

RESPONSE: THE DYSTOPIAN POTENTIAL OF CORPORATE LAW

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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.”¹ 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.”² 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.³

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.”⁴ Doctor Pillsbury had the ability to

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¹ EDWARD BELLAMY, *LOOKING BACKWARD* 7 (Dover Publications 1996) (1888).

² *Id.* at 10.

³ *Id.* at 7.

⁴ *Id.* at 11.

“mesmerize” West, placing him in a “deep slumber, which continued until [he] was aroused by a reversal of the mesmerizing process.”⁵ 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.

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 eleven days.

West’s tale appears in *Looking Backward*, a novel by Edward Bellamy, first published in 1888. *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.⁶

In Bellamy’s utopia, West finds a society in which everyone is equal, not only in material wealth, but also 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”⁷), 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

⁵ *Id.*

⁶ 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.

⁷ *Id.* at 203.

truth, that persons should take part in the proceedings who had an acknowledged motive to color it.”⁸

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.⁹ 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 capital, which displaced numerous entrepreneurial businesses and replaced them with “great corporations.”¹⁰ The rise of these great corporations could not be curtailed, despite popular opposition, because “even its victims . . . were forced to admit the prodigious increase of 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.”¹¹

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”¹²), and thus they would not attempt to turn back the clock. The problem, quite simply, was a distributional one: “[T]he vast increase had gone chiefly to make the rich richer, increasing the gap between them and the poor.”¹³

What West learns under the tutelage of Dr. Leete is that people have not fundamentally changed, but rather 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

⁸ *Id.* at 99.

⁹ See BELLAMY, *supra* note 1, at 23.

¹⁰ *Id.* at 25.

¹¹ *Id.* at 26.

¹² *Id.*

¹³ *Id.* at 27.

evolution”¹⁴ from a capitalist society, in which industry was increasingly concentrated, to a nationalized economy that would “open a golden future to humanity”¹⁵:

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 intrusted [sic] 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.¹⁶

Looking Backward was a publishing bonanza, selling 300,000 copies in its second year of publication.¹⁷ 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*.¹⁸

As one of the major works addressing the role of corporations in society during the Gilded Age,¹⁹ *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 diverse²⁰ and sophisticated.²¹ Nevertheless, CSR remains tightly focused on

¹⁴ *Id.*

¹⁵ BELLAMY, *supra* note 1, at 27.

¹⁶ *Id.*

¹⁷ 1 JOHN FOSTER KIRK, ALLIBONE’S CRITICAL DICTIONARY OF ENGLISH LITERATURE AND BRITISH AND AMERICAN AUTHORS 126 (Supp. 1892).

¹⁸ DONALD C. HODGES, AMERICA’S NEW ECONOMIC ORDER 15 (1996).

¹⁹ See MARK TWAIN & CHARLES DUDLEY WARNER, THE GILDED AGE: A TALE OF TODAY (1873) (using the term “Gilded Age” to characterize the period in the late nineteenth century during which the rise of “big business” occurred).

²⁰ For a recent “business 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).

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.”²² 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.²³ His recent book, *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities*, will cement his reputation as one of the most creative proponents of “progressive corporate law.”²⁴ In the companion piece to this Essay, Professor Greenfield relies on new insights from organizational and regulatory theory to bolster his claim that corporate law needs fundamental reform.²⁵

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 decisionmaking. Part II observes that reformers like Professor Greenfield have only two options for changing corporate decisionmaking: changing the decisionmaker or changing the decision rule. I contend that the existence of powerful product markets, capital markets, and managerial labor markets restricts the options of corporate decisionmakers, 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 suggests that changing the decisionmaker

²¹ 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*, 32 ACAD. MGMT. REV. 836 (2007). The article describes using a model relying on “theories of micro-level organizational justice, meso-level corporate governance, and macro-level varieties of capitalisms” to analyze CSR. *Id.* at 837.

²² Conley & Williams, *supra* note 20, at 1–2.

²³ See, e.g., Kent Greenfield, *New Principles for Corporate Law*, 1 HASTINGS BUS. L.J. 89 (2005) (discussing principles for corporate governance); Kent Greenfield, *An Experimental Test of Fairness Under Agency and Profit-Maximization Constraints (With Notes on Implications for Corporate Governance)*, 71 GEO. WASH. L. REV. 983 (2003) (analyzing the effect of agency on negotiation in a corporate director-shareholder context); Kent Greenfield, *There’s a Forest in Those Trees: Teaching About the Role of Corporations in Society*, 34 GA. L. REV. 1011 (2000) (arguing that law professors should focus on a corporation’s role in society when teaching corporate law).

²⁴ See KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES* (2007). “Progressive corporate law” coalesced around a conference and subsequent book by that title. See PROGRESSIVE CORPORATE LAW, at ix (Lawrence E. Mitchell ed., 1995).

²⁵ See generally Kent Greenfield, *Proposition: Saving the World with Corporate Law?*, 57 EMORY L.J. 947 (2008).

or changing the decision rule would have little or no effect on corporate actions, Part III explores the dystopian potential of corporate law reform.²⁶

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.²⁷ 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.”²⁸ Pared to its core, “corporate law” is the set of rules that defines the decisionmaking structure of corporations.²⁹ Or, invoking Melvin Eisenberg’s memorable maxim, “corporate law is constitutional law.”³⁰

²⁶ The word “dystopia” is usually credited to John Stuart Mill. See, e.g., RICHARD C.S. TRAHAIR, *UTOPIAS AND UTOPIANS: AN HISTORICAL DICTIONARY* 110 (1999).

²⁷ See Henry Hansmann & Reinier 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).

²⁸ Greenfield, *supra* note 25, at 6.

²⁹ Cf. Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 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, 1577–78 (1993) (“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.”).

³⁰ MELVIN ARON EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* 1 (1976).

The rules that define the decisionmaking structure of corporations are both “power-conferring” and “duty-imposing.”³¹ The locus of power in the corporation is the board of directors, which possesses a “large reservoir of authority.”³² 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.³³

The board of directors exercises its authority subject to the will of the shareholders, who are entitled to determine the composition of the board.³⁴ In addition to electing and removing directors, shareholders must approve certain fundamental transactions.³⁵ These voting rights, coupled with limited financial rights,³⁶ the right to sue derivatively,³⁷ and the right to transfer shares without prior approval,³⁸ 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.³⁹

³¹ 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 29, at 1565.

³² *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 953 (Del. 1985) (citing DEL. CODE ANN. tit. 8, § 141(a) (2007) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . .”).

³³ 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 (2007) (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).

³⁴ *See* DEL. CODE ANN. tit. 8, § 211(b) (2007) (election); *Id.* § 141(k) (removal).

³⁵ DEL. CODE ANN. tit. 8, § 242(b) (2007) (amending corporate charter); Model Bus. Corp. Act § 10.03 (2007) (same); DEL. CODE ANN. tit. 8, § 251(c) (2007) (approving mergers); Model Bus. Corp. Act § 11.03 (1999) (same); DEL. CODE ANN. tit. 8, § 271 (2007) (approving sales of assets not in the ordinary course of business); Model Bus. Corp. Act § 12.02 (2007) (same); DEL. CODE ANN. tit. 8, § 275(b) (2007) (approving dissolution); Model Bus. Corp. Act § 14.01 (2007) (same).

³⁶ 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 (2007).

³⁷ *Id.* § 327.

³⁸ *See* Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: “Sacred Space” in Corporate Transactions*, 80 TEX. 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)).

³⁹ *See, e.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005) [hereinafter Bebchuk, *Increasing Shareholder Power*] (arguing that increased shareholder power would reduce governance problems); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006) (advocating limited empowerment of shareholders in corporate governance); Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America*, 119 HARV. L. REV. 1759 (2006) (arguing for a balance

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.⁴⁰ Vestiges remain, such as provisions regarding corporate “powers,”⁴¹ and “purposes,”⁴² or the regulation of “legal capital,”⁴³ but these provisions impose no important constraints on corporate decision making.⁴⁴

between shareholder involvement and traditional corporate board power); Lucian A. Bebchuk, *Reply: Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784 (2006) (discussing ways to let shareholders more actively participate in corporate decisionmaking).

⁴⁰ ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 119–40 (1932).

⁴¹ DEL. CODE ANN. tit. 8, §§ 121, 122 (2007).

⁴² *Id.* § 102(a)(3).

⁴³ *Id.* §§ 154, 160, 170.

⁴⁴ The power of the board of directors may be limited by a corporation’s constitutional documents. *See, e.g., id.* § 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”); *id.* § 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); and 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 title 8, section 216, of the Delaware Code, providing in relevant part, “A bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors.” The synopsis of the bill expressly limited the effect of this amendment to section 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.

In modern corporation statutes, the most important constraints on director power are procedural, not substantive. In broad brush, good procedure requires unbiased directors⁴⁵ who consider “all material information reasonably available.”⁴⁶ Shareholders frequently contest director elections, claiming procedural flaws, both under state law⁴⁷ and federal securities laws.⁴⁸ 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.⁴⁹

Viewed as a whole, the “power-conferring” and “duty-imposing” rules discussed above—along with the ancillary rules regulating the formation of the corporation⁵⁰—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.⁵¹ In the ensuing Parts, 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 solve the labor question. Indeed, the only changes in corporate law that will have a substantial effect on such issues are changes that will make the world worse, not better.⁵²

⁴⁵ 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. S’holders Litig.*, 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.”).

⁴⁶ *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000).

⁴⁷ E.g., DEL. CODE ANN. tit. 8, § 225 (2007); see also 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 section 225, in the Delaware courts).

⁴⁸ Federal securities law contains rules regulating disclosure and proxy voting in director elections. See, e.g., Securities and Exchange Act Schedule 14A, 17 C.F.R. § 240.14a-101 (2007) (stating the various requirements and disclosures that must be filed with the SEC for proxy voting).

⁴⁹ For an extensive discussion of each of these duties, see *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27, 52 (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. See *id.* at 67. In each case, the cited wrong requires “intentional” action by the directors, thus making the inquiry essentially procedural.

⁵⁰ DEL. CODE ANN. tit. 8, §§ 101–110 (2007).

⁵¹ See generally Greenfield, *supra* note 25.

⁵² I do not argue that corporate law is trivial in any meaningful sense. Cf. Black, *supra* note 29, 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:

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.”⁵³ 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.⁵⁴ For Professor Greenfield, by contrast, the question of whether corporate law matters triggers a more expansive inquiry about the effect of corporate actions on labor relations, the environment, and human rights.⁵⁵

If corporate law is fundamentally about the process of corporate decisionmaking, as asserted above, possible strategies for reform are twofold: (1) changing the decisionmaker (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 issue⁵⁶); 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,”⁵⁷ Professor Greenfield must persuade us not only that changing the composition of the board of directors or changing the

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 29, at 1582.

⁵³ Greenfield, *supra* note 25, at 950.

⁵⁴ See, e.g., Craig A. Peterson & Norman W. Hawker, *Does Corporate Law Matter? Legal Capital Restrictions on Stock Distributions*, 31 AKRON L. REV. 175 (1997) (discussing how stock dividends may effect the shareholder-board relationship). 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) (analyzing the relationship between corporate governance and market value); Mark S. Klock et al., *Does Corporate Governance Matter to Bondholders?*, 40 J. FIN. & QUANT. ANAL. 693 (2005) (examining the relationship between the cost of debt financing and corporate governance).

⁵⁵ See Greenfield, *supra* note 25, at 950 (“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.”).

⁵⁶ See, e.g., Bebchuk, *Increasing Shareholder Power*, *supra* note 39, (arguing for a corporate governance approach that allows shareholders to change a corporation’s charter); Thompson & Smith, *supra* note 38 (arguing for direct shareholder action to resolve takeover disputes).

⁵⁷ Greenfield, *supra* note 25, at 950.

shareholder primacy norm would alter corporate decisionmaking but also that the new decisions would be better for society as a whole than the old decisions.⁵⁸ 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.⁵⁹

A. *Changing the Decisionmaker*

As noted above, the problem that was consuming Julian West when he went into a trance in 1887 was the "labor question."⁶⁰ Professor Greenfield tells a similar story about modern employees, even though, like the people of Julian West's youth, Professor Greenfield is forced to acknowledge the "prodigious . . . efficiency"⁶¹ with which corporations operate.⁶² Indeed, like Edward Bellamy, Professor Greenfield wants to "take advantage of the unique capabilities of the corporation to achieve important gains in social welfare."⁶³ 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.⁶⁴

⁵⁸ 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 nonshareholder stakeholders." Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1444 (2006).

⁵⁹ See generally ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (1776) (introducing the concept of the invisible hand).

⁶⁰ See *supra* note 9 and accompanying text.

⁶¹ See BELLAMY, *supra* note 1, at 26.

⁶² See Greenfield, *supra* note 25, at 948 ("Corporations are also immensely successful at creating financial wealth. They represent 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.").

⁶³ Greenfield, *supra* note 25, at 974.

⁶⁴ Professor Greenfield cleverly turns economic analysis against its practitioners:

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 decisionmaking 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.

Professor Greenfield's proposal is reminiscent of Abram Chayes's 1959 proposal to allow non-shareholder constituencies to participate in "[t]heir rightful share in decisions on the exercise of corporate power" by electing representatives to the board of directors.⁶⁵ While Professor Greenfield reassures us that "specifics will be difficult, but not impossible,"⁶⁶ 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."⁶⁷

Even if the logistics of this proposal could be worked out, the likelihood that it would substantially alter corporate decisionmaking is vanishingly small. The obstacle to change is markets. Lots of markets: product markets, capital markets, managerial labor markets.⁶⁸ While changes in the composition of the board of directors may have some marginal effects on corporate decisionmaking, market forces severely constrain the range of options available to the boards of large, publicly traded companies.⁶⁹ 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 decisionmaking to provide greater voice to non-shareholder constituencies would not significantly change the 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

Greenfield, *supra* note 25, at 980.

⁶⁵ Abram Chayes, *The Modern Corporation and the Rule of Law*, in *THE CORPORATION IN MODERN SOCIETY* 40-41 (Edward S. Mason ed., 1959).

⁶⁶ Greenfield, *supra* note 25, at 980.

⁶⁷ RALPH NADER ET AL., *TAMING THE GIANT CORPORATION* 124 (1976). Nader and his coauthors 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," they do include "financial experts," who comprise the audit committee. See Sarbanes-Oxley Act § 407, 15 U.S.C. § 7265 (2006).

⁶⁸ For an attempt to illustrate how these markets combine to exert pressure on corporate decisionmaking, see D. Gordon Smith, *Corporate Governance and Managerial Incompetence: Lessons From Kmart*, 74 N.C. L. REV. 1037 (1996).

⁶⁹ On the power and efficacy of markets to produce socially desirable outcomes, see Ribstein, *supra* note 58, at 1442-60.

attempting to maximize return on capital.”⁷⁰ Similarly, employee ownership has failed to transform large, publicly traded companies.⁷¹

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 decisionmaking. 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.⁷² As the EU prepares for the possibility of charter competition,⁷³ debates about the German model have escalated in intensity, but evidence regarding the effect of codetermination on corporate decisionmaking is “notoriously ambiguous.”⁷⁴

Professor Greenfield also emphasizes racial, ethnic, and gender diversity as a means of changing the decisionmaker. 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.”⁷⁵ Professor Greenfield is not the first to link board diversity with improved corporate decisionmaking,⁷⁶ even though evidence supporting this link is

⁷⁰ Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018, 1020 (1998).

⁷¹ See Steve Sleight, Book Review, 5 U. PA. J. LAB. & EMP. L. 215 (2002). Sleight 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 half [sic] 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.

⁷² With regard to harmonization efforts in the European Union, see Communication of the European Communities, *Modernising Company Law and Enhancing Corporate Governance in the European Union—A Plan to Move Forward*, COM (2003) 284 final (May 21, 2003); Commission Recommendation (EC) No. 162/2005 of 15 Feb. 2005, 2005 O.J. (L 52/51)..

⁷³ Jens C. Dammann, Note, *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).

⁷⁴ Christine Windbichler, *Cheers and Boos for Employee Involvement: Co-determination as Corporate Governance Conundrum*, 6 EUR. BUS. ORG. L. REV. 507, 510 (2005).

⁷⁵ Greenfield, *supra* note 25, at 982.

⁷⁶ See, e.g., Lynne L. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors*, 76 TUL. L. REV. 1363, 1403 (2002); Lisa M. Fairfax, *Clogs in the Pipeline: The Mixed Data on Women*

mixed, at best.⁷⁷ 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."⁷⁸ 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 his proposal on efficiency grounds. Interestingly, on traditional measures of corporate social responsibility, board diversity appears to be ineffectual.⁷⁹ Moreover, the benefits 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 realistically deliver."⁸⁰ As a result, using the business

Directors and Continued Barriers to Their Advancement, 65 MD. L. REV. 579, 590–91 (2006); Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233, 1306–07 (2003); Steven A. Ramirez, *Diversity and the Boardroom*, 6 STAN. J.L. BUS. & FIN. 85, 90–105 (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, 846–57 (2003); Janis Sarra, *The Gender Implications of Corporate Governance Change*, 1 SEATTLE J. SOC. JUST. 457, 477–81 (2002).

⁷⁷ 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*. See 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.

⁷⁸ See Fairfax, *supra* note 77, 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. See *id.*

⁷⁹ See Betty S. Coffey & Jia Wang, *Board Diversity and Managerial Control as Predictors of Corporate Social Performance*, 17 J. BUS. ETHICS 1595 (1998); Fairfax, *supra* note 77, at 825 ("[N]either 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.").

⁸⁰ Fairfax, *supra* note 77, at 797.

rationales to justify board diversity “may lead to the overextension, the marginalization, and even the devaluation of people of color.”⁸¹

Perhaps the most ambitious example of “changing the decisionmaker” in the United States has been the drive to create independent boards of directors, which began in earnest in the 1970s and continues today.⁸² The drive has been successful, if success is measured by the increased number of independent boards. If success is measured by improved performance of the companies, however, empirical evidence is lacking.⁸³ 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.⁸⁴ Nevertheless, the drive continues. Enron,

⁸¹ *Id.* 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. See Orly Lobel, *The Paradox of Extralegal Activism: Critical Legal Consciousness and Transformative Politics*, 120 HARV. L. REV. 937 (2007).

⁸² For a recent survey of the debates over director independence, see Usha Rodrigues, *The Fetishization of Independence* (Univ. Ga. Legal Studies Research Paper No. 07-007, 2007), available at <http://ssrn.com/abstract=968513>.

⁸³ 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).

⁸⁴ See Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1530 (2005) (noting that, with respect to studies of the connection between independent audit committees and firm performance, “[n]one of these studies have found any relation between audit committee

WorldCom, and other corporate scandals early in this decade further raised the stakes, and director independence is a central feature in the Sarbanes-Oxley Act of 2002.⁸⁵ In addition, as part of those Enron-era reforms, the New York Stock Exchange and Nasdaq have adopted more stringent definitions of director independence.⁸⁶

Each of the foregoing examples of changing the decisionmaker has its own peculiar history and back story, but together they support the notion that, over a broad swath of firms, corporate decisionmaking 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.⁸⁷ 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 of their conception of boards of directors as “mediating hierarchs,”⁸⁸ and Stephen Bainbridge has asserted that “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.”⁸⁹ 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

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”).

⁸⁵ Pub. L. No. 107-204, 116 Stat. 745.

⁸⁶ See NYSE, Inc., Listed Company Manual § 303A (2004); NASDAQ, Inc., Marketplace Rules R. 4350(c)–(d) (2006).

⁸⁷ Cf. Ribstein, *supra* note 58, at 1459 (arguing that “long-run profits may depend significantly on satisfying the social demands of consumers, employees and local communities”).

⁸⁸ Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 280–81 (1999) (“[T]he 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 M. Blair & Lynn A. Stout, *Specific Investment: Explaining Anomalies in Corporate Law*, 31 J. CORP. L. 719, 738 (2006) (“[D]irectors 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.”).

⁸⁹ Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 550–51 (2003) (citation omitted).

governance.”⁹⁰ Thus, while changes in board composition may work marginal changes in corporate decisionmaking, 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.”⁹¹ 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.⁹²

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.⁹³ Like many before him, Professor Greenfield criticizes the shareholder-centric focus of corporate

⁹⁰ 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, 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.

⁹¹ BELLAMY, *supra* note 1, at 46.

⁹² *Id.* at 64. Later, Dr. Leete explains to West that the feeling of universal brotherhood became a reality only when all classes were eliminated..

⁹³ See Greenfield, *supra* note 25, at 965 (arguing against the shareholder primacy norm).

decisionmaking.⁹⁴ His argument is straightforward and powerful: “Corporate law should not presume, without strong arguments, to prohibit corporate decisionmakers from taking into account the very societal interests that the corporation is ultimately meant to serve.”⁹⁵ While many corporate governance scholars defend the shareholder primacy norm as an essential feature of the corporate governance system,⁹⁶ 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.”⁹⁷

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* 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.⁹⁸

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.*,⁹⁹ which contains the most-cited articulation of the shareholder primacy norm.¹⁰⁰ Indeed, in his response to Berle, Dodd cites

⁹⁴ See *id.* For a recent example of a similar approach, see Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005), which criticizes the shareholder-centric focus of corporate decisionmaking.

⁹⁵ Greenfield, *supra* note 25, at 965.

⁹⁶ See, e.g., Bainbridge, *supra* note 89, 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. See Ribstein, *supra* note 58, at 1476–82.

⁹⁷ D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 322–23 (1998).

⁹⁸ Adolf A. Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931).

⁹⁹ 170 N.W. 668 (Mich. 1919).

¹⁰⁰ *Id.* at 684 (“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.”); see also Smith, *supra* note 97, at

*Dodge*¹⁰¹ and asserts, “[I]t 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 that end in view.”¹⁰² So why the debate, when Berle and Dodd seem to agree that the shareholder primacy norm applied to corporate decisionmaking?

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.¹⁰³ A major point of concern seemed to be managerial self-dealing.¹⁰⁴ Dodd states that the motivation for Berle’s piece was “[t]he fact that managers . . . not infrequently act as though maximum shareholder profit was not the sole object of managerial activities.”¹⁰⁵ The cases referred to by Dodd are not cases of managerial inattention or incompetence,¹⁰⁶ but cases of self-dealing.¹⁰⁷

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

315 n.186 (showing that citations to *Dodge* for this premise are found much more often in law review articles than in court cases).

¹⁰¹ See E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1146 n.3 (1932).

¹⁰² *Id.* at 1146–47.

¹⁰³ 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. See Berle, *supra* note 98, at 1049–50.

¹⁰⁴ For example, Berle proposes the following rule with respect to dividends: “[D]ividends must be withheld only for a business reason: private or personal motives may not be indulged.” *Id.* 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.” *Id.* at 1063.

¹⁰⁵ Dodd, *supra* note 101, at 1147.

¹⁰⁶ See generally Smith, *supra* note 97.

¹⁰⁷ See, e.g., Dodd, *supra* note 101, at 1147–48 (“[I]t 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).

on the interests of the corporation is adequate. Thus, identifying the beneficiaries of the rule is, to establish this modest principle, of secondary importance.¹⁰⁸

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,¹⁰⁹ 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."¹¹⁰ As a legal matter, he is surely right, as Berle conceded 20 years later.¹¹¹ In *The Shareholder Primacy Norm*, I observed that "the universal application of the business judgment rule makes the shareholder primacy norm virtually unenforceable against public corporations' managers."¹¹²

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?¹¹³ 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.¹¹⁴

¹⁰⁸ Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 596 (1992).

¹⁰⁹ Dodd claims to be "thoroughly in sympathy with Mr. Berle's efforts to establish a legal control which will more effectually prevent corporate managers from diverting profit into their own pockets from those of stockholders." Dodd, *supra* note 101, at 1147.

¹¹⁰ Dodd, *supra* note 101, at 1162.

¹¹¹ ADOLF A. BERLE, JR., *THE 20TH CENTURY CAPITALIST REVOLUTION* 169 (1954).

¹¹² 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 25, at 964.

¹¹³ See Posting of Brayden King to CONGLOMERATE, *The Problem with Shareholder Primacy*, http://www.theconglomerate.org/2006/07/the_problem_wit.html (July 25, 2006) ("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.").

¹¹⁴ Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APPLIED CORP. FIN. 8, 16 (2001).

Even though courts do not enforce the shareholder primacy norm, businesses seem quite focused on maximizing profits.¹¹⁵ Some have argued that this drive for profit maximization is spurred in part by the “expressive effect” of the shareholder primacy norm,¹¹⁶ though these arguments rest on the mistaken assumption that the shareholder primacy norm is required to deter self-interested behavior.¹¹⁷ 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. And 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.¹¹⁸ Bellamy’s Boston of 2000 was a world without capitalists.¹¹⁹ 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.”¹²⁰ With the benefit of twenty-first century hindsight, Bellamy’s vision is frightening:

¹¹⁵ 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) (arguing, in reference to the 1950s, that “[c]orporate leaders spoke of the corporation’s new responsibility, but none seemed ready to abandon the profit-maximizing and shareholder-primacy norms that had guided their actions for many years”).

¹¹⁶ 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).

¹¹⁷ 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 89, at 582.

¹¹⁸ BELLAMY, *supra* note 1, at 89.

¹¹⁹ As Dr. Leete asserts, “the nation [had] become the sole capitalist.” BELLAMY, *supra* note 1, at 139. But to suggest that “capitalism” exists without markets is doublespeak.

¹²⁰ *Id.* at 27.

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 [sic] 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.¹²¹

The change was not caused by bloody revolution, but by consensus.¹²² Ironically, one of the most important changes in the history of U.S. corporate law occurred in 1888, the year that *Looking Backward* was first published, when New Jersey amended its constitution to allow corporations to hold and dispose of the stock of other corporations.¹²³ 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."¹²⁴

Other states, including Delaware (in 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 adopted many passages of the New Jersey statute *in ipsissimis verbis*.¹²⁵ Despite copying New Jersey's statutes and cases and offering lower taxes, Delaware was unable

¹²¹ *Id.*

¹²² *See id.* at 28 (explaining that "the whole mass of people was behind it").

¹²³ Henry N. Butler, *Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges*, 14 J. LEGAL STUD. 129, 163 (1985).

¹²⁴ *See* 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).

¹²⁵ *See* *Wilmington City Ry. Co. v. People's Ry. Co.*, 47 A. 245 (Del. Ch. 1900).

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 1913,¹²⁶ 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.¹²⁷ Though Professor Greenfield has not endorsed a federal incorporation explicitly, he refers to “U.S. corporate law” in his paper, and whatever means he would employ to implement his reforms, the national scope of his ambition is clear.¹²⁸ Just as members of utopian societies may be required to sacrifice freedom on the altar of equality, so Professor Greenfield’s proposals would require corporations to forfeit the liberal regulations embedded in state corporate laws for a more constraining federal system. 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 conventional objection to proposals like Professor Greenfield’s is that stakeholder governance leads to diminished accountability of corporate managers. This so-called “two-masters problem” has been thoroughly advanced in the existing literature,¹²⁹ and proponents of stakeholder

¹²⁶ See Joel Seligman, *A Brief History of Delaware’s General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 270 (1976). Wilson was a lame duck governor at the time, having been elected President of the United States in 1912.

¹²⁷ See, e.g., Nader, *supra* note 67. 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., at vii (1950).

¹²⁸ 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’s 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).

¹²⁹ See, e.g., FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 38, 70 (1991); Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 640–65 (1997); Stephen N. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1435–38 (1993); 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, 31–36 (1991).

governance have answered the charge.¹³⁰ But that debate is merely a sideshow to the larger concern over the dystopian potential of corporate law. While the “two-masters problem” focuses on the potential for managerial self-dealing, Professor Greenfield’s proposal would be problematic even in a world without self-dealing.

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 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. And the failure to pursue such strategies would be a problem of managerial incompetence, not a problem of improper incentives.¹³¹

Professor Greenfield’s proposals to change the decisionmaker and change the decision rule would have the effect of shifting power and attention away from shareholders and toward non-shareholder constituencies. As Larry Ribstein has observed, “[S]hifting power to stakeholders solves the problem of shareholder opportunism to stakeholders by creating a potentially more serious problem of stakeholder opportunism to shareholders.”¹³² The inevitable result would be an increase in 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,¹³³ could become a flood.

Victor Fleischer has observed that stock expatriations are an example of “regulatory-cost engineering,” and he asserts that “[t]he puzzle is not why inversion deals take place, but rather why we see so few.”¹³⁴ Using the aborted

¹³⁰ Marleen A. O’Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899, 958–59 (1993); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Constituency Statutes*, 70 TEX. L. REV. 579, 589 (1992).

¹³¹ For a similar point, see Henry Manne, *First Lecture*, in *THE MODERN CORPORATION AND SOCIAL RESPONSIBILITY* 4–5 (1972).

¹³² Ribstein, *supra* note 58, at 1440.

¹³³ Such stock expatriations include 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).

¹³⁴ Victor Fleischer, *Brand New Deal: The Branding Effect of Corporate Deal Structures*, 104 MICH. L. REV. 1581, 1621 (2006).

expatriation proposal of Stanley Works as a case study, Professor Fleischer hypothesizes that “[b]randing may be part of the answer.”¹³⁵ 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—“Sarbanes-Oxley”—suggests that the tipping point for incorporations may not be far away.¹³⁶ While that debate has not yet come to a resolution, shifts in the patterns of cross-listings¹³⁷ away from the U.S. and toward Europe have reminded us of the existence of a global market for regulation.¹³⁸ 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

¹³⁵ *Id.*

¹³⁶ Empirical work to date suggests that Sarbanes-Oxley has improved the quality of financial audits, thus increasing investor confidence. See 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 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 . . . 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*, 105 MICH. L. REV. 1857 (2007); Kate Litvak, *The Effect of the Sarbanes-Oxley Act on Non-U.S. Companies Cross-Listed in the U.S.*, 13 J. CORP. FINANCE 195 (2007).

¹³⁷ See Joseph D. Piotroski & Suraj Srinivasan, *The Sarbanes-Oxley Act and the Flow of International Listings* (Apr. 2007) (unpublished manuscript, on file with authors), available at <http://ssrn.com/abstract=956987> (“[T]he frequency of foreign listings on the NYSE and NASDAQ has fallen by nearly 63% in the four-year period following the passage of Sarbanes-Oxley, and that this decline cannot be fully explained by differences in market conditions before and after the Act. In contrast, the frequency of foreign listings on the LSE has more than doubled since the Act, with the increase being driven by the nearly seven-fold increase in foreign listings on the LSE’s AIM.”); see also INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION (Dec. 5, 2006), available at http://www.capmksreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf.

¹³⁸ See generally Larry E. Ribstein & Erin A. O’Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. (2008).

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 decisionmaker and change the decision rule.

In response to Professor Greenfield’s challenge, I contend that corporate law does not matter in the way that he claims because powerful markets constrain corporate decisionmaking. 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.