2018

Corporate Ethics: Approaches and Implications to Expanding the Corporate Mindset of Profitability, 49 Loy. U. Chi. L.J. 637 (2018)

Arthur Acevedo
John Marshall Law School, 7acevedo@jmls.edu

Corporate Ethics: Approaches and Implications to Expanding the Corporate Mindset of Profitability

*Arthur Acevedo**

> *"The highest use of capital is not to make more money, but to make money do more for the betterment of life."*[1] *– Henry Ford*

This Article discusses the convergence of law and ethics in the context of corporations. It begins by detailing past attempts at and limitations on regulating corporate conduct. It then explores the business judgment rule in the context of ethical conduct. Finally, it considers the growing influence of millennials and social investing on corporate conduct, and concludes by cautioning corporate directors to adopt ethical practices in order to remain relevant in the marketplace.

INTRODUCTION 638
I. ATTEMPTS AND LIMITATIONS IN REGULATING CORPORATE CONDUCT 640
  A. Laissez-Faire Prevails 641
  B. On a Collision Course 642
  C. BMW of North America, Inc. v. Gore 643
  D. State Farm Mut. Auto. Ins. Co. v. Campbell 644
  E. Philip Morris USA v. Williams 645
  F. Legal Action but Unethical Conduct 646
    1. Efficient Breach and Ethics 646
    2. Non-Disclosure and Ethics 647
    3. Misleading Statements, Materiality, and Ethics 648
II. THE BUSINESS JUDGMENT RULE AND ETHICAL CONDUCT 649
  A. Protecting Board Considerations of Non-Equity Constituents 649

---

* Arthur Acevedo is a Professor of Law at The John Marshall Law School in Chicago, Illinois. He earned his Juris Doctor, Master of Science in Taxation, and Baccalaureate Science in Commerce from DePaul University. He also received his certificate as a Certified Public Accountant (Illinois). I wish to express my gratitude to Victor Salas, Reference Librarian, The John Marshall Law School, for his research assistance.

1. HENRY FORD, MY LIFE AND WORK 194 (Samuel Crowther ed., 1923).

B. Protecting a Board's Loss-Making Decision 650
C. Protecting "Stupid," "Egregious," or "Irrational" Board Decisions 651
III. THE GROWING INFLUENCE OF MILLENNIALS AND OF SOCIAL INVESTING 652
CONCLUSION 653

INTRODUCTION

Consider the following scenarios and decide whether the corporate actions[2] can be described as ethical: (i) to avoid ordering a product recall, a board of directors chooses instead to pursue a litigation and settlement strategy; (ii) to circumvent a mandatory 10 percent employee profit-sharing requirement, a board creates two companies with the first one capturing 99 percent of the profits from sales and marketing activities, and the second one providing the needed labor force on a cost basis plus 1 percent of the first company's profits; (iii) a board chooses to ignore repeated calls for increased racial and gender diversity within its management ranks while simultaneously actively selling products and services to members of minority communities. Though ethically questionable because of the negative distributive effects on society, there is nothing inherently illegal about the decisions taken by the board of directors in these illustrations. In fact, almost all directors will defend their actions by stating it is their sole duty to increase corporate wealth and shareholder value.

In light of these scenarios, the question to consider is, *are ethics and corporate profitability mutually exclusive?* Specifically, does the corporate decisionmaking process allow for inclusion of ethical factors? If so, what framework of analysis should corporate management use when weighing its choices and actions?[3] For example, is a "consequentialist model" that focuses on the ultimate outcome preferable? Is a "utilitarian model" that focuses on the greatest good provided to the greatest number of individuals superior? Or is the emerging "applied ethics model" that creates and applies a set of specific norms within a distinct environment the soundest approach?[4]

2. The scope of this Article is limited to for-profit entities such as corporations, LLPs, and LLCs. Throughout this Article I chose the corporation and its governance structure as my means of analysis, although the same decision process for ethical considerations applies with equal force to LLCs and LLPs.

3. An analysis of the various schools of thought are beyond the scope of this Article.

4. For example, professions (e.g., legal, medical) and industries (e.g., construction) may adopt their own set of ethical rules. The following statement illustrates the moral hazard in applied ethics:

Nearly a century ago, the Supreme Court of Michigan in the case of *Dodge v. Ford Motor Co.*[5] gave voice to what has become an inviolable principle in corporate law:

> 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 non-distribution of profits among stockholders in order to devote them to other purposes.[6]

Corporate decisions—such as a strategic alliance, a capital investment, or the hiring of a key employee[7]—have remained true to the singular objective of maximizing corporate wealth and increasing shareholder value. But the question remains: is a singular profit-oriented focus warranted, or is a broader approach that includes ethical outcomes desirable?

Globalization, privatization, and industry consolidation all fueled an upward trajectory for the major post-World War II economies.[8] Emerging markets, developing industries, and ground-breaking technologies all contributed immensely to the economic growth. The profit maximization principle articulated in *Dodge v. Ford Motor Co.* is now firmly ensconced throughout many of the world's economies. However, the economic growth and its accompanying opportunities have not been without controversy. For instance, a glance of recent headlines reveals questionable corporate conduct: Mylan's EpiPen price gouging scandal;[9] Wells Fargo's fake accounts scandal;[10] Volkswagen's emissions

---

"A former head of the N.H.T.S.A. testified on Ford's behalf, stating that in his opinion the Pinto's design was no more or less safe than that of any other car in its class, like the Chevrolet Vega or the A.M.C. Gremlin." *See* Malcolm Gladwell, *The Engineer's Lament*, THE NEW YORKER (May 4, 2015), https://www.newyorker.com/magazine/2015/05/04/the-engineers-lament (examining different schools of thought regarding automotive safety).

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

6. *Id.*

7. Disney hired Michael Ovitz with the expectation that he would remedy Disney's then-current weaknesses including "poor talent relationships and stagnant foreign growth." *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 37 (Del. 2006).

8. For an excellent discussion on the effects of globalization see STEVEN A. RAMIREZ, LAWLESS CAPITALISM: THE SUBPRIME CRISIS AND THE CASE FOR AN ECONOMIC RULE OF LAW, 105–30 (N.Y. Univ. Press 2013).

9. Katie Thomas, *Mylan's Chief Is Chastised by Lawmakers Questioning EpiPen Pricing*, N.Y. TIMES (Sept. 21, 2016), https://www.nytimes.com/2016/09/22/business/mylan-chief-to-insist-epipen-is-priced-fairly-at-house-hearing.html.

10. Michael Corkery, *Wells Fargo Fined $185 Million for Fraudulently Opening Accounts*, N.Y. TIMES (Sept. 8, 2016), https://www.nytimes.com/2016/09/09/business/dealbook/wells-fargo-fined-for-years-of-harm-to-customers.html.

scandal;[11] and Arthur Andersen's accounting scandal.[12] These are but a few of the numerous examples illustrating the hazards of unrestrained capitalism. Although varied across industry sectors, these scandals all share a common theme—the pursuit of profit through some form of corporate misdeed.

Corporations are created for the sole purpose of organizing a collective activity and pursuing a profitable venture. Unlike individuals who possess cognitive abilities, self-rule, and choice of action, corporations are juridical entities acting through a board of directors. A corporation establishes its social and commercial identity through the decisions of its board of directors. Therefore, while corporations are creatures of the law, enjoy the protections of the law, and are subject to the law, they obviously lack the inherent values that make one human. They lack the objects of will, choice, and cognition. Corporate directors must supply the values when making corporate decisions. We have reached the point in history where corporate decisions can no longer ignore the broader social and ecological implications of corporate action while pursuing profitability. A path to responsible profitability must be found.

Law and ethics run on parallel paths. They converge because both involve value judgments about choices and actions. They converge because both require judgments and rationalizations in the decisionmaking process. And, they converge because both contain norms for expected behaviors. However, they diverge in a significant and substantive effect: the law creates enforceable rights and legal consequences, whereas ethics does not.

I. Attempts and Limitations in Regulating Corporate Conduct

Legislating business conduct becomes necessary when market forces fail to address a situation when employees or consumers demand reform or when legislators perceive a need for regulation. However, legislating and regulating business conduct presents its own sets of challenges. Two monumental events during the twentieth century illustrate the challenges and limitations encountered in undertaking such effort.

11. Jack Ewing, *Engineering a Deception: What Led to Volkswagen's Diesel Scandal?*, N.Y. TIMES (Mar. 16, 2017), https://www.nytimes.com/interactive/2017/business/volkswagen-diesel-emissions-timeline.html.

12. Richard A. Oppel Jr. & Kurt Eichenwald, *Enron's Collapse: The Overview; Arthur Andersen Fires an Executive for Enron Orders*, N.Y. TIMES (Jan. 16, 2002), http://www.nytimes.com/2002/01/16/business/enron-s-collapse-overview-arthur-andersen-fires-executive-for-enron-orders.html.

A. Laissez-Faire Prevails

The first of these events was the rise of the *Lochner* Era, so named by economic historians and legal academics after the case of *Lochner v. New York.*[13] This was a period of time that spanned the years from 1905 to 1937. This was also a period of time when federal and state governments enacted protectionist legislation in an attempt to regulate working hours, working conditions, and minimum pay for the American worker. However, the Supreme Court declared many federal and state statutes unconstitutional on the basis that such statutes exceeded Congress' commerce power,[14] or such statutes interfered with an individual's "liberty" interest contained in the Fourteenth Amendment.

In *Lochner v. New York*,[15] the state of New York enacted a statute that regulated the maximum hours an employee can work. The objective of the law was deemed "to be necessary or appropriate as a health law to safeguard the public health, or the health of the individuals who are following the trade of a baker."[16] The United States Supreme Court declared the state statute unconstitutional. The Supreme Court reasoned:

> The statute necessarily interferes with the right of contract . . . concerning the number of hours [an employee] may labor in the bakery of the employer. The general right to make a contract . . . is part of the liberty of the individual protected by the 14th Amendment of the Federal Constitution.[17]

The *Lochner* decision set in motion a judicial philosophy that economic legislation was to be subject to rigorous judicial scrutiny despite legislative attempts at regulation. This approach shaped American law for the next three decades[18] and influenced attitudes about exploitation and profitability.

The case of *Adkins v. Children's Hospital of the District of Columbia* is another example of protectionist legislation that failed to achieve its purpose. Here, the District of Columbia enacted legislation establishing a minimum wage with the objective of "supply[ing women workers] with the necessary cost of living, [in order to] maintain them in health and protect their morals. . . ."[19] The Supreme Court held that a statute which

13. Lochner v. New York, 198 U.S. 45, 53 (1905), *abrogated by* W. Coast Hotel Co. v. Parrish, 300 U.S. 379 (1937).
14. U.S. CONST. art. I, § 8, cl. 3.
15. *Lochner*, 198 U.S. at 53.
16. *Id.* at 58.
17. *Id.* at 53.
18. In *West Coast Hotel Co. v. Parrish,* the Supreme Court shifted its philosophy from subjecting economic legislation to increased judicial scrutiny to a lesser form of judicial scrutiny. 300 U.S. 379 (1937).
19. Adkins v. Children's Hosp. of Dist. of Columbia, 261 U.S. 525, 540 (1923).

"provid[ed] for the fixing of minimum wages for women and children in the District of Columbia"[20] was unconstitutional. In particular, the Court reasoned:

> Included in the right of personal liberty and the right of private property . . . is the right to make contracts for the acquisition of property. Chief among such contracts is that of personal employment, by which labor and other services are exchanged for money or other forms of property.[21]

Federal and state legislators perceived a need to enact legislation during the *Lochner* Era as a protective response to the overreaching and exploitive employers. These protections—be they hours,[22] wages,[23] working conditions,[24] or consumer protection[25]—were deemed necessary by legislatures during a period of time that saw American economic activity transform from a local activity, to a regional activity, and finally into a national activity.

B. On a Collision Course

The second monumental event occurred near the end of the twentieth century when a series of Supreme Court cases set the doctrines of punitive damages and due process on a collision course. The precedents set by *BMW of North America, Inc. v. Gore*,[26] *State Farm Mutual Automobile Insurance Co. v. Campbell*,[27] *and Philip Morris USA v. Williams*[28] redound to the benefit of corporations because of their limiting effect on punitive damages. Corporations abhor uncertainty because of its imprecise effects on economic modeling. These cases firmly establish the proposition that excessive punitive damages are a violation of the Due Process Clause of the Fourteenth Amendment to the United States Constitution.[29] The twin effect of these cases is that they substantially weaken the law of punitive damages and provide corporate planners with a measure of certainty in the form of a de facto cap on damages.

At issue in these cases is a conflict of values between two legal doctrines—punitive damages and the Due Process Clause. The theory of

---

20. *Id. at* 539.
21. *Id.* at 545, *overruled by* W. Coast Hotel Co. v. Parrish, 300 U.S. 379 (1937).
22. *Lochner*, 198 U.S. at 47.
23. *Adkins*, 261 U.S. at 539.
24. Muller v. Oregon, 208 U.S. 412 (1908).
25. Weaver v. Palmer Bros. Co., 270 U.S. 402 (1926).
26. *See* BMW of North America, Inc. v. Gore, 517 U.S. 559, 563–64 (1996) (creating a three-prong test to be used when assessing the constitutionality of punitive damages).
27. State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 412–14 (2003).
28. Philip Morris USA v. Williams, 549 U.S. 346, 349 (2007).
29. U.S. CONST. amend. XIV, § 1.

punitive damages holds that punitive damages may be awarded to punish and deter wrongful activity by the defendant.[30] The theory of the Due Process Clause ensures that a person's right to life, liberty, and property is not impaired by government action unless and until applicable due process considerations have been satisfied.[31]

C. BMW of North America, Inc. v. Gore

In *BMW of North America, Inc. v. Gore,*[32] the plaintiff, Dr. Ira Gore, purchased a new BMW automobile for $40,750.88 from an authorized dealership in Birmingham, Alabama. Nine months later, "Dr. Gore took the car to 'Slick Finish,' an independent detailer, to make it look 'snazzier than it normally would appear.'"[33] The painter informed Dr. Gore that his car had previously sustained damage and that it was repainted. Dr. Gore filed a lawsuit against BMW and the authorized dealer alleging "that the failure to disclose that the car had been repainted constituted suppression of a material fact."[34] BMW defended the practice by arguing that cars that sustained less than 3 percent property damage were repainted and sold as new in accordance with its company policy. BMW maintained "that it was under no obligation to disclose repairs of minor damage to new cars and that Dr. Gore's car was as good as a car with the original factory finish."[35]

The jury found BMW liable and awarded $4,000 in compensatory damages and $4 million in punitive damages. On appeal, the Alabama Supreme Court reduced the punitive damages from $4 million to $2 million. BMW challenged the damages and appealed the case to the United States Supreme Court.

The issue before the Supreme Court was whether "[t]he Due Process Clause of the Fourteenth Amendment prohibits a State from imposing a

---

30. *See* RESTATEMENT (SECOND) OF TORTS § 908 (AM. LAW INST. 1979):

> (1) Punitive damages are damages, other than compensatory or nominal damages, awarded against a person to punish him for his outrageous conduct and to deter him and others like him from similar conduct in the future.
>
> (2) Punitive damages may be awarded for conduct that is outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others. In assessing punitive damages, the trier of fact can properly consider the character of the defendant's act, the nature and extent of the harm to the plaintiff that the defendant caused or intended to cause and the wealth of the defendant.

31. *See* Mathews v. Eldridge, 424 U.S. 319, 323 (1976) (establishing the standard for determining what procedures are required in a given case).

32. *See* BMW of North America, Inc. v. Gore, 517 U.S. 559, 563–64 (1996) (creating a three-prong test to be used when assessing the constitutionality of punitive damages).

33. *Id.* at 563.

34. *Id.*

35. *Id.* at 564.

'grossly excessive' punishment on a tortfeasor."[36] The Supreme Court ruled the damages unconstitutional. It reasoned that "[e]lementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose."[37] The Supreme Court's decision relegated the doctrine of punitive damages to a subordinate role when a conflict arises with the Due Process Clause.

D. State Farm Mut. Auto. Ins. Co. v. Campbell

In *State Farm Mut. Auto. Ins. Co. v. Campbell,*[38] Curtis Campbell, insured by State Farm, attempted to pass six cars on a two-lane highway in Utah. An oncoming car, driven by Todd Ospital, swerved onto the shoulder to avoid a head-on collision with Curtis Campbell. However, Todd Ospital lost control of his car and "collided with [another] vehicle driven by Robert G. Slusher."[39] Robert Slusher was rendered "permanently disabled."[40] Todd Ospital lost his own life in the accident.

State Farm "decided to contest liability and declined offers by Slusher and Ospital's estate," choosing instead to defend against a tort action and a wrongful death action.[41] At trial, "a jury determined that Campbell was 100 percent at fault, and a judgment was returned for $185,849, far more than the [$50,000] amount offered in settlement."[42] State Farm refused to cover the $135,849 in excess liability.[43] The record indicates that State Farm's counsel told the Campbells, "'[y]ou may want to put for sale signs on your property to get things moving.'"[44] The record also indicates:

> State Farm ignored the advice of one of its own investigators and took the case to trial, assuring the Campbells that "their assets were safe, that they had no liability for the accident, that [State Farm] would represent their interests, and that they did not need to procure separate counsel."[45]

State Farm's actions in this case seem to belie its "well-understood and well-publicized policy of holding itself out as a 'good neighbor,' offering insurance products premised upon assuring consumers 'peace of

36. *Id*. at 562.
37. *Id*. at 574.
38. State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 412–14 (2003).
39. *Id*. at 412–13.
40. *Id*. at 413.
41. *Id*.
42. *Id*.
43. *Id*.
44. *Id*. (internal quotations omitted).
45. *Id*. (alterations in original).

mind.'"[46]

Dismayed and distraught by the turn of events and fearing financial ruin, "[t]he Campbells . . . filed a complaint against State Farm [in state court] alleging bad faith, fraud, and intentional infliction of emotional distress."[47] Following a complicated appeals process, the Utah Supreme Court "reinstated the $145 million punitive damages award"[48] against State Farm.

The next appeal was to the United States Supreme Court, where the Supreme Court rejected the imposition of the $145 million punitive damage award. Citing the evolving punitive damage precedents,[49] the Supreme Court reasoned that "[t]he Due Process Clause of the Fourteenth Amendment prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor."[50]

E. Philip Morris USA v. Williams

In *Philip Morris USA v. Williams*,[51] the widow of the decedent, Jesse Williams, filed a lawsuit against the Phillip Morris company "for negligence and deceit."[52] The widow claimed that the business practices of the Philip Morris company caused the death of her husband. "A jury found that Williams' death was caused by smoking; that Williams smoked in significant part because he thought it was safe to do so; and that Philip Morris knowingly and falsely led him to believe that this was so."[53] The jury also determined that Philip Morris engaged in deceit and negligence. It "awarded compensatory damages of about $821,000 . . . along with $79.5 million in punitive damages."[54]

On appeal, the Supreme Court declared the punitive damage award unconstitutional and reasoned that "the Constitution's Due Process Clause forbids a State to use a punitive damages award to punish a defendant for injury that it inflicts upon nonparties or those whom they directly represent, [meaning], injury that it inflicts upon those who are, essentially, strangers to the litigation."[55]

46. Campbell v. State Farm Mut. Auto Ins. Co., Case No. 890905231, 1998 WL 35159343, at *2j (D. Utah Aug. 3, 1998), *aff'd in part, rev'd in part* 65 P.3d 1134 (Utah 2001).

47. *State Farm Mut. Auto. Ins. Co*., 538 U.S. at 414.

48. *Id*. at 415.

49. Cooper Indus. Inc. v. Leatherman Tool Grp., 532 U.S. 424, 433 (2001); BMW of North America, Inc. v. Gore, 517 U.S. 559, 562 (1996).

50. *State Farm Mut. Auto. Ins. Co.,* 538 U.S. at 416.

51. Philip Morris USA v. Williams, 549 U.S. 346, 349 (2007).

52. *Id*.

53. *Id.* at 349–50.

54. *Id.* at 350.

55. *Id*. at 353.

These three cases present complex questions of individual autonomy, corporate responsibility, and ethical considerations. These cases also illustrate the powerful and wide-ranging limits the U.S. Constitution places on efforts to deter and redress behavior through punitive damage awards. *BMW v. Gore* places substantive procedural limits on punitive damages, *State Farm v. Campbell* creates the presumption that double-digit damages awards are unconstitutional, and *Phillip Morris v. Williams* excludes from consideration the effect on third parties by the tortfeasor. The cumulative effect of these cases is not only to displace state regulatory schemes, but also to elevate "'fairness' in punishment"[56] to a more exacting judicial scrutiny. Viewed objectively, these cases tip the scale against ethical considerations by corporate defendants because plaintiffs must now not only plead and prove punitive damages, but also determine whether the punitive damages sought are themselves unconstitutional.

F. Legal Action but Unethical Conduct

Consider the following cases as studies in ethical conduct. When so viewed, they highlight another aspect of the tension between ethical conduct and permitted legal action. While the underlying acts are not illegal, the consequences of the actions taken leave an undesirable ethical outcome.

1. Efficient Breach and Ethics

At times the law allows individuals to invoke a legal defense and disregard their contractual performance obligations. Such is the case when performance under a contract is excused in cases of impossibility, impracticability,[57] or frustration of purpose.[58]

The doctrine of efficient breach[59] functions in effect as an excuse of performance because one party fails to perform. Technically, however, it is not an excuse. Instead, it operates as a unilateral substitution of one party's expectation interest by awarding damages for the non-performance of the counter-party. The doctrine of efficient breach "supports a rule that allows one party to a contract to breach and pay damages rather than perform, at least where it is worth more [to the

56. BMW of North America, Inc. v. Gore, 517 U.S. 559, 598 (1996) (Scalia, J., dissenting).
57. RESTATEMENT (SECOND) OF CONTRACTS § 261 (AM. LAW INST. 1981).
58. *Id.* at § 265 (AM. LAW INST. 1981).
59. For an excellent discussion on efficient breach, see Avery Katz, *Virtue Ethics and Efficient Breach*, 45 SUFFOLK U. L. REV. 777, 785–86 (2012). The writer "identified a number of straightforward and well-known objections to the argument laid out in the previous section." *Id.* at 785.

breaching party] to breach rather than to perform."[60] Rather than complete a performance obligation, the breaching party opts to trigger expectation damages as the substitute for the performance.

> Essentially, where it is worth more to the promisor to breach rather than . . . perform a contract, it is more efficient for the law to allow the promisor to breach the contract and . . . pay the promisee damages based on the benefit the promisee expected to gain by the completed contract.[61]

The efficient breach doctrine is a particularly sinister form of contract jurisprudence because it denies the contracting party the benefit of his bargain by substituting expectation damages for completed performance. There is nothing legally impermissible with this approach. It is what the law prescribes. There is, however, something ethically questionable with unilaterally altering the expectation interest of the counter-party without his or her consent.

2. Non-Disclosure and Ethics

Absent a statutory or fiduciary duty to disclose, the common law in some states does not impose upon sellers of personal property a general duty of disclosure.[62] As a consequence, unsuspecting purchasers may unwittingly pay more than fair market value for a good or a service.[63] This was the case in *Levine v. Blue Shield of California*.[64] In November 2004, Michael Levine purchased insurance coverage for himself and his two minor dependents. In October 2007, he married his wife, Victoria, and sought to add her to the policy. In August 2009, Blue Cross raised their premiums by 30 percent.[65]

> Michael learned that the monthly premiums that he had been paying since adding Victoria to his plan would have been substantially lower

60. Mission Beverage Co. v. Pabst Brewing Co., LLC, 223 Cal. Rptr. 3d 547, 562 (Cal. Ct. App. 2017) (internal quotations omitted).

61. Huynh v. Vu, 4 Cal. Rptr. 3d 595, 608 (Cal. Ct. App. 2003) (citing Fred S. McChesney, *Tortious Interference with Contract Versus "Efficient" Breach: Theory and Empirical Evidence*, 28 J. LEGAL STUD. 131, 132 (1999)).

62. *See* RESTATEMENT (SECOND) OF TORTS § 551 (AM. LAW INST. 2017) (emphasis added):

> One who fails to disclose to another a fact that he knows may justifiably induce the other to act or refrain from acting in a business transaction is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, *if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question*.

63. The IRS defines fair market value "as the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." Rev. Rul. 59-60, 1959-1 C.B. 237 (1959).

64. Levine v. Blue Shield of Cal., 117 Cal. Rptr. 3d 262, 266–67 (Cal. Ct. App. 2010).

65. *Id.*

> if Victoria, rather than Michael, had been named as the primary insured, and if Michael had added his dependents to a single health plan rather than maintaining a separate health plan for one and a separate insurance policy for the other.[66]

Michael immediately changed his insurance elections to adjust the cost of his insurance premiums and modify his insurance coverage. "Michael also requested a refund of all 'overpayments of premiums.' Blue Shield refused to provide a refund."[67] The court determined that Blue Shield was not under an obligation to disclose the lower monthly premium nor issue a refund.[68] *Levine* unfortunately illustrates that the doctrine of *caveat emptor* is still a viable doctrine.

3. Misleading Statements, Materiality, and Ethics

Basic v. Levinson is generally associated with the fraud-on-the-market theory[69] and the definition of materiality.[70] When viewed from an ethical perspective, however, *Basic* raises serious questions of corporate integrity and unethical conduct by the board of directors.

The shareholder-litigants were "former Basic shareholders who sold their stock between Basic's first public denial of merger activity and the suspension of trading in Basic stock just prior to the merger announcement. . . ."[71] The shareholder-litigants claimed they "were injured by selling their shares at prices artificially depressed by those statements."[72]

Corporate management denied on three separate occasions that the company was not aware of the reasons for the increased activity in the company's stock. The first denial "appeared in the Cleveland Plain Dealer," a major newspaper, when "'[Basic] President Max Muller said the company knew no reason for the stock's activity and that no negotiations were under way with any company for a merger.'"[73] The second denial occurred when "reply[ing] to an inquiry from the New

66. *Id.* at 267.

67. *Id.*

68. *Id.* at 274.

69. *See* Basic Inc. v. Levinson, 485 U.S. 224, 241 (1988) ("The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business.") (quoting Peil v. Speiser, 806 F.2d 1154, 1160 (3d Cir. 1986)).

70. *See Basic*, 485 U.S. at 231–32 ("[T]o fulfill the materiality requirement there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.") (internal citations omitted).

71. *Id.* at 224.

72. *Id.*

73. *Id.* at 228 n.4.

York Stock Exchange, Basic issued a release . . . [stating] . . . 'management is unaware of any present or pending company development that would result in the abnormally heavy trading activity and price fluctuation in company shares. . . .'"[74] The third denial occurred when "Basic issued to its shareholders a 'Nine Months Report 1978[,]' [which stated:] 'With regard to the stock market activity in the Company's shares we remain unaware of any present or pending developments which would account for the high volume of trading and price fluctuations in recent months.'"[75]

Notwithstanding the legal ruling by the Supreme Court,[76] *Basic* mixes complex questions of disclosure and deception, and pushes the bounds of ethical conduct. The facts in *Basic* are further complicated by the dynamics of ever-changing market conditions. The pressures on corporate management during this event are unimaginable. In an environment of such turbulence and uncertainty, the best response from a legal and an ethical perspective is "no comment."

II. The Business Judgment Rule and Ethical conduct

Does the business judgment rule exclude consideration of ethics by a board member in the decisionmaking process? Simply stated, the answer is "no." As currently interpreted by the courts, the business judgment rule permits consideration of economic and noneconomic factors by a board of directors when weighing competing factors. The Delaware courts have indicated:

> The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors. The rule itself is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.[77]

The following cases illustrate the broad range of discretion directors enjoy when making corporate decisions.

A. Protecting Board Considerations of Non-Equity Constituents

In *Schlensky v. Wrigley,*[78] the plaintiff, a minority shareholder,

74. *Id.*
75. *Id.*
76. *See id.* at 238 ("[I]n order to prevail on a Rule 10b–5 claim, a plaintiff must show that the statements were misleading as to a material fact. It is not enough that a statement is false or incomplete, if the misrepresented fact is otherwise insignificant.").
77. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985), *overruled by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009) (citations and internal quotations omitted).
78. Shlensky v. Wrigley, 237 N.E.2d 776, 781 (Ill. App. Ct. 1968).

challenged the decision by the board of directors to refrain from installing lights in Wrigley Field, the home baseball field for the Chicago Cubs. Schlensky, the plaintiff, presented evidence that other baseball teams had installed lights in their fields, that night games produced more revenue for teams with lights, and that the majority shareholder and director, Philip K. Wrigley, expressed concerns that night baseball would be upsetting to the neighbors.[79]

The court rejected the plaintiff's contention. The court reasoned that "it cannot be said that directors, even those of corporations that are losing money, must follow the lead of the other corporations in their field. Directors are elected for their business capabilities and judgment and the courts cannot require them to forego their judgment. . . ."[80] The defendant prevailed on the strength of the business judgment rule. *Schlensky v. Wrigley*[81] can be read as supporting the proposition that directors may take into consideration economic and noneconomic factors when making corporate decisions.

B. Protecting a Board's Loss-Making Decision

In *Kamin v. American Express,* the court demonstrated a high degree of deference to the judgment of the board of directors. Two minority shareholders filed suit challenging a decision by the board of directors to issue a property dividend to the shareholders in lieu of claiming a tax deduction on the corporate tax return. Claiming the tax deduction would have saved the company approximately $8 million in federal income taxes.[82]

The court nonetheless rejected the plaintiffs' challenge and reasoned that "[i]t is not enough to allege, as plaintiffs do here, that the directors made an imprudent decision, which did not capitalize on the possibility of using a potential capital loss to offset capital gains. More than imprudence or mistaken judgment must be shown."[83] The court was unwilling to second guess the director's wisdom in choosing among competing alternatives. The court added:

> Questions of policy of management, expediency of contracts or action, adequacy of consideration, lawful appropriation of corporate funds to advance corporate interests, are left solely to their honest and unselfish decision, for their powers therein are without limitation and free from restraint, and the exercise of them for the common and general interests

79. *Id.*
80. *Id.*
81. *Id.*
82. Kamin v. American Express, 383 N.Y.S.2d 807, 809–10 (N.Y. Sup. Ct. 1976).
83. *Id.* at 813.

> of the corporation may not be questioned, although the results show that what they did was unwise or inexpedient.[84]

The court emphasized:

> [D]irectors are entitled to exercise their honest business judgment . . . and to act within their corporate powers. That they may be mistaken, that other courses of action might have differing consequences, or that their action might benefit some shareholders more than others present no basis for the superimposition of judicial judgment. . . ."[85]

Once again, the company directors prevailed by operation of the business judgment rule. *Kamin v. American Express* supports the proposition that directors, when faced with competing alternatives, may opt for a course of action that may have a negative economic effect on the company so long as they are acting in good faith.

C. Protecting "Stupid," "Egregious," or "Irrational" Board Decisions

In the case of *In re Caremark International Inc. Derivative Litigation*,[86] the Delaware Court went even further in describing the scope and the protections offered by the business judgment rule. In explaining the business judgment rule, the court stated:

> Whether a judge or jury considering the matter . . . believes a decision substantively wrong, or degrees of wrong extending through "stupid" to "egregious" or "irrational," provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in . . . good faith. . . .[87]

Caremark makes clear that a board of directors enjoys great latitude in choosing among competing reasons, including ethical reasons, even if such chosen factors are themselves suboptimal.

84. *Id.*
85. *Id.* at 815.
86. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).
87. *Id.* at 967.

III. THE GROWING INFLUENCE OF MILLENNIALS[88] AND OF SOCIAL INVESTING

The board of directors of a corporation is empowered by statute to act on behalf of the corporation.[89] Notwithstanding this broad grant of authority, history demonstrates that investors continually question decisions made by corporate management. For instance, during the Vietnam War, "[t]he Medical Committee for Human Rights . . . [requested to include] a proposal to amend Dow's Certificate of Incorporation to prohibit the sale of napalm unless the purchaser gives reasonable assurance that the napalm will not be used against human beings."[90]

Additional instances of shareholder activism include shareholders questioning management decisions regarding theme-park smoking policies,[91] sales of assault rifles,[92] and human rights violations and discrimination matters.[93]

Shareholders and corporate management alike are critically examining the ethics of corporate conduct. A study by PricewaterhouseCoopers reports that "dismissals for ethical lapses rose from 3.9 percent of all successions in 2007–11 to 5.3 percent in 2012–16, a 36 percent increase. The increase was more dramatic in North America and Western Europe."[94]

---

88. The names and age ranges for the various demographic groups are:

Gen Z, iGen, or Centennials: Born 1996 and later.

Millennials or Gen Y: Born 1977 to 1995.

Generation X: Born 1965 to 1976.

Baby Boomers: Born 1946 to 1964.

Traditionalists or Silent Generation: Born 1945 and before.

See American Generations Through the Years, CNN (May 5, 2011) http://www.cnn.com/interactive/2011/05/living/infographic.boomer/index.html (summarizing the definitions of generations).

89. *See* MODEL BUS. CORP. ACT § 8.01(b) (2016) ("[A]ll corporate powers shall be exercised by or under the authority of the board of directors, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of the board of directors.").

90. SEC v. Med. Comm. for Human Rights, 404 U.S. 403, 404 (1972). The proposal was ultimately voted upon and received "[l]ess than 3% of all voting shareholders support[.]" *Id*. at 406.

91. *See* Walt Disney Co., SEC No-Action Letter, 2010 WL 4312760, at *2 (Dec. 22, 2010) ("The Proposal requests that the Company's Board of Directors direct management to modify the Company's 'current smoking policy to not allow children within the designated smoking areas of its theme parks (children being defined as any person not qualified by age to legally purchase smoking materials).'").

92. *See* Trinity Wall St. v. Wal-Mart Stores, Inc., 792 F.3d 323, 328–29 (3d Cir. 2015) (challenging management's decision to sell "the Bushmaster AR-15" (a model of sporting rifle)).

93. *See* Apache Corp. v. New York City Emps.' Ret. Sys., 621 F. Supp. 2d 444, 452 (S.D. Tex. 2008) (seeking to "incorporate anti-discrimination directives based on sexual orientation and gender identity into such activities").

94. Per-Ola Karlsson, DeAnne Aguirre, & Kristin Rivera, *Are CEOs Less Ethical Than in the*

Additionally, millennial investors are flexing their economic muscle and believe they can reorder corporate priorities. This phenomenon has not gone unnoticed. "[T]he aggregated net worth of global millennials is predicted to more than double compared to 2015, with estimates ranging from US$19 to 24 trillion."[95] A 2017 survey of millennials conducted by Morgan Stanley reports that "75% say their investments can influence climate change [and] 84% say their investments can help lift people out of poverty."[96] A shift in investor attitudes is taking place as the traditionalist generation and the baby-boomer generation age out of the economy and society, and as millennials come of age. This shift in investor attitude will influence how corporate decisions will be made in the coming years.

CONCLUSION

Ethics is a mindset. Whether we speak of individual behavior or of organizational behavior such as a corporation, ethics is a mindset which implies the existence of an expected pattern of behavior by the actor. In the case of a corporation, the board of directors is responsible for setting this mindset. In abstract terms, the expectation of ethical behavior is no different in form then a corporate mindset of managing costs, constant innovation,[97] or employee benefits.[98] Ethics creates an expectation of a

Past? Why more chief executives are losing their jobs after scandals and corporate misconduct, STRATEGY+BUSINESS (May 15, 2017), https://www.strategy-business.com/feature/Are-CEOs-Less-Ethical-Than-in-the-Past?gko=50774.

95. Dr. Daniel Kobler, Felix Hauber, & Benjamin Ernst, *Millennials and Wealth Management: Trends and challenges of the new clientele*, DELOITTE (June 2015), https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/lu-millennials-wealth-management-trends-challenges-new-clientele-0106205.pdf.

96. *Millennials Drive Growth in Sustainable Investing*, MORGAN STANLEY (Aug. 9, 2017), http://www.morganstanley.com/ideas/sustainable-socially-responsible-investing-millennials-drive-growth.html.

97. In promoting its corporate culture and mindset, the Apple Inc. jobs website describes itself in the following terms: "We're perfectionists. Idealists. Inventors. Forever tinkering with products and processes, always on the lookout for better." *Jobs at Apple*, APPLE, https://www.apple.com/jobs/ae/corporate.html (last visited Dec. 1, 2017).

98. Facebook employees consistently rank the company highly for employee benefits. Facebook's employee benefits for North America include:

> Medical, dental and vision insurance to keep you and your family healthy; [m]edical second opinion service to make sure you get the best care; [c]ompetitive retirement plans to help you plan for the future; [l]ife insurance and survivor support to give you peace of mind; [g]enerous vacation days so you can take time off when you need it; [p]aid leave for new parents so you can bond with your family; [s]upport for family planning: adoption and surrogacy assistance, and baby cash to help with newborn expenses; [w]ellness allowance to support all your healthy activities; [e]mployee assistance program; [t]ransportation support for a stress-free commute; [m]eals and snacks when you need them.

Benefits, FACEBOOK, https://www.facebook.com/careers/benefits/ (last visited Dec. 1, 2017).

certain behavior by all members within the organization.

Unlike individuals, who come into daily contact with a limited number of other people, corporations have the potential of touching thousands, if not millions of lives each and every day. One court remarked:

> [M]odern super-corporations . . . wield immense, virtually unchecked, power. . . . The philosophy of our times . . . requires that such enterprises be held to a higher standard than that of the "morals of the market-place" which exalts a single-minded, myopic determination to maximize profits as the traditional be-all and end-all of corporate concern.[99]

There is growing evidence that the marketplace responds to ethical conduct. Businesses that ignore ethical considerations do so at their own peril. Consider, in this regard, the Volkswagen emissions scandal, its devastating impact on corporate profitability,[100] and the negative publicity it received throughout the marketplace.[101] The marketplace is an increasingly interdependent, complex, and sophisticated economic system. An unscrupulous move by a corporation can have ripple effects throughout its supply, distribution, and sales chain. To remain competitive and relevant in the marketplace, it will behoove corporations to seriously consider ethics in its decisionmaking process.

It is only a matter of time before today's millennials and iGens take their seats and begin making decisions in our legislatures, courts, and corporate boards. Corporate directors that fail to act in a responsible and ethical manner will face mounting pressure to change. The shift in investor attitude is already on the horizon. Let's hope the shift arrives before our society reaches the tipping point.

---

99. SEC v. Med. Comm. for Human Rights, 404 U.S. 403, 409–10 (1972).

100. *See* Jack Ewing, *VW, Setting Aside $18 Billion for Diesel Scandal Costs, Reports Record Loss*, N.Y. TIMES, (Apr. 22, 2016) https://www.nytimes.com/2016/04/23/business/international/volkswagen-loss-emissions-scandal.html (discussing the record loss Volkswagen experienced after the scandal related to diesel emissions).

101. *See* Matt Robinson, *11 Hilarious Reactions to the VW Emissions Scandal*, CAR THROTTLE, (2016) https://www.carthrottle.com/post/11-hilarious-reactions-to-the-vw-emissions-scandal/ (showing examples of the public's reaction to the Volkswagen emissions scandal).