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The Third Way: Beyond Shareholder or Board Primacy

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The Third Way

*Kent Greenfield**

INTRODUCTION

In this Article, I have both a descriptive and a normative claim about corporate governance. As a descriptive matter, I believe that we in the United States and, indeed, perhaps worldwide, find ourselves in an unusual and potentially pivotal moment in the intellectual history of corporate law theory and doctrine. As a normative matter, I believe we should use this moment to adjust corporate governance so as to situate corporations more dynamically within a broader social, political, and economic context.

The descriptive claim is based on a judgment, shared by some others, that there is more openness to revisiting the core questions about what corporations are, to whom they owe obligations, and how best to conceptualize them and their regulation than at any time in a generation. This moment has been engendered because of the increasing skepticism the public is showing toward corporations and the people who manage them. The skepticism springs from shocks in the economic and political fields that revealed the risks of unbridled corporate power, short-termism, managerial opportunism, and shareholder (read Wall Street) supremacy.

To paraphrase Rahm Emanuel, one never wants such a moment to go to waste.¹ The question, of course, is what to do with such an oppor-

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1. Speaking of the Global Financial Crisis, Rahm Emanuel said that "you never want a serious crisis to go to waste. And what I mean by that is an opportunity to do things that you think you could not do before." WSJDigitalNetwork, *Rahm Emanuel on the Opportunities of Crisis*, YOUTUBE (Nov. 19, 2008), http://www.youtube.com/watch?v=_mzcbXi1Tkk.

tunity to question, rethink, and re-conceptualize some first principles in the field.

One obstacle to taking advantage of this moment is the failure of academic analysis to break out of the conceptual dichotomy that has long dominated these debates within corporate law. The typical debate has been between shareholder supremacists and managerialists. All too often, moments of ferment in the field have brought about merely a swing of the pendulum from one of these paradigms toward the other.²

Shareholder supremacists lament the instances of managerial mismanagement and self-dealing, and offer a remedy of increased shareholder power.³ If only management were constrained, they argue, by additional shareholder power to nominate directors, approve executive pay, or receive financial disclosures, then management's incentives would better align with shareholder interests. The downside of this remedy is that many of the risks of corporate power would increase with increased shareholder say. Shareholder empowerment would hardly resolve the problems of short-termism, environmental degradation, employee mistreatment and disempowerment, and risk externalization. In fact, the opposite would likely be true. This is because the interests of shareholders at best align only haphazardly with the interests of other stakeholders and of society as a whole, and at worst align not at all.⁴

Meanwhile, the managerial and directorial apologists suggest that the way forward is to protect managerial prerogative.⁵ The goal is to empower the benevolent corporate elites to resist the shortsighted urges of the marketplace and manage the firm for the long-term benefit of its investors and perhaps even society as a whole. If only management would

2. While labeled differently, these two paradigms map fairly closely to the two schools of thought identified and analyzed in David Millon, *Radical Shareholder Primacy*, ___ ST. THOMAS L. REV. ___ (forthcoming). Millon labels the two schools "radical shareholder primacy" and the manager-protective "traditional model." Both, as he points out, ultimately are aimed at shareholder benefit, though the former is more skeptical of managerial agency, and the latter is more permissive of it.

3. The leading voice of the shareholder supremacists is probably Lucian Bebchuk. See Lucian Ayre Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005). He is not alone of course. For other examples, see Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 522 (2002); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2000); Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993).

4. See Kent Greenfield, *Defending Stakeholder Governance*, 58 CASE W. RES. L. REV. 1043, 1055-59 (2008).

5. The most prominent of these scholars is probably Stephen Bainbridge. See Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003); see also Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409 (1998); Jonathan R. Macey, *The Legality and Utility of the Shareholder Rights Bylaw*, 26 HOFSTRA L. REV. 835, 837 (1998).

be loosened from the bothersome constraints of shareholder activism and government regulation, we would witness a burst of competitive energy that would carry us toward economic nirvana. The downside of this remedy is that managerial prerogative is, as a descriptive matter, overwhelmingly used to benefit managers. Explosions in executive compensation and perquisites, the manipulation of financial reporting and disclosure, and self-dealing in various guises are a more common outcome than benevolence. If the treatment for the ills of shareholder primacy is managerial empowerment, the cure may be worse than the disease.

There is a third way, and my normative claim is that we should use this moment to consider it. Managerial obligation could be increased without the obligation running solely to the holders of equity. Fiduciaries of companies could be subject to meaningful constraints and obligations, enforceable by courts, without disabling their ability to use the corporate form for economic gain. The conceptual innovation of this third way—I use “innovation,” though the idea is actually quite ancient—is for the fiduciary obligations of management to run to the firm as a whole, which would include an obligation to take into account the interests of all those who make material investments in the firm. Within this framework, it would continue to be a violation of fiduciary duties for management to self-deal, act carelessly, or exercise something less than good faith judgment. It would also be a violation of their duties to prioritize one stakeholder over others consistently and persistently or to fail to consider the interests of all stakeholders in significant corporate decisions.

This Article proceeds in four parts. First, I situate the current moment of intellectual churning in corporate law in a larger historical narrative and explain why we find ourselves in this moment now. Second, I suggest what a third way might require in terms of conceptualization, process, and substance of corporate governance. Third, I propose some affirmative benefits we could achieve with these changes. Lastly, I answer a few of the principal objections to such a conceptual and regulatory shift.

I. A MOMENT OF INTELLECTUAL CHURNING

The intellectual history of corporate law, of course, must be understood in broader historical and legal trends. Not surprisingly, the law of business reflects social understandings and presumptions about both business and law.

A. A Look Back

A century ago, federal courts in the United States protected businesses from regulatory mandates and limits by use of a broad Due Pro-

cess Clause and a narrow Commerce Clause.⁶ The most emblematic constitutional case of the time, *Lochner v. New York*, in which the Supreme Court struck down New York's attempt to limit the hours that bakers would be forced to work by their employers, gave its name to the jurisprudential era. Meanwhile, the corporate law doctrine reflected a similar emphasis. The most famous corporate law case of the era, *Dodge v. Ford Motor Company*, announced that "[a] business corporation is organized and carried on primarily for the profit of the stockholders."⁷ Though this was a statement articulated only by a court in one state, it encapsulated the zeitgeist of the Gilded era ideals of private property and the judiciary's willingness to protect them aggressively. The courts saw the companies as the private property of shareholders and were willing to protect them from legislative encroachments with constitutional tools and from managerial encroachments with corporate law tools.

The Great Depression amounted to an intellectual turning point, as the economic upheaval caused people to re-conceptualize the market itself as a creature of the state rather than existing in a state of nature.⁸ A part of this shift was a fundamental rethinking of the role of business corporations, the nature of their ownership, and of their obligations to broader society.⁹ The ramifications of this re-conceptualization were immense, with the most profound changes for business coming in the form of the great Securities Acts of 1933 and 1934,¹⁰ the labor protec-

6. See, e.g., *Lochner v. New York*, 198 U.S. 45 (1905); *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936).

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

8. See CASS SUNSTEIN, *AFTER THE RIGHTS REVOLUTION* 20 (1990) ("For the New Deal reformers . . . the common law was hardly neutral or pre-political, but instead reflected a set of explicit regulatory decisions."); The intellectual leaders of the legal realist movement are owed credit for this insight. See, e.g., Felix S. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809 (1935); Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470 (1923).

9. ADOLF A. BERLE JR. AND GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932). Berle and Means, of course, pointed out that there had been a separation of the firm's "ownership" from its "control." Contrary to many descriptions of their work, however, they did not believe that the remedy for such separation was necessarily increased shareholder power. Instead, they urged that managers be required to use their greater independence from shareholders to take into account broader social concerns. See Lawrence E. Mitchell, *Talking with My Friends: A Response to a Dialogue on Corporate Irresponsibility*, 70 GEO. WASH. L. REV. 988, 989 (2002) (stating that Berle's theory of corporate governance required strict regulations channeling managerial efforts "to the benefit of the stockholders, thus allowing for the confident investment and the healthy economy that would bring us out of the Depression and ultimately benefit everyone"); see also David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201 (1990); Dalia Tsuk, *From Pluralism to Individualism: Berle and Means and 20th-Century American Legal Thought*, 30 LAW & SOC. INQUIRY 179 (2005).

10. Securities Act of 1933, §§ 1–26, 15 U.S.C. §§ 77a–77bbb (2006); Securities Exchange Act of 1934, §§ 1–37, 15 U.S.C. §§ 78a–78nn (2006).

tions in the National Labor Relations Act of 1935¹¹ (protecting the right to bargain collectively), and the Fair Labor Standards Act of 1938¹² (creating a federal minimum wage).

We again saw a burst of interest in the fundamental questions of the nature of corporations from the 1960s through the 1970s as a part of a broader social critique on the status quo that also included the civil rights and anti-war movements. Environmental scholars such as Rachel Carson¹³ and consumer activists such as Ralph Nader¹⁴ raised awareness of how the political influence, unsustainable practices, and global reach of corporations posed dangers to society. In response, environmental law, anti-discrimination law, anti-corruption law, and consumer protection law were all strengthened on the regulatory side.¹⁵ On the corporate side, we saw the rise of the so-called stakeholder statutes, which claimed to protect the ability of company management to look after the interests of companies' non-shareholder constituents.¹⁶ Among academics, we saw an increasing skepticism about Delaware's status as the preeminent and predominant provider of corporate governance law in the United States.¹⁷

Thereafter, we saw a significant pushback—even retrenchment—in politics, law, and academia. The “Reagan Revolution” was about more than merely who won the White House in 1980 and 1984. More broadly, it engendered an attack on regulation generally and fostered a belief in and a presumption in favor of the market. In the legal academy in the United States, we saw the rise of the “law and economics” movement, whose scholars applied a simplistic version of neoclassical economic thought to law, arguing that individuals are rational maximizers of utility and act with free will.¹⁸ These scholars argued that the grand purpose of law is to allow people to satisfy their preferences, primarily by empowering private agreements and otherwise standing aside.

The law and economics scholars gained particular purchase in the corporate law field. The corporation was re-conceptualized as a nexus of

11. 49 Stat. 449 (1935), 29 U.S.C. § 151 (Supp. 1937).

12. Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201–19 (1982).

13. See RACHEL CARSON, *SILENT SPRING* (1962).

14. See RALPH NADER, *UNSAFE AT ANY SPEED* (1965); RALPH NADER, JOEL SELIGMAN & MARK GREEN, *TAMING THE GIANT CORPORATION* (1976).

15. See CASS R. SUNSTEIN, *AFTER THE RIGHTS REVOLUTION: RECONCEIVING THE REGULATORY STATE* (1993).

16. See Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 *GEO. WASH. L. REV.* 14, 24 (1992); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 *TEX. L. REV.* 579, 592–94 (1992).

17. See William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 *YALE L.J.* 663, 666 (1974).

18. See RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 3 (6th ed. 2003) (“[M]an is a rational maximizer of his ends in life.”).

contracts, with the law needing only to establish presumably efficient default rules that the parties could otherwise negotiate around.¹⁹ Law and economic scholars saw corporate law as emphatically private law.²⁰ Corporate law should thus provide “off-the-rack” rules that were primarily enabling rather than prescriptive and that could be easily contracted around. Law should not dictate the details of the obligations among the parties because each party—including each of the various stakeholders of the firm—is assumed to know her own interests and to protect them best through bargaining and exchange. If the parties disliked the terms of the “contract” between themselves and the company, they could leave. Not only could shareholders sell their shares, but employees could quit, managers could find a different company to manage, suppliers could sell their goods elsewhere, and creditors could sell their bonds.²¹

This academic re-conceptualization went hand-in-hand with a shift in emphasis among management. Duties to the company ceased to be seen as or enforced as a function of legal or moral obligation. Duties to the company were simply a function of the market.²² Thus, the obligation of management began to be seen as maximization of share value, and the law—for the most part—stepped aside in enforcing fiduciary duties except in those cases where managerial self-interest polluted their obligation to maximize share price. Corporate health was equated with share price or, actually, the positive movement of share price from quarter to quarter, then month to month, then day to day, then nanosecond to nanosecond.

These trends revealed themselves in various ways over time. The 1980s saw a fixation on leveraged buy-outs and hostile takeovers, driven more by the uber-competitive personalities of celebrity CEOs than by corporate need or economies of scale. (“Winners” in the takeover battles

19. See Kent Greenfield, *The End of Contractarianism? Behavioral Economics and the Law of Corporations*, in HANDBOOK ON BEHAVIORAL ECONOMICS AND THE LAW (Eyal Zamir & Doron Teichman eds., forthcoming 2014). The foundational texts of this contractarian view are Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) and FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

20. KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES* 29–39 (2006). See Daniel Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1273–74 (“Because the corporation is a particular type of firm formed by individuals acting voluntarily and for their mutual benefit, it can far more reasonably be viewed as the product of private contract than as a creature of the state.”).

21. See generally Jonathan Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23 (1991).

22. See Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595 (1997).

mostly lost over time.²³) In the 1990s, we saw an explosion of managerial compensation, most famously at Disney, where president Michael Ovitz was paid \$130 million to accept his firing after one ego-puncturing year in that role.²⁴ Charity stopped being seen as something done for the public and instead a boon for management—a way to compensate elite managers by funding their pet projects and the like. (The best example was The Armand Hammer museum in Los Angeles, an iconic tribute to the ego of Occidental Petroleum's CEO, funded by Occidental Petroleum.²⁵)

In the 2000s, as corporate leaders came to see themselves less as managers and more as financiers, those holding stock came to see themselves less as owners and more as investors, even speculators. Institutional investors owned most stocks in the United States, and most shares changed hands at least once a year. By 2008, in fact, stocks turned over four times a year.²⁶ The financial elite derived a host of new products, and the market came to depend more and more on derivative markets. The upside of betting on the markets became huge; the richest people in town were not the celebrity CEOs but the celebrity managers of hedge funds and private equity funds.²⁷ They made money because they maximized their income by way of leverage. But the risk—we now know in hindsight—was largely externalized to and borne by the economy as a whole, especially by those who owned the underlying physical assets on which the financial elite were betting, derivatively. Meanwhile, corporate executives were driven by this new market frenzy to care more and more about the short-term.²⁸

Meanwhile, the dedication of the professional managerial class to their company's employees and communities—something that Berle and Means had urged onto management decades before, and which had in fact characterized a material portion of the economy during the middle of the century—decayed. Real wages stagnated or fell; job security erod-

23. Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59 J. BUS. 197 (1986); James Fanto, *Quasi-Rationality in Action: A Study Of Psychological Factors in Merger Decision-Making*, 62 OHIO ST. L.J. 1333 (2001).

24. See *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 35 (Del. 2006).

25. See *Kahn v. Sullivan*, 594 A.2d 48, 54–55 (Del. 1991).

26. *Stocks Traded, Turnover Ratio (%)*, WORLD BANK, http://data.worldbank.org/indicator/CM.MKT.TRNR?order=wbapi_data_value_2008+wbapi_data_value+wbapi_data_value-first&sort=desc (last visited Sept. 27, 2013).

27. *Hedge Fund Salaries*, CAREERS-IN-FIN., <http://www.careers-in-finance.com/hfsal.htm> (last visited Sept. 27, 2013).

28. See Kent Greenfield, *The Puzzle of Short-Termism*, 46 WAKE FOREST L. REV. 627 (2011).

ed.²⁹ Unions lost power; private rates of union membership in the United States fell to their historical nadir.³⁰ As companies became more international, and certainly as finance became global, workers' wages became depressed and nations found it more difficult to maintain national regulatory boundaries.

This period of roughly thirty years, from the 1980s through the first decade of the 2000s, saw the triumph of "contractarianism," which I use simply as shorthand for the concurrence of three phenomena: first, in boardrooms—a fixation on share price; second, in politics—a push for deregulation (sometimes called self-regulation), especially of financial markets; and third, in law and legal theory—a dependence on the notion of contract as the conceptual centerpiece rather than fiduciary duty. While there were always dissenters within the corporate law academy,³¹ contractarianism was certainly dominant during this period.

B. The Current Moment

The dominance of contractarianism was the state of play in the early years of the twenty-first century. But the last decade has seen its decline. In the academy, the lead author of its decline has been behavioral economics, which questions the so-called rational actor assumptions of neoclassical economics. Behavioral economics began to be taken seriously in the legal academy in the last decade of the twentieth century,³² beginning to gain traction in corporate law scholarship by the early 2000s.³³ By 2011, one of the leading legal behavioralists could claim that "the battle to separate the economic analysis of legal rules and institu-

29. For a review of the pertinent economic statistics at the end of the Twentieth Century, see Kent Greenfield, *There's a Forest in Those Trees: Teaching About the Role of Corporations in Society*, 34 GA. L. REV. 1011 (2000).

30. The best source for United States statistics to substantiate these claims is The Economic Policy Institute, available at www.epi.org, particularly their annual book-length reports entitled *The State of Working America*.

31. For a good review, see David K. Millon, *New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373 (1993). For book-length treatments, see LAWRENCE MITCHELL, *PROGRESSIVE CORPORATE LAW* (1995) and GREENFIELD, *supra* note 20.

32. See Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998); Donald C. Langevoort, *Behavioral Theories of Judgment and Decisionmaking in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499 (1998); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051. (2000).

33. Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)*, 146 U. PA. L. REV. 101 (1997); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001); Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law As Regulatory Tool*, 35 U.C. DAVIS. L. REV. 581 (2002).

tions from the straightjacket of strict rational choice assumptions has been won.”³⁴

The implications of the strength of behavioral economics are immense. It meant that, if the political and economic situation allowed for a broader challenge, the intellectual basis for challenging contractarian assumptions in corporate law (and indeed law generally) had been established.

The Global Financial Crisis of 2007–08 (GFC) provided that context and finally marked the end of the glory days of *homo economicus*. The collapse pulled back the curtain, revealing the Great Oz of the rational market behind the curtain to be a fraud, along with its subsidiary dependence on the rational actor model.³⁵ If a stalwart of the rationality school, such as former Chairman of the U.S. Federal Reserve Alan Greenspan, was forced to admit that he had “found a flaw” in his theory of the free market, then few absolutists were left indeed.³⁶

A few months after the GFC, another shock in the United States came in the form of the Supreme Court decision in *Citizens United v. Federal Election Commission*,³⁷ which validated the constitutional rights of corporations to engage in political discourse and to spend money from general treasury funds to influence electoral outcomes. Federal and state laws limiting the political spending of corporations—laws that had been on the books in some instances for a century—were struck down.³⁸ As a result, we saw a massive inflow of money into the mid-term elections in 2010 and then again in 2012, mostly by way of “Super-PACs,” corporate entities organized for the purpose of collecting and spending the money

34. Russell Korobkin, *What Comes After Victory for Behavioral Law and Economics?*, 2011 U. ILL. L. REV. 1653, 1655 (2011).

35. *See id.* (“[T]he battle to separate the economic analysis of legal rules and institutions from the straightjacket of strict rational choice assumptions has been won.”).

36. Edmund L. Andrews, *Greenspan Concedes Error on Regulation*, N.Y. TIMES (Oct. 23, 2008), http://www.nytimes.com/2008/10/24/business/economy/24panel.html?_r=0.

37. *Citizens United v. Fed. Election Comm’n*, 558 U.S. 310 (2010).

38. *Id.* at 395 (Stevens, J., dissenting) (“The majority’s approach to corporate electioneering marks a dramatic break from our past. Congress has placed special limitations on campaign spending by corporations ever since the passage of the Tillman Act in 1907.”). The Tillman Act, originally enacted in 1907, prohibited corporations and national banks from contributing money to federal campaigns. Tillman Act, ch. 420, 34 Stat. 864, 864–65 (1907) (codified as amended at 2 U.S.C. § 441b (2006)). The Federal Corrupt Practices Act, originally enacted in 1910, extended federal regulation of campaign contributions and expenditures in federal elections. 43 Stat. 1070, 2 U.S.C. §§ 241–256. For an example of the *Citizens United* decision effectively striking down state laws limiting the political spending of corporations, see *Am. Tradition P’ship, Inc. v. Bullock*, 132 S.Ct. 2490 (2012) (striking down a Montana Supreme Court decision to uphold the state’s campaign finance laws since the legal issue had already been precluded by *Citizens United*).

of very rich individuals. So-called “independent expenditures” exploded by a factor of 10, from less than \$100 million to over \$1 billion.³⁹

Within the Court’s reasoning was embedded a law-and-economics view of corporations as a private entity, rightly insulated from the constraints of public regulation of their political influence. Previously, the Court and commentators had given credence to an argument that corporations should be limited in their political activities to protect shareholders from having their resources used by management to further views inconsistent with those of shareholders.⁴⁰ But in *Citizens United*, the Court argued that shareholders could protect themselves through the normal mechanisms of corporate governance.⁴¹ This was simply a conventional application of contractarianism. The needs of shareholders need not be considered within the First Amendment calculus because their involvement in corporations is voluntary, and they have the power to protect themselves from any encroachment of their interests. What was remarkable about *Citizens United* was that it used these contractarian notions found in mainstream corporate law in service of an effort to expand corporate prerogatives in constitutional law.

One might argue that *Citizens United*, in expanding contractarian notions beyond corporate law and using them as a foundational principle

39. See, e.g., *McConnell v. Fed. Election Comm’n*, 540 U.S. 93, 204 (2003) (discussing the pre-*Citizens United* requirement that corporations speak through PACs, saying that such requirement “allows corporate political participation without the temptation to use corporate funds for political influence, quite possibly at odds with the sentiments of some shareholders or members”); *Citizens United*, 558 U.S. at 476 (Stevens, J., dissenting) (arguing that the restrictions on corporate independent expenditures “curbs the rent seeking behavior of executives and respects the views of dissenters” (citing *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652 (1990), to argue that a crucial reason for maintaining integrity of the electoral process is to protect shareholders from coerced speech)); Adam Winkler, *Beyond Bellotti*, 32 Loy. L.A. L. Rev. 133, 201 (1998) (arguing that a restriction on corporate expenditures “simply allows people who have invested in the business corporation for purely economic reasons to avoid being taken advantage of, without sacrificing their economic objectives”).

40. See, e.g., *McConnell*, 540 U.S. at 204 (discussing the pre-*Citizens United* requirement that corporations speak through PACs, saying that such requirement “allows corporate political participation without the temptation to use corporate funds for political influence, quite possibly at odds with the sentiments of some shareholders or members . . .” (citing *Fed. Election Comm’n v. Beaumont*, 539 U.S. 146, 194–95 (2003)); *Citizens United*, 558 U.S. at 476 (2010) (Stevens, J., dissenting) (arguing that the restrictions on corporate independent expenditures “curbs the rent seeking behavior of executives and respects the views of dissenters” and citing *Austin*, 494 U.S. 652, to argue that a crucial reason for maintaining integrity of the electoral process is to protect shareholders from coerced speech); Winkler, *supra* note 39, at 201 (arguing that a restriction on corporate expenditures “simply allows people who have invested in the business corporation for purely economic reasons to avoid being taken advantage of, without sacrificing their economic objectives”).

41. See *Citizens United*, 558 U.S. at 361–62 (“There is, furthermore, little evidence of abuse that cannot be corrected by shareholders through the procedures of corporate democracy” (internal quotations omitted)); *id.* at 370 (“Shareholders can determine whether their corporation’s political speech advances the corporation’s interests in making profits . . .”).

in expanding corporate constitutional rights, amounted to the capstone of the contractarian triumph. But I believe the exact opposite view is more persuasive. The response to the opinion was massive and almost universally negative. Soon after the decision, as many as 80% of Americans thought it was a mistake,⁴² and President Obama faced down members of the Court at the State of the Union, accusing them of judicial activism.⁴³ In the almost four years since the decision, opposition to the decision has remained steady, and a movement to amend the Constitution to overturn the decision is gaining serious traction. At this writing, fifteen states, more than 500 localities, 27 U.S. senators, over 100 U.S. representatives, and the President have endorsed an amendment of some kind.⁴⁴ In fact, a petition to the Securities and Exchange Commission to require public corporations to disclose to shareholders their political spending received over 500,000 comments.⁴⁵

So for our purposes, it is not the *Citizens United* decision that is key. Rather, the fact that it has engendered such a political backlash reveals much about the public's fear of corporate power and, implicitly, its skepticism of the contractarian notions driving the opinion. Occurring so soon after the GFC, *Citizens United* impressed onto the United States public that the misuse of corporate power posed significant risks not only to the economy but to democracy as well.

In my view, these shocks have engendered a new openness to rethinking the conventional notions of corporate law and governance and

42. *In Supreme Court Ruling on Campaign Finance, the Public Dissents*, ABC NEWS (Feb. 17, 2010, 7:00 AM), <http://abcnews.go.com/blogs/politics/2010/02/in-supreme-court-ruling-on-campaign-finance-the-public-dissents/>; Dan Eggen, *Poll: Large Majority Opposes Supreme Court's Decision on Campaign Financing*, WASH. POST (Feb. 16, 2010), http://articles.washingtonpost.com/2010-02-16/politics/36773318_1_corporations-unions-new-limits.

43. Jesse Lee, *President Obama on Citizens United: "Imagine the Power This Will Give Special Interests over Politicians,"* WHITE HOUSE BLOG (July 26, 2010, 3:07 PM), <http://www.whitehouse.gov/blog/2010/07/26/president-obama-citizens-united-imagine-power-will-give-special-interests-over-polit>.

44. See Caitlin MacNeal, *Citizens United Constitutional Amendments Introduced in the Senate*, HUFFINGTON POST (June 19, 2013, 11:56 AM), http://www.huffingtonpost.com/2013/06/19/citizens-united-constitutional-amendment_n_3465636.html; Byron Tau, *Obama Calls for Constitutional Amendment to Overturn Citizens United*, POLITICO (Aug. 29, 2012, 5:35 PM), <http://www.politico.com/politico44/2012/08/obama-calls-for-constitutional-amendment-to-overturn-133724.html>. I have expressed skepticism of such an effort to amend the Constitution, especially if such amendment purports to end corporate "personhood" or constitutional rights. See Kent Greenfield, *How to Make the 'Citizens United' Decision Worse*, WASH. POST (Jan. 19, 2012), http://articles.washingtonpost.com/2012-01-19/opinions/35440165_1_corporate-rights-constitutional-rights-constitutional-law.

45. Paul Blumenthal, *SEC Petition for Corporate Political Spending Rule Reaches Half-Million Comments*, HUFFINGTON POST (April 16, 2013, 2:50 PM), http://www.huffingtonpost.com/2013/04/16/sec-corporate-political-spending_n_3093121.html.

of corporations more generally. An article in the *Harvard Business Review* recently proclaimed,

There's a growing body of evidence . . . that the companies that are most successful at maximizing shareholder value over time are those that aim toward goals other than maximizing shareholder value. Employees and customers often know more about and have more of a long-term commitment to a company than shareholders do.⁴⁶

A popular, non-business essayist in the *New York Times* wrote that “it feels as if we are at the dawn of a new movement—one aimed at overturning the hegemony of shareholder value.”⁴⁷ The *Washington Post* sympathetically covered an essay⁴⁸ that I wrote, in a progressive policy journal, calling for reform.⁴⁹

My normative claim is that we should take advantage of this moment of skepticism of the status quo and of openness to new frameworks. The devil, of course, is in answering how we do that.

II. IDEAS FOR CHANGE

Often, the battle within corporate law has been between managerialists and shareholder supremacists. Efforts to protect the other stakeholders of the corporation have been left to the “external” regulation of antitrust law, environmental law, labor law, and the like. But these efforts have mostly been of the “command-and-control” type, working like a fleet of tugboats to pull the corporate tanker ship away from what would otherwise be their natural course.⁵⁰

My argument is simply that we should consider a new kind of regulatory effort—actually, an old one if truth be told—building a public in-

46. Justin Fox & Jay W. Lorsch, *What Good Are Shareholders?*, HARV. BUS. REV. (July–Aug. 2012), available at http://www.shareholderforum.com/access/Library/20120700_HarvardBusinessReview.htm.

47. Joe Nocera, *Down with Shareholder Value*, N.Y. TIMES, Aug. 11, 2012, <http://www.nytimes.com/2012/08/11/opinion/nocera-down-with-shareholder-value.html>; see also LYNN STOUT, *THE SHAREHOLDER VALUE MYTH* (2012); Steven Denning, *The Dumbest Idea in the World: Maximizing Shareholder Value*, FORBES (Nov. 28, 2011, 1:19 PM), <http://www.forbes.com/sites/stevedenning/2011/11/28/maximizing-shareholder-value-the-dumbest-idea-in-the-world/>; Justin Fox, *How Shareholders Are Ruining American Business*, ATLANTIC (June 19, 2013, 10:05 PM), <http://www.theatlantic.com/magazine/archive/2013/07/stop-spoiling-the-shareholders/309381/>.

48. Dylan Matthews, *In Germany, Workers Help Run Their Companies. And It's Going Great!*, WASH. POST WONKBLOG (Oct. 7, 2012, 3:39 PM), <http://www.washingtonpost.com/blogs/wonkblog/wp/2012/10/07/in-germany-workers-help-run-their-companies-and-its-going-great/>.

49. Kent Greenfield, *The Stakeholder Strategy*, 26 DEMOCRACY J. IDEAS 47 (2012), available at <http://www.democracyjournal.org/26/the-stakeholder-strategy.php?page=all>.

50. See Kent Greenfield, *Proposition: Saving the World with Corporate Law*, 57 EMORY L.J. 948, 970–74 (2008).

terest element into corporate governance itself, creating the possibility that businesses become a more positive social force on their own. I am not urging that corporations become altruistic or charitable institutions. The best way for corporations to serve the public interest is to create wealth, primarily by selling worthwhile goods and services for a profit.⁵¹ What I do suggest is that we should define wealth broadly and require corporations to focus on creating it with both a greater awareness of the costs inherent in its creation and the benefits that flow from broadly distributing it. If we can create the initiative within large corporations to head in the correct direction on their own, we will need fewer tugboats to correct their course later.

A. The Conceptual Shift

What specific reforms are needed? The most crucial one, I believe, is conceptual rather than legal or political. We should cease thinking of corporations as pieces of property owned by shareholders, whose ownership in any event is recognized only in the breach. Instead, we should conceptualize businesses as team-like collective economic enterprises making use of a multitude of inputs from various kinds of investors. As I have said elsewhere, “Corporations are collective enterprises, drawing on investments from various stakeholders who contribute to the firm’s success.”⁵² The success of corporations depends on the contributions of many different stakeholders, and the governance of corporations should recognize those contributions. Fixating on the contributions of only one of these groups—shareholders—blinds us to the essential investments of the others and encourages management to prioritize shareholder interest alone. But for a business to succeed, people and institutions must invest financial capital; other people must invest labor, intelligence, skill, and attention; and local communities must invest infrastructure of various kinds.

None of these investors makes its contribution out of altruism or obligation. What they are doing is contributing in hopes of potential gain if things go well. They expect management to gather inputs from other contributors, put them together in a way that will enable the company to produce goods or services for a profit, and then distribute the wealth that is created. The benefits can come in various forms—goods and services for consumers, jobs for employees, tax bases for communities, financial returns for investors. Each of the contributors has a stake in the company,

51. I develop this point extensively in GREENFIELD, *supra* note 20, at 125–42.

52. Greenfield, *supra* note 4, at 1043. The classic description of the “team” theory of the firm, some of which I accept and some of which I do not, is Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 318–22 (1999).

and the company depends on the contributions of each stakeholder. Unfortunately, in our current regulatory scheme in the United States, the concerns of the other stakeholders are not considered within the internal, structural machinery of corporate governance. These stakeholders are to be taken care of, to the extent they are at all, by way of protections they can gain through contract or external regulation.

Compare this to the U.K. model of corporate governance, which at least recognizes the obligations to consider these interests, and the European model, which requires much more robust social obligation on the part of corporations embodied both in cultural norms and law.⁵³ Under the European model, the duty to disclose information and consult with employees is much more robust, and many large European companies include labor representatives on their boards. These efforts to include employees in company governance are intended to embody norms of workplace democracy and economic fairness. But they are also seen as an important component of economic success, and indeed, Germany—where co-determination is strongest—is now the economic powerhouse of Europe. The CEO of the German company Siemens argues that co-determination is a “comparative advantage” for Germany;⁵⁴ the senior managing director of the U.S. investment firm Blackstone Group has said board-level employee representation was one of the factors that allowed Germany to avoid the worst of the financial crisis.⁵⁵

B. Specific Regulatory Changes

Once we escape the conceptual stranglehold of shareholder-as-owner, then we can ask the kind of robust questions that go to the heart of the matter, most crucially: How can we create, empower, and regulate business entities so that they are most likely to create wealth, broadly defined and distributed, while minimizing their harms both immediate and latent? There are a wide range of possible answers to this question, but allow me to propose a few specific regulatory changes for corporate law and governance that would fit within this framework.

53. ALINE CONCHON, EUR. TRADE UNION INST., REPORT 121, BOARD LEVEL EMPLOYEE REPRESENTATION RIGHTS IN EUROPE: FACTS AND TRENDS (2011) (Belg.), available at <http://www.etui.org/Publications2/Reports/Board-level-employee-representation-rights-in-Europe>; see also MAP: Board-Level Representation in the European Economic Area, WORKER-PARTICIPATION.EU, <http://www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Board-level-Representation2/MAP-Board-level-representation-in-the-European-Economic-Area2> (last visited Sept. 27, 2013) (showing that nineteen of thirty-one countries in the European Union have legislation on employee board-level representation).

54. CONCHON, *supra* note 53, at 7 n.3.

55. *Id.* at 8.

First, the law of corporate governance should expand the fiduciary duties of management to include an obligation to consider the interests of all stakeholders in the firm. For decades, the fiduciary obligations of management have been categorized as including a duty of care and a duty of loyalty. Under current judicial interpretation in the United States, both mean something less than one might assume—“care” has essentially become the duty to gather information and avoid gross negligence; “loyalty” has devolved into a mere ban on undisclosed self-dealing, such as managers doing special deals with the company on the side.

While it wouldn't hurt if both of these duties were more robust with regard to shareholders, what I'm suggesting here is that they run to all the stakeholders of the company, not just shareholders. With regard to the duty of care, this would mean that when senior management or the board makes decisions on the strategic course of the company, they would need to gather and consider information on the effects of the decision on the company's stakeholders. They would not be able to meet their obligation simply by evaluating the impact of the decision on the company balance sheet but by assessing the long-term impact of the decision on the company as a whole, including its implications for employees, consumers, and other stakeholders. As to the duty of loyalty, little would change except to whom the duty would run, meaning there would be a greater number of people interested in monitoring the possible malfeasance of management. And, by the way, if a broader duty also meant that the duties were more seriously enforced, the shareholders, too, would be happier.

Admittedly, this change would be more in terms of process than in required results. But process matters, especially when we are talking about the choices of some of the most powerful group decision makers in the world. At the very least, corporate directors (and the executives who putatively report to them) would not be able to make decisions in which the only metric that matters is stock price, measured day-to-day, or even quarter-by-quarter.

Besides, this broader fiduciary duty would benefit the company over time. Fiduciary obligations build trust in those who contribute because they know management has a duty to look after their interests. If management owes obligations of care and loyalty to all the firm's important stakeholders, they are both more likely to invest in the first place and more likely to leave their investment in place over time. This has long been thought to be true of shareholders, but it is true for other kinds of “investors” as well. For example, employees who do not fear that their interests will be shoved aside any time they are in conflict with short-term profitability will be more loyal and more willing to develop firm-

specific skills that benefit the company over time, and they will take less of an us-versus-them attitude toward management.⁵⁶

The second specific regulatory change I propose would be to change the actual structure of company boards to allow for the nomination and election of board members who embody or can credibly speak for the interests of stakeholders.⁵⁷ Currently, the board of U.S. companies embodies the interests of two groups: senior management and large shareholders. Once we recognize that a variety of stakeholders make essential contributions to the firm, we must face the reality that the current structure does not serve most of those stakeholders well. The way to change this is to require boards to reflect a broader cross section of those who contribute to their companies' success.

How to do this? Figuring out which stakeholders deserve representation and how much they deserve would undoubtedly be tricky. But it need not be impossible. Employee representatives would be fairly straightforward to elect—either we could use the German model, in which employee representatives are selected by the company workforce, or we could simply issue each employee one share of a special class of stock and have a number of board seats elected by that class. If we wanted other stakeholders represented, there are various ways it could be done. Community leaders in the localities where the company has a major presence could nominate a director; long-term business partners and creditors could be represented as well. We could even draw on the Dutch experience and require companies to include a “public interest director,” whose special obligation would be to vet company decisions from the standpoint of the public.⁵⁸

III. BENEFITS OF CHANGE

As scholars, we should remind ourselves that the mere fact that change is possible does not mean that change is worthwhile. So allow me to articulate three reasons why the changes I am proposing would be worth the political and legal effort.

56. Evidence from Europe bears this out—countries that have strong worker involvement in corporate governance enjoy higher rates of worker productivity and fewer days lost to strikes than in countries without such involvement. SIGURT VITOLS, PROSPECTS FOR TRADE UNIONS IN THE EVOLVING EUROPEAN SYSTEM OF CORPORATE GOVERNANCE 22, tbl.5 (2005), available at <http://library.fes.de/pdf-files/gurn/00299.pdf>.

57. See Greenfield, *supra* note 4.

58. Waheed Hussain, *The Law Should Make Boards More Diverse*, N.Y. TIMES (July 4, 2012, 7:00 PM), <http://www.nytimes.com/roomfordebate/2012/07/04/who-are-corporate-directors-working-for-anyway/the-law-should-make-boards-more-diverse>.

A. An Effective Tool Against Inequality

One reason to support these changes is that they could provide genuine benefits to a range of people, in a way that is relatively efficient as a matter of regulatory policy. For example, in the United States, the problems of wealth and income inequality are at historically high levels. The causes of inequality vary, but they spring in part from the behavior of corporations—low wages for the working-class, exorbitant compensation for corporate executives, and a disproportionate amount of shareholder gains going to the richest among us.

The policy tools that are available to address such inequality are incomplete at best. We can advocate for an increase in the minimum wage, but the benefits diminish above the lowest rungs of the economic ladder. We can seek to empower labor unions, but in the United States less than 7% of the nation's private work force is organized.⁵⁹ We can redistribute financial wealth from the rich by way of the tax system, but that creates resentment even among those who would benefit and arguably decreases the incentives to produce in the first place.

In comparison, changes in corporate fiduciary duties and the makeup of the board would mean that the allocation of the financial surplus created by successful corporations is likely to be fairer to all concerned. Because the allocation of corporate surplus is one of the most important decisions for boards and senior management, a change in their duties and their composition is bound to make a difference. Moreover, executives presently receive the compensation they do in part because directors and executives are members of what amounts to a private club of financial elites, all of whom look after one another. Adding fiduciary duties to interests outside the group will diminish this tendency, and the inclusion of employee representatives and other stakeholder advocates at the board level will make such "insiderism" transparent and less pervasive.

This improvement in the initial allocation of wealth is bound to be more efficient in lessening inequality than having government redistribute wealth after the fact. Fairness in the initial distribution will cause less resentment than post hoc redistribution using the tax system. Further, employees receiving a fair wage will reciprocate good will toward their employers, increasing productivity and decreasing the need for strict monitoring. These effects do not exist with a regimen of government redistribution. In comparison to increases in the minimum wage, a stake-

59. U.S. DEP'T OF LABOR, *Union Affiliation of Employed Wage and Salary Workers by Occupation and Industry*, BUREAU OF LAB. STAT., <http://www.bls.gov/news.release/union2.t03.htm> (last modified Jan. 23, 2013) (Table 3, showing 6.9% of work force in private industry represented by unions).

holder-oriented corporate governance system would benefit stakeholders up and down the economic hierarchy and earlier in the wealth creation process.

B. Better Decision Making Through Pluralism

The benefit of requiring corporations to take into account the interests of a broader range of stakeholders in corporate decision making is that the quality of the decisions themselves will improve. To be sure, group decision making is thought to be a significant reason for the success of corporations as a business form, in part because of a group's ability to improve on the decision making of individuals by exposing and mitigating bias and mistake. These benefits, however, can vanish and, indeed, transform into costs if the group reinforces bias and submerges mistakes, worsening irrationalities. Group decision makers that are homogeneous in perspective, experience, and values fall easily into "group-think"—a label attached to mistakes made by institutional decision makers when the presence of similarly thinking participants in a group results in biases being reinforced rather than challenged and mistakes validated rather than exposed.⁶⁰

Another example of group tendencies that worsen decision making is the inclination for discussion within groups comprised of individuals with similar world views and perspectives to harden those perspectives and views. In discussions about political issues, for example, groups on the extremes of political discourse become more extreme after discussion within the group.⁶¹ These implications are greater within groups that are homogeneous in perspective and in racial, gender, and class composition because "defective decision-making" is "strongly correlated" with structural flaws such as "insulation and homogeneity."⁶² As Christine Jolls and Cass Sunstein have articulated, "erroneous judgments often result when deliberations are undertaken by like-minded people."⁶³

The worry from a corporate governance perspective is that the quality of the decision making of the board is eroded when its homogeneity and insularity make it less likely that ideas will be properly vetted or that assumptions will be appropriately challenged. If a key element of the success of the corporation as a business form is the presence of a sophis-

60. IRVING L. JANIS, *GROUPTHINK* (2d ed. 1983); Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233 (2003); Kath Hall, *Looking Beneath the Surface: The Impact of Psychology on Corporate Decision Making*, 49 MANAGERIAL L. 93 (2007).

61. Daniel J. Isenberg, *Group Polarization: A Critical Review and Meta-Analysis*, 50 J. PERSONALITY & SOC. PSYCHOL. 1141 (1986).

62. CASS R. SUNSTEIN, *WHY SOCIETIES NEED DISSENT* 28 (2003).

63. Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 218 (2006).

ticated group decision maker at the top of the business structure, this success is put at risk when the board suffers from structural or formational defects that weaken the decisional process or skew the results. One thing we know about group decision making is that dissent is essential, and that social bonds among people in the group can make disagreement less likely, exactly when disagreement is most needed to spur discussion and analysis.

If the homogeneity of groups is a reason to worry about the quality of its decisions, then the current makeup of most boards is quite flawed. In fact, corporate boards may be the least diverse powerful institutions in the United States. Scholars increasingly point out the gender and racial homogeneity of boards and executive suites, and note the dangers posed to decision making by such narrowness.⁶⁴ Yet the point is broader: A diversity of perspectives and an allowance of dissent and disagreement will allow for better decisions over time. A more pluralistic board may be more contentious at times but will more likely vet decisions much more thoroughly. In the words of Aaron Dhir, “[E]stablishing a level of ‘cognitive diversity’ in the boardroom is . . . a key strategic asset which assists the firm in averting the perils and docile conduct associated with groupthink.”⁶⁵ Indeed, the Blackstone executive cited above claimed that German codetermination mitigated the effects of the crash there and argued that the mechanism by which this worked was that it “introduces a range of new perspectives” at the board level.⁶⁶

C. The Long-Term over the Short-Term

One of the few notes of agreement between business commentators and academics on both the right and the left is that “short-termism” is a problem.⁶⁷ The problem is caused by the increasingly short time horizon of shareholders, who now hold their stocks, on average, for only a few months at a time. As much as 70% of the daily volume in the United States is high-frequency trading where investors hold stocks for seconds.⁶⁸ Thus, management adhering to the interests of those shareholders prioritize short-term gains even if the result is long-term difficulties. A survey of more than 400 chief financial officers of American companies—conducted before the 2008 collapse—revealed that a significant

64. DOUGLAS M. BRANSON, *THE LAST MALE BASTION: GENDER AND THE CEO SUITE IN AMERICA'S PUBLIC COMPANIES* (2010); Lisa M. Fairfax, *Board Diversity Revisited: New Rationale, Same Old Story?*, 89 N. CAR. L. REV. 855 (2011).

65. Aaron A. Dhir, *Towards a Race and Gender-Conscious Conception of the Firm: Canadian Corporate Governance, Law and Diversity*, 35 QUEEN'S L. J. 569, 595 (2010).

66. CONCHON, *supra* note 53, at 8.

67. See Kent Greenfield, *The Puzzle of Short-Termism*, 46 WAKE FOREST L. REV. 627 (2011).

68. See Fox & Lorsch, *supra* note 46.

majority of them would prioritize meeting Wall Street's quarterly expectations over doing what was best for the company in the longer term of even a few years down the road.⁶⁹ The GFC revealed the risks of this prioritization of the short-term over the long-term.

Including broader stakeholder concerns at the senior level of corporate decision making will help roll back the pervasive short-termism of corporations. Stakeholders in general, and employees and communities in particular, know their interests are not well served by prioritizing the short-term. They hope to have their jobs and their neighborhoods for more than a year; they are unwilling to assume away risk when they are the ones who would bear the costs if those risks play out. A more technical way of describing this is that there is less moral hazard with boards that include a diversity of interests. A less technical way of describing this is that people don't play with fire when it's their own house that will burn.

IV. ANSWERING OBJECTIONS

A variety of objections arise when discussing the idea of a more robust framework of managerial obligations and a more pluralistic corporate governance structure. I have answered a host of these objections elsewhere, but allow me to discuss two prominent ones here.

A. The "Two Masters" Argument

One worry about stakeholder governance is that a broadening of corporate responsibilities would actually make it easier for managers to *avoid* responsibility altogether. The argument goes something like this: If corporate managers have more than one "master" (that is, not just shareholders), they can avoid real responsibility to any stakeholder by claiming their actions are to further the interests of another stakeholder. Economists would call this an "agency costs" argument: enlarging the duties of management will increase the agency costs inherent in managing the firm because it will be more difficult to monitor whether the managers are in fact doing their jobs carefully and in good faith.

This concern is inconsistent with another objection to stakeholder governance that one often hears, namely that corporate law need not worry about stakeholder interests because looking after shareholders will inevitably help other stakeholders as well. Of course, shareholder advocates cannot have it both ways. If the interests of shareholders and other stakeholders are not in conflict, then agency costs will not increase much

69. See LAWRENCE E. MITCHELL, *THE SPECULATION ECONOMY: HOW FINANCE TRIUMPHED OVER INDUSTRY 1* (2007).

if the law requires managers to take into account the interests of other stakeholders.

A more accurate view is that there is indeed conflict between the interests of shareholders and other stakeholders in a range of cases, especially in the short-term. Such conflict, however, is not a reason to fear that managers are unable to handle increased responsibility or that it would be impossible to know whether managers are doing their jobs well. It is true, in a mundane way, that someone who has two responsibilities may have more difficulty meeting both than she would if she had only one. Nonetheless, people routinely have more than one responsibility, some of them even conflicting. Humans are quite accustomed to having a range of obligations.

Many business managers are asked to balance a multitude of obligations, some arising from corporate law, some from other areas of law, and some from the market. For example, corporations regularly issue different classes of stock that afford different rights, but directors still owe fiduciary duties to holders of all classes of stock even when the interests of the various classes are in conflict. It is not impossible for courts to analyze whether the managers satisfied their fiduciary duties to be careful, act in good faith, and not act in their own self-interest.

The only way in which having more and broader responsibilities would make it easier for managers to avoid responsibility is that it would allow them to use one obligation as a defense to a claim that they failed to satisfy another. This, however, is not a function of the number and scope of responsibilities; rather, it is a function of 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.

Consider the duty of care. When courts enforce that duty, they reduce it essentially to a procedural obligation, namely to investigate various alternatives, consider various possible outcomes, take the time necessary to deliberate effectively, and erect certain monitoring systems to ensure the smooth flow of information from throughout the company to the centralized management.⁷⁰ If managers were required to take account

70. *See* *Smith v. Van Gorkom*, 488 A.2d 858, 891 (Del. 1985) (finding that director-defendants breached the duty of care because of their failure to inform themselves of all information reasonably available to them and relevant to their decision and by their failure to disclose all material information to the stockholders); *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996) (finding that director-defendants upheld the duty of care by meeting and being informed by experts on the relevant issues and having monitoring information systems in place); *Francis v. United Jersey Bank*, 432 A.2d 814, 821 (N.J. 1981) (finding that director-defendant had breached the duty of care by nonfeasance because a director has a duty to act, including acquiring "at least a rudimentary understanding of the business of the corporation").

of, for example, employees' interests, the duty of care would be enforced in the same way it is now. No manager would be able to erect a defense to a shareholder claim by saying she was unable to pay attention to the impact of the decision on shareholders because at the time she was thinking about employees. The managers would have to do both. Yes, this may be more difficult, but it is not impossible, and it is certainly not the kind of difficulty that throws up such dust that one cannot discern if the management is doing their jobs.

Similarly, the duty of loyalty would not be loosened if managers were required to look after non-equity investors. In corporate law, loyalty requires managers not to engage in self-dealing. Such an obligation would not be undermined by including employees among the beneficiaries of managers' fiduciary duties. Rather, adding to the number of people who benefit from managers' fiduciary duties will make it less likely that managers will be able to get away with self-dealing. More corporate stakeholders will have an interest in monitoring managerial conflict of interest.

Beneath the surface of the agency-cost argument, the mainstream theorists worry 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 asserting that such a change is a problem simply begs the question of whether managers should serve only the interests of the shareholders.

Moreover, the existence of shareholder agency costs is not itself a persuasive argument because other stakeholders also have agency costs. Other stakeholders make important contributions to the firm, and all stakeholders 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 rely 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. Nonetheless, we cannot justify the rule of shareholder primacy by pointing to shareholder agency costs unless the agency costs of other stakeholders are discounted. Those costs can only be discounted if shareholders are supreme.

B. Competitiveness

Another objection to a stakeholder model is that such a brand of corporate governance might kill the golden goose of American competitiveness. Forcing corporate managers to take into account the interests of employees and other stakeholders will deaden companies' ability to make tough allocation decisions, produce products at a low price, and succeed over time.

This worry is overblown. No stakeholder in the firm benefits when a company fails, and no one is hurt more from the failure of a publicly-traded company than its employees. Shareholders, on the other hand, typically hold a diversified portfolio of stocks, and the failure of one firm or another is not usually debilitating to a shareholder's overall financial situation.

In fact, a focus on shareholders will mean that companies will be more, not less, likely to fail. Because of their diversified portfolios and the fact that they enjoy the protection of limited liability, shareholders actually tend to prefer that companies whose stock they hold make risky decisions that create an above-average return for their entire portfolio, but that risks bankruptcy for individual firms. Shareholders do not care much whether any given firm fails, as long as their portfolio as a whole maximizes their expected returns.

Employees, on the other hand, are not diversified in their labor investment—they typically work for one employer at a time and may have invested much time and effort to develop firm-specific human capital. They are not risk neutral but, as to their employment, risk averse. Rather than being indifferent as to the risk of failure for the company for which they work, employees care deeply about their firm's financial health because they stand to lose a great deal if their firm suffers.

What this means is that a company required to take into account employee interests will fail less often than a shareholder-dominated firm. Because shareholders are relatively indifferent as to the possibility of any single firm failing, managers who make decisions according to what is good for the shareholders will bring about the failure of their companies more often than managers who make decisions based on what is good for a broader mix of stakeholders.

There is nothing incompatible with employee and stakeholder involvement in management and business success. As discussed above, as employees feel more "ownership" in their firm, they will work harder, contribute more ideas, improve their productivity, malingering less, and obey company rules more. This will tend to improve company profitability over time.

The more difficult competitiveness critique to answer is not that individual firms will fail if they take into account the interests of stakeholders, but that capital (i.e., shareholders) will flee U.S. markets if a stakeholder governance framework is established. That is, if corporations are required to take into account the interests of non-equity investors, then equity investors will take their capital elsewhere.

It is true that recognizing a stakeholder framework might bring about a reallocation of the corporate surplus away from shareholders and toward other stakeholders. That is part of the objective of such a framework. As the stakeholder model creates gains for the corporation as a whole, the slice of the pie going to shareholders may grow in an absolute sense, even if it is not as large in a comparative sense.

The judgment of capital is always a relative one—“will I make more if I invest here or elsewhere?”—so a stakeholder corporate governance regime will only cause capital to flee if it can find a better risk/return mix elsewhere. Given the power and stability of U.S. markets, there are very few places likely to offer a better risk/return ratio. Europe’s current corporate governance framework is more protective of stakeholders than any regime the United States is likely to enact, making it unlikely that capital will flee to Europe. Indeed, the fact that Europe has such a robust system of stakeholder protection while maintaining healthy and competitive capital markets is an indication that there is little reason to worry that capital will abandon ship if the United States adopts a similar model.

Of course, an argument that capital will punish efforts to impose a stakeholder governance regime is analogous to an objection to any regulatory effort that imposes costs on capital, whether it be a minimum wage, additional environmental protection, or ban on child labor. In those settings, a range of factors determines regulatory choices, including whether the regulatory effort will be worth the various costs that might arise. In some cases, a public policy initiative—limiting carbon emissions from factories—would impose costs on capital, and those costs might have an effect on whether capital will flow to U.S. securities markets or markets overseas. But an analysis of the costs must include a look at the potential benefits as well (e.g., a lessening of the rate of climate change), and it would be unwise simply to succumb to the pressures from those who threaten to take their capital and go home.

The same should be true with regard to stakeholder governance. The question is not simply whether there might be some short-term costs to capital, but whether benefits can be gained from the initiative that would balance out those costs. There is reason to be optimistic that they

would because these benefits are of the kind that will build on themselves.

V. CONCLUSION

To take advantage of the historical moment of intellectual churning in which we find ourselves, corporate law theorists will need to break out of the traditional paradigm of shareholder power versus managerial prerogative. A third way, linking broader managerial obligations with a more pluralistic governance structure, merits the attention of the corporate law academy. Such a framework will protect against the worst risks of corporate power and will provide benefits that will multiply over time.