

## **A Natural Law Perspective of Corporate Governance**

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### **Introduction**

My aim is to consider the legal regulation of the public corporation and its governance from the perspective of natural law theory. There are many theories of natural law that have appeared since the Stoic philosophers in Ancient Greece first coined the term natural law more than 2500 years ago. A vast array of moral, legal and political theories are considered natural law theories because they, more or less, reflect Aristotle's view that law is necessary because humans are rational and social beings with a capacity for morals. The natural law perspective that law and morals are connected and that the purpose of law is to achieve justice and the common good stands in sharp contrasts to more limited generally accepted views of the nature and function of law. For the sake of clarity and precision the references to natural law, for the most part, are to elements of the thought of John Finnis, who in his treatise, *Natural Law and Natural Rights*, sets out a restatement of the classical Aristotelian-Thomistic view of natural law.<sup>1</sup>

Different understandings of the modern public corporation and the role of those responsible for its governance reflect different conceptions of the nature and function of law. The notion that the corporation is merely private property for the benefit of shareholders is in accord with the narrow descriptive view of law of legal positivists,<sup>2</sup> who hold that law is a social fact and a product of legislative will that consists of an aggregate of rules for the violation of which a sanction is imposed. For proponents of natural law, who define law broadly as value laden, a product of reason and the means to promote justice and the common good, the corporation is considered a social entity with a responsibility to promote the interest of all its stakeholders including employees, managers, creditors, customers and suppliers and the public interests of the communities that it is a part of.

The narrow view that a corporation is simply private property for the benefit of shareholders fails to account for the obvious fact that business corporations do far more than create wealth for their shareholders. They also provide essential goods and services, give employment to many, serve as a forum for the exchange of ideas, promote various forms of social interaction and cooperation, and provide opportunities to form friendships and to pursue excellence. From a natural law perspective those responsible for corporate governance have both legal and moral obligations to act to serve all stakeholders of the corporation and to promote the public interest or the common good.

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<sup>1</sup> J. Finnis, *Natural Law and Natural Rights*, 2d ed. Oxford: Clarendon 2009, 1<sup>st</sup> ed. 1980.

<sup>2</sup> See H.L.A. The Concept of Law, 2d ed. Oxford: Clarendon (1994), 1<sup>st</sup> ed. 1961. H.L.A. Hart was the foremost Legal Positivist of the 20<sup>th</sup> century. Finnis recognizes the value of the descriptive analysis of law provided by legal positivists but insists that the positivist assertion that law and morals are separate and distinct spheres is untenable. The debate between adherents of natural and adherents of legal positivism has faded away with the general acceptance by both camps that law is subject to a moral critique.

The elements of a sound theory of natural law, such as John Finnis' contemporary theory, provide a particularly helpful framework within which to evaluate competing conceptions of the business corporation and the central questions of corporate governance: Whose interests should management serve? Should managers of the corporation serve only shareholder interest or should they serve the best interests of the corporation as a whole and take into account the interests of non-shareholder stakeholders. Natural law theory also is helpful to assess whether the regulation of large and powerful public corporations is consistent with the requirements of commutative and distributive justice, especially with respect to corporate actions that adversely impact the environment; fraud, self-dealing and other abuses of authority by agents of the corporation; a lack of diversity of employees at every level, excessive executive compensation that is unrelated to performance; the limited taxation of corporate income; and the impact of corporate political contributions on the democratic process.

### **A Summary of John Finnis' Theory of Natural Law**

Finnis' rationalistic theory of natural law begins with an exhaustive theory of the good, which identifies seven basic or fundamental universal values: life, knowledge, friendship, play, art, religion, and practical reason. These basic or universal values or goods form the substrata for the instantiation or application of Finnis' methodological requirements of practical reason which consists of nine principles of practical reason that Finnis describes as the deep structure of moral thought. The nine principles are: (1) act according to a rational life plan; (2) have no arbitrary preference of values; (3) have no arbitrary preference of persons; (4) have commitment to avoid apathy; (5) have detachment to avoid fanaticism; (6) give limited relevance to consequences; efficiency within reason; (7) respect every value in every act; (8) foster the common good in all the communities one is a part of; and (9) follow one's conscience. Finnis asserts that the seven basic goods and principles of practical reason are self evident, and, as such, they are indemonstrable. They are not logically derived through speculative reason but are simply grasped by the exercise of practical reason and follow as conclusions from the first self evident principle of natural law that the good is to be done and promoted and its contrary, evil, is to be avoided. These principles of practical reason are objective principles of rationality that are the means to discern how to achieve a full flourishing life and to act as a mature morally responsible person.<sup>3</sup>

Like Aquinas, Finnis attaches importance to Aristotle's two-fold definition of reason and his distinction between theoretical or speculative reason and practical reason. Aristotle posits that speculative reason is the source of apodictic or necessary truth and that it reveals what is by deriving conclusions from self-evident principles, such as, the principle of identity or non-contradiction that something cannot be what it is not.. Practical reason is based on entirely different self-evident principles and has an entirely different function than speculative reason. Whereas speculative reason reveals what is, practical reason reveals how one should act or what one ought or (ought not) do.<sup>4</sup> Thus, for Finnis, natural law, properly understood, is about self-evident objective values or goods and the principles of practical reason that is the foundation of morality or ethics. It concerns the impact of our choices on others.

Finnis blurs the lines between moral, legal and political theory, which he considers within the context of the requirements of practical reason that concern what one ought or (ought not) do to achieve human flourishing or happiness. Finnis maintains that the good is prior

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<sup>3</sup> J. Finnis, *Id. supra* note 1, Chapters 3 and 4 describes the seven basic goods, 59-99 and Chapter 5 Defines and describes the principles of practical reasonableness, 100-127.

<sup>4</sup> Finnis, *Id.*, at 36, Finnis notes Aquinas' Aristotelian distinction between speculative and practical reason. Speculative reason involves discovery of what is (facts) and practical reason involves discovery about how to act or what ought (or not) be done (values).

to the right and the primacy of ethics over politics, law and economics. Central to Finnis' natural law theory is the recognition of absolute values, which must be respected in every action. Thus, choices that involve a direct attack on a basic value are never justified. Conversely, the only justification for any choice is that it in some way promotes one or more of the basic values (goods). Finnis identifies five criteria for distributive justice. In lexical order of importance they are: need, function, capacity, merit and whether a risk of harm was created or accepted. Finnis asserts that distributive justice is primarily an individual responsibility and only secondarily a responsibility of government.

### **The Regulation of Business in the 19<sup>th</sup> Century and the Emergence of the Modern Public Corporation**

Although one can trace the modern business corporation's origins to ancient Rome,<sup>5</sup> there were very few corporations before 1800. Those that existed in the 19<sup>th</sup> century were mostly chartered by the state to operate banks and insurance companies and to build and operate canals and roads. The dominant feature of these early corporations was their public character. With their charter came the privilege of monopoly status and the power to assess members of the local community for capital requirements and deficiencies in operating expenses. As America embraced capitalism and competition corporations were viewed less as instruments of the state and more as engines for private profit. State incorporation statutes became increasingly enabling and permissive.

Throughout most of the 19<sup>th</sup> century there was little difference between public and private corporations. The first general incorporation act that allowed any person to incorporate by compliance with terms of the statute was enacted in New York in 1811. <sup>6</sup>Almost any business enterprise could be conducted in a corporate form with simple statutory formalities. State legislatures exercised the rights of sovereignty by imposing regulations on business enterprises without regard to their form.

The U.S. Supreme Court, in Munn v. Illinois,<sup>7</sup> drew a sharp distinction between a business affected with a public interest and a strictly private business. Other cases followed in which attempts to regulate business in the public interest were held unconstitutional. Lockner v. New York,<sup>8</sup> reflects the dominance of the private property conception of the corporation over the conception of the corporation as a social entity with an obligation to act in accord with the public interest and the requirements of justice. In Lockner, the Court struck down a New York statute limiting the hours of work in a bakery. From a natural law perspective, cases, like Lockner, that ignore individual rights and subordinate the moral claim that every person has a right not to be treated as a means to another's end to property and contract rights are morally unjustified. The decision in Lockner violates Finnis' nine requirements of practical reason because permitting unlimited hours of work is not in accord with a rational life plan, arbitrarily prefers the instrumental value of efficiency to the fundamental values of life and friendship, arbitrarily prefers the interest of corporate managers and shareholders over the interest of workers, is a direct attack on the health and dignity of workers, is contrary to the common good and, all things considered, someone with an informed conscience would discern that a decision not to limit hours of work that threatens the health and wellbeing of workers is not morally justified.

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<sup>5</sup> <http://britanica.com>, Corporations/Definitions, History and Facts. The word corporation comes from the Latin word "corporare", which means to combine into one body. The Romans were the first to codify the notion of an organization as having an identity that was distinct from that of the person who owned it or belonged to it.

<sup>6</sup> See W. C. Kessler, A Statistical Study of the New York General Incorporation Act of 1811 for a detailed account of the impact of the statute.

<sup>7</sup> 94 U.S. 113 (1876).

<sup>8</sup> 198 U.S. 45 (1905).

In the 20<sup>th</sup> century there was substantial growth in the economic power and political influence of the modern business corporation. In 1896 New Jersey enacted the first permissive modern corporation act conferring broad powers on corporations and permitting incorporators to set up almost any kind of governance structure with broad powers to directors and substantial protection against liability for directors and managers.<sup>9</sup> Delaware<sup>10</sup> and other states followed New Jersey's lead and eventually all states adopted broadly permissive enabling corporation statutes with very little regulatory restrictions.

In 1919, a Michigan Supreme Court opinion in Dodge v. Ford Motor Co.<sup>11</sup> clearly reflects the shareholder primacy view of corporate governance and the property conception of the corporation. The case involved the decision of the board of directors of Ford to reject the minority shareholders effort to compel the highly profitable company to pay a large dividend. At the urging of Henry Ford, the board decided to use the company's \$58,000,000 in profits to create more jobs and to benefit consumers by reducing car prices. The Michigan Supreme Court came down firmly on the side of shareholders.

### **The Berle-Dodd Debate**

In 1932 two Harvard professors, Adolf Berle and Merrick Dodd engaged in a debate in the pages of the Harvard Law Review on the issue of the purpose of the corporation.<sup>12</sup> Berle argued that corporate managers are analogous to trustees, who act solely for the shareholders, who are owners of the corporation.<sup>13</sup> Dodd countered that the corporation has a large social purpose beyond simply providing returns for shareholders.<sup>14</sup> Dodd argued:

*....public opinion which ultimately makes law, has made  
and is today making substantial strides in the direction of  
a view of the business corporation as an economic  
institution which has a social service as well as a  
profit making function.*<sup>15</sup>

The conception of the corporation as a social entity with a larger purpose beyond maximizing returns to shareholders began to take hold with the growth of the modern business corporation, the development of sophisticated securities markets, and the emergence of a class of professional managers who saw themselves as trustees of great institutions. In 1946, Frank Abrams, then chairman of Standard Oil of New Jersey, described the role of the modern manager as "an equitable and working balance among the claims of the various directly interested groups—stockholders, employees, customers, and the public at large."<sup>16</sup> In 1954, Professor Berle, more than twenty years after the famous Berle-Dodd debate, clarified his position about the nature of the corporation and

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<sup>9</sup> General Statutes of New Jersey, 1896 edition. General Statutes of New Jersey, 1896 edition.

<sup>10</sup> Delaware's General Corporations Act of 1899.

<sup>11</sup> 204 Mich.459, 170 N.W. 668 (1919).

<sup>12</sup> See C.W. Wells, The Cycles of Corporate Social Responsibility: An Historical Perspective for the Twenty-First Century, 51 Kansas L.R. 71 (1991) for a thorough analysis of the Berle-Dodd debate and other similarly debates over the last century about the social responsibility of the corporation.

<sup>13</sup> A.A. Berle, Jr., Corporate Power as Powers in Trust, 44 Harv. L.R. 1049 (1931).

<sup>14</sup> M. Dodd, For Whom Are Corporate Managers Trustees? 45 Harv. L.R. 1145 (1932).

<sup>15</sup> Id., at 1148.

<sup>16</sup> Delbard, The Corporate Social Responsibility Agenda: The Case for Sustainable and Responsible Business, at 4.

emphasized corporate powers, as a matter of law, are held in trust for the entire community.<sup>17</sup>

### **Alternative Conceptions of the Corporation as Private Property or Social Entity**

The shareholder value model of corporate governance is derived from a contract and property conception of the business corporation, that is, the view that a corporation is merely an extension of the shareholders' right to own private property, the freedom of association and the freedom to contract. The stakeholder model of corporate governance is linked to a conception of the corporation as a social entity responsible to further the public interest, which from a natural law perspective is synonymous with the common good.

Early U.S. Supreme Court cases are cited in support of the property conception of the modern public corporation. In Trustees of Dartmouth College v. Woodward,<sup>18</sup> Chief Justice Marshall recognized constitutionally protected property and contract rights arising out of the grant of a corporate charter to Dartmouth College by the state of New Hampshire. Justice Marshall writes:

*A corporation is an artificial being, invisible, intangible,  
and existing only in contemplation of law. Being the  
mere creature of law, it possesses only those properties  
which the charter of its creation confers upon it....*<sup>19</sup>

Proponents of the corporation as private property contend the right to incorporate inheres in the right to own property and to enter contracts and that corporations should be considered legal extensions of their owners, the shareholders with the rights and responsibilities of property owners. Throughout the 19<sup>th</sup> century, vested rights, that is, property and contract rights were the theoretical basis for constitutional and private law decisions regarding the use of property and the regulation of business activities. These decisions embodied a positive doctrine of "public rights" that expressed community values.<sup>20</sup>

Judges who put in place the foundation stones of the vested rights doctrine invoked the precepts of natural law to advocate the fundamental and inalienable character of private rights. Proponents of public rights also drew upon natural law theory in asserting that the rights of "sovereignty" were inherent and inalienable powers of states, which serve as grounds for regulation of business as well as the basis for taxation and property takings through the exercise of the power of eminent domain.<sup>21</sup>

Natural law theories recognize the importance of private property as a requirement of justice and the common good. Aristotle countered Plato's contention that all goods should be held in common with the argument that private ownership was necessary to insure the productive use of property and to express the virtue of liberality, Aristotle's term for generosity.<sup>22</sup> Aquinas also recognized the importance of private property but he carefully distinguished between ownership and use of property.<sup>23</sup> He held that the ownership of private property could be absolute but that it had to be put to reasonable use. Finnis

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<sup>17</sup>R. Tilman, Apology and Ambiguity: Adolf Berle on Corporate Power, 8 J. of Economic Issues 111 (March 1974).

<sup>18</sup> 17 U.S. 518 (1819).

<sup>19</sup> Id., at 636.

<sup>20</sup> See A. Macleod, Of Brutal Murder and Transcendental Sovereignty: The Meaning of Vested Private Rights, 41 Harv. J. of Law & Policy 254 (2018).

<sup>21</sup> Id., at 260-265.

<sup>22</sup> Newman, The Politics of Aristotle, Vol. 7, 160-168.

<sup>23</sup> T. Aquinas, Summa Theologica, Question 94.

contends that some regime of private property is a requirement of justice. He equates the obligation of the owner of property with that of a trustee for the benefit of society.<sup>24</sup> He posits that property owners have an obligation to put their property to productive use and that, after receiving its first fruits; they have an obligation of distributive justice.<sup>25</sup>

From a natural law perspective the right to contract is a necessary corollary to the right to private property. The institution of contract contributes to the common good. It is an important element of a well ordered society because through contracts individuals exercise autonomy and find self expression and self realization. Although natural law theorists affirm the importance of the right to own property and the right to contract, they hold that both are subject to reasonable limitations in their exercise. The significance for corporate governance is that it matters not whether the corporation entity or its shareholders have a property interest, the use of the property controlled by the corporation is subject to the same reasonable limitations and the requirements of commutative and distributive justice.

### **Alternative Models of Corporate Governance**

There are essentially two different models of corporate governance: the shareholder value model and the stakeholder model. The shareholder value model comes in different forms including the finance model and the market myopia model.<sup>26</sup> Both the finance model and the market myopia model of corporate governance are based on the assumption that the purpose of the corporation is to maximize shareholder value, but they differ on how best to achieve this goal. Finance model advocates believe that shareholder interests are best served by policies and strategies that maximize the corporation's stock price in the short run. They contend that a corporation's stock price on a given day reflects the market's best estimate of the corporation's future profits and growth. They argue that there should be an unfettered market for corporate control and reforms that enhance the power of shareholders. Market myopia advocates, however, reject the idea that today's stock price is a reliable indicator of a corporation's future profits and value. They fear that pressures from the financial markets will result in too much managerial attention on stock prices and a bias against managing for the long term.<sup>27</sup>

Despite their differences, both the finance model and market myopia model of corporate governance stress the importance of maintaining wide discretion in the managers of the corporation and consider managers as the agents of shareholders, who are owners of the corporation. Although the stakeholder model of corporate governance allows for wide discretion by corporate officers and managers, it emphasizes the social purposes of the corporation and considers managers as trustees for all stakeholders of the corporation.

From a natural law perspective the need for managers with wide discretionary authority to act for the corporation does not obviate the question whether the authority to act for the corporation under existing corporate law arbitrarily prefers shareholder and management interests over other stakeholders of the corporation. Concern for all the stakeholders sets a broader framework to evaluate the exercise of authority to act for the corporation. As such, the stakeholder model of corporate governance, far more than the shareholder value model, accords with natural law principles, which emphasize impartiality among values and persons, concern for justice, and the common good.

With the growing acceptance of the social entity model of the corporation and the stakeholder model of corporate governance, corporate officers and boards made increasing

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<sup>24</sup> Finnis, *supra*, note 1, at 171.

<sup>25</sup> *Id.*, at 173.

<sup>26</sup> See S. Letza, X. Sun and J. Kilpatrick, *Shareholding v. Stakeholding: A critical Review of Corporate Governance*, 12 *Corporate Governance: An International Review* issue 3 (July 2004), at 249.

<sup>27</sup> *Id.* at, 244.

commitments to advance the interest of employees and the common good of the communities they are a part of, especially through increases in wages and benefits for employees and contributions to a myriad of charitable, civic and political organizations. Moreover, the movement toward a stakeholder model of corporate governance is reflected in mission statements of corporations and the adoption of best practices as part of efforts from the top down to protect and promote respect for human dignity and the common good of those who are directly or indirectly affected by corporate policies and practices.

The debates about corporate governance have been dominated by advocates of the shareholder value model of corporate governance and the proponents of law and economic analysis. They assert that legal decisions should promote the twin goals of efficiency and wealth maximization that corporations should be run for the benefit of shareholders, and that reform in corporate governance should provide greater control to shareholders. Milton Friedman, a leading proponent of economic analysis of law and among the founders of the law and economics movement, flatly asserted that the social responsibility of business is to simply maximize profits.<sup>28</sup>

Economic analysis is based on the erroneous assumption of classical economic theory that human beings are rational maximizers. It relies on a narrow instrumental view of rationality that focuses on the consequences of chosen ends. Finnis and other natural law theorists, especially John Rawls,<sup>29</sup> reject consequentialist reasoning, act and rule utilitarianism, as senseless and irrational. Finnis has a radically different understanding of rationality than most economists and proponents of an economic analysis of law. From a natural law perspective, rationality involves concern for both values, i.e. good ends, and the means to pursue those ends. This value rationality focuses on intrinsic basic or universal values or goods and underscores their importance as the point of continuing cooperation and the foundation of civil society. The purpose of value rationality is to determine what is good and bad, right and wrong. Thus, it is a radically different understanding of rationality than instrumental rationality, which ignores basic universal values and objective principles of practical reason and focuses on efficiency and wealth maximization.

Instrumental rationality is much more limited than value rationality. It involves only the means to achieve chosen or desired ends, without regard to whether those ends have intrinsic value, i.e. value for their own sake. It stresses logical thinking and concern for clarity and coherence in the expression of ideas to communicate and ultimately to achieve shared meanings. Economic rationality is even more limited than instrumental rationality. It consists of a utilitarian calculus of the greatest good for the greatest number and a cost benefit analysis based on narrowly defined self-interest and an impoverished view of human nature. It has no place for altruism and completely discounts the fact that most people respect the moral claims of others.

Value rationality, instrumental rationality and economic rationality are not mutually exclusive. From a natural law perspective instrumental and economic rationality are useful but simply too limited. Whereas value rationality encompasses instrumental and economic rationality, neither instrumental or economic rationality take into account the central point of value rationality—the concern for and promotion of basic, universal values necessary for integral human flourishing.

### **The Corporate Governance Movement and Other Signs of Recognition of the Public Corporation as a Social Entity with Social Responsibilities**

As an increasing number of scholars, activists and business leaders began to support the idea of a corporation as a social entity, corporate governance reform movements appeared

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<sup>28</sup> M. Friedman, A Friedman Doctrine—Social Responsibility of Business Is to Increase Its Profits, N.Y. Times Magazine, September 13, 1970.

<sup>29</sup> J. Rawls, A Theory of Justice: Justice as Fairness (Harvard Univ. Press (1964)

in the 1960's and the 1970s. In the 1980s there were increasing calls for reform of legal regulations of corporations amid increasing concern over the abuses of corporate power, the dramatic increase in executive compensation, and a spate of corporate scandals leading to the collapse of banks and other financial institutions and a threat to world economic stability.

Amendments to the Model Business Corporations Act (MBCA) <sup>30</sup> and the American Law Institute's Principles of Corporate Governance proposed reforms of the laws on corporate governance. <sup>31</sup> The MCBA was amended to permit the board of directors to support civic, educational, charitable and humanitarian projects. Sections 2.01 of the ALI's Principles went farther and permit a corporation to "take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business" and to "devote a reasonable amount of resources to public welfare, humanitarian, educational and philanthropic purposes even at the expense of corporate profits and shareholder value." The ALI also recommends the appointment of independent outside directors who would constitute the majority of the board of directors that would function through an auditing committee and other committees to nominate board members and to fix executive compensation.

Even when publicly held corporations have a substantial number of outside directors or a majority of the board, they are subject to some of the same constraints as other directors, especially insufficient time and expertise. Under current law, directors generally owe their appointment and retention to the corporation's chief executive officer, who controls the proxy machinery that can effectively determine who will be the directors. Thus, the real decision making power is concentrated in officers rather than the board of directors.

Proponents of reform assert that publicly held corporations are often unresponsive to the needs of the public or even to the interests of their shareholders. The CEO and his or her management team, not the board of directors, are seen as, essentially, unregulated, unbridled and accountable to no one because directors who are chosen and dominated by management cannot effectively monitor the conduct and quality of management's performance. Among the proposals for reform of corporate governance is the call for federal chartering of corporations or legislation imposing minimum standards on publicly held corporations. The Securities and Exchange Commission (SEC) amended its rules to require additional disclosure of information, including information about the structure, composition and function of the board of directors. <sup>32</sup> The Sarbanes Oxley Act, enacted in 2002, requires agents of the corporation to disclose violations of the law and violations of obligations to the corporations. The law also provides protection for whistle blowers. <sup>33</sup>

The cases that reflect the view that a corporation is a social entity with responsibility to the public interest are rare but notable. In Theodora Holding Corp. v. Henderson, <sup>34</sup> the Delaware Chancery Court recognized the authority of directors to use corporate funds for

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<sup>30</sup> Model Business Corporation Act (MBCA) 1969, was revised in 2016 and amended in 2019 to include Chapter 17, which expressly expands the purpose of the corporation beyond acting primarily in the interest of shareholders.

<sup>31</sup> The American Law Institute's Principles of Corporate Governance (1994), were amended in 2022.

<sup>32</sup> SEC adopted amendments to Rule 10b-5 under the Securities Exchange Act of 1934 that increase Disclosure requirements to enhance investor protection against insider trading, SEC Press Release (December 14, 2022).

<sup>33</sup> Sarbanes Oxley Act of 2002 is commonly referred to as SOX. Its text is at federal Public Law 107-204. Congress provided for a robust enforcement and oversight provision. See 18 U.S.C., Sec. 1350, which imposes criminal liability on any officer, i.e. CEO or CFO, who knowingly submits non-complying financial statements.

<sup>34</sup> 257 A.2d 398 (Del. Ch.1969).



charitable, civic, educational and humanitarian purposes. In Shlensky v. Wrigley,<sup>35</sup> the board of directors of the Chicago Cubs major league baseball team were permitted to reject business strategies that would increase profits at the expense of the local community. Applying the business judgment rule the court sanctioned the board of directors' decision against installing lights to play night games because it would disturb the peace and quiet of the surrounding community. In Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.,<sup>36</sup> a creditor was given standing to bring a stockholders derivative suit and directors were permitted to avoid risky undertakings that would benefit shareholders at the expense of creditors. In Paramount Communications Inc. v. Time Inc.,<sup>37</sup> the directors of Time, Inc. were permitted to reject Paramount's premium take-over bid to pursue a merger with another company that would preserve "Time Culture" of journalistic integrity. In other cases Courts have permitted directors to fend off a hostile take-over at a premium price to protect interest of employees and the community.

The legal standards for review of the decisions of officers and directors give wide latitude to their decision making power. The fiduciary duties of care, competence, undivided loyalty and utmost good faith provide a measure of accountability and prevent egregious acts of illegality, fraud and various forms of self-dealing. Courts, however, are generally reluctant to intervene in the internal affairs of a corporation in the absence of proof of serious wrongdoing. This procedural burden and the application of the business judgment rule, i.e. a rule that presumes corporate managers have wide discretionary authority and immunity for negligence, effectively prevents efforts to hold management more accountable. Under current corporation law and governance structures, managers are able to exercise their wide discretionary authority to benefit themselves at the expense of shareholders and other stakeholders, especially when it comes to executive compensation of one form or another that is unrelated to the corporation's performance.

In recent years there is increasing evidence that the stakeholder model has become the prevailing and generally accepted form of corporate governance. After decades of fighting against proposals for reform of corporate law and embracing the Friedman doctrine that maximizing shareholder value is the corporation's only social responsibility, the Business Round Table (BRT), an organization of more than 200 CEOs of major corporations recently announced a corporation has social responsibilities and is not solely an engine of profits for shareholders.<sup>38</sup> A CNN Survey of Global 500 corporations in the U.S., the UK, and Canada found near unanimous acceptance of the stakeholder model of corporate governance.<sup>39</sup> Also in recent years the front pages of the New York Times<sup>40</sup> and the Wall Street Journal<sup>41</sup> and a Forbes<sup>42</sup> magazine cover story declared that corporations have a social responsibility to promote the public interest. Another sign of change is the plethora

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<sup>35</sup> 237 N.E. 2d 776 (Ill. App. Ct. 1968).

<sup>36</sup> 1991 Del. Ch. 15.

<sup>37</sup> 571 A. 2d 1140 (Del. Ch. 1989).

<sup>38</sup> In 2019 The Business Round Table (BRT moved away from its promotion of shareholder primacy in its statements on the principles of corporate governance it issued periodically since 1978 and declared that the corporation should serve all stakeholders and promote an economy that serves all Americans. NY Times, Sept. 13, 2019.

<sup>39</sup> See P.M. Vasudev, The Stakeholder Principle: Corporate Governance and Theory, 41 Hofstra L.R. (2012), Iss. 2, Art. 6, for a good discussion of the results of the CNN Survey of corporations In U.S., UK, and Canada indicating a near unanimous view that the corporation should serve the interests of all the stakeholders.

<sup>40</sup> September 11, 2020 New York Times.

<sup>41</sup> August 20, 2020, Wall Street Journal

<sup>42</sup> September 16 Forbes Magazine.

of proposed “Best Practices”<sup>43</sup> for corporations that include among other things transparency, accountability and fairness in corporate governance. Many states adopted anti-takeover<sup>44</sup> and constituency statutes<sup>45</sup> that permit or require a board of directors to consider the affect of corporate action on nonshareholder stakeholders. Corporate contributions to charitable organization have substantially increased as have voluntary efforts to protect the environment and partnerships between private corporations and government to promote economic development. Corporations are now concerned about the ESG (Environmental, Social, and Governance) rating,<sup>46</sup> which renders their shares more attractive and, at the same time, ensures the corporation’s sustainability.

### **The Role and Responsibility of Corporate Counsel**

How much influence corporate counsel have on specific decisions of the corporation or on the corporate culture will depend on various factors, especially the management style of the CEO. It will also depend on the extent of potential exposure of the corporation and its agents to the risk of legal liability, how corporate counsel view of their role and their knowledge of business, in general, and the business of the corporation they represent.

In-house and outside corporate counsel are subject to some of the same constraints as managers and directors and, as such, may have a limited role in shaping corporate policies and practices. Although in-house counsels are employees of the corporation, they must be members of the bar, and as such, are subject to state ethics rules. In-house counsels are subject to liability for the unauthorized practice of law when they represent a corporation in states where they are not licensed. Both in-house and outside counsel are subject to liability for legal malpractice as well as professional discipline for violations of ethics rules.

The ABA Model Rules of Professional Conduct<sup>47</sup> that have been adopted in most states include mandatory disclosure rules and other rules that are particularly helpful to corporate counsel in the performance of their role as a gatekeeper for the corporation with respect to both its internal governance and external activities involving compliance with local, state, national and international laws. RPC 1.13, entitled An Organization as a Client, is directly applicable to corporate lawyers. It provides that a lawyer for an organization represents only the organization as distinct from its officers, directors, employees and other constituents of the organization. RPC 1.13(b) spells out how to proceed when the lawyer learns of wrongdoing by an agent of the corporation likely to result in injury to the corporation. RPC 2.1 is a general rule that requires a lawyer to exercise independent professional judgment and to render candid advice that may refer to not only law but other considerations such as moral, economic, social, and political facts that may be relevant to the client’s situation. Viewed in their entirety, the rules enable corporate counsel to act as an independent moral agent advising or otherwise representing a corporation. As an independent moral agent corporate counsel can be expected to offer principled objections to morally unacceptable proposals and positive insights regarding the permissible scope of managerial discretion in the pursuit of corporate objectives and goals.

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<sup>43</sup> See, for example, Toolkit1: Developing Corporate Best Practices, International Finance Corporation (2003)

<sup>44</sup> See for example the anti-takeover statute of New York, N.Y. Bus Corp. Law, Sec. 912 (McKinney 1986).

<sup>45</sup> A total of 44 states have enacted constituency statutes that permit directors to consider the interest of nonshareholder stakeholders. February/March 2020 Practical Law Journal.

<sup>46</sup> See G. Kell, The Rise in the Market for ESG Information. *Forbes*, July 11, 2018.

<sup>47</sup> The Most recent version of the ABA Model Rules of Professional Conduct was published on October 25, 2022. Some version of the Model Rules has been adopted in most states.

**The Concern for Values and the Priority of Ethics**

From a natural law perspective of corporate governance legal regulations in the form of prescriptive and proscriptive rules to constrain the exercise of discretion by corporate officers and directors must not unduly restrict or interfere with their freedom to seek new and ever more creative ways to foster both the efficiency and the ultimate purposes of the corporation as a social entity with social responsibilities. Although the law protects against various forms of corporate wrongdoing through civil or criminal sanctions for fraud, self-dealing, sexual harassment, insider trading, and tortuous and criminal behavior, the law imposes only a minimum morality. Changes in the law of corporate governance, for the most part, only permit and do not require the adoption of policies and programs consistent with a sense of social responsibility and the requirements of justice.

From a natural law perspective any moral appraisal of current corporate practices and legal regulation of corporations necessarily involves an assessment of whether they are in accord with the requirements of commutative and distributive justice. Thus, for example the principle of subsidiarity, which is a principle of commutative justice that requires that individual members of a large organization be allowed to make decisions that directly affect them, has obvious implications for corporate decisions related to establishing conditions in the work place. A corporate practice that fails to respect the integrity of workers and, effectively, reduces a worker to a cog in a vast corporate machine with little or no capacity to participate in the decision making process would violate the natural law principle of subsidiarity.

Corporate policies and practices should also be in accord with the principle of distributive justice that requires a fair distribution of benefits and burdens connected to different forms of communal enterprise. Thus, for example, the rate and amount of corporate income taxes and excessive executive compensation present questions of distributive justice. Proposals for the imposition of excess profits taxes, enactment of a minimum corporate income tax and other reforms that limit executive compensation and political contributions seek a redistribution of wealth in accord with the requirements of distributive justice.

**Conclusion**

Whether large public corporations will ever more directly serve public ends beyond the maximization of profits for shareholders will depend more on changes in attitude, orientation and commitment of those responsible for corporate governance than on changes in the law. From a natural law perspective the gatekeeper function is an important aspect of the role and responsibility of corporate counsel. As a gatekeeper corporate counsel, in a sense, acts as the conscience of the corporation to insure, not only, compliance with the requirements of law but also with the demands of commutative and distributive justice. The performance of corporate counsel in these different but related roles, in large part, will depend on their view of the nature and purpose of law as well as their integrity, moral character and capacity for moral discernment.

There are some obvious implications from what has been said about the legal regulation of public corporations and their corporate governance for the education and training of business leaders and lawyers, many of whom are destined to join the ranks of the legion of corporate managers and advisors throughout the world. The curriculum of business schools and law schools must provide pervasive ethics instruction that leads their students to an adequate knowledge and understanding of the relationship between moral, legal, political and economic theory. That entails, teaching about the objective principles of morality, i.e. the principles of practical reason that Finnis calls the deep structure of moral thought and that have been variously described as the higher law, the tradition of reason, the wisdom tradition or natural law. With knowledge and understanding of sound principles of natural law future business leaders and corporate lawyers will be better able to offer principled objections to morally unacceptable corporate practices and positive insights about the

functions, goals and purposes of the corporation. Natural law principles can also help lawyers and judges to engage in a healthy moral critique of corporate law and to contribute to its improvement.

Conversely, the absence of sufficient attention to the development of moral discernment in the education of future business managers and lawyers who will advise, direct, and act for corporations, could render public corporations less than fully responsive to the public interest and the demands of justice. Unless the managers and legal counsel to corporations consider themselves independent moral agents and are committed to maintaining the primacy of ethical considerations over legal, economic, and political factors when dealing with corporate problems, they may, not only, violate the salutary principles of natural law but may, inevitably, undermine the stability and the long-run interests of the corporations they serve. From a natural law perspective the inclination and capacity to integrate sound ethical or moral principles into business strategies and systems of governance should be the hall mark of effective and successful corporate officers, managers and in-house and outside counsel. Finally, and perhaps most importantly, on a human level all those involved with corporate governance in one capacity or another, from a natural law perspective, have an individual moral responsibility to make choices that respect basic human values, are consonant with rationality in all its forms and foster justice and the common good of all the communities they are a part of, including the international community.

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