

HAS CORPORATE LAW FAILED? ADDRESSING PROPOSALS FOR REFORM

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THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES. By *Kent Greenfield*. Chicago: University of Chicago Press. 2006. Pp. ix, 288. \$45.

INTRODUCTION

Successful corporations create extraordinary wealth. The longstanding question is how this wealth should be distributed.¹ The conventional answer has been shareholder primacy.² Most stakeholders, such as customers, suppliers, creditors, and employees, must negotiate their portion *ex ante*, but everything left over, the residual interest, belongs to the corporation's shareholders.³ The job of the board of directors is thus to maximize the residual interest, thereby creating shareholder value. Nobel Laureate Milton Friedman was perhaps the leading proponent of the shareholder-primacy model of corporate governance, famously arguing that “[f]ew trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible.”⁴ At least since the

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1. People have posed this question since at least as far back as the formation of the limited-liability joint-stock company in mid-nineteenth-century Britain. *See, e.g.*, JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, *THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA* 54 (2003); Paddy Ireland, *Shareholder Primacy and the Distribution of Wealth*, 68 *MOD. L. REV.* 49, 49–50 (2005).

2. *See, e.g.*, Jill Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy* 2 (Univ. of Cal. Berkeley Law & Econ. Workshop, Paper No. 5, 2004), available at http://repositories.cdlib.org/berkeley_law_econ/Spring2005/5 (“Corporate scholarship is premised on the shareholder primacy norm . . .”).

3. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 15–17 (1991).

4. MILTON FRIEDMAN & ROSE FRIEDMAN, *CAPITALISM AND FREEDOM* 133 (40th Anniversary ed. 2002). Nobel Laureate Gary Becker also believes that corporations have no “responsibilities beyond trying to maximize stockholder value, adhering to contracts, implicit as well as explicit, and obeying the laws of the different countries where they operate.” Posting of Gary Becker to The Becker-Posner Blog, http://www.becker-posner-blog.com/archives/2005/07/do_corporations.html (July 24, 2005, 19:43 CST). The debate, however, has existed for at least seventy-five years. *See, e.g.*, A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 *HARV. L. REV.* 1049, 1049 (1931) (arguing that corporations should always act solely in the shareholders’ interests); E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 *HARV. L. REV.* 1145, 1148 (1932) (claiming that corporations have a social function).

days of President Reagan, this laissez-faire approach has tended to prevail, not only among the educated elite⁵ but also on the Supreme Court.⁶

The progressive answer is that wealth should be distributed fairly to all stakeholders, and that corporations have a social responsibility that goes beyond the mere maximization of shareholder wealth.⁷ Whereas shareholder primacists seek to protect shareholders (or their residual interest) from other stakeholders, particularly greedy corporate management, stakeholder primacists seek to protect the nonshareholder stakeholders from the overreaching corporation.⁸

In *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities*, Professor Kent Greenfield⁹ develops and extends the argument for a broader stakeholder approach.¹⁰ In Greenfield's view, the problem is that public corporations are only public in a very limited sense—anyone with a brokerage account and money can buy shares—rather than public in the sense of having societal obligations or even facing close governmental oversight (pp. 1–2). Corporate law should thus be reconceived as public law and employed as a powerful regulatory tool.¹¹ Greenfield proposes reforms that he believes will increase contributions to social welfare.¹² His proposals include eliminating the profit-maximization norm, extending the scope of fiduciary duties to include stakeholders other than shareholders, and

5. See, e.g., Jeffrey Rosen, *Supreme Court Inc.*, N.Y. TIMES MAG., Mar. 16, 2008, at 38, 41 (“Among the professional classes, many . . . have come to share a relatively laissez-faire, technocratic vision of the economy and are suspicious of excessive regulation and reflexive efforts to vilify big business.”).

6. See, e.g., *id.* at 40–41 (“Today, however, there are no economic populists on the [Supreme] court . . . With their pro-business jurisprudence, the justices may be capturing an emerging spirit of agreement among liberal and conservative elites about the value of free markets.”).

7. Progressive corporate law appears to have become a popular term with the publication of a collection of essays in a book of that title. See PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995). A recent search in Westlaw's Law Journal database revealed that 302 articles have used the phrase.

8. Arguably both groups focus too much on the question of wealth distribution and not enough on the conditions that lead to wealth creation, particularly because wealth creation can be a positive- rather than zero-sum game. Greenfield, however, does look at wealth creation. P. 39.

9. Professor of Law and Law Fund Research Scholar, Boston College Law School.

10. Greenfield characterizes his book as the first “comprehensive, theoretical response to Easterbrook and Fischel from the stakeholder perspective.” P. 4 (referencing EASTERBROOK & FISCHEL, *supra* note 3).

11. Chapter 7. Corporate law is defined, uncontroversially, as that law which “produces the fabric of governance for our most important and powerful nongovernmental institutions.” P. 27.

12. Greenfield is, of course, not the only professor that has recently attacked the laissez-faire markets-know-best philosophy. See, e.g., DAN ARIELY, PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS 87 (2008) (“[L]ife with fewer market norms and more social norms would be more satisfying, creative, fulfilling, and fun.”); MICHAEL SHERMER, THE MIND OF THE MARKET: COMPASSIONATE APES, COMPETITIVE HUMANS, AND OTHER TALES FROM EVOLUTIONARY ECONOMICS (2008) (arguing that we have an innate sense of fairness and justice that goes beyond profit maximization); Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 639 n.7 (2006) (adopting a welfare economics perspective).

requiring boards of directors to include stakeholder representatives who will meaningfully contribute to corporate decision making.¹³ Although he accepts that these changes would be “profound,” he also believes that they “would not require seismic shifts in corporate law” (p. 242).

It is also worth emphasizing the substantial areas of agreement between Greenfield and those he criticizes. For example, Greenfield recognizes that freedom of contract, even to maximize wealth, is important (p. 17–18). But he believes that this freedom should be balanced against other concerns, at least since the rejection of the near-universally criticized *Lochner v. New York*.¹⁴ Financial wealth, after all, is (hopefully) not the most important thing in people’s lives, but rather a means to other ends (pp. 132–33).

Moreover, Greenfield does not want to tamper with those special characteristics of corporations—perpetual existence, limited liability, specialized management, and share transferability—that create such a powerful ability to generate financial wealth (p. 131). He also accepts that wealth creation, by itself, is enough to make a corporation successful, at least absent negative externalities (p. 132). He takes pains to note (perhaps a bit defensively?) that he does not advocate socialist economic organization and that, unlike some progressive corporate law supporters, he does not want to reduce corporations’ First Amendment rights (pp. 241–42).

Reviewers have praised Greenfield’s work effusively. Benedict Sheehy describes the book as a “seminal piece of writing” that “merits a place along Berle and Means, Easterbrook and Fischel, and indeed, one can but hope that it becomes the touchstone for further corporate law reform globally.”¹⁵ Joseph Singer writes that this is “simply the best and most well-reasoned progressive critique of corporate law yet written.”¹⁶ Laurence Boylan proclaims himself “moved” and “inspired” by this “persuasive” and “passionate book.”¹⁷

Much of this praise is warranted. Greenfield is certainly passionate and almost always lucid. He is not, however, always persuasive.

Greenfield is perhaps weakest in explaining market failure. He argues that some of his proposals will *increase* corporate profits. If this is so, his

13. P. 242. Greenfield also proposes three less fundamental reforms: scrapping the internal affairs doctrine, pp. 112–13, enacting an antifraud law to protect workers similar to antifraud laws that protect investors, p. 215, and allowing shareholders to enforce corporations’ obligation to obey the law, pp. 94–95. This last proposal is perhaps unnecessary given that the Delaware Supreme Court has determined that acting “with the intent to violate applicable positive law” is an example of bad faith, and acting in bad faith violates the fiduciary duty of loyalty. *Stone v. Ritter*, 911 A.2d 362, 369–70 (Del. 2006) (quoting *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006)). It remains to be seen whether this would necessarily be a breach, or whether the directors would have a defense.

14. 198 U.S. 45 (1905).

15. Benedict Sheehy, Book Review, 17 *LAW & POL. BOOK REV.* 663, 668 (2007), http://www.bsos.umd.edu/gvpt/lpbr/reviews/2007/08/failure-of-corporate-law-fundamental_10.html. *But see* Christopher C. Faille, Book Review, *FED. LAW.*, Jul. 2007, at 41, 41 (asserting that Greenfield has brought “little new or interesting to the table”).

16. Joseph Singer, Book Review, *ETHICAL CORP.*, Nov. 2006, at 55, 55.

17. Laurence Boylan, Book Review, *TRIAL*, Oct. 2007, at 56, 56.

explanations for why corporations do not already follow his suggestions are sometimes unsatisfactory. Mainstream publications have already recognized that corporate social responsibility will sometimes increase profits and is thus simply good management.¹⁸ Even without a change in the legal regime, many corporations are already moving in Greenfield's direction: "[c]orporate social responsibility, once a do-gooding sideshow, is now seen as mainstream."¹⁹ Why then are these legal changes necessary?

Greenfield's answer might be externalities. Corporations do not bear all the costs of their actions, leading to flawed decisions that might benefit them but that are harmful to society. Greenfield's overarching claim is that corporate law in the United States, by encouraging decision making based on incomplete costs and benefits, is inherently flawed, resulting in "corporate scandals . . . artificially low wages for working people, environmental degradation, and an even higher risk of terrorist attacks" (p. 2).

Undoubtedly these are problems; perhaps of greatest interest are Greenfield's focus on corporate law as the solution²⁰ and his overall argument that corporate law matters.²¹ For example, he boldly claims that "[c]orporate law made the tragedy of September 11 more possible, and thus made the war in Iraq more likely as well" (pp. 9–10). His proposed changes would result, he claims, in us not only being safer but also having more money, better jobs, a cleaner environment, more nutritious food, better

18. Michael E. Porter & Mark R. Kramer, *Strategy Society: The Link Between Competitive Advantage and Corporate Social Responsibility*, HARV. BUS. REV., Dec. 2006, at 78, 80 (showing how corporate social responsibility "can be a source of opportunity, innovation, and competitive advantage"); Daniel Franklin, *Just Good Business*, THE ECONOMIST (SPECIAL REPORT), Jan. 19, 2008, at 3, 3.

19. Franklin, *supra* note 18, at 3. Corporate social responsibility is also described as "corporate responsibility," "corporate citizenship," or "building a sustainable business." *Id.*; see also John A. Pearce II & Jonathan P. Doh, *The High Impact of Collaborative Social Initiatives*, MIT SLOAN MGMT. REV., Spring 2005, at 30, 31 ("The issue is not whether companies will engage in socially responsible activities, but how they should do so.").

20. Directors do not choose actions based only on legal constraint and profit maximization, but also choose actions "that are called for on any sensible view of business ethics or good management practice. These include not lying to your employees, for instance, not paying bribes, and looking farther ahead than the next few weeks." *The Union of Concerned Executives*, THE ECONOMIST (SURVEY OF CORP. SOC. RESP.), Jan. 22, 2005, at 6, 6; see also Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1642–44 (2001) (arguing that "nonlegally enforceable rules and standards" will govern much of a firm's conduct); Robert B. Thompson, *The Law's Limits on Contracts in a Corporation*, 15 J. CORP. L. 377, 379–80 (1990) (observing that a "nexus of constraints" beyond law constrain corporate behavior).

21. Not everyone agrees that corporate law matters. See, e.g., Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 544 (1990) (answering yes to the titular question); Michael D. Klausner, *The Limits of Corporate Law in Promoting Good Corporate Governance* 5 (John M. Olin Program in Law and Econ., Working Paper No. 300, 2004), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=637021 ("[I]t is difficult to imagine that these sets of [corporate] legal rules have a significant direct effect on the incentives of a board of directors to govern in an affirmatively effective manner.").

products, stronger communities, an improved political process and reduced crime.²²

Agreeing with Greenfield's goals, however, and viewing corporate law as the optimal vehicle of reform are two different things.²³ For example, problems with privatized airport security had many causes besides corporate law.²⁴ Or even if an antifraud law for workers is desirable, it does not follow that it should be a part of corporate rather than employment law.²⁵ Though Greenfield has highlighted its possible comparative advantages (pp. 181–83), corporate law is only one potential regulatory tool among many.

Part I of this Review discusses the modern “nexus of contracts” approach to corporations and highlights how Greenfield's views differ. Part II examines corporate goals and purposes, suggesting that Greenfield overstates the impact of the shareholder-primacy norm and does not offer a preferable alternative. Part III critiques the means to the ends—Greenfield's proposals for changing the mechanics of corporate governance. Although several of his proposals are intriguing, they seem unlikely to achieve their pro-social aims. This Review remains skeptical, in part because—even given its problems—the U.S. “director-centric governance structure has created the most successful economy the world has ever seen.”²⁶ Overall, regardless of whether one is persuaded by all of his claims, Greenfield has made a valuable contribution to the field. Both lay readers and corporate law scholars of all types will find this an absorbing and thought-provoking book.

I. CORPORATE LAW: REGULATING A NEXUS OF CONTRACTS

Greenfield accepts as his starting point the modern contractarian view that corporations are a legal fiction best seen as a “nexus of contracts,”²⁷

22. P. 5. Greenfield, of course, is not alone (even among corporate-law professors) in putting the blame for many of our social ills on corporate law. *See, e.g.*, JOEL BAKAN, *THE CORPORATION: THE PATHOLOGICAL PURSUIT OF PROFIT AND POWER* 166 (2004) (“Corporate rule must be challenged in order to revive the values and practices it contradicts: democracy, social justice, equality, and compassion.”); LAWRENCE E. MITCHELL, *CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT* 1–3 (2001) (attributing environmental damage, hazardous products, declining real wages, increasing income inequality, and massive layoffs to a root cause of the “corporation's legal structure”).

23. The Office of Management and Budget estimated that, by the year 2000, American companies paid \$289 billion annually to meet social regulations. MICKLETHWAIT & WOOLDRIDGE, *supra* note 1, at 150. Other experts believed the correct figure was three times higher. *Id.*

24. *See* NAT'L COMM'N ON TERRORIST ATTACKS UPON THE UNITED STATES, *THE 9/11 COMMISSION REPORT* (2004), available at <http://www.gpoaccess.gov/911/index.html> (identifying failures, not including corporate law, that caused the 9/11 tragedy).

25. *See infra* note 73.

26. Martin Lipton & Paul K. Rowe, *The Inconvenient Truth About Corporate Governance: Some Thoughts on Vice-Chancellor Strine's Essay*, 33 J. CORP. L. 63, 63 (2007).

27. Probably the most influential work is Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310 (1976) (defining a corporation as a “nexus for a set of contracting relationships” (emphasis omitted)). For a modern summary, see STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 27–33 (2002).

rather than the concession-theory view that corporations are a creation of the state.²⁸ All corporate stakeholders—shareholders, creditors, employees, suppliers, customers, etc.—are assumed to have voluntarily entered into explicit or implicit “contracts” that define each party’s rights and obligations.²⁹ Because participation is voluntary, parties will only enter into contracts that they think will make them better off, and parties are generally best suited to judge their own interests. Accordingly, state interference with private contracting should be relatively limited, at least where there is little impact on those who are not contractual parties.³⁰

The “nexus of contracts” theory views corporate law as a branch of private law (p. 29). Corporate law is predominantly enabling, existing merely to reduce transaction costs between shareholders and the directors who actually oversee the corporation. Rather than having the contracting parties invent or negotiate all contractual terms, the state essentially supplies a standard form contract comprised of the default rules that, as a general matter, the parties would have reached had they been able to negotiate them costlessly.³¹ Parties are free to modify these default rules in case the state has provided suboptimal terms or they are simply unsuited to the situation. Contractarians view shareholders as having the most difficult relational contracts to negotiate. Therefore, corporate law includes hard-to-specify provisions like fiduciary duties in the shareholder contract, and “narrowly focuses on the rights and responsibilities contained within the ‘contract’ between management and shareholders,” rather than addressing other stakeholders’ contracts (p. 29).

These other stakeholders must rely on something besides corporate law—such as expressly negotiated contracts, other government regulation, or social pressure—to affect the corporation’s behavior. If they want provisions such as fiduciary duties, they must bargain for them.³² Protection of the public from market defects or addressing distributional concerns is achieved particularly through the political process, rather than through

28. P. 4. For detailed descriptions of theoretical approaches to the corporation in the United States, see David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 211–31.

29. “Contracts” is used in an economic sense to mean “any process by which property rights to assets are created, modified or transferred.” BAINBRIDGE, *supra* note 27, at 28; accord William W. Bratton, Jr., *The “Nexus of Contracts” Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 417–18 (1989).

30. P. 31 (“[T]he issue is not one of public policy but of contract law.” (quoting Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1273 (1982))). Of course, even contracts face substantive legal limits, such as the doctrine of unconscionability or the duty of good faith and fair dealing.

31. There are other ways to set the default rules. See, e.g., Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591, 1591 (1999) (describing penalty default rules designed to force information disclosure); Lucian Arye Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 NW. U. L. REV. 489, 491–92 (2002) (arguing that pro-shareholder rules should be the default).

32. Pp. 61–62. For example, after Nabisco’s bonds dropped in value following its leveraged buyout, debt holders began negotiating event-risk covenants. See *Metro. Life Ins. Co. v. RJR Nabisco, Inc.*, 716 F. Supp. 1504, 1524 (S.D.N.Y. 1989) (holding that bondholders were not owed fiduciary duties).

interference with the legal relationship between management and shareholders (and thus the internal corporate governance of the firm) (pp. 37–39).

Greenfield, although accepting the basic framework, lists several problems with the “nexus of contracts” view of corporations. Default rules may affect the parties’ expectations, or otherwise be sticky, and thus affect a contract’s substantive terms.³³ For example, because by default shareholders are the only stakeholders to enjoy directors’ fiduciary duties, they are more likely to retain the duties than if there were some other default position. They also illustrate distributional concerns. Shareholders, both because they tend to be wealthiest and because capital has the most mobility, typically have the most market power. Even if contracts are entered into voluntarily, each stakeholder’s returns will reflect the stakeholder’s preexisting market power. In effect, even if not by intention, corporate law serves to “bolster the power of those who are already powerful” (p. 19).

Further, Greenfield rejects the contractarian’s claim that there are few substantial third-party effects, or negative externalities:

By centralizing power in management, limiting the involvement of other stakeholders in corporate decision making, and imposing a requirement that the firm’s management care about making money first and foremost, the law has created an entity that is guaranteed to throw off as many costs and risks onto others as it can. (p. 16)

These others are simply the less powerful stakeholders (p. 19). According to Greenfield, the tragedy of September 11 was precisely such an externality, caused in part by corporate law.³⁴

Due to these drawbacks, Greenfield believes that corporate law should be reconceived as public law, like any other tool of “social and macroeconomic policy” (p. 27), “subject to the same analysis as environmental law, labor law, tax law, and the like” (p. 37). In other words, corporate law should be “predicated upon our collective political decisions about what we want our society to look like.”³⁵ Corporate law is a particularly “powerful and underutilized tool” (p. 124) that has been wrongly ignored in the political process.³⁶

In addition, Greenfield argues it may have “comparative advantages” over specific substantive laws, such as employment or environmental law

33. See, e.g., Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 611 (1998) (describing the endowment effect in the context of contract default rules).

34. Pp. 10–16. According to Greenfield, September 11 was a result of market failure, caused in part by profit seeking and because no stakeholder had the ability to increase airport security. Pp. 12–14.

35. P. 37. Others have also supported reconceiving corporation law as public law. See, e.g., David A. Westbrook, *Corporation Law After Enron: The Possibility of a Capitalist Reimagination*, 92 GEO. L.J. 61, 108–10 (2003).

36. P. 31. The Sarbanes-Oxley Act is one exception. See Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1585–91 (2005).

(p. 141). Greenfield reasons that taxing a company to pay for pollution remediation is likely to be less efficient than requiring “corporations to change their internal practices to reduce the amount of pollution,” because avoiding a problem is often cheaper than fixing it, “and it is often better to give the responsibility to avoid a problem to the person who knows most about it and can avoid it at the least expense” (p. 141). But how altering internal practices achieves these aims better than a transparent tax on polluting is unclear. With a tax, corporate decision makers who know the most about the problem can work out the lowest-cost means of compliance. Greenfield is probably not suggesting that companies are bad at determining these lowest costs, for he accepts that generating wealth is what corporations are good at. Why then would government-mandated changes on internal processes result in a better decision? It seems unlikely that a corporate decision maker is better able to determine the social costs of pollution than the state. In any case, Greenfield correctly concludes that whether corporate law has a comparative advantage is an empirical question (p. 140).

At the very least, he argues that we should discuss potential changes, and evaluate them on empirical grounds (p. 39). Greenfield uses the examples of a minimum wage law and a law requiring directors to consider the interests of nonshareholder stakeholders. Typically, the former law would be contested on empirical grounds such as the likely impact on unemployment, whereas the latter would almost certainly face foundational objections based on the (allegedly) private nature of corporations (pp. 32–33).

Greenfield’s view is that the United States should harness the corporation’s ability to generate profits for the ultimate good of society. His ultimate ends are thus uncontroversial. The ends he chooses for *the corporation* and the means by which they are to be achieved, however, are anything but.

II. CHANGING ENDS: RELAXING SHAREHOLDER PRIMACY

There is little dispute regarding the ultimate purpose of a corporation. Whether one supports the concession-theory or contract view of a corporation, the ultimate ends of a corporation should invariably be the pursuit of aggregate social welfare and the interests of society as a whole.³⁷ Greenfield’s view that “the corporation is an instrument whose purpose is to serve the collective good, broadly defined” is readily acceptable (p. 127).

The disputed normative question, however, is how best to achieve this ultimate end. For many, the answer is shareholder primacy: a corporation’s sole purpose should be to maximize shareholder value because shareholder

37. See, e.g., Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 Geo. L.J. 439, 441 n.5 (2001).

primacy is the best way to benefit society.³⁸ Greenfield favors a more direct approach, arguing that the connection between shareholder primacy and a desirable society is unexplained and unsupported.³⁹ The United States, for example, is very wealthy but lags behind on social measures like child poverty, racial inequality, and income inequality (p. 23). According to Greenfield, the instrumental claim that shareholder primacy best achieves aggregate social welfare “is largely unsupported by empirical data and has heretofore been untested by rigorous counterargument” (p. 126).

Although Greenfield may be right that there is little data supporting shareholder primacy, and his critique of the underlying economic theory points out weaknesses, he misses the mark in asserting that the law requires shareholder primacy. As a result, relaxing the goal of shareholder primacy would have little practical impact.

A. *The Myth of Shareholder-Wealth Maximization*

There is evidence that corporations are not in fact limited to maximizing shareholder wealth. Although Greenfield argues that “[t]here is no principle of corporate law that is more central to the way businesses are organized and regulated within the United States” than that of shareholder-wealth maximization (p. 42), the reality is more complex. Corporate statutes, for example, do not state the principle of shareholder-wealth maximization,⁴⁰ and in fact expressly permit corporations to make charitable donations.⁴¹

If there is such a principle, it comes from case law, notably dicta, in an old chestnut that appears in nearly every corporate law book: “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.”⁴² The case is a one-off, however, commonly used as the sole authority for the so-called principle of shareholder-wealth maximization.⁴³ As Professor Stout concludes, “shareholder wealth maximization is *not* a modern legal principle.”⁴⁴ Professor Elhauge, similarly definitive, observes that “the law

38. *Id.* at 441 (claiming that “logic and experience” shows that making “corporate managers strongly accountable to shareholder interests and, at least in direct terms, only to those interests” is the “best means” to benefiting society).

39. P. 23. Greenfield concedes that maximizing shareholder value may result in a larger economy but maintains that this does not necessarily mean a more desirable society. Pp. 22–23.

40. ROBERT CHARLES CLARK, *CORPORATE LAW* 678 (1986).

41. *See, e.g.*, CAL. CORP. CODE, § 207(e) (West 1990) (allowing corporations to “[m]ake donations, regardless of specific corporate benefit”); DEL. CODE ANN. tit. 8, § 122(9) (2001) (allowing “donations for the public welfare or for charitable, scientific or educational purposes,” albeit arguably only if they serve corporate purposes).

42. P. 41 (quoting *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919)).

43. Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, in *THE ICONIC CASES IN CORPORATE LAW* 1, 2 (Jonathan R. Macey ed., 2008).

44. *Id.* at 5. Professor Stout also states that the case is “a mistake, a judicial ‘sport,’ a doctrinal oddity largely irrelevant to corporate law and corporate practice.” *Id.* at 3; *see also* FRANKLIN A. GEVURTZ, *CORPORATION LAW* 309 (2000) (“[B]y and large, courts have not scrutinized business decisions to see whether directors sacrificed profit maximization to advance the

has *never* barred corporations from sacrificing corporate profits to further public interest goals that are not required by law.”⁴⁵

Looking beyond case law, thirty states have passed nonshareholder constituency statutes that typically permit (or in the case of Connecticut, require) directors to consider the impact of their decisions on nonshareholder stakeholders.⁴⁶ For example, Pennsylvania allows directors to consider “any or all groups affected by [their decisions], including shareholders, employees, suppliers, customers and creditors of the corporation, and [some] communities.”⁴⁷ Concededly, Delaware does not have a nonshareholder constituency statute but, like other states, allows a corporation to form for “any lawful business or purposes.”⁴⁸

Even if shareholder-wealth maximization were a modern legal principle, corporations may not follow it,⁴⁹ or the business-judgment rule that serves to insulate directors from liability for breaches of the duty of care renders it irrelevant.⁵⁰ Under the business-judgment rule, “directors who consider nonshareholder interests in making corporate decisions, like directors who do not, will be insulated from liability.”⁵¹ Greenfield sees it as paradoxical that there is a strict duty to maximize shareholder value coupled with near total unenforcement, but he attributes it to the underlying irrationality of the duty (pp. 226–27). More plausibly, this strict duty does not actually exist.

Greenfield repeatedly posits that a board choosing to reward its employees financially in a way that exceeded the shareholders’ benefits

interests of employees, creditors, customers and the community.”); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 773 (2005) (arguing that *Dodge* merely “limits the degree of profit-sacrificing discretion rather than imposing a duty to exclusively profit-maximize”).

45. Elhauge, *supra* note 44, at 763 (emphasis added).

46. Jonathan D. Springer, *Corporate Constituency Statutes: Hollow Hopes And False Fears*, 1999 ANN. SURV. AM. L. 85, 85, 101. These statutes have not resulted in “revolutionary change.” *Id.* at 120; accord BAINBRIDGE, *supra* note 27, at 417 (“[T]he probability of holding directors liable for operational decisions was so low before the nonshareholder constituency statutes came along that the statutes could not further lower it.”).

47. 15 PA. CONS. STAT. ANN. § 1715(a)(1) (1995); see also 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE § 2.01(b) (1994) (stating that a corporation may “take into account ethical considerations” and devote reasonable resources to the public good “[e]ven if corporate profit and shareholder gain are not . . . enhanced”).

48. DEL. CODE ANN. tit. 8, § 101 (2001).

49. See Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 286 (1999) (claiming that many directors act “as disinterested trustees charged with faithfully representing the interests” of all corporate stakeholders).

50. The business-judgment rule states that a director satisfies her duty of care if the director is disinterested, reasonably informed, and “rationally believes that the business judgment is in the best interests of the corporation.” 1 AM. LAW INST., *supra* note 47, § 4.01(c).

51. BAINBRIDGE, *supra* note 27, at 414; see also GEVURTZ, *supra* note 44, at 313 (“[A] rule which requires directors to act purely as profit maximizers is unenforceable.”). A narrow exception to this is the takeover context, where in some circumstances directors must act to maximize shareholder value. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). Directors typically, however, can easily avoid these circumstances. See, e.g., *Paramount Commc’ns, Inc. v. Time Inc. (In re Time Inc. S’holder Litig.)*, 571 A.2d 1140, 1151 (Del. 1990).

could only legally avoid liability by lying about its reasons.⁵² This seems wrong. More likely, just as in the famous *Shlensky v. Wrigley* case, if such a decision were ever necessary, a court could simply create its own shareholder-wealth-maximizing rationale for the company's actions, regardless of whether the directors considered it themselves.⁵³ In a real-world situation, the board would simply acknowledge that multiple reasons motivated their actions. Therefore, while Greenfield believes that shareholder primacy is the driving force behind corporate law today, it is not clear that corporations always adhere to that model, or that if they do, it is because they are constrained by law.

B. *Economic Rationales and Shareholder Primacy*

Notwithstanding the descriptive reality, it is interesting to see whether shareholder-wealth maximization is justified at the level of economic theory. Although it used to be justified on the basis of corporate ownership,⁵⁴ now the rationale is typically based on agency costs, ownership of the residual claims, and, most importantly, economic efficiency (p. 43). Greenfield is able to show the weakness of these arguments, in particular because they fail to adequately distinguish shareholders from workers.⁵⁵

1. *Agency Costs*

Agency costs result from directors' interests diverging from shareholders' interests for various reasons, including "differences in effort, time horizon, and risk aversion" (p. 48). Shareholders' agency costs are reduced, among other things, by product and employment markets, large shareholders monitoring performance, and the usually efficient capital markets that provide accurate pricing and the threat of a takeover. Corporate law may also reduce agency costs, notably by protecting fiduciary duties.

Workers, however, also face agency costs in that their future well-being depends on the efforts of senior management (p. 50). Agency costs may be even more important for workers than shareholders because for them exiting is more costly⁵⁶ and diversification is less likely. In addition, workers do not

52. Pp. 135, 179, 233–34. The book suffers from occasional repetitiveness, no doubt reflecting the book's origin in eight law review articles. P. x.

53. 237 N.E.2d 776, 780 (Ill. App. Ct. 1968) (speculating on reasons why it might have been a rational business decision not to play night baseball games).

54. The property-rights approach is something of a straw man. Greenfield notes that "[n]o prominent contemporary corporate law scholar uses property rights as the primary rationale for shareholder dominance. . . . [It] is rightly seen . . . as crude and analytically unsound." P. 47.

55. Others have noted that maximizing shareholder wealth is itself a weak guiding principle given the many differences among shareholders. See, e.g., Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 575–593 (2006).

56. Greenfield cryptically writes: "The efficient market also allows investors to sell their interest in firms whenever they hear that managers are failing to maximize profits. The liquidity of the security means that existing shareholders can dispose of their security before they suffer significant harm because of the managers' actions." P. 49. However, unless the shareholder has

enjoy the protection of anything equivalent to the antifraud protections of securities regulation, and unlike large investors, they are unlikely to have access to directors and senior management. Finally, a worker's "‘firm-specific’ skills make a worker more valuable to her present employer, but also make her more vulnerable to a firm's opportunistic behavior" because "no employee will leave as long as her present wage is higher than what she would make elsewhere" (pp. 52–53).

2. Residual Claims

A similar counterargument applies to the proposition that shareholders, as owners of the residual interest, have interests most aligned with the health of the enterprise itself and are therefore most likely to want to maximize the value of the firm over the long run. Workers also have, or may have, an unfixed claim on the firm, including explicit claims such as unfunded pension plans and implicit claims such as job security or access to promotions (p. 55). Workers, just like shareholders, are usually better off the healthier the company is.⁵⁷ What matters is not whether the claim is residual (the leftovers after the obligations to others have been satisfied), but whether the claim is unfixed and varies positively with the corporation's success (p. 55).

Shareholders' claims are also positively correlated with the firm's success; however, shareholders are able to diversify their portfolios and can thus be risk neutral with respect to individual investments. Undiversified workers, on the other hand, will care about the continuing existence of their jobs and are thus more likely to care about the continuing existence of the company. A corporation that takes into account employees' interests rather than simply following the shareholder-wealth-maximization model would generally face a lower insolvency risk (pp. 57–58). One obvious situation where this would not apply is when the company's survival is jeopardized by the cost of its workforce.⁵⁸ Accordingly, if a corporation's best interests include its survival, including workers' interests is more likely to ensure its survival, and shareholder primacy should be rejected (p. 58).

Greenfield may be right, but he does not address the different timeframes of workers and shareholders. Workers have no interest in the success of the corporation after their departure, or at least after they no longer have claims on the firm's assets. In contrast, shareholders want to

inside information, the market price of the security would also drop upon news of managers failing to maximize profits, and to the degree that the market is efficient, it will drop by the correct amount. A security's liquidity only guarantees an exit. It does not provide any guarantee of minimizing losses. (Enron stock was liquid even after its bankruptcy, albeit at a price a tiny fraction of previous prices.)

57. A successful company is likely a better place to work than an unsuccessful company, but success is not enough to make employment attractive, at least if the popular view of working at McDonald's or Wal-Mart is accurate.

58. See *infra* notes 91–97 and accompanying text.

maximize the value of the corporation, which includes all future earnings (albeit discounted to present value).⁵⁹

3. *Efficiency*

The most powerful reason for shareholder primacy is that shareholders appear willing to pay the most to control the corporation, and it is thus most efficient for them to do so. Greenfield notes that efficiency should not necessarily be the dispositive criterion, but is just one basis for policy along with nonutilitarian values (p. 67). People have values beyond bare economic self-interest and are “frequently motivated by their sense of fairness, connection to others, and ideas of duty” (p. 176). Even conceding efficiency as the criterion, the existing corporate regime may not accurately reflect the parties’ aggregate preferences. Labor markets are not as efficient as capital markets, meaning that pricing is much less accurate. In addition, the endowment effect may impact both shareholders’ willingness-to-accept and other stakeholders’ willingness-to-pay (p. 69),⁶⁰ if shareholders are viewed as the owners of the right of wealth maximization.

C. Alternatives to Shareholder Primacy?

If shareholder-wealth maximization should not be the sole norm, or should be “relaxed,” what should be added? It is not always clear that Greenfield is providing a workable alternative standard. Aggregate social welfare, including all externalities, is difficult to measure, potentially yielding widely varying estimates—and so difficult to maximize accurately. (Even a relatively narrow question, such as the impact of a minimum-wage increase on employment, yields studies with conflicting answers.)⁶¹ Thus, even if we think companies that extract “net wealth” from society should fail (p. 130), the calculations would be disputed. Nor is it clear that we want corporate directors making these socially oriented decisions.⁶² Even with the inclusion of stakeholder representatives,⁶³ boards are likely to lack

59. In the real world, short-term pressures on directors may outweigh shareholders’ theoretical longer-term interest. See MITCHELL, *supra* note 22, at 4–5.

60. The endowment effect is a type of status quo bias whereby people “often demand much more to give up an object than they would be willing to pay to acquire it.” Daniel Kahneman et al., *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, in CHOICES, VALUES AND FRAMES 159, 159 (Daniel Kahneman & Amos Tversky eds., 2000).

61. See, e.g., David Card & Alan B. Krueger, *Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Reply*, 90 AM. ECON. REV. 1397 (2000) (responding to criticisms of Card and Krueger’s study on the effect of a higher minimum wage).

62. *But cf.* Robert A. Katz, *Let Charitable Directors Direct: Why Trust Law Should Not Curb Board Discretion over a Charitable Corporation’s Mission and Unrestricted Assets*, 80 CHI.-KENT L. REV. 689 (2005) (arguing that a charitable corporation’s directors should have broad discretion regarding a charity’s operation and purpose).

63. See *infra* notes 72–85 and accompanying text.

representativeness and diversity. They also would be less accountable to the general public than legislators that face periodic elections.

Greenfield argues that distributing a corporation's wealth "fairly" among those who contribute to its creation should be the norm.⁶⁴ Leaving aside the key problem of determining a fair allocation⁶⁵—presumably most corporations would claim that they already do this—Greenfield claims that fair distribution would make firms more successful for two reasons.⁶⁶ First, stakeholders would be more willing to make valuable firm-specific investments,⁶⁷ and second, workers who "believe they are treated fairly tend to work harder, be more productive, obey firm rules more often, and be more loyal to their employers" (p. 144). According to Greenfield, paying more attention to fairness⁶⁸ would increase trust, improve productivity, and reduce agency costs (particularly monitoring costs) (pp. 158–70). More productive employees can, and should, be paid more, which would also help reduce income inequality (pp. 163–65).

If correct, Greenfield's assessment would yield fantastic results—the kind of reform that progressives and traditionalists alike would support. However, Greenfield fails to adequately explain why, if the fair distribution of corporate wealth results in such a win-win outcome, companies do not already engage in such practices. If Greenfield can work out these connections, why cannot profit-motivated managers work them out too? Specifically, where is the market failure? Greenfield has two somewhat inconsistent explanations. He claims that some firms are already following this model (p. 144). This is undoubtedly true but also suggests that legal

64. P. 143. Regardless of whether one agrees that shareholder primacy should be replaced, Greenfield's proposal that corporations should make relevant information available may be desirable. See Antony Page, *Taking Stock of the First Amendment's Application to Securities Regulation*, 58 S.C. L. REV. 789 (2007) (discussing disclosure's importance and limitations). Forcing corporations to "account for their social impact" could well lead corporate decision makers to "take a broader view of their responsibilities" P. 129. However, the market may already be providing much of this information without the requirement of new corporate law. In 2002, thirty-six percent of the top 100 U.S. companies published separate "social reports." 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, 497 (2005) (citing KPMG INTERNATIONAL SURVEY OF CORPORATE SUSTAINABILITY REPORTING 2002, at 14 (2002)). Changes in proxy-voting disclosure may also bring about more social disclosure. *Id.* at 526–30.

65. Michael Ross & Fiore Sicoly, *Egocentric Biases in Availability and Attribution*, in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 179, 179–80 (Daniel Kahneman et al., eds., 1982) (describing the "pervasive phenomenon" of individuals tending to claim more credit for a project than other contributors would give them).

66. Pp. 143–44. Greenfield goes so far as to note that "fairness is a key factor in the long-term success of the firm." P. 161.

67. See Blair & Stout, *supra* note 49, at 253 (arguing that boards exist to protect firm-specific investment of stakeholders).

68. Fair procedure, rather than solely favorable outcomes, determines the organization's legitimacy, and thus how committed employees are to the goals of the firm. Greenfield quotes Tom Tyler stating that "in organizational settings people are more concerned about experiencing justice than they are about receiving favorable outcomes or avoiding punishments." P. 161 (quoting Tom Tyler, *The Psychological Perspectives on the Behavior of Corporate Actors* 12 (1999) (unpublished manuscript, on file with author)). Outcomes do, however, affect how employees judge whether the process was fair. P. 162.

change may not be necessary. He also claims that risk-averse directors do not want to pioneer something new for uncertain, abstract gains.⁶⁹ It would seem, however, that if the firms following the model were particularly successful, directors would be able to see and imitate their practices.⁷⁰ In the face of the claimed clear advantages, Greenfield's proffered explanations for the stickiness of the status quo are unpersuasive. Regardless of any change in corporate law, companies would likely pursue fairness goals if they would really increase profitability.

III. CHANGING MEANS: SHARING STAKEHOLDER RIGHTS

Relaxing the corporation's goal is insufficient to maximize aggregate social welfare. The means by which corporations choose to distribute wealth must also be changed. Currently, as long as the corporation is solvent, corporate law gives shareholders, and no other stakeholders, the protection of directors' fiduciary duties⁷¹ and the sole right to elect directors.⁷² Greenfield would extend these benefits to other stakeholders, not only because it would make society better off, but also because it would make companies more profitable.⁷³ These changes would be "simple" but would have a "profound effect" (p. 148).

A. Fiduciary Duties

The fiduciary duties directors owe to shareholders are the duty of loyalty and the duty of care.⁷⁴ According to Greenfield, corporate law should extend these fiduciary duties to workers because workers are like shareholders in

69. P. 144. This assertion that directors are too risk averse is somewhat in tension with Greenfield's suggestion that directors are too risk seeking and thus jeopardize the existence of the corporation. See *supra* notes 58–59 and accompanying text.

70. Greenfield does not provide examples of firms that pursue fairness norms. Costco Wholesale, described as the "anti-Wal-Mart," is perhaps one example, paying its employees forty-two percent more than its rival Sam's Club and providing generous health benefits. See Steven Greenhouse, *How Costco Became the Anti-Wal-Mart*, N.Y. TIMES, July 17, 2005, at B1.

71. For an insolvent corporation, creditors have standing to pursue derivative claims against directors for breach of their fiduciary duties. *N. Am. Catholic Educ. Programming Found. v. Gheewalla*, 930 A.2d 92, 101–02 (Del. 2007).

72. Arguably shareholders do not benefit much from the right to elect the board. *E.g.*, Blair & Stout, *supra* note 49, at 310–11. Directors are nominated by the board and, absent a proxy contest, are typically elected as long as they receive at least one vote. A shareholder's right to withhold a vote is usually meaningless. In addition, corporations sometimes have supervoting stock, which keeps control of a corporation in private hands.

73. P. 137. Greenfield's most-realized proposal is that under federal law *employers* should not be permitted to lie to workers, just as they are not permitted to lie to the market. Pp. 187–216. He advocates a federal law similar to the SEC's rule 10b-5 antifraud provision, p. 215–16, and provides detailed critiques of possible objections. In particular, his market-failure story here is persuasive. Pp. 204–07. I do not address this proposal here because (1) space is limited, (2) it applies to all employers rather than only public corporations and thus is more appropriately a reform of employment law, and (3) if the duty of loyalty (which includes a duty of candor) were extended to employees there would be far less need for the change.

74. See, *e.g.*, *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

important ways. Both have long-term relational contracts. Workers may also have little bargaining power (pp. 63–64). Fiduciary duties may in fact be even more important in the corporation-employee relationship than the corporation-shareholder relationship because the former tends to be much more important to the employee than the latter is to the typical shareholder. In addition, employee-employer contracts may not be the result of voluntary participation (pp. 63–65).

Extending a duty of care to workers, however, would have little practical benefit. Although a duty to exercise reasonable care suggests a negligence standard, liability for breach of the duty of care actually depends on process because of the business-judgment rule⁷⁵—essentially, a board must only ensure that it is reasonably informed before making a decision.⁷⁶ In order to satisfy a duty of care to multiple stakeholders, a board would have to build a record demonstrating that it considered the interests of each. Additional process would not be costless,⁷⁷ but it seems unlikely to have much impact beyond more deliberation, or at least the creation of a record of more deliberation.

A duty of loyalty to workers would also fail to achieve Greenfield's ends. The core of a board's duty of loyalty is to avoid unfair self-dealing.⁷⁸ Adding parties to whom fiduciary duties are owed, and giving them standing to sue, would increase the number of monitors and thus might increase the quality of the monitoring (p. 139). On the other hand, shareholders are already motivated to detect instances of self-dealing. If substantially all instances of self-dealing are already detected, increasing the number of monitors will not result in improvement and might only increase aggregate monitoring costs.

Extending fiduciary duties to stakeholders other than shareholders may also lead to a perverse result. Greenfield responds dismissively to the argument that a corporate manager with more than one master “can play masters off one another, much as a child might play parents off one another. Instead of the child (the manager) owing a duty to obey both parents (shareholders, other direct stakeholders, and the public at large), the child will be loosed from obligation to either.”⁷⁹ The argument is not so much that a director will be loosed from *obligations*, but that the obligations would be unenforceable. For example, if one parent says, “Do your homework,” and another says, “Mow the grass,” the child is effectively unconstrained between those choices. Neither obligation is enforceable. (And if Grandma

75. See *supra* note 50 and accompanying text.

76. See, e.g., *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985).

77. See, e.g., *In re RJR Nabisco, Inc. S'holders Litig.*, Civ. A. No. 10389, 1989 WL 7036, at *19 (Del.Ch. Jan. 31, 1989) (noting that “information has costs”).

78. See DEL. CODE ANN. tit. 8, § 144(a) (2001) (providing a safe harbor for interested transactions that meet procedural hurdles).

79. P. 138. This parent/child analogy is flawed in that corporate managers have no duty to obey shareholders and would have no duty to obey other stakeholders if fiduciary duties were extended to them. Moreover, shareholders have no right to command directors.

then says the child can watch television . . .) Perhaps an even better analogy is to cast directors in the role of parents dividing ice cream between multiple children. They could divide the ice cream based on age, chore performance, broccoli consumption, or who is thinnest. Any distribution would be defensible and effectively unreviewable. If directors (parents) take more than their share for themselves—agency cost—that too is unreviewable.

Greenfield accepts that shareholders' and other stakeholders' interests will sometimes conflict, but he thinks managers can handle the increased responsibility (p. 138). The issue, however, is not about increased responsibility, but about having multiple evaluation criteria instead of one criterion. For example, assume the board is deciding whether to sign a new labor agreement. The decision whether or not to sign is the same regardless of the number of stakeholders to whom the directors owe fiduciary duties. The evaluation might shift from whether it is best for shareholders to whether it is best for some or all stakeholders, but the result is simply that the answer becomes more indeterminate. Greenfield never adequately addresses how these tradeoffs between stakeholders are to be made other than by a vague appeal to "procedural fairness" (p. 147) and a call for participatory corporate governance.⁸⁰

In a way, there is much less here than meets the eye. If fiduciary duties were extended, directors would become agents of all stakeholders. This may already be an accurate description of the corporate structure, as perhaps boards *already* perform the function of balancing all stakeholders' interests.⁸¹ After all, directors have long owed fiduciary duties to the corporation itself.⁸² In any case, director decision-making is already nearly unconstrained by corporate law, so little would change.⁸³ Here, at least, corporate law, other than through possible extralegal effects,⁸⁴ really may not matter.

B. Board Representation

Of course, just expanding fiduciary duties is insufficient. Stakeholders also need the right to put representatives on the board.⁸⁵ Greenfield boldly

80. See *infra* notes 83–86 and accompanying text.

81. See Blair & Stout, *supra* note 49, at 280–81 (comparing directors to stakeholder trustees or mediating hierarchs).

82. See *N. Am. Catholic Educ. Programming Found. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007) ("It is well settled that directors owe fiduciary duties to the corporation." (citing *Guth v. Loft, Inc.* 5 A.2d 503, 510 (Del. 1939))).

83. See *supra* notes 42–53 and accompanying text.

84. See, e.g., Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2021, 2024 (1996) ("I explore . . . the function of law in 'making statements' as opposed to controlling behavior directly."). For examples in the corporate context, see Jonathan C. Lipson, *The Expressive Function of Directors' Duties to Creditors*, 12 STAN. J.L. BUS. & FIN. 224 (2007); Rock & Wachter, *supra* note 20, at 1641.

85. Of course, stakeholders can elect directors if they obtain enough votes. This may become more important, as voting can now be accomplished independently of economic ownership. See, e.g., Henry T.C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership*:

claims that “[p]articipatory, [d]emocratic [c]orporate [g]overnance [i]s the [b]est [w]ay to [e]nsure the [s]ustainable [c]reation and [e]quitable [d]istribution of [c]orporate [w]ealth” (p. 146). Although he focuses on worker representation, he advocates broader representation by other stakeholders that might include communities, creditors, and “long-term business partners” (p. 149).

This proposal is interesting but unfortunately underdeveloped.⁸⁶ The uncertainty lies in the board’s composition and voting rules. Would shareholders’ directors still have a majority? Greenfield states that his proposal is about allowing stakeholders to “be heard at the decision-making level of the firm” (p. 149) and giving stakeholders a “meaningful way to participate in corporate decision making” (p. 242). However, he also suggests something more radical: “board[s] will be forced to compromise on a decision that is acceptable to a majority or plurality of stakeholders” (p. 151). If there must be compromise, nonshareholder stakeholders would, at a minimum, have veto power.⁸⁷ Having a voice is a very different matter from having the power to block or make substantive decisions. Even Germany’s system, the model of codetermination where employee representatives make up half of a large company’s supervisory board, gives the tie-breaking vote to management.⁸⁸

Greenfield believes that “in most cases, no stakeholder would have an incentive to hurt the company in order to gain a larger piece of the pie” (p. 150), but every decision involving the allocation of wealth (wages, subcontracting, capital structure, production methods, etc.) could involve such a conflict.⁸⁹ A larger piece of a smaller pie may well be attractive. Although the board might “benefit from a greater openness and diversity” (p. 152), the result might also be a factionalized board, able to perform its monitoring role but unable to adequately perform an advisory role.⁹⁰ In

Taxonomy, Implications and Reform, 61 BUS. LAW. 1011, 1014–15 (2006). In any case, various nonshareholder stakeholders have attempted to influence corporations as shareholders. The media reported that Bear Sterns debt holders tried to protect their interest by buying the stock, and thus the right to vote in favor of the JP Morgan takeover that would preserve the value of the debt they held. *See, e.g.*, Posting of Steven M. Davidoff to DealBook, <http://dealbook.blogs.nytimes.com/2008/04/13/anatomy-of-a-merger/> (Apr. 13, 2008, 21:56 EST).

86. To be fair, Greenfield recognizes that his proposal lacks specifics, p. 149, but presumably sees it as a starting point for discussion. Others have previously suggested similar solutions. *See, e.g.*, Abram Chayes, *The Modern Corporation and the Rule of Law*, in *THE CORPORATION IN MODERN SOCIETY* 25, 43 (Edward S. Mason ed., 1959). *See generally* Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, in *EMPLOYEES AND CORPORATE GOVERNANCE* 163 (Margaret M. Blair & Mark J. Roe eds., 1999).

87. A majority of the board is required to make a decision. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(b) (2001).

88. Springer, *supra* note 46, at 90.

89. *See, e.g.*, Steve Sleight, Book Review, 5 U. PA. J. LAB. & EMP. L. 215, 215–16 (2002) (observing that large corporations continued to have a “steady state of ongoing strife” even after employee ownership).

90. *See, e.g.*, Donald C. Clarke, *Three Concepts of the Independent Director*, 32 DEL. J. CORP. LAW 73 (2007); Antony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 11–13.

addition, even though directors would still owe fiduciary duties to all stakeholders and not merely those that they represent, their discretion would not be cabined because, under the business-judgment rule, there is little risk of legal liability regardless of the decision's merits. Furthermore, a director who failed to zealously support her constituency's interests would likely face reduced chances of reelection.

Overall, Greenfield's proposed means to better aggregate social welfare seem unlikely to achieve very much. Unconstrained directors would remain unconstrained and a board with directors representing stakeholders besides shareholders might well result in no change, or worse, even a less effectively run corporation. Given the success of the status quo, at least in creating wealth, we should be wary of change absent more persuasive reasons.

CONCLUSION

Greenfield includes stories of corporate mistreatment of employees, such as that of a New England shirtmaker (p. 237). He should also consider the story of Malden Mills, a Massachusetts textile mill.⁹¹ While nearly all northeastern textile companies had relocated for lower wages, Malden Mills stayed.⁹² During a Chapter 11 bankruptcy in the 1980s, the company had committed itself to the humane treatment of workers.⁹³ In 1995, however, a fire destroyed part of its factory, leading most of the 2900 employees to believe their jobs were lost.⁹⁴ The next day, the CEO announced that not only would they rebuild the factory, but also that they would continue to pay the employees' wages: "[w]e had the opportunity to run to the south many years ago. We didn't do it then and we're not going to do it now."⁹⁵ To Malden Mills, workers were an asset to be protected, rather than a cost to be eliminated.

Unfortunately, it could not last. Malden Mills again filed for Chapter 11 bankruptcy in 2001,⁹⁶ and finally Chapter 7 bankruptcy in 2007.⁹⁷ Although employees were no doubt enriched by Malden Mill's spirited fight, other stakeholders, notably the shareholders and creditors, were not.

We should be wary of changes to corporate law. Insolvency is only one threat. Globalization and privatization are others. Modifying corporate law, if it imposes significant costs on our publicly traded corporations, may simply drive them overseas, into private hands, or into other business forms.

91. Patricia H. Werhane & R. Edward Freeman, *Corporate Responsibility*, in THE OXFORD HANDBOOK OF PRACTICAL ETHICS 514, 514 (Hugh LaFollette ed., 2003).

92. *Id.*

93. ROBERT R. ULMER ET AL., EFFECTIVE CRISIS COMMUNICATION 73 (2007).

94. *Id.* at 73–74.

95. *Id.* at 74.

96. *Malden Mills Seeks Chapter 11 Bankruptcy Protection*, N.Y. TIMES, Nov. 30, 2001, at C4.

97. *Business in Brief*, BOSTON GLOBE, Apr. 4, 2007, at F2.

These unintended outcomes are unlikely to maximize social welfare in the United States.

In *The Failure of Corporate Law*, Greenfield tries to formulate new “rational” and “practical” principles of corporate law based on explicit recognition of society’s interests (p. 127). His aim is merely to be “sufficiently persuasive to bring into doubt the mainstream view” (p. 4). Greenfield’s book has admirably achieved this aim, even if he has not persuasively demonstrated his titular claim that corporate law has failed.