

## The Ethical Significance of Corporate Law

Jeffrey Nesteruk

**ABSTRACT.** Corporate legal scholarship has failed in fundamental ways to grasp the ethical significance of corporate law and policy. While the broader economic and social consequences of particular legal developments are routinely debated, too little reflection is given to how such developments affect the moral quality of individual lives within the corporate hierarchy. What is needed is a framework for illuminating the interaction between developments in corporate legal doctrine and the ethical choices of corporate managers. The ethical significance of corporate law derives from two key factors. First, the corporation as an organization mediates between individuals in the corporate hierarchy and their ethical responsibilities. Second, the organizational choices and decision-making structure of the corporation are to a significant degree the product of corporate law.

### Introduction

Corporate legal scholarship has failed in fundamental ways to grasp the ethical significance of corporate law and policy. While the broader economic and social consequences of particular legal developments are routinely debated, too little reflection is given to how such developments affect the moral quality of individual lives within the cor-

porate hierarchy. This failure is especially striking given the broad and growing interest in the ethical dilemmas faced by individuals in the business environment. As an emerging field, business ethics has attracted considerable attention from academics, corporate managers, government officials, and the popular press. But this widespread concern with improving the ethical environment of business has remained largely distinct from the scholarly legal analysis of corporate law principles and doctrines.

This failure to explore fully the impact of corporate law developments on the nature of the ethical dilemmas faced by those individuals within the corporation is unfortunate. Corporate legal scholarship can be enriched significantly by a more attentive stance toward the concerns of business ethics. My intention here is to suggest a framework for illuminating the interaction between developments in corporate legal doctrine and the ethical choices of corporate managers.

The ethical significance of corporate law derives from two key factors. First, the corporation as an organization mediates between individuals in the corporate hierarchy and their ethical responsibilities. Second, the organizational choices and decision-making structure of the corporation are to a significant degree the product of corporate law. My argument will proceed from an analysis of each of these factors in turn.

### Corporate mediation

It is important to make explicit the manner in which the corporate organization mediates between individuals and their ethical obligations. This can be done by focusing on the application of classical ethical theory in the modern corporate setting.

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By using the term classical moral theory, I mean to include both utilitarian and deontological notions of ethics. These two broad schools of ethical theory figure prominently in the research and teaching regarding business ethics.<sup>1</sup> The difference between them is often cast in terms of the relative priority of the good and the right. While utilitarian theory grants priority to whether an action produces good consequences,<sup>2</sup> deontological approaches stress the rightness of an action according to some ethical criterion independent of consequences.<sup>3</sup> An example of such an ethical criterion is Kant's categorical imperative. According to Kant, we should subject each of our actions to the following standard: Could the maxim it implies be willed as universal law?<sup>4</sup>

Applying classical moral theories directly to the daily ethical dilemmas of individual corporate managers presents difficulties in part because of the orientation of such theories. The focus of classical moral theory is on general moral obligations. General moral obligations are those duties which we all have by virtue of our status as persons or moral agents. But many of the difficult ethical choices of corporate managers stem from conflicts regarding particular role obligations.<sup>5</sup> Thus, the obligations at issue relate to role morality. Role morality is concerned with duties individuals have because of their assumption of specific roles.<sup>6</sup>

What I wish to suggest is that one way classical moral theory may be brought to bear on ethical choices relating to role morality is by focusing on the corporate level of action. By applying classical moral theories to the actions of corporations themselves, the particular role obligations and conflicts of individuals within such organizations may be illuminated in a helpful way. The key here is to realize how such organizational choices determine the scope and character of the roles which make up the corporate decision-making structure.

What first needs to be made clear is the difference between moral choice generally and moral choice as it relates to specific role obligations.<sup>7</sup> Our general moral choices are made as persons or moral agents. They involve the evaluation of the relative worthiness of competing ends or goals.<sup>8</sup> Thus, when we as persons confront a general moral issue such as abortion, we must do such an evaluation. We must consider the relative worthiness of protecting the life of the fetus and respecting the reproductive freedom

of the woman. But the choices of role morality are made as occupants of specific, concrete roles. They necessarily involve the occupying individual's obligation to promote and foster the particular goal which informs the occupied role. Thus, in the corporate setting, a quality control engineer has the primary obligation of promoting and fostering the quality of the company's product.

What we receive from classical moral theories are principles for evaluating the relative worthiness of competing ends or goals. They help us to make moral decisions as persons or moral agents. But they cannot be applied directly to contexts where a particular end or goal has been granted *a priori* pre-eminence. Most ethical dilemmas of corporate managers occur within such a context. This is because each occupies a role within the corporate hierarchy, and such roles mandate the pre-eminence of particular ends or goals. Corporate role morality takes as given precisely what classical moral theory wishes to evaluate, the worthiness of the duties assigned by one's role.

There exists, then, a conceptual gap between classical moral theories and corporate role morality. Within the context of role morality, an individual is not asked to calculate the greatest good for the greatest number, as is required by utilitarian theory.<sup>9</sup> Nor need there be a consideration of whether one's maxim may be willed as universal law, as Kant proposed. Rather, a person's duty is conceived of in terms of fulfilling his or her role. What is deserving of our attention is how to mediate between the more abstract moral principles of utilitarianism and deontological thought and the concrete business decisions of corporate life.

What I am proposing is that organizational choice provides a useful form of mediation. Its usefulness arises because of the connection between individual ethical obligations and the corporate decision-making structure.

The most immediate ethical obligations of corporate managers arise from the duties assigned them by their roles in the corporate hierarchy. But the character and scope of these roles are themselves dependent on the nature of the corporate decision-making structure. These connections among ethical obligations, occupied roles, and organizational structure have been the subject of comment. "The ethically right thing to do as a member of the

organization is what is required by one's role; and one's role will be more or less fully determined by the organization's goals, its structure, and the prevailing circumstances."<sup>10</sup>

What needs to be added is that the corporate decision-making structure is itself to a significant degree the function of organizational choice. Within the parameters of laws, corporations make choices regarding their development and future form. For example, a corporation which has suffered severe financial losses because of environment lawsuits might alter the corporate hierarchy in such a way as to better monitor its activities which have an environmental impact. This may include adding a high-level position, such as Vice-President for Environmental Affairs, or grafting new reporting duties on to the positions of low-level workers. In either case, these changes alter the decision-making structure of the company. And this alteration consists of adding roles or altering roles which individuals occupy.<sup>11</sup> Such adding or altering of roles changes the prevailing role morality within the corporation and thus the ethical obligations of individual corporate managers.

By using classical moral theory to evaluate such corporate or collective actions from an ethical perspective, clarity is gained regarding the moral status of the ends which inform specific corporate roles. This in turn can illuminate the moral aspects of decisions made in the context of a prevailing role morality.

### **Organizational choices and decision-making structure as the product of corporate law**

What has been proposed is that focusing on the corporate organization is a helpful way of mediating between classical moral theory and the ethical dilemmas of individual corporate managers. This emphasis on the corporate organization brings to the fore the importance of corporate choices and underlying decision-making structures. By focusing on such choices and structures, a fundamental connection between corporate law and the ethical dilemmas of corporate executives becomes apparent. This connection exists because the corporate choices and structures are themselves to a significant degree legal products, the result of corporate law principles and

doctrines. Thus, as the law changes, so do the roles in the corporate hierarchy and in turn the ethical dilemmas of individual managers.

A good illustration of the direct interaction of corporate law and the dilemmas of business ethics may be found by looking at how the roles of corporate directors and officers were transformed by the law's transition from the *ultra vires* doctrine to the business judgment rule.<sup>12</sup> Under the *ultra vires* doctrine, the actions of corporate officials were strictly circumscribed by specific rules put forth in the charter of incorporation.<sup>13</sup> The charter might, for instance, restrict the corporation to a particular line of business. In such a case, managers were legally obligated to take only those actions consistent with this requirement. But with the advent and wide adoption of the business judgment rule, such specific rules were replaced by a more flexible legal stance toward corporate management. Managers were given greater discretion by the law bound instead by the generalized duties of loyalty, good faith, and due care.<sup>14</sup> Altering the managerial role in this way necessarily changed the character of the ethical choices faced by corporate managers. Ethical decisions no longer revolved around the interpretation of specific prescriptions but rather focused on defining the contours of an appropriate general comportment toward the corporation and its shareholders. The difficulties of this latter task were manifest during the takeover mania of the 1980s. And now the nature of this general comportment is itself being further transformed by recent state statutes allowing management to take account of the interests of corporate constituencies other than shareholders.<sup>15</sup> Certainly, taking account of the interests of other groups such as employees, consumers, and local community members in decision-making will complicate the nature of managerial choice, bringing new ethical issues to the fore.

Even legal changes which do not directly alter the internal decision-making process of the corporation have an impact on the scope and character of corporate roles. By altering the external environment in which corporate decisions occur, they indirectly encourage changes in the corporate hierarchy. The 1960s and 1970s brought a new influx of social regulation for business. In areas such as environmental protection, employment discrimination, and worker health and safety, the law changed the

context in which corporate choices were made. This new social legislation in turn fostered changes in the corporate role structure, adding new positions and altering old ones. It is unlikely, for instance, that positions involved with monitoring and promoting equal employment opportunities would have existed within corporations absent of such social legislation.

Beyond recognizing the interaction of corporate law developments with the nature of ethical choices encountered by individuals in the corporate hierarchy, it is important to emphasize another aspect of corporate legal scholarship. In evaluating particular legal doctrines, corporate law scholars frequently become involved with broader questions or corporate policy. They find it necessary to address issues regarding the proper character and function of these large organizations within society.

Now if, as we have seen, the decisions of corporate managers are intertwined with organizational structure and goals, policy debates regarding the proper character and function of such large organizations must subtly, yet significantly, affect the nature of individual decision-making within the corporation. In this way, the exchange in legal scholarship regarding such larger questions of corporate policy has an impact upon the particular choices confronted by individual corporate managers.

This impact may be analyzed in the following way. The roles we assign to corporate managers imply certain conceptions of the corporation. Such conceptions in turn raise questions of public policy, issues which we as a community must resolve. How we resolve or accommodate competing conceptions of the corporation within our society influences the kinds of roles and thus the nature of choices we impose on corporate managers.

Consider, for instance, the reoccurring debate within corporate law scholarship regarding corporate social responsibility.<sup>16</sup> This debate is rooted in competing conceptions of the corporation. Is the corporation a social and economic institution which should serve the public good? Or is the corporation primarily a vehicle for increasing the wealth of its shareholders? These latter policy questions are an integral part of corporate legal scholarship. The outcome of the debate over these issues will ultimately influence the roles and obligations seen as appropriate for corporate managers. Such roles and

obligations become central features in the daily ethical dilemmas individual managers face.

## Conclusion

What is important to recognize is the particular manner in which the corporate organization mediates between individual decision-makers and their ethical responsibilities. Many of the difficult ethical choices of corporate managers stem from conflicts regarding particular role obligations. But the character and scope of the very roles which underlie such conflicts are dependent on corporate choices and decision-making structure. Because corporate law impacts both directly and indirectly upon the development of corporate choices and the nature of underlying decision-making structures, its doctrines and principles play an integral part in the formation of the ethical choices faced by corporate managers. Recognizing and exploring this connection can enrich significantly corporate legal scholarship.

## Notes

<sup>1</sup> See, for example, Bowie, N.: 1985, 'Are Business Ethics and Engineering Ethics Members of the Same Family', *Journal of Business Ethics* 4, pp. 46–47.

<sup>2</sup> For a classic statement of utilitarian theory, see Mill, J. S.: 1987, *Utilitarianism* (Macmillan, New York).

<sup>3</sup> For an exposition of this approach, see Kant, I.: 1975, *Foundations of the Metaphysics of Morals*, trans. Lewis White Beck (Macmillan, New York).

<sup>4</sup> *Ibid.*, p. 18.

<sup>5</sup> See Bowie, *loc. cit.*, pp. 44–45.

<sup>6</sup> "The idea behind role morality," writes Norman Bowie, "was captured by the phrase, 'my station and its duties.'" *Ibid.*, p. 44.

<sup>7</sup> I initially expressed these ideas in Nesteruk, 'Legal Persons and Moral Worlds: Ethical Choices Within the Corporate Environment', 29 *American Business Law Journal* (in press). For an examination of the role obligations of corporate managers, see Rodewald: 1987, 'The Corporate Social Responsibility Debate: Unanswered Questions About the Consequences of Moral Reform', 25 *American Business Law Journal*, p. 443.

<sup>8</sup> For my first use of this model of moral agency, see Nesteruk: 1988, 'Bellotti and the Question of Corporate Moral Agency', *Columbia Business Law Review*, pp. 683, 690–91.

<sup>9</sup> John Stuart Mill puts the principle in the following way. "The creed which accepts as the foundation of morals 'utility' or the 'greatest happiness principle' holds that actions are right in proportion as they tend to promote happiness; wrong as they tend to produce the reverse of happiness." *Op. cit.*, p. 10.

<sup>10</sup> Benjamin, M. and Bronstein, D.: 1987, 'Moral and Criminal Responsibility and Corporate Persons', in W. Samuels and A. Miller, eds., *Corporations and Society: Power and Responsibility* (Greenwood Press, Westport, CT), p. 278.

<sup>11</sup> Christopher Stone has proposed that the law might require such a restructuring of corporate roles under certain circumstances. He feels this restructuring could be warranted when specific companies repeatedly break the law and when a particular industry involves areas of major public concern. See Stone, C.: 1985, 'Corporate Regulation: The Place of Social Responsibility', in B. Fisse and P. French, eds., *Corrigible Corporations & Unruly Law* (Trinity University Press, San Antonio, TX), pp. 19–22.

<sup>12</sup> For a short description of the shift from the *ultra vires* doctrine to the business judgment rule, see Friedman, L.: 1973, *History of American Law* (Simon & Shuster, New York), pp. 453–454.

<sup>13</sup> For a summary of the *ultra vires* doctrine, noting how the doctrine has diminished in importance, see Henn, H. and Alexander, J.: 1983, *Laws of Corporations and Other Business Enterprises* (West Publishing, St. Paul, MN), pp. 477–488.

<sup>14</sup> For a summary of the business judgment rule, see *ibid.*, pp. 661–663.

<sup>15</sup> For example, see 15 PA. CONS. STAT. ANN. § 1721(c) (Purdon Pamphlet 1989). For a case which raises the issue of corporate constituencies other than shareholders, see *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

<sup>16</sup> The notion of corporate social responsibility is widely discussed within the legal literature. See Eisenberg: 1983, 'Corporate Legitimacy, Conduct, and Governance – Two Models of the Corporation', 17 *Creighton Law Review*, p. 1; Engel: 1979, 'An Approach to Corporate Social Responsibility', 32 *Stanford Law Review*, p. 1; Epstein: 1979, 'Societal, Managerial, and Legal Perspectives on Corporate Social Responsibility – Product and Process', 30 *Hastings Law Journal*, p. 1287; Hetherington: 1969, 'Fact and Legal Theory: Shareholders, Managers, and Corporate Social Responsibility', 21 *Stanford Law Review*, p. 248; Mangrum: 1983, 'In Search of a Paradigm of Corporate Social Responsibility', 17 *Creighton Law Review*, p. 21; Mashaw: 1984, 'Corporate Social Responsibility: Comments on the Legal and Economic Context of a Continuing Debate', 3 *Yale Law and Policy Review*, p. 114; Solomon and Collins: 1987, 'Humanistic Economics: A New Model for the Corporate Social Responsibility Debate', 12 *Journal of Corporate Law*, p. 331.

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