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Debate: Saving the World with Corporate Law?

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Debate: Saving the World with Corporate Law?*

Kent Greenfield†

(The Proposition)

and

Gordon Smith‡

(The Response)

Abstract: The current debate within corporate law is as fundamental as any time since the New Deal, when the great exchange between Merrick Dodd and A.A. Berle defined the issues for a generation of scholars. Today, the community of corporate law scholars in the United States is split between two groups. The first, heavily influenced by economic analysis of corporations, argues the merits of increasing shareholder power vis-à-vis directors. Another group, animated by concern for economic justice, challenges the traditional, shareholder-centric view of corporate law, arguing instead for a model of "stakeholder governance." The enclosed article is an untraditional method to explore these debates. It comes in the form of a debate between two prominent scholars, one from each of the two major groups, on the audacious question, "Can Corporate Law Save the World?" Each of us has authored a paper comprising one-half of the article. Professor Greenfield, a leading proponent of "progressive corporate law" and the author of THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES (2006, The University of Chicago Press), uses this paper to offer an provocative critique of the status quo using organizational and regulatory theory. In his paper, Professor Smith, one of the nation's leading advocates of increased shareholder power, contends that changes in corporate law cannot eradicate poverty, clean our air or our water, or solve "the labor question." Indeed, he argues, the only changes in corporate law that will have a substantial effect on such issues are changes that will make matters worse, not better.

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Proposition: Saving the World With Corporate Law

Kent Greenfield

Corporate law can change the world.

This is an overstatement, to be sure, but more correct than false. Large, multinational corporations are immensely powerful – affecting investors, workers, governments, communities, and ecosystems the world over – and the law that governs them creates, channels and cabins that power. Corporations are also immensely successful at creating financial wealth. They are the world's most successful business form for facilitating a cooperative process of investment by numerous stakeholders, who unite through the corporate entity to organize their various resources to produce goods or services for profitable exchange.

Despite the corporation's collective nature and collectivizing function, corporate law in the United States is constructed as if the firm consists of only shareholders and executives. Even though corporate law once served as a mechanism for injecting some aspects of public interest into the corporation's structure and goals, in recent decades the focus of corporate law has narrowed to a fixation on shareholder rights and executive prerogatives. This narrow focus has become entrenched in mainstream scholarship and doctrine. What's more, as globalization intensifies, the narrow shareholder/executive focus of U.S. corporate law is increasingly exported, displacing the more expansive, public-oriented view of corporations in other nations.[1]

This article argues that this trend is unfortunate, and that U.S. corporate law should be modernized and expanded. Changes in corporate law could make it possible to take advantage of the distinctive abilities of the corporation to create wealth, while making it less likely that corporations will do so through breaches of the public trust or the imposition of costly externalities on stakeholders or communities. Corporate law could also channel the power of corporations to make them a progressive force in society, using them not only to create wealth but to spread it more equitably – addressing public policy problems that have been remarkably impervious to other public policy tools. Indeed, this article's central claim is that most of us in the United States, as well as many people throughout the world, would be better off if corporate law were different.

[1] See generally LAWRENCE MITCHELL, CORPORATE IRRESPONSIBILITY, AMERICA'S NEWEST EXPORT (2003).

This article and its companion, by Professor Gordon Smith, embody a debate going on broadly across the field of corporate law, which is currently experiencing significant intellectual ferment. While the mainstream, neoclassical view of corporations and corporate law continues to hold sway in most court opinions and at the most prestigious law schools, a growing number of scholars are contesting some of the basic tenets of the dominant school. Disagreements go to the heart of the discipline: what corporations are; who owns them; whether they are public or private institutions; whether managers should be charged solely with maximizing profits or with taking care of other social goals as well. These disagreements are as central as they have been since the great Berle/Dodd debates of the 1930s.[2] Moreover, there is now more disagreement at the core of corporate law than perhaps in any other area of law.

These disagreements are important, and not just to scholars of corporate law. Corporate law determines the rules governing the organization, purposes, and limitations of some of the largest and most powerful institutions in the world. By establishing the obligations and priorities of companies and their management, corporate law affects everything from the return on shareholder equity, to employees' wage rates (whether in Silicon Valley or Bangladesh), to whether companies will try to skirt environmental laws, to whether they will tend to look the other way when doing business with governments that violate human rights. Corporate law is a big deal.

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This article proceeds in several steps. In the first part of the article, the power and success of the corporation are catalogued. The basis for the corporation's success is also examined, as the article draws on evidence that suggests that the basis for the corporation's success over time is its ability to collectivize the inputs of a variety of stakeholders, all of whom expect the firm to provide more of a return on the input than the stakeholders could receive on their own. Also, organizational theory is brought to bear, suggesting that one of the ways through which the corporation is particularly able to achieve this collectivization process is its managerial structure. In this view, the corporation is not distinctive because of its method of financing but because of its structure, namely a vertical hierarchy of managers coordinating information and resources overseen by a board of

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[2] See E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1152 (1932); A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932).

directors occupying a horizontal position at the very top of the hierarchy. The differential success of the corporate form can be traced to the ability of the hierarchy to sort out which issues and decisions should flow up the chain, and the capacity of the board to offer the benefits of group decision making for the most momentous choices.

The failures of the corporation are the focus of the next section of the article. Given their nature, governance, and objectives, corporations fail in predictable ways. They produce costly externalities; they are amoral; they fail to sustain implicit or explicit commitments to communities; they privilege some stakeholders (shareholders) at the expense of others (for example, workers). They manipulate regulatory oversight and exert disproportionate political power; they compete with other firms to their collective detriment by over-utilizing resources or fouling the environment; they provide cover for managerial self-dealing of various kinds. They privilege the short-term at the expense of the long-term.

Corporations thus have long been the focus of various regulatory efforts to prevent these failures and to mitigate their effects, while seeking to preserve the firm's ability to create wealth. These regulatory efforts take various forms, some affecting the internal structure and processes of the firm, and some external to it. In the United States, the "internal" regulation of corporate law – for example, the legal imposition of fiduciary duties of care and loyalty on managers and directors – is used almost exclusively to protect shareholders (or the firm itself). Other stakeholders of the firm – for example workers, communities, or customers – are left to depend primarily on "external" regulations such as minimum wage laws, environmental regulations, and consumer safety rules.[3]

Drawing on regulatory theory, this article then argues that this divide between internal regulation to protect shareholders and external regulation to protect all others is misguided. Instead, the interests of non-shareholder stakeholders would be better protected if internal regulations were made available to protect them as well. The overall goal of the regulation of the corporate form is to maximize its benefits to society while minimizing its costs. This article will argue that this balance is more likely to be struck if the full panoply of regulatory options – internal and external – are available to protect *all* the stakeholders.

Finally, this article will argue that broadening corporate law will not only help in a protective sense, defending stakeholders from harm. Corporate law also has the potential to work in an

[3] For one example of a regulatory protection that flows only to shareholders even though workers deserve protection for the same reasons, see Kent Greenfield, *The Unjustified Absence of Federal Fraud Protection in the Labor Market*, 107 YALE L. J. 715 (1997).

affirmative sense, increasing the ability of the corporation to provide significant public benefits. As mentioned above, corporations are immensely successful at producing financial wealth. They do so because of their ability to collect a diverse range of inputs and organize them through a advantageous managerial structure. This article will argue that these capacities are now being used disproportionately to benefit only a subset of the stakeholders, namely the shareholders and the executives. Instead, corporate law could be used to require corporations to spread the wealth that they create more broadly and more equitably.

This can be done in a variety of ways, while maintaining the important capacities of the corporation. The law could recognize non-shareholder stakeholders as important non-equity investors in the firm, and the legal obligations of the board could be expanded to require it to look after the interests of those non-equity investors. The same duties of care and loyalty that are owed to shareholders would be owed to non-equity investors.

More provocatively, the board's makeup could be broadened to include representatives of non-equity investors. This would lead, almost inevitably, to the more equitable distribution of the corporate surplus among the firm's equity and non-equity investors, which will inure to the benefit of both society and the firm over time. Moreover, instead of *weakening* the board's decision making powers, broadening the board will likely *improve* the board's ability to make good decisions. The ability of the board to make good decisions is a function of its ability to take advantage of the benefits of "the wisdom of crowds," the capacity of groups to outperform individuals in making certain kinds of judgments. This capacity of the board would *increase* with a more pluralistic make-up. We hold this truth to be virtually self-evident in other areas of public and private governance – diversity of thought is seen as a good thing in legislatures, juries, law school faculties, and administrative bodies – and it can be applied to good effect in corporations as well.

The arguments of this article depend on a distancing from traditional assumptions of corporate law: that shareholders are the owners of the corporation and that managers owe duties solely to them; that corporate law is "private" law instead of regulation; that corporations have only one social obligation, which is to make money. Each of these assumptions is both normatively and descriptively false. Corporate law is best seen as a part of the broader regulation of corporations and their managers. It can be a powerful tool to harness the power of the corporation toward satisfying important public policy goals. That is the point about which this article wishes to engender a debate.

I. The Success of the Corporation

Make no mistake, the business form that we call the corporation is an immensely successful mechanism for organizing business endeavors, and has been so since the late 1800s.[4] Compared to the other kinds of business entities available – partnerships, trusts, limited liability companies, sole proprietorships – the corporate form is the dominant method of organizing large (and even small) business enterprises. This is true in the United States and increasingly true throughout the industrialized world.[5]

Scholarly careers have been dedicated to explaining the dominance of the corporate form. The most famous explanation is that of Nobel Laureate Ronald Coase, who theorized that the firm exists because it is often more efficient to engage in intra-firm transactions (organized by direct authority) rather than market transactions.[6] That is, compared to a situation where people could work together only after negotiating a contract for every task, the corporation is superior in that it allows various resources – labor and capital – to be collected and used without negotiating price and terms for each use. Other scholars building on Coase's work have focused persuasively on the ability of the corporation to gather resources from a variety of contributors and to organize those resources efficiently to create value.[7]

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[4] See JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA (2003).

[5] The 2002 tax returns of enterprises in the United States show $18.8 billion in receipts for corporations as compared to $2.6 billion for partnerships and $1 billion for non-farm proprietorships. U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES tbl. 727 at 503 (2006). According to Eurostat, in the European Union during 2001, 77,861 more corporations were born than died, as compared to 9,335 enterprises organized under all other legal forms. See http://epp.eurostat.ec.europa.eu/portal/page?_pageid=0,1136195,0_45572097&_dad=portal& _schema =PORTAL (select "Data" tab, open the "Industry trade and services – horizontal view" folder, open the "Structural Business Statistics (Industry, Construction, Trade and Services)" subfolder, open the "Business demography" subfolder, open the "Business demography indicators presented by legal form" chart applet). Additionally, new corporations tend to employ more people than other forms. EUROPEAN COMMISSION, BUSINESS DEMOGRAPHY IN EUROPE: RESULTS FOR 10 MEMBER STATES AND NORWAY tbl. 3.23 at 34 (2004).

[6] Ronald H. Coase, *The Nature of the Firm*, 4 Economica 386 (1937).

[7] See, e.g., Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am. Econ. Rev. 777 (1972) (arguing that the firm exists to decrease the monitoring costs inherent in team production); Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305, 310-11 (1976) ("Contractual relations are the essence of the firm, not only with employees" but with others as well; the firm is a legal fiction that "serves as a focus for the complex process in which the conflicting objectives of individuals . . . are brought into equilibrium"); *cf.* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247, 305 (1999) (the success of the firm depends on maintaining the "team" of stakeholders over time).

These explanations go more to why the corporation is superior to the market, rather than why the corporation is superior to partnerships, limited liability companies, or other business entities. For that answer, one has to look at the collection of benefits that the corporate form has to offer and which make corporations particularly successful at making money. These traits include: the liquidity and transferability of shares; the protection of shareholders from personal liability for the debts of the entity; and a perpetual existence separate from their shareholders. Some of these characteristics can be found in other forms (for example, limited shareholder liability is a trait of limited liability companies), but they cannot be found together except in the modern, public corporation.

And these characteristics are indeed very powerful. The easy transferability of shares allows thousands or even millions of small investors to finance the equity portion of a company. This in turn allows companies to amass enough capital to overcome high barriers to entry in a market sector, to take advantage of economies of scale in production or marketing, or to survive short-term downturns in the market. Limited liability for shareholders reassures investors that they will not suffer personal liability if the company fails or is unable to pay its debts. Shareholders can buy small numbers of shares and are protected from personal liability for the acts of the company. The separate legal existence of corporations makes it possible for them to be sustained over time, even as shareholders and management change. Moreover, it gives the corporation the capacity to sue and be sued, which allows it to protect its contractual rights in court and to reassure its business partners (not to mention workers, creditors, and the government) that it is subject to contractual and legal obligations that are also enforceable in court.

There is one additional characteristic of the corporation that is often cited as an important distinction – the so-called separation of "ownership" and control.[8] Shareholders, who in this view are considered the owners of the corporation, "have virtually no power to control either its day-to-day operation or its long-term policies."[9] Instead, they hire professional managers to direct the firm. These managers in turn owe their jobs to their ability to make the company successful.

[8] ADOLF A. BERLE & GARNDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 84-90 (1932).
[9] Steven M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 Vand. L. Rev. 1, 4 (2002) (hereinafter *Decisionmaking*).

Even as the conceptualization of the shareholders as owners has lost favor within corporate law doctrine and scholarship,[10] the significance of the fact that the firm is controlled by professional management has retained its centrality.[11] The use of professional management (and here I mean the executives and senior managers in the firm, as opposed to the board) has great efficiency benefits, helping the corporation create financial surplus. Managers have greater knowledge than shareholders and other stakeholders about the day-to-day dealings of the firm, and the market for corporate control as well as the labor market for executives create incentives that help ensure that the managers performs their jobs dutifully and well.

Typically, these professional managers are arranged in a hierarchy of authority, with each level of the hierarchy authorized to act on decisions appropriate to their level while passing information both up and down the hierarchy to other parts of the organization.[12] This hierarchy is also used to ease monitoring of the various participants in the firm – the lowest level of the hierarchy is monitored by the next level, the next level is monitored by the next higher level, and so on up to senior management. Thus hierarchy – made possible by the "separation of ownership and control" – helps keep the monitoring task manageable. "At each hierarchical level, the responsible monitor is responsible for supervising only a few individuals, which usefully limits and focuses his task."[13]

There are some important caveats to this sanguine portrayal of the benefits of hierarchy. First, hierarchy is not unique to corporations. It is difficult to imagine any large institution, corporation or not, organizing itself without some kind of hierarchy. Second, how efficient a hierarchy is depends on a range of variables. Hierarchy can be deep or shallow, easy to traverse or impenetrable. Some ornate hierarchies may be cost effective while others may impose dead-weight losses on the firm. Hierarchy, while an important aspect of corporate organization, is not itself

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[10] See, e.g., id. at 4 n. 11, ("in the dominant nexus of contracts theory of the firm, ownership is not a meaningful concept because shareholders are simply one of the inputs bound together by this web of voluntary agreements."); Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. Rev. 283, 288 (1998) ("this concept of "ownership" no longer provides the dominant justification in corporate law scholarship for shareholder preeminence"); Jonathan R. Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 Duke L. J. 173, 175 (1989)("Contrary to populaw belief, it is not particularly useful to think of corporations in terms of property rights.").

[11] The key text is ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977).

[12] See Bainbridge, *Decisionmaking*, at 5-6 ("hierarchy is a very efficient mechanism for information and transmittal").

[13] Id. at 7.

particularly unique to the firm and (as anyone who has worked in a large corporation can attest) can be more or less efficient.

So what is it about the management structure of the corporation that *is* more or less unique? More and more, scholars are focusing on the role of the board of directors, as opposed to the senior managers. Instead of the hierarchy being topped by a single autocrat, the apex is occupied by a multimember body, a board of directors. This board functions as a group decision maker for the most important questions that the company faces, and in the words of Stephen Bainbridge, the leading legal scholar of the board, "it seems useful to think of the board as a production team."[14]

What the board produces is decisions. And scholars are increasingly pointing to the board as the kind of group decision maker that offers material benefits as compared to solitary, individual decision makers of the sole proprietorship or to small groups of decision makers typical in partnerships or similar enterprises. According to scholars, the benefits of group decision making are significant, and in many cases so outpace individual decision making that the success of groups is higher not only than the average individual in the group but even higher than the best individual in the group.[15] In experimental settings, groups outperform individuals not only at tasks that have a unique correct outcome[16] but also at tasks that require critical evaluative judgment, learning and concept attainment, creativity, and abstract problem solving.[17]

Scholars have presented various explanations for the superiority of groups in decision making, and they essentially correlate with what one would intuit from every day human experience. Groups are able to identify and dismiss individual biases more quickly than individuals themselves. Groups can pool their best resources, creating multiplier effects among the abilities of the individuals in the groups. Groups take advantage of different perspectives. All this matches with what we see in wide areas of public life, from Congress to administrative agencies to universities. As it turns out, in most cases, two heads are indeed better than one.[18]

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[14] Id. at 8.

[15] For a review of the scholarship, see Bainbridge, *Decisionmaking* at 12-19. See also JAMES SUROWIECKI, THE WISDOM OF CROWDS (2004).

[16] Bainbridge, at 12-13.

[17] Id. at 16 n. 68; id. at 19; see also id. at 54 (""With respect to the exercise of critical evaluative judgment, … groups have clear advantages over autonomous individuals.").

[18] See Alan S. Blinder & John Morgan, *Are Two Heads Better Than One? An Experimental Analysis of Group vs. Individual Decisionmaking* (Nat'l Bureau of Econ. Research, Working Paper No. 7909, 2000) at http://www.nber.org./papers/w7909.

What's more, corporate law seems to internalize these insights, recognizing and protecting the role of the board. Statutes explicitly give the board the authority to manage the corporation. The most relevant statute is Delaware's, which states that the corporation "shall be managed by or under the direction of a board of directors."[19] This reflects the belief that "the effective oversight of an organization exceeds the capabilities of any individual and that collective knowledge and deliberation are better suited to the task."[20] Bainbridge drives the point home, saying "[C]orporations are well-served by group decisionmaking at the top."[21]

There are, however, numerous land mines in group decision making, and scholars have identified some traits of groups that tend to lead to poor decisions. I will discuss that topic below. For now, however, the point to emphasize is that the corporation's structure takes advantage of the benefits of both hierarchy and group decision making. This appears to give it significant advantages over competing business forms, making the corporation a very powerful money-making institution. Other business forms – whether partnerships, sole proprietorships, small, privately-held corporations, or newer forms such as limited liability companies – have their advantages. But none of them is as broadly successful as the public corporation in providing the framework for large, successful business enterprises.

II. The Failure of Corporations

The corporation is an immensely successful business form because its distinctive mix of characteristics and organizational structure gives it the ability to collect inputs from a number of different kinds of contributors (shareholders, employees, creditors, customers) and put them to work cooperatively to create goods and services for profitable sale. Making money is their comparative advantage.[22] But the corporation – as presently constructed and regulated in the United States -- has its pathologies as well, and they are a function of its advantages. Society creates an institution that is intended to create wealth (broadly defined), and we give it significant power to do that. But without constraints, it can be too single-minded in the pursuit of profit. As an artificial entity, it has no conscience of its own. And with the separation between the company

[19] Del. Code Ann. Tit. 8, § 141(a)(2000); see also Bainbridge, *Decisionmaking* at 4.
[20] Daniel P. Forbes & Francis J. Milliken, *Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups*, 24 Acad. Mgmt. Rev. 489, 490 (1999).
[21] Bainbridge, *Decisionmaking*, at 54.
[22] For a more extensive discussion, see KENT GREENFIELD, THE FAILURE OF CORPORATE LAW 130-34 (2006).

and its investors, the conscience of those investors are not easily brought to bear. The company has every incentive to externalize costs onto those whose interests are not included in the firm's financial calculus – and the firm can do this by polluting the environment, selling shoddy products to one-time purchasers, raiding their employees' pension funds, or producing their goods in sweatshops.[23] In fact, because of the corporation's tendency to create benefits for itself by pushing external costs onto others, the corporation could aptly be called an "externality machine."[24]

Society has long understood that the corporation's penchant for overlooking the negative impacts of its drive for profit means that, while corporations should be appreciated for their special ability to create wealth, they should also be treated warily because of their inability (absent regulation) to take into account values other than (and far more important than) financial wealth. Justice Brandeis explained this balance best when explaining the historical basis for greater regulation of the corporation:

> The prevalence of the corporation in America has led men of this generation . . . to accept the evils attendant upon the free and unrestricted use of the corporate mechanism as if these evils were the inescapable price of civilized life and, hence, to be borne with resignation. Throughout the greater part of our history a different view prevailed. Although the value of this instrumentality in commerce and industry was fully recognized, incorporation for business was commonly denied long after it had been freely granted for religious, educational and charitable purposes. It was denied because of fear. Fear of encroachment upon the liberties and opportunities of the individual. Fear of the subjection of labor to capital. Fear of monopoly. Fear that the absorption of capital by corporations, and their perpetual life, might bring evils . . . . There was a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations.[25]

As Brandeis observes, it has long been the case that society has been mindful of the importance of monitoring corporations to make sure they are moving us in a positive direction, given the form and powers we have bestowed upon them. In other words, we should be wary of the power of the corporate form.

This wariness has translated into a willingness to regulate the corporation to ensure it uses its ability to make money to further the collective good. While in theory the necessary regulation could come either in the form of external pressures on the corporation or as internal adjustments in corporate governance rules themselves, for most of the corporation's history we have chosen to

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[23] For a related (and perhaps more provocative) example, see Kent Greenfield, *September 11 and the End of History for Corporate Law*, 76 TULANE L. REV. 1409 (2002).
[24] To paraphrase MITCHELL, *supra*.
[25] Liggett v. Lee, 288 U.S. 517, 548 (1933) (Brandeis, J., dissenting).

regulate it from the outside rather than to require changes on the inside. To be more precise, the "internal" regulation of corporate governance – for example, the legal imposition on managers and directors of fiduciary duties of care and loyalty – is used almost exclusively to protect shareholders (or the firm itself). "External" regulations such as minimum wage laws, environmental regulations, and consumer safety rules are used to protect other stakeholders.[26]

In fact, there is a tension between the internal and the external regulation of the corporation. The internal regulation, intended to protect the shareholders, has long been interpreted to impose a duty on the managers to maximize the return to the shareholders.[27] What this means is that managers are held – or consider themselves held – to an obligation to take care of shareholders even when it hurts other stakeholders or society at large, and even when the benefits to those shareholders do not outweigh the costs to others. This obligation is seen by some to be so important that leading scholars in corporate law have argued that managers have an obligation to violate *external* laws when necessary to meet their *internal* obligations to maximize returns to shareholders.[28] Because of this tension, and the drive the internal obligation creates in the firm to disregard the interests of stakeholders other than shareholders, the profit maximization norm may be the central flaw in all of corporate law.[29] The business judgment rule – which gives the managers some leeway in how they define profit – may offer some relief, but such relief is marginal at best.[30]

III. Stakeholder Governance to Address the Failures and Fulfill the Potential of Corporations

This article now turns to addressing the potential of stakeholder governance. My principal argument is that stakeholder governance offers much promise in two ways. First, stakeholder

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26 Though there are notable and illustrative exceptions, which will be explored at length in the complete article.
27 See Gordon Smith, *The Shareholder Primacy Norm*, 23 J. OF CORP. LAW 277 (1998); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439 (2001).
28 See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155, 1177 n.57 (1982) ("(M)anagers not only may but also should violate the rules when it is profitable to do so."). For a comprehensive review and critical assessment of this view, see Kent Greenfield, *Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality (With Notes on How Corporate Law Could Reinforce International Law Norms)*, 87 VA. L. REV. 1279 (2001). See also Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. REV. 1265 (1998).
29 See Greenfield, *September 11, supra.*
30 See GREENFIELD, *supra*, at 224-30. Here I differ from some other "progressive" corporate law scholars, who have argued that the business judgment rule gives business managers such leeway that the profit maximization norm does not in fact exist as a matter of real constraint on corporations and their management. See, e.g., Blair & Stout, *supra* n. __, at 287-88]

governance is a better way to moderate and mitigate the pathological failures of the corporate form. Stakeholder governance will in effect create regulatory controls internal to the corporation, which will allow society more efficiently to satisfy the public policy goals of constraining corporate misbehavior. Second, stakeholder governance offers the potential of using the corporation's distinctive attributes to serve society even more than at present. Through stakeholder governance, the corporation can serve not only to create wealth but also to share it more broadly. This can be done without destroying the corporation's distinctive ability to make money, and stakeholder governance in fact has the potential of improving corporate decision making for even broader benefit.

A. Some Beginning Premises

To begin this discussion, I should make explicit some of my premises. Perhaps the most fundamental is that *corporate law is not an area of law governed by rights or ownership in the traditional sense.*[31] This view is still championed by a few traditionalists who regard shareholder rights essentially as an article of faith, developed from a rights-based view of the private nature of corporations.[32] In this view, shareholders are seen as owners, and the corporation is their individual property. Their control is to be respected. Managers are agents, and the correct law to apply is the law of property and trusts. Corporations are to serve their owners, and the proper stance of government is one of deference, with minimal governmental regulation if any.

The defects with this model are numerous and pervasive, and the model does not find legitimacy in the reality of the corporate world today.[33] Shareholders do not have a complete "bundle of rights" to make them "owners" in the traditional sense, nor are they owners in any other way that would distinguish their contribution to the firm from the contributions of other stakeholders.[34] An argument that corporate governance operates in the realm of natural rights is a difficult, unpersuasive, and increasingly undefended contention. Even among the most vehement

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[31] See Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as a Regulatory Tool*, 35 U.C. DAVIS L. REV. 581, 591-601 (2002) (arguing that corporate law should be seen as public law rather than private law); Thomas W. Joo, *Contract, Property and the Role of Metaphor in Corporations Law*, 35 U.C. Davis L. Rev. 779 (2002).
[32] The leading advocate of this view remains Milton Friedman, and the most famous statement of this view is his essay in the New York Times over 35 years ago. See Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 32 ("In a free-enterprise, private-property system a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible. . . .").
[33] See GREENFIELD, *supra* n. __, at [ch. 6 – will update cite].
[34] A full articulation of this argument can be found in Greenfield, *The Role of Workers, supra* n. ___.

proponents of the shareholder primacy model, very few continue to make the natural rights argument because of its myriad difficulties.

This leads to my second major premise: *corporations, and therefore corporate law, are created in the interest of society as a whole.* They are state creations, and no state in its right mind would willfully allow for the creation of institutions as powerful as corporations unless there was a belief that, on balance, society would be better off. To be clear, however, this does not mean that the internal rule of decision making within the corporation should necessarily be that the managers should act always to maximize the benefit to society. (More on that below.) But it does mean that whatever rule we construct for corporate decision making – whether one of shareholder primacy, or stakeholder balance, or societal protection – the ultimate goal is to create social welfare, broadly defined.

In this light, the next and third premise becomes clear: *the socially optimal amount of regulation of corporations is not zero.* The free market is a figment of imaginations, and only of outlandish ones at that. Even the most shareholder-centric scholars acknowledge that public policy demands regulation of the corporation; they just believe it should come in the form of external, rather than internal, regulations.[35] Corporations will not, through their own generosity, internalize the external costs of their decisions or keep an eye on the social harms they produce. Perhaps ironically, we use law to grant corporations the characteristics that make them capable of generating great wealth, but we also need to constrain them with law. Otherwise, a small group of managerial or shareholder elites is likely to gain at the expense of the rest of us. Whether *corporate* law should be adjusted to take into account the interests of non-equity investors should therefore turn on whether such an adjustment would tend to create more social welfare, broadly defined, not on whether it is inconsistent with the so-called free market.

Finally, my use of the term "non-equity investor" as a way to characterize stakeholders embodies my fourth premise: *corporations are a collective entity, demanding a variety of investments from a variety of sources.* This fourth premise is simply a statement of one of the important implications of the first – that corporations are not an entity wherein "ownership" makes much sense. Shareholders

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[35] See, e.g., FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991); Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1271 (1982) (Those who are concerned with corporate misdeeds should "seek redress through the political process and [should] not . . . attempt to disrupt the voluntary arrangements that private parties have entered into in forming corporations."); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 36, 42-43 (1991) (expanding the scope of a firm's fiduciary duties to include local communities is unnecessary because such communities "can appeal to their elected representatives in state and local government for redress.").

own their shares, of course, but as Margaret Blair and Lynn Stout write, "shareholders are not the only group that provides essential, specialized inputs into public corporations."[36] Bondholders own their bonds, suppliers own their inventory, governments "own" their infrastructure, and workers "own" their labor. All of these contribute something essential to the firm, and none is doing so as an altruistic act. They all contribute to the firm because they believe they will gain more by allowing the corporation to collect and use their inputs than if they kept them to themselves.[37] Indeed, the notion that corporations depend on multiple stakeholders is implicit in most theories of the firm.[38]

B. Using Corporate Law to Address the Failures of Corporations

As argued above, there is social consensus that corporations require regulation in order to keep them honed toward their central purpose of creating wealth for society, while moderating and mitigating the costs than corporations impose on society in doing so. The core argument of this section – and indeed the entire article – is that corporate law should be a part of this regulatory framework.

In an important sense, corporate law is already a part of this framework. Corporate law's imposition of the duties of care and loyalty help ensure than managers perform their tasks dutifully and without acting on the basis of self interest. The duties to disclose certain kinds of information to shareholders and not to commit fraud on shareholders (mostly arising form federal law but still best seen as "corporate law," as I am using the term here) are other ways that corporations' internal affairs are regulated in furtherance of public policy goals. The question is whether corporate law should be put into use in furtherance of those public policy goals that extend beyond creating money and protecting shareholders from managerial negligence, theft, or mendacity.

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36 Blair & Stout, *supra* n. ___ at 250.

37 For a more detailed argument, see GREENFIELD, *supra* n. __, at 47-53 (noting that workers have agency costs of their own).

38 The modern theory of the corporation owes much to Ronald Coase, who theorized that the firm exists when it is more efficient to engage in intra-firm transactions (organized by direct authority) rather than market transactions. See R.H. COASE, THE FIRM THE MARKET AND THE LAW 33 (1988). Thus the theory of the firm depends much on insights about when it is most efficient for people to work together within a firm rather than through individually- negotiated contracts. Other writings on the economics of the firm turn on arguments about the consolidation of productive work. See, e.g., Armen A. Alchian & Harold Demsetz, Production, Information Costs, and Economic Organization, 62 AM. ECON. REV. 777 (1972) (arguing that the firm exists to decrease the monitoring costs inherent in team production); Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. FIN. ECON. 305, 310-11 (1976) ("Contractual relations are the essence of the firm, not only with employees" but with others as well; the firm is a legal fiction that "serves as a focus for the complex process in which the conflicting objectives of individuals ... are brought into equilibrium ....").

1. The Current Shareholder Focus of Corporate Law.

To begin this discussion, it bears emphasis that existing corporate law is so narrowly focused that it routinely makes the simultaneous generation of wealth and societal benefits *less* likely. The most obvious example is the requirement in corporate law that directors look after the interests of shareholders first and foremost. I understand that it is a contentious question as to whether directors have an enforceable duty to maximize profit. But there is little doubt that by law and norm, the managers feel constrained to put the shareholders first.[39] As an illustration, consider a situation in which a board of directors of a public company makes a decision that benefits its employees financially but imposes real, long-term costs on shareholders (e.g., fully funding a pension fund, where such funding is routinely avoided by the company's competitors). Also assume that the board makes that decision because they have determined that benefits to the employees would far outweigh the costs to shareholders, and they say so.[40] Such a decision would violate existing law.

This seemingly makes little sense. Corporate law should not presume, without strong arguments, to prohibit corporate decision makers from taking into account the very societal interests that the corporation is ultimately meant to serve. Instead, the presumption should be that corporate directors are empowered or required to take a broader view of their responsibilities and of the responsibilities of the corporation itself. If we mean to enable institutions to create financial wealth for an expansive range of stakeholders, the rules governing those institutions should align with that purpose rather than work against it.

The best arguments in favor of shareholder primacy do, however, assert that it is unnecessary or counter-productive to have corporate law mandate that corporate managers do anything but look after shareholder interests. Corporations make money, and (as the argument goes) if we want them to act in a certain way then we should impose external costs, such as taxes, fines, and other penalties. Easterbrook and Fischel make this point, arguing that society is better

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[39] The best statement of this is still Dodge v. Ford, 170 N.W. 668 (Mich 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end.") A more recent statement, in the limited context of hostile takeovers, came from the Delaware Supreme Court in Revlon, Inc. v. MacAndrews & Forbes Holdings Inc., 506 A.2d 173, 182 (Del. 1986) (the "board may have regard for various constituencies in discharging its responsibilities, provided that there are rationally related benefits accruing to the stockholders").

[40] If they lied about the reason, and said that the long-term benefits to shareholders outweighed the long-term costs to shareholders, the business judgment rule would likely protect the decision. See Kent Greenfield & John E. Nilsson, *Gradgrind's Education: Using Dickens and Aristotle to Understand (and Replace?) the Business Judgment Rule*, 63 BROOKLYN L. REV. 799 (1998)

off when it "conscript[s] the firm's strength (its tendency to maximize wealth) by changing the prices it confronts."[41] They argue that an internal change in corporate structure to make the firm "less apt to maximize wealth" will yield less in both wealth and social goals.

This argument is so well established that its audaciousness is often missed. The argument, as I understand it, is that corporate managers best advance society's interests by ignoring them. Not even Adam Smith's invisible hand was assumed to be so powerful that people should be *prohibited* from taking the interests of others, or society in general, into account.[42]

So how is the argument made? While it is seldom spelled out in detail, the mainstream view seems to contain three separate claims: (1) advancing shareholder wealth trickles down and advances societal wealth; (2) requiring managers to look after responsibilities other than advancing shareholder interests in fact releases them from any real responsibility; and (3) it is more efficient to regulate corporations from the outside than from the inside. Even though these traditional claims have gone unquestioned for so long, they should all be rejected. The first two I answer here, and the third I will answer in the next section.

a. <u>Trickle-down</u>. The first claim is that we need not worry about non-shareholder interests, since looking after shareholders will inevitably help other stakeholders as well. At a simple, mundane level, this claim can be true. A failing company is not much good to anyone with any sort of investment in the firm, whether that investment be in the form of labor, money, or infrastructural support. But when we look past this narrow circumstance of when the firm is failing, the claim becomes much more dubious. A firm that makes money for shareholders does not necessarily create wealth for others or for society.[43] Without a mechanism within the corporation to force it to absorb externalities or to share gains among all stakeholders, there is no inevitable gain on the part of workers or society even when the company is making lots of money. The "trickle-down" is not inevitable. Indeed, shareholder profit could even result from a transfer of wealth *from* the company's employees or from society generally *to* the shareholders.[44]

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[41] FRANK H. EASTERBROOK AND DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991). Hansmann and Kraakman make this point as well. See Hansmann & Kraakman, *supra* n. ___.

[42] ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 687-88 (R.H. Campbell & A.S. Skinner eds., Liberty Fund Press 1981 (1776).

[43] See E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1152 (1932) ("It can not, however, be successfully maintained that the sort of industrial planning which may be found desirable to protect the employee is necessarily under all circumstances in line with the interest of the stockholders of each individual corporation.").

[44] For example, by some accounts Wal-Mart's employee wages are so low that its workers must subsist on a range of government assistance programs. In effect, then, government programs are subsidizing the profits of Wal-Mart

Moreover, a decision making calculus that takes shareholder interests as its goal will result at times in decisions that are overly risky, from the standpoint of society as a whole. Shareholders enjoy limited liability and thus suffer only a portion of the costs of bad decisions. On a societal basis, all costs have to be accounted for. There is no such thing as a "limited liability society" in which society contributes to the corporation in very meaningful ways (providing workers, real property) without fear of bearing the negative impact of its operation.

The trickle-down claim, even at its strongest, is not that a broader view of corporate obligations is a bad idea but that it is simply unnecessary. The existing scope of duties is good enough not only for shareholders but for society as well. This is less an argument about facts than about beliefs.

b. More Responsibility Means Less. The second claim made by mainstream scholars is that a broadening of corporate responsibilities is counterproductive because managers can use the additional responsibilities to avoid responsibility. If corporate managers have more than one "master," they can play masters off of one another, as a child might do to parents. Instead of the manager actually serving all stakeholders, she will be loosed from obligation to any. The economists would call this an "agency costs" argument. Enlarging the duties of management will increase the agency costs inherent in managing the firm, since it will be more difficult to monitor whether the managers are in fact doing their jobs carefully and in good faith.

This assertion is made so often and so forcefully that few question it anymore.[45] In reality, the argument is tenuous and overblown, and so much so that it is rarely used outside the setting of corporate law. First, it is worth remarking that this claim is in conflict with the trickle-down argument. If the interests of shareholders and other stakeholders are not in conflict, then agency costs will not rise much if the law requires managers to take into account the interests of other stakeholders.

My view is that there is indeed conflict between the interests of shareholders and other stakeholders in a range of cases. This conflict, however, is not a reason to fear that managers cannot handle increased responsibility or that would be impossible to know whether managers are doing their jobs well. It is true, in a simple way, that a person who has two responsibilities may

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shareholders. According to one Congressional study, the federal taxpayers subsidize Wal-Mart over $2000 per employee per year. George Miller, Everyday Low Wages: The Hidden Price We Pay for Wal-Mart, House Committee on Education and the Workforce, Feb. 14, 2004 available at http://edworkforce.house.gov/democrats/WALMARTREPORT.pdf.

[45] Indeed, this argument has been made forcefully since the time of the New Deal. See Berle, *supra* n. ___ at 1367.

have more difficulty meeting both than if she had only one. But people routinely have more than one responsibility, some of them even conflicting, and we do not throw up our hands. I am a professor and also a parent. The obligations I owe to my employer sometimes conflict with the obligations I owe to my son. But it is not impossible to tell if I am a good professor or a good parent. In fact, humans are quite accustomed to having a range of obligations. Multiple obligations routinely exist even in business institutions. Corporate directors and managers, in actual practice, regularly balance a number of obligations, some arising from corporate law, some from other areas of law, and some from the market itself.

The only way that having more and broader responsibilities would make it easier for managers to avoid responsibility is that they could use one obligation as a defense to a claim that they failed to satisfy another. But this is not a function of the number and scope of responsibilities but how they are enforced, and corporate law duties are simply not enforced in a way that would allow managers to play one duty off the other. Both the duty of care and duty of loyalty have been reduced in recent decades to essentially procedural obligations – to investigate various alternatives, to look at the various possible outcomes, to take the time necessary to make a good decision, to make decisions untainted by self interest.[46] These obligations would not be weakened if they were owed to more stakeholders. On the contrary, adding to the number of people who benefit from managers' fiduciary duties will make it *more* difficult for managers to violate those duties. More corporate stakeholders will have an interest in monitoring and remedying managerial misconduct. Furthermore, if faced by a shareholder duty of care claim, no manager would be able to erect a realistic defense by saying she was unable to pay attention to the impact of the decision on shareholders because she was thinking at the time about workers. If faced with a shareholder duty of loyalty claim, a manager will not be able to defend herself by saying that she was actually acting on behalf of the employees. That would be nonsense. A loyalty suit is essentially about theft – and theft from both shareholders and workers is no more defensible than stealing from shareholders alone.[47]

In the end, the argument that more responsibility means less is actually an argument that adding to the responsibilities of management will make it less likely that management will act like agents of the shareholders. Managers may indeed change their behavior in that way, but that simply

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[46] See Bainbridge, *Decisionmaking*, at 52-54 (discussing procedural requirements of duty of care).
[47] A more developed version of this argument can be found in Kent Greenfield, *New Principles for Corporate Law*, 1 HASTINGS CORP. L. J. 89 (2005).

begs the question of whether managers should serve only the interests of the shareholders, which is the question with which we started. One cannot answer the question circularly: it makes no sense to argue that shareholders should be supreme because any other rule makes it harder for them to be supreme. And the existence of shareholder agency costs is not itself a persuasive argument, since other stakeholders have agency costs, too. Other stakeholders make important contributions to the firm, and all of them depend on management to use those contributions to create wealth. All stakeholders depend on managers and therefore have an incentive to monitor them. A shareholder primacy rule makes it more difficult for these other stakeholders to depend on management, which raises the stakeholders' agency costs. A relaxation of the shareholder primacy model might increase the agency costs of shareholders, but it will *decrease* the agency costs of non-shareholder stakeholders, which are just as important as shareholders' agency costs.

To say that only shareholders should have a rule that lowers their agency costs assumes shareholder primacy. In other words, we cannot justify the rule of shareholder supremacy by pointing to shareholder agency costs, unless the agency costs of other stakeholders are discounted. And they can only be discounted if shareholders are supreme.

2. External vs. Internal Regulation

The contention that corporate law should focus on shareholders alone reduces to a third and final claim: that it is more efficient to regulate corporations from the "outside" than from the "inside." At base, this is simply an empirical question: if we want to regulate corporations to force them to consider the interests of non-equity investors but still allow them to generate wealth, are we better off using corporate law along with other regulatory mechanisms or just those other mechanisms alone? Even so-called progressive corporate scholars disagree on how to answer this question.[48]

Perhaps it is useful to begin with the acknowledgement that this "external" versus "internal" dichotomy is too simple. Regulations of corporations come in a multitude of forms. Even ones that are seen as external – tax law, for example – often have as a goal the adjustment of behavior within the firm.

[48] See Adam Winkler, *Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History*, 67 LAW & CONTEMP. PROBS. 109 (Autumn 2004).

It is more correct, as a matter of regulatory theory, to characterize the regulation of the corporation as falling into three categories: (1) regulation requiring or encouraging certain results (e.g., pollution laws that prohibit the discharge of certain effluents); (2) regulation requiring or encouraging certain processes or actions (e.g., disclosure laws, nondiscrimination laws); and (3) regulation requiring or encouraging certain internal structures (e.g., a board that is elected by shareholders). When characterized this way, it becomes clear that the non-equity investors typically have to depend on regulatory initiatives that focus on results and on process. The only stakeholder that has any significant structural protection within the corporate form are the shareholders.

Consider the following chart.

Examples of Regulatory Efforts to Constrain and Harness Corporate Power

Stakeholders ------------------------------------Regulatory Focus------------------------------------

	Results	**Actions/Process**	**Structure**
Shareholders	Limited Liability Profit-maximization norm Capital markets (Quasi-legal)	Duty of Care Duty of Loyalty Disclosure Law Anti-Fraud Law (10b-5) Insider trading law	Shareholder voting for directors Right to sue derivatively Right to vote on major corporate changes
Workers	Min wage OSHA	ERISA (limited protection) Tort/ Wkrs' Comp Law Anti-discrimination law WARN Act Labor Law (limited)	
Community/ Environment	"Command and control" statutes; EPA, CERCLA, CAA, CWA, etc.	Tort law WARN Act NEPA Planning/Permitting Processes	
Customers	Contract law Consumer Safety law Regulatory protections (FAA, FDA, NHTSA, etc)	Anti-fraud law Tort law Anti-trust	
Creditors	Contract Law	Good faith in Contract /UCC Anti-fraud law Bankruptcy law	

One might think that this chart shows the extent of the regulatory efforts aimed at protecting stakeholders of various kinds, and that nothing else need be done. This response would be apt if the interests of stakeholders are in fact being adequately protected by these efforts. This is something about which people may disagree. But to the extent that one believes that we have not reached utopia, another (and I believe more reasonable) response to this chart is to question why regulations of the corporate structure – the stuff of corporate law – is not being utilized to its full potential. The empty boxes represent regulatory opportunities presently ignored. Whether we should use them is a question of whether the corporation's structure can be adjusted so that its distinctive abilities can be put to greater use.

There is reason to be hopeful in this regard. It is often cheaper to avoid a problem than to rectify it later, and it is often better to give the responsibility to avoid a problem to the person who knows most about it and can avoid it at the least expense. What I mean is that corporate law may have comparative advantages over other kinds of law in addressing certain kinds of concerns. For example, because the central purpose of the corporation is to create wealth, broadly defined, it is likely to be more efficient to have the corporation distribute it among those who contribute to its creation rather than having government redistribute the wealth after the fact. Redistribution is important, to be sure, but it may be more efficient to distribute the corporate surplus fairly as an initial matter by using an internal mechanism than by settling up after the initial distribution by using tax and welfare law to accomplish economic fairness. Further, a fair distribution of corporate profits to employees will likely have significantly positive multiplier effects (such as workers being more productive because they feel they are being fairly treated) that would not likely occur with later governmental redistribution initiatives. (More on this below.)

Moreover, corporate managers may have expertise in areas that government bureaucrats do not. There may be efficiencies in a corporate setting that do not exist in a governmental setting. A broadening of corporate responsibilities would allow corporations and their management to be proactive in addressing issues of social concern, which in turn might be more efficient than relying on the mostly reactive power of government regulation. In the end, if we believe that non-shareholder stakeholders need more regulatory protection than they now receive, then it is foolish as a matter of public policy to leave corporate law as an untapped resource. Using corporate law to adjust the composition or duties of the board to force the consideration of stakeholder interests could be a powerful tool to rein in the worst excesses of the corporation.

C. Using Stakeholder Governance to Make Corporations Better

The most powerful reason to accept changes in corporate governance is not to address the failures of the firm. Rather, the central reason to adjust corporate law – the reason it will save the world – is to take advantage of the successes of the corporation in order to achieve important gains in social welfare.

As pointed out at the beginning of this article, the corporation is immensely successful in creating wealth. But because of the narrow fixation on shareholder benefit imbedded both in the market and in corporate law, non-equity investors are shortchanged in the distribution of the wealth they help create. Even though the corporation is a collective enterprise when it comes to inputs, the distribution of the outputs is determined by a body – the board – that is dominated by representatives of only two stakeholders: the shareholders and the senior management. Changing this arrangement has the potential not only of improving the corporation's ability to create wealth but also of addressing serious and enduring social and economic ills.

I should hasten to make clear that I am not proposing a wholesale revamping of the corporate structure. As discussed in Part I, the structure of hierarchy topped by a board is, by many accounts, a fundamental source of corporations' success. What I am proposing is (1) to take advantage of the existing structure's ability to satisfy the objective of creating wealth, but change the definition of wealth within corporate law to mean the wealth of all the stakeholders rather than just the shareholders; and (2) to improve the corporation's structure by diversifying the board to include representatives of stakeholders other than shareholders. I will look at these proposals in turn.

1. Changing the Corporate Objectives to Include the Well-Being of Non-Equity Investors

As emphasized throughout this article, the corporation is a collective enterprise, calling on the resources of a number of contributors to create goods or services for profitable sale. Also, as argued earlier, the reason society cedes power to corporations is to create wealth, broadly defined. The argument here is that if the managers of the firm were required to consider the interests of the firm more broadly – to include the well-being of all investors, equity or non-equity – in their decision making calculus, the firm would be more successful in satisfying the social goal of creating wealth, broadly defined. More precisely, directors should be held to a fiduciary obligation to all the firm's stakeholders that varies according to the nature of the contributions of the stakeholders to the success of the firm.

It is worth noting that even though this might strike some as being a major change, as I do, it could be achieved by way of a remarkably simple doctrinal adjustment. The directors and management could simply be seen as owing a duty to the firm as a whole, defined as the collection of interests imbedded in the firm, rather than a specific subset of it (the shareholders). This is such a simple shift that some corporate law scholars – most prominently Margaret Blair and Lynn Stout[49] – believe that this is even the best description of *current* corporate law. Indeed, some cases can be read to presume such a broad reading of fiduciary obligations.[50] In any event, such a change in doctrine would not represent a huge transformation.

I believe the benefits to this change would be significant. First, it would be better for firms themselves over time. One reason for this is that it will encourage stakeholders to make firm-specific investments. Firm-specific investments are great assets for the firm because it can then take advantage of and build on the knowledge and expertise of their investors, suppliers, communities and employees over time. The problem that has bedeviled corporate economists, however, is that the more a specific stakeholder makes investments that are firm-specific, the greater the risk the stakeholder is taking that the firm will collapse, violate some implicit or explicit contract with the stakeholder, or extort concessions from the stakeholder. As the stakeholder becomes more valuable to the company, she also becomes more vulnerable.[51]

Because corporations are a collective effort, the key to sustainability is for those who contribute to the firm to believe that the firm can be trusted. Broad fiduciary obligations will help build this trust, ensuring that *all* stakeholders will be willing to make firm-specific investments.[52] This will help ensure the firm survives over time.[53]

There is an additional reason why fair allocation of the corporate surplus will inure to the benefit of the firm over time. Numerous studies have shown the truth of what we intuit from our

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[49] See Blair & Stout, *supra* n. ___ at 305.
[50] Margaret Blair and Lynn Stout, *A Team Production Theory of Corporate Law*, 24 J. OF CORP. LAW 751, 785 (1999). See, e.g., Paramount Communications v. Time, Inc., 571 A.2d 1140, 1148 (Del. 1989) (discussing Time, Inc. directors' rejection of Paramount's premium purchase offer because it threatened "Time culture"). Cheff v. Mathes, 199 A.2d 548 (Del. 1964) (regarding directors' defense against hostile takeover that would be harmful to employees).
[51] Non-equity investors also become more vulnerable the shorter the time horizon used by management in making decisions for the firm. At present, most large companies in the United States have experience 100% turnover in their shares each year, virtually guaranteeing that the firm will take a short-term rather than long-term view when making managerial decisions. See New York Stock Exchange Factbook, available at http://www.nysedata.com/factbook.
[52] It is worth noting the irony of the present legal regime, which offers more legal protection to shareholders – whose investment is not firm-specific at all – than to other stakeholders.
[53] The leading scholar arguing for recognizing the importance of the firm-specific investments of workers is Marleen O'Connor. See, e.g., Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899, 909-10, 923 (1993).

everyday interactions, namely that human beings are "reciprocators." Human beings tend to treat others the way that others treat them. Road rage is the negative example; the norm of giving gifts during the holidays is a positive example. In the working world, people are reciprocators as well. For example, workers who believe they are treated fairly tend to work harder, be more productive, obey firm rules more often, and be more loyal to their employers. This in turn likely makes those firms more profitable than they would have been absent such fair treatment.

Even if one is not convinced that more parity among stakeholders is better for firms themselves, there is an additional reason to push for broader fiduciary duties. When we take society's interest as our ultimate guidepost, society is not concerned exclusively with the maximization of aggregate wealth. Rather, the fairness of the allocation of society's wealth is an important principle for the United States as well as other democracies. As a society, we look not only at the total social wealth, but at the equality of its distribution. This concern is particularly acute now, as income and wealth inequality the United States is worse than anytime in the past 70 years, is worse than in any other industrialized nation, and is worsening rather than improving.[54]

Presently, economic fairness is ignored in mainstream corporate law. In fact, a theory of corporate law that is based on unconstrained ability to contract – the mainstream view – virtually insures that inequality will be worsened.[55] When people use bargained-for exchange to distribute goods, the weaker bargainer will be less able to extract concessions from the other. So unless there is some constraint on the ability of corporations to pass along the lion's share of profit to shareholders, the nation's inequality will worsen over time. A concern for economic fairness is a component of society's interests, and public policy needs to (and does, in a variety of ways) take that value into account.

The question, then, is why *corporate* law should be used to further the interests of fairness rather than other areas of regulation. The answer to this query harkens back to the previous sections. As noted above, it may simply be more efficient, as a matter of regulatory policy, to use corporate law to redistribute wealth and income than to use other mechanisms. Public policy tools that redistribute wealth and income tend to either work after the initial distribution of financial wealth (e.g., taxes, welfare policy) or tend to benefit only those at the lowest rung of the economic ladder (e.g., the minimum wage). A stakeholder-oriented corporate law would work at the initial

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[54] For a host of statistics, see Greenfield, *Using Behavioral Economics, supra* n. __, at 601-04. Updated citations can be found in GREENFIELD, *supra* n. __ at [ch. 7] and sources cited therein.
[55] For a more robust treatment of this argument, see GREENFIELD, *supra* n. ___, at [ch. 6].

distribution of the corporate surplus and would benefit stakeholders up and down the economic hierarchy. Certainly, once we take economic fairness seriously as a value, we should not blindly accept a corporate law framework that makes fairness less rather than more likely.

2. Changing the Composition of the Board

The best way to realize the potential of the corporation as a progressive force is to adjust the composition of the board so that it contains directors who represent stakeholders other than shareholders. At present, shareholders occupy not only a supreme position within the legal framework, being the only beneficiary of management's fiduciary duties, but also within the board itself. Only shareholders vote in elections for corporate directors, and votes are weighed according to the number of shares they own. Once we recognize, however, that corporations are to serve *all* their stakeholders, it becomes clear that the dominance of shareholders within corporate management is a mistake.

Why would a stakeholder board be beneficial? The answer is two-fold. First, such a change will inevitably mean that the corporate surplus will be more equitably and efficiently shared, which will help ensure the sustainability (and profitability) of the enterprise over time. Second, a more pluralistic board will improve corporate decision making, which will help ensure the sustainability (and profitability) of the enterprise over time.

a. <u>Benefit #1: More Fairness</u>. The first benefit is straightforward. When the board decides how to allocate the corporate surplus, a stakeholder board will behave differently than a shareholder board. The market will be a constraint, to be sure, but the goal of the board will be to allocate the surplus so as to maintain the firm as a going concern. Shareholders will get their proportion, but so will others. In a sense, this conception would use the corporation not only as the mechanism for creation of wealth but its distribution as well.

This is not as jarring as it might seem at first. In the United States and indeed in most industrialized countries, one of the most important tasks of the state is to redistribute wealth. Mechanisms include the tax and welfare system, the minimum wage, Social Security. At base, my proposal is simply that the structure of corporate law be adjusted so it can be better used for this purpose as well.

The strength of this argument is bolstered by evidence from other nations. In a recent study, Sigurt Vitols measured the macroeconomic implications of worker participation in corporate management throughout Europe. On a country-wide level, European countries with strong "co-determination" (i.e., worker participation on boards) had lower income inequality than countries that have no or weak worker participation. Moreover, strong co-determination countries had higher labor productivity, fewer days lost to strikes, and lower unemployment.[56]

The stakeholder board, in an ironic sense, is a genuine realization of the "nexus of contracts" view of the firm. If the firm is best seen as a microcosm of the market, then let us be honest about recognizing all contracts by putting the most important market participants in a position where they can be heard at the decision making level of the firm. The specifics will be difficult but not impossible: employees could elect a proportion of the board; communities in which the company employs a significant percentage of the workforce could be asked to propose a representative for the board; long-term business partners and creditors could be represented as well.

The specifics do not matter as much as does the notion that the board itself should be a place where more than just a shareholder perspective will be heard. As they participate on the board, each stakeholder representative will have the incentive to build and maintain profitability in order to sustain the company over time. Moreover, the board will be the locus of the real negotiations among the various stakeholders about the allocation of the corporate surplus. Even though board members might be selected for their positions in different ways and from different constituencies, each would be held to fiduciary duties to the firm as a whole. Decisions that affect major stakeholders would no longer be made cavalierly, without someone on the board being able to anticipate and articulate the likely impact such a decision would have on the workers, creditors, and other interested stakeholders.

b. Benefit #2: Better Decisions.

This proposal for board pluralism will strike most readers, at least in the United States, as outlandish. But co-determination is common in many countries in Europe, and is used to good effect.[57] Perhaps the reason for its success is that overall, board pluralism makes for better decisions.

Recall the discussion in Part I about the success of corporations being based in part on their dependence on a group decision maker at the top of the hierarchy. But the benefits of group decision making are drastically mitigated, and sometimes undermined completely, when the group is

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[56] Sigurt Vitols, *Prospects for Trade Unions in the Evolving European System of Corporate Governance*, Final Report for European Trade Union Institute, Nov. 2005 (on file with author) (also available on line at www.seeeurope-network.org).
[57] See id.

too homogeneous. In fact, more and more studies show that good decision making requires diversity of viewpoints. As Cass Sunstein has detailed in his recent book *Why Societies Need Dissent*, conformity among people in a decision making group inevitably breeds error. Dissent is essential, and sometimes "social bonds and affection" can suppress dissent.[58] Sunstein notes, "if strong bonds make even a single dissent less likely, the performance of groups and institutions will be impaired." He extends the points to corporate boards: "The highest performing companies tend to have extremely contentious boards that regard dissent as a duty and that 'have a good fight now and then.'"[59]

If homogeneity is a flaw, then corporate boards are blemished indeed. At present, corporate boards are among the least diverse institutions in America. A 2002 survey found that 82% of the director positions on Fortune 1000 companies were held by white men while only 11% were held by white women, 3% by African-Americans, 2% by Asian-Americans, and 2% by Hispanics.[60] Only 8% of public companies have three or more female directors, and only 6% of public companies have three or more directors who are ethnic minorities.[61] Adding perspectives other than those of rich, white men will almost certainly improve the quality of business decisions made by the board.

This idea is hardly as radical as it might seem at first. Even mainstream scholars are sometimes found to recognize the benefits of board pluralism. For example, Steven Bainbridge has said in the context of suggesting that larger boards are better than smaller boards that "[m]ore directors will usually translate into more interlocking relationships with other organizations that may be useful in providing resources such as customers, clients, credit, and supplies."[62] Note that Bainbridge sees the benefits of including persons on the board who can speak for and offer insight from various non-equity investors, even though he notably does not include workers in his list. He describes the benefits of this kind of board pluralism as including the ability to address information asymmetries and thus aiding in the creation of strategic alliances.[63] This insight, which seems right, would be true not only for business partners but for all non-equity investors, including workers. Workers, too, are in effect entering into a strategic alliance with a firm when they invest their time,

[58] Cass R. Sunstein, Why Societies Need Dissent 27 (2003).
[59] Id. At 28, quoting Jeffrey A. Sonnenfeld, What Makes Great Boards Great, 80 *Harv. Bus. Rev.* 106, 111 (Sept. 2002).
[60] Microquest White Paper, Shattering the Glass Ceiling, available at http://www.mqc.com/glass_witeppr.html.
[61] Id. See also The Harris Poll, The Enron Effect: The American Public's Hostile Attitudes Toward Top Business Managers (Oct. 18, 2002) available at http://www.harrisinteractive.com/harris_poll/index.asp?PID=334.
[62] Bainbridge, *Decisionmaking*, at 43.
[63] Id.

energy, and futures with the company. Thus they, too, "need credible information about the competencies and reliability of prospective partners," just as the firm needs credible information about their "competencies and reliability."[64]

The worries often expressed about co-determination are overblown. No constituency would have an incentive to hurt the company in order to gain a larger piece of the pie. Even if they did, they would be violating their fiduciary duties to the firm as a whole and could be held to account for their behavior. Second, the possibility of strategic, "rent-seeking" behavior *already* exists in the firm. Directors now are elected by shareholders only, and shareholders already have incentives in certain circumstances to put their interests ahead of the interests of the firm as a whole. A pluralistic board could actually retard those selfish impulses, because any behavior that benefits one stakeholder at the expense of the firm must be done in full view of the others.

To be sure, making the board less homogeneous will make decisions less tidy, since more views will have to be taken into account and since the board will be forced to compromise so that decisions are acceptable to a majority or plurality of stakeholders. But the fact that decisions will be more difficult is not in itself a reason to refuse to improve boards by having them listen to a range of views and perspectives. The real question is whether additional diversity results in decisions that are worth the extra effort. In fact, a greater diversity in perspectives and backgrounds within the boardroom will lessen the risk over time that the board will engage in the defects and systematic mistakes of "groupthink." [65]

On this point we can gather insight from our experiences outside of business. The notion that decisions produced by a finely wrought process of dialogue and compromise are better than decisions made unilaterally by a uniform group of individuals is widely accepted by institutions other than corporate boards. We recognize in legislative bodies, administrative agencies, school faculties, and non-profit boards that diversity of viewpoints and people increase the likelihood that

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[64] Id. Bainbridge also suggests that boards perform better when a larger board includes a greater number of "specialists" who would aid in both the board's monitoring and service functions. As he says, "complex business decisions require knowledge in such areas as accounting, finance, management, and law. Providing access to such knowledge can be seen as a part of the board's resource gathering function." Id. Boards cannot expect to be, and probably should not be particularly specialized, but they benefit from having specialists among them. While Bainbridge's examples are of investment bankers and attorneys, his reasoning would extend to those having specialized insight about other non-equity investors. As Bainbridge argues, "larger, *more diverse* boards likely contain more specialists, and therefore should get the benefit of specialization." Id. (emphasis added). Bainbridge's focus is more the *size* of boards, but he – perhaps inadvertently – makes my point about the *diversity* of boards as well.

[65] See, e.g., Sunstein, *supra*, at 143 ("defective decisionmaking" is "strongly correlated" with structural flaws such as "insulation and homogeneity); Bainbridge, *Decisionmaking, supra*, at 32 (discussing groupthink).]

dissent will be welcomed, important perspectives will be heard, and decisions will be more fully vetted. As Madison argued in the Federalist Papers, a pluralistic federal government where power is balanced among many different groups actually *weakens* factions.[66] To make important decisions, one must build coalitions; individual factions cannot act on their own. The same is likely true in corporate governance.

* * *

These principles of good decision making are not new or earth shaking. They are just systematically ignored in corporate governance. If we adopted these insights into corporate law, the strengths of the corporate form could be maintained and then harnessed for a purpose higher than the aggregation of shareholder profit. *Social* wealth could be built; social interests could be internalized into firm decision making; wealth could be more fairly distributed. Perhaps the world will not be saved. But it would be better.

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[66] James Madison, Federalist Papers #10 (George W. Casey & James McClellan eds., Liberty Fund 2001)(1788) at 48.

Response: The Dystopian Potential of Corporate Law

D. Gordon Smith[†]

Introduction

Julian West was born a Boston Brahmin in 1857. At age 29, he was engaged to be married to Edith Bartlett, whom he described as wealthy, beautiful, and graceful. Their marriage awaited only the completion of a new house, which West was attempting to build in "one of the most desirable parts of the city, that is to say, a part chiefly inhabited by the rich." Although West owned his own home, it was, in his words, "not a house to which I could think of bringing a bride, much less so dainty a one as Edith Bartlett." But construction on the new house had been repeatedly delayed by labor strikes. Later recounting his frustration at these strikes, West wrote:

> What the specific causes of these strikes were I do not remember. Strikes had become so common at that period that people had ceased to inquire into their particular grounds. In one department of industry or another, they had been nearly incessant ever since the great business crisis of 1873. In fact, it had come to be the exceptional thing to see any class of laborers pursue their avocation steadily for more than a few months at a time.

On the evening of May 30, 1887 – after spending the day with Edith and her family – West retired to his home. He was exhausted after suffering from insomnia the previous two nights. So severe was his affliction that he had built a secret, soundproof chamber under the foundations. Even this extreme measure, however, sometimes failed to produce the desired results. On these occasions, West solicited the assistance of Doctor Pillsbury, a self-proclaimed "Professor of Animal Magnetism." Doctor Pillsbury had the ability to "mesmerize" West, placing him in a "deep slumber, which continued until I was aroused by a reversal of the mesmerizing process." On this particular night, West asked his servant to summon Doctor Pillsbury, who came only reluctantly because his was preparing to leave Boston that very night to pursue a new professional opportunity in New Orleans. Nevertheless, Doctor Pillsbury visited West, who submitted to the treatment after giving instructions to his servant to be awakened at 9:00 a.m. the next morning.

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When West was finally awakened, he did not see the face of his servant, but the face of a stranger, who identified himself as Dr. Leete. West found himself in a house he had never before seen and when he demanded an explanation, the reluctant Dr. Leete told him that the date was September 10, 2000. West had slept for 133 years, three months, and 11 days.

West's tale appears in *Looking Backward*, a novel by Edward Bellamy, first published in 1888.[70] *Looking Backward* describes Bellamy's utopian vision through West's eyes as he explores the differences between Boston in the year 2000 and the Boston of his youth. Much of the book recounts conversations between West and Dr. Leete, an educated and inquisitive man who gradually introduces West to the strange new world. West also occasionally ventures out to see the new world with Dr. Leete's beautiful daughter, Edith.[71]

In Bellamy's utopia, West finds a society in which everyone is equal, not only in material wealth but in dignity. It is a world with clean air (because people no longer use combustion to heat their homes), no jails (for "lying has gone out of fashion"), and no military organizations (because the "civilized" world is united in a great economic community). There are no taxes because there is no private property; everything, beyond limited personal effects, is owned by the national government. (Note that it is not a "federal" government, because the states have been eliminated.) The national government exists primarily to direct the affairs of the nation's industrial operations, and for this function, there is no need for lawyers. Accordingly, Bellamy – who labored for a brief time as a practicing attorney – eliminates them completely. After all, in the words of Dr. Leete, "It would not seem reasonable ... in a case where the only interest of the nation is to find out the truth, that persons should take part in the proceedings who had an acknowledged motive to color it."

The persistent question that occupies Julian West throughout the novel is how this utopia could have been achieved without a basic change in human nature. When West entered the state of suspended animation in 1887, the problem consuming American society was the "labor question," that is, the problem of reconciling employers and workers. Dr. Leete, living in a world after the labor question had been resolved, analyzes the problem with admirable simplicity. According to Dr. Leete, the labor question arose in the nineteenth century because of the unprecedented concentration of

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70 EDWARD BELLAMY, LOOKING BACKWARD (Penguin Classics 1986) (1888).

71 Late in the book, it is revealed that Edith is the great-granddaughter of Edith Bartlett, who had reluctantly married another after the supposed death of her fiancé in a house fire.

capital, which displaced numerous entrepreneurial businesses and replaced them with "great corporations." The rise of these great corporations could not be curtailed, despite popular opposition, because "even its victims . . . were forced to admit the prodigious increase in efficiency which had been imparted to the national industries, the vast economies effected by concentration of management and unity of organization, and to confess that since the new system had taken the place of the old the wealth of the world had increased at a rate before undreamed of."

Dr. Leete's account seems strangely contradictory. On the one hand, corporations caused resentment because they forced people who previously had been able to survive independently to subject themselves to the whim of the great capitalists. On the other hand, those same people acknowledged the power of the great corporations to improve their lives (to dismantle the great corporations "would have involved returning to the day of stage-coaches"), and thus they would not attempt to turn back the clock. The problem, quite, simply, was a distributional one: "the vast increase had gone chiefly to make the rich richer, increasing the gap between them and the poor."

What West learns under the tutelage of Dr. Leete is that people have not fundamentally changed, but that the structure of society has changed. Somehow, while West slept, *society* had made a conscious decision to pursue equality with full conviction. The public policy that ushered in this new era was nationalization of all industry. Dr. Leete describes the "logical evolution" from a capitalist society in which industry was increasingly concentrated to a nationalized economy that would "open a golden future to humanity":

> Early in the last century the evolution was completed by the final consolidation of the entire capital of the nation. The industry and commerce of the country, ceasing to be conducted by a set of irresponsible corporations and syndicates of private persons at their caprice and for their profit, were entrusted to a single syndicate representing the people, to be conducted for the common interest for the common profit. The nation, that is to say, organized as the one great business corporation in which all other corporations were absorbed; it became the one capitalist in the place of all other capitalists, the sole employer, the final monopoly in which all previous and lesser monopolies were swallowed up, a monopoly in the profits and economies of which all citizens shared.

Looking Backward was a publishing bonanza, selling 300,000 copies in its second year of publication. In the wake of its publication, Bellamy Nationalist Clubs formed across the United States, and though the nationalist movement fizzled by the mid-1890s, Bellamy's vision of corporations brought to heel by the government left an enduring mark on the American psyche. In 1935 Charles Beard, John Dewey, and Edward Weeks each listed *Looking Backward* as the second most influential book written since 1885, behind only *Das Kapital.*[72]

As one of the major works addressing the role of corporations in society during the Gilded Age,[73] *Looking Backward* serves as a marker by which to measure the progress of the "corporate social responsibility" (CSR) movement. In some ways, the modern version of CSR seems light years from Bellamy's nationalization nightmare, as CSR scholarship has become increasingly diverse[74] and sophisticated.[75] Nevertheless, CSR remains tightly focused on the notion that "the legitimate concerns of a corporation should include such broader objectives as sustainable growth, equitable employment practices, and long-term social and environmental well-being."[76] For reformers who choose corporate law as their workshop, the list of potential targets that might achieve those ends is short.

Kent Greenfield has written meaningfully about corporate law from a CSR perspective for many years. His recent book, *Fundamental Flaws, Progressive Possibilities: A New View of Corporate Law*, will cement his reputation as one of the most creative proponents of "progressive corporate law."[77] In the companion piece to this article, Professor Greenfield relies on new insights from organizational and regulatory theory to bolster his claim that corporate law needs fundamental reform.[78]

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72 DONALD HODGES, AMERICA'S NEW ECONOMIC ORDER 15 (1996).

73 *See* MARK TWAIN & CHARLES DUDLEY WARNER, THE GILDED AGE: A TALE OF TODAY (1873).

74 For a recent ethnography of the CSR movement, *see* John M. Conley & Cynthia A. Williams, *Engage, Embed, And Embellish: Theory Versus Practice In The Corporate Social Responsibility Movement*, 31 J. CORP. L. 1 (2005).

75 *See, e.g.,* Ruth V. Aguilera et al., *Putting the S Back in Corporate Social Responsibility: A Multi-Level Theory of Social Change in Organizations*, 31 ACAD. MGMT. REV. (forthcoming 2006), available at http:// ssrn.com/abstract=820466.

76 Conley & Williams, *supra* note 74, at 1-2.

77 "Progressive corporate law" coalesced around a conference and subsequent book by that title. LAWRENCE E. MITCHELL, ED., PROGRESSIVE CORPORATE LAW: NEW PERSPECTIVES ON LAW, CULTURE, AND SOCIETY (1995).

78 Kent Greenfield, *Saving the World with Corporate Law* (working paper March 2007).

In the following sections, I respond to Professor Greenfield's challenge to traditional corporate law. Part I describes the scope of my inquiry, defining "corporate law" as essentially about the structure of corporate decision making. Part II observes that reformers like Professor Greenfield have only two options for changing corporate decision making: changing the decision maker or changing the decision rule. I contend that the existence of powerful product markets, capital markets, and managerial labor markets restrict the options of corporate decision makers, thus frustrating attempts to materially alter the substance of corporate actions. Finally, Part III considers a potential dark side of corporate reforms. While Part II suggested that changing the decision maker or changing the decision rule would have little or no effect on corporate actions, Part III explores the dystopian potential of corporate law reform.[79]

I. The Irreducible Core of Corporate Law

What is corporate law? Legal scholars often describe corporations by reference to a handful of legal characteristics: legal personality, limited liability, transferable shares, delegated management, and investor ownership.[80] One might reasonably conclude, therefore, that "corporate law" consists of the set of rules that create and sustain those characteristics.

While this conception of "corporate law" might be useful in defining a course of study or the scope of a treatise, a more austere definition will focus our analysis. Professor Greenfield is on the right track when he observes, "Corporate law determines the rules governing the organization, purposes, and limitations of some of the largest and most powerful institutions in the world."[81] Pared to its core, "corporate law" is the set of rules that defines the decision making structure of corporations.[82] Or, invoking Melvin Eisenberg's memorable maxim, "corporate law is constitutional law."[83]

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[79] The word "dystopia" is usually credited to John Stuart Mill.

[80] Henry Hansmann & Reinier H. Kraakman, "What is Corporate Law?" in THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 17-19 (Reinier R. Kraakman et al. eds., 2004).

[81] Greenfield, *supra* note 77, at 2.

[82] *Cf.* Bernard S. Black, *Is Corporate Law Trivial?*, 84 NW. U. L. REV. 542, 546-47 (1990) ("I define 'corporate law' to include laws – whether made by legislators, judges, or regulators – that primarily govern the relationship between a company's managers and investors"); Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565, 1578-79 (1993):

The rules that define the decision making structure of corporations are both "power-conferring" and "duty-imposing."[84] The locus of power in the corporation is the board of directors, which possesses a "large reservoir of authority."[85] In a typical corporation, much of this management authority is delegated to officers, though the extent of such delegations is regulated more by custom than by positive corporate law.[86]

The board of directors exercises its authority subject to the will of the shareholders, who are entitled to determine the composition of the board.[87] In addition to electing and removing directors, shareholders must approve certain fundamental transactions.[88] These voting rights, coupled with limited financial rights,[89] the right to sue derivatively,[90] and the right to transfer shares without prior

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> Corporate law, like most law, is primarily about the rule-oriented structuring of social power, and it is specifically about the rules that structure the organization of economic power. Corporate law is primarily concerned with business, that is, the structure of economic power in the form of its institutions and processes. Its subject is not primarily economics, although economic policy must obviously play a central role in the development of corporate law. The most basic rules of corporate law involve the structure and governance of businesses that "incorporate," which means simply filing with a state government "founding documents" (usually a certificate of incorporation and any required supporting documents). Beyond the ministerial requirements of the founding act, corporate law also structures and, at least to a certain extent, circumscribes the activities of incorporated businesses and the participants associated with them. Moreover, the powers and restrictions of corporate law are formulated with a view (at least in theory) toward achieving a set of rules for incorporated businesses that conduce to the public advantage.

[83] MELVIN ARON EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 1 (1976).

[84] H.L.A. HART, THE CONCEPT OF LAW 40-41 (1961). Eric Orts employed this dichotomy in his excellent discussion of complexity in corporate law. *See* Orts, *supra* note 82, at __.

[85] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953 (Del. 1985) (citing Del. Code Ann. tit. 8, § 141(a), which states, "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors …").

[86] Provisions relating to officers are scant in modern corporation statutes, and the provisions that exist allow tremendous flexibility in defining the titles, duties, and other terms of office. *See, e.g.,* Del. Code Ann. tit. 8, § 142 (providing that the titles and duties of the officers are to be determined in accordance with bylaws or a resolution of the board of directors).

[87] *See* Del. Code Ann. tit. 8, § 211(b) (election) and 8 Del. C. § 141(k) (removal).

[88] Del. Code Ann. tit. 8, § 242(b) (1991); Model Bus. Corp. Act § 10.03 (1999) (both amending the corporate charter); Del. Code Ann. tit. 8, § 251(c) (1991); Model Bus. Corp. Act § 11.03 (1999) (both approving mergers); Del. Code Ann. tit. 8, § 271 (1991); Model Bus. Corp. Act § 12.02 (1999) (both approving sales of assets not in the ordinary course of business); Del. Code Ann. tit. 8, § 275(b) (1991); Model Bus. Corp. Act § 14.01 (1999) (both approving dissolution).

[89] Common stock possesses the "residual claim" against the corporation's assets. Absent special arrangements in the corporate charter or extreme circumstances, however, holders of common stock are not entitled to receive dividends. The corporation statute gives the board of directors almost complete discretion over the declaration of dividends. Del. Code Ann. tit. 8, § 170.

[90] Del. Code Ann. tit. 8, § 327.

approval,[91] comprise the statutory rights of shareholders vis-à-vis the corporation. Though this array of rights may seem substantial on paper, impediments to effective shareholder governance have been extensively catalogued and debated.[92]

The rules of corporate law that constitute the board of directors, officers, and shareholders, and allocate authority among them are the "power-conferring" rules. The "duty-imposing" rules limit the exercise of authority, partly through substantive constraints, but mostly through procedural constraints.

Substantive statutory constraints on board power have largely been abandoned or eviscerated in modern corporation statutes. In their landmark 1932 book, *The Modern Corporation and Private Property*, Adolf Berle and Gardiner Means lamented the passing of such provisions from nineteenth-century corporation codes.[93] Vestiges remain, such as provisions regarding corporate "powers"[94] and "purposes"[95] or the regulation of "legal capital,"[96] but these provisions impose no important constraints on corporate decision making.[97]

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[91] *See* Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: ASacred Space@ in Corporate Transactions*, 80 TEXAS L. REV. 261, 304 (2001) ("State corporations codes do not see the need to specify this basic right of property, but it is implicit in statutory provisions regulating restrictions on share transfer"), *citing* Del. Code Ann. tit. 8, § 202 (1991).

[92] *See, e.g.,* Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006); Leo E. Strine, *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 Harv. L. Rev. 1759 (2006); Lucian A. Bebchuk, *Reply: Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784 (2006).

[93] ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 119-40 (1932).

[94] Del. Code Ann. tit. 8, §§ 121 & 122.

[95] Del. Code Ann. tit. 8, § 102(a)(3).

[96] Del. Code Ann. tit. 8, §§ 154, 160 & 170.

[97] The power of the board of directors may be limited by a corporation's constitutional documents. *See, e.g.,* Del. Code Ann. tit. 8, § 102(b)(1) (allowing the certificate of incorporation to contain "any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders … if such provisions are not contrary to the laws of this State"); Del. Code Ann. tit. 8, § 109(b) (authorizing bylaws that "contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees").

The extent to which shareholders are allowed to limit the authority of the board of directors through shareholder-adopted bylaws remains an open question in Delaware. For thorough discussions of this issue, see Brett H. McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills*, 3 BERKELEY BUS. L. J. 205 (2005); Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409, 428-33 (1998).

In 2006, the Delaware legislature adopted amendments to Del. Code Ann. tit. 8, § 216, providing in relevant part, "A bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall

In modern corporation statutes, the most important constraints on director power are procedural, not substantive. In broad brush, good procedure requires unbiased directors[98] who consider "all material information reasonably available."[99] Shareholders frequently contest director elections, claiming procedural flaws, both under state law[100] and federal securities laws.[101] In addition to technical requirements of statutes and regulations, courts impose on directors duties of care, loyalty, and good faith, all of which are primarily procedural duties.[102]

Viewed as a whole, the "power-conferring" and "duty-imposing" rules discussed above – along with the ancillary rules regulating the formation of the corporation[103] – are the rules that comprise "corporate law." Professor Greenfield believes that we can change the world for the better by improving these rules. More specifically, he focuses on board composition and shareholder primacy. In the ensuing sections, I will argue that changes in corporate law cannot eradicate poverty or materially change existing distributions of wealth, except by impairing the creation of wealth. Changes in corporate law will not clean our air or our water. And changes in corporate law will not

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not be further amended or repealed by the board of directors." The synopsis of the bill expressly limited the effect of this amendment to § 216, thus leaving open the general issue of the viability of shareholder-adopted bylaws:

> Section 5 Amends § 216 to provide that a bylaw adopted by a vote of stockholders that prescribes the required vote for the election of directors may not be altered or repealed by the board of directors. This amendment does not address any other situation in which the board of directors amends a bylaw adopted by stockholder vote.

98 The concept of "bias" in corporate law traditionally has been framed in terms of "independence" and "disinterestedness." *See, e.g.,* In re Tele-Communications, Inc. Shareholders Litigation, 2005 WL 3642727 (Del.Ch. 2005) ("In order to rebut the presumption of director disinterestedness and independence, a stockholder must show that the directors' self-interest materially affected their independence.").

99 Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000).

100 Del. Code Ann. tit. 8, § 225. *See* Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 169-70 (2004) (describing "expedited statutory proceedings," including proceedings under § 225, in the Delaware courts).

101 Federal securities law contains rules regulating disclosure and proxy voting in director elections. See Securities and Exchange Act Schedule 14A, 17 C.F.R. §240.14a-101 (2001).

102 For an extensive discussion of each of these duties, see In re Walt Disney Co. Derivative Litigation, 2006 WL 1562466 (Del. 2006). The *Disney* case is particularly important for the definition of "good faith," which is the duty that comes closest to embodying substantive constraints on the board of directors. The *Disney* Court described the duty of good faith as a duty to avoid intentional infliction of harm on the corporation, intentional violations of law, and intentional derelictions of duty. In each case, the cited wrong requires "intentional" action by the directors, thus making the inquiry essentially procedural.

103 Del. Code Ann. tit. 8, §§ 101-110.

solve the labor question. Indeed, the only changes in corporate law that will have a substantial effect on such issues are changes that make the world worse, not better.[104]

II. Does Corporate Law Matter?

This question lies at the heart of my disagreement with Professor Greenfield, who proclaims: "Corporate law is a big deal."[105] Ask most corporate governance scholars whether corporate law matters, and you risk receiving a disquisition on the connection between corporate law and stock price or profitability.[106] For Professor Greenfield, by contrast, whether corporate law matters triggers a more expansive inquiry about the effect of corporate actions on labor relations, the environment, and human rights.[107]

If corporate law is fundamentally about the process of corporate decision making, as asserted above, possible strategies for reform are twofold: (1) changing the decision maker (Professor Greenfield's reform efforts are aimed at the board of directors, though recent work on increasing the role of shareholders also speak to this issue[108]), or (2) changing the decision rule (the "shareholder primacy norm"). Like other aspiring reformers before him, Professor Greenfield explores both options. To sustain his claim that "corporate law is a big deal,"[109] Professor Greenfield must persuade us not only that changing the composition of the board of directors or changing the shareholder primacy norm would alter corporate decision making, but also that the

[104] I do not argue that corporate law is trivial in any meaningful sense. *Cf.* Black, *supra* note __, at 544 ("After a century of erosion through competition for corporate charters, what is left of state corporate law is an empty shell that has form but no content."). On this issue, I am in agreement with Eric Orts: "Even if Black's 'triviality hypothesis' proved correct, corporate law would nonetheless remain important. Even if corporate law were entirely enabling, it would describe the rules by which economic power is socially structured, which is not a trivial matter, although corporate law would then collapse into a specialized category of contract and property law." Orts, *supra* note 82, at 1582.

[105] Greenfield, *supra* note 77, at 2.

[106] *See, e.g.,* Craig A. Peterson & Norman W. Hawker, *Legal Capital Restrictions on Stock Distributions*, 31 AKRON L. REV. 175 (1997). The slightly broader question – "does corporate governance matter?" – has triggered an important set of studies at the intersection of law and finance. *See, e.g.,* Bernard Black, *Does Corporate Governance Matter? A Crude Test Using Russian Data*, 149 U. PA. L. REV. 2131 (2001); Mark S. Klock et al., *Does Corporate Governance Matter to Bondholders?*, 40 J. FIN. & QUANT. ANAL. 693 (2005).

[107] Greenfield, *supra* note 77, at 2 ("By establishing the obligations and priorities of companies and their management, corporate law affects everything from the return on shareholder equity, to employees' wage rates (whether in Silicon Valley or Bangladesh), to whether companies will try to skirt environmental laws, to whether they will tend to look the other way when doing business with governments that violate human rights.").

[108] *See, e.g.,* Bebchuk, *supra* note 92; Smith & Thompson, *supra* note 91.

[109] Greenfield, *supra* note 77, at 2.

new decisions would be better for society as a whole than the old decisions.[110] In this Part II, I argue that Professor Greenfield's proposed changes would not materially alter corporate decision making, and in Part III, I argue that forcing material changes through corporate law reform would decrease societal wealth. Like other would-be reformers, Professor Greenfield runs smack into Adam Smith's invisible hand.[111]

A. Changing the Decision Maker

As noted above, the problem that was consuming Julian West when he went into a trance in 1887 was the "labor question." Professor Greenfield tells a similar story about modern employees,[112] even though, like the people of Julian West's youth, Professor Greenfield is forced to acknowledge the "prodigious … efficiency" with which corporations operate.[113] Indeed, like Edward Bellamy, Professor Greenfield wants to "take advantage of the successes of the corporation in order to achieve important gains in social welfare."[114] Rather than nationalizing corporations, however, Professor Greenfield would prefer to change the composition of the board of directors to include representatives of a broad range of corporate stakeholders.[115]

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110 Larry Ribstein appropriately frames the issue as follows: "The relevant issue … is not whether markets force shareholder-maximizing managers to maximize social wealth. Rather the question is whether permitting firms to contract to make managers accountable to shareholder leads to greater social wealth than forcing them to serve non-shareholder stakeholders." Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1444 (2006).

111 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (1776).

112 Greenfield, *supra* note 77, at .

113 Greenfield, *supra* note 77, at 2 ("Corporations are also immensely successful at creating financial wealth. They are the world's most successful business form for facilitating a cooperative process of investment by numerous stakeholders, uniting through the corporate entity to organize their various resources to produce goods or services for profitable exchange.").

114 Greenfield, *supra* note 77, at 23.

115 Professor Greenfield cleverly turns economic analysis against its practitioners:

> What I am imagining here is, in an ironic sense, a genuine realization of the "nexus of contracts" view of the firm. If the firm is best seen as a microcosm of the market, then let us be honest about recognizing all contracts by putting the most important market participants in a position where they can be heard at the decision making level of the firm. The specifics will be difficult but not impossible: employees could elect a proportion of the board; communities in which the company employs a significant percentage of the workforce could be asked to propose a representative for the board; long-term business partners and creditors could be represented as well.

Greenfield, *supra* note 77, at 28.

Professor Greenfield's proposal is reminiscent of Abram Chayes' 1959 proposal to allow non-shareholder constituencies to participate in "[t]heir rightful share in decisions and the exercise of corporate power" by electing representatives to the board of directors.[116] While Professor Greenfield reassures us that "specifics will be difficult but not impossible," Ralph Nader was not so sanguine: "It seems impossible to design a general 'interest group' formula which will assure that all affected constituencies of large industrial corporations will be represented and that all constituencies will be given appropriate weight."[117]

Even if the logistics of this proposal could be worked out, the likelihood that it would substantially alter corporate decision making is vanishingly small. The obstacle to change is markets. Lots of markets: product markets, capital markets, managerial labor markets.[118] While changes in the composition of the board of directors may have some marginal effects on corporate decision making, market forces severely constrain the range of options available to the boards of large, publicly traded companies.[119] Of particular relevance to the current discussion, powerful capital and takeover markets provide strong incentives for corporate managers to maximize profits.

The available evidence strongly suggests that changing the structure of corporate decision making to provide greater voice to non-shareholder constituencies would not significantly change this profit-maximizing orientation of those firms. For example, labor unions acting as shareholder activists in the 1990s were a "model for any large institutional investor attempting to maximize

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[116] Abram Chayes, "The Modern Corporation and the Rule of Law," *in* THE CORPORATION IN MODERN SOCIETY 40-41 (Edward S. Mason ed. 1959).

[117] RALPH NADER, ET AL., TAMING THE GIANT CORPORATION 124 (1976). Nader and his co-authors proposed instead that each director be given "a separate oversight responsibility, a separate expertise, and a separate constituency so that each public concern would be guaranteed at least one informed representative on the board." *Id.* at 125. While modern boards of directors typically do not include a director who is expressly identified as an expert on "employee welfare" or "consumer protection," modern boards include "financial experts," who comprise the audit committee. 15 U.S.C. § 7265 (Supp. 2002) (Sarbanes-Oxley Act § 407).

[118] For an attempt to illustrate how these markets combine to exert pressure on corporate decision making, see D. Gordon Smith, *Corporate Governance and Managerial Incompetence: Lessons From Kmart*, 74 N.C. L. REV. 1037 (1996)

[119] On the power and efficacy of markets to product socially desirable outcomes, see Ribstein, *supra* note 110, at 1442-60.

return on capital."[120] Similarly, employee ownership has failed to transform large, publicly traded companies.[121]

Professor Greenfield invokes the German model of codetermination, under which employees of large German corporations elect one-half of the supervisory board, despite the absence of persuasive evidence that codetermination changes corporate decision making. Codetermination has been widely studied among corporate governance scholars, particularly in recent years as the European Union (EU) has endeavored to harmonize company law among the Member States.[122] As the EU prepares for the possibility of charter competition,[123] debates about the German model have escalated in intensity, but evidence regarding the effect of codetermination on corporate decision making is "notoriously ambiguous."[124]

Professor Greenfield also emphasizes racial, ethnic, and gender diversity as a means of changing the decision maker. He defends diversity on instrumental grounds: "Adding perspectives other than those of rich, white men will almost certainly improve the quality of business decisions made by the board."[125] Professor Greenfield is not the first to link board diversity with improved

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120 Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018, 1020 (1998).

121 See Steve Sleigh, Book Review: THE REAL WORLD OF EMPLOYEE OWNERSHIP BY JOHN LOGUE & JACQUELYN YATES, 5 U. PA. J. LAB. & EMP. L. 215 (2002). Sleigh offers the following as a stylized view of "a big, publicly traded, highly visible firm that is majority-owned by its employees":

> The reality is that labor-management relations were not transformed by employee ownership, but remain in a steady state of ongoing strife. This is due to a number of factors, not the least of which is an industry-wide culture of conflict, and class and gender distinctions among various union-represented groups. In and of itself, employee ownership barely raises its head as an issue except at shareholder meetings. Indeed, while employees collectively own over have of the common stock, the real control of the company is still exerted by a small handful of senior executives, bankers, and other companies who act as both suppliers of capital goods and operating money.

Id. at 215-16.

122 With regard to harmonization efforts in the European Union, *see* Communication from the Commission to the Council and the European Parliament – Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward, COM (2003) 284 final, available at: http://europa.eu.int/eur-lex/en/com/cnc/2003/com2003_0284en01.pdf; Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, *OJ* L 52 of 25 February 2005, p. 51.

123 Jens C. Dammann, *The Future of Codetermination After Centros: Will German Corporate Law Move Closer to the U.S. Model?*, 8 FORDHAM. J. CORP. & FIN. L. 607 (2003).

124 Christine Windbichler, *Cheers and Boos for Employee Involvement: Co-Determination as Corporate Governance Conundrum*, 6 EUR. BUS. ORG. L. REV. 507, 510 (2005).

125 Greenfield, *supra* note 78, at 29.

corporate decision making,[126] even though evidence supporting this link is mixed, at best.[127] These arguments raise an obvious question: if diversity is value enhancing, why don't corporations pursue a policy of diversity voluntarily? One possibility is the so-called "pool problem."[128] Another possibility is that entrenched incumbents receive private benefits from the status quo or are motivated by a desire to exclude women or racial or ethnic minorities. Of course, a third possibility is that diversity is not value enhancing.

Professor Greenfield's reliance on business rationales to support his argument for diversity is surprising, given his general willingness to eschew business rationales in favor of other considerations, such as social justice. I suspect that Professor Greenfield views increased diversity as inherently good, even though he feels obliged to defend on proposal on efficiency grounds. Interestingly, on traditional measures of corporate social responsibility, board diversity appears to be ineffectual.[129] Moreover, the goodness inherent in board diversity may be diluted by linking diversity with business outcomes. Lisa Fairfax has recently concluded that business rationales for racial and ethnic diversity "promise more – and in some cases significantly more – than directors of color can

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126 *See, e.g.,* Lynne L. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors*, 76 TUL. L. REV. 1363 (2002); Lisa M. Fairfax, *Clogs In The Pipeline: The Mixed Data On Women Directors And Continued Barriers To Their Advancement*, 65 MD. L. REV. 579 (2006); Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233 (2003); Steven A. Ramirez, *Diversity and the Boardroom*, 6 STAN. J.L. BUS. & FIN. 85 (2000); Steven A. Ramirez, *A Flaw in the Sarbanes-Oxley Reform: Can Diversity in the Boardroom Quell Corporate Corruption?*, 77 ST. JOHN'S L. REV. 837 (2003); Janis Sarra, *The Gender Implications of Corporate Governance Change*, 1 SEATTLE J. SOC. JUST. 457 (2002).

127 Proponents of diversity can point to one study showing a correlation between number of women or people of color on a corporation's board and firm value as measured by Tobin's q. David A.Carter et al., *Corporate Governance, Board Diversity, and Firm Value*, 38 FIN. REV. 33 (2003). Lisa Fairfax is skeptical of the "governance rationale" for diversity on corporate boards. *See* Lisa M. Fairfax, *The Bottom Line On Board Diversity: A Cost-Benefit Analysis Of The Business Rationales For Diversity On Corporate Boards,* 2005 WIS. L. REV. 795, 831-37.

128 *See* Fairfax, *supra* note 127, at 815 (noting that "very few people of color (and, for that matter, relatively few white people) appear to meet the qualifications of a traditional board member"). Fairfax argues that the numbers of minorities in professional, managerial, and related jobs "suggest that the available talent pool of people of color is greater than the current representation within corporate boards suggests, and hence that corporations should do a better job of reaching out to them." *Id.* at 817. Professor Fairfax concedes, however, that the relatively small numbers are an obstacle to board diversity. *Id.*

129 Betty S. Coffey & Jia Wang, *Board Diversity and Managerial Control as Predictors of Corporate Social Performance*, 17 J. BUS. ETHICS 14 (1998); Fairfax, *supra* note 128, at 826 ("neither the empirical nor the anecdotal evidence appears to support the presumption that enhanced board diversity correlates with reduced incidents of discrimination among employees and their corresponding lawsuits").

realistically deliver."[130] As a result, using the business rationales to justify board diversity "may lead to the overextension, the marginalization, and even the devaluation of people of color."[131]

Perhaps the most ambitious example of "changing the decision maker" in the United States has been the drive to create independent boards of directors, which began in earnest in the 1970s and continues today.[132] The drive has been successful, if success is measured by the increased number of independent boards. If success if measured by improved performance of the companies, however, empirical evidence is lacking.[133] Indeed, with the exception of an increased willingness to replace chief executive officers, there is no evidence that decisions by independent boards of directors differ qualitatively from the decisions of insider boards.[134] Nevertheless, the drive continues. Enron, WorldCom, and other corporate scandals early in this decade further raised the

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[130] Fairfax, *supra* note 128, at 797.

[131] Fairfax, *supra* note 128, at 854. Fairfax's arguments track those generally employed by critical scholars concerned with "legal cooptation." In a recent article, Orly Lobel "unbundles" the cooptation critique of law and attempts to restore a "critical optimism" to the role of law in promoting social change. Orly Lobel, *The Paradox of Extralegal Activism: Critical Legal Consciousness and Transformative Politics*, 120 HARV. L. REV. 937 (2007).

[132] For a recent survey of the debates over director independence, see Usha Rodrigues, *The Fetishization of Independence* (working paper 2007).

[133] *See* Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231, 233 (2002):

> We find evidence that low-profitability firms respond to their business troubles by following conventional wisdom and increasing the proportion of independent directors on their boards. There is no evidence, however, that this strategy works. Firms with more independent boards (proxied by the fraction of independent directors minus the fraction of inside directors) do not achieve improved profitability, and there are hints in our data that they perform worse than other firms. This evidence suggests that the conventional wisdom on the importance of board independence lacks empirical support. Board size also shows no consistent correlation with firm performance, though we find hints of the negative correlation found in other studies.

The notion that independent boards of directors should improve performance depends on the assumption that conflict-of-interest transactions are a material drag on corporate performance. But this assumption may be misplaced. As noted by Jill Fisch:

> [T]he focus on independence as a criterion for evaluating board structure may place undue emphasis on the monitoring role of the corporate board while ignoring its management function. Although director independence may enhance the board's ability to monitor effectively, this gain may come at the expense of a decline in the board's management capacity. This analysis suggests that the normative vision of independence currently embraced by the corporate governance movement is a vision that imposes costs as well as benefits upon corporations that respond to the reform pressure.

Jill E. Fisch, *Taking Boards Seriously*, 19 CARDOZO L. REV. 265, 267 (1997).

[134] *See* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1588 (2005) (noting with respect to studies of the connection between independent audit committees and firm performance, "None of these studies have found any relation between audit committee independence and performance, using a variety of performance measures including both accounting and market measures as well as measures of investment strategies and productivity of long-term assets.").

stakes, and director independence is a central feature in the Sarbanes-Oxley Act of 2002.[135] In addition, as part of those Enron-era reforms, the New York Stock Exchange and Nasdaq adopted more stringent definitions of director independence.[136]

Each of the foregoing examples of changing the decision maker has its own peculiar history and back story, but together they support the notion that, over a broad swath of firms, corporate decision making on matters of corporate social responsibility is not highly responsive to changes in board composition. Perhaps this should not be surprising, given the extent to which modern corporations in the U.S. already take account of social considerations.[137] Certainly, corporate law endows directors with tremendous discretion to serve the interests of all corporate stakeholders. Indeed, Lynn Stout and Margaret Blair have made the ability of directors to satisfy non-shareholder constituencies the distinguishing feature their conception of boards of directors as "mediating hierarchs,"[138] and Stephen Bainbridge has asserted, "the board of directors is not a mere agent of the shareholders, but rather is a *sui generis* body – a sort of Platonic guardian – serving as the nexus for the various contracts comprising the corporation."[139] Even if one were dissatisfied with the results of director discretion, it is clear that the U.S. corporate governance system already contains a substantial dose of "stakeholder governance."[140] Thus, while changes in board composition may

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135 Pub. L. No. 107-204, 116 Stat. 745.

136 NYSE, Inc., Listed Company Manual §303A (2004); NASDAQ, Inc., Marketplace Rules R. 4350(c)-(d) (2006).

137 *Cf.* Ribstein, *supra* note 110, at 1459 (arguing that "long-run profits may depend significantly on satisfying the social demands of consumers, employees and local communities").

138 Margaret Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 280-81 (1999) ("the primary job of the board of directors of a public corporation is not to act as agents who ruthlessly pursue shareholders' interests at the expense of employees, creditors, or other team members. Rather, directors are trustees for the corporation itself – mediating hierarchs whose job is to balance team members' competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together"); Margaret Blair & Lynn Stout, *Specific Investment: Explaining Anomalies in Corporate Law*, 31 J. Corp. L. 719, 738 (2006) ("directors are better described as 'mediating hierarchs' who must balance the competing needs and demands of shareholders, creditors, customers, suppliers, executives, rank-and-file employees, and even the local community, in a fashion that protects specific investment in the corporation and keeps the corporation alive, healthy, and growing").

139 Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 550-51 (2003).

140 Admittedly, the extent to which corporations in the U.S. serves various stakeholders may depend in large part on the predilections of shareholders. Cynthia Williams and John Conley provide an interesting comparison between corporations in the U.S. and the U.K. Both countries "share a pattern of widely dispersed share ownership," and both "have well-developed securities markets, and both depend upon similar mechanisms to promote managerial accountability, including financial transparency, stock market valuations, and the market for corporate control." Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 Cornell Int'l L. J. 493, 498 (2005). In addition, "both exhibit a form of shareholder capitalism, under which the purpose of the corporation is to maximize shareholder wealth." *Id.* Nevertheless, "institutional investors in the UK have acted,

work marginal changes in corporate decision making, the likelihood that Professor Greenfield's proposals would "save the world" is remote.

B. Changing the Decision Rule

Edward Bellamy was a clever man, and he anticipated the question that would naturally occur to his readers: would the utopian world described by Dr. Leete require a fundamental change in human nature? In response to a similar question asked by Julian West, Dr. Leete stated: "I don't think there has been any change in human nature in that respect since your day. It is still so constituted that special incentives in the form of prizes and advantages to be gained, are requisite to call out the best endeavors of the average man in any direction."[141] Nevertheless, the people in Dr. Leete's day seem to experience life differently from Julian West's people. Again, from Dr. Leete:

> "If I were to give you, in one sentence, a key to what may seem the mysteries of our civilization as compared with that of your age, I should say that it is the fact that the solidarity of the race and the brotherhood of man, which to you were but fine phrases, are, to our thinking and feeling, ties as real and as vital as physical fraternity."[142]

Professor Greenfield hopes to work a similar change in the attitudes of directors, not by changing their fundamental nature, but by changing the decision rule that governs their deliberations. Like many before him, Professor Greenfield criticizes the shareholder-centric focus of corporate decision making.[143] His argument is straightforward and powerful: "Corporate law should not presume, without strong arguments, to prohibit corporate decision makers from taking into account the very societal interests that the corporation is ultimately meant to serve in the first place."[144] While many corporate governance scholars defend the shareholder primacy norm as an

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and reacted, to bring stakeholder concerns and issues of social responsibility into the financial mainstream in a way that has not happened in the United States." *Id.* at 500.

141 Bellamy, *supra* note 70, at 57-58.

142 Bellamy, *supra* note 70, at 81. Later, Dr. Leete explains to West that the feeling of universal brotherhood became a reality only when all classes were eliminated. *Id.* at 94-95.

143 For a recent example, see Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005).

144 Greenfield, *supra* note 77, at 15.

essential feature of the corporate governance system,[145] I prefer to respond with a shrug of the shoulders. The problem with Professor Greenfield's argument is not that the shareholder primacy norm is an essential foundation stone in the corporate governance system, but that the shareholder primacy norm is both unenforced and unenforceable. As a result, "the shareholder primacy norm may be one of the most overrated doctrines in corporate law."[146]

Shareholder primacy was the locus of the most famous debate over corporate social responsibility, which took place in the early 1930s between Columbia Law Professor Adolf A. Berle and Harvard Law Professor Merrick Dodd (the "Berle-Dodd Debate"). In the wake of the stock market collapse in 1929, Berle wrote *Corporate Powers as Powers in Trust*[147] and asserted in the first sentence:

> It is the thesis of this essay that all powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears.[148]

Why did Berle feel the need to defend shareholder primacy in 1931? The conventional wisdom of today holds that the shareholder primacy norm was well-entrenched by 1919, when the Michigan Supreme Court issued its opinion in *Dodge v. Ford Motor Co.*, [149] which contains the most-cited articulation of the shareholder primacy norm.[150] Indeed, in his response to Berle, Dodd cites *Dodge*[151] and asserts, "it is undoubtedly the traditional view that a corporation is an association of stockholders formed for their private gain and to be managed by its board of directors solely with

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[145] *See, e.g.,* Bainbridge, *supra* note 139, at 577-84; David L. Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1, 29-34 (1979). Larry Ribstein has recently proposed various reforms that would enable corporations to implement partnership-like structures that would increase accountability of managers to shareholders. Ribstein, *supra* note 110, at 1476-82.

[146] D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 322-23 (1998).

[147] Adolf A. Berle, *Corporate Powers As Powers in Trust*, 44 HARV. L. REV. 1049 (1931).

[148] Berle, *supra* note 147, at 1049.

[149] 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end.").

[150] Smith, *supra* note 146, at 315 n. 186.

[151] E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees*, 45 HARV. L. REV. 1145, 1146 n. 3 (1932).

that end in view."[152] So why the debate, when Berle and Dodd seem to agree that the shareholder primacy norm applied to corporate decision making?

Though Berle does not explain his motives, one might infer from his language and from the nature of the proposals in the article that he was attempting to lay the foundation for reforms that would improve corporate performance during the Great Depression.[153] A major point of concern seemed to be managerial self-dealing.[154] Dodd states that the motivation for Berle's piece was "[t]he fact that managers … not infrequently act as though the maximum shareholder profit was not the sole object of managerial activities."[155] The cases referred to by Dodd are not cases of managerial inattention or incompetence,[156] but cases of self-dealing.[157]

The problem with using shareholder primacy to focus on managerial conflicts is that the beneficiary of the conflicted managers' duty is superfluous. Larry Mitchell has observed:

> [I]t is enough to prohibit directorial self-dealing to recognize that directors have no legitimate financial interest in the property they manage that would permit them to use any portion of that property to further their own interests. Although logical, the correlative statement that these transactions should be precluded in the interest of the stockholders is not necessary: the older formulation focusing on the interests of the corporation is adequate. Thus, identifying the beneficiaries of the rule is, to establish this modest principle, of secondary importance.[158]

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152 *Id.* at 1146-47.

153 Berle seems to be preoccupied with the possibility that corporations would be hampered by "technical rules," and he contends that such impediments would yield in the face of the shareholder primacy norm. Berle, *supra* note 147, at 1049-50.

154 For example, Berle proposes the following rule with respect to dividends: "dividends must be withheld only for a business reason: private or personal motives may not be indulged." Berle, *supra* note 147, at 1060. Later in the article, Berle asserts, "The power to acquire stock in other corporations must be so used as to tend to the benefit of the corporation as a whole and may not be used to forward the enterprises of the managers as individuals or to subserve special interests within or without the corporation." Berle, *supra* note 147, at 1063.

155 Dodd, *supra* note 151, at 1147.

156 *See generally* Smith, *supra* note 118.

157 *See, e.g.,* Dodd, *supra* note 151, at 1147-48 ("it is undesirable, even with the laudable purpose of *giving stockholders much-needed protection against self-seeking managers*, to give increased emphasis at the present time to the view that business corporations exist for the sole purpose of making profits for their stockholders") (emphasis added).

158 Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 591 (1992).

Thus, at the foundation of the Berle-Dodd debate lies the fallacious assumption that the role of the shareholder primacy norm is to police managerial conflicts. Dodd seems to recognize the insignificance of the shareholder primacy norm to the problem of discouraging managerial self-dealing because he expresses sympathy for Berle's project,[159] but argues that "experiments" in the direction of socially responsible behavior by corporate managers should not "run counter to fundamental principles of the law of business corporations."[160] As a legal matter, he is surely right, as Berle conceded 20 years later.[161] In *The Shareholder Primacy Norm*, I observed, "the universal application of the business judgment rule makes the shareholder primacy norm virtually unenforceable against public corporations' managers."[162]

If courts suddenly changed course, as urged by Professor Greenfield, could they enforce the shareholder primacy norm? In other words, does the shareholder primacy norm provide a tractable decision rule?[163] Economist Michael Jensen suggests that it does not:

> Value seeking tells an organization and its participants how their success in achieving a vision or in implementing a strategy will be assessed. But value maximizing or value seeking says nothing about how to create a superior vision or strategy. Nor does it tell employees or managers how to find or establish initiatives or ventures that create value. It only tells them how we will measure success in their activity.[164]

Even though courts do not enforce the shareholder primacy norm, businesses seem quite focused on maximizing profits.[165] Some have argued that this drive for profit maximization is

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159 Dodd claims to be "thoroughly in sympathy with Mr. Berle's efforts to establish a legal control which will more effectively prevent corporate managers from diverting profit into their own pockets from those of stockholders." Dodd, *supra* note 151, at 1147.

160 Dodd, *supra* note 151, at 1162.

161 ADOLPH A. BERLE, JR., THE 20TH CENTURY CAPITALIST REVOLUTION 169 (1954).

162 D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 286 (1998). Professor Greenfield acknowledges, "it is a contentious question as to whether directors have an enforceable duty to maximize profit." Greenfield, *supra* note 77, at 15.

163 *See* Brayden King, "The Problem with Shareholder Primacy," *Conglomerate* (July 25, 2006) (http://www.theconglomerate.org/2006/07/the_problem_wit.html) ("The problem with the shareholder primacy norm is that it doesn't actually tell directors how they are to allocate resources. That's a big problem for a norm that is supposed to assist decision-making and provide a legal justification for corporate actions.").

164 Michael C. Jensen, "Value Maximization and the Corporate Objective Function," 14 J. APPLIED CORP. FIN. 8, 16 (Fall 2001).

165 *See* C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77, 101 (2002) (referring to the 1950s, "Corporate leaders spoke of the corporation's new responsibility, but

spurred in part by the "expressive effect" of the shareholder primacy norm,[166] though these arguments rest on the mistaken assumption that the shareholder primacy norm is required to deter self-interested behavior.[167] In any event, given that directors and officers make their decisions in the shadow of the markets described above, the notion that an unenforceable and unenforced legal rule is a powerful determinant of those decisions seems almost fanciful. Any Professor Greenfield's claim does not rest on the expressive effect of the shareholder primacy norm, so I will not belabor the point.

III. Dystopia

The usual objection to utopian societies is that their members are required to sacrifice freedom on the altar of equality. Dr. Leete assures West, however, that "liberty is as dear as equality or fraternity" to those in latter-day Boston.[168] Bellamy's Boston of 2000 was a world without capitalists.[169] In the great new society, the consummation of the trend of capital consolidation begun by the great monopolies of the end of the nineteenth century, was the result of "the final consolidation of the entire capital of the nation."[170] With the benefit of twenty-first century hindsight, Bellamy's vision is frightening:

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none seemed ready to abandon the profit-maximizing and shareholder-primacy norms that had guided their actions for many years.").

166 On the expressive effect of law, see Robert Cooter, *Expressive Law and Economics*, 27 J. LEGAL STUD. 585 (1998); Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649 (2000); Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2021 (1996).

167 For example, Stephen Bainbridge observes:

> Because the shareholder wealth maximization norm is central to director socialization, the norm provides a forceful reminder of where the director's loyalty lies. Even if the business judgment rule renders its rhetoric largely unenforceable, the shareholder wealth maximization norm is an ever-present goad. By removing the psychological constraint that the shareholder wealth maximization norm provides, and by simultaneously exacerbating the two masters problem, we are less likely to encourage directors to pursue the collective interests of the firm's various constituents than to encourage directors to pursue their own self-interests.

Bainbridge, *supra* note 139, at 582.

168 Bellamy, *supra* note 70, at 111.

169 Dr. Leete asserts, "the nation [had] become the sole capitalist." Bellamy, *supra* note 70, at 169. But to suggest that "capitalism" exists without markets is doublespeak.

170 Bellamy, *supra* note 70, at 34.

> The industry and commerce of the country, ceasing to be conducted by a set of irresponsible corporations and syndicates of private persons at their caprice and for their profit, were intrusted to a single syndicate representing the people, to be conducted for the common interest and for the common profit. The nation, that is to say, organized as one great business corporation in which all other corporations were absorbed; it became the one capitalist in the place of all the other capitalists, the sole employer, the final monopoly in which all previous and lesser monopolies were swallowed up, a monopoly in the profits and economies of which all citizens shared. . . . At last, strangely late in the world's history, the obvious fact was perceived that no business is so essentially the public business as the industry and commerce on which the people's livelihood depends, and to entrust it to private persons to be managed for private profit is a folly similar in kind, though vastly greater in magnitude, to that a surrendering the functions of political government to kings and nobles to be conducted for their personal gratification.[171]

The change was not caused by bloody revolution, but by consensus.[172] Ironically, one of the most important changes in the history of U.S. corporate law occurred in 1888, the year *Looking Backward* was first published, when New Jersey amended its constitution to allow corporations to hold and dispose of the stock of other corporations.[173] New Jersey was already the leader in the competition for corporate charters, on the strength of its general incorporation statute of 1875, but subsequent reforms in the late 1880s and 1890s strengthened New Jersey's position. On the basis of these reforms, New Jersey became widely known as the "Mother of Corporations" or the "Traitor State."[174]

Other states, including Delaware (1899), followed New Jersey's lead by liberalizing their corporation statutes. Moreover, in 1900 the Delaware Court of Chancery held that it was bound by the corporation precedents from the New Jersey courts because the Delaware legislature had

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[171] Bellamy, *supra* note 70, at 34.

[172] Bellamy, *supra* note 70, at 35 ("the whole mass of people was behind it").

[173] Henry N. Butler, *Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges*, 14 J. LEGAL STUD. 129, 163 (1985).

[174] Charles M. Yablon, *The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880-1910*, 32 J. CORP. L. 323, 337 (2007).

adopted many passages of the New Jersey statute *in ipsissimis verbis*.[175] Despite copying New Jersey's statutes and cases and offering lower taxes, Delaware was unable to attract a substantial number of corporations until then-Governor of New Jersey, Woodrow Wilson succeeded in convincing the New Jersey legislature to adopt the "Seven Sisters Acts" in 1913,[176] which effectively outlawed holding companies. Though New Jersey repealed the Seven Sisters Acts in 1917, the damage had been done, and Delaware had established itself as the leader in the competition for corporate charters.

As the beneficiary of this cautionary tale, Delaware wisely has avoided radical innovations in its corporate law. As a result, most ambitious corporate reformers have embraced federal incorporation as the only feasible route to major reform.[177] Though Professor Greenfield has not endorsed a federal incorporation, he refers to "U.S. corporate law" in his paper, and whatever means he employed to implement his reforms, the national scope of his ambition is clear.[178] The very real risk – indeed, the almost certain effect – of implementing his proposed reforms would be an exodus of corporations from the United States.

The crucial point of departure for this section is the following incontrovertible fact: Professor Greenfield's vision of utopia would require boards of directors to make decisions that sacrifice potential shareholder value in favor of value for non-shareholder constituencies. When boards of directors are able to enhance employee welfare, make the environment cleaner, or improve human rights throughout the world without impairing shareholder value, they often do it. This is not "corporate social responsibility," but good management.[179] And the failure to pursue

175 Wilmington City Ry. v. People's Ry., 47 A. 245 (Del. Ch. 1900).

176 Wilson was a lame duck governor at the time, having been elected President of the United States in 1912. Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249 (1976).

177 *See, e.g.,* Nader, *supra* note 117. The major statutory competitor to Delaware is the Model Business Corporation Act, which grew out of a New Deal project to draft a Federal Corporation Act. *See* Ray Garrett, *History, Purpose and Summary of the Model Business Corporation Act*, 6 BUS. LAW. vii (1950).

178 Cynthia Williams argues that the terms of the debate over corporate social responsibility have changed with globalization, which "undermines the ability of sovereign nations to impose substantive, proactive limits on economic actors such as transnational corporations and capital market participants." Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705, 725 (2002). This insight is relevant to any proposal relating to corporate law, including Professor Greenfield's and, presumably, Professor Williams' call for expanded "corporate social transparency." *See id.* at 777. *See also*, Cynthia A. Williams, *The Securities Exchange Commission and Corporate Social Transparency*, 112 Harv. L. Rev. 1197 (1999).

179 The vast literature that passes under the heading "corporate social responsibility studies" contains myriad examples of "responsible" companies that are nothing more than well-managed firms.

such strategies would be a problem of managerial incompetence, not a problem of improper incentives.[180]

Changing the decision maker or changing the decision rule would have the effect of shifting power and attention away from shareholders and towards non-shareholder constituencies. As Larry Ribstein has observed, "shifting power to stakeholders solves the problem of shareholder opportunism to stakeholders by creating a potentially more serious problem of stakeholder opportunism to shareholders."[181] The inevitable result would be an increase the cost of public equity capital that, in turn, might prompt many companies to search for a more hospitable host for incorporation. The present trickle of stock expatriations, motivated by the potential for tax savings,[182] could become a flood.

Victor Fleischer has observed that stock expatriations are an example of "regulatory-cost engineering," and he asserts, "the puzzle is not why inversion deals take place, but rather why we see so few."[183] Using the aborted expatriation proposal of Stanley Works as a case study, Professor Fleischer hypothesizes that "branding may be part of the answer."[184] If Professor Fleischer were right about the constraining effect of branding, the predicted flood of expatriations that would otherwise follow implementation of Professor Greenfield's proposals might be muted. Nevertheless, demand for incorporation within the U.S. is not perfectly inelastic, and at some level, increased regulatory costs would cause corporations to flee. The recent debate surrounding the effects of the Public Company Accounting Reform and Investor Protection Act of 2002 (a.k.a. "Sarbanes-Oxley") suggests that the tipping point for incorporations may not be far away.[185] While that debate has not

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180 For a similar point, see Henry Manne, "First Lecture," in THE MODERN CORPORATION AND SOCIAL RESPONSIBILITY 4-5 (1972).

181 Ribstein, *supra* note 110, at 1440.

182 *See, e.g.*, McDermott (Panama), Helen of Troy (Bermuda), Tyco (Bermuda), Everest Reinsurance Holdings (Bermuda), Fruit of the Loom (Cayman Islands), PX Re (Bermuda), TransOcean Sedco Forex (Cayman Islands), Applied Power (Bermuda), Accenture (Bermuda), Foster Wheeler (Bermuda), Ingersoll-Rand (Bermuda), and Cooper Industries (Bermuda).

183 Victor Fleischer, *Brand New Deal: The Google IPO And The Branding Effect Of Corporate Deal Structures*, 104 MICH. L. REV. 1581, 1621 (2006).

184 *Id.*

185 Empirical work to date suggests that Sarbanes-Oxley has improved the quality of financial audits, thus increasing investor confidence. John C. Coates IV, *The Goals and Promise of the Sarbanes-Oxley Act*, 21 J. ECON. PERSP. 91, 106-07 (2007) (describing empirical studies on the benefits of Sarbanes-Oxley). But even the most ardent supporters of the Sarbanes-Oxley Act admit that it imposes substantial compliance costs. The focus of the debate, therefore, is

yet come to a resolution, shifts in the patterns of cross-listings[186] away from the U.S. and toward Europe have reminded us of the existence of a global market for regulation.[187] In my view, Professor Greenfield's proposals would drive that lesson home with unambiguous force.

Conclusion

Professor Greenfield's central claim is that corporate law is broken because it is shareholder-centric, and that corporate law could be improved by expanding its borders to include non-shareholder constituencies of the corporation. At the heart of this "progressive" vision lies the notion that *corporate law matters* to issues of distributional equity among various corporate constituencies. A similar motivation animated Edward Bellamy's novel, *Looking Backward*, and the solutions proposed by Bellamy and Professor Greenfield also are similar: change the decision maker and change the decision rule.

In response to Professor Greenfield's challenge, I contend that corporate law does not matter in the way he claims because powerful markets constrain corporate decision making. If Professor Greenfield somehow succeeded in materially changing the content of corporate decisions, he would sacrifice potential shareholder value in favor of value for non-shareholder constituencies. In the process, Professor Greenfield's vision of corporate law would destroy much of the good that corporations have done.

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whether the Sarbanes-Oxley Act produces *net benefits to investors*. The resolution of this debate remains elusive. *See id.* at 107 ("No methodology yet developed permits summing the benefits of Sarbanes-Oxley into dollar amounts that could be compared meaningfully to rough estimates of its costs, which, as discussed next, are substantial. Thus, whether the legislation produced *net* benefits remains unclear."). Nevertheless, there is evidence from cross-listed companies that the costs of Sarbanes-Oxley to investors outweigh the benefits. *See* Kate Litvak, *Sarbanes-Oxley and the Cross-Listing Premium*, __ MICH. L. REV. __ (forthcoming 2007); Kate Litvak, *The Effect of the Sarbanes-Oxley Act on Foreign Companies Cross-Listed in the U.S.* (working paper 2005), available at http://ssrn.com/abstract=876624.

[186] *See* Joseph D. Piotroski & Suraj Srinivasan, *The Sarbanes-Oxley Act and the Flow of International Listings* (working paper 2007), available at http://ssrn.com/abstract=956987 (finding "strong evidence that U.S. exchanges have experienced a decrease frequency of foreign listing following the [Sarbanes-Oxley] Act" and that "a portion of the decline in foreign listings is attributable to firms bypassing a U.S. exchange listing and opting to list on the LSE's Alternative Investment Market following the enactment of the Act"). *See also*, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION (December 5, 2006), available at http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf.

[187] *See generally* Larry E. Ribstein & Erin A. O'Hara, *Corporations and the Market for Law* (working paper 2006), available at http://ssrn.com/abstract=956919.