittersweet experience. It was a thrill and an honor to interview him—I had started EconTalk[3] that spring and to have Milton Friedman as a guest was a wonderful coup. At the same time, I realized he was getting old and I might not see him again. When we parted at the door, I thanked him, not just for the interview but for everything, thinking of his kindness to me over the years, but more than that, for his writing that had taught me so much. The interview covers a wide range of topics, including the social responsibility of business and his article on the topic decades earlier. I am pleased that portions of this interview will appear in print for the first time here in the *Chapman Law Review*. I hope you enjoy Milton Friedman's insights.

INTERVIEW TRANSCRIPT[4]

Russ Roberts: Welcome to EconTalk, part of the Library of Economics and Liberty. I'm your host, Russ Roberts, of George Mason University. My guest today is Milton Friedman. Milton is a senior research fellow at Stanford University's Hoover

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3 ECONTALK, http://www.econtalk.org (last visited Jan. 4, 2013).

4 Interview with Milton Friedman, Senior Research Fellow, Hoover Inst., Stanford Univ., in S.F., Cal. (July 28, 2006). This transcript has been excerpted. For the full transcript, visit http://www.econlib.org/library/Columns/y2006/Friedmantranscript.html. This transcript is being reprinted with permission from Professor Russell Roberts and Liberty Fund, Inc. (http://www.libertyfund.org). The transcript was originally published September 4, 2006, on http://www.econlib.org. Liberty Fund is a private educational foundation dedicated to increased knowledge of a society of free and responsible individuals.

Institution, the 1976 Nobel Laureate in Economics and a hero to millions in the United States and around the world for his insights and actions on behalf of economics and liberty.

. . .

Russ Roberts: Milton, let's turn to *Capitalism and Freedom.* In the book, you lay out the principles of what you call liberalism. Sometimes you call it liberalism, sometimes 19th Century liberalism. Sometimes you've called it classical liberalism. And you advocate there a limited role for government in the legal and monetary system and maximal freedom and responsibility for the individual. And in that book, which was published in 1962, but based on lectures, I think, that you gave in the late 1950s—

Milton Friedman: 1956.

Russ Roberts: So the ideas in that book are 50 years old this year. And in 1956 and thereafter in the book in 1962, you argued for a volunteer army, flexible exchange rates, a monetary rule for stable prices, educational vouchers, privatizing Social Security and a negative income tax. At the time, those ideas were not conservative at all—

Milton Friedman: They were very radical.

Russ Roberts: Some people might call them conservative but you called them liberal because they were about freedom. They were considered either conservative or whacky. What was the reaction to the book when it came out?

Milton Friedman: I don't know. I really don't know how to answer that question because when it came out, it did not receive a great deal of attention to begin with. It was reviewed in no major newspaper. *The New York Times* didn't review it. The only reviews were in professional magazines. It was reviewed in the *American Economic Review,* in the *Economic Journal* and other major professional journals but it got very little public attention.

Russ Roberts: And I'm surprised it was actually reviewed there. A book like that today would be much less likely to be reviewed in the *American Economic Review* or *Economic Journal.* It was a polemic of sorts. That's a little strong.

Milton Friedman: It *was* a polemic.

Russ Roberts: It was a treatise. It was a manifesto.

Milton Friedman: But by that time, I had acquired a considerable reputation as an economist in professional economics. There was a good deal in this book, however, which was of professional economics importance. What you've

mentioned—floating exchange rates—and the monetary stuff. It was polemic but it wasn't *primarily* polemic.

Russ Roberts: And it's not written in a polemical style.

Milton Friedman: No, it tried to be a rational argument and it tried to consider the evidence for the points that are made. But you're stressing how much has since been achieved from it.

Russ Roberts: Correct.

Milton Friedman: But I've always stressed the opposite. If you look at the list in Chapter 1 or 2—I have a long list of things government ought not to be doing.

Russ Roberts: And it's not exhaustive. You say at the end of it this is just the beginnings of a list.

Milton Friedman: The only one of those that has really been achieved is a volunteer army.

Russ Roberts: Right. We've made *some* inroads potentially on agricultural price supports which is, I think, the first thing you list on that page. There was actually somewhat serious talk about changing them. But you're right. You could argue the glass is half empty. But as, again, someone who came of intellectual age in the 1970s and who was sympathetic to the ideas in the book, to put it mildly, advocating those ideas at the time, any of the ones we've talked about on the positive side that actually happened or are close to happening, was a recipe for being treated as a buffoon or a fool or a heartless person. I think it's an extraordinary intellectual and policy experiment over the last 50 years that so many of those things have come to pass.

Milton Friedman: And what's happened is that the public attitude has changed tremendously. In 1945, 1950, at the end of the war, intellectual opinion was almost wholly collectivist. Everybody was a socialist. They may not have used the term but that's what they were. However, practice was not socialist. Practice was free enterprise.

The role of government at that time was such smaller than it has since become and from 1945 on to 1980, what you had was galloping socialism. Government took over more and more control. Government spending went from about 20 percent of national income—government federal, state and local—to about 40 percent of national income until Reagan came along.

But Reagan was able to do what he did because in that 20-year period, intellectual opinion had changed. What had before been a hypothesis was now fact. You now could *see* what the government did and people didn't particularly like what the government did. So public attitudes about government had

changed very much over that period and I think maybe *Capitalism and Freedom* added a little of that but I think experience was much more responsible.

Russ Roberts: At the time, the other side of the intellectual argument, the socialist or communist side, was doing quite poorly. But we were not aware of it. The Soviet Union was doing much, much worse than it appeared to be doing.

Milton Friedman: Sure.

Russ Roberts: And so if we had had the facts about the Soviet Union, the experiential case for capitalism and markets might have been even stronger. But it really is rather remarkable that given the intellectual apologists for the Soviet Union of the day, how much the tide changed in public opinion despite the lack of direct evidence that we had.

Milton Friedman: We had very little direct evidence outside the United States and I think it was the evidence of the government in the United States that was playing a role. But I really have never done any serious work on trying to trace the course of general public opinion except as it worked for the politics of it. Reagan could never have gotten elected if there had not been a big change in public opinion. He could not have been elected in 1950.

Russ Roberts: And Goldwater was not electable in 1964 who in many ways was the most free market candidate of the 20th Century. Yet George W. Bush, who is not much of a classical liberal, did at least talk about what he described as privatizing Social Security, a topic that Reagan might think was a good idea but I don't think ever talked about it publicly, advocated it, never made it a campaign issue. I think probably afraid of it, perhaps correctly so.

I remember in my youth, again going back to the '70s, talking about eliminating Social Security was an invitation to be described as a person who wanted to see old people die in the streets "as they did before the 1930s" as if somehow Social Security had prevented this from happening, which is bizarre given the level of Social Security in the '30s.

Milton Friedman: Of course.

Russ Roberts: —and all the private mechanisms we have for taking care of ourselves. And so, obviously, *Capitalism and Freedom* played a role. You mentioned earlier *The Road to Serfdom* by Hayek in affecting public opinion. There was definitely an intellectual foundation laid for these public opinion changes that gave people something to hold onto.

Milton Friedman: Well, we know that, for example—we happen to know—that Reagan read *Capitalism and Freedom* before I ever met him and, clearly, that's a way in which a book has influence.

Russ Roberts: But it also has influence through affecting the electorate who—

Milton Friedman: Oh, sure.

Russ Roberts: And *Free to Choose,* a book we haven't mentioned yet, which was a documentary on public television at first and then I think the book followed the documentary or was it the other way around?

Milton Friedman: The book was based on the documentary but appeared in print before the documentary. What happened was we finished all the work on the documentary in the spring of '79 and we spent the summer of '79 using the transcripts of the program as a basis for *Free to Choose* book and Harcourt Brace did a remarkable job of publishing the book. We went to the printers in September and it was in the bookstores in December. Jovanovich—at the time, it was Harcourt Brace Jovanovich—Bill Jovanovich was very much of a fellow thinker and he contributed to our program.

Russ Roberts: In what way?

Milton Friedman: Oh, to begin with, the first step in creating the program was that I gave a series of lectures all over the country on the subjects that were going to be in the program to provide material for the producer and directors to weave into film. And he gave us a contract for publishing the transcripts of those lectures.

Russ Roberts: So that helped finance the trip. The book and the TV series, which reached millions, obviously, helped as well with the ideas of *Capitalism and Freedom* which probably didn't sell quite as well—marketed by the University of Chicago Press—but with similar ideas.

Milton Friedman: No, no. The University of Chicago Press did a good job in marketing considering the absence of book reviews. After all, *Capitalism and Freedom* has sold something like 600,000 copies. *Free to Choose* has sold over a million copies. And we found it very fascinating to observe the way sales of *Capitalism and Freedom* went. To begin with, they were relatively few. And then they gradually started to increase and it was entirely person to person—word of mouth.

Russ Roberts: And it is a book that's still quite topical.

Milton Friedman: The basic principles that we believe in

are going to stay the same for the next thousand years. That aspect of it will never go out of date. What goes out of date are the particular applications. We still find Adam Smith's book, *Wealth of Nations* well worth reading even though it's published in 1776.

Russ Roberts: Yes, it is surprisingly informative.

Milton Friedman: It certainly is and it's so well written.

Russ Roberts: I think a huge part of your success—obviously not the logic but the success of the ideas—is your ability to communicate clearly and effectively to a non-technical audience.

Milton Friedman: Well, I'm not a stylist the way Smith was. The modern economist who really I think matches that is George Stigler.

Russ Roberts: Absolutely. He had a graceful pen. And it was a pen probably, not a keyboard, if I had to guess.

Milton Friedman: Oh, there's no doubt that it was a pen.

Russ Roberts: I know you can give us the empirical evidence. Let me ask you about another idea in *Capitalism and Freedom* that you later elaborated on in a Sunday *New York Times* magazine story in the early 1970s. You wrote there: "There is one and only one social responsibility of business, to use its resources and engage in activities designed to increase its profits, so long as it stays within the rules of the game which is to say engages in open and free competition without deception or fraud."

I feel that that view of business, the one that says it should maximize its profits, is increasingly under attack and there's a strong activism afoot in the land to turn corporations and businesses into social organizations, welfare agencies, charitable organizations. One, do you agree with me? Do you think that's true? And two, what can we do about it? Any ideas?

Milton Friedman: I think it's absolutely true. There's no doubt that that's—the view that there are many stakeholders and not only the shareholders has spread. And business itself propagates the idea because it's good public relations. They spend money entirely with a view to the bottom line but label it social responsibility spending.

And that sentence, I think, is still just as true as it ever was and I've never seen an occasion to change my view about that. Suppose a business wants to do charity. What is it that gives it any special ability to do charity properly? The XYZ Company, in addition to producing XYZ trucks, also wants to be socially

responsible and so it does what it thinks is charity. What is its special capacity for that?

It may know how to make trucks but does it know the right way to spend charitable money? And whose money is it spending? It's spending somebody else's money. It's a very bad practice. Business has had such a big incentive to label itself socially responsible—it's primarily responsible for that conception.

Russ Roberts: Yeah, I worry about that slippery slope as they brag about how well they've done in those different dimensions. I'd like them to brag about how profitable they are. That means they've produced something that people enjoy, are willing to pay for and have found a way to produce it at a lower cost.

Milton Friedman: The truth of the matter is that the only way anybody can make money is by producing something that people want to buy, but it can give away money without meeting that restriction.

Russ Roberts: That reminds me of one explanation for why people, I think, lean on businesses to indulge other activities besides producing products well. It's the Willie Sutton theory of why you rob banks—that's where the money is.

The Chicago City Council recently passed an ordinance requiring large retailers—mainly Wal-Mart and Target—to pay at least $10.00 an hour in wages and $3.00 an hour in benefits.

If you ask the proponents why should Wal-Mart finance a higher standard of living for their workers, why should the investors of Wal-Mart, the stockholders, and Target, be the ones that finance that, I think the answer would be "Well, they have the money."

That ignores, of course, the incentive effects that then result. They're the last people that you'd want to have finance this because it discourages them from creating jobs for low skill people. But I think that first order effect of "Well, they've got the money, they write the checks so therefore they've got the responsibility" has a huge appeal to the average person.

Milton Friedman: But it's always been true that business is not a friend of a free market. I have given a lecture from time to time under the title *Suicidal Impulses of the Business Community,* something like that, and it's true. It's in the self-interest of the business community to get government on its side. It's in the self-interest of a *particular* business. Look at this crazy business about ethanol. Who's benefiting from that?

Russ Roberts: Farmers. Corn farmers.

Milton Friedman: No, the farmers aren't benefiting.

Russ Roberts: The landowners.

Milton Friedman: What's the company that produces it?

Russ Roberts: Archer Daniels Midland. So of course, they lobby and talk about the enormous environmental benefits of ethanol.

Milton Friedman: But the real puzzle—puzzle isn't quite the right word—the real *problem* here is where do you find the support for free markets? If free markets weren't so damn efficient, they could never have survived because they have so many enemies and so few friends. People think of capitalism or free markets as something that obviously is supported by business. People think that if a business party is a party in politics, it will promote free market. But that's wrong. It will be in the self-interest of individual businesses to promote a tariff here and a tariff there, to promote the use of ethanol—

Russ Roberts: Special regulations for its competitor that apply just by chance to its competitors but not to itself—

Milton Friedman: That's right.

Russ Roberts: —or that they already comply with but their competitors don't happen to comply with.

Milton Friedman: And it's so hard in general, so much harder, to repeal anything government is doing than it is to get it to do it. There are so many stupid things that government is doing that, clearly, it would be in the self-interest of the public at large to have repealed. Who would—who can really on logical grounds defend sugar quotas? There's no way of defending sugar quotas.

Russ Roberts: You don't think it's a big national security issue? [laughter]

Milton Friedman: That was why they were imposed. Because of Cuba. They were initially imposed against Castro. But once you got them, you couldn't get rid of them.

Russ Roberts: It's a good example because the beneficiaries are very few.

Milton Friedman: They're very few.

Russ Roberts: We understand that politically that gives them a certain reason to be loud in talking to the representatives but you'd think the fewness of them would eventually be decisive in overturning it but it has not.

Milton Friedman: No, it's not, because it's an advantage. If

50% of the people were sugar farmers, you couldn't possibly have sugar quotas, because it costs too much to the others. But if 1% of the people are sugar producers, for each dollar that they get, that's divided among 99 people so it's only one cent to the individual.

Russ Roberts: So their incentive to yell is small—which brings us back to a question that you write about in *Capitalism and Freedom*. Issue by issue, it's easy to make the case for discretion.

When you see the cumulative effect of going issue by issue, you really can make the case for principles. You give the example in the book of freedom of speech. Obviously, a lot of Americans are against freedom of speech.

Milton Friedman: Oh, sure.

Russ Roberts: And if you went issue by issue, you'd find a lot of speech that would be voted down as not appropriate and yet we sustain it through enough people believing that it's a good thing.

Milton Friedman: But even here, with the campaign finance laws, we're reducing freedom of speech drastically.

Russ Roberts: That gets back to your point about businesses wanting government to protect them. In this case, the business is the industry of government. Politicians like the protection that campaign finance laws gives them.

Milton Friedman: Yeah.

Russ Roberts: That's a very tough one when they regulate themselves. They do tend to be a little self-interested there. It's very sad.

Milton Friedman: But how do we get that repealed? What politician is going to come up and make a big fight on repealing the McCain-Feingold legislation.

Russ Roberts: Although the Supreme Court occasionally does speak up and suggest that this is not really consistent with the Constitution.

Milton Friedman: Well, the Supreme Court is not a very strong support in some cases. Look at what it did with property—with eminent domain. The Kelo case is not really a good advertisement for a free market Supreme Court.

Russ Roberts: But ironically, it did produce a backlash at the state and local level against using it.

Milton Friedman: The Institute of Justice—which is a remarkably good organization—has been promoting that

backlash against it and they've been doing a very good job. It may well be that you'll end up with a stronger support for property than you originally had. But that wasn't the intention of the Supreme Court.

Russ Roberts: Let's go back to the difficulty of repealing bad laws. You mentioned sugar quotas, sugar price supports, as an example. What role do you think economic illiteracy, a lack of understanding on the part of the public of the full effects of legislation, plays in sustaining laws that are described as in the national interest but are really serving special interests?

Milton Friedman: Very little. Because it's not in the self-interest of the recipients to figure it out. What housewife is going to spend the time to save the extra money—maybe it's $5.00 or $10.00 a year she pays extra on sugar? It doesn't pay to try to figure out. What you're dealing with is rational ignorance. The rational part is what I want to emphasize. It's not ignorance that is avoidable because it's rational to be ignorant.

Yet somehow, people do get it. Minimum wages have become less popular than they used to be. They've been trying to pass a rise in the minimum wage for years and they haven't passed one. And that's because, I think, there is more understanding of the economic merits or demerits of it than there used to be—more people recognize the effect of a higher minimum wage on the employment of the poor.

Russ Roberts: On the flip side, the living wage, which are these local ordinances or like the one in Chicago we spoke about earlier, gets attention and often passes.

And if anything, you'd think there the effects are going to be more stark in a local area—employers have more choices to leave the area which they wouldn't have at the federal level. On the case of gasoline price controls, true, no one clamors for price controls but we have all these implicit price controls—threats by attorney generals to prosecute gougers in the wake of Katrina or worse, vaccine manufacturers who might have the gall to charge a market-clearing price.

Instead we have the president of the United States two winters ago begging people to not use the vaccine if they're not really at risk, instead of using the price mechanism which is so much more effective. It seems to be a paradoxical pattern? Do you have any thoughts on that?

Milton Friedman: I don't think there's anything very paradoxical about it. First place, we are now only twenty or thirty years from when we had price controls [on gasoline]. And so a large fraction of the population had personal experience with

it. Twenty or thirty years from now, after there's nobody living who had experience with price controls, I wouldn't be surprised to see it come back again.

We have to keep ourselves open to the facts. The facts are that the world has become better and better over time. The 19th Century was better than the 18th Century. The 20th Century was better than the 19th Century. The 21st Century is going to be better than the 20th Century. There was once an article back in, oh, 1780 or something, which said how many people lived in free countries and how many lived in the rest—non-free.

And the ratio of people who live in free countries to the total population of the world has surely been going up throughout this whole—these past two centuries. It went up most dramatically recently when the Berlin Wall fell, when the Soviet Union went out of existence. So there's reason to be optimistic.

Somehow or other, these stupid individuals who vote these bad laws seem to have enough sense to keep from voting laws bad enough to create a negative GNP. So I think in the end, you've got to remain an optimist.

Russ Roberts: I share your optimism and I like the long-term perspective. On any one day, you can always get depressed about what's going on in Washington or in city hall but the long-term trend is toward more freedom and a higher standard of living and although it seems very difficult for people to recognize that, they're always moaning; the educated class is always moaning about how things have never been worse. We stand on the brink of a precipice either because we have a trade deficit or China or manufacturing jobs are in decline or the inequality due to this, that or the other, or immigration. There's always some threat to our prosperity that's imminent and yet we manage to keep going.

Milton Friedman: And yet—another thing on the glass being half empty. While everybody complains about Bush's tax cuts, nobody really is in favor of higher taxes. There's no broad sentiment, no broad move [to raise taxes].

Russ Roberts: I want to ask you about George Stigler who you mentioned earlier. Stigler was an observer of the political scene. He was a political economist who described why things were the way they were but he felt it was a waste of time to be an advocate, a preacher, a proselytizer for a particular philosophy or ideology because politicians face these incentives and you're not going to change what they do. Being an advocate for this policy or that policy or trying to increasing liberty—as you have—is a Quixotic endeavor. Is that a fair assessment of his view?

Milton Friedman: There's a lot of truth to it. George always used to say, "Milton wants to change the world. I just want to observe it." But it wasn't true. That was what he would say. But after all, you never heard George say a good thing about bigger government. You never heard him in any way express views that differed from yours and my views about what we ought to be doing. So I think that was a little bit of a show that he put on.

Russ Roberts: But he didn't spend as much time as you have professionally.

Milton Friedman: No, no. He did spend much more time on observing.

Russ Roberts: And you have spent a great deal of time obviously on observing but a sizeable amount of time on urging or prodding or pushing politicians and others—the rest of us—to advocate for smaller government and more individual freedom.

Milton Friedman: I have.

Russ Roberts: As a person who spent a lot of time in the—not just in the academic vineyard but in the policy vineyard, do you look back on that as fruitful work?

Milton Friedman: I really had two lives. One was as a scientist—as an economist—and one was as a public intellectual. And everybody more or less does his major scientific work at a relatively early age And it's kind of natural, I think, that people switch from the one area to the other. Really until the 1970s, I did not have much contact in politics whatsoever.

I had some but not much. But then, I think increasingly as the scientific side of my life matured and I happened to know more people in politics, my interests and my activities switched to some extent. I think what really motivated it more than anything else was when I was writing columns for *Newsweek.*

Russ Roberts: Which was fun, I assume.

Milton Friedman: It was fun. It was fine. I found it a very challenging thing to do and it made me—forced me—to keep up with the current affairs that were going on and also it brought me into contact with people who were active in politics.

Russ Roberts: Did colleagues other than George voice an opinion about you spending your time that way? I know at that point in your life, you were already incredibly respected and successful but—

Milton Friedman: No. No.

Russ Roberts: For a young scholar, it's not the best use of time often.

Milton Friedman: I always told my students that if they went to Washington, they shouldn't stay there more than two years or they'll get ruined. And in general, I've argued to youngsters who came up to me and wanted to be ideologists, wanted to promote an ideological view, that they first better get themselves established as an economist or as a scholar and get a good job and then they could afford to do it.

Russ Roberts: What advice would you give to those who love liberty and would like to see its cause thrive? You talked about some optimism, that the broad historical trends are good. Anything in the short run that you think would be useful or good for people to be aware of or take advantage of?

Milton Friedman: I think people have to do what they want to do. I think that the best thing that people can do who want to promote the free market is to talk about the free market, to think about the free market, to write about the free market and to get into arguments.

Russ Roberts: Something you've spent a lot of time at.

Milton Friedman: I've had a lot of experience in it, a great deal.

Russ Roberts: That's good advice. Thank you, Milton.

Introduction to *Dodge v. Ford Motor Co.*: Primary Source and Commentary Material

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Original documents in historic cases provide a uniquely valuable perspective on the cases themselves and the surrounding circumstances and history that contribute to the development of legal principles. Understanding that access to historical materials can be difficult, the *Chapman Law Review* has endeavored to collect source documents regarding the case of *Dodge v. Ford Motor Co.*[1] After a short introduction to this compilation, including a discussion of research methodologies, several key historical documents are reproduced and transcribed that we hope will aid future researchers.

In a Michigan courtroom in 1917, Elliot Stevenson is cross-examining industrialist and Ford Motor Company majority shareholder Henry Ford. Stevenson represents minority shareholders Horace and John Dodge, two brothers who had sued the very profitable Ford Motor Company for withholding dividends and proposing to spend corporate funds to build a new facility, one that would eventually become the largest automobile manufacturing plant in the world.[2]

Stevenson is grilling Ford about his plans for the new plant:

Stevenson: Who is doing that sort of thing now?

Ford: Nobody.

Stevenson: Nobody?

Ford: No.

Stevenson: You are going to experiment with the Ford Motor Company's money, to do it, are you?

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* Hugh and Hazel Darling Foundation Library Director and Professor, Dale E. Fowler School of Law at Chapman University. I would like to thank Patricia Pelz Hart, Lawyer/Librarian at the Dale E. Fowler School of Law at Chapman University for researching and obtaining the source documents, Debbie Lipton, for her assistance in researching and support, and the editors of the *Chapman Law Review* for transcribing the historical materials.

1 170 N.W. 668 (Mich. 1919).

2 *Id.* at 668, 671.

Ford: We are not going to experiment at all; we are going to do it.

Stevenson: Nobody yet has ever done it?

Ford: That is all the more reason why it should be done.

Stevenson: Therefore, you are going to undertake to do something that nobody else has done, that nobody else has even tried to do?

Ford: Oh, certainly. There wouldn't be any fun in it if we didn't.

Stevenson: You are going to find some fun in it?

Ford: Yes, certainly.

Stevenson: But at the expense of the Ford Motor Company?

Ford: That is all I am working for at the present time, is to have a little fun, and to do the most good for the most people, and the stockholders.

Stevenson: I understand that is the principal thing that you have in mind, doing the most good for the most people?

Ford: And the stockholders, and everybody.[3]

Then, Stevenson queries Ford about a statement Ford made in an interview with the *Detroit Evening News* a week or so before trial.

Stevenson: What I have reference to, Mr. Ford, is the statement contained in your published statement in the Evening News a week or so ago. "Bear in mind, every time you reduce the price of the car, or reduce the quality, you increase the possible number of purchasers. . . . [L]ess profit on each car, but more cars, more employment of labor; and anyway, we will get all the total profits that we ought to make. And, let me say right here, that I do not believe we should make such awful profits on our cars. A reasonable profit is right, but not too much. It has been my policy to force the price of the car down as fast as production would permit."

And so forth. Is that your statement?

Ford: Yes.[4]

Stevenson zeroes in on the crux of the matter:

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3 Transcript of Record at 211, Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1918) (No. 47) (from State of Michigan, Circuit Court of Wayne County; cross-examination of Ford).

4 *Id.* at 219.

Stevenson: And . . . you were not satisfied to continue to make such awful profits?

Ford: We don't seem to be able to keep the profits down.

Stevenson: You are not able to keep them down; are you trying to keep them down? What is the Ford Motor Company organized for except for profits, will you tell me, Mr. Ford?

Ford: Organized to do as much good as we can, everywhere, for everybody concerned.

Stevenson: Do you know anything in the law that discusses anything about doing people good, in connection with the manufacture of automobiles, or any other manufacturing business?

Ford: I don't know very much about law.[5]

Out of these colorful courtroom exchanges (among others similarly pointed) arises one of the significant early cases in U.S. corporate law.

Forced to reconcile Ford's remarkably blunt statements[6] with traditional corporate purposes, the trial court sided with the Dodges, ordering a dividend and enjoining Ford's proposed new plant.[7] Michigan's Supreme Court, however, was more circumspect, and overturned the lower court—ordering a dividend to be paid, but otherwise declining to block the new plant.[8]

To this day, *Dodge v. Ford Motor Co.* remains instructive on a number of points of corporate governance and the role of courts in adjudicating shareholder disputes. The case is widely cited for the proposition that "[a] business corporation is organized and carried on primarily for the profit of stockholders,"[9] though the proper contours of corporate purpose are still the subject of much modern debate.[10]

To understand the business environment that existed in the early twentieth century, scholars today can find much value in historical source material such as trial transcripts, interviews,

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5 *Id.* at 221.

6 Professor M. Todd Henderson calls it "among the worst testimony given by any corporate defendant in any trial at any time." M. Todd Henderson, *The Story of Dodge v. Ford Motor Company: Everything Old Is New Again*, *in* CORPORATE LAW STORIES 37, 61 (J. Mark Ramsey ed. 2009).

7 Dodge v. Ford Motor Co., 170 N.W. 668, 677 (Mich. 1919).

8 *Id.* at 684.

9 *Id.*

10 *See generally* Henderson, *supra* note 6; Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163 (2008); Jonathan R. Macey, *A Close Read of Excellent Commentary on* Dodge v. Ford, 3 VA. L. & BUS. REV. 177 (2008).

and newspaper articles published as the events were unfolding. Contemporary newspaper coverage provides insight into the conflicts at the core of the dispute, the circumstances of the case, and the perspectives of the parties leading up to the controversy and as it made its way through the courts. Henry Ford explained many of his business theories in great detail in an interview with the *New York Times* several years prior to the lawsuit,[11] and he delivered an unapologetic response to the trial court decision in an interview with the *Detroit News*.[12] Ford's interviews and trial testimony bring his personality to life and vividly illustrate the reasons for his actions and the strength of his convictions in his own words.

Finding these types of historical source documents is challenging because they may not be published (in the case of trial court documents) and are not available electronically, in part because of the age and obscurity of the sources.

Specialized legal databases, commercial digital archives, and independently produced digital repositories allow legal researchers to find a wealth of information that was previously accessible only in print. But that has led to the mistaken assumption that everything worth finding is online, and if information is more than a few clicks away, it may as well be on another continent. The "Googlization" of research has encouraged an over-reliance on less than authentic and reliable sources, and has resulted in more superficial and inaccurate research.[13] Search engines like Google are great for finding *some* information on almost any topic, but for scholars who need to find *precise* information, they can be hazardous.[14] The Internet is rife with unreliable and inaccurate information.

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11 *Henry Ford Explains Why He Gives Away $10,000,000*, N.Y. TIMES, Jan. 11, 1914, *available at* http://query.nytimes.com/mem/archive-free/pdf?res=9D03EFDF1E39E633A25752C1A9679C946596D6CF.

12 *Henry Ford Makes Reply to Suit Brought by Dodge Brothers*, DETROIT NEWS, Nov. 4, 1916, at 1.

13 *See* Steven G. Bell, *The Infodiet: How Libraries Can Offer an Appetizing Alternative to Google*, CHRON. HIGHER EDUC. (Feb. 20, 2004), chronicle.com/article/The-Infodiet-How-Libraries/4458/; Jan Brophy & David Bawden, *Is Google enough? Comparison of an internet search engine with academic library resources*, 57 ASLIB PROCEEDINGS 498 (2005), *available at* http://www.soi.city.ac.uk/~dbawden/bawden%20and%20brophy%20ap.pdf; Konstantina Martzoukou, *Students' Attitudes Towards Web Search Engines – Increasing Appreciation of Sophisticated Search Strategies*, 58 LIBRI 182 (2008), *available at* http://www.librijournal.org/pdf/2008-3pp182-201.pdf.

14 The usefulness of Google Books to the casual searcher, as opposed to scholars, is evident in a comment by Sergey Brin (the co-founder of Google): "We just feel this is part of our core mission. There is fantastic information in books. Often when I do a search, what is in a book is miles ahead of what I find on a Web site." Motoko Rich, *Google Hopes to Open a Trove of Little-Seen Books*, N.Y. TIMES, Jan. 5, 2009, at B1, *available at* 2009 WLNR 182925.

The Google Books project,[15] designed to create the "world's largest digital library"[16] by scanning the collections of major research libraries, sounds like a wondrous thing for all involved (all the books in the world at your fingertips!). Produced by a huge corporation with the resources to do the seemingly impossible, it is not without significant problems, especially for researchers who need to rely on the accuracy of information. Google Books has become a prime example of issues inherent with mass digitization of print publications—not only the quality of scanned documents—but more importantly, the accuracy of metadata.[17] Metadata is the information that identifies specific works; the date of publication, edition, author, and subject classifications—it allows researchers to access particular sources; gather and compare works by authors, subjects, and time periods; trace the evolution of ideas; and engage in substantive analysis in order to draw conclusions. But errors and omissions in metadata make scholarly research more difficult.[18]

At the same time, the art of historical research is being lost. Thorough historical research requires skill, tenacity, an awareness of resources that exist in different formats, and a certain amount of effort. Not so long ago, legal scholars routinely tracked down sources wherever they could find them, and were undaunted by using print indexes or scrolling through rolls of microfilm. That kind of research now seems anachronistic—the stuff of moody historical novels and period films set in dusty, antiquated libraries. Resources that have not been digitized, and may never be, are likely to be forgotten, the information they

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15 *See* GOOGLE BOOKS, http://books.google.com/.

16 Miguel Helft, *Federal Judge Rejects Google's Negotiated Deal to Digitize Books*, N.Y. TIMES, Mar. 23, 2011, at B1 ("Google's ambition to create the world's largest digital library and bookstore has run into the reality of a 300-year-old legal concept: copyright."), *available at* 2011 WLNR 5638818.

17 *See* Geoffrey Nunberg, *Google's Book Search: A Disaster for Scholars*, CHRON. HIGHER EDUC., Aug. 31, 2009, *available at* http://chronicle.com/article/Googles-Book-Search-A/48245/; GEOFF NUNBERG, GOOGLE BOOKS: THE METADATA MESS, GOOGLE BOOK SETTLEMENT CONFERENCE, UC BERKELEY, Aug. 28, 2009, *available at* http://people.ischool.berkeley.edu/~nunberg/GBook/GoogBookMetadataSh.pdf; Geoffrey Nunberg, *Counting on Google Books*, CHRON. HIGHER EDUC., Dec. 16, 2010, *available at* http://chronicle.com/article/Counting-on-Google-Books/125735.

18 "A search for books published before 1950 and containing the word 'Internet' turned up the unlikely bounty of 527 results. Woody Allen is mentioned in 325 books ostensibly published before he was born. Other errors include misattributed authors – Sigmund Freud is listed as a co-author of a book on the Mosaic Web browser and Henry James is credited with writing 'Madame Bovary.' Even more puzzling are the many subject misclassifications: an edition of 'Moby Dick' categorized under 'Computers,' and 'Jane Eyre' as 'Antiques and Collectibles' ('Madame Bovary' got that label, too)." Laura Miller, *The trouble with Google Books: How rampant errors threaten the scholarly mission of the vast digital library*, SALON (Sept. 9, 2010), http://www.salon.com/2010/09/09/google_books/.

contain lost, and with it their potential contribution to the collective exchange of ideas.

Access to historical newspaper articles depends on the publication. Traditionally, newspapers like the *New York Times* published volumes of print indexes, and the articles themselves could be found in large bound volumes or microform; but researchers had to go to a library that owned them. Commercial vendors have created digital archives of significant national newspapers,[19] but they are very costly and access is restricted by the terms of the purchasing library's agreement with the vendor, usually to those affiliated with the academic institution. In addition, databases may contain only partial coverage of publications, or include the text but not accompanying images. Other resources, such as regional and local newspapers, may not be online at all.

Historical trial transcripts, if they exist, are notoriously difficult to locate. If a trial is of sufficient notoriety, they may be part of a digital archive, or if the trial court decision is appealed, transcripts may be included in the appellate court's records and briefs (which can also be difficult to obtain). Court records and briefs are often not online,[20] and are not "published" (or cataloged) in the usual sense, so it is difficult to determine if libraries own them. The courts themselves are most likely to have historical trial documents, but court policies vary wildly; not all trial transcripts are produced, and if they are, it is common practice to move them to off-site storage or discard them after a certain period of time. In addition, obtaining them often requires a trip to the courthouse and significant fees. The Detroit court where the *Dodge v. Ford* trial took place keeps records for only fifteen years. Attorneys involved in the litigation may have owned trial transcripts, but after so many years it is unlikely that the attorneys will be living, that their firms exist in a similar form, or that their files have been kept.

In some states, law libraries may have agreements with state courts to serve as repositories for records and briefs. The coverage and format varies according to the age of the law library, space limitations, and more recently, state budgets, and access requires going to the library to use them. For a geographically distant researcher, the options may be limited to hiring a local research service or depending on the kindness of

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19 *See, e.g.*, *ProQuest Newsstand*, PROQUEST, http://www.proquest.com/en-US/catalogs/databases/detail/newsstand.shtml.

20 With the exception of U.S. Supreme Court Records and Briefs, and more recent court documents that require electronic filing.

strangers with research skills. In this case, the Thomas M. Cooley Law Library in Lansing, Michigan, owns a collection of Michigan Supreme Court records and briefs, and we were fortunate to find a law librarian[21] willing to dig through boxes of court records for the years leading up to the 1919 decision. The Michigan Supreme Court Record, consisting of over 800 pages, contains a wealth of information that cannot be found elsewhere. The documents attest to the hard-fought, acrimonious nature of the trial, including the transcripts of testimony from eighteen witnesses that took place between May 21, 1917 and June 7, 1917, listed by direct, cross, and multiple re-direct, and re-cross examinations. The Record also includes the trial court pleadings, minutes of director's meetings, financial statements, contracts, newspaper articles, letters, and photographs.

Similar to newspaper archives, commercial publishers have created archival collections for famous trials.[22] Academic institutions and other organizations are creating free digital repositories of material for historically significant collections that would otherwise be inaccessible.[23] However, most legal principles are not created by a singular dramatic event, and lack the notoriety that might give rise to sufficient interest to undertake a digital archival project like those cited above. But generally, laws are products of the unique social and economic environment at a point in history and, like *Dodge v. Ford Motor Co.*, often have complex competing interests, strong personalities, and background stories that inform a full understanding of how the law developed as it did.

As current scholars explore legal concepts rooted in influential, historical cases and the circumstances that contributed to their development, it is a worthwhile endeavor to provide access points to original source documents. With that in mind, we have reproduced and transcribed the following selected articles and trial testimony:

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21 Our thanks to Eric Kennedy, Reference and Administrative Services Librarian, Thomas M. Cooley Law Library.

22 *See, e.g.*, *The Making of Modern Law: Trials, 1600–1926*, GALE DIGITAL COLLECTION, http://gdc.gale.com/products/the-making-of-modern-law-trials-1600-1926/; *World Trials*, HEINONLINE, http://heinonline.org/HeinDocs/Trials-new.pdf.

23 *See, e.g.*, *Arizona v. California*, WILLIAM A. WISE LAW LIBR., http://lawlibrary.colorado.edu/arizona-v-california-collection; *Trial Pamphlets Collection: Contemporary accounts of trials from the 1600s to the 1800s*, CORNELL UNIVERSITY L. LIBR., http://ebooks.library.cornell.edu/t/trial/.

1. Henry Ford Explains Why He Gives Away $10,000,000: Declares That He Is Dividing Profits with His Employes, Not Paying Them Higher Wages, and That Workers as Partners Will Give Increased Efficiency
N.Y. TIMES, Jan. 11, 1914 502

In a magazine-style article with local reporting, Henry Ford gives a substantial interview regarding the business case and his rationale for profit-sharing with labor in the early days of Ford Motor Company.

2. Dodges Sue Henry Ford: Stockholders Object to "Reckless Expenditures" of Company's Assets
N.Y. TIMES, Nov. 3, 1916 514

A brief announcement that the Circuit Court granted the Dodge brothers a temporary injunction restraining Henry Ford from using assets of the Ford Motor Company as he planned.

3. Newspaper Specials
WALL STREET J., Nov. 4, 1916 515

A brief article providing financial details (including earnings and dividends) contained in the complaint filed by the Dodge brothers, and the temporary injunction issued against the Ford Motor Company, calling Ford's plans "reckless in the extreme."

4. Ford Makes Reply to Suit Brought by Dodge Brothers: Says Present Plans of Expansion Are Only in Line With Past History of Company
DETROIT NEWS, Nov. 4, 1916 516

A substantial interview with Henry Ford and his attorney Alfred Lucking regarding details and circumstances of the Dodge brothers' lawsuit and Ford's response.

5. Ford Denies Recklessness: Asserts He Cannot Hurt the Dodges Without Injuring Himself
N.Y. TIMES, Nov. 5, 1916 522

Article quoting from a statement issued by Henry Ford in response to the temporary injunction: "They own 10 per cent of the stock and I own about 58 per cent. I can't injure them $10 worth without at the same time injuring myself $58."

6. Transcription of *Dodge v. Ford*
Cross-Examination of Henry Ford 523

Excerpts of Testimony of Henry Ford.

7. Ford Loses Dodge Bros. Profit Suit: Judge Hosmer Orders 50 Per Cent Division of $59,000,000 Dividends. Ruling Reviews Rise of Motor Company
DETROIT NEWS, Oct. 31, 1917 575

Article describing the trial court decision in favor of the Dodge brothers, ordering a distribution of 50% of the company's profits. Ford's attorney announced plans to appeal.

8. Henry Ford Beaten in $60,000,000 Suit: Dodge Brothers Win Action for Disbursement of Dividends
N.Y. TIMES, Nov. 1, 1917 578

A brief article announcing the trial court decision in the Dodge brothers' lawsuit and Ford's intent to appeal.

Henry Ford Explains Why He Gives Away $10,000,000

Declares That He Is Dividing Profits with His Employes, Not Paying Them Higher Wages, and That Workers as Partners Will Give Increased Efficiency.

N.Y. TIMES (1857–1922), Jan. 11, 1914, at SM1.

A sixteen-year-old lad decided one day that he was "through" with farm work. He wanted to be a machinist. He walked eight miles to Detroit and applied at one of the biggest machine shops for a job. He got it.

Some years later the youngster went to a bottling establishment and saw for the first time a gasoline engine at work. He had been experimenting for years on an idea that a road vehicle ought to be made to propel itself, but the weight of a steam furnace and boiler seemed an insurmountable obstacle.

He saw the boilerless stationary engine doing the same kind of work as the small steam engine, and an idea came to him: Why not put a similar engine on wheels?

He did it. Two years of hard labor in spare times it cost him, for he had to fashion every part of the thing himself.

But another inventor, he learned afterward, had obtained what many people seemed to think a blanket patent for a gasoline engine. Most of the others who started in to develop the automobile were frightened into acknowledging the monopoly of the idea, and for years paid tribute to that monopoly in the shape of a royalty on every machine they made.

Not so with Henry Ford. He knew his engine was different from the type covered by the Selden patent, and he determined to fight. At first he had allies. When the lower courts decided against him these fell away, but he continued his contest single handed. He won.

Within ten years from the time he started his present business he built up the biggest automobile manufacturing plant in the world. He dumfounded foreign manufacturers by a demonstration that he could turn out cars that could go, and stand hard service as well, at a fifth or a sixth or less of the price at which they could afford to sell them, and his factory grew so fast that he came to turn out completed automobiles in less time than rivals could manufacture some parts.

Last year, so successful was his business, his company, on a capital of $2,000,000 made profits of $25,000,000. It is asserted that no other industry of the present time, where money has been legitimately invested and where work is actually done—not mere high financing—can show a like result.

Such is a brief story of Henry Ford.

His Startling Announcement.

On Tuesday the whole world was startled by the announcement in the newspapers that this same Henry Ford or the company of which he is the biggest owner had adopted a scheme of sharing equally its profits with its employes. Fifty per cent. of its net profits, it was told, the company would take. The other 50 per cent., estimated for the year 1914 at $10,000,000, would be distributed among the men working for the Ford Company on a new plan. It would be given in the regular pay envelopes handed out every week, in proportion to the daily wage now received.

Of such importance was this dividend that in some cases is was more than equal to the wage a man actually received for his work. The lowest paid employe, the sweepers, who receive $2.34 a day for work which in New York City may claim $1 to $1.50, was to receive $5. That sum, it was announced, was to be the least given to anybody in the establishment over twenty-two years of age.

In the open-mouthed wonder resulting from this announcement the public has hardly had time to realize what this means. While the course of Mr. Ford and his associates has been generally approved, the very novelty of the plan has provoked doubt as to its practicability. That Mr. Ford, by this unprecedented generosity, has made it difficult for those employers of labor who have to figure on very small profits, and who, therefore, cannot increase wages without wrecking their business, has been pointed out. The scheme has been pronounced Utopian, or, at least, extremely altruistic, and some critics have pronounced it foredoomed to failure.

A special correspondent of THE TIMES went out to Detroit to see what manner of man this was that seemed to be shoveling out money by the million to men who were already said to be better paid than any other workmen in the automobile industry, and just why he was doing it—if, perhaps, there was any reason that had not been made known.

The story of Henry Ford in the last ten years is almost the story of Detroit, which in that time has grown to a

manufacturing centre of the first magnitude, and the centre of the automobile industry in the United States. A boy on the farm he was, with a hankering for fixing watches and machinery that were in the habit of getting out of order when there was no itinerant repairer going about. Then a machinist. Then a man with an idea. That idea has meant millions for himself and has played a big part in the development of Detroit.

Mr. Ford is a tall, slim, keen-eyed, alert man, who is apparently never too much occupied to see anybody that actually has something to talk over with him; a man who is just fifty, in perfect health, and as active as any of his young employes; a man who speaks in millions with no more effort than many of us think in single dollars. Mere money-getting and the spending of it do not seem to have absorbed He[n]ry Ford. He still spends half the day in his factory, much of the time in going through it, exchanging a word here and there, or making a suggestion.

Then, his actual workday done, he gets into his own car and heads, not for his fine house in the city, but to his place in the country, the farm on which he was born. For he is a man with a hobby, and that hobby is farming and the care and conservation of wild creatures, particularly birds. On that farm he is building a big house, and he expects before many years to pass most of his time there.

All over the place are scattered houses for birds and means of feeding them; and these, finding lodging and food provided so bountifully, flock to the place. Mr. Ford has taken an active interest in all legislation designed to protect wild birds, and is now working to have a treaty made with Canada to further the protection of game birds.

If you look about Detroit for a sign of the Ford Motor Company you will find in the outskirts a huge concrete structure bearing the company's name. But this is only a warehouse. To find the place where much of the prosperity of the city has its origin you have to board a trolley car for a six-mile journey into the country to a fashionable suburb.

For the manufacturing plant of the company is at Highland Park. To be more definite, it is on a spot where people used to throw away money on race horses. The great office building stands on what used to be the race track, and now, where the cries of the bookmakers and the cheers of winners used to resound, the roar of acres of machinery is continuous.

When one learns that Henry Ford has a son, a young man, one's first thought is—is he the familiar type of son of the usual unusually successful man? Should not the father, one cynically

asks, be hoarding up money so that his successor may make ducks and drakes of it? If you suggest that to Mr. Ford he smiles.

"My son," he says proudly, "is in the business. When he finished the high school last year I had him come right into the factory. All the bodies of our cars he designs himself, and I have no fear that he will not be able to take care of himself. My son is a worker."

Crowd Threatened with Fire Hose.

On Tuesday, following the announcement that appeared in the morning papers, a crowd of something like 10,000 men flocked to the gates of the factory, at Highland Park, besides the 15,000 men that went there to their regular work. It had been announced that the company was going to take another 5,000 men in addition to its present force. The idea of making $5 a day or more made a strong appeal. At many factories workmen reported late that day. The police had to appear in strong force, and while the crowd was told that nobody would be engaged at the works many persisted in lingering. To disperse then a show had to be made of bringing up a fire hose.

Wednesday morning, one who rode out to Highland Park about 9 o'clock found the car packed, and policemen were busy at the entrance of the big factory keeping away such as had no errand there. At the same time, Ford agents were stationed at various points in the town taking on men who seemed to meet the requirements.

Highland Park is not a workingman's colony. It is a fashionable residential place. A few of the workmen live near by but the great number live in the city and come out on the cars. Under the new three-shift which will be installed men will keep coming and going all the time. In fact, shifts begin work each of the first six hours of the eight. This solves the transportation problem and makes it possible for the street car company to handle the workingmen without difficulty.

When you get off the street car you view an assemblage of four and six-story buildings covering the greater part of sixty acres, each one as fire-proof as possible, and the windows so arranged that in case of a fire their frames, being of iron, may be used as ladders, the glass being knocked out.

In the vast lobby of the big office building a crowd of men were sitting, waiting to see various officials of the company. A clear-eyed, clear-headed young woman commanded the scene from behind a desk on a raised platform.

Mr. Ford was found on the second floor in a big office at the left-hand corner of the front. In discussing his excellent health, he said:

"The only boiler that bursts is one which has too much fuel. No man need be sick in my opinion, if he exercises a moderate care in the food he consumes. Even the mistakes that are made in childhood in the matter of feeding I believe can be overcome if one tries."

When he guided the visitors through the vast building where the automobiles that bear his name are made one was able to discover one secret of the success of the business. That is specialization. A glance through the vast forest of machinery, with its veritable jungle of presses and stamps and furnaces, the overhead railway, with its regular service, maintained by a manager and a force of eighty men, gave an impression of bustle and confusion. But if one picked out a single workman and regarded him for a minute, one found that as a rule that workman's duty was to make four or five motions—nothing more. The machine he was operating required a stroke of this lever or that, and, presto! out came the finished product.

Indeed, when you watched closely, nobody seemed to be hurrying. He performed the few motions his work required him to make, and that was all. There was no haste. It was all just—clockwork!

A man wearing overalls and a good deal of grease passed.

"Hello, Henry," he called. "I tell you you are the boy that's always doing the big thing," slapping Mr. Ford on the back.

The latter returned a pleasant greeting and the slap.

"He used to be a fireman when I was with Edison company," he said. "By the way, we have with us the first man we ever employed."

There are twelve physicians in the building, with a main hospital and six first-aid stations. Besides their medical and surgical work the doctors have to do a sort of sociological work in looking after the employes.

Once back in his office Mr. Ford introduced his son, Edsel B. Ford, a youth of twenty, who seemed to be on friendly terms with everybody, and who was waiting to make a report, and then he gave himself up to be interviewed.

"I was born only eight miles from Detroit," said Mr. Ford, in answer to a question. "I still own the farm on which I was born. I

am going to sell my place in the city and build a house out there and live there the rest of my life.

"After I had learned my trade as a machinist, I went to work for the Edison Company, when it first started in Detroit. In that way I came to meet Thomas A. Edison, and I may confess to you he has been one of the great inspirations of my life.

"In my opinion Edison to-day is the top man of the world. He is the man who has done most for it."

Mr. Ford crossed the office and took down a photograph of the great inventor.

"I think a lot of this," he said. The photograph bore the inscription:

To Henry Ford, one of a group of men who have helped to make the U. S. A the most progressive nation in the world.

THOS. A. EDISON.

"It was in 1891 that I started at work on my first gasoline engine," said Mr. Ford, in answer to a question. "I was working on it for two years. I made every part of it myself. I had seen a gasoline engine at the bottling works in Detroit. It was a slow-speed machine.

"Called Me Crazy."

"As I said, I labored on my car for two years. There was absolutely no part of any kind to be had for a gasoline engine in this part of the country, and that is why every part of the car had to be fashioned by my own hands.

"It was the first gasoline machine ever seen on the streets of Detroit, and, though people made a lot of fun of it and called me crazy, the car actually went.

"But four or five years passed before I made any effort to commercialize my new machine, and, in fact, I built a second car before I did so. Then I organized a small company and started to turn out automobiles, but for personal reasons I got out of it and started this company in 1903.

"Our first factory was a little frame building on Mack Avenue, Detroit. Within two years the business had outgrown it, and we built and moved into brick buildings covering about three acres.

"In four years more these quarters had become too small, and four years ago we moved to this sixty-acre plot, which, as you see, is now almost entirely covers with four and six-story buildings.

"I may tell you that from the first I always had the idea of making quantity, and I believe I got it from what I once heard Mr. Edison tell his father-in-law, in reference to making mowing machines in Buckeye, Ohio: 'What you want to do, in order to make money, is to make quantity,' he said. That made a strong impression on me.

"In reasoning it out I came to the conclusion that that was the proper thing to do in the manufacture of automobiles. In my opinion, and in the light of what experience has shown me, the way to put this principle in force the world over is for every manufacturer to concentrate his attention upon one thing, and make quantities of it, at a small profit on each article.

"It was the Selden patent fight that forced us into establishing branches around the world. Lawsuits and threats of lawsuits naturally made some people timid about buying our cars."

"What gave you the nerve or the courage to fight the Selden patent when so many manufacturers surrendered without a blow?" Mr. Ford was asked.

"Well, you see, as a mechanic and engineer, I was able to look over the Selden patent and its drawings, and decided for myself that I had not infringed upon it.

"Most persons seemed to think that the Selden patent was of a blanket type, covering everything in the nature of a gasoline engine. Investigation showed me it covered only a certain type of gasoline and liquid hydro-carbon engine.

"Now we were using an entirely different type of engine cycles. The Selden type could not be made small and light. It was a low pressure engine, while ours was a high compression kind.

"Well, that was a hard fight. For seven years it was bitterly contested in the courts. They beat us at first in the Federal District Court of Southern New York, but when an appeal was made, we won.

"By this time we were alone. At first we had had a group of other manufacturers allied with us; but at the first decision they flunked."

"Our capital," Mr. Ford said in answer to a question, "is $2,000,000, but our assets now are about $35,000,000. We have no stock in the market. There are only seven stockholders in the company, and of these Mr. James Couzens and I hold the majority. My own holdings are 58½ per cent.

"This idea of the distribution of part of our profits without employes, Mr. Couzens, our Vice President and treasurer, and I have been working on for some years," said Mr. Ford.

"It is not, I may emphasize, an increase in wages. It is a system of profit sharing which we have carefully worked out, and which, we believe, will be successful in operation.

"Our scheme is to distribute among our employes about one-half of the year's profits. Our men have been efficient and faithful, and we believe they should share in what this means to us.

"At the same time, mind you, we have always paid good wages. Our lowest wage at present is $2.34 per day. The lowest we pay girls who work in our factory is $12.50 a week. The work they do is mostly making magnets—all light work.

"We have never had any difficulty in getting plenty of labor, and we have never had any labor trouble.

"Except for supplying a hospital and six emergency or first-aid stations, in our works, to which twelve physicians are attached, we have never attempted to do anything for our employes in the line of what is commonly regarded as social improvement work—I mean by that, we are not in the habit of founding 'institutions' for them.

"One reason is we do not believe in paternalism. We consider our employes as independent beings, and we do not believe they would relish paternalism any more than we."

"But how do you figure that you will be able this year to give your employes $10,000,000 as half of your profits?" Mr. Ford was asked.

"On the basis of last year's profits," he replied. "We made last year $25,000,000. We figure that this year one-half our profits will be fully $10,000,000 to $12,000,000, and that sum we shall distribute to our employes. While this will be distributed in the form of an extra wage, it is distinctly a sort of dividend. We are starting in to pay this dividend on Jan. 12."

"What do you expect to result from this distribution?"

"For one thing, we shall get increased efficiency. Bear in mind that we are shortening the length of a day from nine to eight hours. I am positive the men will feel a keener interest in their work. Under the terms of the plan, it is not a stated sum that is to be distributed. The figures we name—$10,000,000 to $12,000,000—are approximate. The men will get half the profits.

Is it not to their interest to increase their output and thus increase their share of the profits?

"Our eight-hour system goes into effect on the same day the distribution of profits begins. We have a $5, $6 and $7 a day scale for men who work by the day in the factory. For salaried employes and for foremen, there may be a distribution in the way of increases in pay, though the management takes care of a bonus at the end of the year, which extends only to employes of these grades.

"At the present time we consider that our organization is well under control, so that we shall be able to slide into the three-shift plan without a hitch. This means that our factory will run continuously, except on Sunday. We have so many furnaces and so many things that require heat treatment that it is much better to run them continuously than have them slacken down. The fact is, we already have some eight-hour shifts going on the furnaces."

"But what do you think will be the effect of your example on other automobile manufacturers?" Mr. Ford was asked. "Will they not find it difficult to keep their workmen, not feeling, perhaps, that they can afford to pay wages on a scale that yours, joined with the profit sharing, will amount to?"

"We cannot give employment to all the men in the automobile industry," was the reply. "Let me tell you something: There is no factory that is big enough to make two models of automobiles. The secret to successful modern business is concentration. Let automobile manufacturers concentrate."

"And do you expect others to follow your example in the matter of profit sharing?"

"I do. Some of those manufacturers who are making bodies and tops for us will follow this example, and we expect to show them how."

"But some call your scheme Utopian," was suggested.

Mr. Ford smiled. "If you remember, there were many 'practical' people, so called, who solemnly warned us, several years ago, that it was impossible to make a car for $500 that would carry anybody anywhere."

"Something was said in the announcement of your scheme about your following up your employes with sociological investigations."

"We have had a sociological department connected with our first aid department for some time," Mr. Ford replied. "It is our

experience that doctors are in better position to exercise a sort of watchfulness over men than lawyers or superintendents, and our method is to have them straighten up men who show evidences of not keeping up to their standard. It is always possible to straighten a man out, and the doctors find out whether a man takes to drink, and show him the mistake he is making. The main thing is to keep a man busy. Anything that is put into operation for good will always work out. It is very rare that a man has to be discharged.

"It is a matter on which we congratulate ourselves that we have never had a particle of trouble with labor unions. They have never succeeded in organizing our factory. We pay better than anybody else, and we keep close to our men. I keep going through the shops all the time. We keep track of any talent that develops, and many of our men invent devices for assisting or simplifying their work. Such a man always gets advanced.

"Nobody need apprehend," said Mr. Ford, with a smile, "that we shall not be able to carry out what we have set out to do. Our plan for profit sharing is not a scheme that was born in a moment.

"For my part, I don't expect to leave much of a fortune when I get through. I believe if a man really wants to do a little good he can accomplish a lot more with his money while he is alive than by willing it so that other people will cut it up for him after he is gone.

"I wish you would lay stress on the fact that it is not higher wages we are going to pay our employes, but profits. We have estimated that we shall be able to distribute a certain amount this year, and we have figured that the best means of apportioning this out is with the regular pay envelopes, instead of in a lump sum at the end of the year."

"Are you a Socialist?" Mr. Ford was asked.

"I am not sure that I really know anything about socialism. I understand it as a doctrine which is popular among those who want to share other people's money without doing any work. I don't believe socialism appeals to me; nor, I may say, do I regard our profit-distribution scheme as socialistic.

"We do not expect to pay anybody anything who does not work. And we can tell here when a man shirks. I could myself go out into the shops to-day and make any piece of a car, and I know when a man is not doing his proper share."

"But how about the effect of your plan on the automobile labor market? Will you not draw away the best men of other manufacturers?"

"Let me repeat what I said before: The number of men we can employ is limited. Now, we do not know anything about conditions in any other automobile factory than our own. We are trying to do something that we consider for the good of a lot of people. All our men have helped us in our business. We feel they are entitled to share in the profits.

"If you expect to get anything out of a man nowadays you must pay him well. If you want the best there is in him, you must make it really worth his while. You must give him something to live for.

"I do not believe in prolonging the conditions which ever since the civil war have been developing into a curse upon the country, and which in these last few years have caused the Federal Government to step in and make war upon big corporations. You know what I mean—the conditions which have built up a few millionaires and actually pauperized millions or kept them poor. They are out of date.

"I believe it is better for the nation, and far better for humanity, that between 20,000 and 30,000 people should be contented and well fed than that a few millionaires should be made."

"But suppose," was suggested, "your profits should dwindle below what you estimate? Suppose there should be no profits?"

"We shall share half. If there are none, then, of course, there will be no sharing. But, I repeat, there will be at least $10,000,000 to distribute this year."

"The suggestion has been made that you might let the public in on this by putting a lower price on your cars."

"We shall continue to make our cars better and cheaper, and we shall cut the price regularly every Fall. With increased economy in manufacture we shall be able to lower the price next Fall by fully $30—perhaps by more. If we have to lay off men on account of overproduction, or for any other reason, we shall do this during the Summer, in time for them to go to the farms and help in the harvesting.

"Let me tell you one of our business principles which may explain a lot to some of those who are painfully distressed over the impracticability of our distribution scheme," Mr. Ford continued. "We don't borrow money.

"When we first started business we decided we would be our own bankers. Now, we started last Fall with between $15,000,000 and $20,000,000 of our own money to keep us going through the Winter. And I may tell you that so far we haven't had to draw on that fund."

Dodges Sue Henry Ford.
Stockholders Object to "Reckless Expenditures" of Company's Assets

N.Y. TIMES (1851–2009), Nov. 3, 1916, at 12.

DETROIT, Nov. 2.—John F. and Horace Dodge, automobile manufacturers and stockholders in the Ford Motor Company, obtained a temporary injunction in the Circuit Court here today, restraining Henry Ford from using the assets of the Ford Motor Company to extend the business as planned, instead of distributing profits in dividends.

In their application to the court, the Dodge brothers allege that increased labor costs and unstable business conditions, coming at the end of the war, make "reckless expenditures of the company's assets unwise."

The company's annual statement issued recently, showed profits of several million dollars, which, it was announced, would be put back into the business.

Newspaper Specials

WALL ST. J. (1889–1922), Nov. 4, 1916, at 2.

John F. and Horace E. Dodge, owners of the Dodge Bros. Motor Car plant, and holders of 10% of Ford Motor Co. stock have secured a temporary injunction against Henry Ford to restrain the Ford Motor Co. from disbursing and re-investing its surplus earnings in the extension of the business following the declaration by Mr. Ford at the end of the last fiscal year that no special dividends in the future would be declared by the company. Bill recites that $34,000,000 had been distributed from January, 1914, to October, 1915, in addition to regular monthly dividends of 5%. No declaration was made at the end of the last fiscal year, although earnings reached $60,000,000. It is alleged that Mr. Ford owns 58% of the stock of the company and he is contemplating investing millions in iron ore mines in the northern peninsula of Michigan or Minnesota; building ships and establishing steel manufacturing plants. The bill also states that this policy in view of the increased labor and material costs and uncertain business conditions is "reckless in the extreme" and demands that at least 75% of the accumulation of the cash surplus and in the future all earnings of this company be distributed to stockholders.

Ford Makes Reply to Suit Brought by Dodge Brothers

Says Present Plans of Expansion Are Only in Line With Past History of Company. Declares That on Investment of $10,000 Dodges Have Drawn Out $5,571,500 in Dividends, and Still Have Holdings That They Value at $50,000,000. Attorney Alfred Lucking Says the Suit Against the Ford Company Has Political Motives Back of It.

DETROIT NEWS, Nov. 4, 1916, at 1.

Henry Ford was asked to discuss the suit begun by Dodge Bros. to restrain Mr. Ford from using the $52,000,000 surplus funds of the Ford Motor Co. in expanding the business of the company, and to force Mr. Ford to divide at least $39,000,000 of the money among the stockholders, of which amount the Dodge Bros. would get $3,900,000 if their suit proves successful.

Mr. Ford discussed the suit, making his statements quietly, simply, dealing in sums that ran into the millions as modestly as the average manufacturer would deal in thousands, as the grocer would deal in hundreds, and as the toller would deal in dollars, all the while his bearing and statements showing an earnestness, with an occasional note of sadness (with no note of fear) that made you think that he was wondering how any one in the world could attempt to interfere with the great plans he has for extending the business of his organization and giving employment to more men, and much less how that interference could come from men with whom he had been associated in business for a long time, and who would themselves profit by his efforts.

The suit came as a surprise in view of the fact the night before the suit was started Mr. and Mrs. John Dodge were at the wedding of Mr. Ford's son, Mr. Dodge chatting freely with Mr. Ford.

"To understand what this is all about, you must understand the general principles on which I have tried to have the business of the Ford company built up and extended, the principles on which we have attained the measure of success that is ours," said Mr. Ford.

"In the first place I hold that it is better to sell a large number of cars at a reasonably small margin than to sell fewer cars at a large margin of profit.

"I hold this because it enables a larger number of people to buy and enjoy the use of a car and because it gives a larger number of men employment at good wages. Those are two aims I have in life. But I would not be counted a success; I would be, in fact, a flat failure if I could not accomplish that and at the same time make a fair amount of profit for myself and the men associated with me in business.

"This policy I hold is good business policy because it works, because with each succeeding year we have been able to put our car within the reach of greater and greater numbers, give employment to more and more men, and at the same time through the volume of business increase our own profits beyond anything we had hoped for or even dreamed of when we started.

"Bear that in mind: every time you reduce the price of the car without reducing the quality, you increase the possible number of purchasers. There are many men who will pay $360 for a car who would not pay $440. We had in round numbers 500,000 buyers of cars on the $440 basis, and I figure that on the $360 basis we can increase the sales to possibly 800,000 cars for the year—less profit on each car, but more cars, more employment of labor and in the end we get all the total profit we ought to make.

"And let me say right here, that I do not believe that we should make such an awful profit on our cars. A reasonable profit is right, but not too much. So it has been my policy to force the price of the car down as fast as production would permit and give the benefits to users and laborers with resulting surprisingly enormous benefits to ourselves.

"The men associated with me haven't always agreed with this policy—"

"Yes," broke in Alfred Lucking, Mr. Ford's attorney, "Mr. Ford has usually had to force expansion through and over opposition. I remember years ago when he proposed to expand the output from 25,000 to 75,000 cars a year, we gasped. But Mr. Ford had his way and his way has proved itself."

"And I have the same idea in wanting to expand the output to 800,000 cars—a simpler problem now than when we made the jump from 25,000 to 75,000," said Mr. Ford.

"The Dodge brothers say in their bill of complaint that last year the Ford company produced 500,000 cars at a profit of

$60,000,000 and had a satisfied public to deal with; that without taking any chances we could repeat the output, get the same prices we got last year and produce the same margin of $60,000,000 this year.

"Holding to that policy might be in the interest of the manufacturers of some other line of automobiles, but at this time we are interested in the manufacture of Ford cars, in the people who look to us for their cars and the men and women who look to us for employment.

"Dodge Brothers say I ought to continue to ask $440 for a car. I don't believe in such awful profits. I don't believe it is right.

"So, would I be serving the interest of our firm best by holding up the price because the manufacturer of another automobile wants us to or by reducing the price in the interest of our own customers, our own employes and our own business standing and profit? I think I am right in my policy.

"Again they contend in their bill of complaint that if we keep on increasing the output and reducing the price we will be able to make them cheaper and cheaper so that we will have a practical monopoly of our line of the business.

"Did you ever before in your life hear of any concern being complained of as 'violating state, federal and common laws,' because the goods were sold at too low of a price, as the Dodge Brothers allege we are doing.

"The bane of monopolies as I understand it is in getting control of goods and making the price unreasonably high. I venture to say that when the force of the paragraph of their contention strikes the average citizen or the men who drew it up it will be looked on as one of the huge jokes of the industrial world. Think of it! Trying to make us a public menace because we sell our goods at too low a price to suit them!

"But as a matter of fact, there is the most intense competition in the automobile business, and every cut we make is in the interest of the public, because it forces our competitors to their best effort and highest efficiency which really produces healthy competition resulting beneficially to the public in general.

"They complain because we are getting ready to expand our business at the end of the war, when no one will know what the conditions will be. Well, we expanded our business before the war, we expanded our business during the war, and we are preparing to expand our business after the war; we are getting ready to expand it on a secure, safe, progressive basis—that is

just why we are using some of the surplus we have, to make our cost of production so secure on the present basis or less, if any difference that there will be no break in our success.

"And how do we propose doing it? First, we are going to expand by increasing output of our present models and then by making trucks. No sane business man will deny that there is a great demand for trucks of the type we are building and at the price we will be able to offer them. Is it reckless to furnish an article for which there is a sure demand, when you can do so at a reasonable profit? We are using some of our money to expand that branch of the business which will employ something like 10,000 men.

"Again, our present cost of production is based on our present contracts for our supply of steel. It is true that our contract price is below the present market price, but we are protected by the contracts for three years on some of our essential materials, and for one year on the remainder. Is there any sane man who expects steel to go up after the war? If we were to continue to buy steel wouldn't it be reasonable to expect a decline after the warring nations stop drawing on this country for the enormous amounts for military purposes.

"But we don't propose taking any chances, even on that. We intend making our own iron. We have already contracted for blast furnaces to be built at the River Rouge. They will be followed by mixers, which will insure us an even grade of iron by a simple process, a plant so modern and complete, so conveniently arranged that we will be able to get our iron even below our present price, and I hope out of it to be able then to afford a still further reduction in the price of the car.

"We are now buying 600 tons of iron a day, which under present methods has to be melted twice, once by the maker of the iron and once by us. In making the iron ourselves we intend running it right through in one melting, which everyone must know will make a good saving.

"No man who has any understanding of business can keep his face straight and say that it is against the interest of a business concern to prepare for its future supply of materials and to produce them itself at a saving and keep out of the hands of a trust manipulated from Wall street.

"Why, we used to buy many millions of dollars worth of our parts from Dodge Brothers themselves. It was on the profits of their sales to us that they built their enormous plants. We are now making the parts ourselves at an enormous saving and are giving our customers the benefit of that saving in the reduced

price of the car. And will it be a bad business move if we save still more money for our customers and our laborers and ourselves by making our own steel? To deny that it is good business isn't using ordinary common sense.

"The charge that we are going into the mining business isn't true. I thought at one time that we might have to, but have had a thorough investigation made and have concluded that there is competition enough in the output of the mines to enable us to buy ore at reasonable prices so reasonable that I don't deem it good business judgment to buy mines now. If conditions should change I shouldn't hesitate to go into that branch too, or any branch that would help us to produce a cheaper and better car.

"There is a complaint as to the amount of surplus cash we carry. That amount has been as high as $52,000,000 at the close of the fiscal year. We did a business of $206,000,000 last year and I don't think our surplus is any too large to carry that amount of business and our continually expanding trade. It is our aim to safeguard our business in every way, and I am of the old-fashioned idea that having money in the bank for use at the time of large purchases of materials and other times is a wise policy.

"I have always wanted to have enough cash to swing our purchases without borrowing. I have always been opposed to going to Wall street because I don't want them to get our hide. We are not afraid of them because we have the cash assets. They enable us to get all our materials at the lowest prices.

"How much money did Dodge Bros. ever put into the business?" Mr. Ford was asked.

"Ten thousand dollars, but I don't think any of it was in cash. There may have been a check for some—the books will show that—but my recollection is that it was largely if not entirely put in work."

"And what dividends have they had on that?" was asked.

Mr. Ford consulted the bookkeeping departments and replied: "They were in at the start, and they have had dividends since 1908, amounting to a total of $5,671,500 in cash paid to them. They have already drawn that amount out in profits for their ten thousand dollar investment, and still have a 10 per cent interest in the business, which they claim is worth $50,000,000 for their share.

"I don't think they can complain any on a policy of 'expansion' when that expansion has enabled them to draw over

five and a half million on ten thousand and still have holdings worth $50,000,000 on their own valuation.

"Besides that during this time we have paid them over $27,000,000 in cash for materials and parts made for us, on which I believe they made a profit of at least $10,000,000, and it is on the profits of these payments and the dividends drawn from the Ford Motor Co. that their present large fortune is built.

"They say my course is likely to injure them. They own 10 per cent of the stock and I own 58 per cent. I can't injure them $10 without at the same time injuring myself $58, and I don't think any one can reasonably accuse me of pursuing such a course. My present course is precisely in line with what we have been doing in the past, and nowhere near as venturesome."

Alfred Lucking, the general counsel for the Ford company, was asked for a further expression regarding the suit. He said:

"I don't care to discuss the case out of court; but in view of the publication heretofore made will say The Ford Motor Co. is one of the most successful and best managed institutions in the world. This is conceded everywhere. The present plan of expansion is strictly in line with all its past methods. In view of such record and such results, for a court to interfere would be contrary to all precedents and the simplest elemental law.

"One other thing, Mr. John F. Dodge is an intense partisan of Mr. Hughes, actively engaged in politics at the present time, and I have received absolutely reliable information which I believe to be true that this suit was started by Mr. Dodge just at this particular juncture for political purposes."

Ford Denies Recklessness

Asserts He Cannot Hurt the Dodges Without Injuring Himself.

N.Y. Times (1851–2009), Nov. 5, 1916, at E9.

DETROIT, Nov. 4.—Henry Ford, in a statement made public here today, denied that his plans for greatly expanding the Ford Motor Car Company's business could be considered "reckless and unwise." His statement was in reply to the temporary injunction which Horace and John F. Dodge, automobile manufacturers, obtained against the Ford Company last Thursday, restraining the company from using its assets to develop its business along lines recently announced by Mr. Ford.

In their petition, the Dodge brothers, who own ten per cent. of the Ford Motor Car Company's stock, demanded that most of the company's immense surplus should be paid out in dividends to stockholders. They alleged that Mr. Ford's plans to buy iron mines, establish blast furnaces on the Detroit River, near here, and double or triple the capacity of the Ford plant in Detroit, were "reckless and unwise."

Mr. Ford asserted in his statement today that the keynote of his company's success has been its ability to sell a tremendous number of automobiles at a small margin of profit on each car. This idea, he said, was to be carried out in his expansion plan. Speaking of the Dodge brothers' assertion that the proposed plan would bring financial injury to them, Mr. Ford said:

"They own 10 per cent. of the stock and I own about 58 per cent. I can't injure them $10 worth without at the same time injuring myself $58."

The injunction case is to be heard here on Nov. 11. It has temporarily tied up about $52,000,000, and seeks to compel Mr. Ford to distribute about $39,000,000 of this amount in dividends.

Transcription of Dodge v. Ford: *Cross-Examination of Henry Ford*[*]

By Mr. Stevenson:[*]

Q: Mr. Ford, you are the president of the Ford Motor Company?

A: Yes, sir.

Q: And have been how long?

A: Five or six years.

Q: What?

A: Six or seven years, I guess.

Q: How long?

A: Six or seven years.

Q: Six or seven years. You are one of the original incorporators?

A: Yes, sir.

Q: How much of a stock holding did you have in the organization of the company?

A: 25 and one-half per cent., I think.

. . . .[*]

Q: Now, let us see; you received a letter from Dodge Brothers on or about the 23rd of September, didn't you, asking that this cash, or a large part of it, be distributed as dividends?

A: I think so.

Q: Why didn't you answer that letter?

A: I did answer the letter.

Q: How long afterwards?

A: Shortly after.

Q: How long after?

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[*] Transcript of Record at 140, 159–67, 210–11, 213–30, 281–88, 303–16, 333–37, 354–55, 356–58, 397–404, Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1918) (No. 47) (from State of Michigan, Circuit Court of Wayne County; cross-examination of Ford). The excerpts contained herein represent portions of the transcript that are most relevant to the discourse on Corporate Social Responsibility. The page ranges that follow indicate where the testimony appears in the official transcript.

[*] The following section can be found on page 140.

[*] The following section is excerpted from pages 159–67.

A: I don't know, but it is all a matter of record; you can easily find out.

Q: But I want your recollection of it.

A: I don't recollect.

Q: Now, you received the letter on the 23rd of September, didn't you?

A: Possibly.

(Papers were produced, and handed to the witness)

Q: You read that letter and see if that is a copy of your letter.

A: Of my letter?

Q: Yes.

A: Well, this, you can compare it with our copy.

Q: If you have got a copy, let us see the copy.

Mr. Stevenson: I will read the first letter, to refresh your recollection, Mr. Ford.

"Detroit, Mich., September 23, 1916.

Mr. Henry Ford,

President Ford Motor Company,

Detroit, Mich.

Dear Sir:

We have for some time, as you know, been endeavoring to make an appointment to see you, for the purpose, as you assumed, and informed one of your associates, of discussing the affairs of the Ford Motor Company, from the standpoint of our interest as stockholders, and with a view of securing action by the board of directors looking to a very substantial distribution from its cash surplus as dividends."

Q: That was true, wasn't it?

A: Yes.

Q: What I have read; he answered, yes.

A: Yes.

Q: Not having been able to make—

A: That letter is a correct copy of the letter I had.

Q: That is a fact, is it not?

Mr. Lucking: What is a fact?

Q: "We have for some time, as you know, been endeavoring to make an appointment to see you, for the purpose, as you

assumed, and informed one of your associates, of discussing the affairs of the Ford Motor Company from the standpoint of our interest as stockholders—"

A: If that is an exact copy of the letter, I received, it is.

Q: Don't get excited. You knew that Dodge Brothers had been endeavoring to make an appointment to see you about dividends, didn't you?

A: I knew that Dodge Brothers had been making—

Q: Had been endeavoring to make an appointment to see you about dividends?

A: Before the letter was written?

Q: Yes.

A: No, sir.

Q: Didn't you tell Mr. Couzens that you knew that they wanted to see you about the question of dividends, or that they had been phoning, and that you had not seen them?

A: I told Mr. Couzens that they wanted to see me about selling their stock to me.

Q: You did?

A: Yes.

Q: When? When did you tell him that?

A: I don't remember when I told him that.

Q: But you told him that?

A: Yes. I never knew— I never told Mr. Couzens anything about dividends.

Q: You didn't tell him anything about dividends?

A: Not that I know of.

Q: What did you think they wanted to see you about? Not about dividends, but to sell their stocks, was it?

A: To sell their stocks.

Q: Not dividends?

A: No.

Mr. Stevenson: "Not having been able to make an appointment to discuss the matter with you personally, we very much desire to do, we write you this letter upon the subject.

"The condition shown by your recent financial statement—showing approximately $60,000,000 of the net profits for the past year, and cash surplus in banks exceeding $60,000,000—it seems

to us would suggest, without the action being requested, the propriety of the board taking prompt action to distribute a large part of the accumulated cash surplus as dividends to the stockholders to whom it belongs."

Q: Do you recall that[?]

Mr. Lucking: Recall what?

Q: That part of the letter?

A: If it is a copy of the letter that I received—

Q: Mr. Lucking says it is.

Mr. Lucking: Yes, Mr. Ford received the letter.

A: If I received the letter—

Q: You received it, now, Mr. Lucking says so; did you?

A: Yes. I haven't denied that I received the letter.

Q: Your reply to that letter, Mr. Ford, is dated October 10th?

Mr. Lucking: No, September 23rd.

Q: No, it is not; it is October 10th.

Mr. Lucking: I beg your pardon; that is right. You are right.

Q: It is as follows:

"Detroit, Mich., Oct. 10th, 1916.

Messrs. John F. Dodge and H. E. Dodge,

care Dodge Brothers Motor Company,

Detroit, Mich.

Dear Sirs:

I beg to acknowledge due receipt of your letter of September 23rd."

Q: Is that right?

A: Yes, sir.

Q: Then you waited from September 23rd to October 10th before you even acknowledged receipt of the letter, didn't you?

A: Possibly, if it so states there.

Q: "—and to say that it would have been answered before this, but for my absence from town for a considerable length of time, and pressure of other matters.

"It seems to me in view of all the conditions of business, and other extensions which have been determined upon for so long a time—"

Mr. Lucking: "Our extensions."

Q: What?

Mr. Lucking: "Our extensions;" not "other." In the bill of complaint, our copy, it says "our extensions."

Q: Here it says, "and other extensions." It doesn't make much difference; it isn't important, however.

"It seems to me, in view of all the conditions of business, and other extensions, which have been determined upon for so long a time—"

Mr. Lucking: "Our" is the correct word.

Q: I said "other." It isn't important.

"So long a time past, and to which we have been working, that it would not be wise to increase the dividends at the present time."

That was your position, wasn't it?

A: Yes.

Q: What were the dividends at that time, the regular dividend of five per cent, per month, payable quarterly, wasn't it?

A: Yes.

Q: And when you received this letter, you informed Dodge Brothers, that according to your policy, it wasn't wise to pay any more dividends. Just answer, so the stenographer will get it. Answer.

A: Yes, sir, according to the letter.

Q: Was that according to the fact?

A: Certainly.

Q: Certainly; it was according to the fact?

A: Yes.

Q: So that you made up your mind not to pay any more dividends except the regular dividends, for the present, at least, hadn't you?

A: For the present, yes, sir.

Q: For how long? Had you fixed in your mind any time in the future, when you were going to pay—

A: No.

Q: That was indefinite in the future?

A: That was indefinite, yes, sir.

Q: And might be some time, might or might not be in the future, as the circumstances might develop?

A: Yes.

Q: But for the present, on October 10th, the policy that you had decided upon, was not to pay any more dividends, except the regular five per cent. a month?

A: Right then I think so, yes, sir.

Q: Had you made up your mind to pay at any time in the future?

A: Certainly.

Q: When?

A: Always.

Q: Had you in mind to pay it this year?

A: Yes, sir.

Q: You said a few minutes ago that you had not any definite time in mind in the future, but at some time when the circumstances warranted the paying of dividends; but for this year you had decided not to pay any more than the regular dividend.

A: Not this year; not this year.

Q: Did you indicate that, had you decided to pay any dividends this year?

A: In the letter, you mean?

Q: Yes, at the time you wrote the letter:

A: Yes.

Q: What?

A: No.

Q: No, you had not; you told them, so far as they could judge from your letter, of your fixed policy not to pay any more dividends but the regular dividend.

Mr. Lucking: I object to that; the letter speaks for itself.

A: It is all in the letter.

Q: I am asking you what you meant by that letter, Mr. Ford.

A: What we meant by the letter?

Q: Yes.

A: We meant just what it said.

Q: That you had decided not to pay any more dividends, but the regular dividends?

A: At that time, yes, sir.

Q: And that you had not in mind any definite time in the future, as to when you were going to pay any dividends?

A: No, I guess not.

Q: And you had decided that you were going ahead and spend all the money that was available, for extensions?

Mr. Lucking: I object to that; it doesn't say that.

Q: What?

A: We had not spent any money.

Q: You hadn't spent any money?

A: No.

Q: On October 10th you had not spent any money?

A: Not very much.

Q: But you had decided on spending the money?

A: Decided to bring it up to the board.

Q: You had decided on spending it, hadn't you?

A: As far as I was concerned, yes.

Q: So far as you were concerned; you were pretty nearly "it" in the Ford Motor Company, weren't you?

A: No, sir.

Mr. Lucking: He ought to be; he owns 58 per cent of the stock.

Q: Take that down.

Mr. Lucking: He ought to be; he owns 58 per cent. of the stock. What do you want? I suppose that every corporation did—

Q: I am very glad to have that; he has got a lot of dummies on his board of directors. You admit it. That is just what we have alleged.

A: You will find out whether I have dummies or not, before we get done.

Q: We will see as to how much dummies the rest of them are, and when you pull the string, how quick they jump.

. . . .*

Q: You are familiar with the pig iron market, of course, and have been during the past few years?

A: Oh, yes.

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* The following section is excerpted from pages 210–11.

Q: You know, don't you, Mr. Ford, that up to the time the war commenced, that the market price of pig iron was less than the cost of production, don't you?

A: We are not going to—

Q: Just answer the question.

A: We are not going to make pig iron.

Q: You are not going to make pig iron at all?

A: No, sir.

Q: How are you going to make any other iron, without making pig iron?

A: Because we are going to try and work out a new scheme.

Q: You are going to try and work out a new scheme?

A: Yes, sir.

Q: Tell us, let us know about your new scheme?

A: I did start to tell you a little while ago.

Q: If I stopped you, start again.

A: Yes. We are going to make iron out of ore, directly out of ore, melted out of ore, and we are going to use it to cast our cylinders, and our castings, and use our scrap, and use our material up, and to make the castings directly from the ore; and we are going to get uniform castings, which has never been got where we melt pig iron in eleven or twelve cupolas at the factory. We take the pig iron and mix it with something, mix it with our borings, and stuff, and we never get a uniform casting. We have a great waste, and a great loss, from our castings, because the cupolas are a very poor thing to melt iron in. The wrought iron comes down first, and we never get a uniform casting.

In this new scheme, we are going to melt the iron directly out of the ore, and run it into a mixer, and we are going to get a uniform mixture with proper analysis, and turn it directly right into castings right there, and save a great deal of money by doing it, reduce the cost of the car, and get an absolutely strong iron metal.

Q: Who is doing that sort of thing now?

A: Nobody.

Q: Nobody?

A: No.

Q: You are going to experiment with the Ford Motor Company's money, to do it, are you?

A: We are not going to experiment at all; we are going to do it.

Q: Nobody yet has ever done it?

A: That is all the more reason why it should be done.

Q: Therefore, you are going to undertake to do something that nobody else has done, that nobody else have even tried to do?

A: Oh, certainly. There wouldn't be any fun in it if we didn't.

Q: You are going to find some fun in it?

A: Yes, certainly.

Q: But at the expense of the Ford Motor Company?

A: That is all I am working for at the present time, is to have a little fun, and to do the most good for the most people, and the stockholders.

Q: I understand that is the principal thing that you have in mind, doing the most good for the most people?

A: And the stockholders, and everybody.

. . . .*

Q: On the production of the 500,000 cars in the fiscal year, 1915, and '16, the Ford Motor Company made a net profit of $60,000,000, in round figures?

A: Yes.

Q: That was with the manufacturing capacity, so far as the plant and facilities are concerned, as they existed during the year 1915, and '16 of course?

A: Yes.

Q: And before these enlargements were taken into account, so far as the production was concerned?

A: Yes, sir.

Q: To what extent have you considered the necessity for increased facilities for production of cars?

A: We expect to increase it double.

Q: To double; that is, you produced 500,000 cars, with the old plant, as we speak of it, as up to July 31st, 1916?

A: Yes, sir.

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* The following section is excerpted from pages 213–30.

Q: And you are duplicating that plant, or more than duplicating it?

A: About duplicating it.

Q: Your policy is to increase the production to a million cars per annum?

A: Yes, sir.

Q: Yes. You are not satisfied with producing five hundred thousand cars per annum?

A: The demand was not satisfied.

Q: The demand was not satisfied?

A: No.

Q: Do you mean that the Ford Motor Company during the year 1915 and '16, when it produced and sold 500,000 cars, could not meet the demand?

A: Could not quite meet the demand; and, besides, we left the price—

Q: What is that?

A: We left the price as it was the preceding car.

Q: That is, you left the price in 1915 and '16 the same as the year 1913 and '14?

A: Left the price the same in 1916.

Q: What?

A: We left the price the same in 1916 as we did in 1915.

Q: Your fiscal year ends July 31st, 1916?

A: Yes, sir.

Q: So that year would include from July 31st, 1915, to July 31st, 1916?

A: Yes, sir.

Q: And you left the price of the car—

A: Yes, sir.

Q: The same for 1915–16 as for 1914–15?

A: Yes; for the purpose of accumulating money to make these extensions.

Q: You found that even with the old price, and the increased production to 500,000 cars a year, you were unable to keep up with the demand for the car?

A: Just about.

Q: Just about?

A: Yes.

Q: So far as your experience of 1915 and '16 was concerned, you had good reason to believe that you could duplicate the production and sell it at the same price during the next year, didn't you?

A: Yes, but that isn't our policy.

Q: Well, that is, you are satisfied you could do that?

A: No, we couldn't do it.

Q: What is that?

A: No, we couldn't do it; not keep the same price.

Q: Not, and produce the same number of cars?

A: Not and keep the same price.

Q: Why not?

A: Because the price was too high.

Q: Well, you could not meet the demand the year before, you say?

A: That has been always our policy, to reduce the price.

Q: I am not asking you about your policy now; I am asking you about the facts. You have told us both ways about it. You told me first that you had no reason to think that you could not sell 500,000 more cars this year, at the same price you sold them last year?

Mr. Lucking: No, he did not.

A: I didn't say that.

Q: Which way, then, will you have that?

A: Perhaps I did not understand it.

Q: What is that?

A: Perhaps I didn't understand it.

Q: You didn't understand it?

A: I perhaps didn't understand what you meant.

Q: Didn't you tell me that you were unable to meet the demand last year?

A: No, I didn't tell you we were unable to meet the demand last year.

Q: You didn't tell me that? Let's test it. Just go back there and see what he said.

(Testimony was read by the reporter).

A: I will let you do a lot more of the talking, and I will be careful about answering.

Q: Oh, you will! Now, will you tell us which way it is.

A: You ask the questions and I will tell you.

Q: You said, in answer to my question, that you produced 500,000 cars, and that they did not meet the demand; was that true, or wasn't it?

A: When?

Q: The year that this financial statement that we have referred to, covered and represented.

A: 1916 was the financial statement.

Q: Do you call that the 1916 business?

A: Yes.

Q: We will call it the 1916 business; then, for the year of 1916, you produced 500,000 cars, and you sold them?

A: Yes, sir.

Q: And you said that didn't meet the demand, those 500,00[0] cars?

A: Not quite.

Q: Not quite; so that you had no reason to believe, from the experience of 1916, that you could not sell 500,000 more cars in 1917?

A: No.

Q: At the same price, had you?

A: Yes, sir, we did.

Q: What reason did you have?

A: The price was too high.

Q: Why was the price too high, if you were able to sell them?

A: Because we looked ahead to know what we could sell the next year.

Q: How could you know what you could sell the next year?

A: Just from the way we run our business.

Q: Tell us that secret, how you judge, when you were able to do it in 1916, you were not able to meet the demand, that you could not do it the next year?

A: The only thing that makes anything not sell is because the price is too high.

Q: Was the price any higher than it was in 1913?

A: It was about the same price; I don't remember.

Q: Three years ago the price was higher than it was in 1916, wasn't it? Wasn't it?

A: Yes, I think so.

Q: It was higher still in 1910?

A: Yes, sir.

Q: Now, didn't every customer of the Ford Motor Company who bought a car in 1916 get just as good a car, and just as good value as they did in 1912 when they paid a higher price?

A: What are we there for?

Q: Just answer the question? I am not asking what you were there for.

A: I don't understand the question.

Q: Read it, please.

(The question was read by the reporter).

Mr. Lucking: Yes, and they sold more of them, to, because they reduced the price.

Mr. Stevenson: Just put that in.

Mr. Lucking; Because they reduced the price, and they sold more.

Q: What do you say to that, Mr. Ford?

A: I don't quite understand what you are trying to get at.

Q: You say that you sold 500,000 cars in 1916?

A: Yes, sir.

Q: And you sold in 1912 a less number of cars, at a higher price, in 1912?

A: Yes, sir.

Q: In 1913?

A: Yes.

Q: And you sold a less number of cars in 1910 at a still higher price?

A: Yes; and, I think, six or seven years ago, the same car, we got $900 for it.

Q: Now then, I ask you if every customer of the Ford Motor Company of 1916 did not get just as good a car, and just as good value as the customer who paid a higher price in 1912 and '13?

A: He got a better car.

Q: He got a better car, and he got it for a less price?

A: Yes, sir.

Q: And yet you say that you could not conscientiously think of making as much profit as you were making in 1916, in selling the Ford Motor Company car, didn't you?

Mr. Lucking: When has he said that:

Q: In Mr. Pipp's editorial.

Mr. Lucking: You better read his exact words.

A: I don't remember.

Q: Don't you recall that?

A: I don't understand you.

Q: You don't recollect that?

A: I don't say that. I don't understand what you are trying to get at.

Q: You don't? Whose statement was that, yours or Mr. Pipp's.

A: A combination statement, I guess.

Q: A combination. You ought to recollect what part of it was yours, wouldn't you.

A: I don't try to recollect anything that I want to forget. I only try to touch the high spots.

Q: Just the high spots?

A: Just the high spots.

(Interruption).

Q: What I have reference to, Mr. Ford, is the statement contained in your published statement in the Evening News a week or so ago. "Bear in mind, every time you reduce the price of the car, or reduce the quality, you increase the possible number of purchasers. There are many men who will pay $360 for a car who would not pay $440. We had, in round numbers, 500,000 buyers of cars on the $440 basis; and I figure on the $360 basis, we can increase the sales to possibly 800,000 cars for the year; less profit on each car, but more cars, more employment of labor; and anyway, we will get all the total profits that we ought to make. And, let me say right here, that I do not believe we should

make such awful profits on our cars. A reasonable profit is right, but not too much. It has been my policy to force the price of the car down as fast as production would permit."

And so forth. Is that your statement?

A: Yes.

Q: Then your conscience would not let you sell cars at a price that you did last year, and make such awful profits? That is what you said, isn't it?

A: I don't know that my conscience has got anything to do with the case.

Q: Why did you say that it wasn't right to get such awful profits, if it wasn't your conscience?

A: It isn't good business.

Q: It isn't good business. That is what you were thinking about, was it?

A: It isn't good business for the institution.

Q: Was that all you thought about when you said it was not right?

Mr. Lucking: That is objected to as immaterial.

Q: Another place, "Dodge Brothers say I ought to continue to ask $440 a car. I don't believe in such awful profits." That is what you stated, wasn't it? "I don't believe it is right." Was that your testament, or wasn't it, or was that Mr. Pipps?

A: You seem to be using the News for a Bible; I guess that's all right.

Q: That seems to be your Bible.

A: Yes, sure.

Q: Yes, sure it does. Does that express your sentiments now?

A: It did then.

Q: Have you changed your sentiments since then?

A: I don't know; I haven't thought about it since.

Q: You haven't thought about it since. You don't know now whether these are your sentiments or not?

A: No, not altogether.

Q: When would you be able to tell whether you have changed your sentiments, or not?

A: My mind changes quite often.

Q: What is that?

A: My mind changes quite often.

Q: Your mind changes often. Now, I will ask you again, do you still think that those profits were awful profits, and not right?

A: Well, I guess I do, yes.

Q: You still do?

A: Yes.

Q: And for that reason you were not satisfied to continue to make such awful profits?

A: We don't seem to be able to keep the profits down.

Q: You are not able to keep them down; are you trying to keep them down? What is the Ford Motor Company organized for except for profits, will you tell me, Mr. Ford?

A: Organized to do as much good as we can, everywhere, for everybody concerned.

Q: Do you know anything in the law that discusses anything about doing people good, in connection with the manufacture of automobiles, or any other manufacturing business?

A: I don't know very much about law.

Q: You don't know much about it. You didn't object, in the beginning, to have pretty satisfactory profits, did you?

A: We needed them.

Q: You said that Dodge Brothers drew out $5,000,000 in dividends, didn't you?

A: Yes, sir.

Q: While they drew out five million dollars, you drew out twenty-five million dollars, didn't you, and more, too, thirty million dollars?

A: Yes.

Q: We will go back to that just a minute. You started out with a model of a car?

A: Yes, sir.

Q: That is what you started with, wasn't it, Mr. Ford?

A: Yes, sir.

Q: Yes; and a pretty poor model at that, wasn't it?

A: It seemed to sell, all right; it would sell, though.

Q: Sold after it was made; but who made it?

A: We made the first model ourselves.

Q: Who made the first cars that you sold?

A: Dodge Brothers made part of them.

Q: Dodge Brothers made the car?

A: Made part of it.

Q: What part of it did they make?

A: The motor.

Q: What else?

A: The frame.

Q: They made the whole thing, except the tires and the body, didn't they?

A: From our drawings, yes.

Q: And they made a car you were able to sell, too, didn't they?

A: From our drawings.

Q: From your drawings; they made a car that you were able to sell?

A: Yes, sir.

Q: You didn't pay any attention to it. And where was your plant, your big plant, in those days?

A: Which days?

Q: When you started the business in 1903?

A: On Mack avenue.

Q: What kind of a plant did you have?

A: A barn, I guess.

Q: You had a barn. Mr. Streelow's carpenter shop, wasn't it?

A: I guess it was.

Q: Mr. Streelow's carpenter shop. Dodge Brothers made the completed car, except the rubber tires and the body; and that was taken up to Mr. Streelow's carpenter shop, and the body was put on the car, and then your selling agent sold it?

A: Yes, sir.

Q: That was the history of it, wasn't it; Dodge Brothers had to equip their plant to produce those cars, too, didn't they?

A: I guess they must have.

Q: And jeopardized everything they had in the world, didn't they, in the start, to make those cars, didn't they?

A: If you think so, yes.

Q: What is that? I am asking you what you think about it; you know about it.

A: I don't know what they jeopardized.

Q: You don't know what they jeopardized?

A: No.

Q: You didn't jeopardize anything, did you? Didn't have anything to jeopardize, did you?

A: Well—

Q: What is that?

A: We had our drawings and plans to jeopardize.

Q: You did? How were you going to jeopardize those?

A: We gave them up to be manufactured.

Q: Is that the way you jeopardized them?

A: If they jeopardized anything, we jeopardized those.

Q: Didn't they have to equip a machine shop to manufacture those cars?

A: I guess they did.

Q: You guess they did; you know they did, don't you, Mr. Ford?

A: Yes.

Q: And they had to buy machinery?

A: Yes.

Q: And wasn't the extent of the purchases they had to make on that account, in their situation, jeopardizing everything they had, if that had not been a success?

Mr. Lucking: I object to that; that is ancient history.

A: You can find that all upon the records.

Q: You can find it on the records?

A: Yes.

Q: What is upon the record about the Dodge Brothers jeopardizing their business in undertaking the manufacture of these cars, that had never been developed at all?

A: You can find out what they done.

Q: What is that?

A: You can find out what they did.

Q: You can find out what they did?

A: Yes.

Q: You know what they did, don't you?

A: I guess I did at the time.

Q: Have you forgotten what they did?

A: Quite a lot of it; yes, sir.

Q: A lot of it?

A: Yes, sir.

Q: You have forgotten, have you, that they produced the cars that were sold, to bring the money to make the Ford Motor Company a success, have you?

A: No, sir.

Q: No. There isn't any doubt about that, is there?

A: No.

Q: Yes, you talk in this article as though they were stealing something from you, when they wanted a part of what belongs to them. They have got or they own a ten per cent interest in your property, in that property, don't they?

A: Yes, sir.

Q: They didn't steal it, did they? I said, they didn't steal it, did they?

A: I didn't say that anyone stole anything.

Q: What? You tried to make out that they were ingrates because they wanted a share of the profits that belonged to their property, didn't you?

Mr. Lucking: I object to that. The article hasn't any such language in it at all.

Q: Well, we will construe this matter at a later period. Have you ever been offered anything for your property.

Mr. Lucking: He has had phoney offers, perhaps. I object to this as immaterial.

The Court: Answer the question.

Q: Answer the question, Mr. Ford.

A: I have had some phoney offers, I suppose.

Q: "Phoney offers"?

A: Yes, sir.

Q: What was the kind of phoney offer that you had? You heard Mr. Lucking say "phoney offers," didn't you?

A: Certainly.

Q: And so you say "phoney offer"?

A: Yes, sir.

Q: Who made the offer?

A: I don't remember who made it.

Q: What was the offer?

A: Well, there have been offers at different times.

Q: What were the offers at different times, then?

A: I don't remember.

Q: Can't you recollect anything about what you were offered?

A: No.

Q: Was it a hundred million?

A: It may have been over that.

Q: Was it two hundred million?

A: Might have been; I think it was somebody who wanted to know if I would take two hundred million dollars for it.

Q: Two hundred million dollars for your interest in it?

A: Yes, sir.

Q: Who was that somebody?

A: I don't remember.

Q: Where was it?

A: I think it was in the factory.

Q: What did you reply to them when you were asked if you would take two hundred millions dollars for your 58 per cent?

A: I said that it wasn't for sale.

Q: You wouldn't take it?

A: No; it wasn't for sale.

Q: Did you consider it worth that?

A: I di[d]n't say anything of the kind. I said it was not worth—and I said it was not for sale.

Q: It wasn't for sale. You didn't say anything about what it was worth?

A: No.

Q: But when you were asked if you would take two hundred million dollars, you said you would not?

A: I said it wasn't for sale.

Q: It wasn't for sale. You intended that as a refusal of any further negotiations, didn't you?

A: I just simply said it wasn't for sale.

Q: It wasn't for sale; what do you mean by that?

A: You can draw it out just the same as I can draw it.

Q: Did you understand that this party was willing to pay you two hundred million dollars for your interest?

A: I didn't give it any thought.

Q: Didn't give it any thought, just said it wasn't for sale?

A: Yes, sir.

Q: Why wasn't it for sale? You started in to make money, didn't you?

A: Because I wanted something to work at.

Q: You started in it to make money, didn't you? That was what the company was organized for, wasn't it?

A: I didn't give it very much thought.

Q: You didn't give it any thought?

A: About making the money.

Q: You got a lot of money out of it, didn't you?

Mr. Lucking: I object to that.

A: Yes, I have.

Q: You are still making money, I suppose?

A: Just because we didn't have money in mind, I guess.

Q: Just because you didn't have money in mind. What is your policy about this business, Mr. Ford?

A: In what respect?

Q: You say you do not think it is right to make so much profits? What is this business being continued for, and why is it being enlarged?

A: To do as much as possible for everybody concerned.

Q: What do you mean by "doing as much good as possible?"

A: To make money and use it, give employment, and send out the car where the people can use it.

Q: Is that all? Haven't you said that you had money enough yourself, and you were going to run the Ford Motor Company thereafter to employ just as many people as you could, to give

them the benefits of the high wages that you paid, and to give the public the benefit of a low priced car?

A: I suppose I have, and incidentally make money.

Q: Incidentally make money?

A: Yes, sir.

Q: But your controlling feature, so far as your policy, since you have got all the money you want, is to employ a great army of men at high wages, to reduce the selling price of your car, so that a lot of people can buy it at a cheap price, and give everybody a car that wants one?

A: If you give all that, the money will fall into your hands; you can't get out of it.

Q: You think, if you do all that, it will fall into your hands? How many people are there in the United States?

A: You ought to know.

Mr. Lucking: I object to that as immaterial.

Q: Don't you know?

A: About a hundred million, I guess.

Q: What proportion of them are men who are in business, or earn a living by labor? About one-fifth?

A: About that, I guess.

Q: About a fifth?

A: Yes.

Q: So, out of the entire population of the United States, there are, in round numbers, twenty million of people who are men, laboring men, mechanics, farmers, business men, clerks, and other people, who earn their living, and some people who don't. That is about right, isn't it?

A: Yes, I guess so.

Q: Yes. How many Ford cars are there on the market in the hands of the public now?

A: I don't know.

Q: About how many?

A: I know about how many we have sold.

Q: About how many have you sold?

A: A million and a half, about, I guess.

Q: A million and a half?

A: Yes.

Q: Then, if you are going to produce a million cars a year, one out of every twenty of the men in this nation, whether they are laboring men or mechanics, whatever they be, have got to buy a Ford car, haven't they?

Mr. Lucking: I object to this discussion of business policies. This is up to the board of directors of this company, if the court please.

Mr. Stevenson: This is the board of directors right here.

Mr. Lucking: It isn't up to you, anyhow.

(The question is repeated.)

Mr. Lucking: I object to that as simply a problem in mathematics. Counsel can figure it out just as well as the witness.

Mr. Stevenson: Here is a man, if your honor please, who says he won't distribute any dividends, because he is going to put his money into—

Mr. Lucking: He hasn't said anything of the kind.

Mr. Stevenson: — to carry on this business, expand the business. He has started out on a purely reckless, chimerical, hare-brained scheme to spend the money of these stockholders in a plan that will, of its own force, break down and bring ruin and destruction on every man who has any money invested in it. He is ready to go on with this sort of hare-brained policy.

. . . .*

Q: All right. Now, in making this reduction of eighty dollars a car, Mr. Ford, from the price of $440 a car to $360, I suppose you seriously took into account the effect that was going to have on the business and the stockholders?

A: The effect upon the business and the stockholders?

Q: Yes.

A: We took everything into account.

Q: Did you take those things into account? You knew that on the face of things, it meant a difference of forty million dollars in the selling price of the car, didn't you?

A: No, I didn't know that.

Q: You didn't know that. It was a reduction of eighty dollars a car, wasn't it?

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* The following section is excerpted from pages 281–88.

A: Yes, sir.

Q: And you sold 500,000 cars the year before?

A: Yes, sir.

[Q]: So that on the same production of 500,000 cars, the price being eighty dollars each less, it would equal forty million dollars, wouldn't it?

A: Not with increased efficiency.

Q: I am not talking about efficiency. I am talking upon the face—

A: You asked me if I took everything into consideration.

Q: Now I asked you if you realized that it meant forty million dollars on the same production, difference in the selling price, on the price of the car?

A: I don't know as I ever thought of that.

Q: Never thought of that?

A: No.

Q: A little thing like forty million dollars didn't trouble you?

A: Because it isn't forty million dollars, with increased efficiency.

Q: That was something to be done wasn't it? That was something that you had to do? But, what you actually did by striking down the price of those cars, eighty dollars a car, was to reduce the selling price of the cars as compared with the year before, forty million dollars, wasn't it?

Mr. Lucking: He took most out of his own pocket, didn't he?

Q: Will you answer the question now, Mr. Ford, after you have had the suggestion from Mr. Lucking?

(The question was read by the reporter.)

A: We reduced the price of the car $80.

Q: Did you realize that in reducing the price of the car $80 that you were cutting off forty million dollars on the basis of the production and selling price of the year before?

A: No.

Q: You didn't realize that?

A: No.

Q: You didn't take that into account at all?

A: No.

Q: Why didn't you?

A: Because we increased our efficiency.

Q: How did you increase your efficiency?

A: In every way, in the factory.

Q: How does the reduction in the price of the car increase efficiency?

A: Reduces the cost of selling, for one thing.

Q: How much effect would that have on the forty million dollars?

A: Quite a lot.

Q: How much?

A: I don't know, but a great deal.

Q: By the way, is it true, Mr. Ford, that the Ford Motor Company have required all of their agents to discontinue the sale of any other car?

A: No, it is not true.

Q: That is not true?

A: No.

Q: Are you sure about it?

A: I am sure about that, yes, sir.

Q: You are sure about that?

A: Yes.

Q: Was there any circular sent out to that effect?

A: Not that I know of.

Q: Never heard of that?

A: No.

Q: Now, then, we will go back to that. You say that you did not take into account the fact that—you recognize it as a fact, don't you, that on the sale of five hundred thousand cars, at $360 each, as compared with $440, that it reduces the selling price by forty million dollars, don't you?

A: It reduces the selling price by $80 upon each car.

Q: The selling price on 500,000 cars, reduced $80 apiece, is forty million dollars, isn't it?

A: Oh, I guess so, if you figure it.

Q: Have you any doubt about it?

A: You can figure that out.

Q: Have you any doubt about that?

A: No.

Q: You say you never figured it, never considered it at all?

A: We did not consider it in that way. We considered it by making the place more efficient.

Q: How did you make it more efficient by reducing the price of the car? Just tell us what scheme you have got for increasing the efficiency by reducing the selling price?

A: It costs us less to sell it.

Q: You have told us about that; what else?

A: Efficiency all through the shop, everywhere.

Q: Is it efficiency, reducing the commission? Do you call that efficiency?

A: Commission?

Mr. Lucking: He said efficiency all through the shop.

Q: What efficiency all through the shop is affected by reduction in the price of cars? Tell us, Mr. Ford, please, if you can, in any particular in which the reduction of the price of the car in any way increases or affects the efficiency of the workmen in the plant, or the efficiency of the plant itself. We are waiting, patiently waiting, Mr. Ford, whenever you get ready. Do you want the question repeated?

A: I don't understand the question?

Q: Just repeat it, Mr. Stenographer.

(The question was read by the reporter.)

A: I don't understand the question.

Q: You have said Mr. Ford, that you did not take into account the fact that there was forty million dollars cut off the selling price, when you decided on this; but what you did take into account was that there would be increased efficiency.

A: That is right.

Q: Now, will you tell us in what particular there would be increased efficiency in the production of the car, because of the reduction of the selling price?

A: It makes everybody dig more for the profits.

Q: What is that?

A: It makes everybody dig more for the profits.

Q: Who do you call everybody?

A: The whole factory.

Q: The whole factory; what have they got to do with the profits?

A: Because they know that we have got to have profits.

Q: What is that?

A: They all know we have to have profits.

Q: Is that the best answer you can give to that?

A: Yes, sir, that will do; that will be all right.

Q: Is that the best answer you can give?

A: It will do for me.

Q: What?

A: If it satisfies you, why, it is all right.

Q: I am not to be satisfied; I would like to get you to give me some intelligent explanation of what you have done, Mr. Ford, if you can. Your answer doesn't in any way attempt to give anything intelligent on the subject. If you are satisfied with it, I am.

A: Perhaps it doesn't give you any intelligence.

Q: Perhaps not.

A: Because you are not versed with factory practice, or anything.

Q: Will you tell us again in what respect the reduction in the price of the car increases efficiency?

A: Because it makes everybody dig for profits.

Q: Dig for profits. They have no part of the profits, have they, the men in the shop?

A: No, they don't have part of the profits.

Q: How are they affected by the question of either an increase or reduction; they get so much a day, don't they?

A: They know we have got to make money.

Q: Are you satisfied with that answer?

A: If it satisfies you.

Q: Did you communicate with the men in the shop to that effect, that they had to hustle more, because you had reduced the price of the car?

A: Yes, sir.

Q: They have been hustling about all they could, haven't they? Didn't you claim that the five dollars a day wages, and

eight hours a day, that it made them hustle so that they hadn't any hustle left in them at the end of eight hours?

A: Did I claim that?

Q: Yes.

A: Did I claim that?

Q: Yes.

A: Where?

Q: Everywhere. Isn't that the fact?

A: Did I claim it? You I claimed it?

Q: I don't know whether you did or not; I am asking if you did.

A: No.

Q: Didn't you claim that by reason of increasing the pay of your employes, and reducing the number of hours to eight hours, that they hustled as they did not do before, when they were getting less wages?

A: I did claim that they took more interest in the institution.

Q: Took more interest, and you got better results, more value from their services at five dollars a day, and eight hours, than you got on a less sum, and longer hours?

A: Certainly.

Q: Yes, sir. Isn't it true that when they hustle for eight hours, the way they have to hustle to get that five dollars a day, that there isn't any hustle left in them at the end of eight hours?

A: Do you know anything about the way they have to hustle?

Q: I am asking you; I am not on the witness stand; I am not a manufacturer.

A: I can see that plainly.

Q: I am not professing to take care of all of the people in this world, like you, you know.

Mr. Lucking: You are sneering at these policies that produced all this money in the past.

Mr. Stevenson: I am not sneering at any policy. I believe Mr. Ford is very sincere in his desire to improve the conditions of his men. I am ready at any time to accord him all the credit that it is possible for anybody to have in that line; but I still want to say—

Mr. Lucking: Do you claim, as the president of this company, and the chief stockholder, that he is under a contract to squeeze

every cent he can out of the public, and out of his workmen? Is that your claim?

Mr. Stevenson: I haven't made any such claim.

Mr. Lucking: That is pretty near it, judging from your bill, and from what you have said here.

Mr. Stevenson: I am not called upon to make any claim. I am claiming that it is his duty, as the trustee for the stockholders, to earn all the money that he legitimately can earn for the stockholders.

Mr. Lucking: And get every cent he can out of it?

Mr. Stevenson: I am not saying every cent; every dollar he legitimately can.

. . . .*

Q: You got a letter from Dodge Brothers on or about the tenth of October?

A: Yes.

Q: Saying that there were rumors current that you had very ambitious plans with reference to extensions, and that they had already warned you that, in their opinion, you had no right to make any further extensions, and asking you for information?

A: Yes.

Q: By return mail, as to what you had in contemplation, didn't they?

A: I suppose so.

Q: Why didn't you answer that letter before you did all these things?

Mr. Lucking: The letter was answered.

Q: Just a moment. It has never been answered.

Mr. Lucking: The tenth of October.

Q: Just a minute. It wasn't. I object to your suggesting the answers to the witness, too. I want this to go on the record.

Mr. Lucking: All right.

Q: Why didn't you answer Dodge's letter and tell them what you proposed to do, if you were going—

Mr. Lucking: I object to that, unless the letter is shown to the witness, what letter you refer to.

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* The following section is excerpted from pages 303–16.

Q: Give us the letter of October 11th.

Mr. Lucking: I haven't got it here. You use your copy out of your bill.

Mr. Stevenson (reading):

"Detroit, Mich., Oct. 11, 1916.

Mr. Henry Ford,

President Ford Motor Company,

Detroit, Mich.

Dear Sir:

"We are in receipt of your esteemed favor dated October 10th, acknowledging receipt of our letter of September 23, 1916, and have noted contents of the same.

"Inasmuch as all the directors of the company are accessible and a considerable time has already passed, we would thank you to advise us that an early meeting of the board will be convened to consider the request made by us contained in our letter referred to, dated September 23d.

"Rumors are current to the effect that the company has very ambitious plans for the expansion of the operations of the company under consideration and negotiations looking to carrying them into effect that would involve the disbursement of a large part of the cash assets of the company.

"We would thank you very much to advise us by early mail as to whether there is any foundation for the rumors referred to and what plans for the extension or expansion of the operations of business of the company that would absorb any considerable part of the company's present resources, are under consideration and the status of any negotiations relating thereto. In short, as stockholders, we would ask to be advised promptly as to what plans for the enlargement of the plants, property or operations are underway or under consideration.

"Of course it would be idle to have the board of directors consider the question of disbursing the cash assets of the company in dividends if, before the board has considered our request, the same have been appropriated in the directions referred to.

"We would respectfully urge that we be given a prompt and full reply to this letter."

Q: Why didn't you answer that letter, Mr. Ford?

A: You dig around and see. If you dig deep enough, perhaps, you will find that we did answer it.

Q: Do you claim that you answered that letter?

A: You can dig around and find it.

Q: Do you claim that you answered that letter?

A: I think that we answered the letter, yes, sir.

Q: Mr. Ford, you did not answer the letter; I would ask you for a copy of it.

Mr. Lucking: I beg your pardon; it was answered.

Mr. Stevenson: This is what you claim is the answer, is it (indicating book to Mr. Lucking)?

Mr. Lucking: These two letters and the enclosed minutes and estimates and so on, yes.

Q: Then, Mr. Ford, I will call your attention to that (indicating papers).

A: Yes, I signed that.

Mr. Lucking: Better look it over, to refresh your recollection.

A: You say it is all right?

Mr. Lucking: Look them over, Mr. Ford. Refresh your recollection.

A: There is a lot of stuff here to look over; it is supposed to be kept in one place.

Q: On or about the tenth of November you got the letter that I read, asking you to inform the Dodge Brothers as to what you had in contemplation, about spending this money, didn't you?

A: Yes.

Q: And you said you replied to that letter, and you referred to your letters of November second and November third as replies?

A: Yes.

Q: That is, after you had passed the resolution of the board of directors authorizing the expenditure of money, you then told them what you had done?

A: Yes.

Q: Instead of giving them the information that they asked for before the money was appropriated, as they asked, you went ahead and appropriated the money and then told them what you had done. That was the effect of it, wasn't it?

A: It is all there.

Q: That was the effect of it, wasn't it?

A: It is all there; you can dig it out, and put it in your own language.

Q: I am going to have you dig it out, Mr. Ford.

A: You can put it in any language you like.

Q: You got a letter on October 11th asking you for information as to what you purposed, didn't you?

A: It is all there; dig it out.

Q: Did you get that or didn't you?

A: I suppose I did, if it says so there.

Q: If Mr. Lucking says so, I suppose you did?

A: No.

Q: No?

A: No, if it says so there.

Q: Says so where?

A: Right in that letter there.

Q: "Answering your letter of recent date." That is the letter of November second. The letter of recent date was Dodge Brothers' letter to you, of October 11th, wasn't it? I will repeat what he said:

"We would thank you very much to advise us by early mail as to whether there is any foundation for the rumors referred to, and what plans for the extension or expansion of the operations of business of the company that would absorb any considerable part of the company's present cash resources, are under consideration, and the status of any negotiations relating thereto."

A: Yes.

Q: "In short, as stockholders, we would ask to be advised promptly as to what plans for the enlargement of the plants, property or operations, are under way, or under consideration. Of course, it would be idle to have the board of directors consider the question of disbursing the cash assets of the company in dividends if, before the board had considered our request, the same have been appropriated in the direction referred to."

A: Yes.

Q: Now, then, you waited until the second of November, after you had gone on and appropriated more than twenty million dollars of this money, before you replied to that letter, didn't you?

Mr. Lucking: No, that is not so.

Q: Just a minute.

Mr. Lucking: As to the amount.

Q: What?

A: Just what it says.

Q: Just a moment, now. Put this all upon the record. Mr. Lucking suggests everything for this man to answer.

Mr. Lucking: Why did you say twenty million?

Q: This man echoes just what you suggest, and I want it all on the record.

Mr. Lucking: That is not so; I object to such complicated questions, as to conceal a number of factors in them that the witness is apt to overlook.

Q: We will separate. The furnace plant; you appropriated eleven million dollars for the furnace plant, didn't you?

A: I guess we did, if it says so there.

Q: Without answering Dodge Brothers' letter, so that you might be stopped from doing that, you went ahead and replied to his letter after you had done what he had requested you not to do, didn't you?

A: I don't know.

Q: You got a request on October 11th to advise him as to what you had in contemplation, didn't you?

A: I guess we did.

Q: You ignored it until after you had done what he was protesting against, didn't you?

A: I don't know.

Q: What?

A: It is all there, whatever you can find out.

Q: Isn't that the fact, that your reply, the first reply to that letter, was under date of November second, when you sent him a copy of the proceedings of the board [of] directors, appropriating all this money; that was the first reply you made to that letter?

A: I don't remember; it is all there. Dig it up.

Q: We will have you dig it up now, Mr. Ford.

A: All right, dig away.

Q: If you are so anxious to save time you better answer this question, because I am going to have an answer.

A: All right.

Q: Or else I will have you on the record to show just what kind of a prevaricator you are.

Mr. Lucking: I think that is an outrageous statement of counsel.

Q: It is an outrageous proceedings for this witness, and for you both.

Mr. Lucking: It is an outrageous statement, which you will regret in five minutes.

Q: No, I won't regret it in fifty-five minutes. I want an answer to that question, Mr. Ford.

Mr. Lucking: This i[s] purely argumentative from the facts. He has given you the facts.

Q: Will you read the question.

(The question was read as follows): "Q[:] Isn't that the fact, that your reply, the first reply to that letter, was under date of November second, when you sent him a copy of the proceedings of the board of directors, appropriating all this money; that was the first reply you made to that letter, wasn't it?"

Mr. Lucking: Divide it into three different questions.

Q: I want an answer to that question.

A: Separate it so that I can understand it, and I will answer you.

Q: I am not responsible for your understanding. You can understand the plain English language.

A: You are the only one that can talk plain English language, are you?

Q: No, not the only one; but you seem to be the only one who is not willing to understand it. Now, repeat that question.

(The same question was again repeated by the Stenographer.)

Mr. Lucking: To that particular letter?

A: Whatever replies I made they are all right there.

Q: Will you answer the question? Repeat the question.

(The same question was repeated by the Stenographer.)

A: Are those dates all right, Mr. Lucking?

Mr. Lucking: I think they are, Mr. Ford.

A: Well, then, all right. That is it.

Q: All right. Mr. Lucking tells us again.

A: I don't know the dates.

Q: Perhaps your own letter will indicate those dates just as well (handing paper to witness).

A: Well, if it is dated, that is all there is to it.

Q: Look at it, Mr. Ford.

A: I say it, yes.

Q: Then on the second of November was the first time that you replied to the letter of October eleventh?

A: Yes, sir.

Q: Now we have got it.

Mr. Lucking: If you had asked the question simply in the first place, you would have got it without so much argumentative stuff in it.

Q: It was simple enough so that he finally understood it.

Mr. Lucking: As you finally put it.

Q: It was the same question exactly, repeated, and he answered it.

Mr. Lucking: The first answer has a certain date; that is simple; but when you sprung a lot of argument, you confused it.

Q: I am not responsible for what you regard as simple, Mr. Lucking. I asked you whether you did not, before you appropriated this money, why you did not answer that letter as requested?

A: I don't know that.

Q: You don't know that. You say on the sixteenth of October, after this letter of October eleventh was written to you by Dodge Brothers, you had concluded the arrangement with Riter-Conly, of Pittsburgh, for expending a million dollars. You have said that, haven't you?

A: Yes.

Q: And after the receipt of their letter, you went right ahead and concluded an arrangement to spend that million dollars, without replying to their letter, or giving them any information about it; that is true, isn't it?

A: If it is there, it is true.

Q: I am not asking you if it is there; isn't that true?

A: I suppose it is.

Q: Yes. Why didn't you give the information to Dodge Brothers, stockholders, that they asked for?

A: I guess we were working it out so that we could give them the information.

Q: You were working it out. You waited until after the board of directors had appropriated the money before you informed them, didn't you?

Mr. Lucking: I object to this; it has been gone into four or five times.

Q: Mr. Ford, you never advised Dodge Brothers of your New York venture, either, did you?

A: I didn't know that they were directors.

Q: But you knew that they were stockholders, didn't you?

A: Yes, sir.

Q: And you knew that they asked you for information, too, didn't you?

A: About the New York—

Q: About all the proposed expenditures. That is what they asked you for, wasn't it?

A: It must be, certainly.

Q: Do you claim that as trustee, as president and managing officer and trustee for the stockholders, it is not your duty to inform the stockholders about what you propose to do, when they ask it?

A: I don't know.

Q: You don't know whether it is your duty or not? Do you say that?

Mr. Lucking: What was that question?

(The question was read.)

Q: Answer the question.

A: I don't understand it.

Q: Repeat it.

(The question was read by the reporter.)

A: I informed the directors.

Q: But you won't inform stockholders when they ask for information?

A: They can find out anything they want.

Q: How are they going to find it out? Isn't the proper way to find out to ask you for information?

A: Yes, come up and find out.

Q: They did ask you for information, didn't they?

A: Yes.

Q: They didn't get it until after you had appropriated the money, did they?

A: Perhaps not.

Q: You know they did not, don't you?

A: Possibly not.

Q: I am not asking you possibly; you know that they didn't get the information until after you had appropriated the money?

A: Yes.

Q: You may just as well answer the question, and not dodge it in the beginning, you know.

A: Yes.

Q: You don't have very much regard for stockholders, anyway, do you?

A: I have shown quite a regard.

Q: You have?

A: I have paid them lots of dividends.

Q: You have called them parasites, on occasions, haven't you?

A: Not Mr. Dodge, no, sir; not Dodge Brothers; I learned that word from Mr. Dodge.

Q: You learned that from Dodge?

A: Yes. He called all people that did not work, parasites.

Q: You called your stockholders parasites?

A: No, I did not.

Q: But you didn't mean Mr. Dodge?

A: No, never.

Q: Who did you refer to?

Mr. Lucking: I object to that as an unnecessary bit of dirt.

Q: I purpose to show that this man has absolutely shown incapacity to appreciate his relation to the stockholders of this corporation.

A: Do you claim that I called the stockholders parasites?

Q: Yes, I do, in a published statement.

A: A published statement?

Q: What? Do you say that you did not?

A: I may have been quoted.

Q: Do you say you did not?

A: I never called anyone a parasite.

Q: "Ford is building his tractor plant on Dearborn site. Will use building where 'gasoline horse' was designed. Two other structures to form nucleus of works. Employes to share profits; no stockholders or parasites."

A: I told that man not to put that word in, parasites.

Q: You told him not to?

A: Yes, sir.

Q: You used the word, and then told him not to put it in?

A: He used it.

Q: But didn't you use it first?

A: No, I didn't use it; I told him not to put it in. He wrote the articles.

Q: And you told him not to put the word "parasites," in?

A: Yes.

Q: "The old Wagner brickyard in the southeast corner of the village, is the site of the tractor plant which is already under way, with several score of workmen busy on buildings. The first of two new building is completed, and the other is progressing rapidly. Will be no 'parasites.' With the announcement Friday of the beginning at Dearborn, Mr. Ford gave the following outline of the directing force behind the project: 'In the new tractor plant there will be no stockholders, no directors, no absentee owners, no parasites,' he said."

A: Well, I told him not to use the word "parasites."

Q: Didn't you use those words?

A: No, sir.

Q: You didn't use those words?

A: No, sir; I never used them.

Q: Why did you tell him not to use them, if you didn't use them?

A: Because he put them in, and I didn't want him to use it.

Q: Where did he put it in?

A: He put it in the article, that he was preparing.

Q: He submitted the article that he prepared, to you, did he?

A: Yes.

Q: And you told him not to use "parasites?"

A: Yes.

Q: The next day you say you sent word over to Mr. Dodge that you didn't mean that he was a parasite, didn't you?

Mr. Lucking: Who was it said that?

Q: Didn't you send Mr. Wills over to Mr. Dodge the next day to tell him that when you used the term "parasite," that you didn't refer to him?

A: I don't remember anything about it.

Q: Who do you refer to?

A: I didn't refer to anybody; I told him not to use the word.

Q: You told him not to use the word; who was the man that told you not to use the this word?

A: Well, he was a newspaper man in Dearborn, at Dearborn there.

Q: What is that?

A: I have forgotten his name. I think his name is Woodworth, or Woodruff.

Q: Woodworth or Woodruff; you told Mr. Woodruff, after he submitted the article to you, to strike that out?

A: Yes.

Q: And he didn't strike it out?

A: No. Are you able to control newspaper articles?

Q: You saw it when it was published, didn't you?

A: I saw it, I guess probably I saw it when it was published.

Q: Did you retract it in any way, or give any explanation?

A: No, I don't think I did.

Q: What?

A: I don't think so.

Q: You let it stand, published as it was, referring to your stockholders as parasites?

A: Yes, sir.

Q: That is what you did, didn't you?

A: I must have, yes.

Q: You didn't attempt to make any correction of it?

A: No, I would be pretty busy at that sort of thing.

Q: You would?

A: Yes.

Q: You think after the reporter had misquoted you, and made you say that you regarded or characterized your stockholders as parasites, that it was not up to you to correct it?

Mr. Lucking: I object to that; I submit that we have enough of this. Your honor has got control over it; you can have it stopped.

A: Well, he is only tiring himself out, roaring, anyway.

. . . .*

Q: In all these plans of expansion and increase and reduction of price, and increased amount of production, who, if any person, has been the one to advocate those policies? Who is the one?

A: I have, generally.

Q: You made about 500,000 cars last year?

A: Yes.

Q: What were you making, say, three years ago, if you remember?

A: Two hundred; I don't remember just exactly. It is all on the—

Mr. Stevenson: Can't we have the accurate figures on that?

Mr. Lucking: Yes, we can get it accurately. I just wanted to see who it was that poured these millions in.

Mr. Stevenson: I am not objecting to it.

Q: Did the increase of production increase your profits?

A: Yes.

Q: In spite of the reduction in price?

A: Yes.

Q: Did you have opposition to this increase of production?

A: Yes, I have always had more or less opposition.

Q: I mean among yourselves?

A: Yes, among our directors.

Q: Honest differences about it?

A: Honest differences, yes.

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* The following section is excerpted from pages 333–37.

Q: Was your action in reducing the price this year any different from what you have done many times before?

A: No, sir.

Q: What has been the uniform result up to this time?

A: Well, we have always made lots of money.

Q: What is that?

A: We have always made lots of money out of it.

Q: How long ago was it that you were making about 25,000 cars a year?

A: Five or six years, I guess; somewhere about eight or nine years, I guess.

Q: This is 1916?

A: Yes. I think we made 18,000 in 1906.

Q: When you were making 25,000 a year, what was your next proposed jump in amount?

A: I think 75,000.

Q: Who was it that proposed that?

A: I did.

Q: Was it opposed?

A: Yes, I guess it was opposed.

Q: Was there any institution in the world making 25,000 cars, except yourselves, at that time?

A: I don't think so.

Q: You proposed to jump to 75,000?

A: Yes.

Q: The wise-heads shook their heads, did they, at that time?

A: I think they did.

Q: The wise ones shook their heads?

A: The wise ones shook their heads at 10,000.

Q: How did your jump from 25,000 to 75,000 turn out?

A: Very profitably, I guess.

Q: Did the country absorb the cars?

A: Yes, sir.

Q: Bought the cars, did they?

A: Yes, sir.

Q: You reduced the price, did you?

A: Reduced the price.

Q: Who was it decided upon the policy of making a single standard article, cheap-priced article?

A: I did.

Q: Who has pursued that policy? Who in your in— situation has been in favor of that policy constantly, consistently?

A: Well, I don't know; I always have, and Mr. Rackham always has, I guess, and Mr. Klingensmith. .

Q: Has there been diversity of opinion about it?

A: Yes; always been some opposition and diversity of opinion about it.

Q: When it came to a year ago this last summer, at which time, I understand, you fixed prices, do you not, in the midsummer, about August?

A: Yes.

Q: Did you reduce the price a year ago?

A: No, we did not reduce it a year ago.

Q: Why not?

A: Well, we wanted to make a little extra money to go on with these expansions.

Q: These very extensions?

A: These very extensions.

Q: Was that talked in the company? You understood that, all of you?

A: Talked among the engineers; yes, sir.

Q: Among your directors, is what I want.

A: Yes.

Q: The raising of that money?

A: Yes.

Q: With Mr. Wills?

A: Mr. Wills is factory manager, has been associated with me right from the very start, the first man that ever came with me in the business.

Q: Does he hold any official position in the company?

A: No.

Q: An able man?

A: Very able man.

Q: What is his salary?

A: $80,000 a year.

Q: Is he worth it?

A: Yes, sir.

Q: Is he worth the money?

A: Yes, sir.

Q: In order to hold his services, have you paid him privately, in addition to that, out of your own pocket?

A: Yes, we have always divided up some of the profits.

Then you have not asked the company to pay that?

A: No.

Q: Does Mr. Wills recommend these extensions?

Mr. Stevenson: Hadn't we better have Wills?

Q: Can't have everybody at once. Has he recommended these?

A: I think he has.

Q: Do you know whether he has, whether he endorses them?

A: We have been so busy talking about the plans that I don't know whether the has given the policy of it very much thought.

Q: Take the extension at Highland Park; has he had anything to do with those?

A: Oh, yes.

Q: Why are you wanting to put up additional buildings at Highland Park?

A: To make more cars, make them cheaper, make more profits, extend further.

. . . .*

Q: In your conversations with Messrs. Rackham and Couzens, in which you had informally agreed upon this dividend, was anything said with respect to a future dividend?

A: Yes, we talked for some time about a dividend after the first of the year; talked for months.

Q: What has been your policy with respect to having or not having ample cash?

A: Always had the policy to have ample cash.

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* The following section is excerpted from pages 354–55.

Q: If you have been more conservative this year in the matter of dividends, will you state your reasons, or are you any more conservative than you have been?

A: We have not been any more conservative.

Q: It appears that in some previous years, especially the last three years, since Messrs. Dodge have been out, that you have paid some quite large dividends?

A: Yes.

Q: What are the facts about that, in the matter of your judgment, and other members of the board?

A: It has been against my judgment.

Q: Why?

A: Because I have felt as though we ought to extend more, because we need the extensions.

Q: Have you so expressed yourself to the other members of the board?

A: Always.

Q: But you yielded your judgment, did you, at times?

A: Yes.

Q: In the matter of those very large dividends?

A: Always, yes.

Q: Those matters have been discussed in your board, have they?

A: They have been discussed.

Q: And individually among members of the board?

A: Individually, yes, and private.

Q: Have you any settled policy of withholding dividends?

A: None that I know of.

Q: Except as you may deem for the best interest of this company?

A: Yes.

Q: Can you withhold dividends from Mr. Dodge, or the Messrs. Dodge, without withholding them from yourself?

A: Not that I know of.

Q: Is it affecting your action in any respect, or desire to injure them in any way?

A: Not a particle.

Q: Have there always been honest differences of opinion in your board, as to just what should be done?

A: Yes.

Q: Not only with dividends, but expansion? [A]nd all of those questions?

A: Yes.

Q: Sometimes one succeeded in the matter of having his view adopted, and sometimes another?

A: Yes.

. . . .*

Q: Mr. Ford, calling your attention to paragraph 12 of the bill of complaint, readings as follows: "That notwithstanding the enormous earnings for the fiscal year ending July 31, 1916, namely, approximately sixty million dollars, the said Ford Motor Company has not since declared any special dividends, and the said Henry Ford, president of said company, has declared it to be the settled policy of the Company not to pay in the future any special dividends, but to put back into the business for the future all of the earnings of the company, other than the regular dividend of five per cent. monthly." Is it true that you have at anytime or place declared it to be the settled policy of the company not to pay any special dividends in the future?

A: No sir.

Q: The following paragraph quotes from a statement purporting to be in the public press, not giving the date.

Mr. Stevenson: It is in the article that contains the financial statement.

Mr. Lucking: Do you remember the date?

Mr. Stevenson: It is August first, or thereabouts. August thirty-first.

Mr. Lucking: Of this year?

Mr. Stevenson: Yes, of this year.

Q: You were quoted as follows:

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

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* The following section is excerpted from pages 356–58.

Is that correct?

A: That is correct, yes.

Q: That is correct. Just what proportion of those profits you put back in at any time, what is that determined by?

A: By the board of directors.

Q: By any fixed policy of any kind?

A: No.

Q: Except what conditions warrant?

A: No fixed policy.

Q: Reading from paragraph 14 of bill:

"That said Henry Ford has stated directly to your orators, personally, in substance, that as all of the stockholders of the company has received back in dividends more than they had invested that they were not entitled to receive anything additional to the regular dividend of five per cent. per month.["]

Did you ever declare anything like that?

A: No, never.

Q: Further quoting:

"And that it was not his policy to have larger dividends declared in the future, and that the profits and earnings of the company would be put back into the business for the purpose of extending its operation and increasing the number of its employes, and that inasmuch as the profits are to be represented by investment in plants and capital investment, the stockholders would have no right to complain."

Did you every [sic] say anything of that kind?

A: Well, I have always been against large profits, myself. I don't think we ought to earn such enormous profits, myself; I may be overruled by the board, as I am many times; but I, myself, do not believe in such exorbitant profits.

Q: But did you ever, if so, where and when, if you can remember, did you say that they were not entitled to receive anything additional to the five per cent. a month?

A: No, I never did.

Q: Reading from Subdivision 16 of the Bill: "That the said Henry Ford, dominating and controlling the policy of said Company." Is that correct, that you dominate and control the policy of the Company?

A: I don't think so; I put everything I can up to the board of directors.

. . . .*

Q: In answer to Mr. Lucking, you have said that you had never decided upon any policy of withholding dividends, and putting the money all back into the plant, didn't you?

A: Yes, sir.

Q: Was that true?

A: Yes, sir. Whatever I said there.

Q: Which time did you say it correctly? You recollect this published statement in your favorite newspaper, the News, on August 31?

Mr. Lucking: What year.

Q: 1916. Do you recall that?

A: Yes.

Q: Who prepared that interview?

A: It was prepared by a number, Mr. Pipp and a few more.

Q: A few more?

A: Yes.

Q: After it was prepared, it was submitted to you for your approval?

A: I don't know as it was.

Q: Was it read over to you?

A: I don't know as it was.

Q: Do you stay it was not?

A: I would not say, either way.

Q: Before or after publication, did you read it, either one; I don't ask you which.

A: I think I read part of it after publication.

Q: After publication did you find you were correctly quoted?

A: I did not give it any thought;

Q: I will read from that interview with you, as follows:

"With regards to dividends, the company paid sixty per cent. on its capitalization of two million dollars, or $1,200,000.00,

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* The following section is excerpted from pages 397–404.

leaving over $58,500,000.00 to re-invest for the growth of the company?["]

A: Yes.

Q: Was that what you stated?

A: I don't know as I stated it myself; don't know as I said anything about it.

Q: (Reading): "This is Mr. Ford's policy at the present time, and it is understood the other stockholders cheerful[l]y accede to this plan."

A: I thought they did accede to it.

Q: Was that your policy? That was your policy, understanding that the stockholders acceded to it, was it?

A: Yes.

Q: Let us have no misunderstanding about it.

Q: I read again, so that there may not be no misunderstanding, Mr. Ford: "With regard to dividends, the company paid sixty per cent. on its capitalization of two million dollars, or $1,200,000.00, leaving 58,500,000.00 to re-invest for the growth of the company. This is Mr. Ford's policy at present, and it is understood that the other stockholders cheerfully accede to this plan." Where you correctly quoted?

A: No, I don't think I was. I think I said part of that.

Q: What part did you say?

A: I don't know what part; perhaps half or so.

Q: Then immediately following: "'My ambition,' declared Mr. Ford, 'is to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes.' [']To do this, we are putting the greatest share of our profits back into business.'"

A: I don't know as I said greatest. I said, a great share of it, good share of it.

Q: Mr. Lucking read that to you about half an hour ago, and you said it was correct?

A: Yes.

Q: Then I read it to you; now you are in doubt about it what do you say about that? Mr. Lucking read those very words to you from the bill of complaint, that we filed here, and in reading it you said that was correct. Was it correct, or incorrect?

A: Correct, I guess.

Q: Correct. Will that be the last word on that, or will you change that?

A: I cannot tell. When I get better posted, I may know more about it. I don't quite understand it.

Q: You said to me a moment ago that understanding that the stockholders acceded to your plan to pay $1,200,00.00, leaving fifty-eight million five hundred thousand dollars to re-invest, for the growth of the company, that that was your policy. Do you change that now?

A: Change it?

Q: Do you change that, or do you say that is correct?

A: I just said that we expect to invest part of it.

Q: I am asking you for the literal words that are in this interview of yours.

A: That is a newspaper article that I never read over.

Q: You said Mr. Pipp came there and got it?

A: Yes. I don't think I ever saw it afterwards.

Q: Didn't you tell us a few minutes ago that you did read it afterwards?

A: Read part of it; I don't know whether I read that part or not.

Q: You don't know whether you did or not?

A: No.

Q: Didn't you tell me just a few minutes ago that this was your policy, and that you understood that the stockholders cheerfully acceded to your policy? Just a few minutes ago, didn't you say that?

A: I think I did.

Q: Is it true?

A: True, if you want it so, yes.

Q: Well, it is quite immaterial to me which way you put it; you have put it so many ways, that I have lost all interest in which way you put it.

A: All right.

Q: Mr. Ford, does the Ford Motor Company have a publication of your own, haven't you?

A: Yes.

Q: What do you call it?

A: Ford Times, I guess you have reference to. We have two or three.

Q: Now we find this on page 106, under date of October, 1916: "With regards to dividends, the company paid sixty per cent. on its capitalization of two million dollars, or $1,200,000.00 leaving over $58,500,000 to re-invest for the growth of the company. This is Mr. Ford's policy at present, and it is understood that the other stockholders cheerfully accede to this plan." Is that correct?

A: I never saw that before.

Q: You did not?

A: No.

Q: They would have not publish anything in your Bible that you did not say, would they?

A: They might.

Q: They reproduced this from your other Bible? the News?

A: That is possibly what they did.

Q: They reproduced this.

A: But I never saw it.

Q: And it was so accurate that they put it in your own bible, out of the News?

A: I never saw it.

Q: You never saw it?

A: I never saw it.

Q: Do you repudiate it?

A: Well, I say that it was put in there without my knowledge.

Q: Do you repudiate it? Does it correctly express your sentiments, or doesn't it?

Mr. Lucking: You ought to put in the whole quotation. Just about the greatest part of our profits.

A: Greatest part; I guess that is all right.

Q: You heard Mr. Lucking say that.

A: That is what I said before, a portion of it.

Q: You heard Mr. Lucking say, "the greatest part."

A: I say, a portion of it.

Q: Did you hear Mr. Lucking?

A: I was reading from the article. You handed it to me, and I was reading from the article.

Q: Did you hear Mr. Lucking?

A: Yes, sir.

Q: I will read both paragraphs, Mr. Ford.

A: Go ahead.

Q: "With regards to dividends, the company paid sixty per cent on its capitalization of two million dollars, or $1,200,000.00." That is correct?

A: Yes.

Q: "Leaving over $58,500,000.00 to re-invest for the growth of the company." That is correct?

A: Yes.

Q: Now, did you gentlemen get that answer?

A: I say that is correct, as you read it there.

Q: "This is Mr. Ford's policy at present, and it is understood that the other stockholders cheerfully accede to this plan."

A: Yes.

Q: That is correct. Will you please answer a little louder. I will get further away, so you can talk at me. If you and I will about split, and you talk a little louder, and I talk not quite so loud, perhaps we would get it about right.

A: Change it from a roar down into—

Q: It has not disturbed you very much, has it?

A: Not very much.

Q: (reading): "'My ambition,' declared Mr. Ford, 'is to employ still more men.'"

A: That is correct.

Q: "'To spread the benefits of this industrial system to the greatest possible number.'"

A: That is correct.

Q: "'To help them build up their lives, and their homes.'" Do you balk at that?

A: Yes, that goes with it, I guess.

Q: Is that correct?

A: Well, it is so stated there.

Q: Does that express the views that you expressed at the time?

A: That was not written by me. It was written in a newspaper, written for a story.

Q: This other story was not written for you, was it? Mr. Pipp came up to your office, spent two or three hours, prepared a nice story, read it over to you, published it, and you were pleased with it, weren't you?

A: I read part of it, yes.

Q: You were pleased with it?

A: Yes, I guess I was pleased with it.

Q: Was that any different when Mr. Pipp wrote this article for you last August?

A: I don't remember much about that article.

Q: Not much about it?

A: No.

Q: Now, I will go back again: "'My ambition,' declared Mr. Ford, 'is to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this we are putting the greatest share of our profits back into the business.'"

A: Yes, the greatest share of the profits back into the business. That is all right.

Q: Now, we understand that.

A: Yes, that is all right.

Q: Those quotations are correct?

A: That is all right, yes.

Q: You don't think you will want to change this now?

A: No, I don't think I will want to change this.

Ford Loses Dodge Bros. Profit Suit
Judge Hosmer Orders 50 Per Cent Division of $59,000,000 Dividends.
Ruling Reviews Rise of Motor Company

DETROIT NEWS, Oct. 31, 1917, at 1.

John F. and Horace E. Dodge won today in their suit against the Ford Motor Co. and Henry Ford to have the profits of the company divided among the stockholders instead of using it as Mr. Ford planned, in enlarging the Highland Park plant, building a $11,000,000 blast furnace on the Rouge river and purchasing a site in New York city for an office building and hotel.

Judge George S. Hosmer handed down a decision in the case this morning declaring that the Dodge brothers are entitled to the relief sought, except that he ordered a division of 50 per cent of the $59,000,000 profits for the fiscal year ending July 31, 1916 instead of 75 per cent asked by the Dodge brothers. The complainants had formerly stated in a letter to Henry Ford that they wanted 50 per cent of the profits divided.

In fixing the division of profits at 50 per cent Judge Hosmer said:

"The acquiescence of a stockholder in the past will probably stop him from demanding full relief in the case at bar. All that complainants asked on Sept. 23, was 50 per cent of the profits of 1916 be declared as special dividends, and in view of the announced policy of the company and its plans for duplication of its plant, the relief should be measured by the demand; retention under the circumstances is an abuse of discretion.

"To that relief complainants are entitled but credit should be given for the dividends declared during the fiscal year ending July 31, 1917[.]"

No Trust Violation.

Judge Hosmer stated that although the Ford Motor Co. had declared dividends equal to only 5 per cent monthly on the $2,000,000 capital stock of the company for several years and a few special dividends previous to 1916, the Sherman antitrust law had not been violated.

"All this has been done absolutely without contract, combinations in the form of trusts or otherwise or conspiracy in restraint of trade or commerce."

The judge's decision was written in great detail, requiring 23 pages. The court goes into the early-history of the motor company, giving the details of the Dodge brothers' early connection with the company. He says that when the company had expanded until it could make its own parts the Dodge brothers discontinued their contracts with the Ford company in 1914.

Make Own Car.

"Having been very successful in their dealings with the company, upon their completion of their contract, John F. and Horace E. Dodge began the manufacture of a car on their own account," said the judge.

"On starting this manufacture John F. Dodge, who had been on the board of directors of the Ford Motor Co., resigned. The Ford Motor Co. has prospered beyond all expectations and has met with unparalleled success. From time to time as its cost had been reduced by economies, the price of the car has been lowered to the general public. It is unnecessary to enter into its full history; it is sufficient to state that this has been the general policy of the company."

Judge Hosmer said that the order of the court didn't mean an immediate payment of the 50 per cent dividend.

"Doubtless counsel can arrange by agreement for a time or times of payment," he said. "If this can be done the court will settle a decree in the usual manner, and if necessary hear testimony. Credit, of course, should be given for the special dividends declared out of the profits of the year ending July 31, 1916."

Furnace "Incidental."

In speaking of the necessity of the $11,000,000 blast furnace as planned by Henry Ford, the court stated that it was "necessarily incidental."

"At the time of the passage of the general corporation law and of the mining and smelting act as well, it was not contemplated that castings should be made direct from the ore," said the court. "The title and provisions of the corporation act excludes commercial smelting of ore. This is conceded in this case, but it is claimed that the defendant may smelt ore for its own use and sell in the open market any excesses of product; that if this is beyond the corporate powers, it may make its castings

direct from the ore and that the building of the Rouge plant comes within the dis[c]retion of the directors. Up to the present time pig iron has been had in sufficient quantity."

Alfred Lucking, attorney for Mr. Ford, says the case will be appealed.

Ford's Expansion Plans.

The suit was a prayer for an injunction to restrain Mr. Ford from building the blast furnaces, by which Mr. Ford was to turn iron ore directly into steel, something never done before, and by which Mr. Ford hoped to save millions of dollars, resulting in the lowering of prices of autos and tractors and higher wages for employes. The tractor and blast furnace plants were expected to give employment to about 30,000 men.

Mr. Ford, when the plea for a three circuit judges, got the right three circuit judges, won the right to go ahead with the construction of the blast furnaces by putting up a bond of $10,000,000.

This bond was put up by Mr. Ford and preliminary work has been in progress. The project involved deepening of the River Rouge. The trial made public astounding facts of enormous wealth made in a few years by Mr. Ford and the Dodges, who broke with Ford a few years ago after making thousands per cent on their original investments.

Henry Ford Beaten in $60,000,000 Suit
Dodge Brothers Win Action for Disbursement of Dividends —Ford to Appeal.

N.Y. TIMES (1851–2009), Nov. 1, 1917, at 24.

DETROIT, Mich., Oct. 31.—Minority stockholders of the Ford Motor Company today won the first round of their fight for increased dividends and a more important voice in the transactions of the company's business.

Circuit Judge George S. Hosmer of Detroit handed down a decision for the plaintiff in a suit brought by John F. Dodge and Horace E. Dodge of Detroit against the Ford Motor Company and Henry Ford, to compel Mr. Ford to disburse about $60,000,000 of accumulated dividends to the company's stockholders. The Dodge brothers, who are automobile manufacturers, are also minority stockholders of the Ford Motor Company, in which Henry Ford holds a controlling interest.

Mr. Ford announced some months ago that he hoped to use this money greatly to increase his company's business. One of the features of his plan of expansion was the construction of great blast furnaces on the River Rouge, near Detroit. The Dodge Brothers attempted to obtain an injunction permanently restraining Mr. Ford from starting construction work on these furnaces, but the State Supreme Court allowed him to begin building provided he furnished a bond to protect the company's stockholders from loss in case the Dodge Brothers won their suit. The bond was furnished and the work at River Rouge was started.

Mr. Ford has declared that he would appeal the case to the United States Supreme Court if the lower courts decisions were against him. It was charged by the Dodge Brothers that he was supreme in directing the business of the Ford Motor Company and the minority stockholders had no voice in the affairs of the company. He denied this charge.

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:

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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

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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.

Transcription of the Chapman University Dale E. Fowler School of Law Dedication Ceremony

Tuesday, September 10, 2013

On September 10, 2013, Chapman University hosted a dedication ceremony to celebrate the renaming of the law school to The Dale E. Fowler School of Law at Chapman University, following the historic $55 million gift given by Chapman University alumnus Dale E. Fowler and his wife Sarah Ann. The *Chapman Law Review* is honored to publish the remarks and speeches by the distinguished speakers who took part in the ceremony.

INTRODUCTION OF JUDGE ALEX KOZINSKI BY TOM CAMPBELL, DEAN, DALE E. FOWLER SCHOOL OF LAW

Alex Kozinski is the Chief Judge of the United States Court of Appeals for the Ninth Circuit. He has been a federal judge for thirty-one years. Judge Kozinski and his parents, both Holocaust survivors, immigrated to the United States in 1962. He graduated from UCLA School of Law, and was a law clerk to both Justice (then Judge) Anthony Kennedy and Chief Justice Warren Burger. Before becoming a United States Court of Appeals Judge, Judge Kozinski was the first Chief Judge of the United States Court of Federal Claims in Washington, D.C. He has been an Angelino from the day he first came to America. Representing the federal judiciary, Judge Kozinski honors us by his presence today.

REMARKS OF JUDGE ALEX KOZINSKI

It's a pleasure and an honor to be here today at this grand event. The rule of law and economic freedom are inseparable. They are inseparable in society and they are inseparable at Chapman University. That's why it was so fitting that when Chapman graduate Dale E. Fowler and his wife Anne were considering where they could make the most important impact through their exceptional generosity, they agreed on the law school at Chapman University as a beneficiary of their philanthropy. No other law school in the country better

exemplifies the role of law in the creation of economic opportunity. Indeed, no other university in the country has a president and a law school dean both of whom received their PhDs in economics from the University of Chicago studying under the legendary Milton Friedman.

At the Dale E. Fowler School of Law, students will learn how the law can be a partner with and not an obstacle to the economic development of society, as well as a guarantor of individual liberties. As an immigrant from a country that lacked economic and individual liberty, I prize them both perhaps a bit more than those who were born into a society that possesses them in full measure. Indeed, I can say you can't have personal freedom without economic freedom, and without a society to create a bounty, an economic bounty to guarantee those freedoms, it just can't happen. Preserving those freedoms is a duty of all Americans by birth or by choice; and preserving the rule of law is a duty of American law schools and the legal profession. I know this is a duty that the law school at Chapman University takes particularly seriously, and I congratulate you for that.

With this gift, the school of law at Chapman announces to the world that it is here to stay. It's here to create opportunity for its students, here to build on the tremendous financial success of Orange County, of the State of California, and of the United States, and it is here to uphold the finest aspects of the noble profession of law without which none of these freedoms would exist. I applaud the Fowlers for all they have accomplished and for their exceptional sharing what they have created so that the generations to come will have the chance that they did.

God bless the Dale E. Fowler School of Law, and all that make it their home or alma mater. And God bless the United States of America.

Thank you very much.

INTRODUCTION OF PRESIDENT JAMES L. DOTI BY WYLIE AITKEN

I assume I'm on this program for balance, is that right Tom? Tom graciously called me and asked if I would make a few remarks, and I originally volunteered to do the singing of the National Anthem. He asked me if I could sing, and I said absolutely not, but how cool would it be to be standing up there? I do have the honor of introducing our incredible president of this university. But before I do that I want to tell a little Dale Fowler story. Dale, I met when he joined the board of trustees. And I know he is not a lawyer; he did not go to law school—hold your applause—but he asked me after we had heard a presentation on

the school of pharmacy, he said, "Can I talk to you Wylie?" I said, "Of course," and he said, "If we start a pharmacy school and any of these students go out and commit a prescription of a bad drug or misprescribe something, would Chapman University be liable for that?" I said that I had never thought about it, but as a tort advocate I don't think that even I could stretch it that far. So I said, "Feel comfortable supporting the pharmacy school. It'll be a great pharmacy school." And with that I want to just take a few moments to introduce our great president. Now, I have two pages of notes, and I will use very few of them. These two pages were condensed from the forty-eight-page coverage of Jim Doti in the *Orange County Register* where they had to eliminate the entire sports section because they didn't have enough room for it.[1] But as you know he's been our incredible president since 1991, and born in Chicago, Illinois where I made my first communion, as well as you Jim. I noted that he would serve twice as acting president, so apparently he failed once, and then failed twice, and then George finally saw the wisdom of bringing you in, and, of course, the rest is history. What he has done for this University, including being the inspiration for this law school itself, and the fact that he has received so many awards, in fact, he is so well known, I have heard it said that he needs no introduction. But he did receive the Humanitarian of the Year Award and the Ellis Island Medal of Honor. Of course, we all know, as Bette reminds me, that I am here because of Bette, and we all know that you, Jim, are here because of Lynn. And this school and you are just so incredible, I cannot tell you how honored Bette and I are to be associated with Chapman University and to follow your leadership. You are an amazing human being, and this is just another major step in the incredible accomplishments. So I give you our incredible, terrific president, Mr. Jim Doti.

PRESIDENT JAMES L. DOTI

Thank you very much, Wylie, for the very kind introduction, though I have a bone to pick with you. It's about that *Register* article where you were quoted as saying, "I warn everyone out there in Orange County not to have dinner or lunch or breakfast with Jim Doti." Ever since that article appeared, no one returns my phone calls.

This truly is a special day in the life of our university. When we name a school or college, it's not only a special day, but an

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1 *Jim Doti: A man who climbs mountains*, ORANGE COUNTY REGISTER, May 31, 2013, available at http://www.ocregister.com/articles/doti-510798-chapman-says.html.

historic day. A number of people have prominent roles in that history. People like George and Julia Argyros, who named our Argyros School of Business and Economics; Dick Schmid and his family, who named the Schmid College of Science and Technology; Larry and Kristina Dodge, who named our Dodge College of Film and Media Arts; Don and Deedee Sodaro and Libby Pankey, who named our Sodaro-Pankey Undergraduate School of Media Arts; and Paul and Marybelle Musco, who named our Hall-Musco Conservatory of Music.

What unites these visionary people is not only their love of Chapman University but also their particular regard for a specific discipline or art form that they believe will have a transformational impact on the lives of our students.

Today, we honor Dale and Ann Fowler, and we may ask ourselves, "Why name a school of law?" I think Judge Kozinski gave us a wonderful answer to that question, but I'd like to focus on examining why Dale and Ann are joining other visionary people who believe in our law school. People like Don Kennedy. His leadership and philanthropy made this wonderful building and our law school possible. Wylie and Bette Aitken gave not only their time and support, but also our moot court room. Phil Case gave us our Dean's Suite. Fritzie Williams gave us our first endowed law professorship in honor of her late husband Frank, a great public defender of Orange County. Professor Frank Doti helped name a classroom in honor of our father and mother, Roy and Carmelina Doti. And Richard Stack, who represents the Darling Foundation, has been a partner with this law school from its very beginning.

All of these people believe that a law school adds immeasurably to the intellectual life of a university. Dale and Ann share that belief. They also believe passionately in America, in America's ideals, and in the American Dream. They realize that the American Dream, as Judge Kozinski so eloquently stated, is an essential component of freedom; and freedom is a necessary part of making that American Dream possible.

A quotation of Dale Fowler now graces Kennedy Hall. It is shown to my left, next to our "Milestones on the Road to Freedom." That quote reads as follows:

> No country is great without the rule of law, which protects individual liberties and guarantees the economic freedom necessary for entrepreneurship and commerce to flourish. A great law school will produce graduates who will excel at both. Law must be a partner

in the creation of opportunity in our country to keep our country free individually and economically.

It is, indeed, a great honor to name our law school for a person with such ideals. We are particularly proud that that person is an alumnus of this university. Through his and Ann's transformational gift, countless generations of Fowler Scholars will be touched by their vision and generosity. On behalf of those students, I wish to express our heartfelt thanks.

INTRODUCTION OF THE HONORABLE GEORGE P. SHULTZ BY DEAN TOM CAMPBELL

George P. Shultz served our country as its 60th Secretary of State. He is a United States Marine, a veteran of the Pacific Theater in World War II. He saw action in the Battle of Peleliu. He served on the staff of the Council of Economic Advisors, and as Secretary of Labor, Secretary of the Treasury, and as the first Director of the Office of Management and Budget. He was dean of the Graduate School of Business at the University of Chicago, formerly a member of its faculty, and the faculty of the MIT Department of Economics and Sloan School of Management. He was president of Bechtel Corporation, the largest construction company in the world, and is now a Distinguished Fellow of the Hoover Institution at Stanford University. He has authored or edited over fifteen scholarly books, and numerous scholarly articles in business, economics, and international policy. He holds our nation's highest civilian honor, the Presidential Medal of Freedom. He is widely regarded, along with President Ronald Reagan, as the architect of the victory of freedom over totalitarianism in the cold war. On the campus of Chapman University, there are statues placed to inspire our students, staff, and faculty with examples of leadership on a worldwide scale. Among these statues are Martin Luther King, Abraham Lincoln, Ronald Reagan, Margaret Thatcher, Benito Juárez, and our dedication speaker today, the Honorable George P. Shultz.

REMARKS OF THE HONORABLE GEORGE P. SHULTZ

I consider it a great privilege to speak at a law school dedication, particularly to such a distinguished audience. I would like to take as the touchstone for my remarks some words that I read as Dale Fowler's challenge to the law school, namely that it should be part of creating an atmosphere where freedom and entrepreneurship can flourish. Those are matters of governance. And the job of looking after governance is the fundamental and higher calling of a law profession and particularly of law schools. Right now I believe that governance

has become increasingly complicated and difficult so it is a real challenge to think this through.

What I am going to do is first of all paint a global picture for you of what is going on as I see it, and then I will briefly mention a couple of case studies to show contrasting governance arrangements. Then I want to talk a little bit about the United States, and wind up with my challenge to you, Tom, and I say particularly to Tom because he has had an unusual set of experiences. He has been a member of Congress; he has been a member of the California State Senate, elected positions. He has also been the director of the budget for the State of California. And I have to say he has been the last one to bring in an honest, balanced budget, so thank you, Tom.

First of all, what's going on in the world? At the end of WWII some gifted statesmen looked back and what did they see? They saw two world wars. The first ended on some rather vindictive terms that helped lead to WWII, so do not make that mistake again. In the Second World War, seventy million people were killed, let alone the people injured, displaced, and the untold amount of destruction. I have been reading a book called *Savage Continent*[2] about Europe right after WWII. You cannot believe the human degradation. They saw the Holocaust, such a horror that Ronald Reagan, when he was an air force officer with the job of putting films together for the higher brass to get a feel for the war, came across films of the Holocaust and he told me that it was so horrible; he said, "People will not believe this happened; it's beyond belief." So he saved some films for himself so that, should anyone question, he could show them the films. These people also looked back, and they saw the Great Depression, they saw the protectionism, and the currency manipulation that aggravated it. They said to themselves, "What a crummy world, and we're part of it whether we like it or not." So they set out to create something better. And as they were getting on, the Cold War emerged, so ideas were produced, institutional arrangements put in place: the Bretton Woods System, The Marshall Plan, NATO, the Doctrine of Containment, and through the years, on almost a nonpartisan basis, there was gradually built a security and economic commons from which everyone benefited, including the United States.

Now what's happening? This commons almost suddenly is being shredded. There are a number of reasons. I will not go into them all, but I want to dwell on one in particular that has a huge

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2 KEITH LOWE, SAVAGE CONTINENT: EUROPE IN THE AFTERMATH OF WORLD WAR II (2012).

bearing on governance. The information and communication revolution is already a major influence and growing all the time. And what does this mean? It means that people anywhere can know what's going on. And people everywhere have their cell phones; they can communicate with each other, they can organize. This is new. Always before the people in charge had a reasonable monopoly of information and a total monopoly on the ability to organize. Those days are gone. So you look around the world and what do you see? You see that this commons is being turned into a world awash in change. It's everywhere you look. It isn't just in the Arab countries, Russia, Turkey, or Brazil. I was talking to a friend of mine from Sweden. I said, "In Sweden?" And she said, "Yes, but it wasn't among the Swedes. It was among the immigrants." I said, "Aha, you have been accustomed to governing over homogeneity, and all of a sudden you have diversity on your hands." So diversity is everywhere. In the past, diversity was handled by suppressing it, but you cannot do that anymore.

So the challenge you need to work on, Tom, and help us on, is this: How do you govern over diversity in an age of transparency? It is hard. Let me refer to a couple of case studies and then talk about the United States. Take Europe right now. Europe, understandably after WWII, sought to create something that would envelop Germany in something bigger so that we could not have them start more world wars. So this instinct to create something larger has prospered. At the same time it is full of an instinct to homogenize. A clear example is the euro. I remember being in Berlin, at the time I was Chairman of the JP Morgan International Council, it was a few months before the adoption of the euro, and the people there—economists, businessmen, financiers—were all saying, "This is a stupid thing. You are putting a fixed exchange rate system over very different economic units. This is simply not going to work." Helmut Kohl came to our meeting. He was chancellor then, and after listening for a while, he got up—all 300 pounds of him—and he said, "The decision has been made. It is a matter of war and peace. It is up to you to make it work." Well, it is not working because it fails to recognize the fundamental importance of diversity. If you are going to govern successfully, you have to recognize the diversity, let it express itself, and at the same time put it into some sort of common framework. And the Europeans are not doing that right now and that is why they are floundering so badly, I believe.

Let me take a little different example. Here is something that people hardly recognize, but I think it is fair to say that North America has arrived. It has sort of stolen in on us. NAFTA

was put in place a couple of decades ago and then things have just taken their course. Nowadays, Canada, Mexico, and the United States are each other's top trading partners. Our U.S. imports from Mexico are 40 percent U.S. content, and from Canada 25 percent. In other words, the production process is integrated. Our imports from China are 4 percent U.S. content, by contrast. Some 230 million people each year from the North American countries tour each other's countries legally. It is a huge number of people. I do not know if you have looked lately at the fertility in Mexico but it has gone down. So there is no more big bulge in Mexican young people. And Mexico's economy is likely to be very prosperous if the reforms that are now being talked about really take hold. Under the circumstances, it should not be surprising that the net immigration of Mexicans to the United States in the last year was zero. Ladies and gentlemen, we are worrying about the wrong border. The border we should be worrying about is Mexico's southern border—call it the North American Southern Border—and help Mexico avoid becoming a transit country, with all of the human degradation and corruption that goes with human trafficking. That is the problem, not Mexico. So suddenly, North America has arrived, and there is no bureaucracy running it; it has just happened. The diversity has been recognized and allowed to express itself.

And what about the United States? I almost hate to undertake this description in the company of all these distinguished jurists, but let me paint the history of our country in a little different way than it is usually done. The people putting together our Constitution realized that they had thirteen very different states on their hands. So they had to recognize this diversity, otherwise they would never get the Constitution ratified. So they constructed a government different from anyplace else. They created a country with a federal government that had limited powers, and those powers were checked and balanced by three branches of government. If you look at the Constitution, the practical things that affect your daily life are reserved to the states, cities, and localities. So that was a Constitution that recognized diversity and let it express itself.

Now what has happened over time? Gradually, the federal government has encroached more and more into the arena that is presumably reserved for the states and localities. They have used the preemption powers, the commerce clause, and, most recently, the taxing powers to say that it is within the federal government's power to tell you to buy something that you do not want or else the IRS will come and penalize you. The Founding Fathers, would they have gone for that? So my message is that in

the United States we inherited a very ingenious form of government that recognized diversity and put it within a framework of an overall common set of values. And that has worked.

And I might say that accompanying the governmental structure was a commitment to market processes. If you think about the marketplace, the marketplace is a natural respecter of diversity. Now Tom Campbell, he wants to drive a Rolls Royce; I will settle for a Chevy. We make our choices. That is the marketplace; it recognizes diversity. People express their different tastes. As soon as the government comes, you all have to buy the same thing. So remember this division of powers, and remember the importance of the market as a way of getting things done.

We have been drifting away from it. And I think we are at a point where, in a way, the United States has been moving against the trends of modern history. We will have a collision in this country, maybe not as violent as we see in other countries, but we are going to see a necessity to sit back for a minute and say in this age, where people know what is going on and they can organize, we have to have a system of government that allows diversity to express itself and put that within a common framework.

I read that the elected president of Turkey sought to take a historic square in Istanbul and construct a building on it. An eruption happened. Suppose the president comes to San Francisco and wants to abolish Chinatown. Get out of here! This is an expression of the diversity of the city.

So, Tom, I think the higher calling of law schools is to think about the process of governance within the framework of the facts that are there. And I think the facts about the problem of governance have changed and they continue to change. And we have to recognize the depth of the information and communication revolution and ask ourselves how that plays into our Constitutional arrangements. They probably stand pretty well. But in the way they are implemented through legislation and by the various court rulings, are they leading us to a system that will recognize diversity? We are the most diverse country on earth. People come here from everywhere. So we have to preserve a system that recognizes diversity within a common framework and I think we are moving in the wrong direction right now. It is up to people in the law schools to recognize that their job is to think about governance. It is particularly up to Tom Campbell, with the kind of experiences he has had, to lead us in our thinking on this subject. So if he succeeds, and I am

sure he will, he will lead us into creating an environment that allows freedom and entrepreneurship to flourish.

PRESIDENT JAMES L. DOTI

It is my honor and privilege now to introduce Dale Fowler.

It's safe to say that Chapman blood flows through the Fowler family. It's not just Dale. His and Ann's son, Jeffrey, and daughter, Kathryn Fowler Flattum, also graduated from Chapman. They have another daughter, Lori, whose daughter, Sarah, is a member of our English faculty, and whose son, Jeremy, earned his pre-med certificate at Chapman.

There is an article in today's *Orange County Register* about how Dale and Ann risked their savings to build an apartment building in Huntington Beach.[3] That first apartment building was the beginning of Fowler Properties, an Anaheim real estate investment and management company.

The incredible success of that company has allowed Dale and Ann to help and support many causes, in particular, higher education. They have made transformational gifts to Gordon College as well as to Chapman University. Indeed, Gordon named its campus in honor of Dale and Ann. At Chapman, they have supported our Musco Center for the Arts, our Presidential Scholars Program, and our Economic Science Institute. Now, in naming the Fowler School of Law, they are helping to create a new trajectory for our law school, to lead it to even greater prominence in terms of its impact on legal education.

Ladies and gentlemen, please join me in welcoming the naming donor to the podium: Dale Fowler.

DALE E. FOWLER

Well some of the things Jim told you were more true than others. The stars he talked about reaching for, I caught one; and that's my wife Ann. Jim gave about half of my talk by describing my family, and I would like to take an opportunity and just introduce two very special people who have not been introduced to you. They are my cousin Dolores Duckett and my cousin Shirley Fowler, and her name is not Shirley Fowler, but it's Shirley Gilbert. Shirley's father was my dad's partner for all of his business life, so we are so thrilled to have Dolores, Shirley, and Shirley's husband Gil with us today.

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3 Sherri Cruz, *Giving until it helps*, ORANGE COUNTY REGISTER, Sept. 6, 2013, *available at* http://www.ocregister.com/articles/fowler-524730-chapman-dale.html.

It's a delight to be here and have Secretary Shultz, who actually was a neighbor of ours for a number of years, not next door but in the general Berkshire area of Western Massachusetts. We enjoyed many evenings together at Tanglewood, listening to the symphonic music of the Boston Symphony. It was always delightful to be with him.

To all of you, to our Dean, to the Chairman of our Board, and to all you wonderful Board members and Ambassador Argyros, whom I have known as George for a long time—we've sat in many classes together—and he and Julia were neighbors of ours for a number of years—it's delightful to be here today, and I just want to thank you for the opportunity to present to you some memories that I share.

Fifty-five years ago, I left this campus with a diploma that indicated I had graduated from Chapman College. Approximately thirty years earlier, my mother sat in the classrooms across the street and walked the halls as a student of Orange High School. In 1912, more than 100 years ago, my grandfather A.E. Fowler, began hauling sand and gravel from Santiago Creek near Cambridge Street. My father and Shirley's dad, my uncle, later joined in this endeavor until their retirement in 1959, after expanding into excavating, heavy equipment, and ready-mixed concrete.

I was born in Orange, at St. Joseph's Hospital, and have lived here for the past sixty years within three miles of this campus. I guess I haven't progressed very much!

I have lived my entire life so far in Orange County, although Ann and I currently have a vacation home on the East Coast. I am proud to be a Chapman alum, but never more so than when Dr. Doti invited Ann and me to an evening of Christmas music, provided by Bill Hall and a group of Chapman students. Ann and I were stunned. We thought it to be one of the finest and most enjoyable evenings of music that we had ever experienced. I was so moved that when speaking with Bill later that evening, I commented that Ann and I would like to do something meaningful for Chapman. Being an alum, and having our son Jeffrey and our daughter Kathryn as alums, and now our granddaughter, Sarah, as a professor and our grandson of course—Jeremy has completed his pre-med work here—waiting for that email to tell him which med school he is going to be going to—we feel truly grafted into the Chapman family.

We are privileged to have the opportunity to invest in the lives of present and future gifted students of this law school. It is through those values, believed in and taught by this institution—

values such as freedom, integrity, and entrepreneurship—that we can and will extend lives of continued liberty to future generations. These values have been so graciously provided to us by a loving God.

Thank you for joining me and my family today in celebrating these special moments.

Chapman Dialogue Series: Unconventional Responses to Unique Catastrophes: Tailoring the Law to Meet the Challenges*

Wednesday, October 23, 2013

*Kenneth Feinberg***

I am here because of Chapman and the distinguished business program. Also, Dean Bogart was so nice to me in explaining how wonderful it would be to visit Chapman. I have heard about Chapman, and I know about Chapman, so here I am and I am honored to be part of the Dialogue Series.

Dean Bogart did not mention my books in his introduction. He neglected to mention *What Is Life Worth?*,[1] the book I wrote after 9/11. And he did not mention *Who Gets What: Fair Compensation After Tragedy and Financial Upheaval.*[2] Now, you may have trouble finding these books. If you look around, they might not be readily available. Do not worry, my personal supply of these books is virtually inexhaustible, and if anybody has trouble, we will get you copies.

The Dean is correct when he mentions the unique assignments I receive occasionally. Now remember at the outset, I am not the one who decides that there ought to be special compensation programs in particular situations in America. I do

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* This transcript has been edited and excerpted. For the full video presentation, visit http://www.chapman.edu/law/events/dialogue-series.aspx.

** Kenneth R. Feinberg served as the Special Master of the Federal September 11th Victim Compensation Fund of 2001; the Fund Administrator for the Hokie Spirit Memorial Fund following the tragic shootings at Virginia Tech; the Distribution Agent for AIG Fair Fund claimants; and, as an arbitrator, Mr. Feinberg helped determine the fair market value of the original Zapruder film of the Kennedy assassination, and the legal fees in Holocaust slave labor litigation. Mr. Feinberg has been appointed to two presidential-level commissions, and has had a distinguished teaching career as an Adjunct Professor of Law at Harvard Law School, Georgetown University, the University of Pennsylvania, Columbia University, New York University, and the University of Virginia. Mr. Feinberg founded Feinberg Rozen, LLP in 1992. In 2004, he was named "Lawyer of the Year" by the National Law Journal (2004), and has been repeatedly named as one of "The 100 Most Influential Lawyers in America" by the National Law Journal.

1 KENNETH R. FEINBERG, WHAT IS LIFE WORTH?: THE UNPRECEDENTED EFFORT TO COMPENSATE THE VICTIMS OF 9/11 (2005).

2 KENNETH R. FEINBERG, WHO GETS WHAT: FAIR COMPENSATION AFTER TRAGEDY AND FINANCIAL UPHEAVAL (2012).

not do that. Policy makers do that: President Bush, President Obama, Mayor Menino after the Boston Marathon Bombings with Governor Patrick, the President of Virginia Tech after the Virginia Tech shootings, or Governor Hickenlooper in Colorado after the Aurora movie shootings at the *Dark Knight* movie. Policy makers occasionally decide that for a particular tragedy we have to think out of the box to compensate victims. Now, when you make a decision to set up a special compensation program just for these victims, while everybody else fends for him or herself, but for these victims we pass a law, or we set up a special program. It raises some very thorny political science issues.

Take the 9/11 Fund. Eleven days after the attacks, Congress passed a law, and the law simply said: "Anybody who would rather come into a special compensation program, if you lost a loved one on the airplanes, the World Trade Center, the Pentagon; anybody who would voluntarily surrender their right to litigate against the airlines, the World Trade Center, Boeing, Massport, the Port Authority, the FAA; anybody who would rather come into a no-fault compensation program and get paid, and waive your right to litigate, you can do so. You do not have to, but if you want to come in, Ken Feinberg is designated to administer that program. You will be paid; you will fill out a form, and Feinberg will decide how much you will receive." Now that program was a stunning exercise in creative legislating. I happen to think the program was the right thing to do. We distributed, in thirty-three months, all taxpayer money—over $7 billion. The average award in that 9/11 Fund for a death claim was around $2 million tax-free. The average award for a physical injury claim was about $400,000 tax-free. Ninety-seven percent of all the eligible family claimants came into the Fund voluntarily. They decided to take the money, waive their right to litigate—end it. Only ninety-four families decided to litigate. We paid 5,300 people. Only ninety-four opted out and sued, and they all settled their cases five years later. It worked.

I say to anybody who asks me, "Was the 9/11 Fund sound public policy?" Yes, it was. "Was it the right thing to do?" Yes. "Did it work?" Yes. But then I always add, "Do not ever do it again." The idea that public money will be used to compensate victims while everybody else fends for him or herself raises some serious public policy questions. You should have read some of the emails I received during the administration of the 9/11 Fund. "Dear Mr. Feinberg, my son died in Oklahoma City, where's my check?" "Dear Mr. Feinberg, I don't get it. My daughter died in the basement of the World Trade Center in the original 1993

attacks committed by the very same people, why aren't I eligible?" And it was not just terrorism. "Dear Mr. Feinberg, last year my wife saved three little girls from drowning in the Mississippi River, and then she drowned a heroine, where's my check?" You better be careful when you earmark public taxpayer money just to pay certain people. Everybody else: ineligible.

The same with the BP oil spill. BP, after that Gulf of Mexico oil spill, walked into the White House, saw President Obama, came out, and said, "We will front $20 billion to pay all eligible claims to people and businesses who suffered damages as a result of that horrific oil spill in the Gulf of Mexico." President Obama and BP said, "Will you do it?" And I said, "Yes, I will do it." Over sixteen months we paid $6.5 billion to 220,000 individuals and businesses who suffered damages as a result of the spill. "Here's your check; you waive your right to sue." But again, "Dear Mr. Feinberg, I'm still waiting for my money from the Exxon-Valdez oil spill. Why can't I file a claim?" The BP oil spill was very interesting. You will recall that BP announced, "Anybody who suffered as a result of the spill, come one, come all." I received in connection with the BP oil spill, in sixteen months, 1.2 million claims from fifty states. I received hundreds of claims from California, most of which we denied, not all, but most of which we denied. But I received claims from fifty states, from thirty-five foreign countries. Build it, and they will come.

But these programs, as you see, raise serious questions about fairness. Because it is policy makers in Washington deciding, "Just for you, special treatment, special generosity, efficiency, and speed. Everybody else, sorry." And I question the serendipitous, haphazard nature of earmarking certain tragedies. You will never see the 9/11 Fund again. That was a unique response to an unprecedented catastrophe—rivaled only by maybe the Civil War, Pearl Harbor, and the assassination of President Kennedy. You will never see that again. I do not think a BP claims program will be seen again unless some company wants to front $20 billion. That is not chump change, without any litigation, to pay victims. But it raises questions about fairness and appropriateness, and what is right for the community and our nation.

Now those types of cases—BP, 9/11—those are very, very different from funds like the One Fund Boston, after the Marathon bombings; Virginia Tech; Colorado; and the killing of the first graders at Sandy Hook in Newtown, Connecticut. Those programs are very different. Those programs, unlike BP and 9/11, are funded by private money that is donated by the American people. They are a gift. If you accept money from those

funds you are not waiving your right to sue. You are not signing away any rights; you are accepting a gift. You can do whatever you want with that money. You can go hire a lawyer and litigate with that money. They are not alternatives to the tort system; those are programs funded entirely by you, the American people, who watch on TV what is going on. "Oh my goodness!" The viewers write out a check for $50, $100, $500, $25, and send it in. And I am asked to design and distribute those funds, but those funds come without any conditions. They are cousins maybe to 9/11 and BP because they offer compensation, special compensation, but they are not in any way tied to the existing tort system. They are free gifts funded by the amazing, charitable impulse of the American people. I have never seen anything quite like this: $7 million, Virginia Tech; $5 million, Aurora, Colorado; $11.5 million, Connecticut; $60 million, the Boston Marathon. The Mayor calls, Mayor Menino, and says, "We are getting all of this money. We need you to come in, design the protocol, and get the money out." Which we did. In sixty days, we distributed $60 million.

Now all of these programs—whether it is 9/11 or BP—they are very unconventional. They are tailored to a particular tragedy, and they raise these political science questions. Five people die in a fire—innocent victims—there is no fund for them. People die every day, innocent victims of tragedy, but they do not have these funds. It is one thing for the government to step in and create a fund. It is another thing if private citizens are so moved by these tragedies that they send money in for distribution. You cannot fault that. But it still raises questions of fairness.

Now, every time I am asked to do one of these programs, it is unbelievably stressful because you are dealing with people who are innocent victims of horror and tragedy. You do not expect any of these families or these survivors to express thanks or gratitude or appreciation. It does not work that way. These are traumatized people, innocent victims, who are angry, frustrated, and uncertain about the future. And the reaction you get from people is what makes the job so stressful. Whenever I am asked to do this, my first reaction is, "Brace yourself. Brace yourself for what you are going to hear from people." And it is important in these programs—whether they are government programs or private donations like the Boston Marathon—to reach out to people. To offer to meet with them, to hear what they have to say, and what their reaction is to the horror. You let them vent. Very few people come to talk with me privately about money. That is rarely the topic. The topic almost every time is venting about

life's unfairness. A couple of months ago, I went to a small rehab hospital in Boston, and I met with a victim of the marathon bombing who lost a limb. He was in the hospital bed, with his wife, his nine-year-old son, his brother, and his mother in the room. I said, "Mr. Jones, you are going to receive a check from One Fund Boston, tax-free, for $1,250,000." He looked at me. He said, "$1,250,000? I have a better idea, Mr. Feinberg. Give me my leg back. You keep the money. I want my leg back!" "I don't have that power, I wish I did. All I can do is give you a check." "Yeah, well, a check, what about my leg?" That is what you confront.

After 9/11, a lady came to see me—twenty-four years old, sobbing—and she said, "Mr. Feinberg, I lost my husband, he was a fireman at the World Trade Center, and he left me with our two kids, six and four. Now you are going to give me $2 million, tax-free. I want it in thirty days." I said to her, "Well, you know, it is going to take time for the Treasury to verify and cut the check. Why do you need this money in thirty days?" She said, "Why? I will tell you why. I have terminal cancer. I have ten weeks to live. My husband was going to survive me and take care of our two children. Now, they are going to be orphans. And I have to get this money, and I have got to set up this trust fund while I have my faculties and my ability to do this." We accelerated the payment, and eight weeks later she died. It is incredible.

The tough part of this job is not being a lawyer. My law degree is a wash. Better a divinity degree, or a degree in psychiatry. Dealing with these people—their horrors, and the problems they face—test your judgment. A lady came to see me sobbing, "I lost my husband. He was a fireman at the World Trade Center, Mr. Feinberg. And he left me with our three kids—six, four, and two. My husband was Mr. Mom. Every day that he was not at the firehouse, he was home teaching the six-year-old how to play baseball, or teaching the four-year-old how to read, or reading a bedtime story to the two-year-old. And what a cook! He cooked all the meals. He was the gardener around the house. He was Mr. Mom. And, you know, Mr. Feinberg, you can give me all the money in the world, it does not matter. My life is over. The only reason I have not jumped out a window to join him is our three kids—six, four, and two—but I will never be the same. Without him, I am lost." She left. The next day I received a telephone call from a lawyer in Queens. "Mr. Feinberg, did you meet yesterday with the woman with the three kids—six, four, and two?" "Terrible. Mr. Mom? Yes, I did." "Well, Mr. Feinberg, look. You have a very difficult job. I do not envy what you are doing. But I have to tell you, she does not know that Mr. Mom

has two other kids by his girlfriend in Queens—five and three. Now I am telling you this because when you cut your check from the 9/11 Fund, there are not three surviving children, there are five surviving children. But I am sure you will do the right thing." Click. He hung up. Do you tell her? That is what keeps you up at 3 a.m. Do you tell her about this call? Paternity and proving it; that is not the issue. Do you tell her? Myself and a couple of people working with me went around and around on this. We never told her. I think she must know by now. It is over ten years later. But we cut one check to the widow and the three children, and we cut—unbeknownst to her—a second check to the girlfriend as guardian of the two other children. I am not a family counselor. I do not know all the facts. I am getting money out the door. That is my job. I felt, at the end of the day, that it was not my place. She has a memory of her husband, and who am I to prick that bubble? But I am not sure. There were people saying, "This woman is in grief. She ought to know."

But people ask me all the time: "What is the toughest part of the job?" The toughest part of the job is psychological challenges. When you confront innocent victims who have been thrown a curveball. It is not their fault; they are adrift suddenly, traumatically. And it is difficult to cope with people like that. But you have to do it. It is very interesting. Half the people never want to see you. They send in their claim forms; they say, "Here is the information. Send me the check. We have not the slightest interest in sharing our memories with you or anybody else." But the other half want to see you, and they come to see me. In the 9/11 Fund, I conducted 900 individual interviews. "Dear Mr. Feinberg, I lost my wife at the Pentagon. We were married for twenty-five years. At this hearing today, I want to show you a video of our wedding twenty-five years ago. I want you to see my angel. I want you to see what those murderers did." "Well, Mr. Jones, look. It will not have any bearing on the compensation and it will be very emotional, and are you sure you. . ." "You are going to watch it! I want you to see it!" "Show the video." My office in 9/11 was filled with memorabilia: ribbons, memorials, certificates, medals, films, videos—unbelievable.

When you dispense money in these programs—whether it is a government program like in 9/11 and BP, or it is a private program like the Boston Marathon—you learn a few valuable lessons about human nature. One: money to victims is a pretty poor substitute for loss. It is pretty hollow. We can sit and reasonably declare that giving somebody $2 million tax-free should have a profound impact on surviving lives. But do not expect to receive thanks from those victims to whom you are

offering money. People know it is pretty hollow. Second: you have to decide how much money to pay somebody. What is life worth? And that raises tough issues. "Mrs. Jones, you are going to get $2 million because you lost your daughter in the Boston Marathon. Thoughts?" "$2 million? Why not $4 million? Why not $1 million? Why not $8 million? Why not $500,000? Where did you come up with $2 million? I am just curious." "Well, we figured in our judgment . . ." "Oh. In your judgment." "Mr. Jones, you lost one limb. You are going to receive $1,250,000." "$1,250,000? What is a guy who lost two limbs going to receive?" "$2 million." "Well, just because I lost one less limb, I get $1 million less? Where is that written?" Problem number two, after money being hollow, is deciding the absolute dollar amount that you earmark for a victim. That is very difficult to do. But that difficulty is insignificant compared to problem number three. Problem number three is not what you are going to pay a victim, but what her next-door neighbor is going to receive. *Everybody counts other peoples' money*, and if you say to somebody, "You are going to receive $2 million," then brace yourself for that person to say, "Why are you giving me $2 million and you are giving my next-door neighbor $3 million? What do you have against me? Why are you demeaning the memory of my wife who died? You did not even know her, and you are only giving her $2 million? And you are giving the next-door neighbor $3 million? You are denigrating the memory, and you are invalidating the memory of my wife. You ought to be ashamed." You have to deal with that. Everybody counts other peoples' money. It is not just one case with one claim. It is collective. Everybody is in the same basket. And everybody talks, and everybody figures out what the next-door neighbor received. You have to be prepared. It happens.

I guess the point I make in conclusion, as the title of the talk suggests, is that these are very unconventional responses. Jim Capretz is here today, one of the best lawyers here in Orange County. And he deals every day in the courtroom with litigants—one litigant, five litigants, ten litigants, and victims—and he does it as well as anybody. These programs are an aberration. They are not the traditional way that we compensate innocent victims of wrong. The way we compensate innocent victims is in the courtroom, and the courtroom works pretty well. But every once in a while, there is a new program, an unconventional response. A rare occurrence. And then you are in uncertain seas, when you try and decide who gets what, who is eligible, what is the methodology for calculating damage, what are the proof requirements, how much due process should you provide people?

It gets thorny. Fortunately, these programs—so far at least—have been successful. They have worked.

What I do is not rocket science. The people in this room could do exactly what I do. I do not have a patent on these types of programs. There are people in this room, like Jim or others, who could do what I do. I am asked to do it. As a citizen, I do it. If you were asked, you would do it. So that is the summary of what I do. We could spend at Chapman a whole semester talking about the unique features of these programs, but at least that gives you the tip of the iceberg. If you want to get into more depth, there are two books I have written in which I get into this at great length. Thank you very much.

[Chapman University Dale E. Fowler School of Law Professors Nancy Schultz and David Dowling facilitated the audience questions.]

Schultz: Excuse me, since [Dean Bogart] was foolish enough to give me the microphone, I am going to ask the first question. My question actually goes to what you were just talking about being the hardest part of the job. I always tell my students, "If you can't handle conflict, don't be a mediator." You get it in floods, and you obviously feel it. I think we could all hear that. How do you handle it? How do you process that when you get 900 people telling you about the worst thing that ever happened to them?

Feinberg: It is devastating. It is stressful, and you do not forget it. Unless you have a heart of stone, you cannot help but be impacted by these events. But, I must say, if President Bush or Attorney General Ashcroft or Senator Kennedy all call you and say, "Thanks for doing this," it reinforces your resolve to do it as a professional, as a lawyer, as best you can. People say, "Well, when people come to see you and they start crying and lamenting life's misfortune, do they get more money?" And I say, "Well, sometimes they do. I am only human, but money is a pretty poor substitute for many of these people." You try and do it, you have a loving family that is very supportive, and, I am surprised, the public is very supportive. I would have thought that, especially with 9/11 where you are spending taxpayer money, it would be like "Watch out!" at the airport and hide; but to this day, people come up, "Thank you, what a horrible task. You did it so well." And that again reinforces your determination if you are asked to do it.

Dowling: I would like to ask a question. You said your law degree is not applicable, and a degree in divinity would be more helpful. What kind of background do those who work with you

have? I have students in this room who come out and mediate cases with me, and they have a passion and interest in mediation and resolving conflicts and disputes, so it would be helpful for them to understand what skill base is important in a role like this.

Feinberg: When I do one of these programs, I outsource everything. My law firm is me, my partner Mike Rozen in New York City, and my colleague Camille Biros in Washington. So anytime we have one of these assignments, we outsource. Now the lawyers, the immediate staff, the deputies, are all lawyers. When I say a law degree is not helpful, I think the law degree is very helpful in designing the program. What I meant to say about a law degree is that you quickly lose the advantage of a law degree once you start dealing one-on-one with victims. But the law degree in designing the program is very helpful. Second, I almost always hire former students who were part of the course that I have taught at Harvard, Columbia, Georgetown, NYU, or wherever. Students who have kept in touch with me, and want to leave their current job and take a sabbatical to work on one of these funds, I almost always hire as part of my immediate staff. Feinberg-trained lawyers. And then of course, the infrastructure of these programs—accountants, claims adjusters, lawyers in local offices, political figures, PR people, anti-fraud unit—we had 4,000 people working in the BP fund.

Audience member: Which case has been the most interesting to you personally?

Feinberg: 9/11. 9/11 was the most interesting because it had a traumatic impact on everybody in the country. And I learned doing the 9/11 Fund that you make mistakes that you hope you will never repeat. You are dealing with individuals; you are not dealing with some abstract legal theory like a tort. You are dealing with real individuals who come to you with tissues and tears, and you are trying to give them some lifeline, at least some financial stability, and you learn. In 9/11 I learned every day on the job the mistakes you make. A man came to see me. He was seventy-one years old and he had lost his son at the Pentagon. He said to me, "Mr. Feinberg, I lost my son. He escaped after the plane hit, but he thought his sister who also worked in the Pentagon was trapped, so he went back into the building to look for her. She had escaped through a side door. He died looking for her." And as this man was crying, he said to me, "It is not right that a parent should bury a child. It is not right, Mr. Feinberg." And I looked at him, and I said to him, "Mr. Jones, this is terrible. I know how you feel." This man, a very nice man, he looked at me and he said, "Mr. Feinberg, you have a tough job,

but I want to tell you something: do not ever tell me, or anybody like me, that you know how I feel. You have no idea how I feel. And just a constructive criticism, be careful what you say to people, because it strikes a raw wound." I will never do that again. 9/11 was the most difficult.

BP was tough because of the volume of claims and problems of proof. "Oh, Mr. Feinberg, I lost $100,000 because I could not fish." "Oh, do you have a tax return?" "No, we do things with a handshake down here." "I am not paying $100,000 with a handshake. Do you have corporate records? Do you have a checkbook?" "Yes, here." "Okay, I am going to send you a check for $100,000. You will have it in two weeks. Now with it, I am sending a 1099 from the IRS." He says to me, "I waive it." You cannot waive a 1099. I said, "You know, I have to send the 1099." He says, "Rip up my claim. Rip it up!" There were problems with people who could not prove their claims.

Schultz: So how do you decide? New Orleans is very near and dear to me, and I know how a lot of businesses operate there.

Feinberg: I want to come to the defense of New Orleans. I do not think that New Orleans is any different than anywhere else in the United States when it comes to compensation claims. How do you deal with an unsubstantiated claim? We are not paying it. Go criticize all you want to the press that I am being cheap, but if you cannot prove your claim, the integrity of the program—the American people would be furious. "We pay our taxes. This guy is getting money, and he does not have any taxes." They would howl over something like this. So, we do not pay it. Now, how much proof we need, we will be as flexible as we can, but you have to show me something.

Audience member: You mentioned ninety-four people decided to litigate. How much did they get? How did it compare to what you gave out on an average?

Feinberg: It is all over the lot. Ninety-four people in 9/11 decided to litigate, and they settled their cases against the airlines and the World Trade Center five years later. Those amounts are sealed. I suppose some received less, some may have received more, but after you pay the costs and twenty-five percent to your lawyer, I would be surprised if more than a handful of people received more. And even if they received more, good luck to them. If they want to litigate for five years and relive 9/11, instead of "here is money, move on as best you can," I think those people made the wrong choice, but that was a choice they could make and that is fine.

What really bothered me in 9/11, were the two people who took nothing. They did not file a claim, and they did not file a lawsuit. One was a priest who lost a brother who told me he did not think it appropriate to take the money. I said, "Father, have you lost your mind? Take the $2 million, give it to Catholic charities." Nope, he wouldn't do it. The other lady, I went to see her at her home, she was seventy-five years old, and she had lost her son. She said, "You're here to talk to me about money? I lost my son, and you are giving me dollars? Leave the application on the kitchen table." She never filled it out, she never filed a claim, and she never filed a lawsuit. You learn that grief can paralyze people, and they can act very unreasonably. Only two—those two were the ones that hurt the most. Those were the ones we could not get to take the money.

Audience member: If I may ask, what is the value of the Zapruder film?

Feinberg: The Zapruder film is the only contemporary recording of the actual assassination of President Kennedy in Dallas. Mr. Zapruder happened to be filming to show his children that night at the dinner table. And he caught it on film. The minute he realized it, he ran to the FBI, the FBI seized the film, and it sat in the National Archives for about thirty-five years. On loan. It is Mr. Zapruder's film. Congress passed a law, calling for government possession based upon eminent domain. We are going to seize that film as a historical artifact to be preserved in the National Archives. And there will be an arbitration established by law to determine the amount that should be paid to Mr. Zapruder's family. Mr. Zapruder was long since dead. So the government chose Walter Dellinger, the Solicitor General, to be its arbitrator. The Zapruder family asked me to be their arbitrator. We together chose the former Chief Judge of the Third Circuit Court of Appeals in Philadelphia, Arlin Adams, to be the third arbitrator. We held a two-day hearing to determine what the film was worth. The government called witnesses and said it was worth maybe $3 million. The Zapruder family called experts from Sotheby's and Christie's, the auction houses, to say, "It's priceless! It's worth at least $35 million as a historical treasure, unique in American history." And the three arbitrators met, and one side said three, and the other side said thirty-five—well, sixteen is about the right price. And that was the value we placed on it. The United States Treasury paid the Zapruder family $16 million, and the film today is in a plastic, enclosed case protected from the elements. The spool is unraveled. It is not exactly a Da Vinci painting. It has no aesthetic value at all, but it is there to be kept for all time by the government on behalf of the American

people as the best evidence of that fateful day, fifty years next month actually, when the film was taken by Mr. Zapruder.

Schultz: I have a question about the BP money in New Orleans. It was not all paid out. Do they get to keep the rest, or is it going somewhere?

Feinberg: I paid out $6.5 billion of the $20 billion. Then BP, out of that amount, paid about $2 billion for clean up in the Gulf. That's about $8.5 total. Then about $2 billion was paid to governmental entities—state and local governments—that lost tax revenue or sales tax revenue. The rest was maintained by BP.

Audience member: Why was BP a government program if it was private money?

Feinberg: The money was private, but the money was distributed pursuant to an escrow agreement entered into with the Department of Justice in which the rules and regulations governing the program would be established consistent with the Federal Oil Pollution Control Act, a federal statute. So you are right. It is more quasi-government in the sense that BP funded it, not the taxpayers, but it was a rather unique hybrid in terms of how the program would operate.

Dowling: I think Professor [David] Gibbs had a question.

Gibbs: I heard you speak more than ten years ago, and it was a time where there were several thousand people not filing claims and the deadline was approaching, and you were very unhappy about that. It was in the thousands! How did you get the number down from thousands to two?

Feinberg: Here is how you do it. That is a fabulous question. I have learned what some of you know from your mediation and arbitration classes. If you set a firm deadline, you have to tell people this is it—"You either come into the program by this date, or you are out of luck." Or you do a mediation and you say, "We are going to start today. This mediation will end tomorrow at noon. So whatever you are holding in your back pocket, if we are going to have a settlement by noon tomorrow, you better put it on the table." Invariably, people wait until the last second. In 9/11, two-thirds of all the claims were filed in the last six months of the program. People delay the day of reckoning. They do not want to make decisions. They will wait until the last minute, and then they will file in droves. In 9/11, I think the last 1,000 claims were filed in the last forty-eight hours. "We are running out of time!" And you know you better come to grips with this because the statute will not be extended. Senator Kennedy came to me about six months before the

program was to expire, and he said, "Ken, only thirty-five percent of the people have filed. Why don't I try and extend the program another year?" "Senator, don't you dare. If you extend the program another year, people will wait and wait, and they will still procrastinate." It does not matter that they are going to get millions instead of paying millions to the IRS when people wait until April 15 at midnight to file their tax returns. This is the other way around! We are ready to give you the money. Nope. People wait and procrastinate until there is no more time. So ten years ago when I was lamenting this, it must have been six months before the end of the program when I was saying, "Oh my goodness, I hope they file." They all came in virtually at the last minute. Everybody just came in.

Professor David Finley: So for the 9/11 program, was there an underlying assumption of liability on the part of the government? Was this just an extraordinary circumstance?

Feinberg: Nope, there were two reasons there was a 9/11 Fund. To this day, as you know, the federal government has never apologized for 9/11. The federal government has never once said that the government was in any way to blame. Not in the slightest. Two reasons for the 9/11 Fund: One, the airlines ran to Congress and said, "If you do not set up an alternative program, you know Jim Capretz and the others are going to sue! And if they sue us, it does not matter whether we will win the case or not, we will be in court for years, everybody will be reading about the airlines, they will be afraid to fly and we will all go bankrupt." That was one reason. The other reason was the American people, and the desire of the American people to come to the rescue of their own. "We will show the world how we take care of our own and we'll rally the troops. The American people will stand as one with the victims. We are their cousins, their family. We are one nation, and we are going to show how generous we can be." And those are the reasons. It had nothing to do with government responsibility. One time I know that the government apologized for a government wrong was in 1980, when President Reagan signed that bill compensating the families of Japanese-American citizens who were interned after Pearl Harbor and were sent to New Mexico and Arizona. The President apologized and said we are sending a check—it was around $20,000—to every member of the next generation. Reparations. The 9/11 Fund was certainly not reparations.

Audience member: Do you think the difference between 9/11 and the Oklahoma City bombing was that it was someone that was American as opposed to someone who was not?

Feinberg: Is the reason we had a 9/11 Fund but not an Oklahoma City fund because the Oklahoma City bomber was an American citizen? I do not know. That does not sound very convincing to me. Whether the terrorist was a foreigner or a domestic terrorist, terrorism is terrorism as far as the victims on the ground. You try explaining that distinction to people. I do not get it. And even if you are right, I do not like the distinction. But the 1993 World Trade Center victims, those were the same people! Same type of foreign terrorism. They were not eligible. The people who died in Kenya when the African Embassy was blown up in 1998, 200 people killed—no fund for them. This was an emotional thing, 9/11. I think if Congress had waited two more weeks, it would not have done it. But, having done it, I think it worked, and I think it was the right thing to do.

Audience member: I am really happy you came today, and I am really happy for you that you have this job because I think you get to cultivate more compassion than most human beings in their whole lifetime. I was wondering after we leave here today, knowing what you know about the human heart and life experience, how do you recommend we all leave here treating each other?

Feinberg: That is a great final question. And I think it is appropriate particularly as we honor the fiftieth anniversary of President Kennedy. I grew up in Massachusetts where a son of Massachusetts was in the White House. I am part of a noble profession. I think it is so important that we lawyers give back to the community. And that does not mean you have to be a legal aid lawyer—although that is wonderful—or work for a non-profit. You can work for a large law firm in Orange County, but I think it is so important that we honor the legacy of President Kennedy, who told all of us how important it was to give back to the country, in any way you can. Even in small ways, but if everyone acts in a way—does something—for the community and for their fellow citizens—it does not have to be what I do. I roll in and roll out with these big programs, and like you said, they are very visible. These programs, fortunately, are few and far between. And if you are going to mediate, you are going to litigate, or you are going to be a corporate merger and acquisitions specialist, just think about the honor of being a member of our profession, and how important it is somehow in your own personal way to give something back to the community in the public interest. And I think that is the best way we honor President Kennedy on this fiftieth anniversary of his death. I think that is important, so thank you all very much.

Chapman Dialogue Series: The Role of Law Schools After the JD

Monday, November 11, 2013

Douglas Sylvester[*]

I want to talk about what I think the role of law schools should be after the JD. This presentation is not a formal presentation; it is just to situate some of the things I want to talk about with all of you. So I not only want to leave time for Q&A, I would like to have as much Q&A as we possibly can, including things like, "You are crazy Sylvester, no one would do these sorts of things," and I am happy to explain to you that, yes, I am nuts.

What I want to talk about today is the crisis we are all feeling with the legal profession and law schools themselves. Then I want to talk a little bit about why I do not think it is a generalized crisis—we all have our own crises, we all have our own individual things. Then I want to use this as one example of a way that we can respond to this crisis, individually, locally, and in a way that makes sense for our school, our students, and our communities. This is just an idea. I think there are a lot more ideas, and again, I am hoping to steal them from you so please do feel free to share throughout the presentation.

Right off the bat we know certain things are true. We know that there is a crisis in legal education—or do we? This phrase itself bothers me. I do not believe there is a crisis in legal education, but I do think law schools and the legal industry are facing a crisis. Law schools are obviously facing, deans especially, an economic crisis because of the drop-off in applications. We are now down another ten percent as of the October applications, so

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it is looking like a tough year to recruit students. There are going to be a lot of difficult choices that schools make, and again, they are individual choices. Some schools are going to choose to go one path, and some will go another, and I think that is fine. The question is the choices you make as you enroll the next set of graduating students.

The crisis is not just a numbers game. We have a crisis in the reputation of lawyers, and I want to talk about that too. When we take polls and surveys about what Americans think of lawyers, we come just slightly ahead of industry salesman and well ahead of former Congressmen. We know that much. The legal profession used to be held in high esteem by the general public. That is not true anymore. Something has changed about the profession, something is different, and I think law schools have a role to play, and a little bit of blame, in how that has occurred. It is not just whether people are going to law school. It is what happens when they get out. It is what our perceptions are of all of us and I think what we hold dear. What can we do now and in the future to change that?

And lastly, there is a job crisis, but that is a national problem. The question is whether it is individually true for one school versus another, because I think it is a different conversation when you focus individually. But overall, there is just no doubt that in this current economy we probably have too many lawyers who are looking for the same kinds of jobs. The question is, can we change the kinds of jobs that people might be looking for? Can we change some aspects of the industry to try to avoid this very clear view that there are too many people graduating for too many jobs? I do not think it is actually as big of a problem as everyone talks about, but I want to at least address it.

Law schools have been guilty of certain things. We (as if we are a single industry!) have certainly been over-enrolling for decades. There is no doubt, as jobs have been rolling out, law schools have increased the size of their classes without much regard for whether the local market can actually sustain that number of people or whether we really have institutions in place to transition people into their practice of law. Obviously, not Chapman or ASU, but every other law school in America is guilty of these things (that is a joke by the way). I think we can do better—or at least the one law school I control can set an example of how to be student-centered in its enrollment and graduation practices.

There was also a quick rise in the cost of tuition at law schools. I have talked about the real crisis in law school being

that there are not enough jobs out there, but I do not think that is right. I think if we were still charging $4,000 a year to attend law school, and if the students did not get a job as a lawyer, then they could still graduate and do other things. Now, if you graduate and have $125,000 in debt, there are not a whole lot of other careers available to help you sustain that debt load.

The critics you may be seeing out there who keep talking about how law schools are constrained by the ABA rules and cannot innovate are just nuts. The costs of legal education are not, and I cannot be clearer on this, caused by ABA rules. Go look at non-ABA accredited institutions and ask whether they are cheaper. Seriously, go look. This is not the time for an extended discussion of what drives up law school tuition (and in some cases it is merely greed, at others sunk-costs, and at others a strong correlation between student willingness to pay and value received).

We at ASU have frozen tuition every year I have been dean. Maybe that is sustainable for longer. But at some point we have to face reality that most law schools will continue to raise tuition and most law students will continue to go into debt for the opportunities a JD provides. Much of the world has called for radical cuts in tuition. I am here to say that this is not going to happen at ASU. It may be possible at other schools, but to the extent critics of legal education continue to call for radical cuts I think they are going to be disappointed. So, I ask, is there another way forward? Can we provide value to students without cutting costs (although I do hope we can stop the rapid rise we have seen over the last decade)?

The answer cannot be that we are just going to cut costs, put our heads in the sand, hope that the economy turns around, and everyone is going to get back to where we were a few years ago. If we are not proactive in trying to change the dynamics for our students, and change the dynamics again of our local communities, I do not think we are going to succeed in moving forward. I think there are things we can all do, and there are things ASU is doing.

What are the endgames? How are we going to shape lawyers' careers beyond just the JD? To start, I want to make this very clear: I do not think there is an education crisis, believe it or not. I believe in the legal education. I think it is a phenomenal degree. Dean Tom Campbell knows this as well as anybody.

I have been teaching in business schools for almost twenty years now, and the JD is a fabulous degree compared to the MBA or just about any other degree of which I know (from a purely

pedagogical perspective). I just think that both degrees are great for what they do, but the analysis, the analytical thinking, the reasoning skills, and the problem-solving skills that law school teaches you over a three-year period is crucial to success in almost anything.

I am a real believer in legal education, and I am also a believer in faculties. I think faculties have done a very good job over the last ten, fifteen, twenty years of responding to the changing needs of our students. Now, when I say this, let me be clear. Faculties have been good innovators. All around the country we see experimentation and addition at law schools—many of which were clearly aimed at aiding students in both their studies and careers. Additions of clinics, supervised externships, practical skills, transactions models, and internationalization are just a few of the massive changes we have seen at law schools in the last two decades. However, faculties do have a problem.

What faculties are great at is adding. They are not so great at getting rid of things we do not need anymore. This is not surprising. Once people have been hired, paths set, and dependencies merged with expectations, it is difficult to shed ideas, projects, and programs that are no longer working. These may increase costs for students—but I think that discussion is incorrect. The costs are already set—law schools need to think more clearly about how to ensure a connection between costs and value for their graduates.

Last week, I was in Los Angeles with a program involving the heads of hiring partners in law firms and a number of deans. We were talking about what law firms want. And guess what they want? They want everything we have been doing for ten or twenty years. They just want us to do it well into their careers. In short, they want us to continue to teach our graduates, train them, and make them even more productive attorneys than we have done in the past. And, to my mind, most responsible law schools have already done a fair bit to achieving those goals.

The number of clinics, the changes in curriculum—there is so much room for law schools to innovate and I think they have done it. If you go look at your law school today compared to what you took, I think you would not even recognize the school you attended. Even Yale has some changes from what I hear. I have not been allowed on campus, but I understand it to be true.

So I think you will see that I do not have a problem with us as educators. We can do better, but we do not have a problem with it. I do not think we need to blow up the legal education

system. I think, again, it is great to have schools innovate. If another school wants to go to a completely different curricular model after a very long period of time, I applaud that. I think it probably does make sense for them, their students, their communities, and their institutions. But I actually think the traditional legal education—a first year curriculum that focuses tremendously on writing, analysis, skills, and reasoning—is the key to being a great lawyer. And then a second year in which people take courses learning more about doctrine, learning more about advanced areas, is a wonderful entrée to the profession. And then at our school, we do not have requirements but we have a huge number of clinics, a huge number of externships, and the vast majority of our 3Ls do take clinics and externships. Students are saying, "This is what we think we need," and our school has a program that is available to them. So I think legal education is strong as long as we view it in specific instances.

The real issue with legal education is as an industry. It sounds a little crass to speak of law schools this way—but we are an industry, and I think we could do a lot better. And this is the point of this talk, which is what I think we have failed to do in our careers, not within the classroom, but the law school administration itself, as an institution, as a service industry. Not just as a place that you come and are educated as a student in a rigorous environment and then are released into the world—and then bugged every three months for money. Something beyond that is what I think we as law schools need to be doing.

There has to be a way that we can recognize that our students should have a lifetime connection to what we provide: education. We need to have a way to say, "As soon as you come to this law school, you are not just here for three years. You are here for the rest of your career, and we are here for you." Which I do think is different than what most law schools have thought about. Most law schools say, "We have you for three years—and again, we pour our hearts and souls into making you a great lawyer—but then when you graduate, off you go. And we will talk to you again hopefully when you make a lot of money, right?"

When I became dean, one of my first experiences was with a successful alum. He and I had a conversation, and he said, "Look, I loved the law school. Believe it or not, even those jerk professors, I even liked them. Everything about it; I enjoyed my classmates; the administration supported me my entire three years there; it was a truly fantastic experience. I loved the law school. And then I showed up for graduation, my parents were there, they were beaming with pride. I was so excited to start my career. I landed a great job, and I wanted to sort of thank

everybody, but as I was being handed a diploma by the dean I heard the sound of a door slamming behind me, and that is the last time I ever had connections to this law school." Now, to apologize on behalf of administrators everywhere, it is tough to follow up with every single alum throughout their careers. Instead, we need to find a way to open ourselves up to allow our alums to come back.

What are some of the ideas? I am not positive about how to make this happen. But we have a bunch of different things we have launched to think about how to make law schools a service organization to everyone who comes through that door. So what can you do to create that lifelong connection? And, again, not as a guarantor of jobs, but as an educator, because that is what we do—we are an education system. I have some ideas about that.

One is to increase the number of public interest positions for our graduates. One thing is clear: public interest positions have dropped off dramatically. From a law school that has its tradition as a public service law school—a whole series of programs to graduate lawyers who will work in the public interest—we have seen a near halving of graduates who end up in those positions, even a year or two out. So why is that? Well, one is debt. One is that public interest jobs do not pay enough to cover the debt load that our students have when they walk out the door. And this is coming from a law school that has frozen tuition for the last three years. For in-state students, it is only $26,000; for out-of-state students, it is $40,000; and it has an overall debt load of about $100,000 for graduating students. Our tuition and debt load are well below the median of all the law schools in the United States. Yet, even we are seeing a huge drop off in public interest.

What else could be causing this drop off? Other answers are that fewer attorneys are retiring, and there are not as many non-profit, public interest organizations out there. You can track the number of public interest organizations, and you can see the number of public interest law firms dropping in the country. And, again, is it economics? Is it a lack of ideas? What is happening out there to make this work? I do not know the answer to these questions, but these are questions that are continually presented to me, and I am sure to many of you. What can we do about that? And that is what I am talking about here. What can we do about those problems, rather than go to the ABA and say, "Can you fix this for me?" because they do not fix anything, that is not their job. And rather than ask my fellow deans, to say, "Come on, we are all in this together. Can we do this as a single organization?" Small anti-trust problem, but generally speaking we are not going to get a lot of feedback that way. So instead, focus on your

own students, your own alums, your own community, and ask what can you do to try and change that?

We have one idea that we are hoping to launch here in the next couple of months; it is to have a venture capital forum every year in the summer. What would that look like? We are hoping to find people in town who are social venture capitalists. They have money, they believe in issues, and we could put alums and students in front of them to basically pitch their ideas, to say, "I want to start a public interest law firm in the following area, and what I am looking for is seed money, or maybe you just relieve my student debt." I do not care how it gets worked out. But there is something we can do. Instead of graduating people out into a community and saying, "Look, you have to go find sources of income, and you have to go and find your own way." Can we play a coordinating role? There are reasons to think we can. One reason is that we are there permanently. We are part of the fabric of Phoenix. We are part of the culture of Arizona, as I am sure you are all here in Orange County.

I do not think anyone is walking in the door expecting that we are actually going to get funders and students matched and launched at a high level or a high percentage. But what we can do is play a coordinating function for people after they graduate from law school. It does not seem that revolutionary to me to actually think in those terms; and yet, the vast majority of law schools do not do anything along those lines. They do not play a coordinating role. At the very least, that seems like something law schools can do to show their alums, to show their current students, that this is a lifetime connection and that we are here to provide services beyond just the classroom in ways that do not undermine in any way, the educational missions that we are undertaking. It does not change students into stakeholders and it does not change students into customers, because I do not think that is an appropriate educational model. It recognizes that students and alums are both. They are students at one point—here to learn and understand a curriculum that we here as experts have formed for them—and then when they leave they have a connection to the institution as a customer, essentially, playing a role in their lives as they go forward. That is just one idea.

One concept has always struck me as strange, and we are going to be launching an idea to address it in the next couple of weeks. You do the JD, you graduate, and then we still want to charge you full price for anything that happens out the door. What we are going to be launching is greatly reduced costs for continuing education for alums. And this is because we recognize

that the law is rapidly changing. You can tell that just by looking at our own curriculum, over a three-year, a five-year, or a ten-year period. It has changed dramatically from five years ago.

I was the first to launch a transactional clinic at ASU back in 2004—there had never been one. Now we have more. Why? Because we think that is something the market and our students desperately need to have in law school. How weird is it to train the next generation of lawyers, and then we have people out there desperate to learn these sets of skills, our graduates, who had the misfortune of graduating before those opportunities were available, and for us to say, "You want to learn? Pay again!"

I will give you another example. We have a very large Native American population, as people may know, in Arizona. The level of economic development on tribal lands has gone through the roof. And so we have thousands of alums out there seeking to prove that they are individuals that can help tribes think about their economic plans as legal consultants. But how do they get that level of expertise? How do they prove that? Well, at the moment, you can go to ASU and for $40,000 you can have an LLM, or for $1,500 you can take a CLE. These things just do not make sense to me. There has to be a way that we can work through your whole career and continue to be the main provider of education for you as you move forward. In short, taking the JD at your home institution should just be the first step in a "Law for Life" program that invites graduates back to learn from those who originally introduced them to the law to get more education—and to do that at greatly reduced prices.

In addition, I have always thought that it is odd that alums have to go to a recruitment agency, so we hired a full-time recruiter. Now this is, again, free, and it is not for current students, it is for alums. If you are looking to transition or you are looking for a first job, we have someone at the law school who is essentially your personal headhunter who charges you no fee and charges no fee to the employers that they contact on your behalf. This is part of what we can do in our own financial planning to think about services to provide people as they move forward. Again, it makes sense if you view your role as a school continuing after students graduate and become alumni.

Also, we meet with managing partners, mainly in Phoenix because I think our backyard is what matters for most of our graduates, but also other places around the country. We meet on a quarterly basis with hiring partners—there are thirty or forty of them—to try to talk about what is happening out there that we can do better. What can we provide, and are there changes to the curriculum that we should at least consider? They do not get to

dictate to us, because sometimes we think we have a better sense of what our students need than they do, but it at least lets us have that dialogue. And so, again, that coordinating role is something that I think we can do a far better job of doing.

One of our big ideas has been transitioning people into jobs when markets are tough. We have started our own law firm—the world's first non-profit teaching law firm (financed entirely by private monies) for our graduates. We have hired a former managing partner of big firms here in town in Phoenix and he is going to be our inaugural CEO. So what is the goal of this? It is first and foremost an educational institution because it turns out that is what we do best. We have been developing a curriculum for what new lawyers might want to do in the first two years after they graduate from law school. We want to ensure associates in the ASU Alumni Law Group get the depth and breadth of experience that associates at big law firms can only dream of getting. We think this will make associates of the ASU Alumni Law Group not only attractive to large law firms but also, and this goes back to an earlier point, attractive to public interest organizations that cannot train. Or, finally, we train our associates in all aspects of law firm operations so they, individually or in groups, can pursue their own dreams. They know how to run a firm, they know how to run the business side of a firm, they know how to get clients, and they also know how to practice law in a way that makes all of this possible.

At a meeting with the managing partners last week—the ABA was there as well—there was a discussion about changing some rules. There has been a lot of pressure to change the rule that says students cannot be paid for an externship. Law firms are pushing for this change as much as law schools. Hearing of this initiative was, for me, a shock. On one level, it would be great if the students firms have already selected to hire, could spend the last semester of their third year in residence doing a full semester externship at a firm, being paid some small amount of money to avoid the FLSA issues, and being "trained" by that firm.

On the other hand, I do not think that this is the greatest model for developing broad-minded and public interest lawyers. This is going to shock a lot of people who practice, but I think law schools do a better job of educating lawyers than the law firms do. My experience with law firms over the last few years is that the way they are training first-, second-, and third-year associates is radically different from even the experience I had back in 1999 and 2000. And those who graduated and worked during an earlier period were probably mentored at a far higher

level than these students today. Law schools have different incentives to train than any law firm can—so paid externships concern me.

Let me tell an anecdote with all knowledge that anecdotes do not good policy make. I had lunch with a student, an alum, who is now an eleventh-year associate at a major law firm in the country. Eleven years in, this associate has not appeared in court, has not led a deposition, or, if he were a transactional attorney, has not led a deal or even a portion of one. In our conversation, it became clear that he was doing essentially the same work in year eleven that he was doing in year three.

One answer is that he may just be terrible, but he is still there at year eleven, so he must have some pretty good skills. And I know him, and I know he is a skilled attorney. The problem is how clients now approach the idea of paying for young attorneys. First, as first-year and second-year associates, clients object to having to pay for any part of their "training"—this is, again from many anecdotes, speaking to partners of large and small firms, regardless of whether the work they are doing is appropriate for newly minted lawyers. These same associates, from third year to, far too often, sixth or seventh, are then subject to client objections on the basis that they add no value beyond that of partner-level work.

The question partners often face is: At what point can you start billing for associate work in order to develop associate skills? The answer nowadays seems to be "never." There are certain narrow areas where associates can be billed to clients, so that is where we assign the associates and that is all they are allowed to do. Let's sum this up: Firms "train" associates only to the extent clients are willing to pay and, far too often, clients never wish to pay for associates unless they are "experts," and "expertise" in the private sector is often defined by clients as partner-level work! Where clients pay the bills and firms must be client-centered, associate training and development are often the casualties.

Let me use one more anecdote from a public agency in Arizona. That agency had a long-standing rule: you could not be hired with fewer than three years of experience. That was their rule—and it worked for a long time, but not anymore. What they are finding is that, in the last five years, people with three years of experience have almost no experience at all. To paraphrase meetings I have had, "We are getting people walking in the door with three years of experience at the biggest firms in town—firms in L.A., firms in D.C.—and we bring them in, and they have not even done a third of the things that we expect people to

do in the first year here." Instead, this agency is now interested in a shared training opportunity for newly minted lawyers.

This idea is great. But I think we, as a law school, can do it as well. That is what our ASU Alumni Law Group really is. It is driven by the curriculum and focused, as only a law school can, on continuing the training and education of our alumni. Here is how our non-profit teaching law firm will work. You join this firm. There are ten lawyers, or there will be, with a minimum of fifteen years of experience. Marty, our CEO has about thirty-five years of experience, and he has been the managing partner of the two biggest law firms in Phoenix, so this is someone who knows how to run a law firm, knows how to train associates, and knows how to do budgets—these are useful things. I hope Marty hires many people who also have real experience, plus an innovative spirit, because that is what I would like to see. But the idea is, when we bring in young associates, graduates of the ASU law school, to work at this firm for two or three years, first and foremost, they are mentored and trained. The cases they take are meant to match the curriculum. If at six months they have a cadre of five young litigators in the litigation group, but they have not gone to trial yet, they need to bring in cases at that point that will get this group in court and conducting depositions. It matches the curriculum, and the curriculum drives case selection. There has to be one hundred ways to do this and I hope others will experiment.

Greenberg Traurig, a very large national firm, has been doing something similar to this. They have been hiring a cohort of associates intending to perhaps keep none. They hire them at a reduced level, but they get to spend a year at Greenberg in a training program and at the end of that period of time, they can be hired, they can be told they are not being hired, or I guess they are also creating a third group. The idea is that they also see that there is a training problem: there is a market out there and an opportunity to meet that need. A law school that would not want to do that for its own graduates is something I do not understand.

Lastly, I have to build a building, and I am obsessed with it. It actually does reflect a little bit about this general ethos. This building itself is intended to reflect something specific to ASU. I do not think this is a building that everyone would want to build or would need to build, and could appear to be wasteful in certain ways because it has a lot of open space. It is split in two to create a shaded street—that is the goal. As you are walking up one of the major streets in Phoenix, you see this street just to the right of it that has shade all the way along. And so we assume that

people will want shade versus non-shade—that is one of the rules you learn in Phoenix. And so you will go in that direction, and once you get in there, we have a great hall, a 1,000-person hall. It actually has an airplane hangar door that is wide open, you can walk in, just sit, and have lunch. There is a restaurant on site, as well as a very large museum that is trying to convey to people the importance of law in their lives.

Now why do I want to do this? It is not inexpensive, and it is unusual to have nothing preventing the public from walking into this building. The first two floors are generally wide open to the public. It is a series of different places where they can be educated about the importance of law. We are no longer supported by our state legislature. We are, as of 2016, at near zero funding through taxpayer money. How are we going to change our future? Well, at some point, you have to be relevant to the community in which you live, because they are the people who are going to support you. When you are not open to the public, when you are not engaging them, when you are not out there trying to explain the law's importance to their lives, to explain that law is something more than coffee dropping in your lap, getting a lawsuit and a lottery win; then you are irrelevant. We need to make sure that people understand that law plays a beneficial role in justice and in their everyday lives. Law is about mediating disputes, it is about facilitating cooperation, and it is about ensuring all citizens get a "fair shake." If you cannot convince people about the importance of law and the importance of lawyers then we are not going to have a future. And I do not mean that just about ASU. I do not think the legal profession has a great future if it cannot start convincing people that we are agents for justice and agents for good, as opposed to just agents for profiteering. And it has to start at law schools, it has to start in communities, it has to start with your alums, and so this building from top to bottom has been thought about in those terms.

Will we succeed? I have no idea. Am I even right? I have no idea. But I am definitely looking forward to hearing from all of you. I am not quite sure what the answer is there. So thank you all for indulging me and I look forward to your questions.

[The Questions and Answers portion follows.]

Dean Daniel Bogart: I know that many of the faculty here can tell you, we have spent a good part of the last year and a half on some pretty significant curricular review. I see some of the same ideas, and I see different ideas. We have a person who is assigned to alumni looking for career help post their first job, and I think that those things are important. We also have revised our

expectations just within the classroom to incorporate a set of skills. I look at this idea that law schools should be more than just a place in which you get your education during those first three years, and after that you are on your own—as you say, the door is closed. I would have said ten years ago that was not really all that possible, that technology would not have permitted it. My first question is, whether this is only possible because technology lets you do it now? And the second question I will ask has to do with this law firm post law school. It is a fairly expensive model, not one that I think most schools would be able to emulate easily. And so since you asked for our good ideas, I am going to ask you where you got your money.

Sylvester: I will start with the former question. I think technology helps, but there is something about the in-person teaching model that I think is part of what is making law school so successful. I am somewhat resistant to the notion that people learn as well—and I am a digital person—digitally, as they do in person. And so I am hesitant to think that we are going to fully expand to a massively technological model. And if we do, I think it will be a lesser model than what we currently have. Most of what we are doing with these LLMs is mostly in person. What makes this possible, at least for us, is we have a large metropolitan area around us, we have a general level of exclusivity within that region, and so most of the people in town who are practicing law are within just a few blocks of where this building is going to be. So we think we are going to have many people coming back in person. Where we do not, I think we will use technology. I do not think there is any doubt about that. One of the things technology clearly can do is reduce the overall costs of providing these things. I guess the question ultimately is—and it is incredibly individual—looking at your own budget, are you prioritizing things in this sort of way? Every firm, every company, goes through these sorts of questions. In times of crisis, they have to be looking at how they have been allocating resources and saying, can we make some small changes?

So, where did I get my money? We allocated some resources for a while. It is all private donations. There is no public money; that is actually one of the complications we had as a public institution, we cannot suddenly compete in the marketplace. So this ASU law firm is its own stand-alone corporation. It is just a license of the ASU name, and it is supported solely by private donations that could have been used to endow another professorship or increase scholarships or other programs. These are private donations that could have been used, frankly, to increase travel and for some conferences. And so, over the last

three years, what we have essentially done is shepherded some portion of private donations that we have been able to receive each year and allocated them to a fund that will create an endowment for this non-profit company. Now, that said, it is not the most fully funded institution in history. If we just fund it out of what we put into the endowment, if it cannot bring in other revenues itself, it is going to be out of business in about two years. So it has to bring in other revenues, and I need to be looking at other sources, including grants, to try and support this. But I think it is an idea that can work. I think it is an idea that is worth boldly failing at, and so we are going to give it a shot. And I think that is probably the best answer for us and our community.

Audience member: I am going to pick up on the discussion of cost. Because of the third-year externships and the third-year clinics, the student-faculty ratio has changed over the last ten years from 20:1 to 8:1, and that is a very expensive thing. We do not have Kingsfield talking to 150 students; we have one professor supervising a clinic with five students. And so one of the things we have done with at least some of our clinics is create a tie-in with our alumni—they become supervising attorneys. We also partner with a law firm, and it gives them the opportunity to assign their young associates to conduct the depositions because they are not paid matters. Young associates at some of the firms in the country are getting exposure to depositions early through our clinics and working side-by-side with our students. So I think one of the ways you might minimize costs and expand that connection is utilizing that clinical role, not just with your law firm, but with the other firms as well.

Sylvester: That is a fantastic model. You are all very lucky. I am going to steal that, but that is okay. And I hope we do that. I actually hope that this is what we do instead of looking for some single solution for everything we are trying to do; you can look at what makes sense for your school. There are clearly certain places where our law firm would not work. If you are in a rural area, I do not think you are going to be able to sustain a true law firm model on the basis of what we have created.

What we have done is have a single seat for every student in the clinic, which means we are undersubscribed in most of our clinics. We have, quite frankly, for the size of our student body, too many clinics, and all of our clinics are faculty-based. So we have grown our faculty by about sixty percent in the last twelve years almost entirely on the clinical and the professional skills side. And so that might be out of balance. These are the kinds of things you need to take a look at and decide from year to year. Is

this what is going to make sense for our students and what we want to do going forward? And if it does not, are there better ways to try and put those together? I do not think we should ever make educational choices based on the economics, but I am not saying that we ignore the economics. Claims of cutting law school to two years—I am perfectly happy to have that conversation; except ninety percent of the people raise it for one reason only, which is: law school is too expensive, let us cut it by a third. That does not make any sense to me as an educator. As someone who believes in legal education, if there are good reasons to have a three-year degree, if there are reasons to have a four-year degree—I do not know if there are—then that is what I think we should do. We should not let the economics drive the pedagogical choices we make. But when we can get the same kind of pedagogical events, when we can have the same educational system, and we can find ways to do it in a more flexible and cost-effective manner, I think we absolutely should.

Audience member: I had a question about the CLE programs. What role do you envision for existing faculty in such programs? And, secondly, how do you incentivize the faculty to do such things?

Sylvester: I actually tell the faculty to stay away. We consciously use our CLE program in a quite specific way, and it is not what I think we hired faculty to do. Most of the faculty we have are phenomenal classroom teachers and great scholars and researchers. That is what we want them to focus their time on. What we do for our CLEs is we have a massive alumni base. What made sense for us is—this is a great way to meet potential clients—if you are trying to build a base, we will put on a CLE for you. The only thing we ask is that you are not going to get paid for it, and in fact, if there are alums in that CLE most of them get to attend for near-free. People from other law schools are certainly welcome to come, but there is going to be a fee for them. But it is a way of saying, once you have graduated from law school, the education at the law school should be essentially subsidized by the JD that you have. And so we do not ask faculty to be deeply involved.

The law firm itself has no faculty involvement whatsoever. The law firm itself is a separate 501(c)(3) sister organization to our alumni association so it has no faculty involvement. I am a strong believer in the faculty-run academic life of the institution, but there is an administrative side that I am talking about here. Focusing on the institution as a service organization is not a faculty role unless they want to have it. But it is not something we hired faculty to do. So unless it is really something that you

have a passion for, the idea that we would make you do it is not something that I am interested in doing.

Audience member: Do you think there are different models for law schools? Colleges have research institutions, small undergraduates have a co-op model. In your presentation, it seems to me you threw a carpet over existing legal education and said, "We are doing a great job, and let us look at what else we can do." Do you think there is room for more variety in the type of law schools, where some law schools focus on research and some law schools focus on practitioners? I come from a practice background, and to say people are in a legal industry is like saying Joe's Autobody is in the legal industry and Toyota is in the legal industry. It seems like law schools are more or less one program.

Sylvester: I think that there can be room. The only way the system works is to have variation, flexibility, and adaptation in each school. And it has to be what you think works for you. I am nervous—again, just as an educator—about one particular model. I think there is plenty of room for variation if what we are also taking into account is the futures of the people from those institutions. And it is hard to know what that answer would be. If a two-year practitioner-based model—the idea is we are going to teach you to run your own firm—could turn into lucrative and decent careers at a low cost for graduates, then I think that is a great idea. If it is like certain for-profit online universities that do not seem to take into account what is going to happen to the people after they pay their tuition, then I am not so sure that is a great future. So I am not positive that we have a good idea of what those alternative models would look like.

I am very nervous about a fully online legal education as something serving the legal profession and changing the dynamics that I was talking about at the beginning. If the crisis we have here is that lawyers are here to serve good and that lawyers are educated and ready to make a positive difference in this world, I am not sure the kind of future that many are advocating is really going to get us there. I am not sure that what we have is perfect by any means, and I think there is room for variations, but I am deeply suspicious of a fully online, for-profit, one-year legal world with apprenticeship.

What I am suggesting is that law schools have a tremendous vested interest in having their law students become the kinds of lawyers that I said I hope we can all become. We have the interest more than firms do, we have that interest more than individual attorneys do, more than Mike's Body Shop. We have that kind of interest in it, so if students and graduates cannot

otherwise receive that kind of training, we can take on that role. And maybe not everybody can. There are very few people out there that have the right kinds of incentives to make sure students are trained properly, and I think we are one of the few institutions that do. And if we can just have the boldness and the focus on these kinds of solutions, I think we could make a real positive difference, and I think that is a better solution than going to a two-year model of law schools.

Audience member: You have spoken about the decreasing number of public-interest attorneys that law schools are producing and solutions for administrations and faculties, but what can student-based organizations do to help produce more public interest attorneys and encourage students to pursue public interest jobs?

Sylvester: I am not sure you can, to be honest with you. I will use ASU as an example: our students graduated last year a class of 200 or so with 114,000 hours of pro bono work; I always say to the city of Phoenix that is about an $11 million economic benefit we provide. We have a full-time administrator for pro bono. We have a full-time administrator for externships. Our students have about dozens of pro bono organizations; that is what drives these pro bono hours. And through the clinics themselves we have a huge amount of effect. So students show real interest in public interest while they are in law school, a real dedication to it. Sacrificing, sometimes probably more than they should, time for studying and class time to carry out the things that are in their hearts. So we are doing something right in law school. I think the students we are enrolling nowadays—especially because of the concern about jobs—really want to be lawyers, and they really want to make a difference. And so, I have seen a real charge on the students to do these things. It is at the moment of graduation out into the market that I think it is ending. And so, as alums, I think you can play a big role once you are out, to create these organizations and to then look to young attorneys to fill the needs you have to advocate the interests that you hold dear. I am just suggesting one role law schools can play. I think law schools can do it in about twenty different ways, but we can play coordinating roles between you and members of the community to get things done. I do not think we can set up public interest organizations for you, but I think you can do it as a student. I do not know, unless you are committed to public interest as a group—and I bet you all are—if there is much you can do in law school, except to keep going and looking for opportunities wherever you can find them, and try not to lose faith in the things that brought you to law school to begin with.

A "Little Ditty About Jack and Diane": Why Jackie's Good Name Should Be Considered Community Property in California Under the Concept of "Celebrity Goodwill"

*Ericka Evans**

INTRODUCTION

Every year *Forbes Magazine* releases a list of *The World's Most Powerful Celebrities*.[1] The stars are ranked based on several categories, including income and earnings, television and radio appearances, and press, web, and social media presence.[2] Powerhouse Oprah Winfrey tops the 2013 list due in part to the success of the Oprah Winfrey Network (OWN), her recent and well-received appearance in Lee Daniels' *The Butler*, and her consistent television and Internet popularity.[3] Oprah Winfrey represents a new form of celebrity; as *Forbes* has noted, "it used to be sufficient for a celebrity to be really, really good at what they do – acting or singing. However today, celebs need to be businesses."[4]

California has not so readily recognized this notion of the "celebrity business" when it comes to community asset

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1 Dorothy Pomerantz, *The World's Most Powerful Celebrities*, FORBES (June 26, 2013), http://www.forbes.com/celebrities/ (2013 rankings).

2 Dorothy Pomerantz, *The Celebrity 100: How We Create The List*, FORBES (June 26, 2013), http://www.forbes.com/sites/dorothypomerantz/2013/06/26/the-celebrity-100-how-we-create-the-list/.

3 *Oprah Winfrey Profile*, FORBES, http://www.forbes.com/profile/oprah-winfrey/ (last visited Nov. 21, 2013); *see also* Dorothy Pomerantz, *Oprah Winfrey Regains No. 1 Slot on Forbes 2013 List Of The Most Powerful Celebrities*, FORBES (June 26, 2013, 6:10 AM), http://www.forbes.com/sites/dorothypomerantz/2013/06/26/oprah-winfrey-regains-no-1-slot-on-forbes-2013-list-of-the-most-powerful-celebrities/.

4 Mfonobong Nsehe, *Thirteen African Celebrities To Watch In 2013*, FORBES (Dec. 30, 2012), http://www.forbes.com/sites/mfonobongnsehe/2012/12/30/thirteen-african-celebrities-to-watch-in-2013/. Singer Justin Bieber has been called "the world's most unconventional venture capitalist," due to his enormous social media popularity and knack for lucrative investments. Zack O'Malley Greenburg, *Justin Bieber, Venture Capitalist: The Forbes Cover Story*, FORBES (May 16, 2012, 9:59 AM), http://www.forbes.com/sites/zackomalleygreenburg/2012/05/16/justin-bieber-venture-capitalist-the-forbes-cover-story/2/.

distribution in divorce situations. "Celebrity goodwill" refers to the enhanced earning capacity of an individual based on his or her status or fame.[5] California currently recognizes goodwill associated with a business as a marital asset, whether the goodwill is related to the name of the business, a brand or product, or the reputation and skill of the individual practitioner,[6] but has yet to recognize celebrity goodwill.[7] California case law criticizes the intangible nature of celebrity goodwill and concludes celebrity goodwill does not fall in line with traditional notions of property and as a result, cannot be divided upon dissolution.[8] However, this argument is not consistent with California's definition of other intangibles, like the analogous right of publicity, which is defined by statute as a transferable property right.[9]

Currently, both New York and New Jersey recognize celebrity goodwill as a divisible marital asset,[10] reasoning that the non-celebrity spouse deserves to be compensated for his or her contribution to the celebrity career in the same way a non-working spouse deserves to be compensated for contributions made to a professional spouse's success.[11] In addition, the New York and New Jersey cases indicate celebrity goodwill can and should be valued in a similar manner to professional goodwill, despite the difficulties that arise.[12]

This article ultimately resolves that California, home to Hollywood and the Walk of Fame, should recognize celebrity goodwill as a divisible marital asset. Part I provides a brief history of the definition of goodwill. Part II provides a general overview of the approaches taken across the nation when it comes to recognizing goodwill in a divorce setting, specifically comparing the approach taken by California to the approaches employed by New York and New Jersey. Part III argues that celebrity goodwill can in fact be considered property, contrary to the analysis provided by the most recent California decision to

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5 Laurence J. Cutler & Robin C. Bogan, *Celebrity Goodwill: The Nature of the Beast From Horses to Hedge Funds, Tips on Valuing Businesses*, FAM. ADVOC., Winter 2003, *available at* http://www.americanbar.org/newsletter/publications/law_trends_news_practice_area_e_newsletter_home/celebritygoodwill.html.

6 *See infra* Part II.B and discussion that follows.

7 *In re* Marriage of McTiernan and Dubrow, 35 Cal. Rptr. 3d 287, 296 (Cal. Ct. App. 2005) (expressly declining to extend the notion of professional goodwill to include goodwill associated with celebrity reputation).

8 *Id.*

9 CAL. CIV. CODE § 3344.1 (West 2013).

10 *See, e.g.*, Piscopo v. Piscopo, 557 A.2d 1040, 1042 (N.J. Super. Ct. App. Div. 1989); Elkus v. Elkus, 572 N.Y.S.2d 901, 904 (N.Y. App. Div. 1991).

11 *See infra* Part II.A.

12 *See infra* Part IV.A.

tackle the issue of celebrity goodwill. Part IV explains the current methods employed when valuing professional goodwill, and offers that professional goodwill valuation methods can be extended to celebrity goodwill situations. Part V discusses that the California courts' refusal to recognize celebrity goodwill as a marital asset goes against the equity concerns that underscore the community property system. Finally, part VI concludes with the proposition that California should recognize celebrity goodwill as a divisible marital asset using a "little ditty about Jack and Diane" to illustrate.

I. THE "MOST INTANGIBLE OF THE INTANGIBLES":[13] GOODWILL DEFINED

The legal concept[14] of goodwill ties back to the often-cited Old English case *Cruttwell v. Lye*,[15] which defined goodwill as "nothing more than the probability that the old customers will resort to the old place."[16] California has followed this traditional understanding by defining goodwill as "the expectation of continued public patronage."[17] More concisely, goodwill is understood to be "the increased value of the business, over and

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13 ROBERT E. KLEEMAN, JR. ET AL., THE HANDBOOK FOR DIVORCE VALUATIONS 73 (1999) (describing goodwill as "the most intangible of the intangibles").

14 Although this article focuses primarily on the legal concept of goodwill, a brief mention of both the economic and accounting understanding of goodwill may add to the foundational understanding of goodwill and its general application in areas outside of dissolution cases. Alicia Brokars Kelly, *Sharing A Piece of the Future Post-Divorce: Toward a More Equitable Distribution of Professional Goodwill*, 51 RUTGERS L. REV. 569, 577 (1999). The accounting concept of goodwill is based on the measurement of goodwill, rather than the nature of the goodwill, and focuses on the difference between the value of the business and the value of the tangible assets. *Id.* at 579. The economic understanding of goodwill rests on the expectation of future earnings. *Id.* According to the economic concept of goodwill "any rate of return in excess of a normal return is attributable to unidentifiable intangible assets, generally goodwill." Allen Parkman, *The Treatment of Professional Goodwill in Divorce Proceedings*, 18 FAM. L.Q. 213, 214 (1984). From an economic perspective, well-established businesses have the ability to make greater profits than new and less-established businesses because well-established businesses have accumulated goodwill. *Id.*

15 Cruttwell v. Lye, (1810) 34 Eng. Rep. 129.

16 *Id.* at 134; Joseph Story defined goodwill as "the advantage or benefit, which is acquired by an establishment, beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement, which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence or punctuality, or from other accidental circumstances or necessities or even from ancient partialities, or prejudices." JOSEPH STORY, COMMENTARIES ON THE LAW OF PARTNERSHIP § 99 (4th ed. 1855), *available at* http://archive.org/stream/commentariesonl03benngoog#page/n192/mode/2up/search/§+99.

17 CAL. BUS. & PROF. CODE § 14100 (West 2013).

above the value of its assets, that results from the expectation of continued public patronage."[18]

Four distinct, though not exclusive, categories have emerged in relation to the legal definition of goodwill: professional, commercial, personal, and enterprise goodwill.[19] Depending on the type of business involved, goodwill may be "professional" or "commercial."[20] Commercial goodwill is simply "goodwill that derives from a commercial establishment."[21] Conversely, professional goodwill is distinct from a trade or business, and is instead attached to the individual.[22] In most situations, professional goodwill is dependent on the skills and attributes of the individual practitioner.[23]

Depending on the source, goodwill can be classified as "personal" or "enterprise."[24] Enterprise goodwill is associated with the elements of a business that are separate from the individual owners and is generally intertwined with a recognizable product.[25] Personal goodwill, similar to professional goodwill, is associated with the individual and is based on the relationships, knowledge, and skill of the individual, and the individual's resulting reputation.[26]

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18 J. THOMAS OLDHAM, DIVORCE, SEPARATION AND THE DISTRIBUTION OF PROPERTY §10.03[1] (2012).

19 Helga White, *Professional Goodwill: Is It A Settled Question or Is There "Value" in Discussing It?*, 15 J. AM. ACAD. MATRIM. LAW. 495, 499 (1998).

20 *Id.*

21 *Id.* For example, goodwill associated with a retail store is considered a form of commercial goodwill. *Id.*

22 *Id.*

23 *Id.* at 500. For example, a lawyer who owns a successful law practice is considered to have professional goodwill because the reputation and goodwill associated with the business is dependent on his or her legal skills. *See* Gary S. Rosin, *The Hard Heart of the Enterprise: Goodwill and the Role of the Law Firm*, 39 S. TEX. L. REV. 315, 321 (1998) (explaining a lawyer's professional goodwill derives from the lawyer's "intelligence, education, experience, skills, judgment, reputation, and relations[hip] with clients"). It should be noted, however, that a hard and fast distinction between professional and commercial goodwill might not be the best approach. White, *supra* note 19, at 500. In some situations "a definition of professional goodwill may span all the categories . . . in addition to having commonality with commercial goodwill, professional goodwill may include elements of both personal and enterprise goodwill, even though courts generally assert it only includes personal goodwill." *Id.*

24 *Id.* at 499.

25 *Id.* Examples of businesses that have enterprise goodwill include LensCrafters and H&R Block. Michael W. Kalcheim & Norah M. Plante, *Professional Goodwill in Divorce After* Zells, 79 ILL. B.J. 624, 624 (1991).

26 White, *supra* note 19, at 499; *see also* CHRISTOPHER P. CASEY & BRIAN R. POTTER, WHAT CREATES PERSONAL GOODWILL 2 (2010), *available at* http://www.srr.com/assets/pdf/what-creates-personal-goodwill.pdf. The similarities between the definition of professional and personal goodwill sits at the root of the argument that professional goodwill should not be considered a divisible marital asset. White, *supra* note 19, at 501. States that have declined to recognize professional goodwill as a divisible marital asset have found it is difficult to distinguish between the goodwill associated only with the individual and the goodwill associated with the individual's business. *See, e.g.*, Beasley v.

Within the definition of personal goodwill, rests the concept known as "celebrity goodwill."[27] "Celebrity goodwill" is a term used to refer to the "excess earning capacity attributable to one's status or fame," and is sometimes referred to as "human capital."[28] "Human capital" has been defined as the "current value of the increased stream of future earnings that will flow to an individual who has been the recipient of an investment in skills or knowledge."[29] Simply stated, celebrity goodwill refers to the idea that the business and the individual are one and the same and the goodwill value is inherent within the individual's celebrity reputation.

II. CELEBRITY GOODWILL IN DIVORCE: WHEN THE PERSON IS THE BUSINESS

Some states have been reluctant to recognize goodwill as marital property, while others have readily accepted goodwill as marital property, despite its intangible characteristics.[30] The views taken across the nation can generally be separated into three distinct groups.[31] The middle ground view accepts all goodwill associated with a business entity as a divisible marital asset, but finds professional goodwill is divisible as marital

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Beasley, 518 A.2d 545, 552–53 (Pa. Super. Ct. 1986); Holbrook v. Holbrook, 309 N.W.2d 343, 354 (Wis. Ct. App. 1981); *In re* Marriage of Zells, 572 N.E.2d 944, 946 (Ill. 1991).

27 Although a lengthy discussion of the term "celebrity" is outside the scope of this article, a basic definition is important to clarify when celebrity goodwill is applicable. One of the most commonly referred to definitions of the term "celebrity" comes from cultural historian Daniel Boorstin, who describes a celebrity as "a person who is known for his well-knownness." DANIEL J. BOORSTIN, THE IMAGE: A GUIDE TO PSEUDO-EVENTS IN AMERICA 217 (1961). A celebrity can also be described as "an individual 'whose name has attention-getting, interest-riveting and profit-generating value.'" Violina P. Rindova et al., *Celebrity Firms: The Social Construction of Market Popularity,* 31 ACAD. MGMT. REV. 50, 50 (2006), *available at* http://www.personal.psu.edu/txp14/pdfs/amr06.pdf (citing IRVING REIN ET AL., HIGH VISIBILITY 15 (1987)). Other social theorists recognize the concept of "celebrity" as a social construct that has emerged as a status-group or class, but unlike historical status groups results from capitalism and the "commodification of reputation." *See* Charles Kurzman et al., *Celebrity Status*, 25 SOC. THEORY, 347, 353 (2007), *available at* http://www.nasaht.com.au/web_images/Kurzmancelebrity.pdf.

28 Cutler & Bogan, *supra* note 5.

29 Allen M. Parkman, *Human Capital As Property in Celebrity Divorces*, 29 FAM. L.Q. 141, 146 (1995) (citing GARY S. BECKER, HUMAN CAPITAL (3d ed. 1993)).

30 *See generally What's Mine is Yours: Goodwill in Divorce,* EISNERAMPER'S LITIG. SERVS. NEWSL. (EisnerAmper Accountants and Advisors, New York, N.Y.), Mar. 23, 2011, *available at* http://www.eisneramper.com/litigation-Business-Valuation/Business-Valuation-Goodwill-Accounting-0311.aspx.

31 *Id.* (labeling the three views as the "majority view," the "all-inclusive view," and the "material view"). A few states have not clearly articulated the view they are inclined to follow when it comes to valuing goodwill in a divorce proceeding. *See, e.g., In re* Marriage of Hogeland, 448 N.W.2d 678, 681 (Iowa Ct. App. 1989) (stating "professional practice is dependent on the ability of the professional to continue to practice his or her profession," but not clearly concluding that professional goodwill is marital property); Endres v. Endres, 532 N.W.2d 65, 69 (S.D. 1995) (declining to consider whether professional goodwill is marital property).

property only to the extent it is separate from the individual's reputation.[32] The second view does not recognize goodwill as marital property, no matter if it is related to the business or the individual.[33] The remaining view recognizes all goodwill, even goodwill related to the individual professional, as property subject to distribution.[34] California generally falls within the latter category,[35] but has stopped short of other states, like New York and New Jersey, that not only accept professional goodwill as a divisible marital asset, but also recognize celebrity goodwill.[36]

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32 *See, e.g.*, Richmond v. Richmond, 779 P.2d 1211, 1213–14 (Alaska 1989) (law practice); Tortorich v. Tortorich, 902 S.W.2d 247, 250 (Ark. Ct. App. 1995) (oral surgery practice); Eslami v. Eslami, 591 A.2d 411, 418 (Conn. 1991) (medical practice); E.E.C. v. E.J.C., 457 A.2d 688, 693 (Del. 1983) (law practice); McDiarmid v. McDiarmid, 649 A.2d 810, 815 (D.C. 1994) (law practice); Thompson v. Thompson, 576 So. 2d 267, 270 (Fla. 1991) (law practice); Miller v. Miller, 705 S.E.2d 839, 844 (Ga. 2010) (medical practice); Antolik v. Harvey, 761 P.2d 305, 308–09 (Haw. Ct. App. 1988) (chiropractic business); *In re* Marriage of Zells, 572 N.E.2d 944, 946 (Ill. 1991) (law practice); Gaskill v. Robbins, 282 S.W.3d 306, 312–15 (Ky. 2009) (oral surgery practice); LA. REV. STAT. ANN. § 9:2801.2 (2009); Ahern v. Ahern, 938 A.2d 35, 39 (Me. 2008) (dental practice); Hollander v. Hollander, 597 A.2d 1012, 1017 (Md. Ct. Spec. App. 1991) (dental practice); Goldman v. Goldman, 554 N.E.2d 860, 866 (Mass. App. Ct. 1990) (medical practice); Roth v. Roth, 406 N.W.2d 77, 80 (Minn. Ct. App. 1987) (chiropractic practice); Hanson v. Hanson, 738 S.W.2d 429, 434 (Mo. 1987) (oral surgery practice); Taylor v. Taylor, 386 N.W.2d 851, 858–59 (Neb. 1986) (medical practice); *In re* Watterworth, 821 A.2d 1107, 1115 (N.H. 2003) (orthodontic practice); McQuay v. McQuay, 217 P.3d 162, 164 (Okla. Civ. App. 2009) (cement business); *In re* Marriage of Maxwell, 876 P.2d 811, 813 (Or. Ct. App. 1994) (public relations firm); Butler v. Butler, 663 A.2d 148, 155 (Pa. 1995) (accounting practice); Moretti v. Moretti, 766 A.2d 925, 927–28 (R.I. 2001) (landscaping business); Smith v. Smith, 709 S.W.2d 588, 591–92 (Tenn. Ct. App. 1985) (law practice); Guzman v. Guzman, 827 S.W.2d 445, 447 (Tex. App. 1992) (C.P.A. practice); Sorenson v. Sorenson, 839 P.2d 774, 775–77 (Utah 1992) (dental practice); Mills v. Mills, 709 A.2d 79, 81 (Vt. 1997) (law practice); Hoebelheinrich v. Hoebelheinrich, 600 S.E.2d 152, 155–56 (Va. Ct. App. 2004) (medical practice); May v. May, 589 S.E.2d 536, 547 (W. Va. 2003) (dental practice); Root v. Root, 65 P.3d 41, 46–47 (Wyo. 2003) (pathology practice).

33 *See, e.g.*, Powell v. Powell, 648 P.2d 218, 223–24 (Kan. 1982) (medical practice); Watson v. Watson, 882 So. 2d 95, 100–01 (Miss. 2004) (veterinary practice); Donahue v. Donahue, 384 S.E.2d 741, 745 (S.C. 1989) (dental practice).

34 *See, e.g.*, Mitchell v. Mitchell, 732 P.2d 208, 211 (Ariz. 1987) (accounting firm); *In re* Marriage of Foster, 117 Cal. Rptr. 49, 52 (Cal. Ct. App. 1974) (medical practice); *In re* Marriage of Nichols, 606 P.2d 1314, 1316 (Colo. App. 1979) (dental practice); Stewart v. Stewart, 152 P.3d 544, 549 (Idaho 2007) (dermatology practice); Kowalesky v. Kowalesky, 384 N.W.2d 112, 115–16 (Mich. Ct. App. 1986) (dental practice); *In re* Marriage of Stufft, 950 P.2d 1373, 1378 (Mont. 1997) (law practice); Ford v. Ford, 782 P.2d 1304, 1310 (Nev. 1989) (medical practice); Dugan v. Dugan, 457 A.2d 1, 6 (N.J. 1983) (law practice); Mitchell v. Mitchell, 719 P.2d 432, 437 (N.M. Ct. App. 1986) (C.P.A. practice); Moll v. Moll, 722 N.Y.S.2d 732, 736–37 (N.Y. Sup. Ct. 2001) (financial advising practice); Poore v. Poore, 331 S.E.2d 266, 271 (N.C. Ct. App. 1985) (dental practice); Sommers v. Sommers, 660 N.W.2d 586, 590 (N.D. 2003) (orthodontic practice); *In re* Marriage of Hall, 692 P.2d 175, 177–78 (Wash. 1984) (medical practice).

35 *See, e.g.*, *In re* Marriage of Rosen, 130 Cal. Rptr. 2d 1, 5–6 (Cal. Ct. App. 2002) (law practice); *In re* Marriage of Fortier, 109 Cal. Rptr. 915, 918 (Cal. Ct. App. 1973) (medical practice).

36 *See, e.g.*, Piscopo v. Piscopo, 557 A.2d 1040, 1042–43 (N.J. Super. Ct. App. Div. 1989); Elkus v. Elkus, 572 N.Y.S.2d 901, 904 (N.Y. App. Div. 1991).

A. Celebrity Goodwill in New York and New Jersey

Thus far, New York and New Jersey are the only states to officially recognize celebrity goodwill as a divisible marital asset.[37] The starting place for the acceptance of celebrity goodwill in New York and New Jersey can be traced[38] to the "landmark"[39] New York case *O'Brien v. O'Brien*.[40] In *O'Brien* the court held the husband's medical license was divisible marital property.[41] The court explained the wife had sacrificed her own education goals and assisted her husband to gain his medical license, which ultimately resulted in his enhanced earning capacity.[42] The court went on to note the wife's contributions to the economic partnership represented an investment for which she had a right of return, and to hold otherwise would go against the underlying goal of equity in divorce proceedings.[43]

In *Golub v. Golub*,[44] the holding in *O'Brien* was extended to include a celebrity career.[45] The court found the increase in the value of the wife's modeling and acting career was marital property,[46] reasoning the wife's income increased during the marriage due to her husband's legal knowledge and business experience.[47] The court stated that when "a person's expertise in a field has allowed him or her to be an exceptional wage earner, this generates a value similar to that of the goodwill of a business."[48] In addition, the court held the increase in the value of the husband's law practice during the marriage was subject to

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37 Jack A. Rounick & R. William Riggs, *What's Perk-olating? How Courts are Handling Perks, Fringe, and Other Employment Benefits*, 23 FAM. ADVOC. 12, 15 (Winter 2001).

38 *See* Cutler & Bogan, *supra* note 5 (calling *O'Brien* the "springboard" for celebrity goodwill).

39 *See* Keane v. Keane, 861 N.E.2d 98, 103 (N.Y. 2006) (describing *O'Brien* as a "landmark" case).

40 O'Brien v. O'Brien, 489 N.E.2d 712 (N.Y. 1985).

41 *Id.* at 713. The *O'Brien* holding has also been extended to include academic degrees. *See, e.g.*, Huffman v. Huffman, 923 N.Y.S.2d 583, 586 (N.Y. App. Div. 2011) (holding a master's degree was marital property). California, on the other hand, does not recognize licenses or educational degrees as marital property, but instead provides that the "community shall be reimbursed for community contributions to education or training of a party that substantially enhances the earning capacity of the party." CAL. FAM. CODE § 2641(b)(1) (West 2013). There is a presumption that the couple, or community, has not substantially benefitted from the degree if the contributions were made less than ten years before the divorce proceedings. FAM. § 2641(c)(1). In addition, if the contributions were made over ten years before the dissolution, it is presumed both spouses have already benefitted from the education and there is no need for additional compensation. *Id.*

42 *O'Brien*, 489 N.E.2d at 716.

43 *Id.* at 717–18.

44 Golub v. Golub, 527 N.Y.S.2d 946 (N.Y. Sup. Ct. 1988).

45 *Id.* at 949.

46 *Id.* at 949–50.

47 *Id.* at 948.

48 *Id.* at 950.

distribution.[49] The court found both spouses had an equal claim to the goodwill and increased earning capacity of the other party, which occurred during, and presumptively stemmed from, the union.[50]

In *Elkus v. Elkus*,[51] the court held the wife's celebrity opera singing career was marital property.[52] Prior to the marriage, the wife had already embarked on her opera career and had been relatively successful.[53] However, during the marriage, the wife's earnings increased substantially.[54] The court reasoned her increased earning capacity was in part due to the indirect contributions of her husband during the marriage, and held that under an equitable distribution framework the wife's celebrity career and goodwill was a divisible marital asset.[55]

In New Jersey, the path toward accepting celebrity goodwill starts with the case *Dugan v. Dugan*,[56] where the court held the professional goodwill associated with a sole practitioner's legal practice was marital property with an ascertainable value.[57] In *Dugan,* the court found where "future earning capacity has been enhanced because reputation leads to probable future patronage from existing and potential clients, goodwill may exist and have value [and] [w]hen that occurs the resulting goodwill is property" subject to distribution.[58]

From there came the New Jersey case *Piscopo v. Piscopo*,[59] which held the career of a well-known comedian to be marital property.[60] The *Piscopo* court reasoned that a "particular and uncommon aptitude for some specialized discipline whether law, medicine or entertainment" is what transforms the average professional into one with "measurable goodwill."[61] Further, the court stated celebrity goodwill should be valued in the same fashion as the professional goodwill of a professional practice.[62] The decision was affirmed on appeal, where the court compared

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49 *Id.* at 948.

50 *Id.* at 950.

51 Elkus v. Elkus, 572 N.Y.S.2d 901 (N.Y. App. Div. 1991).

52 *Id.* at 904.

53 *Id.*

54 *Id.*

55 *Id.* ("[T]he defendant's active involvement in the plaintiff's career, in teaching, coaching, and critiquing her, as well as in caring for their children, clearly contributed to the increase in its value.").

56 Dugan v. Dugan, 457 A.2d 1 (N.J. 1983).

57 *Id.* at 12.

58 *Id.* at 6.

59 Piscopo v. Piscopo, 555 A.2d 1190 (N.J. Super. Ct. Ch. Div. 1988).

60 *Id.* at 1193.

61 *Id.* at 1192.

62 *Id.*

goodwill associated with the celebrity to professional goodwill, which New Jersey had already accepted as marital property.[63]

New York case law advances the reasoning that the enhancement of earning capacity during the marriage indicates the presence of goodwill,[64] and further, the non-celebrity spouse's investment or contribution to the community is the basis for the distribution of celebrity goodwill.[65] New Jersey, on the other hand, recognizes celebrity goodwill as an extension of professional goodwill.[66] Despite such variation, both states have arrived at the same conclusion and not only recognize celebrity goodwill as a marital asset with commercial value, but also that in the interest of equity the commercial value should be considered divisible marital property to the extent it existed during the marriage.

B. California's Refusal to Recognize Celebrity Goodwill

For decades, California has acknowledged the value of professional goodwill associated with a medical practice, law practice, or other comparable professional practice, as divisible marital property.[67] One of the first cases to reach such a conclusion is *Golden v. Golden*.[68] In *Golden*, the court held the value of the goodwill of a professional practice should be considered marital property because "[u]nder the principles of community property law, the wife, by virtue of her position of wife, made to that value the same contribution as does a wife to any of the husband's earnings and accumulations during marriage."[69] The court further reasoned the wife was entitled to be compensated for her contributions in the same manner she would be for the "increased value of stock in a family business."[70]

Five years later in *In re Marriage of Lopez*,[71] the court held the goodwill attributable to the husband's law practice was

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63 Piscopo v. Piscopo, 557 A.2d 1040, 1042 (N.J. Super. Ct. App. Div. 1989).

64 Golub v. Golub, 527 N.Y.S.2d 946, 950 (N.Y. Sup. Ct. 1988); Elkus v. Elkus, 572 N.Y.S.2d 901, 904 (N.Y. App. Div. 1991); *see also* ROBERT D. FEDER, VALUATION STRATEGIES IN DIVORCE 8-68–8-69 (Charles T. Rosoff & Aleza T. Friedman eds., 4th ed. 2013) (citing Mann v. Mann, N.Y. L.J., Jan. 10, 1995, at 5) (finding there are many methods available to value celebrity goodwill, but factual evidence must be presented to show the celebrity career value increased, rather than decreased, during the marriage).

65 *Golub*, 527 N.Y.S.2d at 949; *Elkus*, 572 N.Y.S.2d at 901.

66 *Piscopo*, 557 A.2d at 1041–42.

67 *See, e.g.*, Brawman v. Brawman, 19 Cal. Rptr. 106, 109 (Cal. Dist. Ct. App. 1962) (law practice); Todd v. Todd, 78 Cal. Rptr. 131, 136 (Cal. Ct. App. 1969) (law practice); Fortier v. Fortier, 109 Cal. Rptr. 915, 918 (Cal. Ct. App. 1973) (medical practice); *In re* Marriage of Rosen, 130 Cal. Rptr. 2d 1, 6 (Cal. Ct. App. 2002) (law practice).

68 Golden v. Golden, 75 Cal. Rptr. 735 (Cal. Ct. App. 1969).

69 *Id.* at 738.

70 *Id.*

71 *In re* Marriage of Lopez, 113 Cal. Rptr. 58 (Cal. Ct. App. 1974).

community property.[72] The court, citing *Brawman v. Brawman*,[73] compared the wife's interest to that of a "silent partner" who should be entitled to fair compensation for her share in the professional goodwill upon dissolution of the partnership.[74] The *Lopez* court also set forth several factors that, when present, indicate the existence of goodwill and a probability the goodwill of the business will continue to exist after the dissolution process, including the professional's age, health, past demonstrated earning power, professional reputation in the community, skill, knowledge, comparative professional success, and the nature and duration of the professional's business.[75] These factors have been used in later cases to determine whether professional goodwill exists.[76]

Other California decisions followed the pattern set forth by *Golden* and *Lopez* by reiterating that professional goodwill is a divisible marital asset and seem to indicate a natural progression towards the acceptance of celebrity goodwill.[77] However, in *In re Marriage of McTiernan and Dubrow*,[78] California had an opportunity to deal directly with the issue of celebrity goodwill, but the court declined to classify celebrity goodwill as a divisible marital asset.[79] Although the trial court held the husband's motion picture career, which was dependent on his skill, experience, and knowledge, was comparable to that of a lawyer, physician, or dentist,[80] on appeal it was held an individual could not generate goodwill that could be valued and divided as a community asset.[81]

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72 *Id.* at 69.

73 Brawman v. Brawman, 19 Cal. Rptr. 106, 110 (Cal. Dist. Ct. App. 1962) (finding that, where only one spouse is entitled to the benefits of the professional practice developed during the marriage after a divorce, "it is the case of a silent partner withdrawing from a going business . . . such partner is to receive fair compensation for her share, on her enforced retirement").

74 *Lopez*, 113 Cal. Rptr. at 65 (quoting *Brawman*, 19 Cal. Rptr. at 109).

75 *Id.* at 68.

76 *See, e.g.*, *In re* Marriage of Iredale, 16 Cal. Rptr. 3d 505, 510 (Cal. Ct. App. 2004) (noting the factors set out in *Lopez* are generally applicable to the valuation of professional goodwill, but the specific circumstances of each individual case should still be taken into account). Courts in other states have also used the *Lopez* factors to determine the value of a professional practice. *See, e.g.*, *In re* Marriage of Hall, 692 P.2d 175, 179 (Wash. 1984).

77 *See* Paloma Peracchio, Comment, *The Value of Creative Professionals in the Entertainment Capital of the World: Why "Celebrity Goodwill" Should Be A Divisible Community Property Interest in California Divorces*, 28 LOY. L.A. ENT. L. REV. 129, 156 (2008) (arguing that California case law seemed to indicate that celebrity goodwill could also be seen as a divisible marital asset).

78 *In re* Marriage of McTiernan and Dubrow, 35 Cal. Rptr. 3d 287 (Cal. Ct. App. 2005).

79 *Id.* at 306.

80 *Id.* at 290.

81 *Id.* at 306.

In *McTiernan*, the court distinguished the present circumstances from previous California case law by arguing that prior cases involved an individual who was conducting a business and thus, the goodwill could be attributed to the business entity and separated from the individual.[82] The court found the goodwill associated with the director's career could not be adequately divided from the individual.[83] The court further found the reputation, or celebrity goodwill of the director, could not be sold or transferred, which was a necessary quality in order to classify goodwill as property.[84] If goodwill could not be classified as property to begin with, it was not appropriate to consider it as community property to be divided upon dissolution.[85] In addition, the court noted celebrity goodwill must be transferrable[86] in order to fit within California's statutory definition of goodwill.[87]

The case law in California regarding celebrity goodwill largely ends with the *McTiernan* decision. Therefore, in California the leading criticisms against recognizing celebrity goodwill as a divisible marital asset are first, celebrity goodwill cannot adequately be separated from the individual, and second, celebrity goodwill does not carry the general characteristics of property and thus cannot be classified as divisible community property.[88]

III. CELEBRITY GOODWILL AS A PROPERTY INTEREST

The *McTiernan* decision found the goodwill associated with the director's reputation could not be transferred and as a result could not be characterized as property.[89] But, this conclusion is inconsistent not only with the previous trend in the California case law,[90] but also with the modern understanding of property,[91]

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82 *Id.* at 292–93.

83 *Id.* at 295.

84 *Id.*

85 *Id.* at 296.

86 *Id.* Justice Cooper dissented from the idea that goodwill must be transferable in order to constitute a community property asset, stating that "goodwill is not a commodity in the marketplace, but rather 'a portion of the professional practice as a going concern on the date of the dissolution of the marriage.'" *Id.* at 308 (Cooper, J., concurring in part and dissenting in part) (quoting *In re* Marriage of Foster, 117 Cal. Rptr. 49 (Cal. Ct. App. 1974)). Justice Cooper went on to say the majority's attempt to limit goodwill to only businesses and not the individual is "semantic" in that "[a]ny professional who independently practices his or her profession, for profit—be it lawyer, doctor, computer consultant, or film director—thereby conducts a business, within the lead opinion's own unattributed definition, as well as more traditional ones." *Id.* at 307–08.

87 CAL. BUS. & PROF. CODE § 14102 (West 2013).

88 *McTiernan*, 35 Cal. Rptr. 3d at 295–96.

89 *Id.*

90 *See* Peracchio, *supra* note 77, at 156; DONALD L. GURSEY & MICHAEL T. MISKEI, *Proving the Existence and Value of Celebrity Goodwill*, *in* VALUING PROFESSIONAL PRACTICES AND LICENSES: A GUIDE FOR THE MATRIMONIAL PRACTITIONER 26-8 (Ronald L.

especially when viewed in light of analogous concepts like the right of publicity.[92]

Currently, certain intangibles are divisible upon dissolution in many different jurisdictions.[93] For instance, California recognizes certain intellectual property rights[94] and pension benefits[95] as community property. Further, California recognized at common law,[96] and now by statute, that celebrity status is property that can be transferred in the context of the "right of publicity."[97]

Brown, ed., 2d ed. 1997) (arguing that California case law dictates that "[g]oodwill exists and has value if its owner can derive financial benefits from his or her business in the future even if he cannot transfer that business to another").

91 *See* Llewellyn Joseph Gibbons, *Love's Labor's Lost: Marry for Love, Copyright Work-Made-for Hire, and Alienate at Your Leisure*, 101 KY. L.J. 113, 115 (2013) (noting that historically issues of the economic rights were addressed by looking to the tangible assets of both spouses, but that today the focus is not only on tangible assets, but also intangible rights and other new forms of property). New forms of property, like the right of publicity, essentially emerged in relation to a demand for economic efficiency and in order to help maximize wealth. David Westfall & David Landau, *Publicity Rights as Property Rights*, 23 CARDOZO ARTS & ENT. L.J. 71, 73 (2005) (describing differing theoretical views relating to the emergence of modern property rights).

92 The right of publicity was first recognized as a form of property in the case *Haelen Labs., Inc. v. Topps Chewing Gum, Inc.*, which found "a man has a right in the publicity value of his photograph, i.e., the right to grant the exclusive privilege of publishing his picture." 202 F.2d 866, 868 (2d Cir. 1953). The right of publicity has since been extended to include nicknames, signatures, physical poses, singing and performance styles, gestures, and even body parts. Ann Bartow, *Intellectual Property and Domestic Relations: Issues to Consider When There is an Artist, Author, Inventor, or Celebrity in the Family*, 35 FAM. L.Q. 383, 420 (2001).

93 *See* Kelly M. Haggar, Comment, *A Catalyst in the Cotton: The Proper Allocation of the "Goodwill" of Closely Held Businesses and Professional Practices in Dissolution of Marriages*, 65 LA. L. REV. 1191, 1200 (2005) (explaining valuation of intangibles, like goodwill, associated with a professional practice or family business has proved to be problematic in the context of divorce); *see also* Robin P. Rosen, Note, *A Critical Analysis of Celebrity Careers as Property upon Dissolution of Marriage*, 61 GEO. WASH. L. REV. 522, 532–38 (1993) (discussing valuation difficulties that arise in the dissolution process relating to pension rights, closely held corporations, intellectual property rights, professional degrees, and professional goodwill).

94 California law clearly indicates certain intellectual property rights are considered community property assets. *See In re* Marriage of Worth, 241 Cal. Rptr. 135, 140 (Cal. Ct. App. 1987) (holding copyrights for trivia books written during the marriage were a community property asset). Similarly, California has long since recognized patents as community property. *See, e.g.*, Lorraine v. Lorraine, 48 P.2d 48, 55 (Cal. Dist. Ct. App. 1935) (holding both parties substantially contributed to the husband's business during the marriage, and therefore the patents for his business inventions were community property).

95 *See, e.g.*, *In re* Marriage of Brown, 544 P.2d 561, 562–63 (Cal. 1976) ("Pension rights, whether or not vested, represent a property interest; to the extent such rights derive from employment during coverture, they comprise a community asset subject to division in a dissolution proceeding.").

96 Neil Caulkins, *A Fiduciary's Duties When A Celebrity Persona Is the Asset*, 24 COLUM.-VLA J.L. & ARTS 235, 238 (2001).

97 CAL. CIV. CODE § 3344.1 (West 2013). Although California has not yet recognized the right of publicity as a community asset, the reasoning in *In re Marriage of McTiernan and Dubrow*, 35 Cal. Rptr. 3d 287 (Cal. Ct. App. 2005), would fall flat if the non-celebrity spouse claimed a community property interest in the celebrity's right of publicity. *See*

The "right of publicity" refers to the "right of an individual, especially a public figure or a celebrity, to control the commercial value and exploitation of his name and picture or likeness and to prevent others from unfairly appropriating this value for their commercial benefit."[98] Unlike celebrity goodwill, which focuses on the celebrity's reputation and the effect of the celebrity's reputation on future patronage or employment, the right of publicity focuses primarily on the right to capitalize on the celebrity name.[99] In California, an individual's publicity rights are a property right that can be transferred to a successor in interest.[100] In addition, celebrities can also sell their name and *goodwill* outright.[101] This suggests the value of a celebrity's goodwill can be transferred and quantified,[102] and that it is being quantified in other contexts.

The right of publicity generally comes up in terms of celebrity endorsements, where the name or likeness of the celebrity is bought for the commercial benefit of the purchaser,[103] but is also an issue when managing the estate of celebrities whose name continues to carry commercial value, for example Marilyn Monroe or Elvis Presley.[104] In either scenario, the celebrity's reputation, or goodwill, is a contributing factor to the

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Jonathan L. Kranz, Note, *Sharing the Spotlight: Equitable Distribution of the Right of Publicity*, 13 CARDOZO ARTS & ENT. L.J. 917, 955 (1995) (arguing the right of publicity should be considered a divisible marital asset, separate from the concept of celebrity goodwill).

98 Kranz, *supra* note 97, at 934 (quoting Estate of Presley v. Russen, 513 F. Supp. 1339, 1353 (D.N.J. 1981)).

99 *Id.* at 918; *see also* GARY N. SKOLOFF & FRANCIS W. DONAHUE, *Peace and Goodwill to Celebrities*, *in* VALUING PROFESSIONAL PRACTICES AND LICENSES: A GUIDE FOR THE MATRIMONIAL PRACTITIONER 25-8 (Ronald L. Brown, ed., 2d ed. 1997) (stating although the two terms have some similarities, they are not interchangeable). *Golub v. Golub*, 527 N.Y.S.2d 946, 949 (N.Y. Sup. Ct. 1988), noted that "[t]here is an analogy to be made between the right of publicity and professional goodwill. In both rights, there is a secondary meaning generated by a name and benefits derived therefrom. In either case, the right becomes an income producing source."

100 *See* CAL. CIV. CODE §§ 3344, 3344.1 (West 2013).

101 *See* MARK A. ROESLER, CELEBRITIES' GOODWILL AND RIGHT OF PUBLICITY (Sept. 13, 2010), *available at* http://www.markroesler.com/pdf/speaking/MRChicagoBVRpresentation_Sept10.pdf.

102 GURSEY & MISKEI, *supra* note 90, at 26-9–26-10. Some commentators find both the right of publicity and celebrity goodwill should be seen as a transferrable property right. *Id.* The right of publicity and celebrity goodwill "may be personal and unique, but . . . can be used by others for economic benefit. This would seem . . . to be a transfer." *Id.* at 26-10.

103 *Id.* at 26-9.

104 Caulkins, *supra* note 96, at 253–55. At the time of Elvis Presley's death his estate was valued at 4.9 million dollars, but his estate continues to earn nearly fifteen million dollars annually, due in part to the licensing of his right of publicity. *Id.* at 253–54. Similarly, Marilyn Monroe's estate earns over one million dollars annually from the licensing of the star's right of publicity. *Id.* at 255.

celebrity's commercial value.[105] In other words, a celebrity's right of publicity is valuable only because of the increased earning capacity and marketability of his or her reputation.[106]

Although celebrity goodwill and the right of publicity are not interchangeable concepts,[107] the similarities between the two lend to the conclusion that a celebrity's reputation, in the context of celebrity goodwill, can be seen as a property interest. In fact, some draw little distinction between celebrity goodwill and the right of publicity in a divorce setting.[108] This line of thinking further conflates California's argument in *McTiernan*,[109] in that if the similarities between the two exist then the notion that one is a property right, while the other is not, seems counterintuitive. California's willingness to recognize the right of publicity as a property right shows celebrity goodwill could, and should, be seen as valuable community property.

IV. THE VALUE OF CELEBRITY GOODWILL

A. Professional Goodwill Valuation and the Celebrity

One of the major criticisms against accepting celebrity goodwill as marital property is that substantial difficulties arise when it comes time for valuation.[110] California has not endorsed a single method of valuation when it comes to professional goodwill, but rather has found goodwill is a question of fact to be determined on a case-by-case basis.[111] California case law has made it clear, however, that goodwill cannot be valued according to any method that takes into account post-marital efforts, but instead, "a proper means of arriving at the value of such goodwill

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105 David Tan, *Affective Transfer and the Appropriation of Commercial Value: A Cultural Analysis of the Right of Publicity*, 9 VA. SPORTS & ENT. L.J. 272, 278 (2010) (stating commercial use of an individual's name, reputation, or publicity value is intended to increase the sales or value of a particular product).

106 *Id.* at 277–78 ("[T]he more well-known – and more well-liked – an individual, the greater will be the potential commercial value of that identity.").

107 SKOLOFF & DONAHUE, *supra* note 99, at 25-8. The right of publicity can also be an indicator that celebrity goodwill in fact exists. GURSEY & MISKEI, *supra* note 90, at 26-9–26-10.

108 GURSEY & MISKEI, *supra* note 90, at 26-13 (explaining that as "a practical matter the distinction between the two seems arbitrary").

109 *In re* Marriage of McTiernan and Dubrow, 35 Cal. Rptr. 3d 287, 296 (Cal. Ct. App. 2005).

110 *See* GURSEY & MISKEI, *supra* note 90, at 26-7 (stating that the controversy surrounding celebrity goodwill begins with the question of whether celebrity goodwill exists, and ends with the difficulty in valuation). For a more comprehensive analysis of goodwill valuation, see Randall B. Wilhite, *The Effect of Goodwill in Determining the Value of A Business in A Divorce*, 35 FAM. L.Q. 351, 358–71 (2001) (describing valuation techniques employed by a sampling of states); *see also* White, *supra* note 19, at 521 (discussing common valuation approaches employed by courts that recognize professional goodwill as a marital asset).

111 *See In re* Marriage of King, 197 Cal. Rptr. 716, 719 (Cal. Ct. App. 1983).

contemplates any legitimate method of evaluation that measures its present value by taking into account some past result."[112]

Several common approaches for valuing professional goodwill have emerged in the states that recognize professional goodwill as a divisible marital asset. The first, and arguably most frequently used, is known as the "capitalization of excess earnings approach."[113] According to this approach, the normal earnings of the professional practice must first be established, excluding any earning value attributable to the tangible assets of the business.[114] From there, the compensation given for the services of the individual professional is subtracted from the normalized earnings.[115] If the professional's earnings exceed those of a comparable practitioner,[116] excess earnings exist.[117] The excess earnings are then divided by a capitalization rate to reach the goodwill value.[118]

Another valuation approach that has been used to value professional goodwill is referred to as the "straight capitalization approach."[119] In the straight capitalization approach, the practice's annual profit is determined and then a straight capitalization rate is applied.[120] The capitalization rate is determined by looking to the nature of the practice, the risk involved, and the continuity of clients and patients.[121] The value of the practice's assets is then subtracted from the total value of the practice.[122]

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112 *In re* Marriage of Foster, 117 Cal. Rptr. 49, 54 (Cal. Ct. App. 1974).

113 *See* Christopher C. Melcher, *Valuing of a Professional Practice in a California Divorce Action*, HG.ORG (July 30, 2009), http://www.HG.org/article.asp?id=6785; Kelly, *supra* note 14, at 610. This approach has been criticized for being too closely related to a measurement of future earnings, which is prohibited in California. *See, e.g.*, *McTiernan*, 35 Cal. Rptr. 3d at 294 n.7. But, California courts have frequently used this method to establish the value of professional goodwill, claiming the excess earnings method considers *prior* earnings with the expectation the business will continue. *See, e.g.*, *Foster*, 117 Cal. Rptr. at 51.

114 Kelly, *supra* note 14, at 610–11. Generally, the normal earnings are established by looking at the average business earnings over the past five years. *Id.* at 611.

115 *Id.*

116 *In re* Marriage of Rosen, 130 Cal. Rptr. 2d 1, 6 (Cal. Ct. App. 2002) (explaining the excess earnings method and its use in other California cases that have dealt with professional goodwill).

117 Kelly, *supra* note 14, at 611.

118 *Id.* One criticism of the capitalization of excess earnings method is generally the capitalization rate is based on subjective factors and thus no clear standard can be applied in all situations. *Id.*

119 *See, e.g.*, *In re* Marriage of Hall, 692 P.2d 175, 179–80 (Wash. 1984) (explaining common professional goodwill valuation approaches, including the straight capitalization approach).

120 *Id.* at 179.

121 Kelly, *supra* note 14, at 611; *see also* White, *supra* note 19, at 528–59 (discussing the role of buy-sell agreements in goodwill valuation methods).

122 *Hall*, 692 P.2d at 179.

Partnership and buy-sell agreements have previously been used as evidence of goodwill in a business,[123] and some courts have applied an IRS formula that measures how much the net earnings of a business exceed a fair return on the business's tangible assets.[124] Courts have also looked to the fair market value[125] of the business, considering how much the business would sell for, or what comparable businesses have recently sold for, to determine the goodwill value.[126]

Not all of these approaches may be appropriate when it comes to valuing celebrity goodwill, but the idea behind each serves as a starting point. The discussion provided in the New York and New Jersey cases, which have already recognized celebrity goodwill as a divisible marital asset, indicates valuation methods used to measure professional goodwill can be molded to fit the specific situation in order to determine the value of celebrity goodwill.[127]

When applying the capitalization of excess earnings method to measure the value of celebrity goodwill, the earning power of the celebrity must first be determined.[128] Determining the earning power of the celebrity requires looking to the celebrity's historical gross earnings and then adjusting the gross earnings in order to account for expenses.[129] Although traditionally this method requires the value of the professional practice's tangible assets be subtracted from the total earnings,[130] it is generally not necessary to subtract the value of tangible assets in the case of the celebrity because tangible assets are rarely involved.[131] The gross earnings number then is capitalized by a percentage, determined by looking to factors such as the duration of the celebrity's career, past earning power, and the expected life of the celebrity status,[132] ultimately resulting in the celebrity goodwill value.[133]

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123 Kelly, *supra* note 14, at 606.

124 *Hall*, 692 P.2d at 180.

125 White, *supra* note 19, at 521–22 (explaining the fair market value approach is beneficial in that it does not take into account any post-divorce efforts).

126 *Id.* at 521.

127 *See* Caulkins, *supra* note 96, at 237 (discussing that "valuation of celebrity personas is quite similar to valuation of more traditional assets" as both rely on expert testimony and records of like transactions).

128 ROBERT D. FEDER, VALUING SPECIFIC ASSETS IN DIVORCE, § 29.04 (Charles T. Rosoff & Aleza T. Friedman eds., 2014), *available at* Westlaw VALSA s 29.04.

129 *Id.* Expenses include travel and compensation for the celebrity. *Id.*

130 Kelly, *supra* note 14, at 610–11.

131 *See generally id.*

132 FEDER, *supra* note 128.

133 Kelly, *supra* note 14, at 610–11. The traditional capitalization of excess earnings method relies on a comparison between the professional and other similar professionals to determine if there is in fact excess earnings. *Id.* However, in the context of the celebrity, it

In *Piscopo v. Piscopo*,[134] the court seemed to value the celebrity's goodwill by looking to the gross earnings or revenue method.[135] This method is similar to the fair market value approach for professional businesses, in that the value of the celebrity's goodwill is considered to be a fraction or percentage of the gross earnings or revenues accumulated by the celebrity.[136] Factors used to determine the proper percentage include the duration of the celebrity's career, past earning power, and the expected life of the celebrity status.[137]

The fact that California cases have already recognized professional goodwill as a divisible marital asset, despite obvious valuation issues, shows courts are not opposed to confronting difficult valuation methods.[138] Further, valuation of community property is disputed in any divorce where valuable assets are at issue, and generally requires extensive discovery and expert testimony.[139] The valuation of celebrity goodwill is a difficult task to undertake, but that does not provide an excuse to shy away from providing an equitable result in California celebrity divorce cases.

B. "Hot to Not": When Should Celebrity Goodwill be Valued?

It goes without saying, in today's commercial arena one day you can be "hot" and the next "not." The same can be said for businesses. A professional practice or business entity could enjoy several successful years and due to a change in circumstances, or maybe a tarnished reputation, take a dive in value.[140] With swift

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is difficult to establish an appropriate proxy, as the only comparable individual would be one in equal stature to the celebrity and thus would be earning the same, or close to the same, as the celebrity. FEDER, *supra* note 128. This problem is the basis for much of the criticism against using the capitalization of excess earnings method to determine celebrity goodwill. *Id.*

134 Piscopo v. Piscopo, 555 A.2d 1190, 1193 (N.J. Super. Ch. Div. 1988).

135 FEDER, *supra* note 128.

136 *Id.*

137 *Id.* The issue with this approach is the difficulty that arises in determining what percentage should be applied to adequately value celebrity goodwill. *Id.* Generally the percentage would be determined by looking to the sales of other comparative businesses, however, the celebrity "business" is rarely sold. *Id.*

138 *In re* Marriage of Lopez, 113 Cal. Rptr. 58, 67 (Cal. Ct. App. 1974) (noting the fact that professional goodwill may be difficult to "evaluate and will ordinarily require special disposition, is not reason to ignore its existence in a proper case").

139 *See generally* Carol S. Bruch, *The Definition and Division of Marital Property in California: Towards Parity and Simplicity,* 33 HASTINGS L.J. 769, 782–83 (1982) (discussing the difficulties that arise when valuing separate and community property in California divorces); *see also* Caulkins, *supra* note 96, at 237.

140 *See The 25 Worst Business Failures in History*, BUSINESS PUNDIT, (Jan. 14, 2009), http://www.businesspundit.com/the-25-worst-business-failures-in-history/ (describing twenty-five businesses that failed despite substantial success previously, including the famous downfalls of Enron, DeLorean, and Pan Am). Enron, one of the most famous businesses to suffer a substantial and public downfall, in some ways reached celebrity

market changes, especially in terms of celebrity name value,[141] a standard date of valuation would provide stability within an already difficult to ascertain concept.

In California, all community property must be valued as close to the trial date as "practicable."[142] California case law has recognized, however, good cause exists to value professional practices that rest on the knowledge and skill of the individual practitioner closer to the date of separation than the date of the trial.[143] The rationale behind this exception is that the value of a professional practice, "including goodwill, is primarily a reflection of the practitioner's services . . . and not capital assets," and continues to change after the date of separation, when only one party is contributing to its value.[144]

If California were to recognize celebrity goodwill as a divisible marital asset, the date of valuation exception may follow.[145] In the context of celebrity goodwill, where the object of the distribution is to compensate the other spouse for his or her contribution to the value of the celebrity's reputation, it seems appropriate to value the worth of the celebrity closer to the date of separation, or in other words, the date at which the non-celebrity spouse stops contributing to the value of the celebrity career. Any swift movement in the celebrity's earnings or reputation after the date of separation would then be left out of the resulting value.

Conversely, applying the date of valuation exception may not be the best approach to breed an amicable divorce proceeding.[146]

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status. Rindova, et al., *supra* note 27, at 50. However, "as Enron's current predicament suggests, achieving celebrity is not necessarily indicative of the long-term effectiveness and success." *Id.*

141 For example, Tiger Woods, once the world's highest grossing athlete, suffered substantial financial setbacks after news broke of his extramarital affairs. *See* Ruth Houston, *Tiger Woods net worth since the infidelity scandal and his divorce settlement*, EXAMINER.COM (Feb. 9, 2011), http://www.examiner.com/article/tiger-woods-net-worth-since-the-infidelity-scandal-and-his-divorce-settlement.

142 CAL. FAM. CODE § 2552 (West 2013).

143 *See In re* Marriage of Duncan, 108 Cal. Rptr. 2d 833, 838–39 (Cal. Ct. App. 2001) (citing *In re* Marriage of Kilbourne, 284 Cal. Rptr. 201, 204 (Cal. Ct. App. 1991)). However, a valuation date close to trial may still be appropriate where the post-separation efforts of the working spouse have a "minimal impact" on any increase in value of the business. *Id.* (citing *In re* Marriage of Green, 261 Cal. Rptr. 294, 297 (Cal. Ct. App. 1989)).

144 *Id.* (quoting *In re* Marriage of Stevenson, 24 Cal. Rptr. 2d 411, 412–13 (Cal. Ct. App. 1993)).

145 The date of valuation exception applies in situations where the business relies on the skill and industry of the working spouse. *Id.* at 839. Similarly, the celebrity "business" derives from the skill and the reputation of the celebrity.

146 California recognizes the importance of fostering a collaborative divorce process to solve familial disputes. CAL. FAM. CODE § 2013 (West 2013). The collaborative law process seeks to foster cooperative negotiations and amicable discussions, instead of sticking to

If the date of valuation were set at the date of separation, there would be no incentive for the non-celebrity spouse to remain agreeable during the time period preceding the trial; a spiteful spouse would have no reason not to publicize the celebrity's dirty laundry to potentially destroy the celebrity spouse's future career, while he or she suffers few consequences.[147] However, it can also be argued that in an already contentious setting, it is unlikely that the date of valuation exception would substantially change the behavior of either party. It is a natural extension of the current date of valuation exception to include celebrity goodwill as an asset that should be valued closer to the date of separation than the date of trial.

V. EQUITABLE CONSIDERATIONS: THE "SILENT PARTNER'S" COMPENSATION

The community property system is based on the presumption that marriage should be viewed as an economic partnership and each partner deserves to be compensated for his or her contribution to the value of the marital estate.[148] California's failure to recognize celebrity goodwill in divorce settings, while still accepting professional goodwill, represents an inequity in the application of community property ideals. California has historically been a spearhead in promoting community property principles and more equitable approaches to dissolution,[149] but fails to follow its own example by refusing to recognize celebrity goodwill as a community asset.

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the traditional adversarial system. Andrew Schouten, *Breaking Up Is No Longer Hard to Do: The Collaborative Family Law Act*, 38 MCGEORGE L. REV. 125, 126 (2007).

147 *See* Michelle Fabio, *Nastiest Celebrity Divorces*, LEGALZOOM (Aug. 2008), http://www.legalzoom.com/marriage-divorce-family-law/divorce/nastiest-celebrity-divorces (describing several "nasty" celebrity divorce cases, claiming that "[c]elebrities are known for excess and exaggeration, and . . . their divorces are often extreme as well").

148 Alan Newman, *Incorporating the Partnership Theory of Marriage into Elective-Share Law: The Approximation System of the Uniform Probate Code and the Deferred-Community-Property Alternative*, 49 EMORY L.J. 487, 489 (2000) (discussing that the contemporary view of marriage recognizes the marital relationship as an economic partnership, and partnership theory is the foundation of the community property system); *see also* Michael J. Vaughn, *The Policy of Community Property and Inter-Spousal Transactions*, 19 BAYLOR L. REV. 20, 41 (1967) (stating the policy behind a community property system is to "treat the spouses as equals because of the actual contribution of each to the accomplishment of the partnership purpose").

149 For example, California was the first to enact the no-fault divorce law. Kelly, *supra* note 14, at 153. Today, every state provides a no-fault divorce option, and this emergence of no-fault divorce largely led to the partnership theory of marriage. *Id.*

A. Community Property Goals and the Partnership Theory

California's community property system is based on a partnership model.[150] The partnership model recognizes both spouses as equals because of the contribution each makes to the marriage; both are "equally devoting their lives and energies to furthering the material as well as the spiritual success of the marriage."[151] The nation's general shift towards the partnership theory occurred during the 1970s,[152] and California acted as a leader in the movement by enacting the Family Law Act in 1972, which required the equal division of property between both spouses upon dissolution.[153]

Generally, the partnership theory of marriage uses a "shared-earnings rule."[154] Under the partnership theory, a non- or low-wage earning spouse is found to contribute to the other partner's earnings and career "both directly, by serving as informal consultan[t]and adviso[r], and indirectly, by managing the household and raising children."[155] The partnership theory requires this form of labor, or contribution, be compensated through the shared earnings of both parties.[156]

In re Marriage of Lopez,[157] one of the leading authorities for the acceptance of professional goodwill in California, adopted a similar notion by comparing the non-working spouse to that of a "silent partner."[158] *Lopez* explained that a divorce situation is similar to the "case of a silent partner withdrawing from a going business. And if such partner is to receive fair compensation for her share, on her enforced retirement, it should be so evaluated."[159]

The "silent partner" concept supports the notion that the non-working spouse contributed something to the union, or in some way enhanced the union.[160] This is true in the scenario

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150 *See, e.g.*, *In re* Marriage of Brigden, 145 Cal. Rptr. 716, 722–23 (Cal. Ct. App. 1978) (claiming the "distinctive feature of California marital property law is that the marital community is viewed as a partnership in which the spouses are equal partners").

151 Vaughn, *supra* note 148, at 40–41.

152 Rosen, *supra* note 93, at 526–27.

153 *Id.* at 526 n.20.

154 Shari Motro, *Labor, Luck, and Love: Reconsidering the Sanctity of Separate Property*, 102 NW. U. L. REV. 1623, 1631–32 (2008).

155 *Id.* at 1632–33.

156 *Id.*

157 *In re* Marriage of Lopez, 113 Cal. Rptr. 58 (Cal. Ct. App. 1974).

158 *Id.* at 65.

159 *Id.* (quoting Brawman v. Brawman, 19 Cal. Rptr. 106, 109 (Cal. Dist. Ct. App. 1962)).

160 *Id.;* Motro, *supra* note 154, at 1633. Similar to California, many states have used the partnership theory of marriage as the underlying foundation and reasoning for the

where the "silent partner" supports his or her spouse through medical school or law school, or to gain notoriety in the entertainment world as an actor or singer. In order to keep in line with the community property idea that marriage should be viewed as a partnership,[161] the non-working spouse deserves to be compensated for his or her contribution, whether the working spouse is a working professional or celebrity figure.

B. Investment and Sacrifice

Professor Allen Parkman, a commentator on the subject of celebrity goodwill in marital dissolution, argues:

> Since celebrity status is a form of human capital, it should result in an adjustment in the divorce settlements in two situations: when significant investments were made in human capital during the marriage to acquire celebrity status (celebrity investments) or when the noncelebrity spouse sacrificed human capital for the benefit of the celebrity spouse (sacrificed career).[162]

Professor Parkman further explains that celebrity investments can either produce marital property that should be divided upon dissolution, or may instead require that the supporting spouse be reimbursed for separate property funds provided to further the celebrity career.[163] In the case of a sacrificed career, the supporting spouse requires compensation because he or she contributed separate property, or perhaps the right to an individual career, in order to support the celebrity spouse.[164]

As discussed above, the courts in New York and New Jersey that have recognized celebrity goodwill have used reasoning that emulates Professor Parkman's investment and sacrifice argument.[165] The cases that have recognized celebrity goodwill have picked up on the underlying inequity that exists if celebrity

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acceptance of professional goodwill in divorce proceedings. *See* Kelly, *supra* note 14, at 598.

161 Vaughn, *supra* note 148, at 40–41.

162 Parkman, *supra* note 29, at 151–52.

163 *Id.* at 152.

164 *Id.*

165 *See supra* Part II.A. In Elkus v. Elkus, 572 N.Y.S.2d 901, 904 (N.Y. App. Div. 1991), the court recognized the enhancement of both careers as a product of both party's contributions and as a result, "to the extent the appreciation in the [wife's] career was due to the [husband's] efforts and contributions, this appreciation constitutes marital property." Golub v. Golub, 527 N.Y.S.2d 946, 950 (N.Y. Sup. Ct. 1988), used similar reasoning in stating, "if a spouse devotes himself or herself to the family throughout the marriage, giving up career opportunities . . . the court should compensate this spouse for his or her contribution enabling him or her to pursue his or her career and not just a terminable maintenance award."

goodwill is not recognized as a marital asset.[166] In addition, the investment and sacrifice theory parallels the partnership theory of marriage, which requires each spouse be compensated for investments made to the marital estate.[167] In order to exemplify the partnership rationale that serves as the foundation for California's current community property system, celebrity goodwill should be considered a divisible marital asset. In cases where the non-celebrity spouse provides some sort of contribution, whether it is through personal investment, the sacrifice of a career, or in some other form, the non-celebrity spouse deserves a piece of the celebrity goodwill pie.[168]

VI. CELEBRITY GOODWILL AS A COMMUNITY ASSET IN CALIFORNIA DIVORCES

This article ultimately proposes California extend its recognition of professional goodwill in divorce proceedings to include celebrities and other public figures that reap a commercial benefit from the value of their name or reputation. In an attempt to better illustrate this proposal and the above concepts in a real life situation, this section will focus on a "[l]ittle ditty about Jack and Diane."[169]

Jack and Diane started out as "two American kids growing up in the heartland."[170] Jackie grew up to be a "football star"[171] . . . while Diane stayed home and cared for the couple's three kids. Jack and Diane married right out of high school and quickly started a family, but down the road hit a rough patch and decided to go their separate ways.

At the time of the divorce, Jack is under contract with Nike, who employs him not only because of his successful football career and status as a well-known athlete, but also because he

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166 *See supra* Part II.A.

167 Motro, *supra* note 154, at 1632–33.

168 Notably, some commentators suggest that by recognizing goodwill associated with the individual professional or celebrity as a property right, the court will essentially "double dip" if it later orders a spousal or family support award. *See* White, *supra* note 19, at 503. In other words, the same income will be counted for twice, which could result in an inaccurate measure of the actual ability for the spouse to pay the ordered amount. *See id.* Some courts have used this "double-dipping" notion as reason not to recognize goodwill as a marital asset, and have instead deferred to support awards as reasonable compensation for the non-working spouse. *See, e.g.*, *In re* Marriage of Zells, 572 N.E.2d 944, 946 (Ill. 1991). However, California courts have already sidestepped the issue by recognizing professional goodwill as a marital asset, despite possible "double-dipping" concerns. *See supra* Part II.B. In addition, recognizing goodwill as divisible property may eliminate the need for ongoing support and thus breeds a clean break between the two parties. *See* White, *supra* note 19, at 505.

169 JOHN COUGAR MELLENCAMP, JACK & DIANE, (Criteria Studios 1982).

170 *Id.*

171 *Id.*

has a shiny reputation as a family man. At the start of the marriage, Jack was juggling college football and work at a local diner, but at the time of the divorce, Jack has an estimated annual income of twenty million dollars.[172] On the other hand, Diane worked to support Jack during college, but since then has been the primary caretaker of the children. Diane originally had plans to attend college and pursue a career of her own, but instead supported Jack throughout his career. Assume that upon divorce, Diane claims Jack's "celebrity goodwill" is community property because Jack's celebrity reputation was established during the marriage.[173]

Under this proposed hypothetical, Jack's celebrity goodwill would first be classified as a community property asset,[174] and the value of his celebrity goodwill would then be ascertained.[175] The court would recognize that Jack's public image as a family man and talented athlete helped increase his celebrity reputation, and further, that Diane contributed to Jack's success by caring for the children and sacrificing her own career.

Realistically, the parties would hire an accountant who would then determine the financial figures at issue and apply an appropriate valuation method.[176] Assuming the accountant employed the capitalization of excess earnings method, Jack's earning power would first be determined by looking to his historical gross earnings. Suppose Jack, after taking into account expenses, has earned roughly ten million dollars over the past five years. Under the capitalization of excess earnings method, this ten million dollar figure would then be compared to the net earnings of other comparable football players in the league with similar fame and endorsement deals. Assuming the average earnings for a player similar to Jack is six million dollars, the

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172 For example, top earning NFL quarterback Tom Brady reaps an annual salary of roughly 26.5 million dollars per year. *Tom Brady Net Worth*, CELEBRITY NET WORTH, http://www.celebritynetworth.com/richest-athletes/nfl/tom-brady-net-worth/ (last visited Oct. 10, 2013).

173 Arguably, Diane may also have an interest in Jack's right of publicity. *See* Kranz, *supra* note 97, at 955 (arguing that the right of publicity should be a divisible marital asset). However, this is not the argument advanced in this article.

174 *See supra* Part II.B. This proposal assumes celebrity goodwill is considered a community property asset in California. *Id.* In every divorce, the court must first classify the property interest as separate or community. CAL. FAM. CODE § 2551 (West 2013).

175 The factors listed in *In re* Marriage of Lopez, 113 Cal. Rptr. 58, 68 (Cal. Ct. App. 1974) could serve as a starting place to determine if goodwill exists, including looking to Jack's age, health, past demonstrated earning power, professional reputation, skill, knowledge, and comparative professional success.

176 Under California's current goodwill valuation approach, the expert could employ any of the above-mentioned valuation techniques to reach a number that represents the value of Jack's celebrity goodwill. *See supra* Part IV.A. For illustrative purposes, the capitalization of excess earnings method is discussed.

resulting difference would be four million dollars. A capitalization rate would then be applied to the four million dollar figure, determined according to Jack's past earning power and the projected length of his celebrity career.[177] Assuming the capitalization rate is applied for a period of four years, the resulting value of the celebrity goodwill would be sixteen million dollars. This value would then be split equally between both Jack and Diane as community property attributable to celebrity goodwill.

Jack and Diane's situation illustrates the equitable considerations that come into play in celebrity divorce proceedings where the celebrity spouse has an increased earning power as a result of his or her reputation or goodwill. Diane supported Jack through his entire career, not only sacrificing her own career, but also providing constant support as a confidant, wife, and mother to the couple's three children. Diane's situation illustrates the argument advanced by Professor Parkman that celebrity goodwill should be considered a divisible marital asset when there has been investment or sacrifice.[178] As a result, Diane should have a community property interest in Jack's celebrity goodwill upon dissolution.

CONCLUSION

California's refusal to recognize celebrity goodwill as a divisible marital asset represents an inconsistency in the application of community property goals. In the *McTiernan* decision, California had an opportunity to extend the concept of professional goodwill to include celebrity goodwill,[179] but declined to follow prior case law.[180] In addition, the rationale employed in *McTiernan* is not consistent with California's recognition that other intangibles, including the right of publicity, are a transferable property right.[181] The underlying premise of the community property system favors the acceptance of celebrity goodwill as a divisible marital asset and it is clear that valuation techniques are available to value celebrity goodwill.[182] In the interest of treating both the non-celebrity and celebrity spouse as equal business partners, California should recognize celebrity

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177 Peracchio, *supra* note 77, at 148–49 (stating that generally the capitalization rate must reflect the celebrity's current earnings in order to avoid taking into account future earnings).

178 *See supra* Part V.B.

179 *In re* Marriage of McTiernan and Dubrow, 35 Cal. Rptr. 3d 287, 296 (Cal. Ct. App. 2005).

180 *See* Peracchio, *supra* note 77, at 156.

181 *See supra* Part III.

182 *See supra* Part IV.A.

goodwill as a community asset to be distributed evenly between both parties upon dissolution.

Ending Bullying at a Price?: Why Social Conservatives Fear Legislatively Mandated LGBT Indoctrination in Schools

*Lauren Vanga**

INTRODUCTION

Having gained significant notoriety across the United States and garnering support from some of the most popular politicians and celebrities of our day,[1] the anti-bullying movement has captivated the nation in recent years. In the wake of a number of highly publicized suicides of school-age children who were subjected to chronic harassment[2] from their peers,[3] nearly every state legislature has taken action to implement some version of anti-bullying legislation.[4] Despite an apparent uniform aim—to

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* JD Candidate, May 2014, Chapman University Dale E. Fowler School of Law; BA Political Science, 2009, University of La Verne. I would like to offer my sincere gratitude to the entire *Chapman Law Review* staff for the hours of hard work and effort expended in the production of this piece. It has been a true pleasure to work alongside such exceptional peers. I would also like to thank Professor John Eastman who provided me with insightful guidance and direction during the writing process. I must extend many thanks to my best friends—from home and Chapman—who have been true supporters and have helped me learn what is important in life. Finally, I am particularly grateful for my mother, father, and sister, who encourage me daily and have always shown me unconditional love.

1 The anti-bullying movement has hoards of celebrity supporters including pop stars, politicians, and even the Obama Administration. *See Meet Our Supporters,* STOMP OUT BULLYING, http://www.stompoutbullying.org/index.php/about/our-supporters/ (last visited Oct. 10, 2013) (listing corporate, media, as well as celebrity supporters of the STOMP Out Bullying campaign); *see also* Valerie Jarrett, *Ending Bullying in Our Schools & Communities*, THE WHITE HOUSE (Apr. 20, 2012, 5:42 PM), http://www.whitehouse.gov/blog/2012/04/20/ending-bullying-our-schools-communities (describing the steps the Obama administration has taken to prevent bullying).

2 "Harassment," "intimidation," and "bullying" will be used interchangeably throughout this paper. This is in conformity with many anti-bullying statutes that use the terms synonymously.

3 *See* Lisa C. Connolly, Comment, *Anti-Gay Bullying in Schools—Are Anti-Bullying Statutes the Solution?*, 87 N.Y.U. L. REV. 248, 248–49 (2012) (describing the bully-related suicides of three teens from different states within a three-week span of September 2010); Laurie Bloom, Comment, *School Bullying in Connecticut: Can the Statehouse and the Courthouse Fix the Schoolhouse? An Analysis of Connecticut's Anti-Bullying Statute*, 7 CONN. PUB. INT. L.J. 105, 105 (2007) (noting the trend of presumed bully-related incidents that ended in tragedy, like the shooting at Columbine High School and, more recently, multiple suicides of teens believed to be gay).

4 *See* VICTORIA STUART-CASSEL ET AL., ANALYSIS OF STATE BULLYING LAWS AND POLICIES 1, 3 (2011), *available at* http://www.ed.gov/rschstat/eval/bullying/state-bullying-laws/state-bullying-laws.pdf (noting the wave of legislation sparked by the many "highly

curb bullying conduct in schools—anti-bullying laws vary widely from state to state, with no two states taking the same approach to bullying. Anti-bullying laws come in a variety of different forms. Some states merely outlaw bullying while many others provide schools additional guidance in the form of model policies.[5] Additionally, bullying laws span many levels of comprehensiveness, with some states issuing highly detailed bullying provisions and others merely adopting short and generalized prohibitions on bullying.[6]

Despite their differences, bullying laws across the nation have been attacked on similar grounds. While generally appearing to be based on meritorious principles, it is undeniable that anti-bullying legislation has been the subject of great controversy. Much of the controversy arises out of the way certain anti-bullying laws are structured. Controversially, many states have drafted their legislation to expressly protect specific enumerated groups. Frequently, these enumerated groups include "sexual orientation" and provide express protection for those who may be harassed due to their actual or perceived sexual orientation.[7] The express inclusion of "sexual orientation" as a protected characteristic in certain state laws has led some to

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visible suicides" of students subject to "chronic bullying" as well as the "proliferation of proposed legislation at the state and federal level . . . [and] an increase in the number of court cases filed seeking legal remedies for [bullied] students . . . "); *see also Bully Police USA*, BULLYPOLICE.ORG, http://www.bullypolice.org/ (last visited Oct. 10, 2013) (noting that Montana is the only state without an anti-bullying law).

5 *See* STUART-CASSEL ET AL., *supra* note 4, at 49–50 (detailing the differences among state anti-bullying policies concerning the inclusion, or not, of model policies).

6 *Compare* MINN. STAT. ANN. § 121A.0695 (West 2013) (directing only that each school board must "adopt a written policy prohibiting intimidation and bullying of any student"), *with* N.J. STAT. ANN. § 18A:37-15 (West 2013) (mandating that each school district adopt a policy which, at minimum, must include: (1) a statement prohibiting harassment, intimidation, and bullying, (2) definitions of the prohibited conduct, (3) a description of expected student behavior, (4) consequences and remedial action for those who committed acts of bullying, (5) reporting procedures, (6) investigation procedures, (7) directions for how a school should respond to incidents of bullying, (8) a prohibition of retaliation against anyone reporting bullying, (9) consequences for those who falsely accuse, (10) a statement concerning publication of the policy, (11) a requirement that the policy be available on the home page of the school district's website as well as distributed annually to parents, and (12) a requirement that the contact information for the district anti-bullying coordinator be available on the district's home page).

7 *See* ARK. CODE ANN. § 6-18-514 (West 2013) (defining bullying as an act that may have been motivated based on an actual or perceived "attribute" of the victim including "race, color, religion, ancestry, national origin, socioeconomic status, academic status, disability, gender, gender identity, physical appearance, health condition, or sexual orientation"); IOWA CODE ANN. § 280.28 (West 2013) (outlawing bullying that is based on victim traits or characteristics including "age, color, creed, national origin, race, religion, marital status, sex, sexual orientation, gender identity, physical attributes, physical or mental ability or disability, ancestry, political party preference, political belief, socioeconomic status, or familial status").

question the true purpose and spirit of anti-bullying legislation.[8] The fear harbored by many conservative groups is that anti-bullying laws crafted to expressly protect LGBT[9] students serves the subversive purpose of promoting the "gay agenda," rather than the stated goal of preventing bullying conduct in schools.[10] This fear has caused a number of conservative groups to call for the repeal or limitation of anti-bullying laws.[11]

No one likes bullying, and there are few reasonable adults who would bring themselves to publicly promote teasing or harassment of children in schools. In fact, most who oppose anti-bullying legislation seem to overwhelmingly agree that all children should be protected from bullying no matter what.[12] Thus, while the opponents of anti-bullying legislation seem to at least appreciate the stated goal of the anti-bullying movement, they take issue with the express mention of characteristics of the victim, especially when those characteristics relate to sexual orientation, gender identity, and the like.[13] LGBT advocacy groups believe that express mention of the characteristics of the victim is necessary in anti-bullying legislation in order to afford adequate protection to students.[14] Opponents, however, worry that express protection for LGBT students will result in the

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8 *See* Daniel B. Weddle & Kathryn E. New, *What* Did *Jesus Do?: Answering Religious Conservatives Who Oppose Bullying Prevention Legislation*, 37 NEW ENG. J. ON CRIM. & CIV. CONFINEMENT 325, 325 (2011) (explaining groups like Focus on the Family and the West Virginia Family Foundation fear that an explicit mention of protection for lesbian, gay, bisexual, and transgender (LGBT) students in anti-bullying legislation is nothing more than an attempt by the state legislatures to indoctrinate children in "homosexual lifestyles"); *see also* STUART-CASSEL ET AL., *supra* note 4, at 29 (noting that controversy over enumeration of specific groups in anti-bullying policies "has been a key factor contributing to the failure to pass proposed bullying legislation").

9 The term "LGBT" will be used as shorthand for "lesbian, gay, bisexual, and transgender."

10 *See* Kim Severson, *Seeing a Gay Agenda, a Christian Group Protests an Anti-Bullying Program*, N.Y. TIMES, Oct. 15, 2012, at A15 (commenting that anti-bullying legislation is a "thinly veiled" attempt at promoting the "homosexual agenda").

11 *See* Katy Hall, *Christian Group Takes Issue With Anti-Bullying Laws*, HUFFINGTON POST (Apr. 5, 2012, 7:34 PM), http://www.huffingtonpost.com/2012/04/05/anti-bullying-laws-christian-religious-freedom_n_1406757.html (noting that "[s]ocially conservative groups nationwide have lobbied state legislatures to strike down and limit anti-bullying measures").

12 CANDI CUSHMAN, THE PROBLEM WITH POLITICIZED BULLYING POLICIES 1 (2010), *available at* http://media.citizenlink.com/truetolerance/politicizedbullyingpolicies.pdf (noting that "a good way for schools to address this issue is with a strong prohibition against any form of bullying—for any reason, against any child . . . [s]o we should be sending the message that a bully's actions are always wrong for any reason regardless of why they target the victim").

13 *Id.* at 1–2.

14 *See* Connolly, *supra* note 3, at 260 (noting that "[g]ay rights organizations strongly support enumeration . . . "); *see also* Jason A. Wallace, Comment, *Bullycide in American Schools: Forging a Comprehensive Legislative Solution*, 86 IND. L.J. 735, 737 (2011) (noting the prevalence of anti-gay bullying versus bullying in general).

teaching of "homosexual-themed curricula" in public schools.[15] Although the fear that anti-bullying laws are *merely* a ploy to promote the gay agenda is farfetched, the argument opposing the legislation as a violation of a parent's right to direct the upbringing of their children has some merit. There is also a further related concern that participation in bullying prevention programs forces children to adopt a viewpoint with which they may disagree.

This Note will explore those constitutional concerns raised by the opponents of anti-bullying legislation. Part I of this Note will address the development of anti-bullying legislation, including a brief overview of the states' authority to legislate in this area. Part II will then examine anti-bullying legislation as it is presently employed in the states. Part III will address the constitutional rights that are implicated by anti-bullying laws, including the parental right to direct the education and upbringing of their child as well as the right of the child to be free from a compelled viewpoint. It will also examine the development of bullying prevention and education programs, and the effect those programs may have on the constitutional rights of the parents and students. Part IV will have a more practical import, describing actual bullying prevention programs and assessing their effect on the implicated constitutional rights. Finally, Part V will propose that states give parents of elementary school children opt-out rights for lessons they find objectionable when the lessons concern matters that traditionally fall under the purview of the parental right to raise their children.

I. THE DEVELOPMENT OF ANTI-BULLYING LEGISLATION

> "[E]ducation is perhaps the most important function of state and local governments . . . [I]t is a principal instrument in awakening the child to cultural values, in preparing him for later professional training, and in helping him to adjust normally to his environment."[16]

A. The Origin of Anti-Bullying Legislation

The history of anti-bullying legislation is a short one, but one that is, nonetheless, shrouded in powerful emotion and bitter controversy. The 1999 shooting at Columbine High School in Littleton, Colorado, is frequently cited as the first incident of school violence linked to presumed student-perpetrated

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15 CUSHMAN, *supra* note 12, at 2.

16 Brown v. Bd. of Educ., 347 U.S. 483, 493 (1954).

bullying.[17] In its wake, the Columbine shooting had the unexpected effect of "ignit[ing] a wave of legislation" aimed at curbing bullying on school campuses across the nation.[18] Some state legislatures took almost immediate action to legislatively outlaw bullying in schools.[19] Other states followed soon after this initial wave. In the ensuing years, the anti-bullying movement was further fueled by societal outrage at the suicides of a number of school-age children known to have been subjected to chronic bullying in school.[20] Indicative of this outrage, forty-nine states presently have some form of anti-bullying legislation on their books.[21]

B. The States' Authority to Regulate

State authority over public education is a principle firmly grounded in constitutional law and one memorialized in state constitutions.[22] As the Supreme Court stated in *Wisconsin v. Yoder*, "[p]roviding public schools ranks at the very apex of the function of a State."[23] Given the undoubted importance of education to society—in addition to the states' expansive power to regulate schools[24]—it is no surprise that state and local governments have broad power to direct and control education, subject only to limitations in their respective state constitutions.[25] A safe learning environment for students is a necessary prerequisite to fulfillment of this "important [government] function."[26] It follows, then, that state governments are also tasked with ensuring that schools are safe places for students to learn.[27] For nearly every state, discharging their

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17 *See* STUART-CASSEL ET AL., *supra* note 4, at 15. *But see* Greg Toppo, *10 Years Later, the Real Story Behind Columbine*, USA TODAY, Apr. 14, 2009, at 1A, *available at* http://usatoday30.usatoday.com/news/nation/2009-04-13-columbine-myths_N.htm (noting that the Columbine shooters were not victims of bullying but possibly were bullies themselves).

18 STUART-CASSEL ET AL., *supra* note 4, at 1.

19 *Id.* at 16 (charting the number of state bullying laws by year and noting that by 2001 eleven states had enacted some form of bullying law).

20 *Id.* at 1; *see also* Bloom, *supra* note 3, at 105 (noting the trend of bully related incidents that ended in tragedy, like the shooting at Columbine High School and, more recently, multiple suicides of teens believed to be gay).

21 *See Bully Police USA*, *supra* note 4 (noting that Montana is the only state with no anti-bullying law).

22 William E. Sparkman, *The Legal Foundations of Public School Finance*, 35 B.C. L. REV. 569, 570 (1994) (commenting that states' authority over education is "a truism of constitutional law" and that authority is "made evident in state constitutions through education articles, and exercised with few constraints by legislatures").

23 Wisconsin v. Yoder, 406 U.S. 205, 213 (1972).

24 Pierce v. Soc'y of Sisters of the Holy Names of Jesus and Mary, 268 U.S. 510, 534 (1925) (noting that it is within the powers of the state to reasonably regulate all schools).

25 *See* Sparkman, *supra* note 22, at 578.

26 *See* Wallace, *supra* note 14, at 736.

27 *Id.* at 735–36.

responsibility to ensure a safe learning environment for students has recently come to include the implementation of some form of anti-bullying legislation.

II. ANTI-BULLYING LEGISLATION PRESENTLY

Because the regulation of schools is traditionally the function of state governments, there is no uniform anti-bullying law. Anti-bullying provisions vary widely by state and cover many different levels of comprehensiveness.[28] Some states do not even define "bullying" in their bullying statutes.[29] Instead, taking direction from existing civil rights legislation, certain states prohibit "harassment" rather than "bullying."[30] Some states even leave the definition of bullying to be determined by the state departments of education or to local school districts.[31] Beyond terminology, states also differ on how much guidance to provide school districts in the form of model policies.[32] Furthermore, whether an incident even qualifies as an act of bullying at all is also dependent on the state law that governs. Some states qualify a single act as bullying while others require a systematic pattern of harmful behavior directed at a specific student to qualify.[33]

Most importantly—and perhaps most contentiously—state anti-bullying laws also vary over the inclusion of enumerated classifications of protected groups. Enumeration of specific classes in bullying legislation offers legal protection for groups of individuals who are bullied based on particular personal

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28 *See* DENA T. SACCO ET AL., AN OVERVIEW OF STATE ANTI-BULLYING LEGISLATION AND OTHER RELATED LAWS 4 (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2197961 ("The content and level of detail in the laws varies greatly . . . [with some states having] brief requirements for school districts or other relevant bodies to develop policies . . . [while] [t]he more complex laws have many provisions, each law different from the other.").

29 *See, e.g.*, ALA. CODE § 16-28B-3 (2013) (defining harassment).

30 *See* STUART-CASSEL ET AL., *supra* note 4, at 17 ("Many bullying laws enacted since 1999 were originally modeled on existing civil rights legislation that protects groups from various forms of harassment under the law. The legislative language used in crafting bullying laws often borrows directly from harassment statutes . . . .").

31 *See* SACCO ET AL., *supra* note 28, at 4 (noting that certain states "leave the definition of bullying to the discretion of the state department of education or similar entity," while a few others "leave the definition of bullying entirely up to local school districts").

32 Model policies "provide specific guidance to school districts on how to draft district bullying policies and how to implement provisions outlined in the law." *See* STUART-CASSEL ET AL., *supra* note 4, at 47; *see also* U.S. Dep't of Health & Human Serv., *Policies & Laws*, STOPBULLYING.GOV, http://www.stopbullying.gov/laws/index.html (last visited Oct. 5, 2013) (identifying Arizona, Illinois, Indiana, Kansas, Minnesota, North Dakota, Tennessee, and Texas as the only states without a model bullying policy).

33 *See* IOWA CODE ANN. § 280.28 (West 2013) (defining "harassment" and "bullying" to allow for a single "act" to qualify as bullying). *But see* FLA. STAT. ANN. § 1006.147(3)(a) (West 2013) (defining bullying as "systematically and chronically inflicting physical hurt or psychological distress on one or more students . . . ").

characteristics like race, gender, disability, ethnicity, or religion.[34] Enumeration in bullying legislation serves two distinct purposes: it can either be used to narrow the implications of the laws by restricting bullying to acts solely motivated by the enumerated characteristics or it can be used more broadly to symbolically indicate that the targeting of specific groups for bullying is unacceptable.[35] Some states have not dabbled in the enumeration game, choosing rather to afford "equal treatment" to all students by not specifying protected characteristics.[36] While many disagree over whether non-enumeration actually affords "equal treatment,"[37] it is clear that enumeration is a popular feature of anti-bullying legislation. In fact, twenty states have some form of enumerated class provision in their bullying laws.[38] Of these states, eighteen have expressly enumerated "sexual orientation" as a protected characteristic.[39]

Inclusion of "sexual orientation" as a protected class has created controversy amongst religious groups[40] and caused many to question the true purpose of anti-bullying legislation.[41] Despite

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34 *See* STUART-CASSEL ET AL., *supra* note 4, at 27 (commenting that enumeration "conveys explicit legal protections for certain groups or classes of individuals, or for anyone bullied based on personal characteristics, such as physical appearance or sexual orientation").

35 *Id.*

36 *See* SACCO ET AL., *supra* note 28, at app. 13 (identifying Florida, Massachusetts, Michigan, New Hampshire, Rhode Island, and Utah as states that require "equal treatment for all students" no matter the student's legal status).

37 *See* Connolly, *supra* note 3, at 260–61 (citing GAY, LESBIAN & STRAIGHT EDUC. NETWORK, MODEL STATE ANTI-BULLYING & HARASSMENT LEGISLATION 4–5 (2010), *available at* http://www.glsen.org/download/file/Mjk1OQ==) (commenting that "[g]ay rights organizations strongly support enumeration" and indicating that studies show that students enrolled in schools with express enumeration feel safer and experience less bullying).

38 *See generally* NETWORK FOR PUBLIC HEALTH LAW, ANTI-BULLYING STATUTES 50 STATE COMPILATION, *available at* http://www.networkforphl.org/_asset/khqyg6/50StateAntiBullyingStatutes41612FINAL.pdf; *see also* Connolly, *supra* note 3, at 260 (indicating that while enumeration is still a minority position, the trend appears to be toward enumeration).

39 *See* SACCO ET AL., *supra* note 28, at 5 (noting that as of 2012, sixteen states provide express treatment of sexual orientation). However, New Mexico also prohibits bullying on the basis of sexual orientation and has not been accounted for in the survey. *See* N.M. ADMIN. CODE ANN. § 6.12.7.7 (West 2012). Furthermore, it appears that since the study was conducted, Maine has also elected to include sexual orientation as a protected characteristic. ME. REV. STAT. ANN. tit. 20-A § 6554 (2013).

40 *See* Hall, *supra* note 11 (noting that in addition to Christian groups, opposition to anti-bullying legislation has also come from Orthodox Jewish groups).

41 *See* Nathan A. Cherry, *Will Local Government Force Businesses to Violate Religious Convictions?*, ENGAGE FAMILY BLOG (Apr. 5, 2012), http://engagefamilyminute.com/2012/04/will-local-government-force-businesses-to-violate-religious-convictions/ (commenting that he "ardently oppose[s] bullying in all forms. However, most of [the] so-called laws aim to create a special class of citizens for the LGBT community . . . . Rather than simply opposing bullying in all forms, LGBT advocates seek to elevate their groups beyond all others—creating a special class—by inserting language into 'anti-bullying' laws that singles out 'sexual orientation and gender identity'").

the existence of some evidence indicating that students who identify as LGBT are bullied at a disproportionate rate to other students,[42] opponents ardently challenge enumeration protecting LGBT students. The fear is that giving "sexual orientation" an enumerated status in anti-bullying laws creates special rights for LGBT students to the detriment of other students. [43] Furthermore, opponents use enumeration of "sexual orientation" as proof of the covert purpose of anti-bullying laws: indoctrination of young children in accordance with the homosexual agenda.[44]

III. RAISING THE CONSTITUTIONALITY QUESTION

The notion that *all* anti-bullying legislation is merely a ploy to indoctrinate young children in the "homosexual lifestyle" is farfetched at best. Opponents would certainly face an uphill battle in facially challenging the constitutionality of anti-bullying legislation. In the extreme, even if the legislation actually were directed at promoting homosexuality, a questionable legislative purpose is no reason to strike down otherwise valid legislation.[45] Many anti-bullying legislation opponents would like to argue that anti-bullying policies violate the religious rights of those who dissent from the stated goals of the policies. However, as neutral, generally applicable legislation, anti-bullying laws would be subject to rational basis review.[46] A state legislature

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42 *See* Wallace, *supra* note 14, at 736; *see also* R. Kent Piacenti, Comment, *Toward a Meaningful Response to the Problem of Anti-Gay Bullying in American Public Schools*, 19 VA. J. SOC. POL'Y & L. 58, 61 (2011) (noting that LGBT students face bullying at a significantly higher rate than other groups of students).

43 CUSHMAN, *supra* note 12, at 6 (hypothesizing that policies with enumerated characteristics such as sexual orientation "create[] a system ripe for reverse discrimination, sending the message that certain characteristics are more worthy of protection than others . . . and introduce divisiveness among different groups of students and parents").

44 *See Does anti-bullying bill encroach on religious freedom?*, DAILY HERALD (May 21, 2012, 5:02 AM), http://www.dailyherald.com/article/20120521/news/705219961/ (noting the Illinois Family Institute's fear that Chicago's bullying law was a "beachhead for 'homosexual activist organizations' that want to indoctrinate students and teachers"); *see also* CUSHMAN, *supra* note 12, at 2 (commenting that anti-bullying legislation is really not about protecting kids but about "homosexual advocacy groups" seeking to obtain "the leverage they need to push homosexual advocacy messages into public schools"); Katherine Kersten, *The Real Agenda Behind Anti-Bullying Campaign*, CENTER OF THE AMERICAN EXPERIMENT (Jan. 13, 2013), http://www.americanexperiment.org/publications/commentaries/the-real-agenda-behind-anti-bullying-campaign (commenting that anti-bullying campaigns are less about "protecting the traditional targets of bullies" and more about "shap[ing] your 10-year-old's attitudes and beliefs about sexuality and family structure").

45 *See* United States v. O'Brien, 391 U.S. 367, 383 (1969) (acknowledging that "[i]t is a familiar principle of constitutional law that [the] Court will not strike down an otherwise constitutional statute on the basis of an alleged illicit legislative motive").

46 Under the Supreme Court's current Free Exercise jurisprudence, "laws shown to be neutral and generally applicable . . . trigger rational basis review." Sean Clerget,

would then only have to articulate a reasonable belief that the legislation promotes a legitimate government purpose in an area in which the state may regulate in order to be valid. As preventing bullying conduct in schools is likely to be deemed a legitimate government interest and state legislatures clearly have authority to regulate schools, facial challenges to anti-bullying legislation will be difficult, if not impossible. However, anti-bullying opponents do raise two interesting issues about how bullying legislation, *as implemented*, implicates two important constitutional rights: (1) a parent's right to direct the upbringing and education of his or her child, and (2) the right to be free from compulsory adoption of viewpoints with which the student may disagree.

A. The Implicated Constitutional Rights

1. Directing the Education and Upbringing of One's Child

Parents have a constitutionally protected right to direct the education and upbringing of their children.[47] This principle finds its roots in *Meyer v. Nebraska*,[48] where the Supreme Court overturned the conviction of a teacher under a Nebraska statute that prohibited the teaching of any language other than English to a student who had not yet completed the eighth grade.[49] By means of the substantive due process component of the Fourteenth Amendment, the Court recognized a liberty interest in the right of parents to direct the upbringing of their children.[50] The Court acknowledged that while the "liberty" guaranteed by the Fourteenth Amendment had not been exactly defined, it undoubtedly included the right to "bring up children" and "enjoy those privileges long recognized at common law as essential to the orderly pursuit of happiness by free men."[51] The state could

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Timing is of the Essence: Reviving the Neutral Law of General Applicability Standard and Applying it to Restrictions Against Religious Face Coverings Worn While Testifying in Court, 18 GEO. MASON L. REV. 1013, 1015 (2011) (*citing* Emp't Div., Dep't of Human Res. Of Or. V. Smith, 494 U.S. 872, 879 (1990)).

47 *See* William G. Ross, *The Contemporary Significance of* Meyer *and* Pierce *for Parental Rights Issues Involving Education*, 34 AKRON L. REV. 177, 177 (2000) (noting that "the Due Process Clause of the Fourteenth Amendment protects the right of parents to direct the education of their offspring").

48 Meyer v. Nebraska, 262 U.S. 390, 401 (1923).

49 *Id.* at 403 (reversing the Nebraska Supreme Court's decision upholding Meyer's conviction).

50 *Id.* at 400 (noting that "the right of parents to engage [the teacher] so to instruct their children . . . [is] within the liberty of the Amendment"); *see also* DOUGLAS W. KMIEC ET AL., THE AMERICAN CONSTITUTIONAL ORDER: HISTORY, CASES AND PHILOSOPHY 1424 (3d ed. 2009) (noting that *Meyer v. Nebraska* and *Pierce v. Society of Sisters of the Holy Names of Jesus and Mary* are the "foundation of the substantive due process right to direct the upbringing of children").

51 *Meyer*, 262 U.S. at 399.

"go very far, indeed, in order to improve the quality of its citizens, physically, mentally and morally," but it could not do so by infringing on parents' "fundamental rights which must be respected."[52]

The Court further expounded upon this principle in *Pierce v. Society of Sisters*,[53] where it struck down an Oregon compulsory education statute that effectively required all students to attend public schools.[54] In doing so, the Court found that the statute "unreasonably interfere[d] with the liberty of parents and guardians to direct the upbringing and education of children."[55] The Court further added that "[t]he child [was] not the mere creature of the state" and that "those who nurture him and direct his destiny have the right, coupled with the high duty, to recognize and prepare him for additional obligations."[56]

Today, *Meyer* and *Pierce* are recognized as the seminal cases establishing the right of the parent to direct the education and upbringing of the child as a component of fundamental liberty protected by the Constitution. [57] The Court more recently affirmed the vitality of the *Meyer-Pierce* doctrine in *Troxel v. Granville*[58] by invalidating a Washington statute that gave state courts—rather than parents—discretion in determining visitation rights for third parties when the courts deemed it was in a child's best interest.[59] The plurality opinion identified the parental interest in the "care, custody, and control of their children" as "perhaps the oldest of the fundamental liberty interests recognized by [the] Court"[60] and held that the statute unconstitutionally infringed on this fundamental liberty.[61] While the Court has, elsewhere, held that infringement of fundamental

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52 *Id.* at 401.

53 Pierce v. Soc'y. of the Sisters of the Holy Names of Jesus and Mary, 268 U.S. 510 (1925).

54 *Id.* at 534–36 (affirming the Oregon Supreme Court's finding that the compulsory public education statute was unconstitutional).

55 *Id.*

56 *Id.* at 535.

57 *See* Brad J. Davidson, *Balancing Parental Choice, State Interest, and the Establishment Clause: Constitutional Guidelines for States' School-Choice Legislation*, 33 TEX. TECH L. REV. 435, 445 (2002); *see also* Wisconsin v. Yoder, 406 U.S. 205, 232–33 (describing the "fundamental interest" of the parent in guiding the education of the child as articulated previously in *Pierce* and *Meyer*). *But see* Brown v. Hot, Sexy & Safer Prods., Inc., 68 F.3d 525, 533 (1st Cir. 1995) (questioning whether the right of the parent to direct the education of their child is still fundamental under the Court's present right of privacy jurisprudence).

58 Troxel v. Granville, 530 U.S. 57 (2000).

59 *Id.* at 74 (affirming the judgment of the Washington Supreme Court that the statute unconstitutionally infringed on a parent's right to control the exposure of his or her children to people or ideas).

60 *Id.* at 65.

61 *Id.* at 74.

rights demands strict judicial scrutiny,[62] the *Troxel* plurality ultimately failed to articulate a standard of scrutiny for infringement upon parental rights.[63] As *Meyer* and *Pierce* were decided before the modern strict scrutiny analysis was developed,[64] the *Troxel* Court had an opportunity to clarify the appropriate standard of scrutiny in parental rights cases. Instead, the *Troxel* Court shirked that responsibility in favor of ruling on the breadth of the statute in question.[65] Thus, commentators frequently recognize that there is no real clear standard of review for apparent infringements on the rights of parents to direct the upbringing and education of their children.[66] Consequently, federal circuits have split regarding the boundaries of parental rights, with some circuits adopting the traditional view of the *Meyer-Pierce* right and others finding that parental rights terminate upon the choice to send a child to a public school rather than a private school.[67]

While the precise boundaries of the parental right to educate and bring up a child are somewhat blurry, it appears that the Court is at least willing to consider placing parental rights in a category with other fundamental rights demanding strict scrutiny.[68] Notwithstanding the characterization of parental

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62 *See, e.g.*, Reno v. Flores, 507 U.S. 292, 302 (1993) (noting that that fundamental rights may not be infringed by the government at all, regardless of the process provided, "unless the infringement is narrowly tailored to serve a compelling state interest"); *see also* Griswold v. Conn., 381 U.S. 479, 497 (1965) (Goldberg, J., concurring) ("Where there is a significant encroachment upon personal liberty, the State may prevail only upon showing a subordinating interest which is compelling.") (quoting Bates v. City of Little Rock, 361 U.S. 516, 524 (1960)).

63 *See* KMIEC ET AL., *supra* note 50, at 1434. The Court's failure to articulate a standard of scrutiny in *Troxel* is puzzling given the importance of the fundamental rights at issue. *Id.* Having passed on a valuable opportunity for clarity, the Court in *Troxel* complicated the matter even more than it had been previously. *Id.*

64 *See* Richard H. Fallon Jr., *Strict Judicial Scrutiny*, 54 UCLA L. REV. 1267, 1270 (2007) (noting that modern strict scrutiny analysis did not develop until the 1960s).

65 *See* KMIEC ET AL., *supra* note 50, at 1434.

66 *See* Ross, *supra* note 47, at 185 ("[T]here is no clear standard of review that a federal court must apply in reviewing legislation that affects the rights of parents to direct the education of their children."); *see also* Jennifer Adams Emerson, *"Who's In A Family?": Parental Rights and Tolerance-Promoting Curriculum in Early Elementary Education*, 40 J. L. & EDUC. 701, 706 (2011) ("[T]he Supreme Court has not yet defined the precise boundaries of the parental right to control the upbringing and education of their children . . . .").

67 *See* Emerson, *supra* note 66, at 705–06 (noting the different approaches taken by the Ninth and Third Circuits as to the boundaries of parental rights) (citing Fields v. Palmdale Sch. Dist., 427 F.3d 1197 (9th Cir. 2005) and Gruenke v. Seip, 225 F.3d 290 (3d Cir. 2000)).

68 *See, e.g.*, Emp't Div., Dep't of Human Res. of Or. v. Smith, 494 U.S. 872, 881 (1990) (equating parental rights to direct the upbringing and education of the child with freedom of speech and the press); *see also* Troxel v. Granville, 530 U.S. 57, 80 (2000) (Thomas, J., concurring) (stating, in the context of a case concerning the parental right to direct the upbringing of a child, that strict scrutiny should be the standard for all infringements of fundamental rights).

rights as "fundamental," these rights are not unlimited. [69] Sometimes, the parental right to control the education and upbringing of a child must yield to the state's interest in preserving a safe school atmosphere for students.[70] Schools may, for example, enforce dress codes for the purpose of enhancing school safety over a parent's objection that the dress code violates his right to direct the education and upbringing of his child.[71] The state may also outlaw private racially segregated schools without violating the parental right to direct the education and upbringing of a child.[72] Parents also do not have a fundamental constitutional right to dictate curriculum to the public schools that they have chosen to send their children to, despite claims of infringement of parental rights. [73] The state's interest in preserving a safe school climate for students, however, is not superior to the parental interest in determining the appropriate age for children to be introduced to matters of sexuality and morality.[74] Parents, ultimately, have the high duty to inculcate their children with values. [75] The state may not assume a parental role in determining when to introduce students to concepts that "strike at the heart of parental decision-making authority on matters of the greatest importance."[76]

2. The Right to be Free From a Compelled Viewpoint

Students have a constitutionally protected right to be free from compulsory adoption of a viewpoint with which they disagree.[77] The Supreme Court first announced this principle in *West Virginia Board of Education v. Barnette*[78] when it found that compulsory recitation of the Pledge of Allegiance in schools violated the First Amendment.[79] In so holding, the Court chose "individual freedom of mind in preference to officially disciplined

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69 *See* KMIEC ET AL., *supra* note 50, at 1435.

70 *See* Emerson, *supra* note 66, at 706.

71 *See* Blau v. Fort Thomas Pub. Sch. Dist., 401 F.3d 381, 395–96 (6th Cir. 2005).

72 *See* Runyon v. McCrary, 427 U.S. 160, 176–77 (1976).

73 *See* Brown v. Hot, Sexy & Safer Prods., Inc., 68 F.3d 525, 534 (1st Cir. 1995) ("[T]he rights of parents as described by *Meyer* and *Pierce* do not encompass a broad-based right to restrict the flow of information in the public schools.").

74 *See* Emerson, *supra* note 66, at 706.

75 *See* Wisconsin v. Yoder, 406 U.S. 205, 233 (1972) (stating that the "additional obligations" referenced by the court in *Meyer* include "the inculcation of moral standards, religious beliefs, and elements of good citizenship").

76 *See* Emerson, *supra* note 66, at 707 (quoting C.N. v. Ridgewood Bd. of Educ., 430 F.3d 159, 184 (3d Cir. 2005)).

77 *See* Laurent Sacharoff, *Listener Interests in Compelled Speech Cases*, 44 CAL. W. L. REV. 329, 331 (2008) (stating that the First Amendment protects pupils from compelled speech because compelled speech essentially entails invasion of the speaker's freedom of mind).

78 W. Va. Bd. of Educ. v. Barnette, 319 U.S. 624 (1943).

79 *Id.* at 642.

uniformity."[80] The Court reasoned that if free expression could only be suppressed when there is a "clear and present danger," then involuntary affirmation of an idea could be commanded only in even more serious situations, clearly not attendant in this case.[81] School boards have a highly discretionary function, said the Court, but as "creatures" of the government they cannot achieve permissive ends through means prohibited by the Bill of Rights.[82]

The Court later articulated this principle outside the context of schools in *Wooley v. Maynard*[83] when it held that New Hampshire could not constitutionally compel individuals to disseminate an ideological message on private property.[84] The state of New Hampshire enforced criminal sanctions against a member of the Jehovah's Witnesses faith for covering up the motto "Live Free or Die" on his passenger vehicle license plate.[85] As a Jehovah's Witness, the individual found the motto to be repugnant to his religious and moral beliefs and, consequently, covered the motto on his license plate, thus violating New Hampshire statutory law.[86] Finding for the individual, the Court held that no matter how compelling the state's interest, the state could not violate the First Amendment by forcing the people to be couriers of the state's message.[87] The Court held that the Constitution "protects the right of individuals to hold a point of view different from the majority and to refuse to foster . . . an idea they find morally objectionable."[88]

As conduits of the state, it follows that school boards may not compel a student to ratify a viewpoint with which he or she does not agree. That is easier said than done, however. Schools and teachers have a great deal of influence over young students.[89] Given this influence, the state has the power to inculcate students with values by way of the classroom.[90] Schools fulfill

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80 *Id.* at 637.

81 *Id.* at 633–34.

82 *Id.* at 637 ("The Fourteenth Amendment, as now applied to the States, protects the citizen against the State itself and all of its creatures—Boards of Education, not excepted. These have, of course, important, delicate, and highly discretionary functions, but none that they may not perform within the limits of the Bill of Rights.").

83 Wooley v. Maynard, 430 U.S. 705 (1977).

84 *Id.* at 717.

85 *Id.* at 707–08.

86 *Id.*

87 *Id.* at 717.

88 *Id.* at 715.

89 *See* Ross, *supra* note 47, at 191 (noting that "schools have a very powerful influence in shaping the values of children" and that children "spend a very significant amount of their time in the custody of the state").

90 *See* KEVIN W. SAUNDERS, SAVING OUR CHILDREN FROM THE FIRST AMENDMENT 97 (2003).

this important function by encouraging basic character qualities which most parents would find hard to disagree with, like self-control, empathy, charity, fairness, and respect for others.[91] It is when schools go beyond inculcation of these basic character qualities and attempt to inculcate moral values that controversy arises.[92] As a result, schools must be especially careful when addressing controversial topics like the traditional versus non-traditional family debate.[93] While it is admirable that schools attempt to tackle these complicated issues, it is difficult to do so without implicitly conveying adoption of one side of the debate over the other.[94] Schools, thus, may violate the Constitution by impermissibly compelling student viewpoints when they tackle these controversial issues by taking a side on the debate and then mandating participation without an opt-out right[95] in a program whose teachings conflict directly with the student's beliefs.

B. Developing Training and Prevention Programs

While most anti-bullying laws seek primarily to deter bullying in schools, a significant number of states have gone further than a mere prohibition on bullying and have included provisions for school-sponsored bullying prevention and education programs.[96] States approach training and prevention programs differently across the nation. Some states "encourage" school districts to develop and implement programs for student training,[97] with others going so far as to compel the teaching of bullying prevention principles as part of a school's character education curriculum.[98] Regardless of the terminology used

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91 *Id.* at 99.

92 *Id.*

93 *Id.* at 100.

94 *See id.* ("If the arrangements in which some live are ignored, the message will be that these families are not to be considered acceptable . . . .").

95 *Id.* Kevin W. Saunders argues for an opt-out right for school lessons concerning the teaching of moral values that conflict with the values of the parents, because parents are still meant to be the principal teachers of values to their children. *See id.*

96 *See* SACCO ET AL., *supra* note 28, at 11 (noting that as of 2012, "[l]aws in 40 states contemplate some form of education or prevention programs for students . . . ").

97 *See* STUART-CASSEL ET AL., *supra* note 4, at 34 (noting that of the states addressing training and prevention programs in 2011, there were eleven states that merely "encourage[d] schools to comply with prevention recommendations").

98 *See, e.g.*, GA. CODE ANN. § 20-2-145 (West 2013) (establishing that Georgia's comprehensive character education curriculum shall focus on teaching the character traits of "respect for others . . . compassion, tolerance . . . [and also address] methods of discouraging bullying and violent acts against fellow students"); VA. CODE ANN. § 22.1-208.01 (West 2013) (requiring a character education program for Virginia schools that shall "instill in students civic virtues and personal character traits . . . including the precepts of the Golden Rule, tolerance, and courtesy . . . [and also] address the inappropriateness of bullying . . . "); *see also* SACCO ET AL., *supra* note 28, at 11 (noting

(compulsory implementation or mere encouragement), the laws are generally silent on methods of implementation, electing rather to give school districts broad discretion in developing and implementing their bullying prevention programs.[99] Due to the silence on the specifics of implementation of prevention programs, school districts may choose whether to allow schools to create their own school-specific versions of prevention training or implement a pre-packaged program developed by outside groups for use in public schools.[100] As a result, schools have employed a variety of prevention methods, some of which have drawn a considerable amount of negative attention from the opponents of anti-bullying legislation.

IV. ANTI-BULLYING LEGISLATION IN PRACTICE

A. Crossing the Impermissibility Line: *Welcoming Schools'* Diversity Photo Puzzle

In 2008, the Human Rights Campaign piloted its *Welcoming Schools* program to combat bullying in twelve schools from five school districts in California, Massachusetts, and Minnesota.[101] *Welcoming Schools* is one of a variety of pre-packaged anti-bullying prevention programs available to school districts and crafted to address many forms of biased-based bullying.[102] One of the goals of the *Welcoming Schools* program is to encourage inclusivity and diversity in elementary schools.[103] *Welcoming Schools* offers a variety of lesson plans for teachers aimed at promoting sensitivity to diversity and gives school districts discretion in determining which lesson plans to use.[104] The program is targeted to elementary school students (kindergarten

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that as of 2012, anti-bullying laws in four states actually required schools to undertake character education to combat bullying).

99 *See* STUART-CASSEL ET AL., *supra* note 4, at 33 ("[S]tate laws either require or encourage school districts to implement prevention programs directly, often as a component of district policy, or transfer control over prevention policy to locally established committees and task forces.").

100 *See* LISA JONES ET AL., IMPLEMENTING BULLYING PREVENTION PROGRAMS IN SCHOOLS: A HOW-TO GUIDE 4–5 (2012), *available at* http://cyber.law.harvard.edu/sites/cyber.law.harvard.edu/files/ImplementingBullyingPrevention.pdf (listing different pre-packaged bullying prevention programs made for use in public schools); *see also Bully Prevention Resources*, SEATTLE PUB. SCH., http://www.seattleschools.org/modules/cms/pages.phtml?sessionid=&pageid=217021 (last visited Oct. 31, 2013) (noting that Seattle Public Schools use the Steps to Respect, Second Step, and Olweus bullying prevention programs).

101 *See* HUMAN RIGHTS CAMPAIGN FOUND., AN INTRODUCTION TO WELCOMING SCHOOLS 81 (2009), *available at* http://www.hrc.org/files/images/general/An_Introduction_to_Welcoming_Schools.pdf.

102 *See id.* at 9.

103 *See id.* at 82.

104 *Id.* at 81.

through fifth grade) with primary focus areas of family diversity, gender stereotyping, and name-calling.[105] The program employs a variety of LGBT inclusive children's books[106] and includes lessons and readings about non-traditional families. [107] The Human Rights Campaign touts the pilot program's success, reporting overall "positive improvement in school diversity climate."[108] The program was officially adopted by the Berkeley School District in California in April 2010 [109] and is presently implemented in seventy-four schools across the country.[110] Despite this claimed success, *Welcoming Schools* was not welcomed with open arms everywhere.

In Minnesota, parents successfully challenged official implementation of some of the *Welcoming Schools* lesson plans in their classrooms.[111] At a mere thirty-seven words, Minnesota has one of the weakest anti-bullying laws in the nation.[112] Despite its weakness, the statute clearly commands each school board to adopt a written policy prohibiting intimidation and bullying of any student.[113] The Minneapolis School District adopted such a policy directing school district administration to create a bullying prevention and education program for students, and allowing them to create character development and pro-social skills education programs to prevent and reduce the bullying policy violations.[114] As part of its obligation to ensure that bullying prevention education was being taught to its students, the Minneapolis school district invited *Welcoming Schools* into a few of its classrooms. Three of its elementary schools were targeted

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105 *See id.* at 10–11.

106 *See id.* at 70.

107 *See id.* at 71–73 (listing appropriate children's books about adoption, divorce, homelessness, incarcerated parents, multi-cultural families, among others).

108 *Id. at* 81.

109 *See,* Human Rights Campaign Found., *California School District Officially Adopts Human Rights Campaign's "Welcoming Schools Guide,"* WELCOMING SCHOOLS (Apr. 9, 2010), http://www.welcomingschools.org/blog/entry/california-school-district-officially-adopts-human-rights-campaigns-welcomi.

110 *See Minnesota School District Makes National Case for Anti-LGBT Bullying Prevention,* HUMAN RIGHTS CAMPAIGN (Mar. 6, 2012), http://www.hrc.org/press-releases/entry/minnesota-school-district-makes-national-case-for-anti-lgbt-bullying-preven.

111 *See* Kersten, *supra* note 44*; see also* CUSHMAN, *supra* note 12, at 4.

112 *See Safe and Supportive Minnesota Schools Act,* OUTFRONT MINNESOTA, https://www.outfront.org/resources/safeschools.

113 MINN. STAT. ANN. § 121A.0695 (West 2013).

114 MINNEAPOLIS SCH. DIST. POLICY 5201 BULLYING AND HAZING PROHIBITION 1–3 (2008), *available at* http://policy.mpls.k12.mn.us/UPcms/PolicyFiles/5201_Policy.pdf. Part III of the policy details the responsibilities of each educational entity in carrying out the district's bullying prevention program. *Id.* at 3. Subsections E and F of Part III charge the district administration with the responsibility of implementing bullying prevention and education programs and permitting the district to develop character education curriculum as well. *Id.*

as pilot schools for the program,[115] meaning that these schools were amongst the first in the nation to utilize the *Welcoming Schools* curriculum. It did not take long for parents in the affected schools to voice concerns about the program. The parents worried that the curriculum sought to "indoctrinate" their children into abandoning traditional views on sexuality and family structure and, instead, convince the children to adopt the Human Rights Campaign's attitudes and beliefs on these matters.[116] Given the role the Human Rights Campaign plays as a vocal advocate for the rights of LGBT Americans,[117] parents felt that the program "advanc[ed] acceptance of homosexuality, as distinct from tolerance," rather than counseling students about bullying.[118]

While "indoctrination" is, perhaps, too strong a word to use in this context, the parents in this case were not necessarily off base in their distrust of the program. One of the particularly troubling aspects of the curriculum in question was the so-called "Family Diversity Photo Puzzle."[119] The Family Diversity Photo Puzzle was designed for students in first through third grades.[120] The exercise called for students to arrange the "puzzle pieces" depicting photographs of adults and children into seven families.[121] By design, the students were unable to form seven traditional families with one male parent and one female parent. [122] Instead, the children were forced to create some families with same-sex parents.[123] The students were then asked how to label or name the types of families that they had created. The lesson required teachers to create their own family diversity puzzle with same-sex parents as an example to help students

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115 *See Hale Elementary parents fight 'Welcoming Schools,'* MINNESOTA CHRISTIAN EXAMINER (June 2008), http://www.minnesota.christianexaminer.com/Articles/Jun08/Art_Jun08_06.html.

116 *See* Kersten, supra note 44.

117 *See About Us*, HUMAN RIGHTS CAMPAIGN, http://www.hrc.org/the-hrc-story/about-us (declaring the HRC to be "the largest civil rights organization working to achieve equality for lesbian, gay, bisexual and transgender Americans . . . ").

118 *See* MINNESOTA CHRISTIAN EXAMINER, *supra* note 115.

119 The "Family Diversity Photo Puzzle" is part of the *Welcoming Schools* curriculum on "Understanding and Respecting Family Diversity." *See* AN INTRODUCTION TO WELCOMING SCHOOLS, *supra* note 101, at 79. While the *Welcoming Schools* campaign has made some of their lesson plans public to encourage schools to adopt the program, they have not made the Family Diversity Photo Puzzle lesson plan public. Access to the lesson plan is granted upon adoption of the program. Thus, explanation of the characteristics of the Family Diversity lesson plan for the purposes of this paper comes not from the *Welcoming Schools* website, but from articles and blogs written by observers and concerned parents.

120 *See* CUSHMAN, *supra* note 12, at 4.

121 *Id.*

122 *Id.*

123 *Id.*

form their own families with same-sex parents.[124] After the exercise, the teacher would lead a discussion about same-sex parents by questioning the students about the families they created, why they failed to create some types of families, and whether in the future they would create the types of families that they did not create the first time around.[125] Parents in the Minneapolis school district were displeased when their children were subjected to the program without their consent.

1. The Family Diversity Photo Puzzle and Parental Rights

The Family Diversity Photo Puzzle curriculum appears to violate the parental right to direct the education and upbringing of the child. If parents are really to be the ones charged with teaching their children about matters of sexuality and morality,[126] then the state should not be able to circumvent that parental duty by introducing these concepts to children before the parents deem appropriate. Obviously, children will learn about human sexuality in due course. Moreover, parents have no constitutional right to "restrict the flow of information in the public schools."[127] Thus, parents do not have the right to prevent their children from eventually learning about these concepts in public schools.[128] However, introducing the concept of human sexuality and same-sex marriage to six-year-olds in public schools by means of anti-bullying prevention programs seems an impermissible infringement on parents' rights to direct the education and upbringing of their children, especially if the parents, in their discretion, have chosen to delay this teaching.

If the "fundamental" parental right means anything, it means that parents still have the high duty and ultimate responsibility of inculcating their children in values and morals. Despite an ever-growing body of knowledge recognizing that homosexuality is not a choice,[129] recent events at the Supreme Court[130] are a clear indication that many still understand

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124 *See* Kersten, *supra* note 44.

125 *Id.*

126 *See* Emerson, *supra* note 66, at 709.

127 Brown v. Hot, Sexy, and Safer Prods., Inc., 68 F.3d 525, 534 (1st Cir. 1995).

128 *See* Emerson, *supra* note 66, at 709 (noting the important distinction between parental claims of government preempting the parental right to teach a child as opposed to parental proscription of teaching the concept at all).

129 *See Sexual Orientation and Homosexuality*, AM. PSYCHOL. ASS'N, http://www.apa.org/helpcenter/sexual-orientation.aspx (last visited Oct. 14, 2013) (confirming that "most people experience little or no sense of choice about their sexual orientation").

130 "Recent events" meaning the Supreme Court decisions in the Proposition 8 and DOMA same-sex marriage cases. *Hollingsworth v. Perry*, 133 S. Ct. 2652 (2013); *United States v. Windsor*, 133 S. Ct. 2675 (2013).

homosexuality and same-sex marriage to have moral rather than scientific implications. When schools teach about moral issues they must be very cautious so as not to intrude on parental rights. As long as it is at least arguable that homosexuality is a moral issue, teaching about same-sex couples *at all* in public schools runs the risk of infringing on parental rights. Teaching children as young as five years old about these concepts runs an even greater risk of subverting parental rights.

If nothing else, the state is not giving parents enough time to introduce these concepts to children before taking away a parent's right to do so. Many parents, on both sides of the traditional family debate, would object to introducing children so young to these concepts. Some children will undoubtedly have been exposed to the concept of same-sex parents by first grade based on the circumstances of their family life or parental choice. Equally likely, however, is that some children will not have been introduced to these concepts as a function of parental choice. Stripping parents of the right to withhold this information from their children for a limited time infringes on the parental right to direct the education and upbringing of their children.

It is quite clear that many anti-bullying legislation opponents come from a place of animus towards the LGBT community. That should not, however, give the state the green light to circumvent the parental right to raise their children in a manner they wish through bullying prevention programs, especially when it is arguable that the child is unready to engage in the discussion.

2. Family Diversity Photo Puzzle and Compelled Viewpoint

The Family Diversity Photo Puzzle may also impermissibly force children to ratify a viewpoint with which they disagree. While parents may choose to withhold this information from their children, there are bound to be students in kindergarten through third grade whose parents have already introduced them to the concept of same-sex couples and other LGBT issues. There will also be parents who have chosen to teach their children that, for whatever reason, same-sex marriage violates their moral or religious beliefs. If children are prompted by their teachers to create the most diverse family puzzles possible and, by design, forced to create puzzle families of same-sex couples, they are being encouraged to adopt viewpoints accepting of same-sex couples. Admirable as this goal may be, for the children who have been taught to oppose same-sex marriage, it is compelling them to ratify a viewpoint with which they disagree. While the message may be perceived to be bigoted, that does not detract

from students' constitutional right to be free from compelled viewpoints. If people are still legally allowed to disagree about the morality of same-sex marriage, the state cannot force children to adopt a viewpoint on the matter that conflicts with their own beliefs, regardless of how popular or politically correct the viewpoint is. The First Amendment grants students at least that much.

B. Constitutionally Encouraging Tolerance and Diversity

1. Appropriate *Welcoming Schools* Lesson Plans

There are many bullying prevention and tolerance education programs that do not unconstitutionally infringe on a parent's right to direct the education and upbringing of their children or a student's right to be free from compelled viewpoint ratification. To begin, not all of *Welcoming Schools*' lesson plans must be scrapped. Many of them actually aim at encouraging tolerance and diversity for all students without running the risk of subverting parental rights or potentially forcing children to depart from their own moral or religious beliefs. For example, one of the suggested lessons in the *Welcoming Schools* program teaches students about creating welcoming classrooms.[131] In the lesson, students listen to the short story called *The New Girl . . . and Me*[132] about a friendship between two young girls.[133] After listening to the story, teachers will discuss with their students what it means to make people feel welcome and unwelcome in a given situation.[134] Students are then encouraged to draw pictures and come up with ideas of how to make people feel welcome in their classroom.[135] This lesson plan seems to perfectly align itself with the stated goals of bullying prevention programs. Encouraging students to make others feel welcome goes to the core of bullying prevention as opposed to teaching students at an early age about matters of human sexuality without parental consent.

Another *Welcoming Schools* lesson plan teaches students in fourth and fifth grade about how to handle bullying when they witness it. The lesson is called "Making Decisions: Ally or

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131 *See* HUMAN RIGHTS CAMPAIGN FOUND., WELCOMING CLASSROOM 1–3, *available at* http://www.hrc.org/welcoming-schools/documents/Welcoming-Schools-_Lesson_A_Welcoming_Classroom.pdf.

132 JACQUI ROBBINS, THE NEW GIRL . . . AND ME (2006).

133 *Id.* at 1–2.

134 *Id.*

135 *Id.* at 2.

Bystander."[136] The lesson calls for students to listen to various hypothetical scenarios in which another student has been "bullied" and decide whether in the particular instance they would have been an ally or a bystander.[137] Students are given the option of ignoring the situation, walking away, intervening themselves, or asking an adult to intervene.[138] Students are then asked why they chose their particular course of action.[139] While the lesson does not directly tackle the sensitive issues surrounding students who are harassed due to their perceived sexual orientation, it offers students an opportunity to discuss and learn how to deal with comments like "that's gay" and other stereotype-related teasing.[140] The lesson offers extra resources to teachers who can, in their discretion and based on their own school's needs, discuss stereotyping in the context of sexual orientation, race, and culture.[141] The discussion is centralized around preventing bullying and what students can do when they witness it—the direct target of bullying legislation prevention programs. Sexual orientation is not discussed as an isolated characteristic like it is in the Family Diversity Puzzle. Moreover, the lesson is targeted towards children who are a little bit older and more capable of understanding differences among people.[142] Students are not required to take any stance on sexual orientation, race, or culture but are encouraged to help out a fellow student when they are being bullied or report it to an adult who can take action.

2. Mix It Up at Lunch Day

Another appropriate bullying prevention program is "Mix It Up at Lunch Day." Mix It Up at Lunch Day is a campaign by the Teaching Tolerance organization [143] aimed at encouraging students to cross social boundaries and interact with other

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136 *See* HUMAN RIGHTS CAMPAIGN FOUND., MAKING DECISIONS: ALLY OR BYSTANDER 1–6, *available at* http://www.hrc.org/welcoming-schools/documents/Welcoming-Schools-Lesson_Ally_or_Bystander.pdf.

137 *Id.* at 2.

138 *Id.*

139 *Id.*

140 *Id.* at 5.

141 *Id.*

142 *Id.* at 1 (noting the targeted grade levels for the lesson program are fourth through sixth).

143 *See About Us*, TEACHING TOLERANCE, http://www.tolerance.org/about. Teaching Tolerance is a program founded by the Southern Poverty Law Center "dedicated to reducing prejudice, improving intergroup relations and supporting equitable school experiences for our nation's children." *Id.* The program provides educational materials to schools about teaching tolerance in the classroom. *Id.*

students that they normally would not.[144] As the cafeteria is the place that student boundaries are most clearly drawn, Mix It Up at Lunch Day allows schools to bring students together in the hopes that biases and other misconceptions will fall away.[145] The event is held once a year at more than 2,500 participating schools in order to break up social cliques and, hopefully, deter bullying.[146] Students across the nation are seated at lunch with groups of students outside their normal social groups and provided with questions to ask each other in order to break the ice and spark conversation.[147]

Despite having the admirable goals of breaking down social barriers and encouraging tolerance of others, Mix It Up at Lunch Day was accused by the American Family Association (AFA) of being "a thinly veiled attempt to push the homosexual agenda into public schools."[148] In an effort to keep Mix It Up At Lunch Day out of schools, the AFA called on parents across the country to threaten to keep their students at home on the day of the event.[149] Obediently, many parents made the threats and over 200 schools responded by cancelling the event.[150]

Cancelling the event, however, should not have been the response. Mix It Up at Lunch Day is an event that epitomizes the true spirit of the anti-bullying movement. There is no "homosexual agenda" being pushed and any claim otherwise is ludicrous. Sexual orientation is never even mentioned at the events. [151] Rather, the program aims at curbing bullying by teaching students that everyone has a story and that we are not

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144 *See What is Mix It Up at Lunch Day?*, TEACHING TOLERANCE, http://www.tolerance.org/mix-it-up/what-is-mix.

145 *Id.*

146 *See 'Mix It Up At Lunch Day' Prompts American Family Association To Urge Boycott, Protest 'Promotion Of Homosexual Lifestyle,'* HUFFINGTON POST (Oct. 15, 2012, 2:44 PM), http://www.huffingtonpost.com/2012/10/15/evangelical-group-urges-p_n_1967785.html.

147 *See Mix it Up at Lunch Day Successful Nationwide*, TEACHING TOLERANCE (Nov. 1, 2012), http://www.tolerance.org/blog/mix-it-lunch-day-successful-nationwide. Students are assigned seats in the cafeteria based on whatever differentiation mechanism the school chose. *Id.* One school assigned seating based on the shirt color the students wore to school that day. *Id.* Another assigned seating based on numbered candies that it handed out to the students. *Id.* One school had a Halloween themed Mix It Up day. *Id.* Another school swapped teachers from different grade levels to show students the benefits of getting out of their comfort zone. *Id.*

148 *See* Rheana Murray, *Christian group slams anti-bullying effort 'Mix It Up at Lunch' for promoting homosexuality in schools*, N.Y. DAILY NEWS (Oct. 16, 2012, 8:52 AM), http://www.nydailynews.com/news/national/christian-group-slams-anti-bullying-effort-article-1.1184500#ixzz2QrrySOGP.

149 *Id.*

150 *Id.* (noting also that, although 200 schools cancelled the event, another 180 signed up for it).

151 *Id.*

all that different from each other. In fact, the Mix It Up at Lunch Day program no longer makes any mention of differentiating characteristics among students but lets schools choose for themselves which social problems to tackle.[152] Mix It Up at Lunch Day is not the kind of bullying prevention program to be feared. It neither infringes on parental rights nor requires students to ratify a compelled viewpoint. Rather, Mix It Up at Lunch Day promotes nothing more than something all parents should be able to agree on: tolerance and compassion for all children. Schools should not have responded to parent complaints by cancelling Mix It Up at Lunch Day. Those schools have set a dangerous precedent, giving disgruntled parents the idea that they can dictate school programs and prevent schools from teaching even the most proper forms of tolerance education. That said, even though anti-bullying legislation opponents do have legitimate complaints, if they continue to vocalize the opinion that *every* bullying prevention program is some ploy to promote the "homosexual agenda" and indoctrinate children, they will lose much credibility.

V. PROPOSAL

There is no doubt that many anti-bullying legislation opponents come from a place of animus towards the LGBT community. That, however, is not an excuse to ignore the infringement on constitutional rights caused by some bullying prevention programs. After all, many people on either side of the debate might agree that there is something inherently bothersome about allowing advocacy groups to dictate curriculum in public schools. There is no bright line rule when it comes to school curriculum and parental rights. Society is changing and schools must recognize society's fluidity and change with it. But perhaps it is enough, for now, that schools teach children to treat one another with dignity and respect no matter what. Unless society is willing to relinquish to the state a parent's right to raise their children in the way the parent sees fit, schools should not be able to engage children in conversations about LGBT issues at such an early age. Parents must, at the very least, be given an adequate opportunity to have the discussion with their children before the school intervenes. Schools actively discussing LGBT issues with first graders have not given parents enough time to have the pertinent conversations at all.

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152 *Id.* (quoting Director of Teaching Tolerance, Maureen Costello, saying "We don't tell schools what to do on 'Mix It Up' day . . . . We suggest activities, none of which have to do with sexual orientations. We used to focus on divisions of race and social class, but now we encourage schools to focus on what their own school issues are.").

While setting an age threshold at which schools may entertain these discussions with students is rather arbitrary, perhaps an arbitrary age limit will at least dispel many of the complaints from bullying legislation opponents. Parents cannot prevent schools from eventually teaching their children about these matters, but they should be able to prolong it.[153] Thus, parents of elementary school students between kindergarten and third grade should be given an opt-out right for those lessons the parent finds morally objectionable when those lessons concern matters that typically fall under the purview of the parental right to raise their child. Children in these grades are typically between five and nine years old. At this age, parents should still be the ultimate teachers and inculcators of morals and values. If the lessons are so violative of the parents' moral beliefs that they may fairly be deemed morally objectionable to the parent, they should be able to opt their students of a certain age out of those lessons.

There must be some limitations to this opt-out right, however. Parents should not be able to argue that a lesson is "morally objectionable" just because the lesson merely mentions homosexuality or promotes tolerance of LGBT students. Tolerance is the aim and, at some point, the school must acknowledge that it is okay to be different if it wishes to prevent students from bullying others *because* they are different.[154] The nature of the lesson plan and the age of the students must be taken into consideration when evaluating whether parents should be given an opt-out right for particular lesson plans. Simply acknowledging the existence of same-sex couples cannot be the "morally objectionable" reason for requesting an opt-out. Same-sex couples exist regardless of whether objecting parents approve of the unions. Acknowledging their existence does not convey any moral belief either way to students. Moreover, ignoring the existence of same-sex couples may convey bias,

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153 *See* Emerson, *supra* note 66, at 709 (noting the fundamental difference between parents preventing the teaching of a concept in its entirety as opposed to preventing schools from preempting the right of parents to direct the upbringing of their children).

154 *See* Katherine Stewart, *What's behind the anti-anti-bullying backlash*, THE GUARDIAN (Apr. 3, 2012, 1:21 PM) http://www.guardian.co.uk/commentisfree/cifamerica/2012/apr/03/behind-anti-anti-bullying-backlash (commenting that "[m]any people will undoubtedly conclude that these efforts by the anti-anti-bully lobby are lacking in Christian charity or common sense. But their proponents do have a point that we should carefully consider. To be sure, the notion that the anti-bullying initiatives are driven by 'the homosexual agenda' . . . is preposterous. But the sense that anti-bullying initiatives involve teaching children 'acceptance' of LGBT peers, to use the word of the Concerned Women of America, is not. If you want the school to tell students to stop harassing kids . . . *because they are gay*, you have to let them know, at some point, that the school thinks it's OK to be gay.").

intolerance, and ignorance. However, when children at the age of six are receiving active encouragement from teachers and the parent has a legitimate moral objection to the teaching, the parental right to direct the upbringing of their child may furnish a justification for an opt-out right until the child attains a certain age.

The age of the child, then, is another obvious limitation on any opt-out right under anti-bullying legislation education programs. As children age, they become more capable of understanding human differences and generally have been influenced by other factors outside of parental control. Every child in the classroom will reach the age of maturity at different points, so a definitive age limit applicable to all students is obviously arbitrary. The focus on the child's age, however, is not for the child's sake but for the sake of dispelling legitimate arguments from bullying legislation opponents. It seems that by the fourth grade, the parental justification for withholding discussions about LGBT issues with students dissipates. Parents have, hopefully, been furnished with adequate time to tackle the sensitive issues before the school intervenes. Students by fourth grade are also, hopefully, more capable of understanding the lessons and making their own decisions about what they learn.

CONCLUSION

Anti-bullying legislation opponents have proffered some legitimate arguments that anti-bullying programs may impermissibly infringe on parental rights and the rights of children to be free from compelled viewpoints. While the majority of bullying education programs seem to pass constitutional muster, certain lessons undertaken in compliance with anti-bullying statutes have infringed on constitutional rights. Although there have been some colorable claims against bullying education programs, those proffering the claims would do well to refrain from classifying all anti-bullying programs as mere ploys to "indoctrinate children in the homosexual agenda." Yes, certain programs have definitely gone too far. But gross overstatements like those made by opponents to anti-bullying legislation are inaccurate and do more harm to the cause than good. Today's anti-bullying legislation opponents have an inherently bad image simply because of the cause they rally behind. Who could possibly oppose anti-bullying legislation? Their bad image is massively amplified by the fact that some seriously poor conduits convey their message. As demonstrated, there are some perfectly legitimate arguments proffered by opponents about parental rights and viewpoint compulsion. What those legitimate

arguments are lacking is an intelligent and reasoned means of conveyance. Our democracy thrives because of the existence of vocal dissenters. It is a shame that those dissenters harm the validity of their message simply because of the means they have chosen to convey it. Demonization of the anti-bullying movement as an indoctrination ploy is a not the way to promote a relatively reasonable end. All parents should be able to agree that bullying is wrong and be able to come to a compromise about legitimate means to prevent it without mischaracterizing the entire anti-bullying movement as a covert operation to destroy America's youth.

Despite the fact that the messages of disgruntled parents have been conveyed poorly, schools would still do well to take heed of them. If schools continue to implement programs that infringe on constitutional rights, those infringements will undoubtedly be exposed by those looking to topple bullying legislation for any reason. Anti-bullying legislation opponents are very powerful and have a strong following. They have already been highly successful in mobilizing parents to action. Parents were successful in the Minneapolis school district in getting some of the *Welcoming Schools* programs tossed out. Parents were also successful last year in halting Mix It Up At Lunch Day at over 200 schools nationwide. A Christian group in Arizona was successful at preventing implementation of a stronger bullying bill because the bill would have "focused on gay kids" despite the fact that "homosexuality" and "sexual orientation" were nowhere mentioned in the bill.[155] The "homosexual agenda" fear is a powerful tool that anti-bullying legislation opponents are not afraid to use. Thus, schools must make some accommodations if they wish to retain their bullying education programs.

That is not to say that schools should completely refrain from engaging students in conversations about sensitive subjects. Given the amount of time students spend at school each day, schools are in the unique role of being able to teach the basics as well as implicitly instill morals in students. School is a place to learn and grow and that growth should not be thwarted because of fear over moral indoctrination. However, if schools want to continue to employ anti-bullying programs in their districts, they

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155 *See* Matthew Hendley, *A Homophobic Group Killed Arizona's Anti-Bullying Law*, PHOENIX NEW TIMES (May 31, 2012), http://www.phoenixnewtimes.com/2012-05-31/news/a-homophobic-group-killed-arizona-s-anti-bullying-law/ (noting how the "biblical" group Center for Arizona Policy (CAP) has been massively successful at killing legislation). The article also quotes Cathi Herrod, speaking for the CAP, who claims that "Not only are [bullying bills] a thinly veiled attempt to allow political groups into our schools, they also divert the focus of our school system off the fundamentals . . . . Class time should be for reading, writing, and arithmetic." *Id.*

must find a way to compromise with parents who do not wish for their children to be taught about LGBT issues and have a constitutional right to prevent that teaching. When a parent and the school disagree over whether the child should be introduced to concepts striking at the heart of the parental role, the fundamental right of the parent should trump the school's interest in educating the child on that matter for a period of time. The right slowly dissipates, as the child gets older and more capable of developing his or her own sense of morality and values. At least for the time being, schools should allow parents who have sincere moral objections to the teachings to opt their very young children out of lessons concerning LGBT issues until their children reach the fourth grade. Striking this compromise with parents will hopefully deter anti-bullying legislation opponents from demonizing the entire cause. If bullying education programs do not find a way to satisfy the legitimate constitutional claims of parents, these programs may not survive in the classroom.

Disabled Yet Disqualified: Is It "Unreasonable" to Demand Accommodations for Employees with Depression Under the Americans with Disabilities Act?

*Nancy J. Sandoval**

What rights does an employee with depression have against discrimination in the workplace? Imagine, for example, Claudia Peterson, a hypothetical employee diagnosed with depression[1] working in a typical nine-to-five office setting. Despite her depression, Claudia has consistently performed well; however, in order for her to seek treatment for her disorder she needs to take an extended lunch break once a week to meet with her therapist. Her employers do not want to grant the extended lunch break because they think Claudia merely wants a more favorable schedule than her co-workers. In response to her request, Claudia's employers reduce her hours from full-time to part-time employment. Does Claudia have any recourse against her employers? Is she entitled to such an accommodation?

In 1990, Congress passed the Americans with Disabilities Act (ADA or the Act), which made it unlawful to discriminate against an employee in the workplace on the basis of physical or mental disability.[2] In order to recover under the ADA, the employee bears the initial burden of showing that he or she has a disability,[3] that he or she is qualified for the employment

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1 Depression is a mood disorder most commonly associated with feelings of sadness, loss, anger, or frustration, which lasts for at least two weeks and often longer. *Major Depression*, PUBMED HEALTH, http://www.ncbi.nlm.nih.gov/pubmedhealth/PMH0001941/ (last reviewed Mar. 8, 2013); American Psychiatric Association, DIAGNOSTIC AND STATISTICAL MANUAL OF MENTAL DISORDERS DSM-IV-TR 349 (4th ed. 2000) ("The essential feature of a Major Depressive Episode is a period of at least 2 weeks during which there is either depressed mood or the loss of interest or pleasure in nearly all activities.").

2 42 U.S.C. § 12101(b)(1) (2012).

3 42 U.S.C. § 12102(3) (2012).

position,[4] and that there is a nexus between the discrimination and the disability.[5] Historically, employees with depression were denied coverage under the ADA because they could not prove the presence of a disability,[6] and they could not show that they were qualified for the job under the statute.[7] In 2008, Congress passed the ADA Amendments Act (ADAAA) to strengthen the ADA by making significant changes to the standards for establishing when an individual is disabled.[8] The ADAAA made it easier for an employee with depression to prove he or she has a disability; however, it did not alter the standards governing when an employee meets the ADA's "qualified" standard.[9]

For an employee to be "qualified" under the ADA, he or she must be able to perform the essential duties of the job with or without a reasonable accommodation.[10] Furthermore, an employer is not obligated to provide an accommodation if it would result in undue hardship to the business.[11] This Note argues that employees with depression seeking relief under the current version of the ADA will continue to have their cases dismissed or end in unfavorable summary judgment as the courts will find, in the majority of cases, an employee with depression is not "qualified" for the position in question. This argument is based on the negative impact of depression on what courts consider essential functions of the job, and the difficulty of finding an accommodation that will give the employee adequate support without unduly burdening the employer. On the other hand, excluding employees with depression from the ADA's coverage is troublesome because of the prevalence of depression and the underutilized potential of employees with depression.

"Depression is one of the most common psychiatric disorders, and from a societal perspective, is perhaps the most costly."[12] It is estimated that depression costs $43.7 billion annually in business losses due to absenteeism—missed days from work, presenteeism—coming to work with a physical or mental health

4 42 U.S.C. § 12112(a) (2012). The statute states discrimination will not be allowed against a "qualified individual." *Id.*

5 *Id.* Discrimination is not allowed "on the basis of disability." *Id.*

6 *See infra* note 25.

7 *See infra* notes 45–57, 66–82, and accompanying text.

8 ADA Amendments Act of 2008, Pub. L. No. 110-325.

9 James Concannon, *Mind Matters: Mental Disability and the History and Future of the Americans with Disabilities Act*, 36 LAW & PSYCHOL. REV. 89, 112 (2012).

10 42 U.S.C. § 12112(b)(5)(A).

11 *Id.*

12 HANDBOOK OF DEPRESSION 21 (Ian H. Gotlib & Constance L Hammen eds., 2nd ed. 2002).

condition, and treatment costs in the United States.[13] Thus, depression not only affects the individual living with the disorder, it affects employers as well. Employers may perceive employees with depression as weak or responsible for their condition.[14] However, discriminating employers fail to recognize the underused potential of employees with depression. If caught early enough, depression is more responsive to treatment, thereby restoring the employee's productivity.[15] Individuals with depression may experience increased levels of creativity, concentration, and perfectionism.[16] Society should strive to enable employees with depression to achieve their full potential in the workplace. Thus, this Note proposes changes to the workplace approach to interacting with employees with depression through stronger communication requirements and management education in order to promote a healthier workplace environment and enable employees with depression to reach their full levels of productivity. One way to achieve more effective communication between employers and employees is to modify the U.S. Equal Employment Opportunity Commission (EEOC) regulations[17] to require employers to consistently engage in a brainstorming process to best assist employees who have disabilities where the best accommodation is not readily apparent, such as employees with depression.[18]

Part I will provide a brief update on the ADA following the enactment of the ADAAA. Part II will define what it means to be "qualified" under the ADA. Part III will explore why employees with depression will fail to meet the "qualified" requirement under the amended ADA. Part IV will propose a possible solution, followed by a brief conclusion.

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13 Michael Klachefsky, *Hidden Costs, Losses of Mental Health Diagnosis*, BENEFITS MAGAZINE, Feb. 2013, at 36–37; Kathryn Hawkins, *Depression's Growing Toll On the Workplace*, OFFICEPRO, March 2011, at 14.

14 SUSAN STEFAN, UNEQUAL RIGHTS: DISCRIMINATION AGAINST PEOPLE WITH MENTAL DISABILITIES AND THE AMERICANS WITH DISABILITIES ACT 9 (2001).

15 Sean Sullivan, *Promoting Health and Productivity for Depressed Patients in the Workplace*, J. OF MANAGED CARE PHARMACY S12, S14 (2004).

16 Jonah Lehrer, *Depression's Upside*, N.Y. TIMES MAGAZINE, Feb. 28, 2010, *available at* http://www.nytimes.com/2010/02/28/magazine/28depression-t.html?pagewanted=all&_r=1&.

17 29 C.F.R. § 1630 (2013). The EEOC is the agency that interprets the ADA. *Id.* § 1630.1.

18 Currently, the EEOC regulations state: "to determine the appropriate reasonable accommodation it may be necessary for the covered entity to initiate an informal, interactive process." 29 C.F.R. § 1630.2(o)(3).

I. THE ADAAA: RECENT ADA REFORM

Employees with disabilities became a protected class under civil rights law in July of 1990 with the enactment of the ADA.[19] It was modeled after Section 504 of the Rehabilitation Act of 1973,[20] which disallowed workplace discrimination for government-funded entities.[21] The ADA expanded this protection to the private sector, stating that: "[n]o covered entity shall discriminate against a qualified individual on the basis of disability in regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment."[22] The Act was received amongst high expectations for discrimination reform in the workplace.[23] The Equal Employment Opportunity Commission (EEOC) was the agency granted interpretive and enforcement powers.[24]

Despite the initial enthusiasm, a series of Supreme Court cases reduced the impact of the statute by setting a hard-to-meet standard for when a person has a disability.[25] In 2008, Congress breathed new life into the ADA by passing the ADAAA.[26] The

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19 Americans with Disabilities Act of 1990, Pub. L. No. 101-336.

20 Pub. L. No. 93-112 (1973).

21 "Much of the substance of the ADA was drawn directly from Section 504 of the Rehabilitation Act of 1973—a provision prohibiting discrimination on the basis of disability by entities that receive federal funds—and the regulations implementing that section." E. Pierce Blue, *Arguing Disability Under the ADA Amendments Act: Where Do We Stand?*, FED. LAW, Dec. 2012, at 38. The ADAAA further clarifies the relationship between the ADA and the Rehabilitation Act: "[W]hile Congress expected that the definition of disability under the ADA would be interpreted consistently with how courts had applied the definition of a handicapped individual under the Rehabilitation Act of 1973, that expectation has not been fulfilled." ADA Amendments Act, Pub. L. 110-325 (2008).

22 42 U.S.C. § 12112(a) (2012).

23 Susan Stefan, *Delusions of Rights: Americans with Psychiatric Disabilities, Employment Discrimination and the Americans with Disabilities Act*, 52 ALA. L. REV. 271, 271 (2000) ("When the Americans with Disabilities Act was passed in 1990, one of its principal goals was to enhance employment opportunities for people with disabilities who wanted to and could work but were being kept out of the job market because of discrimination on the basis of disability.").

24 42 U.S.C. § 12116 (2012); 29 C.F.R. app. § 1630 (2013).

25 For a comprehensive discussion of the Supreme Court cases (the "Sutton cases") that narrowed the definition of disability under the ADA and their implication on employees with mental illnesses, see Michelle Parikh, *Burning the Candle at Both Ends, and There Is Nothing Left for Proof: The Americans with Disabilities Act's Disservice to Persons with Mental Illness*, 89 CORNELL L. REV. 721, 735–42 (2004). *See also* Sutton v. United Air Lines, Inc., 527 U.S. 471 (1999); Albertson's, Inc. v. Kirkingburg, 527 U.S. 555 (1999); Murphy v. United Parcel Serv., Inc., 527 U.S. 516 (1999); Toyota Motor Mfg., Kentucky, Inc. v. Williams, 534 U.S. 184 (2002).

26 ADA Amendments Act of 2008, Pub. L. No. 110-325. The ADAAA went into effect on January 1, 2009. *Id.* The ADAAA was not Congress's first attempt at reform. In 2006 and 2007, Congress attempted to pass the ADA Restoration Act (ADARA), which proposed to remove the word "substantially" from the ADA's "substantially limits." The "substantially limits" refers to the ADA's requirement that an employee be substantially

ADAAA "emphasizes that the definition of disability should be construed in favor of broad coverage of individuals to the maximum extent permitted by the terms of the ADA and generally shall not require extensive analysis."[27]

The ADAAA was both reactionary and restorative.[28] Not only did it overturn the Supreme Court cases that had narrowly interpreted the meaning of disabled, it brought the ADA closer to its original purpose—protecting employees from discrimination in the workplace.[29] The ADAAA lowered the bar for establishing the existence of a disability by urging the courts not to take such a narrow interpretation of when a disability "substantially limits" an employee in a major life activity, a pre-requisite to establishing a disability;[30] prohibiting the courts from considering mitigating measures, such as medication, when determining when an employee is disabled;[31] and expressly allowing an episodic impairment or an impairment that is in remission to be classified as a disability if it would substantially limit a major life activity when active.[32] Because the ADAAA is not applied retroactively,[33] there are a limited number of decisions that have applied the ADAAA, and even fewer that have applied the ADAAA in the case of depression. Still, the available case law and the new definition of disabled under the

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limited in a major life activity to qualify as disabled. 42 U.S.C. § 12102 (2012). The bill was met with resistance for what was feared to be overly broad coverage, and Congress closed before its passing. Frederick J. Melkey, *Creating New Law or Restoring the Old? - Retroactivity and the Americans with Disabilities Amendments Act of 2008: A Comment on* EEOC v. Autozone, 34 N.C. CENT. L. REV.1, 28–29 (2011).

27 *Notice Concerning The Americans with Disabilities Act (ADA) Amendments Act of 2008*, EEOC, http://www.eeoc.gov/laws/statutes/adaaa_info.cfm (last visited May 9, 2013).

28 Jeffrey Douglas Jones, *Enfeebling the ADA: The ADA Amendments Act of 2008*, 62 OKLA. L. REV. 667, 667 (2010) (quoting the ADA Restoration Act of 2007: Hearing on H.R. 3195 Before the Subcomm. on the Constitution, Civil Rights, and Civil Liberties of the H. Comm. on the Judiciary, 110th Cong. 18 (2007)). House Majority Leader Steny H. Hoyer stated:

> [W]e could not have fathomed that people with diabetes, epilepsy, heart conditions, cancer, mental illnesses and other disabilities would have their ADA claims denied because with medication they would be considered too functional to meet the definition of disabled. Nor could we have fathomed a situation where the individual may be considered too disabled by an employer to get a job, but not disabled enough by the courts to be protected by the ADA from discrimination. What a contradictory position that would have been for the Congress to take.

Id.

29 ADA Amendments Act of 2008, Pub. L. No. 110-325.

30 42 U.S.C. § 12102(2)(A).

31 42 U.S.C. § 12102(4)(E)(i)(1).

32 42 U.S.C. § 12102(4)(D).

33 *See* Hale v. King, 642 F.3d 492, 499 (5th Cir. 2011) (stating that the ADAAA was not meant to be applied retroactively, hence cases concerning discrimination that occurred before the ADAAA's effective date are still scrutinized under the pre-amended version of the ADA).

ADAAA indicate that an employee with depression will most likely meet the requirements of having a disability because people with major depression are likely to be substantially limited in one or more major life activities, such as sleeping, interacting with others, and concentrating.[34] However, although employees with depression will likely now overcome the first hurdle of establishing a disability under the ADAAA, in addition to being disabled, they must still show they are qualified for the position.[35] The ADAAA did not change the standards set forth by the ADA and EEOC to determine whether an employee is qualified for the position;[36] therefore, employees with depression will likely struggle to establish they are qualified under the ADA, even as amended by the ADAAA.

II. HOW THE ADA DEFINES "QUALIFIED": THE ELEMENTS AND DEFENSES

Whether an employee is qualified is a two-part inquiry. First, the employee must have the "requisite skill, experience, education and other job-related requirements."[37] The second requirement, and the focus of this Note, is that an employee must also be able to perform the essential duties of the job with or without a reasonable accommodation.[38] Finally, even if the employee can meet this initial burden, the employer can claim that the requested accommodation amounts to an undue hardship.[39] The subsections below will elaborate on the meanings of "essential functions" of the job, "reasonable accommodation," and "undue hardship" as defined by the ADA and interpreted by the EEOC.

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34 *See* Palacios v. Cont'l Airlines, Inc., No. CIV. A. H-11-3085, 2013 WL 499866, at *4 (S.D. Tex. 2013) (finding plaintiff's depression was covered under the ADAAA); Naber v. Dover Healthcare Assocs., Inc., 765 F. Supp. 2d 622, 643–47 (D. Del. 2011) (same); Estate of Murray v. UHS of Fairmount, Inc., No. Civ. A. No. 10-2561, 2011 WL 5449364, at *6–8 (E.D. Pa. 2011) (same); *see also EEOC Enforcement Guidance on the Americans with Disabilities Act and Psychiatric Disabilities*, EEOC, http://www.eeoc.gov/policy/docs/psych.html (last visited May 12, 2013) (providing an example that shows how an employee with depression will be substantially limited in several major life activities of sleeping, concentrating, and interacting with others).

35 42 U.S.C. § 12112(a) (2012).

36 *Questions and Answers on the Final Rule Implementing the ADA Amendments Act of 2008*, EEOC, http://www.eeoc.gov/laws/regulations/ada_qa_final_rule.cfm (last visited May 9, 2013) (stating that the ADAAA does not change the definitions of "qualified," "direct threat," "reasonable accommodation," and "undue hardship," nor does it change who has the burden of proof in demonstrating any of these requirements).

37 42 U.S.C. § 12111(8) (2012); 29 C.F.R. § 1630.2(m) (2013).

38 42 U.S.C. § 12111(8); *see also* 29 C.F.R. app. § 1630.

39 42 U.S.C. § 12111(10).

A. The employee must meet the "essential functions of the employment position"

Essential functions means "the fundamental job duties of the employment position the individual with a disability holds or desires," and "does not include the marginal functions of the position."[40] The employer's judgment as to what functions are considered essential are taken into account, as well as job descriptions prepared before advertising the position or interviewing potential applicants.[41] Courts will also consider the following factors when determining whether a job function is essential: (i) whether the position was created for the fulfillment of that function; (ii) whether there are a limited number of employees who are capable of completing the job function and could have the function redistributed to them; and/or (iii) whether the employee was hired for his or her expertise or ability in a highly specialized job function.[42] For example:

> If an employer requires its typists to be able to accurately type 75 words per minute, it will not be called upon to explain why an inaccurate work product, or a typing speed of 65 words per minute, would not be adequate. Similarly, if a hotel requires its service workers to thoroughly clean 16 rooms per day, it will not have to explain why it requires thorough cleaning, or why it chose a 16 room rather than a 10 room requirement.[43]

While essential functions vary based on the job, courts have found regular attendance and interacting positively with others to be essential functions of jobs.[44] As the following cases illustrate, employees with depression and related mental health disorders often have a hard time meeting such qualifying factors. In *Johnson v. Loram Maintenance of Way, Inc.*, Jerry Johnson, a manufacturer assembler with depression and anxiety, was terminated after being unable to work for six months following a severe panic attack,[45] and his doctor expressed a belief that "Johnson was only 'marginally able to return to work full-time.'"[46] Johnson brought suit under the ADA.[47] The court had to determine whether Johnson was qualified to perform the essential functions of his occupation.[48] His employer argued that Johnson was not qualified because he had "poor attendance and

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40 29 C.F.R. § 1630.2(n)(1).
41 42 U.S.C. § 12111(8).
42 29 C.F.R. § 1630.2(n)(2).
43 29 C.F.R. app. § 1630.
44 *See* cases cited *infra* notes 45–57 and accompanying text.
45 Johnson v. Loram Maint. of Way, Inc., 83 F. Supp. 2d 1007, 1010 (D. Minn. 2000).
46 *Id.* at 1015.
47 *Id.* at 1010.
48 *Id.* at 1014.

lack[ed] . . . dependability."[49] The court found that attendance was an essential function of an assembler, and therefore Johnson could not perform an essential function of his job.[50]

In *Pesterfield v. Tennessee Valley Authority*, Troy Pesterfield, a tool room attendant for the Tennessee Valley Authority (TVA), had successfully completed his job for a year when he began to struggle with timeliness and being courteous to his co-workers.[51] Around this time, Pesterfield began to complain of "nervousness and anxiety" and was hospitalized for both "mental and physical reasons."[52] Following hospitalization, TVA's Rehabilitation Department sought a letter from Pesterfield's psychiatrist with a recommendation regarding Pesterfield's return to work.[53] The letter stated:

> [W]hat we have is a very depressed man whose self esteem is very fragile. His physical well being is essentially what he had to offer on the job and now this is damaged resulting in little or no remaining confidence in himself. I suspect he needs considerable support from a supervisory authority in order to function. If there is the slightest hint of rejection or criticism, he becomes extremely anxious and depressed.[54]

TVA fired Pesterfield for medical reasons.[55] Pesterfield sued under the Rehabilitation Act.[56] The court found that Pesterfield could not perform the essential functions of his position because it required him to "get along with supervisors and co-workers" and, given his fragile emotional state, "it would be impossible for him to perform the essential functions of his work."[57]

While employees with depression may struggle to perform the essential functions of their employment positions without an accommodation, they may still be able to establish they are

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49 *Id.* at 1014.

50 *Id.* at 1016; *see also* Vera v. Williams Hospitality Grp., 73 F. Supp. 2d 161, 166 (D.P.R. 1999) (citations omitted) ("Unlike jobs that can be performed off-site, attendance is generally an essential function of any job. Rather than setting a threshold number of absences before considering an employee not to be complying with attendance, courts state that meeting the attendance requirement means that an employee must come to work on a regular and reliable basis. The requisite level of attendance and regularity depends on the particular position or job.").

51 Pesterfield v. Tennessee Valley Auth., 941 F.2d 437, 438 (6th Cir. 1991).

52 *Id.*

53 *Id.*

54 *Id.* at 439.

55 *Id.*

56 Although the *Pesterfield* case was brought under the Rehabilitation Act, the language of the Rehabilitation Act and the ADA are sufficiently similar that the case is relevant. *See* Carrie Griffin Basas, *Back Rooms, Board Rooms - Reasonable Accommodation and Resistance Under the ADA*, 29 BERKELEY J. EMP. & LAB. L. 59, 61 (2008) (stating that the ADA borrowed language regarding the "qualified" elements directly from the Rehabilitation Act of 1973).

57 *Pesterfield*, 941 F.2d at 441–42.

qualified if they make a prima facie showing that they can perform the essential functions of the task with a reasonable accommodation.[58] However, when proposing an accommodation, what the employer and the courts consider reasonable has been a challenge for employees with depression.

B. There is a struggle to find a "reasonable accommodation"

Unless it poses an undue hardship on the business, an employer informed of an employee's mental disability must make a reasonable accommodation.[59] "[A]n accommodation is any change in the work environment or in the way things are customarily done that enables an individual with a disability to enjoy equal employment opportunities."[60] The EEOC Guidelines define reasonable accommodations as:

> (i) Modifications or adjustments to a job application process that enable a qualified applicant with a disability to be considered for the position such qualified applicant desires; or (ii) Modifications or adjustments to the work environment, or to the manner or circumstances under which the position held or desired is customarily performed, that enable an individual with a disability who is qualified to perform the essential functions of that position; or (iii) Modifications or adjustments that enable a covered entity's employee with a disability to enjoy equal benefits and privileges of employment as are enjoyed by its other similarly situated employees without disabilities.[61]

The ADA proposes the following as possible accommodations: "job restructuring, part-time or modified work schedules, reassignment to a vacant position, acquisition or modification of equipment or devices, appropriate adjustment or modifications of examinations, training materials or policies, the provision of qualified readers or interpreters, and other similar accommodations for individuals with disabilities."[62]

However, there are limitations as to what will be considered a "reasonable accommodation." First, while the employer may be expected to reassign nonessential functions of the job, there is no requirement to reassign tasks that are considered essential to the job.[63] Next, there is no duty to provide the best accommodation or even the accommodation that the employee

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58 42 U.S.C. § 12112(b)(5) (2012).
59 *Id.*
60 29 C.F.R. app. § 1630 (2013).
61 29 C.F.R. § 1630.2(o).
62 42 U.S.C. § 12111(9) (2012).
63 29 C.F.R. app. § 1630.

requested.[64] Furthermore, the suggested accommodations found in the statute are not guaranteed to the employee. For example, the following cases illustrate that courts have found that job restructuring, such as transferring the employee to a new supervisor, modifying the work schedule to allow the employee to switch to a part-time schedule, and allowing the employee to alter his or her shift were unreasonable accommodations in those employment situations.[65] In *Kennedy v. Dresser Rand Co.*, Carolyn Kennedy, a nurse, brought suit under the ADA claiming that she was denied her accomodation request relating to her depression, which was triggered by her supervisor who oversaw all of the company's health care personnel.[66] Kennedy requested that "she no longer work for, report to, associate with, or be influenced by her assigned supervisor" and that her employer "eliminate any personal contact" between Kennedy and her supervisor.[67] The court stated that, although all accommodation requests are analyzed on a case-by-case basis, there is a presumption against a request to change supervisors.[68] Here, the court found that shielding Kennedy from her supervisor would lead to "excessive organizational costs" and would make it "virtually impossible for Kennedy to perform her job," and thus a change in supervision was an unreasonable accommodation.[69]

In *Simmerman v. Hardee's Food Systems, Inc.*, Frederick Simmerman, a restaurant manager for the Hardee's chain of restaurants with clinical depression, sought to return to work after a leave of absence and requested that he work forty hours per week maximum, only during the day shift, and in a restaurant outside of Philadelphia.[70] A copy of the Hardee's General Manager Classification Worksheet stated that working fifty hours a week and a flexible schedule were requirements of the position.[71] Hardee's reassigned Simmerman to a crew supervisor in Delaware, a position below general manager.[72] Simmerman sued under the ADA claiming that Hardee's had failed to accommodate his disability in his role as a general

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64 Gile v. United Airlines, Inc., 95 F.3d 492, 499 (7th Cir. 1996) ("An employer is not obligated to provide an employee the accommodation he requests or prefers, the employer need only provide some reasonable accommodation.").

65 *See* cases cited *infra* notes 66–82 and accompanying text.

66 Kennedy v. Dresser Rand Co., 193 F.3d 120, 121 (2d Cir. 1999).

67 *Id.*

68 *Id.* at 122–23.

69 *Id.* at 123.

70 Simmerman v. Hardee's Food Sys., Inc., No. CIV. A. 94-6906, 1996 WL 131948, at *1 (E.D. Pa. 1996), *aff'd*, 118 F.3d 1578 (3d Cir. 1997).

71 *Id.* at *4.

72 *Id.* at *1.

manager.[73] The court found that the requested accommodations were not reasonable because "[t]his [was] not a situation in which, with some adjustment or assistance from the employer—such as special equipment—the employee could in fact perform the essential functions."[74] The court reasoned that Simmerman's request attempted to erase essential functions of being in a supervisory role, which went beyond a reasonable accommodation.[75]

In *Guice-Mills v. Derwinski*, Constance Guice-Mills was a head nurse of the Veterans Administration Hospital.[76] Guice-Mills was diagnosed with depression, anxiety, and insomnia.[77] She began taking a sedative antidepressant upon her psychiatrist's recommendation, which led to Guice-Mills having difficulty meeting the 8:00 a.m. shift start time.[78] She requested that she be allowed to start her shift two hours later.[79] Her employer offered to give her a staff-nurse position, but would not grant the later start time for Guice-Mills in the head nurse role because that would leave the patient units unsupervised by an individual in a management position from 8:00 a.m. to 10:00 a.m.[80] Guice-Mills sued under the Rehabilitation Act because she considered the staff-nurse position a demotion.[81] The court found that Guice-Mill's request was unreasonable and stated that "[w]hen an employer offers an employee an alternative position that does not require a significant reduction in pay and benefits, that offer is a 'reasonable accommodation' virtually as a matter of law."[82] Thus, in this case, a schedule adjustment was found to be an unreasonable accommodation.

C. If an employee is otherwise "qualified," the employer still has an "undue hardship" defense available

Finally, even if an employee can make the initial showing that there is some accommodation that would allow him or her to perform the essential functions of the job, the employer is not forced to provide such accommodation if it would cause an undue

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73 *Id.*

74 *Id.* at *8.

75 *Simmerman*, 1996 WL 131948, at *8. The court continues to explain that these requested accommodations would place an additional burden on the other restaurant managers and Hardee's was "not required to shoulder this burden." *Id.*

76 Guice-Mills v. Derwinski, 967 F.2d 794, 795 (2d Cir. 1992).

77 *Id.* at 796.

78 *Id.*

79 *Id.*

80 *Id.* at 797.

81 *Guice-Mills*, 967 F.2d at 797.

82 *Id.* at 798.

hardship to the operation of the business.[83] An undue hardship is "an action requiring significant difficulty or expense."[84] The ADA includes such factors as "the nature and cost of the accommodation needed" and "the overall financial resources of the covered entity; the overall size of the business of a covered entity with respect to the number of its employees; the number, type, and location of its facilities."[85] The EEOC Guidelines also include the "impact of the accommodation upon the operation of the facility, including the impact on the ability of other employees to perform their duties and the impact on the facility's ability to conduct business" as a factor.[86]

The following case shows that requiring a small employer to hire two people for a one-person job is undue hardship. In *EEOC v. Amego, Inc.*, Ann Marie Guglielmi was a team leader for Amego, Inc., a small nonprofit organization devoted to the care of severely disabled individuals.[87] One of her duties was to administer medication to the patients.[88] A year after starting her job with Amego, Guglielmi was diagnosed with depression and attempted suicide twice by taking an overdose of medications.[89] Guglielmi told her employers she had been diagnosed with depression, but did not tell her employer about either suicide attempt.[90] When her supervisors at Amego learned of the suicide attempts, they terminated Guglielmi, stating that she "could not meet the essential job function of handling prescription medication."[91] The EEOC argued on behalf of Guglielmi that Amego should have accommodated Guglielmi by reassigning her from team leader to behavior therapist, a position that did not explicitly list administering medication as a job responsibility, although all behavior therapists were trained in this duty and were expected to be able to perform this function.[92]

The court found that the suggested accommodation of transferring Guglielmi to a different position was not per se unreasonable, but in this case it would cause Amego undue hardship and therefore would not be granted.[93] The court reasoned that while transfers can be a reasonable accommodation, transferring Guglielmi to a behavior therapist

83 42 U.S.C. § 12112(b)(5)(A) (2012).
84 42 U.S.C. § 12111(10)(A) (2012).
85 42 U.S.C. § 12111 (10)(B).
86 29 C.F.R. § 1630.2(p) (2013).
87 E.E.O.C. v. Amego, Inc., 110 F.3d 135, 137 (1st Cir. 1997).
88 *Id.*
89 *Id.* at 138.
90 *Id.* at 139.
91 *Id.* at 141.
92 *Id.* at 147–48.
93 *Id.* at 148.

position would not eliminate her responsibility to administer drugs to patients. It would require hiring another behavioral therapist to work alongside Guglielmi at all times in order to ensure that Guglielmi's patients received their proper medication and Guglielmi was not left alone with the medication.[94] The court stated, "[t]he expense of hiring these additional staff would be too great for a small nonprofit like Amego to be reasonably expected to bear."[95]

Thus, these pre-ADAAA cases show it has been challenging for employees with depression to meet their initial burden of establishing they are qualified individuals, and why people with depression will continue to hit these obstacles.

III. WHY THE ADAAA DOES NOT ADDRESS THE CONCERNS OF PEOPLE WITH DEPRESSION

The ADA, as amended by the ADAAA, has made it possible for many employees who may not have otherwise been covered by the ADA due to the judiciary's narrow interpretation of who is disabled to fall under the protection of the ADA.[96] However, the ADA still does not adequately protect employees with depression because even if the employee can easily plead he or she has a disability, the nature of the disorder makes it difficult for the employee to properly plead he or she is qualified under the ADA's definition of the term.

First, this section will illustrate how the ADAAA has not altered the standards for showing when an employee is qualified. Next, this section will define depression and its impact on the workplace. Finally, this section will show why the nature of depression and the current state of the law makes it difficult for an employee with the disorder to establish he or she is qualified for the employment position.

A. *Hill v. Walker*: The ADAAA has not altered the "qualified" standards, thus the outcome remains the same

In one of the first opinions to address a mental health disability under the ADAAA, *Hill v. Walker* illustrates the tough road that employees with depression will still likely face. In *Hill v. Walker*, Yulanda Hill, an employee with stress and anxiety,[97] brought suit under the post-ADAAA version of the ADA following

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94 *Id.*

95 *Id.*

96 *See supra* note 34 and accompanying text.

97 Although Hill was not an employee with depression, she was an employee with a mental health disorder; the case is being used for the limited purpose of showing that the ADAAA did not affect any of the requirements of a qualified employee.

her termination as a family service worker from the Arkansas Department of Human Services (DHS).[98] Hill had requested reassignment from a particularly stressful case involving an abusive client.[99] After Hill informed her supervisors "she was on medication for stress and that she had been experiencing [job-related] anxiety attacks,"[100] she was initially granted a month-long leave of absence, then the decision was reversed and she was told to return to work after only two weeks of leave.[101] Hill wrote to her employers asking them to allow her the additional two weeks for a full recovery and warned DHS that sending her certified letters demanding she return to work "while [she was] on medical leave and against [her] doctor's orders" was "unprofessional."[102] Hill then proceeded to take almost a month-long leave of absence.[103] She was terminated for violating company policy regarding following reasonable orders as well as for medical reasons.[104] During discovery, Hill indicated that at the end of the month-long leave she was ready to return to work, but that she would request an accommodation of not being assigned the case that led to her taking leave.[105]

When presented with the issue of whether Hill could perform the essential functions of her job, the court found that "handling of abusive clients and stressful cases" was an essential function of being a family service worker and Hill's resistance to work with a hostile client showed she was unable to perform the functions required of a family worker.[106] The court also considered whether Hill's initial request for a month-long leave of absence was reasonable and whether DHS should have accommodated her.[107] The court stated that once an employee makes a prima facie showing that a reasonable accommodation is possible, the burden shifts to the employer to show why the accommodation cannot be granted.[108] One way an employer can accomplish this is to show that even if the accommodation is granted, the employee cannot perform the essential functions of the job.[109] While the court found that an additional two-week

98 Hill v. Walker, 918 F. Supp. 2d 819, 823 (E.D. Ark. 2013).
99 *Id.*
100 *Id.* at 825.
101 *Id.*
102 *Id.* at 826.
103 *Id.*
104 *Id.*
105 *Id.* at 830.
106 *Id.* at 828–29.
107 *Id.* at 829–30.
108 *Id.* at 830 (citing Fenney v. Dakota, Minn. & E. R.R. Co., 327 F.3d 707, 712 (8th Cir. 2003), a pre-ADAAA case, for the rules regarding when an employee is qualified).
109 *Id.*

leave of absence would have been a reasonable accommodation because it was not an open-ended request for leave, DHS effectively demonstrated that it could not accommodate Hill because her reluctance to return to work on a hostile case showed that even with a reasonable accommodation she could not perform the essential function of working with a hostile client.[110]

Thus, even after the ADAAA's implementation, the results for an employee with a mental health disorder, such as stress, anxiety, or depression, are similar to pre-ADAAA case results regarding whether an employee is qualified and whether an employer has a duty to accommodate. But is this the correct result? Shouldn't employees still be able to show they are "qualified" for a job? Should people with depression be given special accommodations that might appear to be favoritism to the outside world? The answer: it depends.

B. Depression: What it is, the stigma surrounding it, and how it affects the workplace

In order to understand the unique challenges faced by employees with depression seeking to show they are qualified, one must first understand the nature of depression. This subsection will first define depression and identify its symptoms. Next, it will explore the misconceptions of people with depression. Finally, this subsection will discuss the effects of depression in the workplace.

1. Defining Depression: Symptoms and Treatment

"Depression is a disorder of mood, so mysteriously painful and elusive in the way it becomes known to the self—to the mediating intellect—as to verge close to being beyond description."[111] Depression manifests itself differently in each person or even in the same person at different times.[112] It is also a disorder with a high rate of recurrence, and the age of the initial episode is increasingly lower.[113] For many individuals with depression, the symptoms do not fully subside but merely vary in intensity over time.[114] The most common treatments for depression are medication, psychotherapy, or a combination of

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110 *Id.*

111 WILLIAM STYRON, DARKNESS VISIBLE: A MEMOIR OF MADNESS 7 (1990).

112 PETER D. KRAMER, AGAINST DEPRESSION 69 (2005).

113 HANDBOOK OF DEPRESSION, *supra* note 12, at 21.

114 RAYMOND W. LAM & HIRAM MOK, DEPRESSION 5 (2008) ("About two-thirds of patients with a major depressive episode will fully recover, while one-third of depressed patients will either only partially recover or remain chronically ill."); *see also* HANDBOOK OF DEPRESSION, *supra* note 12, at 26 ("Lifetime prevalence estimates of MD in U.S. surveys have ranged widely, from as low as 6% . . . to as high as 25% . . . .").

the two.[115] The earlier treatment is commenced, the more effective it will be.[116] The medications used to treat depression, anti-depressants, can have strong side effects such as: drowsiness, change in appetite, and an increased tendency towards suicide.[117]

2. The Myth of the "Madman": The Stereotypes and Stigmas Surrounding Depression

In October 2012, NBC's *The Office*, a "mockumentary"[118] set in the office of a paper company, featured an episode where one of the main characters finds a little yellow pill that he discovers is used to treat anxiety.[119] The character commences a witch-hunt for the "madman in [their] midst."[120] While the episode simultaneously made light of the stigmas that persist for employees with mental health disorders and educated the viewers on how common and nonthreatening such disorders may be, in many offices the stigmas are no laughing matter.

Employees with mental health disorders, such as depression, have received a disproportionate amount of animus compared to their physically impaired counterparts.[121] Dangerousness, unpredictability, incompetence, defective character, and malingerers are traits often associated in the minds of others with the mentally ill.[122] One poll showed that 47% of Americans blame depression on "the weak character of the sufferer."[123] The belief that depression is within the patient's control may explain some of the stigma surrounding the people with the disorder:

> [C]haracteristics perceived to be within the individual's control are equivalent to character flaws that intensify stigma and the desire for social distance. Because the characteristic is controlled by the individual, society views the failure to conform to its standards as the product of unwillingness, rather than inability. If the individual would

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115 NATIONAL INSTITUTE OF MENTAL HEALTH, DEPRESSION 10 (2011), *available at* http://www.nimh.nih.gov/health/publications/depression/depression-booklet.pdf.

116 *Id.*

117 *Id.* at 11–14; *see also* STYRON, *supra* note 111, at 54 ("The pill made me edgy, disagreeably hyperactive, and when the dosage was increased after ten days, it blocked my bladder for hours one night.").

118 A mockumentary is "a facetious or satirical work (as a film) presented in the style of a documentary." *Mockumentary*, MERRIAM-WEBSTER DICTIONARY, http://www.merriam-webster.com/dictionary/mockumentary (last visited May 9, 2013).

119 *The Office: Here Comes Treble* (NBC television broadcast Oct. 25, 2012).

120 *Id.*

121 Wendy F. Hensel & Gregory Todd Jones, *Bridging the Physical-Mental Gap: An Empirical Look at the Impact of Mental Illness Stigma on ADA Outcomes*, 73 TENN. L. REV. 47, 51 (2005) ("Although individuals with physical impairments have also been the subject of disparaging public opinion, the animus directed at psychiatric impairments is proportionately greater and more pervasive.").

122 *Id.* at 52–56.

123 STEFAN, *supra* note 14, at 9.

> only choose to try harder, all problems would disappear. Rather than viewing group members with pity, an emotion often associated with physical disabilities, society instead views them with anger and irritation. The desire to offer assistance in any respect is seriously diminished because the need only arises as a result of the individual's failure to help himself.[124]

Employers are particularly susceptible to such beliefs, as studies have found that employers "are less likely to hire depressed individuals based on expectation of substandard work performance."[125] The following subsection tests the accuracy of those beliefs.

3. Depression Goes to Work: Costs and Contributions of Depression

Depression is the leading cause of disability in the United States for people between the ages of fifteen and forty-four.[126] This mental health disorder costs employers approximately 200 million lost workdays each year, which translates to billions of dollars.[127] "In terms of work productivity, those suffering with depression are three to four times more likely to take sick days off work than non-depressed individuals."[128] Employees with depression account for the most mental health-related charges filed with the EEOC between 1997 and 2012.[129]

However, the effects of depression in the workplace are not all negative as employees with depression both benefit from being part of the workforce and provide valuable contributions to the workplace. Employees with depression "have a perceived increase in self-rated productivity when they experience fewer and less severe depressive symptoms, suggesting that early treatment of depression would economically benefit

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124 Hensel & Jones, *supra* note 121, at 55.

125 *See* LAM & MOK, *supra* note 114, at 7.

126 *Entering the World of Work: What Youth with Mental Health Needs Should Know About Accommodations*, UNITED STATES DEPARTMENT OF LABOR, OFFICE OF DISABILITY EMPLOYMENT POLICY, http://www.dol.gov/odep/pubs/fact/transitioning.htm (last visited Nov. 13, 2013) ("According to the National Institute of Mental Health, the leading cause of disability in the U.S. for ages 15–44 is major depressive disorder . . . .").

127 *See Depression*, CENTER FOR DISEASE CONTROL AND PREVENTION, http://www.cdc.gov/workplacehealthpromotion/implementation/topics/depression.html (last visited May 9, 2013). This number may be on the rise thanks to the economic recession, which has led to an increase in layoffs, mortgage foreclosures, and expenses. Hawkins, *supra* note 13, at 12.

128 LAM & MOK, *supra* note 114, at 7.

129 *ADA Charge Data by Impairment/Bases*, EEOC, http://www.eeoc.gov/eeoc/statistics/enforcement/ada-merit.cfm (last visited May 9, 2013). In 2012, depression accounted for 6.8% of all EEOC claims. *Id.* Aside from the "other disability" category, depression was one of the most prevalent disabilities, following discrimination based on orthopedic impairments and discrimination based on record of disability or being regarded as disabled. *Id.*

employers."[130] Furthermore, while many studies focus on the negative effects of depression in the workplace, scientists Andrews and Thomson have suggested a controversial theory about the benefits an employee with depression may bring to the office, such as better problem solving skills.[131] They suggest that the lack of interest in sex and food common during depressive episodes is a by-product allowing for better focus and "an extremely analytical style of thinking."[132] For example, Charles Darwin, famous for his contributions to biology, had depression.[133] While Darwin's depression prevented him from objectively perceiving his accomplishments,[134] "the pain may actually have accelerated the pace of his research, allowing him to withdraw from the world and concentrate entirely on his work."[135] Additionally, the negative effects of depression in the workplace may be mitigated. Although the side effects of anti-depressants may be unpleasant, "medications can have a very favorable—and measurable—effect on worker productivity."[136] Thus, with treatment, employees with depression can make great contributions in the workplace if given an opportunity. However, the challenges of establishing that an employee with depression merits protection under the amended ADA may prevent employers and employees from realizing these benefits. The following section explores why employees with depression struggle to meet the initial burden of showing they are qualified for their employment positions in a post-ADAAA setting.

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130 LAM & MOK, *supra* note 114, at 7.

131 Lehrer, *supra* note 16. For more information on Andrews and Thomson's studies, see generally Paul W. Andrews & J. Anderson Thomson Jr., *The Bright Side of Being Blue: Depression as an Adaptation for Analyzing Complex Problems*, 116 PSYCHOL. REV. 620, 620–54 (2009), *available at* http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2734449/.

132 Lehrer, *supra* note 16.

133 *Id.*

134 *Id.* ("The 'race is for the strong,'" Darwin wrote. "I shall probably do little more but be content to admire the strides others made in Science.").

135 *Id.* ("His letters are filled with references to the salvation of study, which allowed him to temporarily escape his gloomy moods. 'Work is the only thing which makes life endurable to me,' Darwin wrote and later remarked that it was his 'sole enjoyment in life.'").

136 Sullivan et al., *supra* note 15, at S14 ("Improvements seen with antidepressants actually appear to be much greater than with medical treatments used to manage anxiety, migraine headaches, and hypertension."). However, for a critical discussion of psychiatric drugs, see generally ROBERT WHITAKER, ANATOMY OF AN EPIDEMIC (2010).

C. The ADAAA does not help employees with depression due to the difficulty of meeting the essential functions of the job, with or without a reasonable accommodation

As the ADAAA did not change the qualified requirements, employees with depression will continue to struggle to show they satisfy the essential functions of the employment obligations. Furthermore, establishing the existence of a reasonable accommodation is a hard task as there are communication complications as well as precedent for excluding accommodations that may assist employees with depression.

1. "Essential Functions": Inseparably Entwined with Symptoms of Depression

Without reaching the issue of whether there is a potential accommodation, it must first be acknowledged that depression and the side effects of the medications used to treat depression can directly affect an employee's ability to satisfy the essential functions of many jobs.[137] "Rarely is anyone—writer, scientist, manager, line worker—set an assignment for which he lacks the skill. The issue is the ailment. Apathy, despair, confusion, perfectionism, anomaly of will—the symptoms are as paralyzing as those of almost any illness we might name."[138] Courts have held such skills as timeliness and the ability to get along with others to be essential functions of various jobs.[139] However, depending on the severity of the disorder, the symptoms or treatments of depression may prevent an employee from performing such tasks.[140] For example, low self-esteem may rob an employee of the confidence necessary to execute a presentation or sales pitch. However, the employee may seek to overcome these limitations on his or her ability to perform essential functions through a reasonable accommodation.

2. Balancing Employee Needs with Business Needs: The Difficult Hunt for a Reasonable Accommodation

There are many factors that contribute to the difficulty of finding a reasonable accommodation for an employee with

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137 Douglas A. Blair, *Employees Suffering from Bipolar Disorder or Clinical Depression: Fighting an Uphill Battle for Protection Under Title I of the Americans with Disabilities Act*, 29 SETON HALL L. REV. 1347, 1396–97 (1999) ("In other words, the manifestations of these disorders might be so pervasive that no reasonable accommodation would enable the individuals to perform their jobs' essential functions. Also, the side effects of medication used to treat these diseases could likewise impede the ability to carry out job-related functions.").

138 *See* KRAMER, *supra* note 112, at 74.

139 *See supra* notes 45–57 and accompanying text.

140 Blair, *supra* note 137, at 1397.

depression that does not cause an undue burden on the employer. First, in order to find a reasonable accommodation, the employee must disclose that he or she has depression in order to start the conversation with his or her employer about seeking an accommodation, which can be intimidating in light of employer animus towards employees with mental health disorders. Furthermore, the circuit courts have set inconsistent standards regarding the employer's duty to engage in such conversations.[141] Finally, the most common accommodations requested by employees with depression have been found to be unreasonably burdensome or difficult to administer by the courts.[142]

a. Bias from employers and uncertain communication requirements decrease the probability of establishing a reasonable accommodation

Unlike a physical disability, where the reasonable accommodation may be more evident, the employee with depression is limited to his or her words to convey the severity of the disorder and the accommodation that will allow for completion of the job's essential tasks. First, an employee must disclose that he or she has a disability—a difficult task when he or she knows that means opening oneself to bias or potentially greater supervisor scrutiny.[143] In fact, to disclose the presence of depression and request an accommodation requires the employee to be assertive and proactive, characteristics that can be dulled by the disorder.[144] From the employer's perspective, it is difficult to justify the requested accommodation:

> Accommodations that are not of a physical nature may also be perceived less as a necessary tool to allow the individual to work than as special or easier treatment of the individual with a psychiatric disability. Non-physical accommodations such as flexible scheduling, time off for therapy, or increased supervision and positive feedback are more likely than physical accommodations to be seen as favorable treatment or as something everyone will want if they can get it.[145]

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141 *See infra* notes 148–56 and accompanying text.

142 *See infra* notes 157–65 and accompanying text.

143 *See* Wirey v. Richland Cmty. Coll., 913 F. Supp. 2d 633, 643 (C.D. Ill. 2012) (quoting Hedberg v. Indiana Bell Tel. Co., 47 F.3d 928, 932 (7th Cir. 1995)) ("We think that an employer cannot be liable under the ADA for firing an employee when it indisputably had no knowledge of the disability."); Matthew I. Kozinets, *The Americans with Disabilities Act: Does the ADA Protect A Person with the Chronic Fatigue Syndrome from Employment Discrimination?*, 13 HOFSTRA LAB. L.J. 139, 167 n.246 (1995) (citations omitted) ("[A] disabled person may be reluctant to disclose such information in fear of discrimination.").

144 *See* KRAMER, *supra* note 112, at 69 (describing a case study about a patient with depression and her difficulty asserting herself and putting her needs first).

145 Stephanie Proctor Miller, *Keeping the Promise: The ADA and Employment Discrimination on the Basis of Psychiatric Disability*, 85 CAL. L. REV. 701, 736 (1997).

The employer, unable to discern if an employee is genuinely disabled due to the non-physical and cyclical nature of depression, feels compelled to defend the business from undeserving employees looking for a way around the rules. Furthermore, the discrimination may not be blatant.[146] It may manifest itself in an inability to comprehend the need to modify the nature of the employment, particularly in stressful work environments where the change is most needed, but where there is a work culture of accepting stress as part of the job.[147]

Another factor that contributes to the difficulty of obtaining a reasonable accommodation is the uncertainty that surrounds the employer's obligation to engage in an interactive process to assist the employee in finding such an accommodation.[148] The amended ADA defines discrimination, in part, as "not making reasonable accommodations to the known physical or mental limitations of an otherwise qualified individual."[149] Whether an employee is qualified is a case-by-case, fact-specific inquiry.[150] In order to provide guidance for both parties as to what such an inquiry would entail, the EEOC regulations state:

> To determine the appropriate reasonable accommodation it *may* be necessary for the covered entity to initiate an informal, interactive process with the individual with a disability in need of the accommodation. This process should identify the precise limitations resulting from the disability and potential reasonable accommodations that could overcome those limitations.[151]

Furthermore, an employment decision based on an employer's bias may be difficult to question in court, as courts are reluctant to question business judgment decisions; *see also* Blair, *supra* note 137, at 1396 (footnote omitted) ("[C]ourts are often all too eager to accept an employer's statutorily sanctioned defenses that a mentally disabled employee either posed a direct threat to the safety of others in the workplace or that accommodating the employee would create an undue hardship.").

146 Susan Stefan, *"You'd Have to Be Crazy to Work Here": Worker Stress, the Abusive Workplace, and Title I of the ADA*, 31 LOY. L.A. L. REV. 795, 800 (1998).

147 *Id.*

148 Sam Silverman, *The ADA Interactive Process: The Employer and Employee's Duty to Work Together to Identify a Reasonable Accommodation Is More Than a Game of Five Card Stud*, 77 NEB. L. REV. 281, 282 (1998) ("Further, the more perplexing question for parties addressing any accommodation issue may be what the employer and employee's duties are with regard to how each must work with the other in an effort to determine whether a reasonable accommodation can be provided.").

149 42 U.S.C. § 12112(b)(5)(A) (2012).

150 Kennedy v. Dresser Rand Co., 193 F.3d 120, 122 (2d Cir. 1999) (citations omitted) ("On the issue of reasonable accommodation, the plaintiff bears only the burden of identifying an accommodation, the costs of which, facially, do not clearly exceed its benefits. This burden is not a heavy one. Moreover, the question of whether a proposed accommodation is reasonable is 'fact-specific' and must be evaluated on 'a case-by-case basis.' Nevertheless, district courts may properly grant summary judgment when a plaintiff fails to meet even this light burden.").

151 29 C.F.R. § 1630.2(o)(3) (2013) (emphasis added).

The permissive wording of the statute, using "may" as opposed to a "must," has led to much debate regarding whether the employer has a duty to engage in the interactive process.[152] As the Supreme Court has not issued a decision on whether failure to engage in the interactive process is a per se violation of the ADA, there is a circuit split on the issue.[153] For example, some courts have found:

> "[T]he 'interactive process' envisioned by Congress in enacting the ADA is one 'by which employers and employees work together to assess whether an employee's disability can be reasonably accommodated.' As such, an employer's failure to engage in the interactive process is insufficient by itself to support employer liability; the employee must also show that the breakdown of the interactive process led to the employer's failure to provide a reasonable accommodation."[154]

Other courts have attempted to fashion incentives for employers to engage in the interactive process, such as courts in the Eighth Circuit where summary judgment will not be granted to an employer who fails to engage in the interactive process.[155] However, even courts that take an employee-favorable approach to the interactive process treat cases where there was no possible accommodation differently, and are less likely to find there was a duty to engage in the interactive process.[156] Regardless of the

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152 *See* John R. Autry, *Reasonable Accommodation Under the ADA: Are Employers Required to Participate in the Interactive Process? The Courts Say "Yes" but the Law Says "No,"* 79 CHI-KENT L. REV. 665, 667–68 (2004) ("[T]he EEOC statements utilize language that, contrary to the suggestion of some judges and commentators, can hardly be considered unequivocal: the regulations state that it 'may be necessary' for employers to interact, while the Interpretative Guidance suggests that reasonable accommodations are 'best determined' through the interactive process. It is, therefore, unclear whether even the agency itself views the interactive process as mandatory.").

153 PollyBeth Proctor, *Determining 'Reasonable Accommodation' Under the ADA: Understanding Employer and Employee Rights and Obligations During the Interactive Process*, 33 SW. U. L. REV. 51, 59 (2003); *see also* Stephen F. Befort, *Reasonable Accommodation and Reassignment Under the Americans with Disabilities Act: Answers, Questions and Suggested Solutions After* U.S. Airways, Inc. v. Barnett, 45 ARIZ. L. REV. 931, 940–41 (2003). The Third, Eighth, and Ninth Circuits have imposed "an affirmative obligation to engage in an interactive process once it has been put on notice that an accommodation may be necessary." *Id.* at 940–41 n.57. However, the Tenth and Eleventh Circuits have pointed out that "the statute only mandates the provision of a reasonable accommodation if such exists, but not participation in a procedural step that may or may not bear fruit." *Id.* at 941 n.58.

154 Lovejoy-Wilson v. Noco Motor Fuels, Inc., 242 F. Supp. 2d 236, 244 (W.D.N.Y. 2003) (citations omitted).

155 Hill v. Walker, 918 F. Supp. 2d 819, 831 (E.D. Ark. 2013) (While it appears there is no per se right to engage in the interactive process apart from the duty to accommodate a qualified employee, in the Eighth Circuit, "an employer's failure to engage in an interactive process does not equal per se ADA liability . . . [however] such a failure does preclude the granting of summary judgment.").

156 *See* Grant T. Collins & Penelope J. Phillips, *Overview of Reasonable Accommodation and the Shifting Emphasis from Who Is Disabled to Who Can Work*, 34 HAMLINE L. REV. 469, 484 (2011) (claiming that circuits have found there is no separate

standard applied, even if the employer engages in the interactive process, there is no guarantee that the employee will be granted an accommodation, particularly as the typical accommodations for employees with depression are not considered reasonable in many business settings.

b. There is a struggle to find a "reasonable accommodation" compatible with business needs

The typical accommodations requested by an employee with depression are a transfer, a reduction in hours, or a leave of absence.[157] While these accommodations are compatible with the accommodations suggested in the ADA, such as "job restructuring, part-time or modified work schedules, [and/or] reassignment to a vacant position,"[158] the reality is that in the vast majority of employment discrimination cases brought by a plaintiff with depression, the court finds even the "suggested" accommodations too unreasonable or too burdensome on the employer to grant.[159]

Because courts have found, with limited exceptions, attendance is an essential function of the job, accommodation requests such as flexible schedules,[160] late-start shifts,[161] and indefinite leaves of absence[162] have been found to be unreasonable accommodations. Focusing on the business perspective, it would be cost-inefficient to keep an employee on

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right to the interactive process if the plaintiff fails to show a reasonable accommodation was even possible); Autry, *supra* note 148, at 687 (arguing that "because the ADA protects only those disabled persons who are statutorily qualified, and because ADA liability attaches for a failure to accommodate an employee's disability, not a failure to interact with the employee regarding the accommodation, there are *no* circuits that currently *require* employers to interact, nor is any court *permitted* to impose such a requirement unless the ADA is amended") (emphasis in original).

157 Susan Stefan, *Delusions of Rights: Americans with Psychiatric Disabilities, Employment Discrimination and the Americans with Disabilities Act*, 52 ALA. L. REV. 271, 295 (2000).

158 42 U.S.C. § 12111(9)(B) (2012).

159 *See supra* cases in notes 66–82 and accompanying text; Stefan, *supra* note 146, at 798–99 ("Employees whose disabilities were related to increasing stress, increased hours on the job, or the demands of new positions or new responsibilities. These people often requested, and were denied, accommodations considered reasonable by the Equal Employment Opportunity Commission (EEOC), including modified work schedules involving limited overtime, no night shifts, transfers, or leaves of absence.").

160 Kennedy v. Applause, Inc., No. 94-CV-5344-SVW, 1994 WL 740765, at *7 (C.D. Cal. 1994), *aff'd*, 90 F.3d 1477 (9th Cir. 1996) ("Thus, numerous courts have held that open-ended 'work when able' schedules are not reasonable accommodations that employers must adopt.") (collecting cases).

161 Guice-Mills v. Derwinski, 967 F.2d 794, 798 (2d Cir. 1992).

162 Barfield v. Bell S. Telecomm., Inc., 886 F. Supp. 1321, 1326 (S.D. Miss. 1995) ("Many courts have held, both under the Rehabilitation Act and the ADA, that employees who are disabled cannot prove that they can adequately perform the essential functions of a job without showing they can maintain a regular and dependable level of attendance at that job.") (collecting cases).

payroll when the employer does not know when the employee will come back to work or when the business must hire a second worker in the interim. Transfers or modifying the schedule to avoid co-workers that exacerbate the employee's condition have been found to be unreasonable accommodations due to the difficulty of administering such a remedy.[163] Furthermore, allowing an employee to modify who he or she works with or under, calls into question the employer's business judgment and ability to structure the business as he or she sees fit.[164] As depression is a recurring condition and an employee who has experienced depression a few times in the past has an increasingly higher probability of relapsing,[165] it is challenging to develop a contingency plan for a disruptive event that is almost certain to reoccur. Due to variability in severity and symptoms of the disorder coupled with different business needs per employer, it would be difficult to declare a bright-line rule to ensure the protection of employees with depression. While broad amendments to the revised ADA may be impracticable, this Note proposes that a small but significant change to the EEOC regulations as well as employer education may be a suitable beginning.

IV. PROPOSING A REQUIRED DUTY TO ENGAGE IN THE INTERACTIVE PROCESS FOR EMPLOYEES WITH DEPRESSION COUPLED WITH BETTER MENTAL HEALTH EDUCATION FOR EMPLOYERS

The first step to finding a solution for employees with depression would be to consistently interpret the EEOC

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163 *See, e.g.*, Gaul v. Lucent Technologies, Inc., 134 F.3d 576, 577, 581 (3d Cir. 1998) (finding an employee with depression and anxiety's requested accommodation of "transfer to a position where he would not be subjected to prolonged and inordinate stress by coworkers" was too burdensome for the following reasons: (1) it would "impose a wholly impractical obligation on . . . any employer" as the employer "could never achieve more than temporary compliance because compliance would depend entirely on [the employee's] stress level at any given moment"; (2) employee's "proposed accommodation would also impose extraordinary administrative burdens on [the employer]" as "[i]n order to reduce [employee's] exposure to coworkers who cause him prolonged and inordinate stress, [employer's] supervisors would have to consider, among other things, [employee's] stress level whenever assigning projects to workers or teams, changing work locations, or planning social events" and "[s]uch considerations would require far too much oversight and are simply not required under law"; and (3) the accommodation requested "essentially ask[ed] this court to establish the conditions of his employment, most notably, with whom he will work").

164 Wernick v. Fed. Reserve Bank of New York, 91 F.3d 379, 384 (2d Cir. 1996) ("[N]othing in the law leads us to conclude that in enacting the disability acts, Congress intended to interfere with personnel decisions within an organizational hierarchy. Congress intended simply that disabled persons have the same opportunities available to them as are available to nondisabled persons.").

165 HANDBOOK OF DEPRESSION, *supra* note 12, at 343.

regulations, that state an employer *may* be required to engage in the interactive process[166] as *must* be required to engage in the interactive process of finding a reasonable accommodation for employees where the disability and the solution are not readily apparent, particularly employees with depression. By requiring the employer to engage in the process at the first sign of trouble, this minor change ensures that the reasonable accommodation takes into account both the employee's and the employer's needs. As the employee is in the best position to know his or her limits and the employer is most aware of how an employment position can be restructured,[167] the sooner the conversation is earnestly commenced, the greater likelihood of finding an accommodation. The EEOC instruction could state that the interactive process is *required* only when the nature of the employee's disability makes a reasonable accommodation difficult to ascertain, such as with mental health disorders. This proposal may raise issues of fairness and unequal treatment among ADA claimants; however, the nature of depression makes early disclosure and employer involvement with finding a solution critical to establishing a reasonable accommodation. Limiting the expansion of the EEOC requirements also compromises with potential employer counterarguments about limited company resources and excessive litigation. This change in the regulations will have a greater impact if coupled with a few in-house best practices, such as fostering an environment of open communication with supervisors and human resource departments well versed in accommodating employees with depression.

Engaging in the interactive process to find a reasonable accommodation will be less effective if the employers are engaging in the conversation strictly for the sake of compliance, and not from a genuine desire to find the best resolution for both parties. Having managers trained in recognizing symptoms of depression and human resource departments equipped with information on how to best accommodate employees with depression may save costs by promoting more productive work hours in a better environment and avoiding litigation due to early resolution.[168]

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166 29 C.F.R. § 1630.2(o)(3) (2013). For a discussion of the confusion and unequal application of the EEOC regulations, see *supra* notes 148–56 and accompanying text.

167 Hillary K. Valderrama, Comment, *Is the ADAAA a "Quick Fix" or Are We Out of the Frying Pan and into the Fire?: How Requiring Parties to Participate in the Interactive Process Can Effect Congressional Intent Under the ADAAA*, 47 HOUS. L. REV. 175, 204 (2010). The Valderrama Comment goes beyond the scope of mental health disorders and proposes requiring the interactive process in every disability discrimination case.

168 While depression can vary in severity and recurrence, one supported generalization is that the sooner it is addressed, the greater likelihood that treatment will

For example, reimagine Claudia Peterson, the hypothetical employee diagnosed with depression who continues to produce high-quality work but is seeking an extended lunch hour once a week to meet with her therapist. One of the hurdles she is facing is her supervisor's misconception that Claudia is merely seeking preferential treatment. However, if Claudia's company had invested in training its supervisors to confront their stigma toward employees with mental health disorders and replace internal bias with empathy while engaging in the interactive process, Claudia's supervisor may have been more amenable to Claudia seeking treatment. In an alternative scenario, what if Claudia feels uncomfortable requesting an accommodation and decides to forgo treatment? She can continue to physically attend work, but in time the untreated disorder may cause her work product to suffer, which in turn will not benefit her employer. If the disorder persists, by the time Claudia seeks treatment, therapy may not be enough and her employer may be even more reluctant to grant more burdensome accommodations, such as an extended time-off request. Thus, an open-communication, flexible approach at the early onset of depression with active employer engagement in the interactive process will allow Claudia to seek the treatment she needs while continuing to contribute valuable work to her employer.

One drawback to this proposal is that it may not go far enough to address the needs of employees with more severe depression in need of more serious accommodations. Another potential wrinkle is time and cost—determining whether required engagement in the interactive process is a misuse of company time if employers will only do the bare minimum to comply and finding who will pay for training managers and hiring departments. Could an employer claim that being forced to engage in the interactive process at the first sign of a potential disability creates an undue hardship and a litigious workforce? An additional potential negative repercussion would be overzealous policing of employees and an increased risk of bias and discrimination based on perceived disability. However, given the millions of dollars wasted on an underutilized workforce, it would appear that employers would benefit from starting the movement toward a more mental health friendly workplace. The ideal solution may be elusive as of yet, but starting with enforcing the EEOC regulations for employees with depression would be a step in the right direction towards protecting them from employment discrimination.

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be effective. *See* Kathryn M. Rost, *Improving Depression Treatment by Integrated Care*, J. OF MANAGED CARE PHARMACY S5, S6 (2004).

CONCLUSION

As the spike in the national average of adults who reported an episode of clinical depression corresponded with the rise in unemployment demonstrates,[169] to many Americans, employment signifies more than a means with which to pay bills. The ability to go to work may equate with feelings of self-worth and a sense of belonging in society.

Yet, the ADA, as amended by the ADAAA, does not address the hurdles faced by employees with depression or the cost faced by employers. Although the ADAAA made it easier to categorize depression as a disability, it did not alter the requirements for establishing when an employee with depression is qualified for a position. It is this qualification requirement that presents a barrier to employment for employees with depression.

One possible solution would be to require employers to engage in the interactive process of finding a reasonable accommodation that would allow employees with depression to perform the essential functions of their jobs for employees with mental health disorders or other "invisible" disabilities. This minor alteration to the EEOC regulations would be most effective if the employers also invested in educating supervisors on confronting mental health stigmas and how to interact with employees that face mental health disorders. This modification should enable employers who have been subsidizing the financial effects of depression in the workplace[170] to receive the benefits of a healthy workforce, and employees with depression to receive the protection intended when the ADA was passed.

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169 Hawkins, *supra* note 13, at 12.

170 *See* Paul Hemp, *Presenteeism: At Work—But Out of It*, HARV. BUS. REV., Oct. 2004, *available at* http://hbr.org/2004/10/presenteeism-at-work-but-out-of-it/ar/1 (defining presenteeism as the term that refers to times when the employee is physically present at work but not fully engaged).

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