

The Coasean Dissolution of Corporate Social Responsibility

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INTRODUCTION

Assertions that corporations should be socially responsible¹ commonly elicit either of two quite different reactions.² On the one hand, there is an enthusiastic affirmative response, generally grounded in moral views and often associated with the liberal end of the political spectrum.³ This response, which is usually coupled with the idea that big business is malevolent and dangerous, holds that corporate managers are too often concerned only with profits and that, unless guided by the values of corporate social responsibility (CSR), corporations cause great harm to society. On this view, corporations are generally not sufficiently socially responsible and ought (in a moral sense of

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

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

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

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

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

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

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

⁶ *Id.*

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

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

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

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

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

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

I. THE COASEAN UNDERSTANDING OF CORPORATE SOCIAL RESPONSIBILITY

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

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

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

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

A. Including CSR Preferences in Economic Analysis

The positive economic analysis of law is based on rational choice theory,¹² which in turn begins with the assumption (usually called the rationality assumption)¹³ that human beings have preferences¹⁴ and in general take actions reasonably calculated to satisfy those preferences, subject to whatever constraints happen to exist.¹⁵ Sometimes economists express this assumption by saying that human beings seek to maximize their own utility or welfare. Although the intended meaning is the same, this latter formulation tends to give rise to the most persistent and pernicious misunderstanding of economic analysis, namely that it presupposes that human beings are exclusively self-interested in the most venal and base sense of the term.¹⁶ This is simply a mistake. It is to confuse the assertion that human beings tend to act rationally to satisfy their preferences with an assertion about what those preferences tend to be. The rationality assumption makes no claims of any kind on this latter issue. On the contrary, to apply the rationality assumption correctly, we must take the preferences of human beings as we find them actually to be in the world. Economic analysis, Gary Becker writes, “does not assume that individuals are motivated solely by selfishness or gain. It is a *method* of analysis, not an assumption about particular motivations The analysis assumes that individuals maximize welfare *as they conceive it*, whether they be selfish, altruistic, loyal, spiteful, or masochistic.”¹⁷

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

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

¹³ *Id.* at 792.

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

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

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

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

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

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

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

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

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

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

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

All this also applies to the normative question of whether a transaction or an outcome is economically efficient. Kaldor-Hicks efficiency²³ (or, better, Pareto Relevance)²⁴ takes the actual preferences of human beings as given, whatever those preferences may be.²⁵ Any good for which there is a willingness to pay counts. Hence, moral preferences for which there is a willingness to pay count like all other preferences in the normative calculus of determining which transactions or outcomes are efficient and which are not. As Zerbe argues, “Moral sentiments are properly economic goods in so far as there is a willingness to pay to obtain their realizations and so in determining efficiency moral claims are properly included directly.”²⁶ Assuming, as seems clear, that some people are willing to pay to realize moral preferences related to CSR concerns, these preferences should be treated on a par with all other preferences, not only in applying the rationality assumption in positive economic analysis but also in calculating efficiency in normative economic analysis.

B. Coasean CSR Transactions

Suppose that two parties who have low transaction costs²⁷ and who, because they each have many alternative transacting partners, are unlikely to engage in strategic behavior,²⁸ are negotiating a commercial transaction, by which I mean one in which one party (the buyer) will exchange money for the performance of the other (the seller), which performance would typically be some obviously economic good or service. Say further that, in addition to his other preferences related to the good or service, the buyer has a moral concern, for which he has a willingness to pay, of a typical CSR type related to the

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

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

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

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

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

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

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

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

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

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

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

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

1. Customers

The general explanation above is immediately applicable to transactions between a firm and its customers in its product markets: some customers are willing to pay for products that reflect CSR concerns, either because the product embeds a CSR attribute (such as being made from recycled materials), or because it was produced by means of a process reflecting CSR concerns (such as being made by unionized workers, by workers in America, or by workers in foreign jurisdictions who are paid super-market wages),³³ or because the firm producing it donates some of the profits from the sale of the product to a CSR cause.³⁴ In each case, there is a CSR concern for which customers are willing to pay, but the right relative to those concerns has been assigned by law to the firm. The firm, we assume, has no preference but to maximize its profits³⁵ within the law.³⁶ Therefore, in accordance with the general argument above, to the extent that customers are willing to pay to see their CSR concerns realized, the firm will sell them the right and realize the concern by modifying its products accordingly.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

⁴² See 49 C.F.R. § 571.208.

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

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

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

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

2. Suppliers and Manufacturers

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

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

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

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

⁴⁹ *Id.*

⁵⁰ *Id.* at 409.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

⁶¹ *Id.* at 5–6, 20.

⁶² *Id.* at 16–19, 21.

⁶³ *Id.* at 22.

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

3. Employees

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

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

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

⁶⁶ *Id.*

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

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

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

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

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

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

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

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

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

⁷¹ *E.g.*, Age Discrimination in Employment Act of 1967, 29 U.S.C. §§ 621–634 (prohibiting employment discrimination against individuals forty years of age or older); Rehabilitation Act of 1973, 29 U.S.C. §§ 701–7961 (2012) (prohibiting discrimination on the basis of disability).

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

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

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

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

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

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

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

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

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

4. Investors

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

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

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

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

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

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

⁷⁹ *Id.* at 136–37.

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

⁸¹ *Id.*

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

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

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

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

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

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

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

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

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

C. CSR Preferences of Third Parties

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

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

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

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

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

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

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

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

II. MORAL CONCERNS ARISING FROM THE COASEAN ANALYSIS

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

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

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

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

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

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

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

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

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

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

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

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

This argument, in my view, turns on the assumption that, for moral purposes, firms are relevantly like individuals. That is, if an individual performs his moral obligations only because someone else is paying him to do so, then the individual would likely be behaving immorally. But it is quite otherwise with firms, for, despite the views of some scholars,⁸⁹ the firm is not a moral agent in any normal sense of the term. It exists only in the contemplation of the law⁹⁰ and amounts to a nexus of contractual relationships,⁹¹ ultimately among individual human beings.⁹² It is not a person but a form of organizing activity by persons. If the

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

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

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

⁹² *Id.*

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

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

CONCLUSION

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

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

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

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

