MARSHALLING REPUTATION TO MINIMIZE PROBLEMATIC BUSINESS CONDUCT

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ABSTRACT

Problematic business behavior continues. The law tries to address it, but without sufficient success.

If the law could readily do a better job preventing or punishing the behavior, it would. But the law is limited in what it can address. In some cases, legal solutions are impossible or infeasible. Specifying the behavior at issue may be impossible; specification may yield a roadmap for other egregious behavior, and/or enforcers may be hopelessly outmaneuvered or out-resourced. In other cases, legal solutions are undesirable. Mandating the "golden rule" in all business relationships is not a good idea, nor is deeply encroaching on people's autonomy to prevent them from making decisions that the government thinks are not good for them.

This Article argues that reputation can help fill the gap, and play more of a role in discouraging problematic corporate conduct. The first step, albeit a huge one, is to develop a principled concept of what reputation should require—more precisely for purposes of this Article, what a good reputation should not permit. A good reputation should not permit a company to have business models and practices predicated on taking advantage of one party's duress or incapacity or on access to a third party's funds where the third party has no say in the matter. This Article argues that such models and practices impose negative externalities.

At this juncture, with increasing attention paid to corporate social responsibility ("CSR"); sustainability; environmental, social, and governance ("ESG") initiatives; broader themes of corporate good citizenship; and regular revelations of problematic corporate behavior, such a concept could get real traction with important and influential constituencies, notably including institutional investors. With CSR and ESG, investor activism has been proactive rather than reactive. Companies' practices as to the environment, diverse

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boards, and other such matters are investigated and those with practices deemed problematic are pressured to do better. Why is that not the case for companies' business models and practices?

Institutional investors, who are increasingly focusing on sustainability, CSR, and ESG concerns, have an important role to play. Institutional investors are well-situated to ask, and get answers to, searching questions, and pressure companies to institute needed reforms. My hope is that they will use their considerable influence to "enforce" reputational sanctions, both positive and negative, and participate in a broader conversation as to what reputation should require.

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INTRODUCTION

In a 2014 biannual memo sent to senior managers, Warren Buffet said:

> We can't be perfect but we can try to be. As I've said in these memos for more than 25 years: "We can afford to lose money — even a lot of money. But we can't afford to lose reputation — even a shred of reputation."
>
> We must continue to measure every act against not only what is legal but also what we would be happy to have written about on the front page of a national newspaper in an article written by an unfriendly but intelligent reporter.[1]

There are many examples of problematic corporate behavior. If law could readily do a better job preventing or punishing the behavior, it would. But law is limited in what it can address. In some cases, legal solutions are impossible or infeasible. Specifying the behavior at issue may be impossible; specification may yield a roadmap for other egregious behavior, and/or enforcers may be hopelessly outmaneuvered or out-resourced. In other cases, legal solutions are undesirable. Mandating the "golden rule" in all business relationships is not a good idea, nor is deeply encroaching on people's autonomy to prevent them from making decisions that the government thinks are not good for them.[2]

What might help? Reputation is generally thought to be a constraint on corporate conduct. Corporations are assumed to want a good reputation if for no other reason than an instrumental one, to do things they would not otherwise do, and to refrain from doing things they would otherwise do, in order to obtain it.[3] Scholarly analyses emphasize the role of reputation, given that corporations are repeat players who rely on the continuing good favor of, among others, customers and regulators.[4]

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[1] Drake Baer, *Warren Buffet Tells Managers Their Top Priority Is To 'Zealously Guard Berkshire's Reputation,'* BUS. INSIDER (Dec. 22, 2014, 1:22 PM), https://www.businessinsider.com/warren-buffett-managers-reputation-top-priority-2014-12 [https://perma.cc/Y3GQ-2M2Q].

[2] These are contestable propositions, but I will nevertheless assume them for purposes of this Article. I believe that most people would agree with at least a mild (or is it extreme?) form of these propositions (government should not stop Apple from making iPhones even though people may regard them as must-have items, buy them notwithstanding having to skimp on "necessaries," and become addicted to them), and nothing in my argument turns on any more than that.

[3] *See generally* Charles J. Fombrun, *The Building Blocks of Corporate Reputation: Definitions, Antecedents, Consequences*, *in* THE OXFORD HANDBOOK OF CORPORATE REPUTATION 94 (Timothy G. Polluck & Michael L. Barnett eds., 2012).

[4] *See* Roy Shapira, *Mandatory Arbitration and the Market for Reputation*, 99 B.U. L. REV. 873, 885 (2019) ("The aggregate of diminished business opportunities constitutes the reputational sanction for violating market norms. And the background threat of losing reputation deters corporate misbehavior ex ante."); *see also* Jonathan M. Karpoff, *Does Reputation Work to Discipline Corporate Misconduct?*, *in* THE OXFORD HANDBOOK OF CORPORATE REPUTATION, *supra* note 3, at 361, 364.

This Article argues that reputation can work better than it has to discourage problematic corporate conduct. The first step, albeit a huge one, is to develop a principled concept of what reputation *should* require—more precisely for purposes of this Article, what a good reputation should not permit. At this juncture, increasing attention is being paid to corporate social responsibility ("CSR"); sustainability; environmental, social, and governance ("ESG") initiatives;[5] and corporate good citizenship generally. There are also regular revelations of problematic corporate behavior. A broader and more integrated perspective as to what reputation should require could therefore get real traction with important and influential constituencies, notably including institutional investors. With CSR and ESG, investor activism has been proactive rather than reactive. Companies' practices as to the environment, diverse boards, and other such matters are investigated and those with practices deemed problematic are pressured to do better.[6] What if companies' *business* models and practices were subject to the same type of scrutiny?[7] Institutional investors are well situated to ask, and get answers to, searching questions, and pressure companies to institute needed reforms.

What sorts of business models and practices are problematic? I argue that problematic models and practices "take advantage," imposing negative

[5] *See* Subodh Mishra, Institutional S'holder Servs., *An Overview of U.S. Shareholder Proposal Filings*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 28, 2018), https://corpgov.law.harvard.edu/2018/02/28/an-overview-of-u-s-shareholder-proposal-filings/ [https://perma.cc/2XAW-TEBU]; SUSTAINABILITY ACCT. STANDARDS BOARD, https://www.sasb.org/ [https://perma.cc/MD75-C2BK] (last visited Apr. 8, 2018); *see also* Terry O'Callighan, *Disciplining Multinational Enterprises: The Regulatory Power of Reputational Risk*, 21 GLOB. SOC'Y 95, 96 (2007) ("'[W]hen the heat is turned up on social responsibility, the international media now stoke the flames originally lit by NGOs.' Consequently, most large corporations have been on something of a crusade to 'reinvent' themselves as socially responsible and environmentally friendly actors."). Even the rating agencies are getting involved. Standard and Poor's has a webpage devoted to ESG, the heading of which states, "Our research shows that institutional investors have a collective demand for sustainable debt." *Environmental, Social & Governance: Essential Insight for Sustainable Financial Markets*, S&P GLOBAL, https://www.spglobal.com/en/who-we-are/corporate-responsibility/esg [https://perma.cc/25MT-7G24] (last visited Apr. 8, 2019).

[6] Indeed, companies are heavily involved in touting what they are doing in these spheres. *See, e.g.*, *AT&T Corporate Environmental Sustainability*, AT&T (May 18, 2018), https://about.att.com/newsroom/att_sustainability_initiatives.html [https://perma.cc/HDA4-KE4S].

[7] Note that my focus here is on a business that is generally considered legitimate, but that has problematic models or practices. I sidestep questions about businesses that make products or provide services that many people may now consider problematic or "wrong" based on changing mores or additional information, such as cigarette or gun manufacturers, or those providing conversion therapy or drugs to be used in executions. I also do not consider examples which arguably fool people who want to be fooled, such as elderly people "duped" by handsome young dance instructors into buying overpriced dance lessons with the pitch that they are the next Ginger Rogers or Fred Astaire.

externalities. They take advantage of incapacity, duress, limited information, or third parties.[8]

In what follows, I explore how corporate reputation works, and how and why it is acquired. I also explore the present bifurcation between avoiding a bad reputation and getting a good reputation. My arguments are in part descriptive and in part normative. The bifurcation exists, but it should not: corporations' reputations should suffer not only when they experience negative reputational events, such as the recent Boeing 737 MAX 8 crashes,[9] and when they fall short of CSR/ESG and like initiatives, but also when their business models and practices take advantage, imposing negative externalities.

I. What Does It Take to Avoid a Bad Reputation?

Perhaps surprisingly, the answer is not clear. There are many easy cases—but quite a few hard ones. There are changes over time;[10] there are differences in different contexts.

Here are some easy cases. One is Volkswagen's creation and use of "defeat devices" to make diesel cars emitting illegal levels of pollutants "pass" emissions tests by cutting emissions purely for purposes of the tests.[11] Another is Wells Fargo's "eight is great" campaign to pressure low-level bankers to open eight accounts per customer or family.[12] Besides the direct legal and financial costs, there have been significant reputational costs to both companies.[13]

These cases involve illegal behavior. But of course, conduct that is legal can nevertheless yield a bad reputation. Consider the purchase by Martin Shkreli's company, Turing, of a company that made an inexpensive generic drug that was necessary for immune-compromised patients, followed immediately by Turing's "exploitation" of what many people would call a loophole to raise the price of

[8] My inquiry here builds on an inquiry I began in an earlier article. *See* Claire A. Hill, *Repugnant Business Models: Preliminary Thoughts on a Research and Policy Agenda*, 74 WASH. & LEE L. REV. 973, 981 (2017) ("Repugnant Business Models are those that are designed to take advantage—either of people under duress, people who are particularly vulnerable (and to which the society may be solicitous), third parties, or some combination thereof, or of a legal privilege, for a reason that violates the spirit of the law.").

[9] *See* Rob Picheta, *Ethiopian Airlines Crash Is Second Disaster Involving Boeing 737 MAX 8 in Months*, CNN (Mar. 11, 2019, 4:54 AM), https://www.cnn.com/2019/03/10/africa/ethiopian-airlines-crash-boeing-max-8-intl/index.html [https://perma.cc/3XRF-APT4].

[10] *See generally* Robert G. Eccles, Scott C. Newquist & Roland Schatz, *Reputation and Its Risks*, HARV. BUS. REV., Feb. 2007, at 104, 113.

[11] *See* Russell Hotten, *Volkswagen: The Scandal Explained*, BBC NEWS (Dec. 10, 2015), https://www.bbc.com/news/business-34324772 [https://perma.cc/SD3K-SBHT].

[12] *See Wells Fargo's Phony-Account Scandal, Explained*, WEEK (Sept. 17, 2016), https://theweek.com/articles/649015/wells-fargos-phonyaccount-scandal-explained [https://perma.cc/QCY3-3VZ6]; *see also* Geoff Colvin, *Inside Wells Fargo's Plan to Fix Its Culture Post-Scandal*, FORTUNE (June 11, 2017), http://fortune.com/2017/06/11/wells-fargo-scandal-culture/ [https://perma.cc/E6F2-K824].

[13] *See* Colvin, *supra* note 12; Hotten, *supra* note 11.

the drug by 5000%.[14] This took place in 2015, but even at this writing, in early 2019, "Shkreli" is the top result of a search for "most hated man in America."[15] It did not help (enough) that Shkreli argued that he was only seeking to raise funds to engage in new drug development.[16] He earned sufficient ire that regulators investigated him for something he had done that *was* illegal, an unrelated fraud; he was subsequently tried and convicted, and is in jail at this writing.[17]

Why were these reputational "hits" so bad? The companies appeared[18] to be cavalier, or worse, affirmatively willing to compromise, as to people's health or well-being, or the law. Other examples include companies found to have unsafe or unhygienic food preparation practices (Chipotle and Domino's);[19] a company

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[14] *See* Heather Long, *Here's What Happened to AIDS Drugs that Spiked 5,000%*, CNN BUS. (Aug. 25, 2016, 12:10 PM), https://money.cnn.com/2016/08/25/news/economy/daraprim-aids-drug-high-price/index.html [https://perma.cc/6HFH-5T44]. Another company, Mylan, raised the price of EpiPens dramatically and was also massively derided in the press, with the CEO being summonsed to appear before Congress. *See* Chris Woodyard & Mary Jo Layton, *Massive Price Increase on EpiPens Rasie Alarm*, USA TODAY (Aug. 22, 2016, 9:41 PM), https://www.usatoday.com/story/money/business/2016/08/22/two-senators-urge-scrutiny-epipen-price-boost/89129620/ [https://perma.cc/AWJ8-RSJH].

[15] I last ran this search on March 22, 2019. The result surprised me. I thought he would have been supplanted by now, maybe by Harvey Weinstein. Shkreli may be retaining the top spot because there is a TV program about him with this title. *See, e.g.*, Zoe Thomas & Tim Swift, *Who Is Martin Shkreli – 'The Most Hated Man in America'?*, BBC NEWS (Aug. 4, 2017), https://www.bbc.com/news/world-us-canada-34331761 [https://perma.cc/EM4B-C9JR] ("He's been called a 'morally bankrupt sociopath', a 'scumbag' a 'garbage monster' and 'everything that is wrong with capitalism.' And those are some of the tamer comments.").

[16] *See* Eric Owles, *The Making of Shkreli as 'Pharma Bro,'* N.Y. TIMES: DEALBOOK (June 22, 2017), https://www.nytimes.com/2017/06/22/business/dealbook/martin-shkreli-pharma-bro-drug-prices.html ("Mr. Shkreli said raising drug prices was necessary to finance the expensive development of new medicines. He even said that a Turing investor had threatened to 'beat the crap out of me' for not raising the price more."). It also did not help that Shkreli is constantly photographed smirking. My diligent efforts to find a picture in which he was not smirking yielded nothing. It should be noted, though, that the principled difference between what Shkreli said he was doing and what drug companies generally do—charge extraordinarily large sums for their drugs—is not as large as it might initially seem. The latter say they are recouping their considerable investment in the drugs, something that is not true in Shkreli's case. He did say, though, that he was going to use the money for new drug development, which is presumably what the drug companies would say they will do as well. But what really seems to elicit outrage is charging such high prices for lifesaving drugs, something that is happening in both types of cases. *See infra* note 51.

[17] *See* Stephanie Clifford, *'Multitude of Lies,' Judge Sentences Shkreli to 7 Years in Fraud Case*, N.Y. TIMES, Mar. 10, 2018, at B2.

[18] A distinction is made in the literature between perception and reality. The point is that even if a corporation "does" the right thing, a good reputation requires that it be recognized as doing so. *See, e.g.*, Fombrun, *supra* note 3, at 104. For purposes of this Article, I assume away the distinction, treating perceptions as accurate such that doing the "reputable" thing will lead to the associated reputation.

[19] *See* Stephanie Strom, *As U.S. Inquiry into Food-Borne Illness Widens, Chipotle Reports a Plunge in Profits*, N.Y. TIMES, Feb. 3, 2016, at B2; Patrick Vogt, *Brands Under Attack:*

that did not fix a potentially life-endangering problem with its ignition switches (General Motors);[20] a company manufacturing and selling airbags with metal shards that, when triggered, could cause serious physical injury (Takada);[21] various companies suffering cyber breaches;[22] various financial institutions creating and selling low-quality securities in disingenuous ways, manipulating interest rates, charging customers for insurance they did not purchase or need (including Wells Fargo);[23] and companies that created techniques to do end-runs around regulations, during and after the 2008 financial crisis.[24]

According to *Merriam-Webster's Dictionary*, "cavalier" means "marked by or given to offhand and often disdainful dismissal of important matters."[25] The *Cambridge Dictionary* defines "cavalier" as "not serious or caring enough about matters that other people are serious about."[26] The respects in which these examples reflect being cavalier or worse as regards people's health and well-being or the law is obvious.

But in many other cases, the judgment might not be so clear. What counts as an important matter? What matters are people serious about? What counts as not being serious enough or not caring enough? And affirmatively being willing to compromise on health/well-being/law is also not a mechanical assessment. Different people hold different views on these matters. Whose views count, come to dominate, or are sufficiently influential? There is obviously no mechanical answer to this question—no authoritative assessment exists. Some people think companies not paying employees "a living wage" or replacing long-standing employees with robots would qualify as "cavalier or worse people's well-being." Others think that making products or delivering services more

Marketers Can Learn From Domino's Video Disaster, FORBES (Apr. 24, 2009, 2:00 PM), https://www.forbes.com/2009/04/24/dominos-youtube-twitter-leadership-cmo-network-marketing.html [https://perma.cc/XT7M-D42B].

[20] *See* Eric D. Lawrence, *GM Settles Deadly Ignition Switch Cases for $120 Million*, USA TODAY (Oct. 20, 2017, 12:56 PM), https://www.usatoday.com/story/money/cars/2017/10/20/gm-settles-deadly-ignition-switch-cases-120-million/777831001/ [https://perma.cc/D7P5-83NH].

[21] *See* Hiroko Tabuchi, *Airbag Maker Hid '04 Tests, 2 Workers Say*, N.Y. TIMES, Nov. 7, 2014, at A1.

[22] *See, e.g.*, Glen Fleishman, *Equifax Data Breach, One Year Later: Obvious Errors and No Real Changes, Report Says*, FORTUNE (Sept. 8, 2018), http://fortune.com/2018/09/07/equifax-data-breach-one-year-anniversary/ [https://perma.cc/S46N-LP9F].

[23] *See* Spencer Tierney, *More Wells Fargo Refunds Coming After $1 Billion Fine*, NERDWALLET (Apr. 20, 2018), https://www.nerdwallet.com/blog/banking/wells-fargo-fined-1-billion-next-steps-customers/ [https://perma.cc/88V9-ETLH].

[24] Many examples are described in detail in Chapter 1 of *Better Bankers, Better Banks*. CLAIRE A. HILL & RICHARD W. PAINTER, BETTER BANKERS, BETTER BANKS: PROMOTING GOOD BUSINESS THROUGH CONTRACTUAL COMMITMENT 2, 19-70 (2015); *see also* DAVIS ENRICH, THE SPIDER NETWORK: HOW A MATH GENIUS AND A GANG OF SCHEMING BANKERS PULLED OFF ONE OF THE GREATEST SCAMS IN HISTORY 5 (2017).

[25] *Cavalier*, MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (11th ed. 2014).

[26] *Cavalier*, CAMBRIDGE ACADEMIC CONTENT DICTIONARY (2009).

cheaply or better (the ATM, for instance) constitutes being appropriately concerned about people's well-being—both employees and customers. Different principled views can exist about the extent to which particular financial engineering techniques that reduce regulatory burdens are legitimate or warrant a bad reputation.[27] But there is significant consensus, such that it makes sense for companies to try to get a good reputation and avoid a bad one. Still, the endeavor (by the company) of trying to have the right sort of reputation and the appraisal (by the "audience" for the reputation) are not purely reactive. Both involve making the case as to what reputation does and should require.

This Article argues that whatever else reputation requires, it should require companies to use their best efforts not to engage in practices that are cavalier or worse people's health and well-being or the law. But what would that mean? To answer that question, I make use of the well-worn concept of negative externalities. Being cavalier or worse about people's health and wealth-being or the law—failing to fully take into account the costs of not doing so—is tantamount to imposing negative externalities.

Standard economic theory argues that firms should be made to internalize the costs—negative externalities—they impose on others.[28] The "should" is normative: firms will be able to profit at society's expense if they can foist costs of their business on others. In an earlier article, I argued that the concept of negative externalities was generally used as though it had more power than it did to inform policy.[29] The term assumes a particular baseline by reference to which the existence of a cost or benefit can be determined, and a way to determine which costs or benefits should be counted.[30] But in most cases, neither of these things can be determined with any precision. For instance, granting mortgages to people who had no possibility of repaying them, as was sometimes done during the financial crisis, had significant negative effects, including on communities experiencing many foreclosures. How would one assess the baseline—the starting point from which costs should be taken into account? And even if we know the starting point, how do we decide which costs count, and how do we compute them? Consider in this regard some possible costs: those borne by neighbors, local schools, and local governments whose tax property receipts plummeted, and by other more distant but still-affected parties.[31] The concept of negative externalities gets at the right thing, though—corporations should be chargeable for the costs they impose on the greater society. What is needed is to (a) hypothesize and justify a baseline from which costs can be computed, and (b) establish some principles by which we decide which costs

[27] *See* Claire A. Hill, *An Identity Theory of the Short- and Long-Term Investor Debate*, 41 SEATTLE U. L. REV. 475, 478 (2018).

[28] *See* FRANCESCO PARISI, THE LANGUAGE AND LAW OF ECONOMICS 115 (2013).

[29] *See* Claire A. Hill, *The Rhetoric of Negative Externalities*, 39 SEATTLE U. L. REV. 517, 524 (2016).

[30] *See id.*

[31] *See id.* at 523.

count and a method to compute those costs. Negative deviations from the baseline should trigger reputational costs.

The baseline I hypothesize is an idealized exchange or transaction with fully capable, informed, and willing parties transacting for their own account. A problematic business model or practice is one that deviates from the ideal, relying on the existence of a party who is not: (a) fully capable, (b) fully willing, (c) fully informed, or (d) transacting for her own account.

II. TAKING A STEP BACK: WHAT IS REPUTATION?

That corporations care about their reputations is assumed and considered to be obvious. A Google search for "companies care about their reputations" on February 23, 2019 yielded 330,000,000 hits,[32] with titles such as: *If You Are in Business, You Care About Your Reputation. Period.*,[33] *Why a Great Company Reputation Is Crucial to Your Business*,[34] and *Companies with the Best (and Worst) Reputations*.[35] A 2017 study by Aon, a large consulting and insurance company, identified reputation as the top risk companies said they were concerned with.[36] There are now many companies in the business of helping

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[32] Search Results for Companies Care about Their Reputations, GOOGLE, https://www.google.com [https://perma.cc/9NDG-DXBZ] (search for "Companies Care about their Reputations"). Interestingly, the same search with "corporations" rather than "companies" only yields 147,000,000 hits. Search Results for Corporations Care about Their Reputations, GOOGLE, https://www.google.com [https://perma.cc/27KQ-BTGJ] (search for "Corporations Care about their Reputations") (last visited Apr. 8, 2019). According to a survey article on corporate reputation, "reputation is arguably the single most valued organizational asset." Kent Walker, *A Systematic Review of the Corporate Reputation Literature: Definition, Measurement, and Theory*, 12 CORP. REPUTATION REV. 357, 357 (2010).

[33] William DeFries, *If You Are in Business, You Care About Your Reputation. Period.*, FORBES (Oct. 29, 2017, 9:45 AM), https://www.forbes.com/sites/groupthink/2017/10/29/if-youre-in-business-you-care-about-your-reputation-period/#2a23e03358be [https://perma.cc/D9QM-5SLQ].

[34] Jonas Sickler, *Why a Great Company Reputation Is Important*, REPUTATIONMANAGEMENT.COM (Oct. 24, 2018), https://www.reputationmanagement.com/blog/negative-company-reputation-affects-business/ [https://perma.cc/ME2Q-FJLN].

[35] 24/7 Wall St., *Companies with the Best (and Worst) Reputations*, MARKETWATCH (May 12, 2016, 6:52 AM), https://www.marketwatch.com/story/companies-with-the-best-and-worst-reputations-2016-05-12 [https://perma.cc/FS52-AZQ6].

[36] AON, GLOBAL RISK MANAGEMENT SURVEY 2017, at 1, 4 (2017), http://www.aon.com/getmedia/d95563c6-a3b8-4ff1-bb45-0ed511c78f72/2017-Global-Risk-Management-Survey-Report-rev-120318.aspx [https://perma.cc/TJ2Y-QZ7C] ("Over the past few years . . . new media technologies have greatly amplified . . . [reputation wreckers'] negative impact, making companies more vulnerable."); *see also 2014 Global Risk Security: Reputation@Risk*, DELOITTE, https://www2.deloitte.com/global/en/pages/governance-risk-and-compliance/articles/reputation-at-risk.html [https://perma.cc/N5Y7-GPAY] (last visited

(other) companies measure, manage, enhance, preserve, and insure their reputations.[37] Indeed, mentions and analyses of corporate reputation are ever-present, including in academic literature,[38] popular media,[39] and corporations' own statements.[40] Miles D. White, the Chairman and CEO of Abbott Laboratories, was quoted as saying, "Today we are in an all out war for reputation."[41]

What is meant by reputation? As discussed earlier, there is no consensus definition,[42] but what it seems to mean is an overall assessment that the company

Apr. 8, 2019) ("[A] company's reputation should be managed like a priceless asset and protected as if it's a matter of life and death . . . .").

[37] *See, e.g.*, *Corporate Reputation*, EDELMAN, https://www.edelman.com/expertise/corporate-reputation [https://perma.cc/YR7K05HDF] (last visited Jan. 27, 2019); REPUTATIONAL INSTITUTE, https://www.reputationinstitute.com/ [https://perma.cc/Z8PV-768C] (last visited Apr. 8, 2019); *see also* Antony Ireland, *Here's Why Putting a Price on Reputational Damage Is So Hard – But Totally Worth It*, RISK & INS. (Sept. 28, 2018), http://riskandinsurance.com/putting-a-price-on-reputational-damage/ [https://perma.cc/CZK4-349K]; *Our Firm*, HARRIS POLL, https://theharrispoll.com/our-firm/ [https://perma.cc/C3D4-DZBM] (last visited Apr. 8, 2019); *Marsh Risk Consulting: Reputational Risk and Crisis Management*, MARSH, https://www.marsh.com/us/services/marsh-risk-consulting/reputational-risk-crisis-management.html [https://perma.cc/F6QN-4HNH] (last visited Apr. 8, 2019); Peter Mitic, Santander, *Reputation Risk Quantification: Measuring How Simple, Personal, Fair Santander Is Toward Their Customers*, WILLIS/IRM SEMINAR (July 2015), https://www.theirm.org/media/1436364/Reputation-risk-quantification-Peter-Mitic.pdf [https://perma.cc/L68U-TMXV].

[38] There is a journal on corporate reputation, the *Corporate Reputation Review*, published by Springer. *See Corporate Reputational Review*, SPRINGER, https://link.springer.com/journal/41299 [https://perma.cc/CSK@-BR5G] (last visited Apr. 8, 2019). An edited volume published by Oxford University Press is *The Oxford Handbook of Corporate Reputation*. There is also an encyclopedia, the *SAGE Encyclopedia of Corporate Reputation*. THE SAGE ENCYCLOPEDIA OF CORPORATE REPUTATION 5 (Craig E. Carroll ed., 2016). And there are, of course, a great many articles in many different disciplines, notably including for this purpose both law and business. *See, e.g.*, Eccles, Newquist & Schatz, *supra* note 10, at 104.

[39] *See, e.g.*, Vicky Valet, *The World's Most Reputable Companies 2018*, FORBES (Mar. 15, 2018, 10:00 AM), https://www.forbes.com/sites/vickyvalet/2018/03/15/the-worlds-most-reputable-companies-2018/#57353e5226d5 [https://perma.cc/5M83-UFXD].

[40] *See, e.g.*, *AT&T Corporate Environmental Sustainability*, *supra* note 6; Tatiana Serafin, *Reputation Risk Leading Company Concernt in 2015*, FORBES (Jan. 5, 2015, 1:19 PM), https://www.forbes.com/sites/tatianaserafin/2015/01/05/reputation-risk-leading-company-concern-in-2015/#5ae635c04ff7 [https://perma.cc/U23U-G2BQ]; *Why Reputation Institute: The Quantification of Reputation*, REPUTATION INST., https://www.reputationinstitute.com/why-reputation-institute [https://perma.cc/WAP8-2R7E] (last visited Apr. 8, 2019) (providing statistics related to executives' beliefs about reputation).

[41] Fombrun, *supra* note 3, at 94.

[42] *Id.* at 99. Grahame Dowling and Naomi Gardberg identify a conceptual obstacle to defining reputation:

> *Construct confusion* stems from the emergence of numerous similar overlapping constructs that are sometimes used interchangeably across disciplines. For example, there is corporate—brand (in marketing), identity (marketing and graphic design), image (marketing and psychology), reputation (economics, organizational behavior, and strategy), and celebrity and status (organizational behavior, sociology, and strategy).

is a good, and not bad, actor.[43] But what is meant by that? Clearly, what will be regarded as "good" and "bad" changes over time, and different constituencies will have different views.[44] There are some constituencies that clearly matter (shareholders, customers, employees, regulators, and suppliers), some that probably do not, and a contestable group in between. Nevertheless, people—academics, practitioners, journalists, and others—do seem to speak intelligibly about an overall "reputation," and I will do the same.[45] Also, to have a good

> These constructs are designed to focus on different viewpoints of a company, for example: (a) Who do we want to be (e.g., corporate identity and corporate brand)? (b) What do people actually think about us (e.g., corporate image and corporate reputation)?

Grahame R. Dowling & Naomi Gardberg, *Keeping Score: The Challenges of Measuring Corporate Reputation*, *in* THE OXFORD HANDBOOK OF CORPORATE REPUTATION, *supra* note 3, at 34, 35 (citation omitted).

[43] But by whom? "I proposed that a corporate reputation can be construed simply as a collective assessment of the attractiveness of a firm to a specific stakeholder group relative to a reference group of peers." Fombrun, *supra* note 3, at 108.

[44] *See, e.g.*, David Crow, *Pharma Chief Defends 400% Drug Price Rise as a 'Moral Requirement*,*'* FIN. TIMES (Sept. 11, 2018), https://www.ft.com/content/48b0ce2c-b544-11e8-bbc3-ccd7de085ffe. One scholar, writing a survey of the literature on corporate reputation notes that:

> [R]eputation is often issue specific. A corporation may have a particular, and potentially different, reputation for each of the following issues: profitability, environmental responsibility, social responsibility, employee treatment, corporate governance, and product quality. For example, Wal-Mart has an excellent reputation for profitability, but a poor one for employee treatment. The second problem is that a corporation may have a different reputation per stakeholder group. For example, [one paper] found that Wal-Mart had a tough reputation with suppliers but a good reputation with customers and investors. It is not appropriate to simply sum these opposing reputations in the development of an aggregate perception. Doing so would be the equivalent of saying you should feel fine if your hair is on fire but you are sitting on ice. However, summing the perceptions *per issue* can help alleviate this problem. Thus, a fundamental question for corporate reputation research is reputation for what and according to whom?

Walker, *supra* note 32, at 369 (citations omitted).

[45] This is not to say that determining what a company's reputation is, or what contributes to it, is straightforward. Professor Roy Shapira treats reputation as something that exists as an intelligible concept, but highlights the complex mechanisms by which learning about reputation occurs:

> Commercial legal scholars frequently invoke the disciplinary force of reputation. The argument is intuitive: upon hearing bad news about the company, stakeholders would infer that the company's "type" is worse than they have realized, and accordingly reduce their willingness to do business with the company going forward. Investors hearing about a corporate governance scandal will start demanding higher returns for their investment, customers hearing about a product recall will purchase fewer products, and so forth. The aggregate of diminished business opportunities constitutes the reputational sanction for violating market norms. And the background threat of losing reputation deters corporate misbehavior ex ante.
>
> The problem with this argument is that it treats reputation as a straightforward, binary process: companies that behave well earn reputation, while those that behave badly lose reputation. Yet a nascent literature shows just how noisy reputational rewards and sanctions can be. Not all bad news is created equal. Similar behaviors lead to different reputational outcomes. One company weathers fraud allegations relatively unscathed

reputation, a corporation cannot merely be extremely good at making and selling a product and controlling costs. There is something that invokes the broader society as well—very roughly, doing "no harm" and also "doing good" in some sense of those terms. "'The world is saying, "Convince me,"' says [a chief research officer of a major reputation measurement and management services firm] . . . . 'Companies that do well in representing their corporate narrative to make the world a better place to live are the ones who make it to the top of the ranking.'"[46]

A top corporate executive said that his company "only serve[s] two masters: revenue and reputation."[47] In principle, the "two masters" could lead in the same direction. Indeed, part of the rhetoric in mainstream pushes for ESG is precisely that—that sustainability yields long-term profits. The President of the Sustainability Accounting Standards Board Foundation, an organization whose mission is to establish disclosure standards on sustainability matters,[48] wrote:

> In recent years, corporations, investors, and regulators alike have become increasingly attuned to the importance of pursuing economic development that is both sustained and sustainable. However, capital markets have often seemed to be moving in the opposite direction, with a widespread – and often problematic – focus on short-term returns. In 2018, a collective effort to nudge capital markets toward a longer-term perspective turned an important corner, bringing the interests of financial markets and broader society into closer alignment. Our work at the Sustainability Accounting

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> while another goes bankrupt. One top executive takes the fall when her company misbehaves while another is unaffected.
>
> In particular, legal scholars too often assume that bad news automatically translates into reputational damages. The fact that news came out (that is, that an allegation of corporate misconduct became public) is a necessary but not a sufficient condition for meaningful reputational damage to occur. Several additional conditions have to hold: *diffusion*, *certification*, and *attribution*.

Shapira, *supra* note 4, at 885 (footnotes omitted).

[46] Valet, *supra* note 39.

[47] Fombrun, *supra* note 3, at 94 (quoting Morten Albaek, Senior Vice President, Vestas).

[48] *Mission*, SUSTAINABILITY ACCT. STANDARDS BD., https://www.sasb.org/governance/ [http://perma.cc/S5NS-DUWL] (last visited Apr. 8, 2019).

Standards Board (SASB) is both an outcome of this increasing alignment and, ideally, a catalyst for its continued progress.[49]

But the two masters may, or at least may seem to, lead in different directions.[50] Drug companies offer a particularly good example. Consider what happened to Turing and Mylan when they raised prices for, respectively, Daraprim and EpiPens, both of which were necessary products that had been on the market for quite some time, so that cost recovery could not be a plausible rationale.[51] The companies and their CEOs were vilified in the press and called to account by regulators.[52]

Many other examples can be given. One is of sellers who target, as potential buyers of low-quality securities, money managers known for their actual lack of sophistication, as happened in the financial crisis.[53] Another is of companies requiring expansive non-competition agreements from their low-wage employees to prevent the companies from having to compete on wages with their competitors. A different sort of example is that of Chipotle, which apparently

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[49] Matthew Welch, *The Year That Capital Markets Finally Woke Up to Climate Risk*, ETHICAL CORP. (Dec. 18, 2018), http://ethicalcorp.com/year-capital-markets-finally-woke-climate-risk?utm_source=hs_email&utm_medium=email&utm_content=68759914&_hsenc=p2ANqtz-_ZkvygoRaImOm1vTpoZrfTtoDJAlAjaZcRlWBz807mkxhr_bvzNK7er_tFekUPKOkg9Qe8lkDZjgOkKWagtGC74jHgnA&_hsmi=68772170 [https://perma.cc/LF8P-FLEZ]. The quote continues: "SASB [has developed standardised performance metrics that] help corporations more effectively communicate with investors about the environmental, social, and governance (ESG) factors most likely to influence their ability to create value over the long term." *Id.*

[50] At least in the short to moderate term. There is a big debate as to the extent to which reputation does or should push companies in directions that adversely affect profits. Insofar as customers and investors can and do "enforce" some sort of sanction for behavior they do not like, there might be a convergence. And certainly, there are some respects in which long-term-focused sustainable initiatives can add to reputation and independently, "the bottom line." There are, however, probably some intractable divergences between the interests of "the society" and those of (at least traditionally profit-maximizing) shareholders. *See* Hill, *supra* note 27, at 478-81.

[51] Even if cost recovery is a plausible rationale, there is still a much-discussed tension in pricing a drug that can materially benefit health at a price beyond what most people can afford. I discussed this issue in earlier work. *See* Hill, *supra* note 8, at 983-84; Hill, *supra* note 27, at 484.

[52] *See supra* notes 14, 44, 51 and accompanying text.

[53] *See* HILL & PAINTER, *supra* note 24, at 34; *see also* WILLIAM D. COHAN, MONEY AND POWER: HOW GOLDMAN SACHS CAME TO RULE THE WORLD 15 (2011) ("A former IKB credit officer, James Fairrie, told the Financial Times that the pressure from higher-ups to buy CDOs from Wall Street was intense. 'If I delayed things more than 24 hours, someone else would have bought the deal' he said. Another CDO investor told the paper, though, that IKB was known to be a patsy. 'IKB had an army of Phd types to look at CDO deals and analyze them,' he said. But Wall Street knew that they didn't get it. When you saw them turn up at conferences there was always a pack of bankers following them.").

just could not figure out (presumably it did not spend enough to do so) why contaminants kept getting into their food and sickening their patrons.[54]

There are of course many more difficult cases. What about a company caught calibrating precisely how much to spend on anti-pollution efforts as a function of how likely they were to get caught violating the rules, and hiring well-connected lobbyists to lobby for a relaxation of the rules?

And what of a company that expressly rejected CSR and ESG, saying that it was in business to make a profit, not serve social ends? Envision the company having, in 2019, a board comprised exclusively of white men, defending itself on grounds that it selected "purely for quality," and that diversity, whether gender, racial, or ethnic, is not a value it shares. Envision the company also announcing that its adherence to the value of cost-cutting was such that it would do as much of its business as possible in countries with the most permissive environmental and labor laws.

These issues show how time-dependent reputational assessments are. They show as well the range of contributors to reputation. There are matters relating more to possible downsides: appearing cavalier, or worse, affirmatively willing to compromise, as to people's health or well-being or the law. These are the sorts of things crisis managers are called in for and that yield lawsuits. But there are also more seemingly upside-associated matters, such as those involving companies that tout their social purpose, desire to make the world a better place, and so on.[55]

III. WHY A GOOD REPUTATION MATTERS (AND WHY COMPANIES THINK IT MATTERS)

What will companies do to get reputational benefits or avoid reputational costs? The answer turns on why they value reputation in the first place. Do they do so for "bottom line" reasons? Because "it is the right thing to do"? Or some combination of the two?

Presumably, bottom line benefits are important. Many such benefits are described at length, especially, unsurprisingly, by those in the business of helping companies manage their reputations. One such reputation-managing company says that "[c]ompanies with an *excellent* reputation not only perform

[54] *See* Susan Berfield, *Inside Chipotle's Contamination Crisis: Smugness and Happy Talk About Sustainability Aren't Working Anymore*, BLOOMBERG BUSINESSWEEK (Dec. 22, 2015), https://www.bloomberg.com/features/2015-chipotle-food-safety-crisis/. The negative reputational effect of tainted food was exacerbated by customers' feelings of betrayal given Chipotle's "food integrity" branding. *See id.*; Madison Flager & Maya McDowell, *UPDATE: This Is What Caused Chipotle's Worst Food Poisoning Outbreak Yet*, DELISH (Aug. 20, 2018), https://www.delish.com/food-news/a22667902/chipotles-food-poisoning-outbreak-ohio/ [https://perma.cc/5DS8-GQ6Q].

[55] *See infra* notes 61-62. But it should be noted that the difference between having a good reputation and avoiding a bad one is, to a significant extent, unintelligible, depending as it does on rapidly changing norms. Is doing at least what others do considered good or simply not bad? There is no particular reason to resolve this issue, but it ought to be acknowledged.

better but are better insulated against risk."[56] They cite a number of statistics, including some relating to a company's desirability as an employer, and people's willingness to give companies with better reputations the "benefit of the doubt."[57] But how sound is their evidence? Another source finds that:

> the strength of a company's reputation prior to an event did little to insulate it against the loss of value. This suggests that while building up a solid reputation is obviously important, it isn't enough in the face of a crisis to ensure an effective recovery. That said, companies that invested in corporate social responsibility did appear to enjoy a halo effect. "The perception is these are just good guys who something bad has happened to," said Randy Nornes, enterprise client leader, Aon.[58]

Academic literature, too, talks about reputation's benefits, and the bottom-line effects of damage to reputation. One article stated:

> Executives know the importance of their companies' reputations. Firms with strong positive reputations attract better people. They are perceived as providing more value, which often allows them to charge a premium. Their customers are more loyal and buy broader ranges of products and services. Because the market believes that such companies will deliver sustained earnings and future growth, they have higher price-earnings multiples and market values and lower costs of capital. Moreover, in an economy where 70% to 80% of market value comes from hard-to-assess intangible assets such as brand equity, intellectual capital, and goodwill, organizations are especially vulnerable to anything that damages their reputations.[59]

Other articles conclude that the issue is more complicated:

> Studies of market reputational losses following legal enforcement suggest that causing harm to third parties who do not deal with the firm (e.g. environmental torts) does not result in any additional reputational losses. . . . But where the harm is to third parties, it will not.
>
> We characterise a firm's *political reputation* as the public perception of the firm's activities in the media. . . . A firm may suffer adverse consequences in the form of heightened probability of investigation or enforcement action being taken against it by public authorities, or possibly reduced likelihood of success in a public procurement competition. The difference between political and market reputation is that a firm's political reputation may potentially be damaged by harm caused to third parties by its activities.

[56] *Solutions: Unlocking the Exponential Power of Reputation Requires Intelligence*, REPUTATION INST., https://www.reputationinstitute.com/solutions [https://perma.cc/SF44-FGCA] (last visited Apr. 8, 2019).

[57] *Id.*

[58] Michelle Kerr, *Social Media Has Doubled the Cost of Reputational Blows*, RISK & INS. (Sept. 28, 2018), http://riskandinsurance.com/social-media-doubled-reputation-costs/ [https://perma.cc/UQ3F-CUW6].

[59] Eccles, Newquist & Schatz, *supra* note 10, at 104.

> Conversely, a firm may seek to enhance its political reputation by engaging in activities that demonstrate its commitment to social responsibility.
>
> While the empirical literature is equivocal as to whether political reputation is a measurable channel through which a firm's value is affected, some studies do report positive valuation effects of corporate social responsibility investments that benefit the environment, consistent with this view. An alternative interpretation is that CSR investment is actually a proxy for compliance activity, meaning that such firms are likely to incur reduced penalties should they be on the receiving end of enforcement actions.[60]

What about "doing the right thing" as a corporation's reason to act or not act in a certain way? Corporations characterize themselves as seeking to do that, and succeeding. The following text is from the AT&T website on sustainability initiatives:

> Our world is facing significant questions in the 21st century. How will we continue to support 9 billion people without inhibiting our natural environment's ability to support us? The future depends on the well-being of our planet. Our technology can help communities and businesses conserve natural resources, but we know we have to look after our own impact, as well. Learn about how we're using our network to help build a better tomorrow [by following the links set forth on the website].[61]

Here is what Citigroup's CEO has to say, on Citigroup's webpage on "Global Citizenship":

> A firm of our size and scale achieves great and big things when we put our mind to it — but my colleagues also positively impact the lives of many in small but meaningful ways each day. The ways we help make our communities stronger, provide opportunities to those who need support, protect our environment and celebrate diversity are the truest reflection of our values and the progress we enable around the world.[62]

Why is any of this important? Because my argument turns on getting corporations to sign on to a particular conception of reputation. Whether they

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[60] *See* John Armour et al., *Putting Technology to Good Use for Society: The Role of Corporate, Competition and Tax Law* 10 (European Corp. Governance Inst., Law Working Paper No. 427, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3287696 (citations and footnotes omitted). For an article arguing that the issue of reputational benefits is complicated, especially given that different stakeholders have different needs and different perceptions, see Walker, *supra* note 32, at 372. *See also* HILL & PAINTER, *supra* note 24, at 2-3 ("Some bankers apparently believe that their clients won't hold problematic behavior against them- or even, that some sorts of problematic behavior are a sign of intelligence and skill.").

[61] *AT&T Corporate Environmental Sustainability*, *supra* note 6.

[62] *Global Citizenship*, CITI, https://www.citigroup.com/citi/about/citizenship/ [https://perma.cc/42NC-JWA2] (last visited Apr. 8, 2019).

are willing to do so depends on why they value reputation (of this sort) in the first place, and how they make their decisions as to what reputational investments they are willing to make.

Regardless of what companies say, bottom line reasons must be a significant part of why they would invest in their reputations (and present themselves as motivated to "do the right thing"). The usual approach to making investments is to assess costs and benefits with as much precision as possible. But a bottom line assessment of reputational costs and benefits is particularly difficult.[63] Indeed, reputational costs and benefits may be different at different times in ways that would have been hard to predict ex ante. Consider the period of time over which the use of child labor became a charged topic and yielded criticism of companies that relied on it. The same can be said of outsourcing.

Of course, assessments of reputational costs and benefits are nevertheless made.[64] Reputational risk insurance, a burgeoning field, does precisely that: insurers and companies agree on a price at which the insurer is willing to sell,

[63] Of course, many computations made by and about companies rely on estimates of what will happen in the future—what revenues will be generated, what costs will be incurred, and what the relevant discount rates will be. But reputational costs and benefits may be particularly hard to quantify except within a broad range. Morever, trying too hard to be precise about making the quantification may carry its own costs. If other companies face the same task and constraints, spending that is perhaps not justified by some plausible assessment of costs versus benefits may nevertheless be the decision-maker's best choice, given that the company's aim is as much positional as absolute. I discuss this issue below. *See infra* text accompanying note 75.

[64] Some of the assessments are by academics or regulators. *See, e.g.*, Nadine Gatzert, Joan T. Schmit & Andreas Kolb, *Assessing the Risks of Insuring Reputational Risk*, 83 J. RISK & INS. 641, 642 (2016); Sergio Scandizzo, *A Framework for the Analysis of Reputational Risk*, 6 J. OPERATIONAL RISK 41, 42 (2011). Some are by people in the industry, and are part of their marketing efforts. *See, e.g.*, RAMY FARHA, EVAN SEKERIS & DANIEL HERMANSSON, OLIVER WYMAN, THE HIDDEN COST OF REPUTATION: AN APPROACH TO QUANTIFYING REPUTATION RISK LOSSES 5 (2017), https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2017/jul/Reputational%20Risk.pdf [https://perma.cc/4M5N-CT6D]; Mitic, *supra* note 37, at 9-10; *see also* Thomas M. Krueger & Mark A. Wrolstad, *Impact of the Reputation Quotient® on Investment Performance*, 19 CORP. REPUTATION REV. 140, 140 (2016) ("Although many years and multiple factors go into creating a reputation, this study found that past share price performance was unrelated to company reputation. However, reputation does appear to provide insight into future firm performance. Firms with the worst reputations often seem to have trouble providing a return sufficient to cover risk, especially in the absence of dividends. By comparison, firms with the best reputations tend to have lower risk, whether measured in terms of systematic risk or total risk, and therefore generate significantly higher risk-adjusted rates of return."). One obvious approach to measuring reputational risk is to measure the effect of a reputation event on stock prices. Krueger & Wrolstad, *supra*, at 140; *see also* Gatzert, Schmit & Kolb, *supra*, at 664-65; Mitic, *supra* note 37, at 9-10. This measure is more relevant for avoiding "reputational risk events" than it is for a broader consideration of reputational costs and benefits. Such a broader consideration might, for instance, suggest doing more to get an "excellent" reputation to get "the benefit of the doubt" or to attract the best employees. *See supra* notes 56-57 and accompanying text; *infra* text accompanying note 74.

and the company is willing to buy, insurance against reputational harms.[65] Note, however, that this insurance is sold to, and bought by, particular companies, and covers events that cause losses relative to a company's "reference" reputation. The reference reputation would surely include the sorts of matters for which crisis consultants would be called in, such as revelations of unsafe products. It might also include some of the more contemporary focuses of social activism insofar as these were part of the expectations the company had set and publicized for itself.[66] Thus, the computations are relevant to a company's assessments of what to spend and on what to spend it. However, they do not capture companies' broader assessments of what reputational credit they might gain or lose as the future unfolds, norms shift, and new facts, positive and negative, are

[65] Reputational risk insurance is becoming more popular, although getting it is is not common. *See generally* LARY HAZNSARD, GALLAGHER HEALTHCARE, INSURING YOUR REPUTATION (2015), https://www.ajg.com/media/1697712/reputation-risk-white-paper.pdf [https://perma.cc/GM4X-7EL6]. The insurance offers a package of services, including ongoing monitoring and assistance in crisis management. Certain types of reputational risk insurance may also offer tax benefits.

[66] Conceptually, there must be some "value" that is insured, and a way to measure the negative deviation from that value. Some policies analyze a company's reputation and measure deviations from that. *See* Ireland, *supra* note 37. Others are more focused on events that do or could yield criminal liability—for example events comparable to BP's Deepwater Horizon oil spill; General Motors' ignition switch problems; Wells Fargo's ghost accounts; or unsanitary, unhealthy, and unappetizing conditions on a Carnival cruise ship. *See* HAZNSARD, *supra* note 65, at 2; Lawrence, *supra* note 20; *Wells Fargo's Phony-Account Scandal, Explained*, *supra* note 12. One definition of reputational risk, from a reputational risk insurer, is "the 'risk of loss resulting from damages to a firm's reputation, in lost revenue; increased operating, capital or regulatory costs; or destruction of shareholder value, consequent to an adverse or potentially criminal event even if the company is not found guilty.'" HAZNSARD, *supra* note 65, at 2. Even that subset of the broader reputational concerns is hard to measure. One analyst noted that, "'It can be the most important quantitative risk at the end of the day, but there are only qualitative measurements for it.' So when a bank is trying to decide how much to spend to address certain types of risks it may face, trying to do a cost-benefit analysis or trying to estimate ROI [return on investment] on a reduction in reputational risk is apt to be frustrating." Tom Groenfeldt, *Calculating Elusive Reputational Risk - - A Task for a Dartboard?*, FORBES (Mar. 13, 2018, 1:41 PM), https://www.forbes.com/sites/tomgroenfeldt/2018/03/13/calculating-elusive-reputational-risk-a-task-for-a-dartboard/#6d34a8f42951 [https://perma.cc/ET5Z-G377] (quoting Danielle Tierney, senior analyst at the Aite Group). One person in the business of offering reputational risk insurance notes that "[t]he greatest challenge for the industry in quantifying reputational risk is the prevalence of simplified notions of the peril. Like fraud risk, reputation risk is a complex peril that has multiple contributing factors, and its going-forward costs are far greater than losses that are immediately appreciated." Ireland, *supra* note 37. Indeed, not surprisingly, insurers discuss at length the difficulties in assessing reputational risk. *See* EY & TAPESTRY NETWORKS, LEADING INSURERS ADDRESS REPUTATION AND ITS RISKS (July 2015), https://www.ey.com/Publication/vwLUAssets/ey-leading-insurers-address-reputation-and-its-risks/$FILE/ey-leading-insurers-address-reputation-and-its-risks.pdf [https://perma.cc/AY48-JMUB].

discovered.[67] The computations also may not be able to pick up "costs" that may seem harder to measure or link to particular conduct (or refraining from particular conduct) as new stakeholders and their interests are identified.[68] Indeed, my inquiry in this Article focuses on how a company might make that broader assessment—an assessment that, perhaps, BlackRock Chairman and CEO Larry Fink's now-famous 2018 letter to CEOs was intended to prompt:

> Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including

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[67] If the company has geared up to proceed in a certain way, a reputational risk insurer can assess how well-situated the company is to prevent or deal with the risk. But as the company is deciding how to proceed and has not yet geared up in any meaningful way, detailed and precise computation will often not be feasible, notwithstanding the increasing sophistication and specialization in measurement of risks of this type.

[68] As stated in a *Harvard Business Review* article:

> Sometimes norms evolve over time, as did the now-widespread expectation in most developed countries that companies should pollute minimally (if at all). A change in the behavior or policies of a leading company can cause stakeholders' expectations to shift quite rapidly, which can imperil the reputations of firms that adhere to old standards. For example, the "ecomagination" initiative launched by General Electric in 2005 has the potential to raise the bar for other companies. It committed GE to doubling its R&D investment in developing cleaner technologies, doubling the revenue from products and services that have significant and measurable environmental benefits, and reducing GE's own greenhouse emissions.
>
> Of course, different stakeholders' expectations can diverge dramatically, which makes the task of determining acceptable norms especially difficult. When GlaxoSmithKline pioneered the development of anti-retroviral drugs to combat AIDS, its reputation for conducting cutting-edge research and product development was reinforced and shareholders were pleased. They were initially on board when GSK led a group of pharmaceutical companies in suing the South African government after it passed legislation in 1997 allowing the country to import less expensive, generic versions of AIDS drugs covered by GSK patents. But in 2001, GSK shareholders did an about-face in reaction to an intensifying campaign waged by NGOs and to the trial proceedings, which made GSK and the other drug companies look greedy and immoral. With its reputation plunging, GSK relented and granted a South African company a free license to manufacture generic versions of its AIDS drugs—but the damage was already done.
>
> Sometimes, particular events can cause latent concerns to burst to the surface. One example would be all the questions about whether Merck had fully disclosed the potential of its painkiller Vioxx to cause heart attacks and strokes. Merck is embroiled in thousands of lawsuits over the arthritis drug, which it pulled from the market in 2004. The controversy has raised patients' and doctors' expectations that drug companies should disclose more detailed results and analyses of clinical trials, as well as experience in the market after drugs have received regulatory approval.

Eccles, Newquist & Schatz, *supra* note 10, at 108-09.

shareholders, employees, customers, and the communities in which they operate.[69]

IV. How Might Companies Preserve and Enhance Their Reputations?

Thus, reputation means more than just avoiding "reputational risk events" or their consequences. It encompasses avoiding a "bad" reputation but also having a "good" reputation, as those concepts are understood at the time. It encompasses not just preserving one's existing reputation based on past decisions and past norms, but also assessing how and to what extent to invest in reputation maintenance and enhancement in a changing world with changing rules and norms. Thus, even if some plausible level of quantification is increasingly possible as to reputational risk events, the same is not true as to the broader sphere of concerns that reputation encompasses.

How should a company determine how, and how much, to invest in its sustainability and diversity initiatives? How does it measure the benefits against which it can compare the costs? How does a company determine the extent to which it will use performance goals that encourage more aggressive production or sales targets, given the legal and reputational risks of potentially going "too far"? How does a company attempt to manage its labor costs, again given countervailing considerations including reputational considerations?[70]

Notwithstanding these complexities, companies must nevertheless decide how to proceed to obtain reputational benefits and/or avoid reputational costs. The inquiry only matters if the costs incurred to get reputational benefits will not yield at least commensurate (non-reputational) benefits so that the net effect on the bottom line is negative. Again, notwithstanding advances in

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[69] Larry Fink, *Larry Fink's 2018 Letter to CEOs: A Sense of Purpose*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter [https://perma.cc/5WJ6-6B27] (last visited Apr. 8, 2019).

[70] Recall, too, that corporate-citizenship reputation can pull in different directions than other types of reputation. One article notes, for instance, that

> [i]n studies of the relationship between reputations and financial success, the evidence is mixed. [One author] found that a company's reputation for financial success can adversely affect its overall reputation. The author reports that firms perceived as making large profits at the expense of customers can adversely affect their reputations. This could possibly explain why some companies with poor reputations are more profitable than other companies with better reputations. Other research found no significant effect on stock prices when new information on corporate reputations was announced.

Krueger & Wrolstad, *supra* note 64, at 141. Might corporate citizenship reputational considerations themselves even push in different directions? One commonly used framework (both commercially and academically) has six "dimensions" of reputation: products and services, vision and leadership, emotional appeal, workplace environment, financial performance, and social responsibility. THE HARRIS POLL, HARRIS INSIGHTS & ANALYTICS, THE 2018 HARRIS POLL RQ® SUMMARY REPORT 14-15 (2018), https://theharrispoll.com/wp-content/uploads/2018/12/2018-HARRIS-POLL-RQ_2-Summary-Report_FNL.pdf [https://perma.cc/PSM9-FM8Y]. Might social responsibility conflict with workplace environment, for instance?

measurement, assessing how much particular reputationally focused expenditures will affect the bottom line cannot be done with precision. Indeed, it seems likely that such expenditures' bottom-line costs will be more salient than the benefits, particularly in the short term. A company might cut labor costs by hiring "contract" labor rather than employees to whom it pays benefits. Would moderate-term negative effects on quality of the product, turnover, and other bottom-line costs be cleanly and readily traceable to the decision to get "independent contractors" rather than employees in the way that the bottom line savings, especially in the short term, would be?

Companies do face competitive pressure to be seen as being concerned about social issues, or at least not falling behind their peers in this regard.[71] Again, whether such a concern translates into bottom line results is not clear. Certainly, there are many assertions to that effect,[72] but a conclusive demonstration is not presently possible. Insofar as companies regard their bottom-line efforts as comparative vis-à-vis their peers—that is, if they think their peers are incurring expenditures of this type—the result may be to lessen a general incentive to be as bottom-line focused as possible. Stated differently, a company would presumably worry less about costs to advance a sustainability initiative, for instance, if it thinks its competitors are also incurring those costs.

What about managers' interests? Managers care about their own reputations, but also their compensation. These forces might, or might not, push them in two different directions. Again, we do not know whether there are bottom-line effects of good or bad reputations and what the magnitudes of those effects are. (We also do not know how sensitive managers' compensation is to the bottom-line effects at issue, if any). If we characterize the managers' principals (the corporation and its shareholders) as wanting "pure" profit maximization for their corporations, it is possible, although by no means assured, that managers' pursuit of better corporate reputation might constitute an agency cost if that pursuit

[71] One piece of anecdotal evidence I have for this is conversations with several top sustainability personnel at major corporations, all of whom spoke to me on the condition of anonymity. But this is an uncontroversial proposition. *See, e.g.*, THE HARRIS POLL, *supra* note 70, at 17 ("In this new world, consumers desire brands that act small, share their values and take a stand on societal issues."). Certainly, many major companies tout their concern for sustainability/ESG issues prominently on their websites. *See, e.g.*, AT&T, 2017 CORPORATE RESPONSIBILTY UPDATE: BUILDING A BETTER TOMORROW 13-14, 21-22 (2017), https://about.att.com/content/dam/csr/sustainability-reporting/PDF/2018/ATT-Corporate-Responsibility-Update.pdf [https://perma.cc/VXD6-9EZ3]. Financial institutions are, perhaps particularly, apt to talk about culture and integrity on their sites, something that is not surprising given the scandals that are not just in memory, but continue to occur. *See, e.g.*, *Corporate Governance: Raising Integrity Concerns*, GOLDMAN SACHS, https://www.goldmansachs.com/investor-relations/corporate-governance/board-and-governance/raising-integrity-concerns/ [https://perma.cc/V7HW-VMXL] (last visited Apr. 8, 2019); *Global Citizenship: Conduct and Culture*, CITI, https://www.citigroup.com/citi/about/citizenship/conduct-culture.html (last visited Apr. 8, 2019) ("For nearly a decade, we've strived to reinforce a culture based on ethics and execution across our businesses.").

[72] "Companies with strong reputations are more likely to attract top talent, investors, and stakeholders – all of which benefit the bottom line." THE HARRIS POLL, *supra* note 70, at 17.

yielded more of a benefit for the managers' image than bottom line results for the corporations.

One possibility is that although neither effect is quantifiable with any precision, pressures from various quarters make meeting certain present-day reputational benchmarks particularly salient. Certainly, as a matter of corporate law, everything in this realm would be a matter of business judgment deference. If managers want to spend more on reputation, they can do so without being second-guessed by shareholders claiming that the managers are breaching their fiduciary duties and not maximizing profits.[73] The managers can easily justify the choice with bottom-line type reasons, such as those that are used for corporate charitable contributions and perhaps regulatory favor—insofar as regulators may feel pressure to pursue and investigate companies whose bad behavior becomes known—and vulnerability to consumer lawsuits that might stem from not "being given the benefit of the doubt."[74] A company, or its managers, might also conclude that being caught at being instrumental about reputation—computing precisely the benefit stemming from a particular reputational expenditure—would be sufficiently costly that making cruder and more generous assessments of those benefits was indicated.[75]

The intuition is readily conjured up. Consider a company trying to calibrate carefully how much to spend on its antibribery efforts based on an assessment

[73] There are cases, notably *Dodge v. Ford* and the more recent eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 28-35 (Del. Ch. 2010), that effectively hold that managers must act to further shareholder profit and not the interests of other stakeholders. The *eBay* case held that directors/controlling stockholders' poison pill to dilute eBay's interest in Craigslist violated Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985): "Ultimately, defendants failed to prove that craigslist possesses a palpable, distinctive, and advantageous culture that sufficiently promotes stockholder value to support the indefinite implementation of a poison pill. Jim and Craig [directors and together, controlling shareholders] did not make any serious attempt to prove that the craigslist culture, which rejects any attempt to further monetize its services, translates into increased profitability for stockholders." In Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919), the court held that "it is not within the lawful power of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others." In *eBay* and *Dodge v. Ford*, the managers made a point of disclaiming profit-based motivations. Craigslist's stance in this regard is well known. As to *Ford*, Henry Ford, CEO, said that his ambition was "to spread the benefits of this industrial system to the greatest possible number," referring in part to the employees and in part to customers. *Id.* at 671. If they had not done so, the cases might very well have come out the other way. Boards can almost always find a reason why some, even very large, not-apparently-business-related expenditure, or a low price offered to consumers, advances the company's goodwill and business prospects.

[74] *See supra* notes 56-57 and accompanying text.

[75] I developed this argument in a prior work. *See* Claire A. Hill, *Caremark as Soft Law*, 90 TEMPLE L. REV. 681, 688 (2018) ("A formalist approach to compliance might be unacceptable for instrumental reasons: ultimately, taking all costs into account, including reputational costs and those associated with regulatory disfavor, it might not be profitable.").

of how likely it is to be caught given enforcement capabilities and political realities. Or consider a company engaging in a business or practice that may not violate the letter of the law but would be looked upon unfavorably, such as very "hard" sales tactics directed to vulnerable consumers. That the company was attempting to carefully calibrate the point at which the costs (such as bad word of mouth or pressure on regulators to "do something") of additional "hardness" equaled the benefits would presumably itself be costly. This should be true for attempts to invest in reputational benefits as well. Think of a company whose deliberations as to what environmental expenditures to incur were found to be based on a precise assessment of how much additional revenue it would get from particular types of customers.

It is impossible to assess the size of this effect. We might expect that when such computations were particularly salient—when a company whose products had caused well-publicized serious harm had been caught deciding against a safety expenditure, for instance, or if a company touting its good citizenship had been caught selecting among "good" initiatives by reference to the profits the pleased constituency would yield—the effect would be largest. But even then, it would presumably be limited. A company's constituencies surely include those who are strongly focused on familiar bottom line line-items and who would constrain pressures to appeal to those who particularly value seemingly revenue-forsaking or cost-increasing expenditures that promote socially desirable objectives.[76] Stated differently, a company's concern for the bottom line as conventionally understood and expressed will limit the amounts available to advance its reputation.

Where does this leave us? Companies are concerned about their reputations, and are willing to incur some costs to get reputational benefits (and minimize the possibility of reputational costs), but the amount and the form of the investment is unclear. And under certain circumstances, their assessments might be cruder and more generous than other sorts of cost-benefit assessments they might make, lest they appear more conventionally bottom-line oriented than they wish to.

V. TWO COMPONENTS OF REPUTATION

The foregoing concerns overall reputation. Interestingly, while the category is a meaningful one, for many purposes, it consists of two very different sorts of matters. One is adverse "reputational events" that are or seem to be immoral, illegal, extremely careless, or otherwise reflect badly on the corporation. Many references to reputation, notably by economists and law and economics scholars, are in this category; a standard formulation is that corporations are constrained from acting in ways that could cause them to get a bad reputation.[77]

The other is conduct on the positive side, relating to the broader society as much as to the corporation itself, such as CSR and ESG. The distinction between

[76] *See* Krueger & Wrolstad, *supra* note 64, at 141.

[77] *See, e.g.*, Shapira, *supra* note 4.

negative and positive here is ultimately unintelligible—an egregious and emphatic disavowal of CSR/ESG concerns could be an adverse reputational event—but the distinction nevertheless resonates. It is as though not having adverse reputational events is, conceptually, a baseline, whereas addressing CSR/ESG concerns would have been above and beyond.[78] Even though some level of adherence to CSR/ESG, at least rhetorically, is now arguably within the baseline, the two seem qualitatively different. Perhaps, to overstate, avoiding the reputational events is critical whereas doing something positive in the general family of CSR/ESG is simply "desirable"?

Another way to articulate the difference is with reference to traditional justifications for law. One such justification is the internalization of negative externalities. Adverse reputational events often impose negative externalities, and are adverse in significant part for that reason. To take a recent dramatic example: In the recent Boeing crashes, hundreds of people died.[79] By contrast, if particular CSR/ESG elements were mandated, (such as required diversity on boards, as California has recently done)[80] the justifications would be more controversial, arguably imputing a particular social duty to corporations (insofar as the business case is not that strong, and in any case, it is not clear why the state would or should mandate a practice on grounds that it helps business).[81] Again, these propositions are contestable too, but they accord with intuition. To take an extreme example, a company creating ways to defeat emissions testing or concealing its knowledge of a major defect in its products is different than a company having a nondiverse board or doing no more for the environment than complying with applicable environmental laws.[82] But the difference may not be as stark or as qualitative as it might appear. Envision, again, as mentioned above, an outlier in realms of CSR/ESG, such as a company with an all-male, all-white board and C-suite, primarily focusing on business opportunities in jurisdictions known for lax labor and environmental laws.

Where is the baseline from which positive, or negative, departures are measured? The answer changes over time. #MeToo provides an example where

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[78] I express no view as to whether these initiatives, in theory or as they are currently pursued, are desirable. I merely characterize them as desirable from the point of view of those pushing corporations in those directions.

[79] Picheta, *supra* note 9.

[80] *See* David Shaywitz, *California's New Diversity Law Aims to Help Businesses Help Themselves*, FORBES (Oct. 1, 2018, 9:58 PM), https://www.forbes.com/sites/davidshaywitz/2018/10/01/californias-new-diversity-law-aims-to-help-businesses-help-themselves/#32aa573265e5 [http://perma.cc/Z92d-94FZ] (requiring gender diversity on corporate boards).

[81] *See, e.g.*, Andrew Ross Sorkin, *Diversify the Boardroom, Just Not Like California*, N.Y. TIMES, Oct. 2, 2018, at B1 ("Despite advocates' insistence that women on boards enhance corporate performance and that diversity of task groups enhances their performance, research findings are mixed, and repeated meta-analyses have yielded average correlational findings that are null or extremely small . . . .").

[82] *See* text accompanying notes 19-23.

expectations of how a corporation should conduct itself have changed, such that the baseline expectation is far higher than it was.[83] What might have been considered above and beyond could now be an adverse reputational event. A recent article described the trajectory:

> Recognizing inappropriate behavior as harassment was a radical concept in 1979, when activist and attorney Catharine MacKinnon published "Sexual Harassment of Working Women: A Case of Sex Discrimination," a groundbreaking book that tackled sexual discrimination in the workplace head-on. Seven years later, MacKinnon was co-counsel in the U.S. Supreme Court case that recognized such harassment as a violation of Title VII of the Civil Rights Act of 1964. Today . . . [she] tells the Gazette she is "inspired by the brilliance, heart, and grit of all the survivors who are speaking out and reflecting on their experiences of sexual violation, and being listened to." And she said the downfall of so many powerful men is stunning, "especially given decades of stonewalling and recalcitrance and siding with abusers."[84]

Another example, again, is the use of child labor, both in the United States and elsewhere.[85] What reputation requires reflects the collective and changing values of the society. These values are sometimes expressed in law and sometimes not.

VI. FOCUSING ON PROBLEMATIC BUSINESS CONDUCT

This Article began by noting the increasing attention being paid to CSR/ESG initiatives. Corporations are being pushed to spend time and effort in various societally salient ways—notably including board diversity and sustainability—and they are responding.[86] This Article noted as well that corporations and their

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[83] *See, e.g.*, Mary Altaffer, *After Being Rocked by Sexual Misconduct CBS News Names Its First Female President*, WASH. POST (Jan. 7, 2019), https://www.washingtonpost.com/nation/2019/01/07/after-being-rocked-by-sexual-misconduct-allegations-cbs-news-names-its-first-female-president/?utm_term=.34cd3ddf9e91.

[84] Christina Pazzanese & Colleen Walsh, *The Women's Revolt: Why Now, and Where To*, HARV. GAZETTE (Dec. 21, 2017), https://news.harvard.edu/gazette/story/2017/12/metoo-surge-could-change-society-in-pivotal-ways-harvard-analysts-say/ [https://perma.cc/BZ2S-NDMS].

[85] *See Nike and Child Labour – How It Went from Laggard to Leader*, MALLEN BAKER (Feb. 29, 2016), http://mallenbaker.net/article/clear-reflection/nike-and-child-labour-how-it-went-from-laggard-to-leader [https://perma.cc/NR2T-GJAK]; Estiban Ortiz-Ospina & Max Roser, *Child Labor*, OUR WORLD IN DATA, https://ourworldindata.org/child-labor [https://perma.cc/972V-A22G] (last visited Apr. 8, 2019) ("Historical studies suggest that child work was widespread in Europe and North America in the 19th century, but declined very rapidly at the turn of the 20th century.").

[86] *See* Fink, *supra* note 69; Celia Huber & Sara O'Rourke, *How to Accelerate Gender Diversity on Boards*, MCKINSEY & COMPANY (Jan. 2017), https://www.mckinsey.com/featured-insights/leadership/how-to-accelerate-gender-diversity-on-boards [https://perma.cc/4V9Y-RNM7]; SUSTAINABILITY ACCT. STANDARDS BD., *supra* note 5; Shirley Westcott, All. Advisors, *Surprises from the 2018 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE &

advisers spend considerable time and effort avoiding adverse "reputational events." Google searches for "reputational risk management" and like terms yield many millions of hits.

These focuses should be complemented by an additional focus—on problematic business models and practices. Such models and practices apparently continue notwithstanding the law's efforts to stop them, and they cause considerable damage. Such a focus would bolster existing law, and help fill gaps where law does not or could not do enough. It would also help in areas where the use of law would be undesirable, perhaps unduly compromising competing values such as autonomy.

A necessary starting point is a definition of what is to be discouraged: problematic business models and practices. This Article's proposed definition is that a business model or practice is problematic if it relies on the existence of buyers or sellers or other parties with less than full capacity (typically because of age or other cause for incompetence, or because they are under duress) or information, or who are not contracting for their own account. Such models or practices impose a negative externality on the broader society.[87] The externality is the cost to the party that lacks full capacity, will, or information, and to the third party who is being burdened (who I call a third party burdenficiary) relative to the baseline (an idealized transaction involving willing and informed parties with full capacity transacting for their own account).[88]

This definition warrants further explanation. Negative externalities are acknowledged to be an appropriate basis for law. Law should, for instance, prevent a company from profiting by skimping on clean-up costs of its activities, leaving those for others to bear. But, as I argued in earlier work, however appealing this concept is as a matter of theory, it is very often indeterminate as a real guide to policy.[89]

The problem with the concept as generally used is that the negative externalities are considered to be facts about the world, when they very often are

FIN. REG. (June 27, 2018), https://corpgov.law.harvard.edu/2018/06/27/surprises-from-the-2018-proxy-season/ [https://perma.cc/R6AC-B9SA]; *Why Gender Diversity Matters*, 20% BY 2020: WOMEN ON BOARDS, https://www.2020wob.com/learn/why-gender-diversity-matters [https://perma.cc/H7XW-LL4T] (last visited Apr. 8, 2019).

[87] Negative externalities are defined in the literature as negative effects "related to the production or consumption of a good that falls on people who are not the producers or consumers." PARISI, *supra* note 28, at 115; *see also* Christina Romer & David Romer, Professors, Univ. of Cal. Berkeley, Presentation at Univ. of Cal. Berkeley: Lecture 10: Externalities (July 2017), https://www.econ.berkeley.edu/sites/default/files/course-homepage/2017-02-16/lecture-notes/Lecture%2010%202-16%20Outline%20and%20Slides_0.pdf [https://perma.cc/8D5X-9NAJ].

[88] *See* Hill, *supra* note 8, at 981. In that article, I attempted to define repugnant business models as, potentially, akin to contracts that would be found unenforceable using doctrines such as incapacity, incompetence, duress, unconscionability, or violating public policy. *See id.* This is a closely related inquiry, but anchors the concept I am trying to define here by reference to "negative externalities."

[89] Hill, *supra* note 29, at 518.

not. In the paradigmatic cases in which the concept has been used, a baseline (say, clean air) is known and agreed upon, the damage can readily be described and quantified, such that what a company would be required to do to "internalize the negative externality" would be straightforward. But in most everyday examples, neither the baseline, nor how to characterize the chain of causation or value the associated damage, is clear. Consider the example of the subprime mortgage crisis. How would we compute the negative externalities of selling toxic subprime securities to money managers who were nominally sophisticated, investing for the proverbial widows and orphans, and were targeted by the securities' sellers precisely for their nominal-but-not-actual sophistication?[90]

Notwithstanding this critique—my critique—this Article argues that the concept of negative externalities can and should be revived, and used for negative externalities that *the society would characterize as such*. The baseline from which an effect is to be measured, what the damages are for the deviation, and how to assess them are determinations society makes, using the information available at that time, and with reference to broader values. Now, given the information presently available to us, we would characterize second-hand cigarette smoke as a negative externality; we would not characterize the aroma of street food that way, even if some people find the smell quite unpleasant. The 2002 Super Bowl featured an anti-drug ad campaign attributing to illegal drug buyers the responsibility for harm done by terrorists who supposedly eventually got the drug buyers' money.[91] The ad was controversial, and in some quarters outrage-inducing; its effectiveness was also questioned. Recreational drug users were, it seems, not readily characterizable as inflicting negative externalities, responsible for horrific conduct of terrorist kingpins who might have gotten some of the proceeds from the recreational users' drug purchases and used them to fund violence.[92]

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[90] *See* Chris V. Nicholson, *New Tourre Emails Show Trader Under Duress*, N.Y. TIMES: DEALBOOK (Apr. 26, 2010, 6:02 AM), https://dealbook.nytimes.com/2010/04/26/new-tourre-e-mails-show-trader-under-duress/ ("I just sold some abacus bonds to widows and orphans that I met at the airport, these Belgians certainly love synthetic abs CDO squared!!!"); *see also* Edward Schoen, *The 2007-2009 Financial Crisis: An Erosion of Ethics: A Case Study*, 146 J. BUS. ETHICS 805, 813 (2017) ("[M]any of the subprime mortgages, marketed to financially unsophisticated borrowers, were simply 'designed to default . . . .'").

[91] *ONDCP – I Helped*, ADAGE (Feb. 3, 2002), https://adage.com/videos/ondcp-i-helped/820 [https://perma.cc/7MBX-W2CP].

[92] The ad was included on a site as one of the Super Bowl commercials that "sparked outrage." Beatrice Verhoeven, *12 Super Bowl Commercials That Sparked Outrage (Videos)*, WRAP (Jan. 30, 2018, 11:30 AM), https://www.thewrap.com/11-most-controversial-super-bowl-commercials-all-time-videos/ [https://perma.cc/T2EW-7PMC]; *see also* Frank Ahrens, *New Pitch in Anti-Drug Ads: Anti-Terrorism*, WASH. POST (Feb. 4, 2002), https://www.washingtonpost.com/archive/politics/2002/02/04/new-pitch-in-anti-drug-ads-anti-terrorism/2e1a63b7-5e85-4e7a-b418-0e9148268b48/?utm_term=.a3eba6827fc2; Naftali Bendavid, *Critics Decry Ads Linking Drugs, Terror*, CHI. TRIB. (Mar. 24, 2002), https://www.chicagotribune.com/news/ct-xpm-2002-03-24-0203240277-story.html; E.J.

Some stylized descriptions of real-world examples help explain the concept. A mayor and the head of a municipal union agree on considerably above-market pension benefits (probably with computational tricks, such as an inflated imputed rate of return, to disguise their actual size) for union members in "exchange" for union members' support for the mayor (and for the head of union). The taxpayers here are third-party burdenficiaries. Another example, where the shareholders are third-party burdenficiaries, is where "their" lawyers argue for settlements in business law cases that yield negligible benefits for them, settlement funds for the lawyers, and expansive releases for the director-defendants.[93] What are the costs to these burdenficiaries? In the former case, the cost is the amount by which the agreed-upon benefits exceed market-rate benefits. In the latter case, the cost is what a settlement favoring the real parties in interest would yield.

An example involving incapacity or incompetence involves a company in the business of persuading people receiving structured settlements for lead paint exposure to accept below-market lump sum payments. The applicable statute required an "independent" person to attest that the settlement recipient was getting the fair value of the settlement, but the nominally independent person was not really independent.[94] Finally, one could argue in a Daraprim-like case that there was an element of duress: the drugs were life-saving and there were no ready alternatives, so those needing them had to find a way to pay for them. In the former case, it is easy to compute the cost. In the latter case, the computation is more difficult—what "should" the Daraprim cost? What would we hypothesize about the price given how much regulation affects drug prices at all stages?

Another example includes the practice by a medical firm of sending personnel to facilities caring for Alzheimer's patients and diagnosing many of the patients as needing elaborate dental work or aggressive skin cancer treatment for slow-growing cancers, to be mostly or completely paid for with government

Schultz, *Whatever Happened to the Ad War on Drugs?*, ADAGE (Mar. 24, 2014), https://adage.com/article/news/happened-ad-war-drugs/292262/ [https://perma.cc/37EY-8UQH].

[93] *See generally In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884 (Del. Ch. 2016); Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1 (2015). There have been inroads against this practice, but it still occurs. A novel solution discussed in a related context is that of giving lawyers the same type of compensation as the real parties in interest receive. *See generally* Christopher R. Leslie, *A Market-Based Approach to Coupon Settlements in Antitrust and Consumer Class Actions*, 49 UCLA L. REV. 991 (2002).

[94] I discuss this example in Hill, *supra* note 8, at 977. As to the practice of structured settlement recipients selling their settlements for a lump sum, see generally Karen Czapanskiy, *Structured Sales and Lead-Poisoned Sellers: Just Say No*, 36 VA. ENVTL. L.J. 2017 (2018).

benefits.[95] Since the patients were clearly incompetent, consent was requested from their relatives, who were told that the treatments were medically advisable.[96] Here, we have two third-party burdenficiaries: taxpayers, and also the incompetent person, who is not really a party to the transaction, but nevertheless may bear considerable costs in the form of discomfort or perhaps fear in the case of the skin cancer treatment. Costs here are hard to compute as well.

These are, in my view, relatively easy cases as far as the existence of the externality; again, computing the associated cost is harder. But for this approach to be as useful as it should be, it needs to accommodate cases where even the existence of the externality is not straightforward. One such case is "just-in-time scheduling," (sometimes known as just-in-time staffing) which is like just-in-time inventory, but with people as the inventory.[97] One description that is highly critical of the practice is the following:

> So-called "just-in-time" scheduling practices [are those in which] employees are asked to come and go depending on how much work there is to do. . . . Company policies can force employees to maintain open availability for full-time hours when they are only assigned and compensated for part-time hours. Supervisors commonly send staff home before their shift ends without compensation. High variance in schedules

95 For more on arguably abusive practices by dermatology clinics acquired by private equity firms, see Katie Hafner & Griffin Palme, *Is Dermatology Doing Too Much?*, N.Y. TIMES, Nov. 21, 2017, at D1 ("The business potential has attracted private equity firms, which are buying up dermatology practices around the country, and installing crews of lesser-trained practitioners . . . to perform exams and procedures in even greater volume."). Indeed, negative news coverage elicited pushback from some people involved in these clinics and transactions. *See* Katie Hafner, *Article Ruffles Doctors Linked to Equity Firms*, N.Y. TIMES, Oct. 27, 2018, at B1.

96 The dental example is based on my own experience involving an elderly relative at a nursing home, and the pressured younger relative is part of that story. More broadly, my sense, based on some conversations and research, is that healthcare providers involved in this practice would never have consented to such procedures being performed on their own relatives.

The general area of late-life-stage aggressive healthcare not intended to extend life or reduce pain seems to be ripe for scrutiny. Helena Temkin-Greener et al., *Rehabilitation Therapy for Nursing Home Residents at the End of Life*, 20 J. AM. MED. DIR. ASSOC. 476, 478 (2019) (noting that "ultra high" levels of therapy increased from 4.4% of end of life nursing home residents to 7.3% from 2013-2016 while low levels of therapy decreased from 24.2% to 19.8% in same period); *see also* Hafner & Palme, *supra* note 95 (reporting 250% increase in aggressive skin cancer treatments since 1994).

97 Stephen Bruce, *Just-in-Time Scheduling—Good News and Bad News*, HR DAILY ADVISOR (Dec. 19, 2016), http://hrdailyadvisor.blr.com/2016/12/19/just-time-scheduling-good-news-bad-news/ [https://perma.cc/3RJS0V2XV].

from week to week can make it difficult to arrange childcare, let alone pursue additional employment or education.[98]

Not surprisingly, the practice has been quite controversial,[99] and some of the more extreme features have been addressed by legislation in some jurisdictions.[100] In some instances, in response to pressure, companies using it have stopped doing so or scaled back.[101]

> [Starbucks' decision to limit just-in-time staffing] comes amid a growing push to curb scheduling practices, enabled by sophisticated software, that can cause havoc in employees' lives: giving only a few days' notice of working hours; sending workers home early when sales are slow; and shifting hours significantly from week to week. Those practices have been common at Starbucks, and many other chains use even more severe methods, such as requiring workers to have "open availability," or be able to work anytime they are needed, or to stay "on call," meaning they only find out that morning if they are needed.[102]

The business case for this kind of staffing would seem to be clear. Low-skilled workers will generally not command high wages or high perquisites—the employers can, and do, get the employees' services cheaply. But improvements

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[98] Michael Wasser, *"Just-in-Time" Scheduling Practices Limit Enployees' Ability to Thrive*, JOBS WITH JUST. (June 12, 2015), http://www.jwj.org/dc-companies-just-in-time-scheduling-practices-limit-employees-ability-to-thrive [https://perma.cc/G74X-PP3Y].

[99] *See* Jodi Kantor, *Starbucks to Revise Policies to End Irregular Schedules for Its 130,000 Baristas*, N.Y. TIMES, Aug. 15, 2014, at A11 (reporting scheduling practices were enabled by sophisticated software that predicted trends and sent workers home when sales were slow); Econ. Policy Inst., *Irregular Work Scheduling and Its Consequences* 2, 5 (EPI Briefing Paper No. 394, 2015), https://www.epi.org/files/pdf/82524.pdf [https://perma.cc/TNY3-88U9] (listing examples of consequences as underemployment, increased family conflict, and higher stress); Lydia DePillis, *The Next Labor Fight Is Over When You Work, Not How Much You Make*, WASH. POST (May 8, 2015), https://www.washingtonpost.com/news/wonk/wp/2015/05/08/the-next-labor-fight-is-over-when-you-work-not-how-much-you-make/?utm_term=.260d5e3abd7e (reporting on Washington DC's attempts to pass retail workers' bill of rights).

[100] *See* NAT'L WOMEN'S L. CTR., RECENTLY ENACTED AND INTRODUCED STATE AND LOCAL FAIR SCHEDULING LEGISLATION 2 (Jan. 2017), https://nwlc.org/wp-content/uploads/2017/01/Fair-Scheduling-Report-1/30.17-1.pdf [https://perma.cc/YH78-BVKG] (surveying twenty-eight passed or propsed bills in various states and cities relating to fairer scheduling practices); Alexia Elejalde-Ruiz, *How Eratic Schedules Hurt Low-Wage Workers*, CHI. TRIB. (Sept. 6, 2015, 12:32 PM), https://www.chicagotribune.com/business/ct-volatile-schedules-0907-biz-20150904-story.html ("Several legislative efforts seek to regulate scheduling practices that make it difficult for low-wage hourly workers to plan for child care, go to school, work a second job or have comfort that they will earn enough to pay their bills.").

[101] *See* Kantor, *supra* note 99; Timothy B. Lee, *The Gap Is Ending On-Call Schedules. Here's Why the Practice Was Making Workers Miserable.*, VOX (Aug. 26, 2015, 7:30 PM), https://www.vox.com/2015/8/17/9151163/on-call-schedule-miserable [https://perma.cc/W698-HX28] (reporting that Abercrombie & Fitch, Gap, and Victoria's Secret were phasing out just-in-time scheduling).

[102] Kantor, *supra* note 99.

in technology have allowed employers to do even better, only having to pay employees when they most need them: "A new generation of software gives employers the ability to manage their labor costs more precisely than ever before, and this often leads to unpredictable and volatile work schedules."[103]

How does just-in-time staffing fit into my account? The "cost" part is conceptually easier, although by no means easy. The critical conceptual point is this: we must identify the "negative externality." That traditionally means a cost to a third party, and here, there arguably is such a party (or parties). Among the obvious costs are the possible need for increased public assistance (such that the third party would be the government). Other possible costs are less obvious but still quite real. One is potentially increased health and mortality costs (borne to some extent by third parties), which may, some research suggests, be a result of having a job in which one has very little control over what one does and when.[104] Perhaps, more speculatively, there are increased costs to the society in the form of stress-triggered behavior, and even violence, by the person in such a job.[105] There are presumably costs associated with diminished prospects for the next generation. These prospects might be diminished for both logistical and psychological reasons. The latter might relate to what psychologists have called a "just world" worldview.[106] A person may conclude that the world is not "just"—that hard work is not necessarily rewarded—and may therefore decide not to invest in her own future, but instead, choose immediate consumption, a decision that could be quite rational but would have negative effects on the person's future.

All this is quite apart from effects on the employee herself. These third party effects may be enough to make the case that employers are engaging in a practice that externalizes costs, and, arguably, relies on doing so. It is possible that even the costs the company internalizes, such as high turnover, low morale and productivity, difficulty in hiring, and difficulty in finding high quality job candidates, make the practice a money-loser on net, but the company might not

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[103] Lee, *supra* note 101; *see also* CATHY O'NEIL, WEAPONS OF MATH DESTRUCTION: HOW BIG DATA INCREASES INEQUALITY AND THREATENS DEMOCRACY 125 (2016).

[104] *See* Erik Gonzalez-Mulé & Bethany Cockburn, *Worked to Death: The Relationships of Job Demands and Job Control with Mortality*, 70 PERSONNEL PSYCHOL. 73, 76 (2017) ("[J]ob demands are positively related to mortality when coupled with low control."); Johannes Siegrist, *Adverse Health Effects of High-Effort/Low-Reward Conditions*, 1 J. OCCUPATIONAL HEALTH PSYCHOL. 27, 38 (1996) ("[H]igh-cost/low-gain conditions at work must be considered a risk constellation for cardiovascular health."); Margaret Whitehead et al., *How Could Differnces in 'Control Over Destiny' Lead to Socio-Econmoic Inequalities in Health? A Snythesis of Theories and Pathways in the Living Environment*, 39 HEALTH & PLACE 51, 59 (2016) (discussing growing recognition that control over one's destiny may be fundamental social determinant of health).

[105] *See* Andrea Lebron, *The Latest on Violence Statistics*, RAVE MOBILE SAFETY (Dec. 12, 2018), https://www.ravemobilesafety.com/blog/latest-workplace-violence-statistics [https://perma.cc/QW75-ZJHE].

[106] Claire A. Hill, *Rationality in an Unjust World: A Research Agenda*, 35 QUEEN'S L.J. 185, 187 n.4 (2009).

be able to make that assessment nearly as confidently as it can make the short-term assessment of lower costs relative to the costs of regularly scheduled and compensated employees in a discrete time period.[107]

What about costs to the employee? In standard economic analysis, they would not be considered a negative externality insofar as the employee is one of the parties to the transaction. But, in my parlance, one could regard them as such, insofar as the characterization of just-in-time scheduling is something in the general family of "duress." If the employee had other alternatives, she would take them; her limited prospects are what makes her take a "just-in-time" job.[108]

Including duress and incompetence quickly and dramatically expands the concept's applicability. Consider some other examples. A casino gets information as to individuals recently out of gambling-caused bankruptcy and sends them a coupon for a free meal and gambling chips. There, the person susceptible to a gambling addiction is more readily considered incompetent. Recall, as well, the example of the elderly people being maneuvered into unnecessary and perhaps painful and frightening medical procedures when their guardians approve such procedures. This presents a harder issue for incompetence. The "guardian" approving the procedure is legally competent. But he may be unduly influenced by the "medical advice" that the services are needed, and in any event is not paying for the services himself. This latter example suggests how this issue might be characterized to fit within my definition. In its extreme but not uncommon form, the business model or practice at issue *relies on* the guardian being influenced more than she should be, and that the costs are borne by a nonconsenting third party. The weaker case for incompetence is made up for by a stronger case for the business model being problematic. As a societal matter, discouraging such business models is surely desirable.

How would the models be discouraged? Reputational forces—both those from outside the corporation and those within it—would propel the inquiry. Institutional investors and others, (and the company itself) would be asking the question: is the company engaging in these practices? Reputational sanctions should, I would hope, be available in the more straightforward cases where the company was indeed engaging in those practices.

Where is law in all this? Why does the law not do a better job of dealing with problematic business practices? Many reasons have already been discussed. They include concerns for autonomy and against excessive paternalism and government intrusion. Another is the classic pathology that can be expected if law attempted to respond to an example such as the Alzheimer dental

[107] *See, e.g.*, Bruce, *supra* note 97 (reporting that some employers who limit hours worked by employees "usually suffer" because of employee turnover and union activity).

[108] *See, e.g.*, Danny Vinik, *Low-Wage Workers Deserve Predictable Schedules*, NEW REPUBLIC (Apr. 14, 2015), https://newrepublic.com/article/121528/lack-scheduling-flexibility-low-income-workers-big-problem [https://perma.cc/63JY-9KFM] (reporting that unstable working hours prevent workers from finding better jobs).

example.[109] Consider an example discussed earlier, in which people exposed to lead paint and awarded damages in structured settlements were persuaded to sell those structured settlements for a lump sum, but too cheaply. The law, anticipating precisely what happened, had required the sales to be approved by a person who was "independent" of the buyer. But the "independence" proved nominal, not real. One can readily imagine what a solution would look like, what an end-run around the solution would look like, what a solution to the end-run would look like, and so on. The larger issue here is that rules-based regimes can serve as roadmaps to evasion. But, as is well known, standards-based regimes have their own problems. Reputational forces would thus seem very well suited to make inquiries as to problematic business conduct, thereby making such conduct salient, and leading to the imposition of appropriate reputational sanctions.

Reputational forces would, I hope, propel further reflection on the broader themes at issue, such as how to deal with differences among people, such as those with very few options to make a living versus those with more options. There are many divergent views on these and other like issues. In my experience, students' views of the famous unconscionability case, *Williams v. Walker-Thomas Furniture Co.*,[110] range widely. In that case, a low-income person bought several items on credit at different times. Among the terms were that payments were applied to all items that had not been fully paid for. The result was that if, as was the case here, the buyer bought items two and three when she had not yet fully paid for item one, each payment would be allocated to all three of the items, so that no item was paid off until they were all paid off.[111] Ms. Williams did not make a scheduled payment and the store sought to take back all the items she had bought but had not fully paid for.[112] Some of my students would readily condemn the seller, as the court did, while others are more solicitous of the seller's challenge in figuring out how to make sales to people with very low incomes. Unconscionability is still good law, and can be invoked to make contracts unenforceable under certain circumstances, but the extent to which it has changed practice in day-to-day life is limited. More significantly, the problems facing people in the position of Ms. Williams and the seller have not been solved. There are simply too many competing considerations that point in conflicting directions.

Indeed, that this is so points to an important limitation of my account. The more egregious business models described above, such as the too-cheap purchases of structured settlements from impaired sellers, and the aggressive dental work done on Alzheimer's patients, are paradigmatic cases which really do rely on "taking advantage" in a commonly accepted and negative form of the term. By contrast, the just-in-time staffing example is far more garden-variety,

[109] *See supra* text accompanying note 96.

[110] 350 F.2d 445, 448-50 (D.C. Cir. 1965).

[111] *Id.* at 447.

[112] *Id.*

and reasonable people could disagree about the extent of advantage-taking. More broadly, being quick to characterize people as incompetent or under duress has significant negative implications, including potentially for the people themselves.

A final objection should be made. A company can presently characterize its expenditures on avoiding "adverse reputational events" and engaging in some measure of CSR/ESG as justified by standard bottom-line concerns. For the former, the argument is obvious; for the latter, even putting aside whatever expectations the company may have promoted, the expenditures can be regarded as akin to advertising. But the headwinds against discouraging what I have characterized as business models and practices that impose negative externalities are significant. What makes the models and practices attractive to businesses is often that they take advantage of available labor, eager sellers, and readily persuaded buyers. That is, they yield significant revenues or cost savings. The double meaning of the term "taking advantage" is telling: taking advantage can be negative or it can be savvy. That courts deal with the legal concepts most akin to those I am describing using their equitable powers, relying importantly on fact-specific determinations, is not surprising. Consider in this regard the discussion above concerning *Williams v. Walker-Thomas*. When should "taking advantage" be discouraged and when should it not be discouraged? The answer is not straightforward. My approach would encourage a readier resort to the negative characterization of "taking advantage." But very strong bottom-line business pressures push in the opposite direction.

CONCLUSION

Problematic business conduct has not abated. Law has not been nearly as effective as one might hope in curtailing it. Perhaps reputation can fill an important part of the gap.

I have argued that reputation could be marshaled more effectively to better deal with business models and practices predicated on taking advantage of one party's duress, imcompetence, or incapacity, or on access to a third party's funds where the third party has no say in the matter. Companies should be pressured to refrain from using such models and practices. Alongside the pressure, the concept—what counts as one of these business models or practices—could and should be far better defined and understood. In its core applications, and in principle, this seems to be low-hanging fruit. There will be many harder cases, notably because of underlying issues as to societal resource allocations and values. But making the concept salient as a focus of institutional investor activism has an enormous amount to recommend it, especially insofar as institutional investors invest not just in the public markets but also in private equity, and thus are able to influence private companies' conduct as well.

My aim is to start an inquiry as to possible principles that might be appropriate. Institutional investors, who are increasingly focusing on sustainability, CSR, and ESG concerns, have an important role to play. My hope is that they will use their considerable influence to "enforce" reputational sanctions, both positive and negative, and participate in a broader conversation as to what reputation should require.