The Moral Responsibility of Business Corporations and Fiduciary Individuals

by

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Themes of the Conference

A perennial question in business ethics concerns the extent to which business firms and organizations themselves can be correctly said to have moral responsibilities and obligations (or not). In philosophical terms, the question is often posed as one of the “moral agency” of organizations. The view that business firms possess moral and ethical qualities of this kind has been strongly advocated by a number of leading scholars in different disciplines. A competing view has argued instead that only individual human beings can be truly said to have moral obligations and responsibilities. To say that a firm or other organization has the capacity for moral behaviour or cognition, on this view, is incorrect. This debate continues among prominent scholars today, and our aim in this conference is to bring together some of the strongest voices on both sides of the debate to update the current state of argument and to develop new and potentially useful approaches to the underlying problem.

Although this debate is primarily a theoretical one, its outcome has great significance for practice. For example, a conclusion that business firms have moral responsibility will have implications for both business practitioners and educators. If a particular business is deemed correctly to be morally compromised, for example, then it would follow that it may deserve a social response such as “shunning” or boycotting its products or services. There are also significant legal consequences, and different societies currently adopt different positions on the issue. In the United States, for example, a corporation can be deemed under appropriate circumstances to be found legally culpable for criminal acts (e.g., SAC Capital). Some scholars have questioned whether this approach is morally justified, and other countries such as Germany have refused to sanction the idea that a business firm can have moral and therefore legal culpability. A result is that laws and their enforcement are focused more directly on the culpability of individuals, that is, the actual human beings involved in various cases of wrongdoing. Subscribing to corporate moral agency might be seen to let these culpable individuals “off the hook.”

We do not anticipate that this conference will finally settle the deep philosophical disagreements about the moral nature of business firms (or not). However, we believe that it will help to resurface this important discussion in business schools and advance mutual understanding of the competing arguments. It will help call attention to the continuing practical importance of this central issue in business ethics, and it is an issue with much wider application as well, not least for the disciplines of economics, finance, law, and management.

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1. Do firms have moral responsibility?
   NO, if by firms we mean “classical firms”.
   YES, if by firms we mean “business corporations”.

Theoretical & practical confusions in corporate ethics & governance are mostly due to the failure to distinguish these two forms of firms, though there is a wide gray zone between them.

2. Does subscribing to corporate moral agency let culpable Individuals off the hook?
   NO, as long as they play the role of fiduciaries.
Part 1:

<Moral Responsibility of Business Corporations>

A grocery shop around the corner

an “unincorporated firm”

or

a “classical firm.”
The single-story structure of a classical firm

(A classical firm is “a nexus of contracts” with the owner(s) as their node.)
Do classical firms have moral responsibility? No.

It is the owners who are the sole subjects of the firm.

The owners have all the responsibilities, legal or ethical, i.e. moral, for any consequence the firm’s activity gives rise to.

Note: Morality à la Kant = Legality + Ethicality (or Virtue).

Even agents’ acts are subject to vicarious liability, except torts outside scope of employment. (and exceptions are a matter of agency law.)
A big super-market chain inc.\(\text{\textbar}\) an “incorporated firm” or a “business corporation.”

A shareholder
WHY?
A shareholder is NOT the legal owner of corporate assets. The Corporation as a Legal Person IS!
(corporate assets = corporation’s assets)

A corporation is a thing. (= Not naturally a person - e.g., organization, fund, &c.)

Yet, “it” has the same power as an individual to do things necessary or convenient to carry out its business and affairs” (RMBCA)

A Corporation is a Thing treated Legally as a Person.

Corporation as Person/Thing Duality!
What, then, is a corporate shareholder?

The owner of (a unit of) the corporation as a thing, distinct from underlying corporate assets.

A corporate share

A bundle of participatory & financial rights in corporation which can be held as a piece of property, separate & distinct from corporate assets

A unit into which corporation as a thing is divided.
Two-story structure of business corporation

- Ownership
- Corporation (Thing)
- Corporation (Person)
- Ownership
- Corporate Assets

Single-story structure of classical firm

- Owners
- Assets
The person/thing duality of corporation has, by joining two private ownership relations, enabled capitalism (or private-property system) to have a wide variety of organization forms.

1st digression:
*Upstairs Downstairs.*

- Where upstairs is emphasized
  ≈ Corporate nominalism
  ≈ Anglo-American corporate system
  ⇒ Maximizing shareholders’ returns

- Where downstairs is emphasized
  ≈ Corporate realism
  ≈ Japanese-German corporate system
  ⇒ Growth and sustenance of the corporation as an organization
Do business corporations have moral responsibility?

Yes.

Cf. A classical firm

Owners

Contracts

Torts & c.

assets

Owners

Contracts

Torts & c.

assets

Corporate Assets

Potential Victims

...... (∞)

Contractual Relations

Torts (Criminal Offenses &c.)

Agents (Employees)

Customers

Suppliers

Creditors (incl. Tort Victims)

(Thing)

Corporation

(Person)
The corporation as a legal person is the sole subject not only of the internal ownership but also of all the external relationships (contracts, torts, criminal offenses &c.).

“*It*” is, at least legally, liable to any consequence, good or bad, its business activities causes to others.

Limited liability of shareholders is a mere corollary of the legal personality of the corporation.

It should not be regarded as an incentive system. (The case of controlling shareholders → later.)
2nd digression:
Fallacy of contractual theory of corporation.

A corporate act cannot be reduced to the joint act of shareholders.

Private contracts among shareholders are incapable of making prior contracts with tort victims who are by def. unknown; hardly capable of keeping contracts even with known others if shareholders themselves are many & varying. (Hohfeldian muddle: trying to reduce infinity to multital.)

A corporation is liable to outsiders only because it is already recognized by society (i.e. by tradition or by fiat or by law) as the ultimate holder of rights & duties.

The corporation is intrinsically a social entity. (Indeed, even a natural person is a social entity.)
Can corporations also be ethical agents? Yes.

Ethics, at least in the sense of Kant, is a set of laws governing all rational-beings.

Rationality = the freedom to choose an end, independently of natural human interests (happiness, sentiments, profits, &c.).

Its two-story structure allows corporation to choose ethical ends, in spite of shareholders’ natural pursuit of profits.

The corporation is a rational-being whose acts can be ethically imputed to it.

(Can a corporation have an absolute worth? ← As a de facto owner of firm-specific human assets.)
Part 2:
<Moral Responsibility of Fiduciary Individuals>

Does subscribing to corporate moral agency let culpable Individuals off the hook?

Two ways to look at the person/thing duality of the corporation.

1) A thing that is legally a full person. ⇒Part 1.
2) A person that is actually a mere thing. ⇒Part 2.
Even if the corporation is in law a person, it is in reality incapable of performing any act except through the act of fresh & blood natural persons.

Any corporation must have managers. (= a board of directors + officers as their agents).

“All corporate powers shall be exercised by or under authority of, and the business and affairs of a corporation shall be managed, under the direction of its board of directors ….” RMBCA.

(Classical firms can do without managers.)

Any act managers perform qua managers (i.e. in the name of the corporation) legally binds the corporation to it as its own act.
Bunraku (Japanese Puppet Theater)

A Play = Puppeteers → Puppets

A Corporate Act = Managers → Corporation
A Fiduciary Act = Fiduciary → Beneficiary
The relation between managers & corporation ≠ Contractual relationship (or agency in economics)

Any contract between managers & corporation would necessarily degenerate, at least in part, into managers’ contract with themselves or its equivalent – a mere vow (=a self-imposed duty) with no standing at law.

Fiduciary Relationship!

Managers owe to the corporation the duty of loyalty & the duty of care (duty to act solely for the benefits of corporation & duty to exercise reasonable care in management)

These fiduciary duties (should) constitute the core of every corporate governance system. (+ supplementary governance by stakeholders.)
3rd digression: **What is Fiduciary Relationship?**

An absolutely unequal relationship in which one party *(fiduciary)* dominates the other *(beneficiary)* in actual or legal capacity, knowledge, skills &c., so that the former has to be ‘entrusted’ to serve the latter.

*(guardian/ward, trustee/beneficiary, manager/corporation, agent/principal, partner/partner, doctor/patient, attorney/client, fund-manager/investor &c.)*

Any contractual arrangement would necessarily degenerate, at least in part, into the fiduciary’s contract with oneself or its equivalent = a self-imposed ethical duty no contract law can enforce!

Any attempt to control fiduciaries by contracts would inevitably lead to their self-contract or the like, creating the very problem it is attempting to solve.

Equity places on anyone who undertakes to be a fiduciary the duty of loyalty & the duty of care & asks courts to enforce them as legal duties.
If managers’ act (or failure to act) as managers causes the corporation to harm third parties, it violates their fiduciary duties to loyally serve the corporation’s interests, at least financially (by paying reparations to victims) & even morally (by e.g., demoralizing its employees).

If intentional, a breach of the duty of loyalty.
⇒ Liable to disgorge their unauthorized gains.
If by negligence, a breach of the duty of care.
⇒ Liable to compensate corporation’s reparation.

‘Control test’ for vicarious liability is by def. inapplicable for fiduciary breaches.

Managers set corporate ends (at least in part) & pursue them in the name of corporation.

They are both controlling & controlled agents.
The issue is not: whether managers are liable to corporate wrongs. They are, as corporation’s fiduciaries.

Indemnification or insurance arrangements with corporations involve managerial self-dealing & contradict the very raison d’être of fiduciary duties.

The issue is rather: how much they are liable to corporate wrongs.

They owe their liability only to the extent of their involvement as fiduciaries to the corporation.

Liability should be limited to incomes & other benefits managers have gained as managers.

(Should the corporation incur all the remaining liability or share it with society is an open theoretical issue.)
Liability of Shareholders & Creditors?

If shareholders are controlling shareholders, they also become liable to corporate wrongs. (In the extreme case → corporate veil piercing.)

&

- If major creditors have taken over the control of the corporation on the brink of bankruptcy, they also become liable to corporate wrongs.

However, their liability to the corporation is neither as its shareholders nor as its creditors but as its de facto fiduciaries.
This presentation is based partly on:

Other important references are: