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Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers

Marleen A. O'Connor

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RESTRUCTURING THE CORPORATION'S NEXUS OF CONTRACTS: RECOGNIZING A FIDUCIARY DUTY TO PROTECT DISPLACED WORKERS

MARLEEN A. O'CONNOR*

As American corporations struggle to compete in international markets, they frequently use layoffs and plant closings as a means to cut costs. These changes may benefit the economy in the long run, but they profoundly destabilize the lives of millions of workers who have grown economically dependent on the relationships they have developed with their employers.

In this Article, Professor Marleen O'Connor argues that corporations should be legally responsible for alleviating the harsh effects that corporate restructuring has on employees. Specifically, she argues that directors should owe employees a fiduciary duty to provide adequate severance pay, job retraining, and other benefits to ease the transition dislocated workers face. Although the law does not now recognize such obligations, many states recently have enacted stakeholder statutes that allow directors to consider the interests of employees, suppliers, and customers when making business decisions. Professor O'Connor concludes that courts should rely upon these statutes, as well as general fiduciary principles, as a foundation for judicial intervention to ameliorate the impact corporate restructuring has on employees.

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* Assistant Professor of Law, Stetson University College of Law. B.S. 1984, DePaul University; J.D. 1987, Duke University School of Law. I would like to thank Thomas E. Allison, Stephen Bainbridge, Robert Batey, Susan Bingham, William Carney, Stuart Cohn, Alfred F. Conard, James Cox, Deborah DeMott, Michael P. Dooley, Richard Epstein, E. Allan Farnsworth, James E. Felman, James Hanks, Lyman Johnson, Duncan Kennedy, Mary LaFrance, Ian Mac Neil, Jonathan Macey, David Millon, Lawrence Mitchell, Gary Myers, Gerald P. O'Connor, Morgan Shipman, William Simon, Joseph Singer, Katherine Van Wezel Stone, Clyde Summers, Michael I. Swygert, Stephen Thel, and Gary Vause for their comments on this Article.

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Safeway Stores, Inc. once had a long-standing reputation as a benevolent employer that offered job security.[1] That perception changed in 1986 after Herbert and Robert Haft launched a hostile takeover attempt for Safeway.[2] Safeway avoided the takeover by increasing its indebtedness to $5.7 billion through a leveraged buyout with Kohlberg, Kravis, Roberts & Company.[3] Consequently, Safeway was forced to streamline its operations to meet its interest and principal payments. To minimize costs, Safeway eliminated 9,500 jobs through store sales and layoffs.[4] Experienced employees found themselves out of work after many years of service.[5] Financial analysts praised Safeway's restructuring as one of the more successful leveraged buyouts because the layoffs enhanced the company's profitability.[6] The workers had a very different impression of the buyout; the transaction profoundly disrupted many of their lives by defeating noncontractual expectations of continued employment.

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1. *See, e.g.*, Faludi, *The Reckoning: Safeway LBO Yields Vast Profits but Exacts a Heavy Human Toll*, Wall St. J., May 16, 1990, at A8, col. 2 (Safeway was a successful company that was gradually "thinning its work force with a program that included some layoffs but generally relied on less painful methods like attrition.").

2. After the leveraged buyout, Safeway replaced its motto "Safeway Offers Security" to "Targeted Return on Current Investment." *Id.* at A8, col. 1. Dart Group, Corp., which the Herbert and Robert Haft family owned, made $140 million in profits from the failed takeover bid. Mayer, *Hafts Drop Bid to Buy Safeway; Family Agrees to End Takeover Effort in Return for $59 Million*, Wash. Post, Oct. 22, 1986, at A1, col. 2.

3. *See, e.g.*, Kaletsky, *How Safeway Blazed a Trail*, Fin. Times, Aug. 2, 1989, at I10 (after refinancing, the company's debt-equity ratio was thirty-one to one).

4. *See, e.g.*, *Oversight Hearings on the Role of Pension Funds in Corporate Takeovers: Hearings Before the Subcomm. on Labor-Management Relations of the House Comm. on Education and Labor*, 101st Cong., 1st Sess. 233, 234 (1989) [hereinafter *Pension Hearings*] (statement of William J. Olwell, Executive Vice President, United Food and Commercial Workers International Union).

5. *See, e.g.*, Faludi, *supra* note 1, at A8, col. 4 (Safeway turned to part-time help to avoid medical insurance and other benefits.); Victor, *What About the Workers?*, 21 Nat'l J., Feb. 18, 1989, at 39 (One Safeway employee stated: "People that have worked for companies 20-30 years, and they shut down overnight and leave you out in the cold—its a very sad situation.").

The United Food and Commercial Workers International Union (UFCW), the largest union in the AFL-CIO, was almost powerless to help its members. Safeway refused to negotiate the possible sale of stores or to discuss the terms of the buyout with the union. *Id.* The union contract did not provide for severance payments and the union did not have much leverage to negotiate severance payments after the layoffs. The Dallas employees, with an average of seventeen years of service, received severance pay of one-half of one week's pay for each year of employment up to eight weeks. Faludi, *supra* note 1, at A8, col. 5. Sixty percent of these workers had not found full-time employment one year after the layoff. *Id.*

6. *See, e.g.*, Farrell, *LBOs: The Stars, the Strugglers, the Flops*, BUS. WK., Jan. 15, 1990, at 58 (increased operating profit margins were due in large part to using the leveraged buyout and the threat of store sales and closings to force concessions from the employees); Fisher, *Safeway Buyout: A Success Story*, N.Y. Times, Oct. 21, 1988, at D1, col. 3 (Safeway sold assets and reduced labor costs to decrease debt, and "walk[ed] a labor relations tightrope."); Kaletsky, *supra* note 3, at I10 (crucial factor in success was reducing average labor costs from 14.1% of gross sales to 11.2%).

The Safeway buyout represents the pattern that many corporations followed during the 1980s when an unprecedented number of corporations increased their leverage to ward off or finance takeovers.[7] These buyouts dramatically illustrate that corporate restructuring extracts severe social costs.[8] Although restructuring may result in long-term benefits for the economy, the issue arises whether a more equitable and efficient transition policy should be developed to aid employees faced with job dislocation.[9] Specifically, the question of an appropriate transition strategy involves whether corporations should be legally responsible to their employees for mitigating the harsh consequences of layoffs and plant closings.

In the past, employees who suffered from layoffs and plant closings had no legal remedy against their employers.[10] Recently, however, Congress and state legislatures have enacted statutes to alleviate the problem.[11] In 1988, Congress

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7. *See, e.g.*, Farrell, *supra* note 6, at 58 (In the 1980s, 2,800 companies engaged in leveraged buyouts totalling $235 billion and averaging nine dollars of debt for every one dollar of equity). In the largest of these deals, Kohlberg, Kravis, Roberts & Co. won the contest for control of RJR Nabisco, Inc., increasing its indebtedness from $5 billion to $20.1 billion. For a detailed description of this transaction, see DeMott, *Introduction—The Biggest Deal Ever*, 1989 DUKE L.J. 1 (symposium).

8. During the later phases of the takeover era, with an increase in bust-up takeovers, the takeover debate shifted from the traditional concern for shareholders to concern for stakeholders. *See, e.g.*, Coffee, *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups*, 1988 WIS. L. REV. 435, 447 (1988) [hereinafter Coffee, *Takeover Reform*] (recognizing an "important paradigm shift" that "moves the focus of the debate away from the law's usual concern with reducing 'agency costs' to protecting the interests of stakeholders"); Gilson, *Just Say No to Whom?*, 25 WAKE FOREST L. REV. 121, 121 (1990) ("The focus has moved from claims that blocking an offer benefits shareholders, to the very different claim that management is warranted in blocking an offer even if doing so is detrimental to shareholders.").

9. *See, e.g.*, B. BLUESTONE & B. HARRISON, THE DEINDUSTRIALIZATION OF AMERICA: PLANT CLOSINGS, COMMUNITY ABANDONMENT, AND THE DISMANTLING OF BASIC INDUSTRY 46-48 (1982); Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 8 (1986) [hereinafter Coffee, *Corporate Web*] ("[A]brupt transitions usually produce casualties, and a recurring concern of the law has been how to cushion the impact of such transitions, either by slowing their pace or offering compensation."); Ryan, *Corporate Directors and the "Social Costs" of Takeovers—Reflections on the Tin Parachute*, 64 TUL. L. REV. 3, 6 n.3 ("The eventual reality of long-term improvements, however, can do little to mitigate the short-term consequences for workers affected by a restructuring, because essentials such as food, clothing, shelter, and education are short-term needs requiring a steady cash flow.").

10. *See, e.g.*, Local 1330, United States Steel Workers of Am. v. United States Steel Corp., 631 F.2d 1264, 1282-83 (6th Cir. 1980) (labor union has no legal right to purchase steelworking plants from employer to prevent shutdown). Professor Singer has written a thorough criticism of this opinion. *See* Singer, *The Reliance Interest in Property*, 40 STAN. L. REV. 611 (1988).

11. Several commentators also have noted that employees and others may be hurt in leveraged buyouts and that measures should be taken to discourage these transactions. *See, e.g.*, Bebchuck, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693, 1793 (1985); Law, *A Corporation Is More Than Its Stock*, HARV. BUS. REV., May-June 1986, at 80, 83; Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 105-06, 117, 122 (1979); Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 36-42 (1987) [hereinafter Lipton, *Corporate Governance*]; Steinbrink, *Management's Response to the Takeover Attempt*, 28 CASE W. RES. 882, 899-900 (1978); *see also* Johnson, *Corporate Takeovers and Corporations: Who Are They For?*, 43 WASH. & LEE L. REV. 781, 803 (1986) [hereinafter Johnson, *Who Are They For?*] (proper for corporation to repurchase shares to prevent takeover to protect customers, employees, and others); Millon, *State Takeover Laws: A Rebirth of Corporation Law?*, 45 WASH. & LEE L. REV. 903, 908 (1988) (discussing the historical development of corporate power with regard to the ultra vires doctrine and other limitations); Note, *State Takeover Statutes and Corporate Theory: The Revival of an Old Debate*, 64 N.Y.U. L. REV. 806, 806 (1989) (raising the old question: "[W]hat is a corporation?"). In contrast, some commentators have argued that takeovers should not

adopted the Worker Adjustment and Retraining Notification Act (WARN), which requires employers to give advance notification of mass layoffs and plant closings.[12] Several states also require notice and severance pay in plant closings.[13] In addition to these direct measures, most state legislatures have provided an indirect source of assistance to workers through antitakeover laws.[14] More than forty states rushed to enact several types of statutes designed to discourage takeovers perceived to threaten layoffs and plant closings.[15] Specifically, over one-half of the states have enacted "stakeholder" statutes which provide directors with more leeway to resist takeovers by allowing them to consider the interests of employees, suppliers, customers, and other nonshareholder constituents in making business decisions.[16]

To date, the courts have not examined the scope of the stakeholder statutes.

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be impeded to benefit nonshareholder constituents. *See, e.g.*, Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 862-65 (1981).

12. Worker Adjustment and Retraining Notification Act (WARN), 29 U.S.C. § 2101 (1988) (requires 60-days notice prior to layoffs of 50 or more employees by an employer of 100 or more employees). For a detailed description of WARN, see *Remarks of John S. Irving on Plant Closings Before NAM Conference*, Daily Lab. Rep. (BNA) Oct. 26, 1988, at D-1. For an analysis of the effects of WARN, see *Studies Conclude Advance Notice Reduces Duration of Workers' Unemployment Spells*, Daily Lab. Rep. (BNA) Feb. 8, 1989, at A-10 (notice facilitates labor market adjustments by allowing workers to find jobs prior to displacement). *But see* Herz, *Worker Displacement in a Period of Rapid Job Expansion: 1983-87*, 113 MONTHLY LAB. REV., May 1990, at 21, 28-29 (WARN may have little impact on length of unemployment).

13. CONN. GEN. STAT. §§ 31-51o (1989) (companies with 100 or more employees required to continue health benefits for 120 days following a closing or relocation); HAW. REV. STAT. §§ 394B-9 to -10 (Supp. 1990) (companies with 50 or more employees required to provide 45-days notice of a relocation or closing and severance pay equal to the employees' weekly pay less unemployment benefits); ME. REV. STAT. ANN. tit. 26, § 625-B (1988) (businesses with 100 full-time workers required to give 60-days notice and one-week's severance pay for every year of service); S.C. CODE ANN. § 41-1-40 (Law. Co-op. 1986) (companies required to provide two-week notice if the company requires worker to give advance notice); TENN. CODE ANN. § 50-1-602 (Supp. 1990) (companies employing more than 50 employees required to give notice); WIS. STAT. ANN. § 109.07 (West Supp. 1990) (companies with 100 or more workers required to give 60-days notice).

14. Professor Coffee asserts:

> [S]tate legislation regulating corporate governance in order to prevent corporate flight arguably achieves what might otherwise be invalidated on either preemption or interstate commerce grounds if the same goals were pursued explicitly through plant closing legislation (or by any other means that sought to embargo the transfer of jobs or assets out of state).

Coffee, *Takeover Reform*, *supra* note 8, at 437-38. For a discussion of the preemption issue, see Note, *NLRA Preemption of State and Local Plant Relocation Laws*, 86 COLUM. L. REV. 407, 414-25 (1986).

15. Coffee, *Takeover Reform*, *supra* note 8, at 437 n.8 (discussing how a "perceived crisis" may lead to state legislatures hastily passing legislation). For further discussion of state anti-takeover legislation, see *infra* notes 288-326 and accompanying text.

16. *See infra* notes 288-326 and accompanying text. Economist Kenneth Arrow defines "stake" as follows:

> [A] value from which one is not shielded by the market nor shielded by the existence of alternative opportunities. . . . [E]mployees are, to some extent, locked into a firm as indeed a firm is locked into its employees. Therefore, the employees can suffer from the firm's failure, not only the firm's failure to deal adequately with the labor situation, but even when the firm's failure in product markets creates a loss to the individual workers.

Arrow, *The Multiple Responsibilities of a Corporation*, in THE FIRST INTERNATIONAL SYMPOSIUM ON STAKEHOLDERS 53, 59 (J. Weiler, ed., Univ. of Dayton, School of Business Admin., June 1988) [hereinafter First Internatioanl Symposium]; Freeman & Reed, *Stockholders and Stakeholders: A New Perspective on Corporate Governance*, 25 CAL. MGMT. REV. 88, 89 (1983) (stakeholder term

Thus, the extent to which they will protect nonshareholder interests remains uncertain. Although state legislatures enacted these statutes to provide management with greater discretion to defend against hostile takeovers, most of the statutes are worded broadly enough to encompass any business decision. The stakeholder statutes have been described as "revolutionizing"[17] corporate law because they may allow directors to pursue objectives other than shareholder wealth maximization. Hence, the stakeholder statutes may alter significantly the legal model of the corporation.

This Article analyzes the implications of the stakeholder statutes for the problem of worker dislocation resulting from layoffs and plant closings.[18] The Article develops a stakeholder model of corporate social responsibility that recognizes that employees have legitimate noncontractual claims against the corporation. Under this model, the directors' fiduciary duty is not viewed narrowly as an obligation only to maximize the shareholders' wealth. Rather, the model expands directorial fiduciary duties to encompass actions that shield workers from disruptions brought about by plant closings and other corporate changes. Such fiduciary duties toward workers would require directors to provide adequate severance payments, job retraining, and other appropriate relief to displaced workers.

Part I of this Article examines the causes and consequences of layoffs and plant closings. This Part then explores how the stakeholder statutes parallel a new economic theory of the firm called the "nexus of contracts" theory. The nexus of contracts theory regards the firm as a set of mutually dependent relationships among various corporate constituents such as shareholders, employees, suppliers, customers, and the community. Next, Part I analyzes the nature of the employees' relationships with the corporation. Labor economists explain that employees tend to develop long-term attachments to corporations under implicit contracts. Under these arrangements, employees accept lower wages in

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"coined in an internal memorandum at the Stanford Research Institute in 1963, refers to 'those groups without whose support the organization would cease to exist.' ").

17. Hanks, *Non-Stockholder Constituency Statutes: An Idea Whose Time Should Never Have Come*, 3 INSIGHTS 20, 22 (Dec. 1989).

18. While other stakeholders suffer injury from corporate restructuring, it is appropriate to concentrate on nonmanagerial employees because they are usually the most vulnerable constituency and they have the most direct relationship with the corporation. M. AOKI, THE CO-OPERATIVE GAME THEORY OF THE FIRM 122-23 (1984) ("[S]ince the employees' body is the most enduring and readily identifiable constituency of the firm, the inclusion of the employees in the model is a first step towards a more complete theory of corporate firms."). In addition, an adverse impact on employees tends to have a multiplier effect on other nonshareholder constituents who rely on the corporation. *See, e.g.*, B. BLUESTONE & B. HARRISON, *supra* note 9, at 67-72; Millspaugh, *Plant Closings and the Prospects for a Judicial Response*, 8 J. CORP. L. 483, 484-86 (1983).

This Article focuses on large corporations that employ a substantial number of people. These corporations are the most likely to provide insurance to employees in terms of implicit contracts. *See infra* text accompanying notes 98-100. One commentator asserts:

> If the rationale of non-stockholder constituency statutes—that return on equity should be shared with all who help to produce it even if they have already been compensated in accordance with statutory rights—is sound, then why limit it to corporations? Why not extend it to partnerships, trusts, and even sole proprietorships?

Hanks, *supra* note 17, at 25. The theories presented in this Article may apply to other business associations as well; such a discussion, however, is beyond the scope of this Article.

return for a degree of job security. This discussion reveals that a significant source of shareholder gains in corporate restructuring may result from opportunistic breaches of the corporation's implicit contracts with its employees.

Recently, Professor Macey recognized that plant closings and other corporate changes exploit nonmanagerial employees.[19] According to Professor Macey, these employees should form unions to bargain for protection.[20] Exactly why private contracts should be deemed sufficient and whether a more efficient and equitable means of safeguarding the interests of employees exists are questions that the corporate law literature has not addressed.[21] Accordingly, this Part then explores how practical and legal restrictions impede the employees' ability to negotiate for contractual restrictions against corporate opportunism. Part I concludes that collective bargaining and traditional corporate governance schemes are inadequate to cope with the losses that fall on employees brought by corporate restructuring events that are necessary in a changing economy.

Part II reviews how courts and legislatures have responded to the social costs of corporate restructuring by allowing directors to consider the interests of nonshareholder constituents. Although these changes are significant, Part II concludes that these developments are inadequate because management may weigh the employees' expectations only when the directors' interests conflict with those of the shareholders. For corporate law to achieve the goal of protecting employees while holding directors accountable, it must recognize that directors have fiduciary duties to protect displaced workers.

Part III turns to the normative question of whether corporate fiduciary law

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19. Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173, 188, 191-97 (responding to Coffee, *Corporate Web, supra* note 9, and Singer, *supra* note 10). Professor Coffee has argued that takeovers and leveraged buyouts hurt managers and others whose expectations deserve protection. Coffee, *Takeover Reform, supra* note 8, at 448-50; Coffee, *Corporate Web, supra* note 9, at 73-75; Professor Coffee, however, would limit this relief to managers who are likely to have deferred compensation and developed firm-specific expertise over the years in exchange for continued employment. Coffee, *Takeover Reform, supra* note 8, at 446-47, 454-58; Coffee, *Corporate Web, supra* note 9, at 73-86. This Article disagrees with Professor Coffee's assertion that "lower-level" employees do not merit this protection. *See infra* notes 166-72 and accompanying text.

20. While Professor Macey prefers a private contractual solution, he states that if a public law solution was necessary, severance pay legislation might be the most appropriate response. Macey, *supra* note 19, at 195. At one point, however, he does recognize that "courts should be sensitive to the possibility of opportunistic behavior by plant owners." *Id.* at 193 & n.76.

21. For this Article's response to Professor Macey's argument that workers should form unions to gain protection, see *infra* notes 173-209 and accompanying text. Professor Macey lists five other reasons why the private contracting solution is better than government regulation. A corresponding citation is provided for this Article's answer to each of these points. For response to Professor Macey's belief that a public law solution would discourage corporate investment, Macey, *supra* note 19, at 195, see *infra* notes 498-523 and accompanying text. For response to Professor Macey's assertion that government regulation would create moral hazard problems, Macey, *supra* note 19 at 193-94, see *infra* notes 416-22 and accompanying text. For response to Macey's statement that the legislative process is inefficient because it is influenced by powerful interest groups, Macey, *supra* note 19, at 175, see *infra* note 510 and accompanying text. In addition, for response to Professor Macey's argument that the problems posed by shareholders' engaging in opportunistic conduct are too diverse for a public law solution, Macey, *supra* note 19, at 193, see *infra* notes 517-19 and accompanying text. Finally, for response to Macey's argument that a public law response would hurt employees because they would be forced to purchase this right by giving up other rights, Macey, *supra* note 19, at 194-95, see *infra* notes 409-13 and accompanying text.

should be expanded to encompass the interests of employees. This Part evaluates the corporate objective by exploring the nature of the corporation's implicit contract with its employees using free market and relational contract perspectives. In contrast to the free market analysis, the relational contract view recognizes that employees should be compensated for the significant investments they make in corporations.

Part IV compares the potential costs and benefits of recognizing a fiduciary duty to protect employees with legislative proposals to modify corporate behavior. Recognizing a fiduciary duty to workers during corporate restructurings is efficient because opportunistic conduct and the remedies to compensate for such behavior can best be identified ex post on a case-by-case basis. This theory leads to the Article's conclusion that the corporation's nexus of contracts should be restructured to recognize that directors have fiduciary duties to mitigate the effects of layoffs and plant closings upon displaced workers.

I. WORKER DISPLACEMENT AND THE NEXUS OF CONTRACTS THEORY OF THE CORPORATION

A. *The Impact of Corporate Restructuring on Labor*

1. Layoffs, Plant Closings, and the Displaced Worker

Extensive layoffs and plant closings have focused national attention on the problems of displaced workers.[22] The current restructuring era differs from prior periods of economic change in at least two respects. First, the impact of plant closings and layoffs is more widespread than in the past few decades.[23] Increasingly, industries with low-margin operations are forced to close plants and lay off workers to avoid labor costs.[24] Yet even large, healthy companies such as Safeway and RJR Nabisco have been compelled to take such measures.[25] Second, the economy is undergoing a "deindustrialization"[26] process that will continue to cause a steady displacement of workers.[27] Thus, this restructuring era may last much longer than previous periods because corporations need to take drastic measures to remain competitive in the face of growing

22. For an extended discussion of plant closings, see F. O'CONNELL, PLANT CLOSINGS: WORKERS' RIGHTS, MANAGEMENT RIGHTS AND THE LAW (1986); Bureau of National Affairs, *Plant Closings: The Complete Resource Guide* (1988).

23. *See, e.g.*, Bennett, *Is Your Job Making You Sick?*, Wall St. J., Apr. 22, 1988, § 3 (Medicine & Health), at 1R, 11R ("Fortune 500 companies alone have eliminated almost 2.8 million jobs since 1980—a million of them managerial."); Herz, *supra* note 12, at 21, 26 (plant closings much more common reason for job loss in 1988 than in 1984).

24. *See* Di Norcia, *Let's Restructure Labor, Too*, in THE ETHICS OF ORGANIZATIONAL TRANSFORMATION: MERGERS, TAKEOVERS, & CORPORATE RESTRUCTURING 245, 246-48 (W. Hoffman, R. Frederick & E. Petry eds. 1987) [hereinafter ETHICS]; Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 867-68 (1990) [hereinafter Johnson, *Corporate Life*]; Sethi & Bhalla, *Demanagerialization of U.S. Industry: Corporate Restructuring, Mergers and Acquisitions, and Displacement of Managerial Level Employees*, in ETHICS, *supra*, at 203, 205-06.

25. *See infra* notes 70-72 and accompanying text.

26. B. BLUESTONE & B. HARRISON, *supra* note 9, at 6 ("By *deindustrialization* is meant a widespread, systematic disinvestment in the nation's basic productive capacity.").

27. *See infra* notes 65-72.

international competition.[28]

Analysis of the effects of this phenomenon upon workers requires consideration of several factors. First, the overall decline in employment from layoffs and plant closings must be examined. According to the Bureau of Labor Statistics' 1988 report on worker displacement, layoffs and plant closings lead to a high incidence of job loss. This report reveals 9.7 million employees lost their jobs between 1983 and 1988 as a result of layoffs and plant closings.[29] Approximately 4.7 million of these workers had held their jobs over three years.[30] The largest number of displaced workers, forty percent, held jobs in manufacturing.[31] The 1988 report also shows a decrease in the past two years in displacement among operators, fabricators, and laborers, but a slight increase in the number of workers losing technical, sales, and administrative support jobs.[32]

Second, a review of the consequences of the deindustrialization era requires an appraisal of the ability of workers to readjust after the permanent loss of their jobs. Workers who lose their jobs to layoffs and plant closings spend an average of eight weeks trying to find other jobs.[33] Several factors influence the length of unemployment, including geographic region, economic conditions, skill level, age, race, and gender. Generally, labor is relatively immobile over markets because workers are unwilling to move to other areas following the loss of their jobs.[34] The geographic region[35] and general economic conditions also influence

28. B. BLUESTONE & B. HARRISON, CAPITAL AND COMMUNITIES: THE CAUSES AND CONSEQUENCES OF PRIVATE DISINVESTMENT 57 (1980) (root of plant closure crisis is the great speed with which capital is moved around the world).

29. BUREAU OF LABOR STATISTICS, REPORT ON DISPLACED WORKERS, 1 (1988) [hereinafter LABOR REPORT]. For analysis of this report, see Herz, *supra* note 12 at 21; *As Economy Grew Since '83, Closings and Layoffs Took 9.7 Million Jobs*, N.Y. Times, Dec. 13, 1988, at B12, col. 1 [hereinafter *As Economy Grew*]; *see also* Horvath, *The Pulse of Economic Change: Displaced Workers of 1981-85*, 110 MONTHLY LAB. REV., June 1987, at 3, 7 (surveying period from 1981 through 1985, 10.8 million displaced workers; almost half worked for three years or more with one-third of that number having at least ten years on the job). For an overview of individual cases, see B. BLUESTONE & B. HARRISON, *supra* note 9, at 51-55.

30. LABOR REPORT, *supra* note 29, at 1; Herz, *supra* note 12, at 22.

31. LABOR REPORT, *supra* note 29, at 2; Herz, *supra* note 12, at 24; *As Economy Grew*, *supra* note 29, at B12, col. 4 (slight decline from 50% shown in 1986 survey).

32. LABOR REPORT, *supra* note 29, at 2; Herz, *supra* note 12, at 25.

33. Herz, *supra* note 12, at 28-29 (average slightly over eight weeks, but older workers suffer 10.5 weeks of unemployment); Horvath, *supra* note 29, at 8 (median duration of unemployment 13 weeks for workers reemployed by January, 1986; older workers and those unemployed in January, 1986 had longer periods of unemployment); *see also* Rosen, *Implicit Contracts: A Survey*, 23 J. ECON. LIT. 1144, 1171 (1985) (Workers have difficulty finding jobs because "[i]nformation gathering and job search activities are costly and cannot be a matter of common knowledge by the idiosyncratic nature of job-worker matches.").

34. Herz, *supra* note 12, at 30 (one out of six displaced workers moves to another city or country to find employment; figures slightly higher than previous survey); Horvath, *supra* note 29, at 10; *see also* Podgursky & Swaim, *Job Displacement and Earning Loss: Evidence from the Displaced Worker Survey*, 41 INDUS. & LAB. REL. REV. 17 (1987) (survey used to examine post-displacement experience of large sample of workers); Ruhm, *The Economic Consequences of Labor Mobility*, 41 INDUS. & LAB. REL. REV. 30 (1987) (examining the impact of labor mobility on earnings).

35. LABOR REPORT, *supra* note 29, at 2 (900,000 displaced workers in midwestern states). The 1986 survey demonstrated that the East North Central area—Illinois, Indiana, Michigan, Ohio, and Wisconsin—suffered the most, with 1.1 million displaced workers. Horvath, *supra* note 29, at 6. Sixty-five percent found employment as of January 1986, yet almost one-third had been without work for six months or more. *Id.*

the probability of finding new employment.[36] Similarly, as the workers' skill level increases, the duration of unemployment decreases.[37] Statistically, employees losing managerial and professional positions have a much better chance of finding other jobs than displaced operators, fabricators, and laborers.[38] To a considerable extent, the hardship visits disproportionately on older workers with years of dedicated service.[39] Their only alternative may be early retirement, although they may not be eligible for livable pensions.[40] Blacks, Hispanics, and women also experience longer periods of unemployment from job displacement than white males.[41]

Third, an analysis of the impact of the current restructuring phase must take into account the severe consequences that long periods of unemployment have on workers. Displaced workers often lose their health and pension benefits.[42] In addition, they may not find jobs until well after they exhaust their unemployment payments and savings.[43] As a result, displaced workers are often forced to lose their homes to mortgage foreclosures and to rely upon public welfare.[44] Under these circumstances, unemployment often causes serious psychological and medical problems.[45]

Fourth, when displaced workers find employment, the new positions do not provide them as much income or status. The 1988 report reveals that forty-four percent of displaced workers earn less income from their new jobs.[46] Specifically, thirty percent of the workers were compelled to accept wage losses of twenty percent or more.[47] Workers with large investments in firm-specific skills experience substantial declines in earnings.[48] In addition, once displaced workers find new jobs, they are still vulnerable to job loss because they do not have

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36. Herz, *supra* note 29, at 22 (portion of re-employed workers improved considerably in 1988 as compared to 1984).

37. *See, e.g.*, Horvath, *supra* note 12, at 6 (Table 3); *see also* B. BLUESTONE & B. HARRISON, *supra* note 9, at 59.

38. Horvath, *supra* note 29, at 5 (three out of four persons who lost managerial jobs were reemployed in January 1986; fewer than two out of three of the displaced operators, fabricators, and laborers had been able to find new jobs).

39. Herz, *supra* note 12, at 23-24 (1988 survey shows nearly one in three of displaced workers ages 55 to 64 lost jobs held for 20 years or more); Horvath, *supra* note 29, at 7 (1986 survey shows nearly two-fifths of displaced male workers age 55 and over held jobs for 20 years or more). Older workers do have some protection in that layoffs are usually on a last-hired, first-fired basis. Cornfield, *Seniority, Human Capital, and Layoffs: A Case Study*, 21 INDUS. & LAB. REL. L. REV. 352, 352-54 (1982).

40. *See, e.g.*, Horvath, *supra* note 29, at 4 ("Unplanned early retirements often seem to be the only choice for many of the older displaced workers.").

41. *See, e.g.*, Herz, *supra* note 12, at 23; Horvath, *supra* note 29, at 4.

42. *See, e.g.*, Herz, *supra* note 12, at 30 (large number of workers no longer covered by group health insurance); Podgursky & Swaim, *Health Insurance Loss: The Case of the Displaced Worker*, MONTHLY LAB. REV., April 1987, 30, 30.

43. Herz, *supra* note 12, at 29 (more than half of the workers receiving unemployment insurance exhausted benefits).

44. B. BLUESTONE & B. HARRISON, *supra* note 9, at 62.

45. *See id.* at 63-66.

46. LABOR REPORT, *supra* note 29, at 1.

47. Herz, *supra* note 12, at 31.

48. *See* B. BLUESTONE & B. HARRISON, *supra* note 9, at 58-59; Lipsky, *Interplant Transfer and Terminated Workers: A Case Study*, 23 INDUS. & LAB. REL. REV. 191, 197 (1970); Podgursky & Swaim, *supra* note 34, at 27.

seniority.[49]

Finally, and perhaps most importantly, recent corporate restructuring has brought about a sudden change in labor relations as corporations once known for job security are forced to lay off workers.[50] In the past, corporations slowly restructured their workforces by waiting for attrition; currently, corporations seek to accelerate the timetable to reduce the workforce to the lowest possible level.[51] In the process, many corporations display a diminishing regard for employees.[52] Corporations use increasing concerns about high debt levels and foreign competition to release large numbers of workers, and then use the layoffs as a pressure tactic to force wage concessions.

2. Takeover-Related Restructuring and Job Loss

The takeover phenomenon aided in focusing national attention on workers' vulnerability to layoffs and plant closings. The collapse of the junk-bond market, however, has lessened the pressure to engage in finance-related restructuring.[53] Nonetheless, employees continue to be injured in the aftermath as more cost-conscious management reduces labor expenses by closing or relocating plants, selling divisions, and imposing cutbacks.

Analysis of the impact of takeovers on labor is complicated by the controversy surrounding the causes of hostile takeovers and whether they benefit the economy.[54] Statistical research has concentrated on corporations' stock prices to determine the effect takeovers have on shareholders.[55] This research indi-

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49. B. BLUESTONE & B. HARRISON, *supra* note 9, at 37.

50. *See, e.g.*, Buono & Bowditch, *Ethics and Transformation Tactics: Human Resource Considerations in Mergers and Acquisitions*, in ETHICS, *supra* note 24, at 125, 126.

51. *See, e.g.*, B. BLUESTONE & B. HARRISON, *supra* note 9, at 35 (Corporate managers confront an "unprecedented profit squeeze associated with intensified international competition and chronic stagflation."); Donaldson, *Corporate Takeovers: The Moral Backdrop*, in ETHICS, *supra* note 24, at 3, 12 ("[C]ost-conscious corporate acquirors tend to reduce labor costs more vigorously than existing management.").

52. *See, e.g.*, Newton, *Takeovers, Makeovers, and Destruction: The Ethics of Corporate Transformation*, in ETHICS, *supra* note 24, at 27, 30; Buono & Bowditch, *supra* note 50, at 141 ("The lack of respect for employees as individuals . . . is exemplified in such tactics as deceiving them about job security after the merger, ignoring their personal rights and cultural orientations during the integration period, using coercive strategies to force change, and so forth.").

53. *See, e.g.*, Nathans & Gleckman, *This Year, LBO Means Let's Back Off*, BUS. WK., May 8, 1989, at 123 (the fall of Drexel Burnham Lambert caused hostile takeovers, and thus leveraged buyouts, to decrease dramatically). *But see* Moore, *KJR is Rolling with the Punches*, U.S. NEWS & WORLD REP., May 7, 1990, at 49 ("The demise of leveraged buyouts may prove greatly exaggerated.").

54. *See, e.g.*, Fortier, *Hostile Takeovers and the Market for Corporate Control*, ECON. PERSP., Jan.-Feb. 1989, at 2, 11-12 (empirical data does not clearly demonstrate efficiency gains); Weidenbaum & Vogt, *Takeovers and Stockholders: Winners and Losers*, 24 CAL. MGMT. REV. 157, 159 (1987) (same).

55. *See, e.g.*, Jensen & Ruback, *The Market for Corporate Control*, 11 J. FIN. ECON. 5, 29-42 (1983) (examining the effects of aquisitions based on stock prices); Magenheim & Mueller, *Are Acquiring-Firm Shareholders Better Off After An Acquisition?*, in KNIGHTS, RAIDERS, AND TARGETS 171 (J. Coffee, L. Lowenstein, & S. Rose-Ackerman eds. 1988) [hereinafter KNIGHTS, RAIDERS, AND TARGETS] (studying the effects of acquisitions based on returns to acquiring firm shareholders); Herman & Lowenstein, *The Efficiency Effects of Hostile Takeovers*, in KNIGHTS, RAIDERS, AND TARGETS, *supra*, at 211 (criticizing the reliance on stock price data and offering an alternative based on profitability).

cates that shareholders earn large premiums in takeovers, although the sources of these premiums are unknown.[56] The more important consequences of takeovers, however, may stem from companies' increasing their leverage to avoid takeovers.[57]

Recently, economists have begun to examine the impact that takeover-related transactions have on employees. At this point, little empirical research exists to determine whether employees are better or worse off as a result of changes in corporate control.[58] In one statistical study, Professors Brown and Medoff found that wages and employment increase slightly after corporate acquisitions.[59] They concluded that "the common public perception that acquisitions provide the occasion to slash wages and employment finds little support."[60] Although this study frequently is cited as demonstrating that takeovers do not hurt employees,[61] the Brown and Medoff report fails to substantiate that proposition. The report's findings are highly suspect because they focus on friendly acquisitions of small companies in the state of Michigan.[62] Other estimates of the impact of the takeover phenomenon on labor are questionable because they are made by interested parties. According to union estimates, "hundreds of thousands" of workers have lost jobs due to takeovers this past

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56. *See, e.g.*, Jarrell, Brickley & Netter, *The Market For Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSP. 49, 51-53 (1988); Jensen & Ruback, *supra* note 55, at 5.

57. *See, e.g.*, Coffee, *Corporate Web*, *supra* note 9, at 41.

58. *Impact on Workers of Takeovers, Leveraged Buyouts, Corporate Restructuring and Greenmail: Hearings Before the Employment and Housing Subcomm. of the House Comm. on Government Operations*, 100th Cong., 1st Sess. 132 (1987) (statement of William E. Brock, Secretary of Labor) (estimates range from 100,000 to 500,000 workers have lost jobs due to takeover-related restructuring); Halverson, *First the Merger, Then the Job Cuts*, Christian Sci. Monitor, Aug. 4, 1989, at 9, col. 2 (labor economists are just beginning to gather the data); Knight, *Are LBO's Really Good For Us? Some Academics Question KKR's Claims*, Wash. Post, May 30, 1989, at D10, col. 2 (noting the need for "a study conducted by someone with no ideological ax to grind and no personal profit at stake"); *see also* Johnson, *Corporate Life*, *supra* note 24, at 868 & n.9 (Empirical evidence of the effects of takeover activity on employee job loss "although scant is emerging."); Ryan, *supra* note 9, at 9 (further empirical study needed).

59. Brown & Medoff, *The Impact of Firm Acquisitions on Labor*, in CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 9, 11 (A. Auerbach ed. 1988) [hereinafter CORPORATE TAKEOVERS] (analyzing data from Michigan unemployment insurance system administrative records); *see also* Jensen, *Eclipse of the Public Corp.*, HARV. BUS. REV., Sept.-Oct. 1989, 61, 71 (Kaplan study indicates that employment does not fall after buyouts); *Leveraged Buyout Involvement Common Among Large Public Plans*, 17 Pens. Rep. (BNA) 154 (Jan. 15, 1990) (study by the Institutional Voting Research Analysis Group, Inc. finding that employment among rank-and-file workers did not decline and that plants did not close after leveraged buyouts); *LBOs: Many Invest Small Amounts*, PENSION & INVEST. AGE, Jan. 8, 1990, 10, 10 (same). *But see* Bhide, *In Praise of Corporate Raiders*, POL'Y REV., Winter 1989, at 21, 23 (finding evidence of plant closings and layoffs following two-thirds of hostile takeovers in 1985 and 1986).

60. Brown & Medoff, *supra* note 59, at 23.

61. *See, e.g.*, Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 612 (1989); Macey, *supra* note 19, at 195; Macey, *State Anti-Takeover Legislation and the National Economy*, 1988 WIS. L. REV. 467, 478 [hereinafter Macey, *National Economy*]; Ribstein, *Takeover Defenses and the Corporate Contract*, 78 GEO. L.J. 71, 146 (1989); Scheffman, *The Economics and Ethics of Adjusting to a New Competitive Environment: Mergers and Takeovers*, in ETHICS, *supra* note 24, at 99, 103-04.

62. Carliner, *Comment*, in CORPORATE TAKEOVERS, *supra* note 59, at 25, 27 (criticizing Brown and Medoff study because it concentrated on the friendly acquisition of very small firms in Michigan); Scheffman, *supra* note 61, at 104 (sample contains few mergers and Michigan experience may not be representative).

decade, while thousands more have suffered wage and benefit reductions.[63] At the other extreme, Kohlberg, Kravis, Roberts & Company claims that leveraged buyouts have caused overall employment to rise.[64]

Despite the absence of conclusive empirical data establishing the connection between takeovers and job loss, worker displacement tends to be "the most effective argument favoring restrictions on takeover activity."[65] The many instances of corporations increasing their leverage as a takeover defense and then implementing massive layoffs has fueled the popularity of this view.[66] Dramatic changes in financial practices propelled many of these restructurings, forcing corporations to sell profitable operations to meet short-term cash demands to fund debt.[67] As a result, the layoffs that followed were not only unexpected; they were made within a short period of time.[68] While numerous illustrations exist,[69] a few cases sufficiently exemplify the situation. Owens-Corning Fiberglass Corporation defeated a hostile bid by Wickes Corporation by implementing a stock repurchase, which resulted in $2.6 billion debt. Following the repurchase, Owens-Corning cut 13,000 employees from its 28,000 workforce.[70]

63. *Hostile Takeovers: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 100th Cong., 1st Sess. 262 (April 8, 1987) [hereinafter *Hostile Takeover Hearings*] (statement of Thomas R. Donahue, Secretary-Treasurer, AFL-CIO); *Pension Hearings, supra* note 4, at 6 (statement of Thomas R. Donahue) (estimating 90,000 AFL-CIO jobs lost).

64. Kohlberg, Kravis, Roberts & Co.'s (KKR) study purports to demonstrate how 17 leveraged buyouts resulted in an increase in employment. *Pension Hearings, supra* note 4, at 42 (increase in employees from 276,000 to 313,000 within three years of LBO). This study has been criticized harshly. *See, e.g.*, Knight, *supra* note 58, at D10, col. 1 (KKR used projections, not actual figures, and study did not count operations that were sold after the LBO).

65. *Grundfest Challenges Argument that Takeovers Cause Job Losses*, 20 Sec. Reg. & L. Rep. (BNA) No. 11, at 423 (Mar. 18, 1988) [hereinafter *Grundfest Challenge*]; *see also* Johnson & Millon, *Misreading the Williams Act*, 87 MICH. L. REV. 1862, 1907 (1989) (State legislators and the general public widely believe that hostile takeovers bring plant closings and employee layoffs.).

66. Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 U. CIN. L. REV. 457, 497 (1988) (describing "what social psychologists call the 'availability heuristic' ").

67. Di Norcia, *supra* note 24, at 250 ("closures and employee layoffs are often required purely to finance" a transfer of ownership); Farrell, *supra* note 6, at 58 ("a perilous financial game played to enrich a few savvy paper entrepreneurs"). Employees also have been hurt by corporate restructuring when their corporation terminates pension funds or transfers funds back to the corporation. Thomas Donahue, AFL-CIO Secretary-Treasurer, testified that since 1980, employers have "recaptured" more than $1.4 billion from pension plans terminated because of mergers and buyouts. *Pension Hearings, supra* note 4, at 14; *see also* Williams, *Raking in Billions from the Company Pension Plan*, N.Y. Times, Nov. 3, 1985, § 3, at 1, col. 2 ("some of the most familiar names in corporate America . . . are diverting [pension funds] to other corporate uses such as takeover financing").

68. *See, e.g.*, DeMott, *supra* note 7, at 25-26.

69. Senator Proxmire listed the following cases of leveraged buyouts followed by loss of jobs: GAF-Union Carbide, 25,000 jobs; Chevron-Gulf, 18,000 jobs; Baxter Travenol Laboratories, Inc.-American Hospital Supply Co., 6,000 jobs; Burroughs-Sperry, 11,790 jobs. *Hostile Takeover Hearings, supra* note 63, at 256 ("Some of these numbers are difficult to comprehend. But each unemployed person constitutes a tragedy, a drama of hardship."); *see also* Buzzota, *A Quiet Crisis in the Work Place*, N.Y. Times, Sept. 4, 1985, at A27, col. 2 ("The dramatic growth of corporate mergers and takeovers [is] undermining the elusive pursuit of job satisfaction in America."); Mintz, *Community Dislocations: A Painful Side Effect of Merger*, Wash. Post, Apr. 20, 1980, at A2, col. 1 ("Community dislocations have long been part of the industrial landscape, painful side effects of the corporate drive toward lower costs and higher profits. But today there is a new dimension to this old problem. The reason is the wave of conglomerate mergers that has swept across the economy."); Prokesch, *People Trauma in Mergers*, N.Y. Times, Nov. 19, 1985, at D-1, col. 3 ("Management turnover at all levels is on the rise and employee loyalty is at a low.").

70. *See, e.g.*, O'Brien & Kline, *An Rx For Jobs Lost Through Mergers*, N.Y. Times, Feb. 22, 1987, § 4, at 23, col. 2 (Owens-Corning closed its profitable Barrington, N.J. plant, causing more

Similarly, Phillips Petroleum Company used a $4.5 billion stock buyback to thwart takeover attempts by T. Boone Pickens and Carl Icahn. Phillips subsequently sold substantial assets and dramatically cut its workforce.[71] Recently, RJR Nabisco, Incorporated released 2,300 workers following its leveraged buyout by Kohlberg, Kravis, Roberts & Company that increased RJR's debt to $20.1 billion.[72]

Based upon the relationship between job loss and takeovers, union officials and others assert that takeovers allow shareholders to exploit labor by profiting at the workers' expense.[73] Conversely, commentators such as Professor Joseph Grundfest assert that "while the 'emotional appeal' of tying job losses to takeovers is indisputable, . . . 'the logic of the relationship between job loss and takeover activity simply does not support the political rhetoric.' "[74] In other words, many of the layoffs and plant closings might have occurred anyway, and might not have resulted simply from merger and acquisition activity.[75] Further, layoffs and plant closings are viewed as necessary for corporations to remain internationally competitive.

Thus, the controversy over takeovers merely may be part of the larger, growing concern about the long-standing problem of plant closings in general. Regardless of whether takeovers directly cause job loss, layoffs and plant closings continue to create a high level of unemployment that produces great hardship for displaced workers. Indeed, from the workers' perspective, job displacement resulting from fundamental shifts in the economy is as damaging as that related to finance-driven restructuring. To analyze further how corporate restructuring affects employees, the next section will examine the problem

than 800 people to lose their jobs); Willoughby, *What a Raider Hath Wrought*, FORBES, Mar. 23, 1987, at 56 (In five months following takeover bid, "48% of the firm's total workforce [was] axed or lost in divestitures."). The union has brought suit against Wickes Corp. claiming tortious interference with a prospective business relationship. *See infra* note 208 and accompanying text.

71. *The Shrinkage at Phillip Pete*, BUS. WK., May 27, 1985, at 46.

72. *See, e.g.*, Deutsch, *RJR's Brave New World*, N.Y. Times, Sept. 17, 1989, § 3, at 1, col. 2 ("[T]he new management team [has] discharged so many people that the remaining workers are in shock."); Morris & McCarthy, *RJR, in Long-Awaited Move, to Dismiss About 12% of Workers at Tobacco Unit*, Wall St. J., Aug. 11, 1989, at A3, col. 2.

73. *See, e.g.*, Stein, *With Friends Like Milken . . .; His LBO Advantage is Cut from the Hides of Workers*, L.A. Times, Apr. 12, 1989, Pt. II, at 7, col. 3 ("[I]n large measure, [satisfying cash flow demands] comes out of the hides of the laid-off, cut-back and disenfranchised workers."); Victor, *supra* note 5, at 396 (observing same).

74. *Grundfest Challenge*, *supra* note 65, at 423 (quoting Securities & Exchange Commissioner Joseph Grundfest).

75. *See, e.g.*, *id.* at 424 (disputing that the Chevron-Gulf merger was responsible for adverse consequences on Gulf's Pittsburgh employees, noting that from 1981 to 1983, prior to the takeover threat, the number of Gulf employees had declined from 58,000 to 42,700); Bhide, *supra* note 59, at 23 (In half the cases where layoffs followed the takeover attempt, layoffs may have occurred regardless of the takeover because firms had profitability problem.); Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1190 (1981) ("The new owners cannot improve the firm's performance by discarding valuable employees or suppliers or by harming the interests of creditors."); Macey, *National Economy*, *supra* note 61, at 478 (no loss of jobs for "rank-and-file employees because new firm owners rarely liquidate subsidiaries and fire the employees"); Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 140 (1986) (noting same); Ribstein, *supra* note 61, at 146 ("[T]here is nothing inherent in the structure of the transaction that injures employees."); Romano, *supra* note 66, at 497 (no empirical evidence that acquisitions result in greater job loss).

from a theoretical perspective that focuses upon the employees' long-term implicit employment contracts with the corporation.

B. The Employees' Relationship With the Corporation

1. The Nature of Implicit Labor Contracts

Neoclassical economics employs a model of the firm that views managers as buying and selling goods and labor in markets to maximize shareholder wealth.[76] The labor market establishes wage rates externally with demand decisions made by firms on one hand and supply decisions made by workers on the other.[77] Based upon this market-determined wage, the relationship between the workers and the firm consists of the workers directly exchanging a certain amount of labor for a specific wage.[78] Economists assume the corporation will behave as any other rational economic actor and regard the corporation's participation in this market as a "production function."[79] Viewing the corporation as a "black box," neoclassical economics does not evaluate the functions within the firm or the relationships underlying them.[80] This economic analysis corresponds to the legal model of the corporation that consists of the shareholders owning the firm and the employees contracting with the firm for wages.[81] Under this model, employees are not members of the firm and their rights come from explicit contracts alone, often collective bargaining agreements.[82]

Recently, however, microeconomics has pierced the black box of the firm to analyze its operations under the nexus of contracts theory.[83] This theory regards the firm as a bundle of explicit and implicit contractual relationships among shareholders, employees, consumers, and suppliers.[84] In contrast to the neoclassical view that firms merely engage in exchange in the labor market, the employees' association is evaluated within the context of other relationships in the firm. In particular, the nexus of contracts theory sees the firm in an equilib-

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76. *See, e.g.*, M. AOKI, *supra* note 18, at 3-4; Hart, *An Economist's Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757, 1757-58 (1989).

77. *See, e.g.*, Rosen, *supra* note 33, at 1145.

78. As Professor Bratton explains: "Neoclassical microeconomists followed Adam Smith's dictum that the division of labor, and thus the firm, marks the extent of the market. They did not look at production processes inside the firm or at the contracting arrangements underlying them." Bratton, *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 415 n.35 (1989) [hereinafter Bratton, *Critical Appraisal*]; *see also*, M. AOKI, *supra* note 18, at 3 (discussing workers contracting out labor for wages); Rosen, *supra* note 33, at 1148 (same).

79. *See, e.g.*, Bratton, *Critical Appraisal*, *supra* note 78, at 415-16.

80. *See, e.g.*, *id.* at 416 (Economists "perceived actions inside of firms as 'engineering,' functions of hierarchical structures, and, therefore, as unsuited to a discipline that studies markets."); Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 306-07 (1976) (describing prior analysis as a "black box" view).

81. M. AOKI, *supra* note 18, at 8.

82. *Id.* at 6 (claiming that traditional corporate law treats workers as an exogenous factor rather than as an integral part of the firm with legitimate claims competing with shareholders).

83. This approach began with Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937). *See e.g.*, Alchian & Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); Cheung, *The Contractual Nature of the Firm*, 26 J.L. & ECON. 1 (1983); Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980); Fama & Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301 (1983); Jensen & Meckling, *supra* note 80.

84. *See, e.g.*, Jensen & Meckling, *supra* note 80, at 310-11.

rium position as a result of the participants' competing for the optimal arrangement of risks and opportunities to allocate the costs and rewards within the organization.[85] Thus, the nexus of contracts approach does not distinguish clearly the claims of employees from those of the shareholders. Adopting this economic theory, corporate law scholars have constructed a legal model that considers the rights in the corporation as effected through a set of explicit and implicit contracts.[86] Unlike the traditional legal model, the question of who "owns" the corporation is irrelevant.[87] That is, each stakeholder has an entitlement to the corporation and the issue becomes how to define the entitlement. Most nexus of contract theorists fail to realize the ramifications of this point.[88] This section will explore the nature of the corporation's implicit long-term contracts with its employees within the nexus of contracts framework.

Employees tend to have long-standing relationships with corporations. The typical worker spends eight years on a job; more than twenty-five percent of the workforce stays with the same job for twenty years or more and the probability of turnover decreases as job tenure increases.[89] The implicit contract theory explains why such long-term attachments occur.[90] Implicit contracts are not recognized as legal contracts;[91] rather they are social arrangements typically en-

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85. *See, e.g., id.* at 307-08.

86. The nexus of contracts view has gained wide acceptance among corporate law scholars. *See, e.g.*, Macey, *supra* note 19; Ribstein, *supra* note 61. *But see* Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985) (arguing that contract analysis of investor-management relationship is seriously flawed); DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879 (claiming that contract-law principles add little to resolve quesions of fiduciary obligation).

87. *See, e.g.*, Coffee, *Corporate Web*, *supra* note 9, at 16 n.38 ("Once we view the shareholder as simply a specialist in risk bearing, . . . the normative force inherent in the concept of ownership is lost."); Dallas, *Two Models of Corporate Governance: Beyond Berle and Means*, 22 U. MICH. J.L. REF. 19, 23 (1988) ("Ownership of the firm disappears as a meaningful concept under this model because no one can own a 'nexus.' "); Easterbrook & Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1447 (1989) [hereinafter Easterbrook & Fischel, *Contract*] ("The question is not whether employees and other 'constituencies' of the firm have entitlements or expectations—they do—but what those entitlements are."); Easterbrook & Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 396-97 (1983) (noting same); Fama & Jensen, *supra* note 83, at 289 (corporation does not have "owners"); Macey, *supra* note 19, at 179-80 (corporation not an object of claims based on property rights).

88. *See, e.g.*, M. AOKI, *supra* note 18, at 4; Coffee, *Corporate Web*, *supra* note 9, at 12; Stone, *Labor and the Corporate Structure: Changing Conceptions and Emerging Possibilities*, 55 U. CHI. L. REV. 73, 152 (1988).

89. *See* Hall, *The Importance of Lifetime Jobs in the U.S. Economy*, 72 AM. ECON. REV. 716, 720 (1982) (Job changes occur at a young age; if a worker has been at a job for a number of years, the chances are that employment will continue for a long time.); *see also* Addison & Castro, *The Importance of Lifetime Jobs: Differences Between Union and Nonunion Workers*, 40 INDUS. & LAB. REL. REV. 393, 402 (1987) (noting that union workers enjoy slightly higher tenure which may be due to informational advantage).

90. Labor economists have developed this theory to analyze unemployment for lower-level employees. The three early contributions to the implicit employment contract literature are Azariadis, *Implicit Contracts and Underemployment Equilibria*, 83 J. POL. ECON. 1183 (1975); Baily, *Wages and Employment Under Uncertain Demand*, 41 REV. ECON. STUD. 37 (1974); and Gordon, *A Neoclassical Theory of Keynesian Unemployment*, 12 ECON. INQUIRY 431 (1974). For further contributions to this literature, see Azariadis & Stiglitz, *Implicit Contracts and Fixed Price Equilibria*, 98 Q.J. ECON. 1 (1983); Rosen, *supra* note 33, at 1144. Some economists criticize the overuse of this model to explain unemployment. *See* Bull, *Implicit Contracts in the Absence of Enforcement and Risk Aversion*, 73 AM. ECON. REV. 658, 658 (1983).

91. *See, e.g.*, Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549,

forced through the operation of market forces. According to the implicit contract theory, wages are not set in the external labor market. Instead, large firms internalize their employment structures.[92] Under these employment arrangements, workers are underpaid at the beginning of their association with the firm and overpaid at the end.[93] Hence, as employees continue to work for the firm, their dependence grows and, in a sense, they become "economically wedded" to the corporation.[94] To evaluate the employees' relationship to the corporation, it is necessary to examine in detail the nature of the implicit employment contract as well as the enforcement mechanisms used to police opportunistic breach of such contracts.

Under implicit contract analysis, several factors explain why employees tend to develop long-term attachments to corporations: employee risk aversion, effort-motivating career paths, and human capital.[95] The first reason, employee risk aversion, relates to differences in risk preference between workers and corporations. Employees are risk-averse because they face serious consequences from unemployment if their corporation suffers a temporary fluctuation in the demand for their labor. As employees continue to work for a firm and become older, their employment opportunities tend to decrease.[96] Although employees make risky investments of their time in firms, they cannot diversify their risk because they usually have only one job.[97] In contrast, corporations that employ many workers have the ability to provide implicit insurance contracts to workers protecting them from fluctuations in their wages.[98] Under this insurance contract, younger workers accept wages that are lower than the marginal product they produce for the firm.[99] These reduced wages represent implicit insurance premiums which the corporation credits to the younger workers' accounts. As these workers grow older and cannot produce as much, the corporation indem-

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1549 (1989) (economists' definition of contract is broader than lawyers' definition). Professor Eisenberg believes that this is a serious misuse of the term "contract." Eisenberg, *Comment: Golden Parachutes and the Myth of the Web*, in KNIGHTS, RAIDERS, AND TARGETS, *supra* note 55, at 156-57. In response, Professor Coffee states this is "a largely semantic point that does not meet the real contention made here: that managers may have accepted lower, relatively fixed wages in preference to a variable-wage system as the price of obtaining some employment security." Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, in KNIGHTS, RAIDERS, AND TARGETS, *supra* note 55, at 121 n.42 [hereinafter *Shareholders Versus Managers*].

92. *See, e.g.*, M. AOKI, *supra* note 18, at 52 ("The traditional market-oriented or centrally bargained wage system is gradually giving way to the firm-specific pay structure in so far as jobs are tending to be evaluated more in relation to other jobs in the same firm and less with similar jobs in other factories."); Bull, *The Existence of Self-Enforcing Implicit Contracts*, 102 Q.J. ECON. 147, 147 (1987) (noting same).

93. *See, e.g.*, Hutchens, *Delayed Payment Contracts and a Firm's Propensity to Hire Older Workers*, 4 J. LAB. ECON. 439, 440-41 (1986).

94. *See, e.g.*, Coffee, *Corporate Web*, *supra* note 9, at 19.

95. *See, e.g.*, Addison & Castro, *supra* note 89, at 393-94 (Over twenty-five percent of all workers have twenty or more years of tenure; two-fifths of workers who work at a job for five years will stay there for over twenty years.).

96. *Id.* at 395.

97. *See, e.g.*, Coffee, *Corporate Web*, *supra* note 9, at 78-79 (usual market solutions for risky investments, insurance, or diversification simply not feasible).

98. *See, e.g.*, Chari, *Involuntary Unemployment and Implicit Contracts*, 98 Q.J. ECON. 107, 107 (Supp. 1983).

99. *See, e.g.*, M. AOKI, *supra* note 18, at 14; Bull, *supra* note 90, at 658.

nifies the worker by continuing to pay a steady wage.[100] In addition, these insurance premiums protect workers during external market shocks that produce a decline in the need for labor.[101] Therefore, through implicit contracts, workers gain employment security by shifting some of their risk of unemployment and declining wages onto the corporation.

The second theory, effort-motivating career paths, explains that the corporation is willing to provide unemployment insurance to employees because implicit contracts deter shirking and other misbehavior.[102] In this sense, employees start their jobs for less pay to bond their work by subjecting their income to possible forfeiture for inadequate performance.[103] This allows the firm to retain dedicated workers and ultimately repay them with higher wages by postponing compensation until the later term of the employment relationship and encourages employees to develop long-term relationships with the firm.[104] Thus, the implicit contract serves as an economic "bonding" mechanism to reduce agency costs.

Finally, the human capital theory also illustrates why employees tend to have long-term attachments to corporations. According to this theory, workers usually develop skills that are firm-specific or industry-specific.[105] Risk-averse employees are reluctant to accumulate this human capital because the investment may lose its value when the employee loses his job.[106] For example, an older welder in fabricated metals may have much difficulty finding a new job in the same field.[107] Because this human capital is integral to a firm's success, firms attempt to persuade employees to acquire firm-specific skills by decreasing the employees' risk of unemployment.[108] In addition, employers seek to reduce job turnover to decrease their hiring and training expenses.[109] Thus, each explanation demonstrates that both employers and employees benefit from the implicit contract arrangement.[110]

Implicit contracts shift the employees' risk of job loss to the corporation and theoretically provide employees with job security as long as they are compe-

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100. *See, e.g.*, Azariadis & Stiglitz, *supra* note 90, at 3-5; Bull, *supra* note 92, at 151; Holmstrom, *Equilibrium Long-Term Contracts*, 98 Q.J. ECON. 23, 26 (Supp. 1983).

101. *See, e.g.*, Danziger, *Real Shocks, Efficient Risk Sharing, and the Duration of Labor Contracts*, 103 Q.J. ECON. 435, 436 (1988); Rosen, *supra* note 33, at 1145.

102. *See, e.g.*, Cornell & Shapiro, *Corporate Stakeholders and Corporate Finance*, 16 FIN. MGMT. 5, 5-6 (1987).

103. Wachter & Wright, *The Economics of Internal Labor Markets*, 29 INDUS. RELATIONS 240, 246, 250 (1990).

104. *See, e.g.*, Hutchens, *supra* note 93, at 441.

105. Hart, *Optimal Labour Contracts Under Asymmetric Information: An Introduction*, 50 REV. ECON. STUD. 3, 4 (1983); Schultze, *Microeconomic Efficiency and Nominal Wage Stickiness*, 75 AM. ECON. REV. 1, 1 (1985).

106. *See, e.g.*, M. AOKI, *supra* note 18, at 25-26 (1984); Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1207-09 (1984).

107. Hutchens, *supra* note 93, at 456.

108. *See, e.g.*, Gamber, *Long-Term Risk-Sharing Wage Contracts in an Economy Subject to Permanent and Temporary Shocks*, 6 J. LAB. ECON. 83, 83 (1988); Rosen, *supra* note 33, at 1147 (Wage income is in part an "installment payment on specific-investments.").

109. Hutchens, *supra* note 93, at 450.

110. *See, e.g.*, M. AOKI, *supra* note 18, at 14-15.

tent. These contracts, therefore, require firms to maintain employment even when production declines temporarily.[111] But what about the problems of bankruptcy, demand or supply shifts, and product obsolescence?[112] Labor economists explain that complete implicit contracts would provide severance payments to workers if the probability of permanent job loss results from these factors.[113] They recognize, however, that these insurance contracts should encourage labor mobility,[114] but that they should not create an incentive for the workers to shirk their because they know they are protected if the corporation fails. That is, this "moral hazard" problem cautions against an implicit contract that provides too much job security.[115]

Although employees rely on implicit contracts because they are risk-averse, employees have no guarantee that the employer will honor the implicit contract. Therefore, it is necessary to examine the possibility that employers may not comply with the terms of these contracts and the ways in which employees enforce their implicit contracts.

2. Opportunistic Breach and the Problem of Enforcing Implicit Labor Contracts

Employees bear the risk that firms opportunistically may breach the implicit employment contracts. Firms may enter into implicit contracts, accept the workers' insurance premiums, and then attempt to increase their profits by backing out of the agreement when it is their turn to indemnify workers.[116] Opportunistic conduct may occur in several ways.[117] First, employees make firm-specific investments in their corporation to obtain higher wages than they would

111. *See, e.g.*, Gamber, *supra* note 108, at 84 ("[I]f risk-neutral firms are insuring risk-averse workers, then the real wage responds more to a given permanent shock than to a temporary shock of the same size.").

112. Rosen, *supra* note 33, at 1170 (Implicit contracts are akin to marriage, however, "[n]ot all marriages are made in heaven.").

113. *Id.* at 1170-71 ("Turnover is efficient if the severance payment offers complete insurance, but is inefficient if severance payments are constrained and workers are not fully protected against permanent separations."); Samuelson, *Implicit Contracts with Heterogeneous Labor*, 3 J. LAB. ECON. 70, 87 (1985) (Implicit contract models often allow firms to make severance payments "presumably because of the optimality of doing so.").

114. Samuelson, *supra* note 113, at 87; Holmstrom, *supra* note 100, at 48. Professor Holmstrom assumes the absence of severance payments in his model because such payments would reduce the displaced workers' incentive to search for new jobs; he does recognize, however, that his model could incorporate severance payments.

115. *See, e.g.*, Rosen, *supra* note 33, at 1154 ("[W]orkers and firms jointly control layoff decisions, precisely the type of situation where coinsurance is known to be desirable."); Samuelson, *supra* note 113, at 71 n.3 (Severance pay issue poses serious challenge to implicit contract theory because few firms provide this benefit.).

116. Rosen, *Transaction Costs and Internal Labor Markets*, 4 J.L. ECON. & ORG. 49, 51 (1988) (discussing ex post enforcement problem due to opportunistic breach); Shleifer & Summers, *Breach of Trust in Hostile Takeovers*, in CORPORATE TAKEOVERS, *supra* note 59, at 33, 38, 41-42, 49. "[I]mplicit contracts specify actions that ex post reduce the firm's value, even though agreeing to these actions is ex ante value maximizing. Breach of contract can therefore raise shareholder wealth, and the more so the greater is the burden of fulfilling past implicit contracts." *Id.* at 38.

117. *See, e.g.*, Azariadis & Stiglitz, *supra* note 90, at 7 ("[T]here is always another risk associated with any theory of contract enforcement through bonding: that the employer will fire the worker (or, equivalently, make work conditions so unattractive that the worker will be induced to quit and forfeit the bond).").

earn in the general labor market without such skills.[118] After workers acquire these abilities, however, the corporation can renege on its promise to pay higher wages by reducing the workers' earnings to those paid to workers without the skills.[119] Because the employees cannot use the firm-specific knowledge elsewhere, they are vulnerable to this conduct.[120] Second, opportunistic breach may occur because informational asymmetries exist, that is, the employees do not have access to the firm's data about its operational and financial matters.[121] For example, the firm may announce that production is less than it actually is in order to lay off workers and maximize profits.[122] Third, older workers who become less productive especially are exposed to opportunistic breach.[123] These forms of opportunistic behavior are socially inefficient because they can destroy the market for these implicit contracts.[124]

Because implicit contracts are not recognized as legal contracts, the parties cannot rely on the legal system for enforcement. People usually rely on implicit contracts when they enter into long-term relationships. When parties embark upon an extended association, they cannot foresee every contingency, nor delineate every detail of their arrangement in a written contract.[125] Thus, to a certain extent, transactors must rely on mutual trust and confidence that they will adjust their terms in the face of hardship rather than on the explicit terms of their written contract for judicial enforcement.

Generally, both workers and employers depend on market forces to assure performance of implicit contracts, that is, the penalty of withdrawing from the

118. Economists refer to this problem as "appropriable quasi-rents." Haddock, Macey & McChesney, *Property Rights in Assets and Resistance to Tender Offers*, 73 VA. L. REV. 701, 712-13 (1987) ("[I]nvestments that are specific to assets owned by others place the investor at risk from those others' opportunistic behavior. As long as the individual realizes at least as much as can be had in the best alternative, the invested human capital will remain, even if the returns are expropriated.").

119. Klein, Crawford, & Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 298 (1978).

120. *Id.*

121. Professors Azariadis and Stiglitz explain:

> If contract wage payments do not vary much over states but hours of work do, the employer may announce a good state when the bad one occurs in order to extract more hours from laborers; if, on the other hand, wage payments vary substantially more than do hours of work, the employer may announce the adverse state when the favorable one occurs in order to lower costs.

Azariadis & Stiglitz, *supra* note 90, at 12; *see also* Hall & Lilien, *Efficient Wage Bargains Under Uncertain Supply and Demand*, 69 AM. ECON. REV. 868, 871 (1979) (observing same); Holmstrom, *supra* note 100, at 48 (workers unlikely to observe firm's marginal product to enforce implicit contract).

122. *See, e.g.*, Azariadis & Stiglitz, *supra* note 90, at 12; Grossman & Hart, *Implicit Contracts Under Asymmetric Information*, 98 Q.J. ECON. 123, 125 (Supp. 1983); Grossman & Hart, *Implicit Contracts, Moral Hazard, and Unemployment*, 71 AM. ECON. REV. 301, 302 (1981).

123. *See, e.g.*, Shleifer & Summers, *supra* note 116, at 41-42, 49.

124. *See* Di Norcia, *supra* note 24, at 245 ("Financial restructuring coupled with investor primacy . . . perpetuates the discredited adversarial model of labor/management relations which divides—and weakens—the North American firm.").

125. *See, e.g.*, Rosen, *supra* note 33, at 1149 ("An employment relationship represents a complex interaction of authority, delegation, personal interactions and monitoring, so complex that remarkably few provisions are actually written down."). For a general discussion of relational contracts, see Macneil, *Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus,"* 75 NW. U.L. REV. 1018, 1025-27 (1981).

relationship and acquiring a bad reputation in the labor market.[126] Implicit contracts, however, are designed to deter workers from leaving their jobs; workers pay the firm a bond in the form of accepting lower wages that assures they will perform adequately in the future.[127] To quit, workers must surrender this bond. For the most part, these financial restrictions leave workers to rely on the character of the firm to assure performance.[128] The firm has a strong incentive to abide by an ethical code to treat workers fairly because they want to attract and retain the most qualified employees.[129] This notion corresponds to the theory explaining how firms benefit from implicit contracts by minimizing expenses relating to hiring and training costs.[130] In other words, if the firm breaches the implicit contracts, worker distrust will develop, resulting in lower employee morale, productivity, and loyalty.[131] In addition, once a firm acquires a dishonorable reputation, employees may quit, causing the firm to incur costs recruiting replacements.[132]

The firm's interest in maintaining its reputation, however, fails to solve completely the problem of opportunistic breach of implicit employment contracts;[133] labor economists are just beginning to explore the area of enforcement in more detail.[134] In particular, labor economists note that the risk of opportunistic behavior is very high when the employer leaves a regional labor market and relocates to another part of the country or world.[135] Additionally, as com-

126. *See, e.g.*, Azariadis & Stiglitz, *supra* note 90, at 6; Carmichael, *Reputations in the Labor Market*, 74 AM. ECON. REV. 713, 714 (1984); Holmstrom, *Contractual Models of the Labor Market*, 71 AM. ECON. REV. 308, 313 (1981).

127. Professor Aoki explains:

> In order to 'attach' employees to the firm and to distribute a share of the saved cost thereby, devices are developed in which the employees receive various benefits related to their tenure with the firm, in the form of seniority rights, pension benefits, and the like. If an employee quits his job in the middle of his career, he will lose these attained seniority rights; his pension benefits may not be portable further, his skills and professional knowledge may be firm-specific to some extent, and their economic value may be partly lost if he changes jobs.

M. AOKI, *supra* note 18, at 182; *see also* Azariadis & Stiglitz, *supra* note 90, at 7 (bond assures reliable future behavior by employees).

128. *See* Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947, 967-77 (1984) (loss of reputation in market hurts employer more, to the advantage of the employee).

129. *See, e.g.*, Azariadis & Stiglitz, *supra* note 90, at 19 ("One intuitive answer is obvious here: firms do not wish to jeopardize the investments in hiring, training, and information gathering that attend long-lived job attachments.").

130. *Id.* at 7.

131. Buono & Bowditch, *supra* note 50, at 141 ("Research indicates that mergers have less than a 50-50 chance of being successful . . . and much of that failure is increasingly attributed to mismanagement of the firm's human resources."); Bull, *supra* note 92, at 157 (intrafirm reputation more important than firm's reputation in the labor market).

132. *See, e.g.*, Cornfield, *supra* note 39, at 355.

133. *See, e.g.*, Blades, *Employment at Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power*, 67 COLUM. L. REV. 1404, 1412-13 (1967) (During times of abundant labor supply, the employer's interest in reputation is not "a very substantial deterrent to the employer who is tempted to bend his employees to his will."); Bull, *supra* note 92, at 148 (reputation effects weak in markets for unskilled or semi-skilled, blue collar workers).

134. *See* Rosen, *supra* note 33, at 1169 (listing several possible formulas to analyze the area of enforcement); Rosen, *supra* note 116, at 57-58.

135. *Cf.* Shleifer & Summers, *supra* note 116, at 39 (stating that an employer whose future reputation is unimportant is likely to breach implicit contracts with employees).

petitive pressures increase, firms have a greater incentive to breach implicit contracts to maximize profits in the short run.[136] Recognizing that much work remains in the area of ensuring performance of implicit contracts,[137] labor economists suggest that to avoid opportunistic breach, firms must develop a more complicated scheme to "bond" their future performance to the employees.[138] This "bonding" mechanism would take the form of explicit, guaranteed severance payments.[139] Attempting to explain why corporations often do not provide severance payments, economists surmise that because implicit contracts are not legally enforceable, "the temptation for the firm to renege on promised severance payments may be irresistible."[140]

3. Corporate Restructuring and Opportunistic Breach of Implicit Employment Contracts

This section explores the "expropriation theory," which suggests that shareholders gain in takeovers at the workers' expense when the corporation breaches implicit employment contracts, and extends the theory to encompass other fundamental corporate changes such as layoffs, plant closings, and industrial relocations not related to takeovers. Under this more expansive version of the expropriation theory, many restructuring events allow corporations to engage in opportunistic conduct by breaching implicit employment contracts.

Before examining the expropriation theory, it is important to emphasize that no one really knows the source of the shareholders' premium received in takeovers. Several other theories may explain the nature of the premium in different situations.[141] Some commentators contend that takeovers are beneficial for the economy because they replace inefficient management, create synergy, and allow managers to engage in empire building.[142] In contrast to theories implying that takeovers produce wealth, the expropriation theory suggests that takeovers produce shareholder profit by transferring wealth from employees through breach of implicit employment contracts.

The nexus of contracts and implicit contract theories form the basis for the expropriation theory of the shareholders' premium. Shareholders and employ-

136. Holmstrom, *supra* note 100, at 49.

137. *See, e.g.*, Azariadis & Stiglitz, *supra* note 90, at 18-19.

138. *Id.*; Bull, *supra* note 92, at 153-54.

139. *See* Hall & Lazear, *The Excess Sensitivity of Layoffs and Quits to Demand*, 2 J. LAB. ECON. 233, 250 (1984) (because firm has monopsony power, some degree of severance pay is desirable to offset that power).

140. Samuelson, *supra* note 113, at 87; *see* Brand, *Productivity and Employment: The 1988 International Symposium*, 111 MONTHLY LAB. REV. 32, 34 (1988) (survey found 44% of companies have some type of severance pay) (citing the General Accounting Office's PRELIMINARY ANALYSIS OF U.S. BUSINESS CLOSURES AND PERMANENT LAYOFFS DURING 1983 AND 1984 (1986)).

141. *See* Bradley & Rosenzweig, *Defensive Stock Repurchases*, 99 HARV. L. REV. 1378, 1409-11 (1986); *see, e.g.*, Black, *supra* note 61, at 612 (noting that wealth transfers seem to explain at most a fraction of the aggregate shareholder gains from takeovers); *see also* Jensen, *Eclipse of the Public Corporation*, 67 HARV. BUS. REV. (Sept.-Oct. 1989) 61, 63-64 (stating that "[t]he forces behind the decline of the public corporation differ from industry to industry").

142. R. HAMILTON, CORPORATIONS 936-40 (4th ed. 1990).

ees have conflicting attitudes toward risk based on these theories.[143] On the one hand, shareholders' diversified portfolios protect against losses resulting from unprofitable corporate changes. Firm-specific risks thus do not affect shareholders.[144] Because they receive the corporation's residual returns, shareholders tend to favor a high degree of leverage. On the other hand, employees cannot diversify their firm-specific risk, and thus prefer less risky ventures that will ensure that the corporation will be able to cover their labor costs.[145] Given these assumptions, takeovers provide shareholders a means to compel managers to take risks; managers will leverage up to increase stock prices to reduce the corporation's attractiveness to potential acquirors.

Professors Shleifer and Summers have asserted that takeovers allow shareholders to profit through the corporation's breaching its implicit employment contracts.[146] According to this view, a hostile takeover allows the acquiror to breach the corporation's implicit contracts because the new managers were not parties to these contracts. Thus, new managers are more likely to fire older workers and threaten to bankrupt and close the plants to coerce the other workers to grant wage concessions.[147] Professors Shleifer and Summers suggest that existing managers serve as trustees who safeguard the employees' firm-specific investments. They believe that incumbent management will not seek to breach implicit employment contracts to maintain the corporation's reputation in the labor market.[148] Thus, takeovers allow transfers of wealth from workers in terms of their loss of job security and deferred compensation.[149] This view provides theoretical support linking layoffs and plant closings to hostile takeovers.

In reviewing the theory of Professors Shleifer and Summers, one criticism stands out. Their theory fails to recognize that the most important aspect of the takeover phenomenon may stem from corporations increasing their leverage to avoid takeovers; as discussed previously, these corporations also breach implicit contracts by imposing layoffs and closing plants.[150] Recognizing this problem, Professor Coffee asserts that leveraged restructuring may involve wealth transfers from middle- and upper-level management to the shareholders.[151] He sug-

143. *See* Coffee, *Corporate Web*, *supra* note 9, at 18 ("To sum up, the basic contrast is that shareholders own many stocks, but managers have only one job.").

144. For an extended discussion of portfolio theory, see J. COX, FINANCIAL INFORMATION, ACCOUNTING AND THE LAW 164-75 (1980). Professor Cox notes that a diversified portfolio includes countercyclical stocks. Thus, if one stock performs below average, another stock will perform above average. *Id.*

145. *See id.*

146. Shleifer & Summers, *supra* note 116, at 35 (noting the takeovers by Frank Lorenzo in the airline industry as an example). Specifically, takeovers allow shareholders to capture the workers' appropriable quasi-rents. *Id.* at 41-42.

147. *Id.* at 45; *see* Scheffman, *The Economics and Ethics of Adjusting to a New Competitive Environment: Mergers and Takeover*, in ETHICS, *supra* note 24, at 99, 103.

148. Shleifer & Summers, *supra* note 116, at 46.

149. Shleifer & Summers, *supra* note 116, at 44; *see also* Coffee, *Corporate Web*, *supra* note 9, at 24 (implicit contracts threaten a manager's job because they defer part of a manager's expected compensation and do not legally bind new owners of a corporation after a takeover); Law, *supra* note 11, at 82 (noting that the interests of stockholders and managers conflict and that stockholders' interests prevail).

150. *See supra* notes 70-72 and accompanying text.

151. Coffee, *Corporate Web*, *supra* note 9, at 8-10.

gests that managers should receive severance packages to mitigate the risk of opportunistic breach that occurs when firms increase their leverage.[152]

Professor Coffee explicitly confines his analysis to protecting managers in finance-driven restructurings. This Article contends that Professor Coffee's theory applies not only to leveraged restructuring transactions but also to other restructuring events such as plant closings and layoffs that occur due to general conditions in the economy. Moreover, this Article contends that Professor Coffee's theory applies to employees other than managers. Indeed, several factors suggest that nonmanagerial employees are much more deserving of protection than managers.[153]

First, Professor Coffee argues that the takeover phenomenon involves special circumstances that are not present in typical market operations. More specifically, he asserts that takeovers uniquely allow shareholders to obtain wealth transfers from employees, especially managers.[154] Thus, Professor Coffee distinguishes between layoffs prompted by financial changes and layoffs caused by production changes.[155] This Article suggests that the expropriation theory also encompasses other corporate changes that are not related to takeovers, such as layoffs, plant closings, and industrial relocations.[156] Although shareholders are the ultimate risk-bearers, many types of corporate restructuring allow shareholders to transfer some of this risk to employees.[157] From the implicit contract perspective, employees receive lower wages that represent insurance payments to the corporation. If the firm suffers from market conditions such as increasing competition and shifting industrial investments, employees who are released forfeit job security for which they previously have paid.[158] Thus, shareholders should not receive the extra profits that arise from breaching implicit contracts under these circumstances.[159]

C. *A Comparison of Nonmanagement Employees' and Managers' Vulnerability to Opportunistic Breach of Implicit Contracts*

Professor Coffee limits his use of the expropriation theory by drawing a line between management employees and "lower-echelon workers."[160] He argues that the corporation should protect managers' reliance upon implicit con-

152. *Id.*

153. *See* Brudney, *Comment*, in KNIGHTS, RAIDERS, AND TARGETS, *supra* note 55, at 150, 151 ("There may well be obligations to the community and the enterprise's displaced lower-income employees for mitigation of the effects of any such move. But the case is less clear for entitlements of middle management, and certainly less clear for top management.").

154. *See* Coffee, *Corporate Web*, *supra* note 9, at 76.

155. Brudney, *supra* note 153, at 151.

156. *Cf. id.* at 150 (questioning why Coffee's theory does not apply to plant closings).

157. *Cf.* Oesterle, *supra* note 75, at 138-42 (many exit events allow shareholders to breach implicit employment contracts).

158. Rosen, *supra* note 33, at 83.

159. Brudney, *supra* note 153, at 151.

160. Coffee, *Corporate Web*, *supra* note 9, at 81 (This line is not mandatory, but Coffee strongly advocates it.); Coffee, *Takeover Reform*, *supra* note 8, at 449 ("Lower-echelon employees contract through other means and institutions (i.e., collective bargaining) and are not as exposed to opportunism because they do not invest in much 'firm-specific' capital or expect an ex post 'settling up.' ").

tracts.[161] Professor Coffee provides three reasons for denying protection to nonmanagerial employees. First, employees are not hurt by hostile takeovers as much as managers. Second, employees do not invest as much in human capital and do not expect as much deferred compensation as managers. Finally, employees, unlike managers, have collective bargaining agreements to safeguard their interests.

In examining the first basis for distinguishing between managers and employees, Professor Coffee asserts that takeover-related transactions do not hurt nonmanagerial employees as much as managers.[162] The available evidence indicates that this is true; certainly, in many takeovers, middle managers tend to be the first to lose their jobs.[163] Takeovers, however, also affect nonmanagerial employees in situations such as the Safeway and RJR Nabisco restructurings.[164] More significantly, as explained above, the focus upon takeover-related restructuring is too narrow; the deindustrialization process is causing a steady displacement of labor, particularly blue-collar workers.[165]

1. What Are the Expectations of Nonmanagerial Employees?

Professor Coffee suggests that managers, but not employees, deserve compensation for the breach of implicit contracts because managers possess firm-specific human capital; as a result, they will have a difficult time finding equivalent positions. Professor Coffee concludes: "Because managerial compensation is thus set within an internal market, the loss of a job means more to a manager than to those employees whose wages are determined by an external market."[166] This assertion is surprising because Professor Coffee relies upon the implicit contract theory which, as he acknowledges, labor economists originally formulated to explain unemployment for "lower-level" employees.[167] Coffee extends this model to managers, contending that they are "even more dependent on the firm for [their] expected future wealth and may suffer a greater loss if forced to resort to the marketplace."[168] At one point, however, Professor Coffee states that managers currently are beginning to develop general purpose skills and that firm-specific human capital applies more to lower-level employees in

161. Coffee, *Corporate Web*, *supra* note 9, at 23-24, 73-86.

162. Coffee, *Corporate Web*, *supra* note 9, at 78 ("[S]enior and middle management . . . persons are essentially redundant if the bidder has similar personnel and their discharge does not threaten immediate operating performance.").

163. *See, e.g.*, Halverson, *supra* note 58, at 9 (workers who lose jobs in takeover-related transactions tend to be professionals and middle managers).

164. *See supra* notes 70-72 and accompanying text.

165. Kay & Griffin, *Plant Closures: Assessing the Victims' Remedies*, 19 WILLAMETTE L. REV. 199, 202-04 (1983). (" '[T]he typical worker in a plant shutdown is in his late 40s, with high seniority, relatively high earnings, specialized skills, and has strong ties to family and community.' " (quoting Comment, *Advance Notice of Plant Closings: Toward National Legislation*, 14 J.L. REFORM 283 (1981))).

166. Coffee, *Corporate Web*, *supra* note 9, at 17-18.

167. *Id.* at 23.

168. *Id.*

engineering and manufacturing.[169] Even so, Professor Coffee contends that managers who do not invest in firm-specific skills deserve protection because they are "economically wedded" to their firms. These managers face the problem of "golden handcuffs": they become dependent upon the firm because other job opportunities do not provide them with the prospect of earning the same salary.[170]

Professor Coffee, however, fails to recognize that nonmanagerial employees also make firm-specific investments. Professor Macey, in contrast, notes as follows:

> Unlike high-level managers, who make firm-specific human capital investments as individuals, rank-and-file workers are often trained as groups and make firm-specific human capital investments simultaneously with their co-workers. This arrangement contains additional potential for exploitation, because firms enjoy economies of scale in hiring and training workers.[171]

Even if nonmanagerial employees do not invest as much in human capital as managers, workers who engage in labor-intensive activities also rely upon implicit contracts for job security. As these workers grow older, they cannot produce as much as younger workers; thus, they give up wages when they begin work to maintain a steady wage as they age. Viewed in this light, a distinction between physical and human capital investments is inappropriate because it disregards the interests of most of the corporation's employees. Indeed, unsophisticated, unskilled workers have more need for the job security that implicit contracts can provide because these employees are more vulnerable to opportunism. Instead of facing the "golden handcuffs" problem of lower wages, nonmanagerial employees face the prospect of no wages because they have fewer opportunities for re-employment.[172] Therefore, contrary to Professor Coffee's position, losing a job may mean more to nonmanagerial employees than to managerial employees.

2. Can Nonmanagerial Employees Establish Explicit Contracts to Mitigate the Consequences of Displacement?

Finally, Professor Coffee distinguishes between managers and employees by suggesting that even if nonmanagerial employees are hurt by the breach of implicit contracts, they can seek adequate protection through collective bargaining.[173] Professor Macey[174] and other commentators similarly contend that the presence of a union should mitigate the appropriation of workers' firm-specific

169. *Id.* at 39 ("[T]he road to executive success requires that the executive learn 'general purpose' executive skills, not simply 'special purpose' (but dead-end) technological expertise.").

170. *Id.*

171. Macey, *supra* note 19, at 191.

172. *See supra* notes 33-36 and accompanying text.

173. Coffee, *Corporate Web*, *supra* note 9, at 81.

174. Macey, *supra* note 19, at 192.

investments.[175] Thus, before examining whether a legal response is required to foster a transition policy for workers, it is necessary to assess the extent to which employees can anticipate the risks of restructuring and protect themselves through explicit contracts.

a. Reasons Why Nonmanagerial Employees Do Not Have Explicit Contracts for Employment Security

Most nonmanagerial employees do not have contractual safeguards against job loss. Although golden parachutes often compensate upper-level managers during hostile changes of control,[176] these devices rarely cover lower-level employees.[177] Many commentators assume that unions will bargain to protect their members from the consequences of layoffs and plant closings. This view, however, ignores the fact that less than twenty percent of the work force is unionized.[178] Unorganized workers cannot extract explicit contractual relief and must follow the terms that their employers provide.[179] Union employees do not

175. Carney, *Does Defining Constituencies Matter?*, 59 U. CIN. L. REV. 385, 406-08 (1990); Ribstein, *supra* note 61, at 146.

176. Coffee, *Shareholders Versus Managers*, *supra* note 91, at 131 n.170. Forty-eight percent protected senior management with employment contracts; 50% provided change of control provisions; 21.8% provided for payments if the employee left voluntarily. *Id.* at n.167 & n.170. Several courts have upheld golden parachute provisions. *See, e.g.*, Koenings v. Joseph Schlitz Brewing Co., 377 N.W.2d 592, 604, 126 Wis. 2d 349, 371-72 (1985) (effect of hostile takeover on employee morale considered in determining whether damage clause in golden parachute reasonable); *see also* Note, *Golden Parachutes and the Business Judgment Rule: Toward a Proper Standard of Review*, 94 YALE L.J. 909, 913 (1985) (because of courts' traditional deference to directors' exercise of business judgment, most golden parachutes are likely to pass judicial scrutiny if challenged).

177. Some firms have tin parachutes that apply to job dislocations after hostile acquisitions. Nelson-Horchler, *A Catchall Parachute: Herman Miller Has a Silver Shark Repellent*, INDUS. WK., Feb. 9, 1987, at 16; Robertson, *Corporate Restructuring and Employee Interests: The Tin Parachute*, in ETHICS, *supra* note 24, at 195, 198 (firms are reluctant to disclose the adoption of tin parachutes); Ryan, *supra* note 9, at 10-11 n.17 (identifying 19 companies, but "no official tally"). Most tin parachutes are designed as poison pills, that is, they are triggered when a hostile acquiror discharges employees. Cowan, *New Ploy: 'Tin Parachutes'*, N.Y. Times, Mar. 19, 1987, at D1, col. 3. Most tin parachutes do not address the possibility that target management or its white knight will restructure the company and dislocate its workers. Robertson, *supra*, at 198; Ryan, *supra* note 9, at 38-39. Two courts have refused to enjoin directors from implementing tin parachutes after a hostile bid was announced. *See* GAF Corp. v. Union Carbide Corp., 624 F. Supp. 1016, 1035 (S.D.N.Y. 1985); Tate & Lyle PLC v. Staley Continental, Inc., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,764, at ¶ 98,585 (Del. Ch. 1988). Two other courts have enjoined the tin parachute plans as invalid defensive measures. *See* Black & Decker Corp. v. American Standard, Inc., 682 F. Supp. 772, 787-88 (D. Del. 1988); Minstar Acquiring Corp. v. AMF, Inc., 621 F. Supp. 1252, 1261 (S.D.N.Y. 1985). For further discussion of the case law dealing with tin parachutes, see Block & Hoff, *Employee Severance Agreements in Changes in Control*, N.Y.L.J., June 16, 1988, at 5, col. 1. " 'Labor, at whatever level, should not be victimized or go unrequited by control contests.' " *Id.* at 6, col. 2 (quoting *GAF Corp.*, 624 F. Supp. at 1022).

178. *See, e.g.*, B. BLUESTONE & B. HARRISON, *supra* note 9, at 235 ("Nevertheless, quite apart from the fact that three-quarters of the American labor force has no direct protection at all, those whose jobs *are* covered by collective bargaining agreements receive little—or very weak—protection from job loss related to shutdowns or large cutbacks."); Dickens & Leonard, *Accounting for the Decline in Union Membership, 1950-1980*, 38 INDUS. LAB. REL. REV. 323, 324 (1985) (most believe that plant closures and layoffs are the cause of union decline). In an earlier article, Professor Coffee recognized that a minority of the workforce is unionized. Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1248 (1984).

179. *E.g.*, Blades, *supra* note 133, at 1411; Summers, *The Rights of Individual Workers: The Contract of Employment and the Rights of Individual Employees: Fair Representation and Employ-*

enjoy much more protection against layoffs and plant closings than nonunion employees.[180] Accordingly, this part of the Article analyzes the possible reasons why unionized employees have not sought contractual provisions to mitigate the consequences of restructuring.

The current restructuring era illustrates that the National Labor Relations Act (NLRA)[181] fails to protect displaced workers;[182] labor law scholars consequently are calling for its repeal.[183] Professor Stone describes the situation as follows: "At the same time that corporate investment decisions are causing massive lay offs throughout the unionized sectors, the labor laws are being reinterpreted to give unions less and less input into corporate decision making."[184] The courts and the National Labor Relations Board (NLRB) have construed the NLRA in several ways that allow corporations to restructure without considering the employees' interests.[185] An employer may relocate a plant to another area to hire cheaper labor, yet may not transfer simply to avoid collective bargaining obligations.[186] This distinction often makes a finding of unfair labor practices dependent on the employer's stated business reasons for the transfer. Courts' traditional deference to employers makes it difficult for a union to protect its members from these relocations.[187] Furthermore, a purchaser of assets is not bound by any prior collective bargaining agreements and is free to replace the entire work force under the successorship doctrine. Moreover, an asset purchaser does not have a legal duty to bargain with the union unless the purchaser

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ment at Will, 52 FORDHAM L. REV. 1082, 1108 (1984) (nonunion employees "at mercy" of employer). *But see* Epstein, *supra* note 128, at 954 (even nonunion workers have strong bargaining positions). For criticism of Professor Epstein's position, see Linzer, *The Decline of Assent: At-Will Employment as a Case Study of the Breakdown of Private Law Theory*, 20 GA. L. REV. 323, 409-15 (1986) (discussing the notion of the "romance of freedom of contract").

180. B. BLUESTONE & B. HARRISON, *supra* note 9, at 235; *see also* Rhine, *Business Closings and Their Effects on Employees—The Need for New Remedies*, 35 LABOR L.J. 268, 269 (1984) (noting lack of protection under labor laws and proposing adaptation of existing common-law theories to remedy misrepresentations to employees regarding job security).

181. 29 U.S.C. §§ 141-69 (1988).

182. Professor Stone has written how "the privatized system of collective bargaining that has emerged under the NLRA fails to protect labor from the adverse consequences of corporate decisions, especially decisions that involve major investments or transformations in corporate form." Stone, *supra* note 88, at 158; *see also* Gorman, *The Negligible Impact of the National Labor Relations Act on Management Decisions to Close or Relocate*, 58 TUL. L. REV. 1354 (1984) (examining the legal protection afforded workers by the NLRA when they are terminated upon the relocation or closing of their place of work); Kay & Griffin, *supra* note 165, at 215 (stating that the reality of mass layoffs has shown that labor law currently affords workers little protection).

183. *See, e.g.*, Sweeney & Siegel, *Is There a Need to Amend the National Labor Relations Act?*, 52 FORDHAM L. REV. 1142, 1143 (1984).

184. Stone, *supra* note 88, at 74.

185. *See, e.g.*, Gorman, *supra* note 182, at 1355-56. For an economic analysis of recent labor cases using the implicit contract theory, see Wachter & Cohen, *The Law and Economics of Collective Bargaining: An Introduction and Application to the Problems of Subcontracting, Partial Closure, and Relocation*, 136 U. PA. L. REV. 1349 (1988).

186. *See* NLRB v. Transportation Management Corp., 462 U.S. 393 (1983) (holding that although employers may not discharge workers for union activity, they may discharge for reasons unrelated to union activity).

187. *See, e.g.*, Stone, *supra* note 88, at 96-102. *But see* Baer, *The NLRB and Plant Relocation*, N.Y.L.J., July 28, 1989, at 3, col. 2 (noting that the Supreme Court has held that an employer can terminate his entire business for any reason, even spite against a union).

retains a majority of the workforce.[188]

Although the NLRA does not provide much relief, presumably, unions would attempt to negotiate terms that provide job security.[189] Unions have difficulty in bargaining for explicit contractual protection against layoffs and plant closings because management strongly resents any limitations on its discretion to operate the business.[190] In this regard, management often insists on "managerial prerogative" clauses that assure that it will have great flexibility in determining the level of employment and prevent unions from using their right to strike.[191]

More importantly, a union's ability to provide contractual protections depends on equal bargaining strength.[192] Professor Lynd maintains that the unilateral nature of plant closing decisions demonstrates that unions possess weak negotiating power.[193] A forceful union that is able to obtain high wages often is not sufficiently powerful to shield its employees from a corporation that relocates its operations to another area. As a result, contract clauses restricting management's ability to lay workers off or close a plant are rare because employees do not have the negotiating power to offset the high price that management demands for these provisions.[194]

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188. *See, e.g.*, Stone, *supra* note 88, at 106-07. *But see* DuRoss, *Increasing the Labor-Related Costs of Business Transfers and Acquisitions—The Spectre of Per Se Liability for New Owners*, 67 WASH. U.L.Q. 375, 377-78 (1989) (concluding that "in most transfers the new owner is now the de jure surety for any of the predecessor's labor-related obligations").

189. Stone, *supra* note 88, at 106-07. Some commentators, however, question union effectiveness in representing workers' long-run interests. Traditionally, unions have focused on wages, ignoring job security issues until an emergency arises. *See, e.g.*, Di Norcia, *supra* note 24, at 250. Union leaders concentrate on increasing wages because they hold short-term political positions. *See* Donahue & Raskin, *The Role and Challenges Facing Unions in the 1940s and 1980s—A Comparison*, 52 FORDHAM L. REV. 1062, 1073-75 (1986). Thus, it is hardly surprising that union officials are not motivated to negotiate contract terms that are best for employees in the long-run. *See, e.g.*, F. O'CONNELL, *supra* note 22, at 56 (union members tend to prefer high wages and are not willing to pay the price to obtain protection against corporate restructurings).

In contrast to the union structure notion, some commentators suggest that nonmanagerial employees do not seek contractual safeguards against dislocation because they are unsophisticated. Professor Kennedy asserts that workers may have "miscalculated their true interests" by foolishly sacrificing their long-run welfare for higher income in the present. Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563, 630 (1982). According to Professor Kennedy, workers know they may be laid off, but they tend to underestimate the chances of the plant closing and the difficulty they will have finding a new job. *Id.* Thus, a paternalistic response is necessary because these employees should be protected from mistakes that they will regret later. *Id.* at 631.

190. *See, e.g.*, F. O'CONNELL, *supra* note 22, at 56. For an overview of the impact of plant closures and relocations on collective bargaining, see Craver, *The Impact of Financial Crises Upon Collective Bargaining Relationships*, 56 GEO. WASH. L. REV. 465 (1988).

191. *See, e.g.*, Lynd, *Investment Decisions and the Quid Pro Quo Myth*, 29 CASE W. RES. 396, 410 (1979) ("[L]abor relinquishes its most effective weapon against management—its ability to strike . . . [while] management retains the prerogative to disrupt the lives of its employees by relocating or closing its facilities.").

192. Singer, *supra* note 10, at 649.

193. Lynd, *supra* note 191, at 396.

194. *See* F. O'CONNELL, *supra* note 22, at 56. While there is a general decline in the labor movement, some unions are gaining protection against layoffs and plant closings. Gould, *Job Security in the United States: Some Reflections on Unfair Dismissal and Plant Closure Legislation from a Comparative Perspective*, 67 NEB. L. REV. 28, 29 (1988) (describing the collective bargaining agreements negotiated by the United Auto Workers in the farm equipment and automobile industries).

Three practical reasons may explain further unions' failure to seek covenants explicitly regulating opportunistic behavior. First, unions suffer an information disadvantage in negotiating for these provisions.[195] Second, drafting these covenants leads to great expense in attempting to anticipate and provide for every contingency. Finally, job security may not be subject to mandatory bargaining.[196]

One of the main reasons that so few workers belong to unions is that collective bargaining agreements do not assure job security in this era of rapid economic adjustment.[197] Management has taken an antagonistic stance toward unions reminiscent of the hostility demonstrated in the 1920s.[198] Hence, as Professor Singer claims, "it is no answer to say the workers get what they bargained for."[199]

b. Alternative Means for Unions to Safeguard Members From Corporate Restructuring

In most corporate restructurings, union considerations are ignored because unions are precluded from playing an active role at the negotiating table. Unions that have sufficient power are exploring new methods to establish a voice in corporate decisions that affect their livelihoods.[200] For example, in some chapter 11 bankruptcy proceedings, union officials bargain with other creditors about significant corporate strategies.[201] In this regard, Professor Stone comments that "unions and the other groups literally renegotiate the nexus of contracts that comprise the corporation."[202] In addition to the bankruptcy setting, a few unions have asserted influence in hostile takeovers.[203] By using wage conces-

195. Bull, *supra* note 92, at 149-50 (informational asymmetry between the firm and workers gives rise to a need for implicit contracts).

196. *See* First Nat'l Maintenance Corp. v. NLRB, 452 U.S. 666, 681-86 (1981) (Section 8(d) does not apply to the decision to terminate business.); Otis Elevator Co., 269 N.L.R.B. 891, 893-94 (1984) (no duty to bargain over relocation); *see also* Stone, *supra* note 88, at 95 (same); Note, *An Economic Case for Mandatory Bargaining Over Partial Termination and Plant Relocation Decisions*, 95 YALE L.J. 949, 949-50 (1986) (same).

197. *See* Dickens & Leonard, *supra* note 178, at 324.

198. *See generally* Summers, *Past Premises, Present Failures, and Future Needs in Legislation*, 31 BUFF. L. REV. 9, 10-12 (1982) (describing labor relations before NLRA passed).

199. Singer, *supra* note 10, at 730. Judge Easterbrook and Professor Fischel respond that even "take them or leave them" terms are real contracts that should be enforced "because their value or (detriment) is reflected in price." Easterbrook & Fischel, *Contract*, *supra* note 87, at 1429.

200. *See, e.g.*, Stone, *supra* note 88, at 75-78. "The developments challenge our current understanding of the labor-management relationship and seem to require a new conception of the role of labor in the corporate structure." *Id.* at 79.

201. *See, e.g.*, *id.* at 169 (In these negotiations, "unions fight to the death.").

202. *See, e.g.*, *id.* at 160.

203. *See* Coffee, *Unstable Coalitions: Corporate Governance as a Multi-Player Game*, 78 GEO. L.J. 1495, 1521-26 (1990). Union attempts to bargain for antitakeover protection may fail under corporate law. In Air Line Pilots Association v. UAL Corporation, 874 F.2d 439 (7th Cir. 1990), the Seventh Circuit examined union contract provisions between United Air Lines and the International Association of Machinists designed to prevent the Air Line Pilots Association from taking over the corporation. The Seventh Circuit held that Delaware corporate law barred such provisions. The contract provided that the machinists' union could renegotiate their contract if a takeover occurred and also provided that if United Air Lines offered an ESOP to the pilots, it had to offer a similar plan to all other employees. *Id.* at 441-42.

sions, certain unions have tipped the balance in favor of a bidder that they believe will be more sensitive to employee concerns.[204] On the legal front, unions are lobbying to eliminate the tax deduction for debt to deter corporations from pursuing higher leverage.[205] Organized labor also advocates changes in the law to discourage employers from unilaterally terminating pension plans to finance mergers and acquisitions with the plan's excess assets.[206] Further, many unions propose altering the successorship rules so that subsequent owners of the corporation must abide by previous collective bargaining agreements.[207] Turning to the courts, unions are filing innovative claims against their corporations for wrongful discharge as well as suits against raiders for tortious interference with contracts.[208] So far, these claims have not brought unions relief from corporate restructuring; the courts have been reluctant to create remedies for plant closings even when employees agree to wage concessions and management assures the workers that the plant will not close.[209]

This Article ultimately proposes that corporate directors should have a fiduciary obligation to displaced workers. Other options, however, must also be investigated. In particular, the advantages and disadvantages of alternatives must be analyzed to determine whether a legal solution is needed, or whether the market eventually will adjust to reallocate the risks associated with restructuring.[210]

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204. For example, in the recent contest between Carl Icahn and Texas Air Corporation for control of Trans World Airlines, the unions in effect chose the victor by negotiating a concessions package with Icahn that they believed would be less drastic than the wage cuts and layoffs they anticipated Texas Air would impose upon them if it obtained control. Salpukas, *The Long Fight for TWA: Unions Decided the Winner*, N.Y. Times, Aug. 31, 1985, at 1, col.5, at 35, col. 1.

205. *See, e.g., Pension Hearings, supra* note 4, at 193.

206. *See, e.g., id.* at 197.

207. *See, e.g., id.* at 206.

208. *See, e.g.,* Tasini, *More Workers Are Saying, "Take This Job Cut and Shove It,"* BUS. WK., Dec. 29, 1986, at 38. The Wickes Company attempted to gain control of Owens-Corning through a hostile takeover in the summer of 1986. In defeating the takeover, Owens-Corning incurred $2.6 billion in debt and, as a result, had to implement massive layoffs. *See supra* text accompanying note 70. The Glass, Molders, Pottery, Plastics & Allied Workers International Union brought suit against the Haft group on behalf of 800 employees who previously had worked at the Barrington, N.J. plant, claiming that Wickes intentionally interfered with the workers' prospective economic relations with Owens-Corning. The court denied the company's motion to dismiss the claim. Glass Molders Int'l Union v. Wickes Co., 707 F. Supp. 174, 179-80 (D.N.J. 1989); *see also* Geyelin & Brannigan, *Ex-Workers Can Sue Over Takeover Bid*, Wall St. J., Mar. 27, 1990, at B8, col. 4.

Local governments also are finding ways to seek compensation for their investments in corporations that leave. *See* Russell, *Implied Contracts and Creating a Corporate Tort, One Way State and Local Government Are Starting to Fight Plant Closings*, 90 W. VA. L. REV. 1249 (1988); Schultz & David, *The Use of Eminent Domain and Contractually Implied Property Rights to Affect Business and Plant Closings*, 16 WM. MITCHELL L. REV. 383, 385-86 (1990); Comment, *Eminent Domain: The Ability of a Community to Retain an Industry in the Face of an Attempted Shut Down or Relocation*, 12 OHIO N.U.L. REV. 231-34 (1985).

209. *See* Rhine, *supra* note 180, at 274.

210. M. AOKI, *supra* note 18, at 4 ("When conditions permit, employees and their organizations will no doubt seek to influence the decisions of firms through the exercise of their bargaining power at all levels of the economy."); Coffee, *Shareholders Versus Managers, supra* note 91, at 79 (Employees "will change their behavior as the significance of the takeover's impact grows on them. Over time, the process is a dynamic one, and defensive reactions must be expected from these other constituencies that will in turn affect shareholders."); Stone, *supra* note 88, at 161 ("[A]ssets specificity of the union members' investment . . . gives them a powerful incentive to seek to shape major corpo-

One possible means of protecting employees against displacement is for unions to encourage the growth of employee ownership of the corporation.[211] Recently, the number of Employee Stock Ownership Plans (ESOPs) has escalated,[212] and experts expect the number to continue to rise. A wide difference of opinion exists, however, as to whether employees benefit from these schemes.[213] On the one hand, workers may not benefit because they cannot diversify the risk of unemployment, while ownership of stock increases this firm-specific risk.[214] Thus, employee-ownership of stock tends to widen the gap in risk preferences between employees and shareholders who hold diversified portfolios.[215] On the other hand, employees may benefit from ESOPs even though they increase their firm-specific risk because a trade-off exists between the costs of underdiversification and the benefits of saving their livelihoods through ownership of the corporation.[216]

Despite the debate over the benefits of ESOPs,[217] employees have used these plans to gain bargaining power in several ways. Some have employed ESOPs to take over their corporations as a means of preserving collective bargaining contracts.[218] Other unions have used ESOPs to increase their negotiating

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rate decisions."). *See generally* Kaplow, *An Economic Analysis of Legal Transitions,* 99 HARV. L. REV. 509 (1986) (market solutions are favorable over government regulation).

211. For an extended discussion of ESOPs, see M. ROSEN, K. KLEIN & K. YOUNG, EMPLOYEE OWNERSHIP IN AMERICA (1986). For a criticism of worker-owned firms, see Jensen & Meckling, *Rights and Production Functions: An Application to Labor-Managed Firms and Codetermination,* 52 J. BUS. 469 (1979).

212. Haddock, Macey & McChesney, *supra* note 118, at 701 ("[T]hose making firm-specific human capital investments sometimes defend against potential opportunism by taking control of the asset to which their investment is specific."); *see also* Lipton, *Corporate Governance, supra* note 11, at 44 (predicting that in the twenty-first century employee ownerships will dominate corporate governance). The use of ESOPs will increase after the *Polaroid* decisions, which ruled broadly about the use of ESOPs as a defensive measure. Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 278, 285-92 (Del. Ch. 1989) (*Polaroid II*). Under the plan those cases, the employees would receive more than $300 million worth of stock (14% of the company) over a ten-year period. The employees financed the plan by a 5% pay cut, 401(k) matching funds, a delayed pay-scale change, and profit-sharing retirement contributions. Under a confidential tendering provision, the employees have full voting rights and must direct a trustee to vote both allocated and unallocated shares. The judge referred to the plan as "shareholder neutral." Shamrock Holdings Inc. v. Polaroid Corp., 559 A.2d 257, 262 (Del. Ch. 1989) (*Polaroid I*). In finding that the ESOP was fair, the court stated that the plan would improve morale and performance, even though it was unpopular with the workers because of the 5% pay cut. *Id.* at 272.

213. Farrell & Hoerr, *ESOPs: Are They Good for You?,* BUS. WK., May 15, 1989, at 116; *Ruling on* Polaroid *Anti-Takeover Defense Seen Boosting Use of Employee Stock Ownership Plans,* Daily Lab. L. Rep. (BNA), No. 6, at A-6 (Jan. 10, 1989) (ruling a "mixed bag" for employees because the most effective ESOPs are ones that management believes in because of the concept.).

214. Coffee, *Corporate Web, supra* note 9, at 76 n.210; Doernberg & Macey, *ESOPs and Economic Distortion,* 23 HARV. J. ON LEGIS. 103, 133-36 (1986); Macey, *supra* note 19, at 194 n.81; Note, *The False Promise of Worker Capitalism: Congress and the Leveraged Employee Stock Ownership Plan,* 95 YALE L.J. 148, 168 (1985) (workers may lose jobs and pension benefits).

215. Coffee, *Shareholders Versus Managers, supra* note 91, at 82-83 (ESOPs "exacerbate the asymmetry in risk attitudes between shareholders and managers").

216. *See* R. POSNER, ECONOMIC ANALYSIS OF THE LAW 420 (3d ed. 1986).

217. *See, e.g.,* B. BLUESTONE & B. HARRISON, *supra* note 9, at 257-62.

218. Hyde & Livingston, *Employee Takeovers,* 41 RUTGERS L.J. 1131, 1134 (1989) (efforts of Air Line Pilots Association to purchase United Air Lines resulted in fall of corporate management); *see also* Simmons, Ward, & Watson, *An ESOP Can Be an Effective Anti-Takeover Device,* NAT'L L.J., June 30, 1986, at 25 (discussing recent examples).

power in hostile takeovers by granting wage concessions to a favored bidder.[219] For example, ESOPs aid workers when an anti-union raider has a strong likelihood of winning a hostile battle for control. Under these circumstances, the employees benefit by giving their allegiance to management through an ESOP.[220] In several hostile takeovers, however, managers have exploited the ESOP mechanism to serve their own interests.[221]

In addition to ESOPs, employees indirectly own a great deal of stock through pension plans.[222] Institutional investors that administer employee benefit plans may be an influential ally in defending employees against the consequences of corporate restructuring.[223] Nonetheless, institutional investors at present tend to promote the merger and acquisition fever because portfolio managers receive their compensation based upon short-term profits.[224] Many portfolio managers also presume that fiduciary constraints may prevent them from considering the implications of their investment strategies.[225] Ironically, the intended beneficiaries of these investment decisions, the employees, may be injured by such a shallow outlook.[226] Employees, therefore, should persuade institutional investors to alter the incentive schemes for portfolio managers so that these managers are free to consider the negative effects that corporate restructuring may have upon jobs.[227]

In sum, Professor Coffee's distinction between managers and lower-level employees rests on a weak normative base that does not withstand close analysis. Lower-level employees also rely upon implicit contracts by making firm-specific investments of human capital. Moreover, firms often promise deferred compensation to employees as a performance incentive as well as employment insurance. Although managers also rely upon implicit contracts, they do not present a compelling case for protection. Professor Brudney explains: "Management is, if not the only constituency that can protect itself against the disaster, at least the one best able to do so."[228] Managers are more sophisticated and better in-

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219. *See, e.g.*, Burr, *ESOPs Boom as a Defense*, PENS. & INV. AGE, Apr. 17, 1989, at 1.

220. *See* Coffee, *Unstable Coalitions: Corporate Covernance as a Multi-Player Game*, 78 GEO. L.J. 1495, 1527 (1990).

221. Management uses the ESOP device because under Delaware law, an acquiring company may not merge within three years of a transaction unless it acquires 85% of the company. DEL. CODE ANN. tit. 8, § 203(a)(2) (Supp. 1988). ESOPs are excluded from the calculation unless employees have the right to tender the shares confidentially. *Id.*

222. *See, e.g.*, Ratner, *When Rational Investing Has Adverse Effects*, Legal Times, Apr. 24, 1989, at 24 (Institutional investors owning 24% of U.S. corporations predicted to own a majority by the end of this century.).

223. *See, e.g.*, Conard, *Will Institutional Investors Take Charge?*, 47 CORP. DIRECTIONS 45 (1990) [hereinafter Conard, *Take Charge*]; Conard, *Beyond Managerialism: Investor Capitalism?*, 22 U. MICH. J.L. REF. 117, 131-52 (1989).

224. *See, e.g.*, Ratner, *supra* note 222, at 24.

225. *See, e.g.*, Ravikoff & Curzan, *Social Responsibility in Investment Policy and the Prudent Man Rule*, 68 CALIF. L. REV. 518, 524-28 (1980).

226. *See, e.g.*, Minow, *Social Investing: Making the Right Choices*, Legal Times, Apr. 24, 1989, at 28.

227. DeMott, *Assessing Investors' Long-Term Commitment*, Legal Times, Apr. 24, 1989, at 27 (noting that several British institutions have intervened in corporate management); Ratner, *supra* note 222, at 25.

228. Bratton, *Corporate Debt Relationships: Legal Theory in a Time of Restructuring*, 1989

formed than employees about the risks of restructuring.[229] In addition, management's control of the proxy machine provides them with a means to shelter themselves from the consequences of corporate change.[230] In contrast, contracts do not safeguard employees from layoffs and plant closings. Although a few unions provide some security to employees, most unions do not have the bargaining power to do so. This conclusion raises the question whether a legal response is appropriate to assure employees some degree of compensation for their investments in the corporation.

D. *Externality Analysis: Whether a Legal Solution Is Needed to Protect Employees' Reliance on Implicit Contracts*

Corporations may not have an incentive to mitigate the consequences of worker displacement because they can impose on employees the costs of restructuring without legal sanction. In other words, the quest to maximize profits may lead corporations blindly to forgo devoting earnings to severance benefits.[231] Thus, an externality exists. As Professor Coffee explains: "The implicit contract perspective leads directly to a recognition that shareholder wealth and social wealth do not necessarily coincide."[232] Professor Coffee adds the following observation: "[E]ven if there is no net social loss, any wealth transfer is probably in an anti-egalitarian direction because employees are losing as shareholders gain."[233]

To demonstrate that an externality exists, however, does not complete the inquiry. It is necessary to analyze whether the factors for eradicating an externality are present. Commentators explain that five factors must be met before a legal reply is merited.[234] First, one party's conduct must have an impact on others who have no ability to control this behavior.[235] As the previous discussion reveals, even unionized employees do not have sufficient bargaining power to prevent corporations from imposing on them the social costs of layoffs and plant closings.[236] Second, these social costs must affect the actions of the party that bears these costs. Displaced workers may suffer severe consequences from long periods of unemployment.[237] In addition, opportunistic breaches of implicit employment contracts lower employee morale, productivity, and loy-

DUKE L.J. 92, 147 (1989) ("[Managers'] self-interested behavior . . . provokes restructurings in the first place."); Brudney, *Comment*, in KNIGHTS, RAIDERS AND TARGETS, *supra* note 153, at 152-53 (favors compensating lower-level employees, but finds it "hard, therefore, to see the case for equity requiring a protective adjustment in management's status at takeover time").

229. Macey, *supra* note 19, at 185.

230. *Id.* at 179-80.

231. Singer, *supra* note 10, at 716.

232. Coffee, *Takeover Reform*, *supra* note 8, at 447 ("This may seem an unexciting conclusion, except for the fact that it has not been seriously considered by financial economists.").

233. *Id.* at 448 (If the poor value a dollar more, then such transfers involve negative social utility.).

234. Haddock, Macey & McChesney, *supra* note 118, at 723-26.

235. *Id.* at 723-24.

236. *See supra* notes 192-94 and accompanying text.

237. *See supra* notes 33-52 and accompanying text.

alty.[238] Third, the injured party must desire a correction of the other party's behavior. Workers desire protection from opportunistic breach of implicit employment contracts because market forces are particularly unlikely to be sufficient to enforce the severance payment term of implicit contracts if the employee is leaving a regional labor market.[239] Fourth, a legal response is not appropriate if the legislature has a bias toward any of the actors.[240] Finally, the social costs controlled must be greater than the costs of a public law solution.[241]

Part IV of this Article evaluates these last two factors. At this point, however, it is instructive to review how courts and legislatures have responded to the social costs produced by corporate restructuring by allowing directors to consider the interests of nonshareholder constituents.

II. CORPORATE LAW'S RESPONSE TO CONCERN FOR STAKEHOLDERS' INTERESTS

A. *Courts Construe the Directors' Responsibility to Nonshareholder Constituents in Takeover Context*

Applying the business judgment rule, courts provide directors with a great deal of leeway in making decisions that increase corporate profits. In general, courts have not penalized directors for pursuing social objectives that they reasonably believe will enhance shareholders' wealth in the long run.[242] There is no long-run, however, for the shareholders who want to earn a premium on their investments in a takeover.[243] When takeovers threaten to impose social harm, the interests of nonshareholder constituents may conflict with those of the shareholders.[244] Thus, the issue arises whether the directors' duty to the shareholders takes precedence over a duty to the other stakeholders in the corporation. An overview of several takeover cases reveals that courts face an inherent tension in their efforts to reshape the business judgment rule to protect shareholders from directorial self-interest while at the same time attempting to shield nonshareholder constituents from the consequences of takeovers.

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238. *See supra* note 135 and accompanying text.

239. Singer, *supra* note 10, at 791. (Even if employees prefer higher short-term wages over severance benefits, some commentators have argued the law should imply a property right in the employment contract because unemployment imposes costs upon the state.).

240. Haddock, McChesney & Macey, *supra* note 118, at 723 n.57 ("If the actors in the legal system, such as the legislature, are themselves self-interested, these five conditions, while still necessary, will not be sufficient to assure the desirability of legal intervention.").

241. *Id.* at 725-26.

242. The courts have not had much opportunity to discuss this issue. Courts, however, have allowed directors to make charitable contributions because such actions increase the shareholders' wealth in the long run. A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581, *appeal dismissed*, 346 U.S. 861 (1953) (recognizing corporations have social responsibilities). *But see* Dodge v. Ford Motor Co., 204 Mich. 459, 507, 170 N.W. 668, 684 (1919) ("[I]t is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others . . . .").

243. *See, e.g.*, Davis, *Epilogue*, 1988 WIS. L. REV. 493, 519-20 ("[I]t becomes harder to rationalize benefits for stakeholders on the basis of the corporation's long-term self-interest if its corporate existence is about to end.").

244. *See, e.g.*, Johnson, *The Eventual Clash Between Individual and Legislative Notions of Target Management Conduct*, 14 J. CORP. L. 35, 46 (1988).

When courts first confronted the takeover setting, they applied the business judgment rule to directors' decisions to employ defensive tactics in the same manner that they applied the rule to ordinary business transactions.[245] As takeovers continued, however, the courts eventually modified the business judgment rule in response to the possibility that directors would employ defensive strategies to save their jobs. Recognizing that takeovers empower shareholders to discipline inefficient management, courts in some cases refused to grant the protection of the business judgment rule to permit market forces to operate freely.

For example, in 1984, in *Norlin v. Rooney Pace, Incorporated*,[246] the Second Circuit perceived its role as ensuring that the "owners" of the corporation have a fundamental right to make "decisions affecting [the] corporation's ultimate destiny."[247] The target directors in *Norlin* responded to a takeover by transferring stock to a newly-created ESOP to enable them to retain control of the corporation. The Second Circuit found that in establishing the ESOP, the directors were not seeking "to benefit the employees, but rather to solidify management's control of the company."[248] The *Norlin* court acknowledged that directors should consider the interests of nonshareholder constituents, but focused primarily on restraining directors from acting in their self-interest to prevent shareholders from earning a takeover premium.[249]

As the takeover era proceeded, judges continued to mold the business judgment rule to fit the special circumstances involved in hostile battles for control. In *Unocal Corporation v. Mesa Petroleum Company*,[250] the Delaware Supreme Court enhanced the business judgment rule as applied to defensive tactics by placing the burden on directors to show that the takeover threatened corporate policy and that the defensive response was "reasonable in relation to the threat posed."[251] In dicta, the *Unocal* court noted that directors appraising a takeover bid should gauge "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[252]

245. *See, e.g.*, Panter v. Marshall Field & Co., 646 F.2d 271, 297-98 (7th Cir. 1981) (applying business judgment rule to hold that directors did not breach their fiduciary duty in bringing an antitrust suit against a would-be acquiror); Johnson v. Trueblood, 629 F.2d 287, 293 (3d Cir. 1980) (no error in requiring plaintiff to prove that directors' primary purpose for a course of action is to retain control), *cert. denied*, 450 U.S. 999 (1981); Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984) (plaintiffs failed to plead facts supporting claim that directors rejected takeover proposal solely to retain control).

246. 744 F.2d 255 (2d Cir. 1984).

247. *Id.* at 258; *see also* Hanson Trust PLC v. MC SCM Corp., 781 F.2d 264, 277 (2d Cir. 1986) (enjoining a lock-up option).

248. *Norlin*, 744 F.2d at 265.

249. Johnson, *Who Are They For?*, *supra* note 11, at 800.

250. 493 A.2d 946 (Del. 1985).

251. *Id.* at 955.

252. *Id.* (citing Lipton & Brownstein, *Takeover Responses and Directors' Responsibilities: An Update*, 40 BUS. LAW. 1403 (1985)). Other courts have noted that a board should consider nonshareholder interests. *See, e.g.*, Herald Co. v. Seawell, 472 F.2d 1081, 1094-95 (10th Cir. 1972) ("[A] corporation publishing a newspaper . . . certainly has other obligations besides the making of a profit," including "those people who make its daily publication possible."); Gelco Corp. v. Coniston Partners, 652 F. Supp. 829, 850 (D. Minn. 1986) (directors may consider employees in decisionmaking process); Enterra Corp. v. SGS Assocs., 600 F. Supp. 678, 687 (E.D. Pa. 1985) (defensive mea-

This dicta provided the basis for the court's subsequent discussion in *Revlon, Incorporated v. MacAndrews & Forbes Holdings, Incorporated.*[253] of the extent to which directors can assess the consequences of a takeover on nonshareholder constituents. *Revlon* involved an attempt by the Revlon board to thwart a hostile bid by granting a lock-up option to a white knight in return for certain assurances designed to pacify the corporation's noteholders. The directors defended this action by contending that *Unocal* permitted due regard for other corporate constituents. The *Revlon* court qualified its previous statement in *Unocal* by stating that the board could evaluate the concerns of nonshareholders "provided there are rationally related benefits accruing to the stockholders."[254] In turning to the lock-up provision, however, the supreme court held that once a "break-up of the company [is] inevitable," the duty of the board is to maximize the return to shareholders.[255] Thus, the Revlon directors no longer could weigh the effect of the takeover on nonshareholders once they put the corporation up for sale.[256] Assuming that the corporation is not yet on the market, the board may consider the impact of its actions on nonshareholder constituencies.[257] Thus, the critical issue has become when "the breakup of the company [is] inevitable," that is, when it is in the "*Revlon* mode."

The Delaware Supreme Court addressed this issue in *Paramount Communications, Incorporated v. Time, Incorporated.*[258] After Time had agreed to merge with Warner, Paramount stepped in with a bid for Time. In response, Time and Warner restructured their deal to prevent the takeover. The issue arose whether Time's original agreement with Warner triggered *Revlon* duties. The Delaware Supreme Court held that Time did not place itself on the auction block when it decided to maintain its long-term strategic policies of entering the global entertainment market.[259] *Paramount* reaffirmed the view that directors have no duty to maximize the shareholders' short-term value and that directors may take into account the interests of other constituents in making decisions in the corporation's best interest.[260] Significantly, the lower court opinion emphasized that Time had agreed to the merger because Warner was compatible with the "Time

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sure may provide stability to employment relationship); Mills Acquisition Co. v. Macmillan, Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,401 (Del. 1989) (board may consider impact on constituencies other than stockholders); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341-42 (Del. 1987) (same). Other courts have rejected this approach, stating that the other constituents can gain protection through contract. *See, e.g.*, Kirscher Bros. Oil, Inc. v. Natomas Co., 185 Cal. App. 3d 784, 796-97, 229 Cal. Rptr. 899, 906-08 (1986) (no fiduciary duty to preferred stockholders to restructure merger); Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 593-94 (Del. Ch. 1986) (duty to preferred shareholders contractual); Katz v. Oak Indus., Inc., 508 A.2d 873, 879 (Del. Ch. 1986) (relationship between debtholders, even those holding convertible securities, is contractual).

253. 506 A.2d 173 (Del. 1986).

254. *Id.* at 182.

255. *Id.*

256. *Id.* ("[C]oncern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.").

257. Lipton, *Corporate Governance, supra* note 11, at 40-41.

258. 571 A.2d 1140 (Del. 1990).

259. *Id.* at 1151.

260. *Id.* at 1153; *see* Hansen, *Non-Shareholder Constituency Statutes: Analysis of the Law*, in

culture." That is, the directors did not see the "mission of the firm . . . as wholly economic."[261] Recognizing the importance of Time's sense of social responsibility to its employees, the Delaware Chancery Court noted: "Many people commit a huge portion of their lives to a single large-scale business organization. They derive their identity in part from that organization and feel that they contribute to the identity of the firm."[262]

Other courts specifically have acknowledged the special concerns of employees in takeover transactions. For example, in *GAF Corporation v. Union Carbide Corporation*,[263] a federal court applying New York law declared that the "protection of loyal employees, including managers, of the organization is not anathema in the Courthouse."[264] More specifically, the court asserted:

> A corporation with a perceived threat of dismemberment of large divisions of the enterprise, employing thousands of employees, owes substantial regard for their pension benefits, and in the case of loyal management, severance benefits. These legitimate concerns for the past conduct of the enterprise and its requirements need not be left to the goodwill of an unfriendly acquirer of corporate control in the jungle warfare involving attempted takeovers. The exercise of independent, honest business judgment . . . is the traditional and appropriate way to deal fairly and even-handedly with both the protection of investors, on the one hand, and the legitimate concerns and interests of employees and management of a corporation who service the interests of investors, on the other.[265]

So far, the courts have not compelled directors to take action to assist them.[266] Recently, the American Law Institute proposed a principle of corporate governance that would permit directors to prevent a takeover so long as they did not "materially disfavor the long-term interests of the shareholders."[267] Thus, the ALI proposal takes a step further than the case law by authorizing directors to safeguard the stakeholders' interests to such an extent that the

10TH ANNUAL RAY GARNETT JR. CORPORATE AND SECURITIES LAW INSTITUTE 14-15 (1990) [hereinafter SECURITIES LAW INSTITUTE].

261. *In re* Time Inc. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,269 (Del. Ch. 1989), *aff'd*, 565 A.2d 280 (Del. 1989).

262. *Id.* (The directors took into account Time's "larger role . . . in society.").

263. 624 F. Supp. 1016 (S.D.N.Y. 1985).

264. *Id.* at 1019.

265. *Id.* at 1019-20. The court seemed to imply that concern for the employees ultimately would benefit the shareholders, stating that the board's duty was "solely to the welfare of Carbide's investors and to deal with the interests of Carbide's employees and management fairly, in furtherance of those interests." *Id.* at 1019.

266. *See, e.g.*, Local 1330, United Steel Workers v. United States Steel Corp., 631 F.2d 1264, 1282 (6th Cir. 1980) (directors could close plant in spite of effects on community).

267. AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 6.02(a), at 122-23 (Tent. Draft No. 10, 1990). Section 6.02 of the ALI's Principles states that a target's board "may take an action that has the foreseeable effect of blocking an unsolicited tender offer, unless the action would materially disfavor the long-term interests of the shareholders." *Id.* At the May 1990 meeting of the ALI, a motion passed to amend the draft to include the phrase "corporation and its" before "shareholders." *In Departure from Corporate Governance Draft, ALI Supports Broader Takeover Defense Authority*, 5 Corp. Couns. Wkly. (BNA) No. 21, at 8 (May 23, 1990).

shareholders may lose wealth in the short run.[268] The ALI, like the courts, however, has failed to articulate an underlying theoretical basis for allowing such business strategies.[269] In other words, neither the ALI nor the courts have explained why shareholders should not be entitled to profit in the short run. The cases also fail to provide clear guidance as to when directors may support nonshareholders and the extent to which directors can take nonshareholder needs into account.[270]

In addition to revising the business judgment rule in the takeover context, the courts recently have modified directors' traditional fiduciary duties. The courts have augmented the directors' legal obligations by imposing affirmative obligations beyond the duty of care.[271] For example, in *Smith v. Van Gorkom*,[272] the Delaware Supreme Court held that directors have a special duty to familiarize themselves with the available information about important business decisions.[273] Other cases holding that directors must redeem poison pills illustrate that directors may breach their fiduciary obligations even when they act disinterestedly.[274] In this regard, Professor DeMott contends: "[D]irectors as fiduciaries resemble other types of fiduciaries, like trustees and guardians, whose positions are conventionally held to impart affirmative obligations."[275]

In sum, the takeover context has pushed courts to resolve the inherent tension between shareholder accountability and stakeholder protection. In settling this conflict, the courts have favored the shareholders, at least in the long run. In contrast, a review of the state antitakeover statutes reveals that the legislatures have opted to prefer nonshareholder considerations.

B. States Enact Antitakeover Statutes to Prevent Job Loss

1. Business Combination Statutes

The widespread concern that takeovers cause job loss has prompted most states to enact some form of antitakeover legislation.[276] Because the states ulti-

268. *See* McDaniel, *Bondholders and Corporate Governance* 41 BUS. LAW. 413, 442-43 (1986) [hereinafter *Bondholders*].

269. As Professor Johnson states, "[B]y implicitly seeking to reconcile interests in this manner, the courts fail to state precisely why shareholders should not be entitled to elect an immediate stock premium . . . over longer-run profit for the entity." Johnson, *supra* note 244, at 52.

270. *See, e.g.*, Block & Miller, *The Responsibilities and Obligations of Corporate Directors in Takeover Contests*, 11 SEC. REG. L.J. 44, 69-70 (1983); Feinberg, *The Directors' New Dilemma in the Takeover Crisis: A Special Report*, INST. INV., June 1987, at 30, 46.

271. *See* DeMott, *supra* note 7, at 21-22.

272. 488 A.2d 858 (Del. 1985).

273. *Id.* at 877-78.

274. DeMott, *supra* note 7, at 21; *see* Gilson & Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 267 (1989).

275. DeMott, *supra* note 7, at 21.

276. These statutes have produced a large debate over whether the states sought to benefit nonshareholder constituents or to allow existing management to save their jobs. Some commentators assert that legislatures sought to protect nonshareholders. *See, e.g.*, Bartlett, *Beware of State Takeover Laws*, FORTUNE, Nov. 9, 1987, at 182 (legislatures are protecting local businesses against outsiders); Davis, *supra* note 243, at 515-17 (shareholders no longer protected by takeover statutes); Johnson, *supra* note 244, at 35 (legislatures impose obstacles to takeovers even though such transactions may benefit investors); Johnson & Millon, *supra* note 65, at 1863 (legislatures oppose takeovers

mately bear the social and economic costs of takeovers, legislatures have tipped the balance in favor of local stakeholders rather than nonresident shareholders.[277] Specifically, at least one-half of the states have adopted some form of business combination statute to prevent takeovers that are perceived as causing layoffs and plant closings.[278] For example, the business combination laws of Delaware[279] and New York[280] limit a takeover bidder's ability to restructure the corporation once it gains control. Delaware's statute prevents the bidder from engaging in certain "business combinations"—that is, transferring the target's assets to itself or to its affiliates.[281] Delaware's statute, however, does not totally prevent "bust-up" takeovers as the bidder still can sell the corporation's assets to others, and then distribute the proceeds to the shareholders.[282] New York's "anti-bust-up" statute goes further and restricts the acquiror's ability to sell the corporation's assets for five years after the takeover.[283]

Pennsylvania recently passed the most controversial antitakeover provision to date which requires a "controlling person" to disgorge to the target corporation any profits made on the sale of stock within eighteen months after becoming

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because they result in layoffs); Johnson & Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846, 848 (1989) (legislatures pursue objectives inconsistent with shareholder welfare); *More States Are Telling Raiders: Not Here, You Don't*, BUS. WK., Feb. 13, 1989, at 28 (statutes designed to repel raiders rather than to protect shareholders). Other commentators contend that these statutes allow managers to act in their own interests. *See, e.g.*, Butler, *Corporation-Specific Anti-Takeover Statutes and the Market for Corporate Charters*, 1988 WIS. L. REV. 365, 367 (the purpose of state antitakeover statutes is to protect management jobs); Macey, *National Economy*, *supra* note 61, at 478 (major national unions voice opposition to state antitakeover statutes); Romano, *supra* note 66, at 462 (noting that labor does not lobby for such statutes); Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 137-38 (1987) (same). For additional commentary on the role of the states in regulating takeovers, see Hazen, *State Anti-Takeover Legislation: The Second and Third Generations*, 23 WAKE FOREST L. REV. 77 (1988); Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on* CTS Corp. v. Dynamics Corp. of America, 101 HARV. L. REV. 96 (1987). For an overview of state antitakeover statutes, see Beasey, Finkelstein & Shaughnessy, *The Delaware Takeover Law: Some Issues, Strategies and Comparisons*, 43 BUS. LAW. 865, 877-81 (1988).

277. *See, e.g.*, Johnson & Millon, *supra* note 65, at 1980 (legislatures act because takeovers cause plant closings and layoffs). For a discussion of the constitutional concerns raised by these statutes, see Dynamics Corp. of America v. CTS Corp., 481 U.S. 69 (1987) (holding Indiana control share statute constitutional under Williams Act and Commerce Clause); Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496 (7th Cir.) (Wisconsin statute upheld), *cert. denied*, 110 S. Ct. 367 (1989); BNS, Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988) (holding tender offeror seeking order declaring Delaware's Business Combinations statute unconstitutional not likely to prevail on merits of Williams Act or Commerce Clause challenge); Black & Decker Corp. v. American Standard, Inc., 679 F. Supp. 1183 (D. Del. 1988) (Delaware antitakeover law held constitutional).

278. For a list of these statutes, see Garmer & Ryba, *State Takeover Statutes*—Amanda v. Universal Foods *and its Aftermath*, SECURITIES LAW INSTITUTE, *supra* note 260, at 1, 8 n.10.

279. DEL. CODE ANN., tit. 8, § 203 (Supp. 1988); *see also* Johnson, *Corporate Life*, *supra* note 24, at 909 ("Delaware's recent statute alone governs about half of all companies listed with the New York Stock Exchange.").

280. N.Y. BUS. CORP. LAW § 912 (Consol. 1988) (restricting mergers, certain asset sales, or liquidations for five years after a hostile takeover).

281. DEL. CODE ANN. tit. 8, § 203(c)(3) (Supp. 1988) (corporations cannot engage in a merger, liquidation, or sale of assets for three years after acquiring 15% of the stock without board approval).

282. J. CHOPER, J. COFFEE & C. MORRIS, CORPORATIONS 1097 (3d ed. 1989).

283. N.Y. BUS. CORP. LAW § 912 (Consol. 1988). New York's statute bars *any* substantial sale of assets or merger for five years after any shareholder acquires 20% of the corporation's stock without prior board approval.

a controlling person.[284] As responses to the problem of job loss, these statutes are overbroad because they apply to all takeovers, not just those that result in layoffs and plant closings.[285]

Few states have tailored their statutes to apply to layoffs resulting from takeovers. Massachusetts enacted a statute, the first of its kind in the nation, which provides that any employee terminated within two years after a change in control is eligible for a lump sum payment from the acquiror equal to twice the employee's weekly compensation times the number of years of service.[286] The statute, however, does not apply to layoffs and plant closings implemented by existing management.[287]

2. Stakeholder Statutes

In response to the perception that takeovers produce job loss, over one-half of the states have adopted some form of stakeholder statute.[288] As noted previ-

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284. *Controversial Pennsylvania Legislation Would Require Raiders and Others to Disgorge Profits*, Corp. Coun. Wkly. (BNA) No. 12, at 7 (March 21, 1990) (applies to the target company's stock acquired during the 24-month period before becoming a controlling person and the 18-month period afterward); Armstrong, *At Least 67 Firms Buck Act 36*, 9 PHIL. BUS. J. 1 (July 30, 1990) (One-third of companies covered opt out.).

285. *See, e.g.*, Coffee, *Takeover Reform*, *supra* note 8, at 460 ("[T]he problem with statutes such as New York's is that they confer a de facto veto power. Real and exposed as the interests of stakeholders are, they do not merit relief this drastic when less restrictive alternatives will suffice.").

286. MASS. GEN. L. Ch. 149 § 183(b) (1988).

287. Note, *supra* note 11, at 855 ("As long as managements' 'golden parachutes' are golden enough, Business Corporation laws will do nothing to stop management from selling or closing down the shop.").

288. ARIZ. REV. STAT. ANN. § 10-1202.A (Supp. 1990); CONN. GEN. STAT. ANN. § 33-313(e)(3) & (4) (West Supp. 1990); FLA. STAT ANN. § 607.0830(3) (West Supp. 1991); GA. CODE ANN. § 14-2-202(b)(5) (1989); HAW. REV. STAT. § 415-35(b) (Supp. 1990); IDAHO CODE §§ 30-1602 & 30-1702 (Supp. 1990); ILL. ANN. STAT. ch. 32 para. 8.85 (Smith Hurd Supp. 1990); IND. CODE ANN. § 23-1-35-1(d) (Burns 1989); IOWA CODE § 491.101B (1989); KY. REV. STAT. ANN. § 271B.12-210 (4) (Michie/Bobbs-Merrill Supp. 1990); LA. REV. STAT. ANN. § 12:92G(2) (West Supp. 1991); ME. REV. STAT. ANN. § 716 (West Supp. 1990); MASS. ANN. LAWS ch. 156B, § 65 (Law. Co-op. Supp. 1990); MINN. STAT. ANN. § 302A.251 (5) (West Supp. 1991); MISS. CODE ANN. § 79-4-8.30(d) (Supp. 1991); MO. ANN. STAT. § 351.347.1(4) (Vernon Supp. 1991); NEB. REV. STAT. § 21-2035(1)(c) (Supp. 1990); N.J. REV. STAT. § 14A:6-1(2) (Supp. 1989); N.M. STAT. ANN. § 53-11-35 (Supp 1989); N.Y. BUS. CORP. LAW § 717(b) (McKinney Supp. 1991); OHIO REV. CODE ANN. § 1701.59(E) (Anderson Supp. 1990); 1989 OR. LAWS § 60.357(5); PA. STAT. ANN. tit. 15, §§ 511(c) & 1721(c), tit. 42 § 8363(b) (Purdon Supp. 1990); S.D. CODIFIED LAWS ANN. § 47-33-4 (Supp. 1990); TENN. CODE ANN. § 48-35-204 (1988); WIS. STAT. ANN. § 180.305 (Supp. 1990); WYO. STAT. § 17-16-830(e) (Supp. 1989).

Pennsylvania was the first state to pass a stakeholder statute. PA. STAT. ANN. tit 42 § 8363(b) (Purdon Supp. 1990). One commentator refers to these statutes as "social justice" statutes. Andre, *A Preliminary Inquiry Into the Utility of Vote Buying in the Market for Corporate Control*, 63 S. CAL. L. REV. 533, 574 (1990). The idea for these statutes originated in a charter amendment by Control Data Corporation. Hanks, *supra* note 17, at 20. Other corporations also have charter amendments that allow directors to take such considerations into account. Lipton, *Corporate Governance*, supra note 11, at 41 n.188 (McDonald's Corporation). Many corporations adopt the stakeholder model of management. The purpose of these statutes and charter amendments is not only to make hostile takeovers more difficult, but also to alleviate concerns about directors' liability. Hanks, *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1210 (1988). For additional commentary, see Gavis, *A Framework for Satisfying Corporate Directors' Responsibilities Under State Nonshareholder Constituency Statutes: The Use of Explicit Contracts*, 138 U. PA. L. REV. 1451 (1990); Hart & Degener, *Non-Stockholder Constituency Statutes*, N.Y.L.J., Apr. 19, 1990, at 1; Wester, *Achieving a Proper Economic Balance: Nonshareholder Constituency Statutes*, 19 STETSON L. REV. 581 (1990); Note, *Takeover Dangers and*

ously, most of these statutes are worded broadly to permit directors making business decisions to consider the interests of employees, suppliers, consumers, and, in some jurisdictions, the local and national economies. These stakeholder statutes are permissive; with one exception,[289] they do not mandate that directors address the needs of nonshareholder constituencies.[290] So far, the courts have not examined stakeholder statutes;[291] thus, the extent to which they will assist stakeholders is uncertain.

The stakeholder statutes create uncertainty in two ways. First, the legislation does not explain why directors should have responsibilities to various constituents.[292] Second, the stakeholder statutes assume that directors must balance the concerns of a variety of stakeholders, but fail to provide standards for assigning relative weights to these interests.[293]

By enacting the stakeholder statutes, state legislatures appear to be directing judges to develop the common law of directorial fiduciary duties.[294] Commentators are beginning to analyze how these statutes may alter the traditional notion that a director's primary fiduciary duty is to maximize shareholder wealth.[295] The uncertainty surrounding these statutes has given rise to active debate.[296]

Nonshareholders: Who Should Be Our Brother's Keeper?, 1988 COLUM. BUS. L. REV. 301; Note, *Stakeholder Versus Stockholder: The Director's Proper Constituency in a Contest for Corporate Control*, 15 WM. MITCHELL L. REV. 475 (1989).

289. CONN. GEN. STAT. ANN. § 33-313(e) (West Supp. 1990). The United Kingdom has a system of voluntary regulation for its securities industry, called the City Code, which specifically instructs that directors shall consider nonshareholder constituents in the tender offer context. The board of a U.K. company also has a statutory fiduciary duty to its employees. While these statutes use the "shall" formulation, employees do not have the right to enforce the duty. *See generally* Karmel, *The Duty of Directors to Non-Shareholder Constituencies in Control Transactions—A Comparison of U.S. and U.K. Law*, 25 WAKE FOREST L. REV. 61, 61 (1990) (matter of business judgment of directors); *see also* DeMott, *Current Issues in Tender Offer Regulation: Lessons From the British*, 58 N.Y.U. L. REV. 945, 968 (1983); Greene & Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions*, 132 U. PA. L. REV. 647, 734 (1984). The European community has proposed a corporate statute that requires the board to carry out its function "having regard in particular to the interests of the shareholders and the employees." COMMISSION OF THE EUOROPEAN COMMUNITIES BULLETIN OF THE EUROPEAN COMMUNITIES, STATUTE FOR A EUROPEAN COMPANY, Art. 74(2) (Supp. Mar. 1989). Germany once had a stakeholder statute, but it was not successful. Conard, *Reflections on the Public Interest Director*, 75 MICH. L. REV. 941, 948 n.33 (1977).

290. *See, e.g.*, Karmel, *supra* note 289, at 68 ("[G]iving directors the right to consider nonshareholder constituencies is different from imposing upon them the obligation to do so.").

291. *See* Baron v. Strawbridge & Clothier, 646 F. Supp. 690, 697 (E.D. Pa. 1986) (noting propriety of board's consideration of nonshareholders, such as employees, customers, and the community, but not analyzing the impact of statutes in any detail).

292. *See, e.g.*, Donaldson, *Corporate Takeovers: The Moral Backdrop*, in ETHICS *supra* note 24, at 3, 7; Macey, *supra* note 19, at 178 (Courts "have failed to articulate a theoretical basis" for taking into account nonshareholder constituents.).

293. *See, e.g.*, Donaldson, *supra* note 292, at 9; Hanks, *supra* note 17, at 21; Karmel, *supra* note 289, at 70.

294. *See, e.g.*, Hart & Padegs, *Legacy of Junk Bond, LBO Era*, NAT'L. L.J., Sept. 10, 1990, at 15, 20, col. 3; McDaniel, *Bondholders and Stockholders*, 13 J. CORP L. 205, 222 (1988).

295. Hanks, *supra* note 17, at 22 (Stakeholder statutes are "[o]ne of the most remarkable but least remarked developments in corporation law in many years.").

296. *"Other Constituency" Statutes: Necessary or Misguided?*, Corp. Coun. Wkly. (BNA) No. 22, at 8 (May 30, 1990) (calling nonshareholder constituency statutes "anti-theft" statutes and raising the debate of who is stealing from whom); *see also* Carney, *Does Defining Constituencies Matter?*,

Certain commentators favor a narrow approach, contending that the courts should give stakeholder statutes little effect by merely interpreting them in accordance with existing case law.[297] These commentators assert that, absent explicit authorization to disregard the shareholders' interests, the stakeholder statutes only permit directors to aid nonshareholder constituents for the purpose of increasing the shareholders' wealth in the long run.[298] Thus, according to this view, the statutes should not be construed in derogation of the common law.

Another principle of statutory construction, however, suggests that legislatures would not have passed the stakeholder statutes merely to codify existing case law.[299] Rather, these commentators assert that the statutory recognition of stakeholders' interests reshapes the business judgment rule to bestow upon directors more leeway to make decisions. In this regard, a few stakeholder statutes explicitly provide that courts should scrutinize directorial decisions to defend hostile takeovers to the same degree they would defend ordinary business decisions.[300] With such judicial deference, the stakeholder statutes could allow directors to "just say no" to attractive takeover bids.[301] In addition, these statutes may lessen the threat of shareholder derivative suits for waste based on managerial conduct that does not maximize shareholder wealth in the short run.[302]

In contrast to these views, some commentators interpret the stakeholder statutes as profoundly altering the basic foundations of corporate law. Under these statutes, the courts may allow directors to disregard the notion of shareholder wealth maximization in certain instances and to recognize that other constituents have legitimate claims against the corporation.[303] According to this

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59 U. CIN. L. REV. 385, 385 (1990) ("The question [of stakeholder statutes] has been an important subject of debate among American corporate lawyers for at least fifty years."); Solomon, *Humanistic Economics: A New Model for the Corporate Constituency Debate*, 59 U. CIN. L. REV. 321, 321 (1990) ("Concern over the corporate role and whether corporate decision-makers should consider the interests of 'stakeholders' other than the shareholders" is continuing.); Sommer, *Other Constituency Statutes: "A New Form of Welfarism?,"* 11 BUS. LAW. UPDATE 1 (1990) (recognizing that about half of the states have adopted stakeholder statutes while others continue to grapple with constituency issues); Wallman, *Corporate Constituency Statutes: Placing the Corporation's Interests First*, 11 BUS. LAW. UPDATE 1, 2 (1990) (citing selected benefits and objections to stakeholder statutes fueling continued debate).

297. *See* A.B.A. Comm. on Corp. Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2254 (1990). *But see* Hansen, *Non-shareholders Constituency Statutes: Analysis of Law*, in SECURITIES LAW INSTITUTE, *supra* note 260, at 18 (courts should read "*some* relationship to the interests of the shareholders" into the statutes).

298. Hansen, SECURITIES LAW INSTITUE, *supra* note 260, at 13, 19-20.

299. McDaniel, *The Promise and Potential of Non-Shareholder Constituency Statutes*, in SECURITIES LAW INSTITUTE, *supra* note 260, at 11 n.17 ("[Stakeholder] statutes should be liberally construed to accomplish their remedial purpose.").

300. *See, e.g.*, IND. CODE ANN. § 23-1-35-1(f) (Burns 1989); OHIO REV. CODE ANN. § 1701.59(B)-(C), (E)(1)-(3) (Anderson Supp. 1990).

301. *See, e.g.*, Andre, *supra* note 288, at 576 ("[I]t is clear that these statutes potentially provide directors a far more secure shelter in rejecting tender offers than the case law currently bestows."); Franklin, *Legislative Toss-up: Effect on 'Stakeholders' Is Factor to Consider in Takeovers*, N.Y.L.J., July 6, 1989, at 5, col. 3; Klein & Greenbaum, *Takeover Law: Many Pa. Companies Opt Out*, Nat'l. L.J., Sept. 10, 1990, at 15, 22, cols. 3-4; *cf.* Sparks, *"Constituencies" and the Auction for Control*, 3 Corp. Coun. Wkly. (BNA) No. 11, at 8 (March 16, 1988) (rejecting the precept that any beneficial outcome could flow from stakeholder statutes).

302. Ryan, *supra* note 9, at 61 n.202.

303. *See, e.g.*, Hanks, *supra* note 17, at 21 ("[T]he real purpose of non-stockholder constituency statutes must be to enable directors to provide benefits to non-stockholder groups even when doing

view, the statutes revise the directors' historical fiduciary duties to encompass fiduciary obligations to other corporate constituents.[304] One commentator notes: "By blurring the distinction between the corporation's commercial and fiduciary relationships, constituency statutes represent a significant change in the basic ground rules."[305] These statutes may symbolize a transition period in which corporate law will identify the corporation's purpose as serving its various constituents in a more balanced fashion.[306] Hence, these statutes suggest a new definition of the corporation's role.[307]

Viewed in this light, the stakeholder statutes have the potential for providing the most important source of relief for workers who must adjust to the permanent loss of their jobs in an era of rapid economic change.[308] During previous restructuring periods, corporations have implemented layoffs and closed plants without prompting shifts in the focus of concern from shareholders to stakeholders.[309] Traditionally, courts have refused to recognize employees' noncontractual expectations, insisting that they lacked legal precedent to create a remedy for displaced workers.[310] These courts steadfastly adhered to the principle of a representative democracy in which the legislature decides controversial policy matters.[311] The stakeholder statutes, however, provide courts with the inherent legitimacy of legislative approval by explicitly acknowledging nonshareholder interests in the corporation. The stakeholder statutes signify a broad social consensus to acknowledge the noncontractual expectations of various nonshareholder constituents.[312] With the widespread concern over the economic consequences of capital mobility, social conditions may be changing so that the courts may use stakeholder statutes as a basis for judicial intervention to ameliorate the impact of corporate restructuring.[313]

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so would *not* benefit the stockholders."); Johnson & Millon, *supra* note 65, at 1907 ("State law that successfully restricts their opportunity to receive tender offers in order to further other policy objectives—specifically the protection of various nonshareholder interests—represents a profound departure from the orthodox principle of shareholder primacy as the principal focus of corporation law . . . .").

304. Hanks, *supra* note 288, at 1228-29; Karmel, *Duty to the Target: Is an Attorney's Duty to the Corporation a Paradigm for Directors?*, 39 HASTINGS L.J. 677, 695 (1988); Macey, *National Economy*, *supra* note 61, at 469, 482.

305. Mahoney, *New Laws Place Directors in Untenable Position*, Nat'l L.J., July 4, 1988, at 26.

306. Millon, *Redefining Corporation Law*, 24 IND. L. REV. 223, 225 (1991).

307. *Id.*

308. Professor Karmel states:

> The support which organized labor has given to the stakeholder statutes suggests that the power directors have been given to consider the interests of employees in responding to a takeover could be transformed into a duty. Such a duty may be presaged in the Massachusetts stakeholder statute which imposes on tender offerors the obligation to honor existing collective bargaining agreements and in addition to give two weeks severance pay per year of service to any employee who is laid off as the result of a takeover.

Karmel, *supra* note 289, at 69-70.

309. *See, e.g.*, Johnson, *Corporate Life*, *supra* note 24, at 905 (Corporate law usually has "shunned" the issue of effect on nonshareholders, leaving it to other disciplines and institutions to resolve.).

310. *See, e.g.*, Singer, *supra* note 10, at 620.

311. *See id.*

312. *See* Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1, 33 (1979).

313. As Professor Karmel explains:

The permissive nature of these statutes, however, creates two problems. First, the stakeholder statutes may function only as a screen for directors because the statutes fail to reconcile the tension between corporate social responsibility and accountability to shareholders. Instead of following the shareholder wealth maximization standard, directors may hide behind vague duties to conflicting groups to serve their own interests.[314] Second, the permissive nature of these statutes loses much in terms of shareholder accountability without gaining much in terms of protecting nonshareholder constituents.[315] These statutes merely offer employees limited, indirect relief.[316] Ironically, managers faced with a hostile takeover contend that they must establish defensive barriers in order to save jobs. Yet, these same managers resist legislation that would restrict their ability to make layoff and plant closing decisions.[317] Even in the takeover setting, directors may not seek to benefit the employees if the directors have golden parachutes or can respond with a leveraged buyout.[318] Because

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> The idea that directors can even consider employee interests in a takeover is . . . novel and the idea that directors should owe a duty to employees in a takeover is contrary to long standing legal principles. Nevertheless, the traumatic impact on both labor and the public of takeovers and restructurings of U.S. businesses in recent years has given rise to at least the question of what priority employee interests should have when there is a change of corporate control.

Karmel, *supra* note 289, at 69; *see also* Hanks, *supra* note 17, at 20 ("The interests of social activists meshed nicely with others' concerns over unsolicited takeovers.").

314. As Professor Berle stated, "[I]t is one thing to say that the law must allow for such developments. It is quite another to grant uncontrolled power to corporate managers in the hope that they will produce that development." Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1372 (1932). These statutes simply may allow management to defeat a takeover bid by providing management with an endless supply of excuses. *See* Davis, *supra* note 243, at 521 ("[T]he end result of the existing state statutes is essentially to leave stakeholder matters to management's discretion, subject only to judicial review under existing fiduciary principles not particularly suited for the idiosyncrasies of the task."); Hanks, *supra* note 17, at 20 ("Any benefit in increased latitude for board decision-making is more than offset by countervailing costs."); Johnson, *Who Are They For?*, *supra* note 11, at 811 ("[The] chief concern is that defensive measures render shareholders vulnerable to their own management, thereby nullifying the important governance protection provided to shareholders by the market for corporate control."); Karmel, *supra* note 289, at 68 ("The latitude to consider multiple constituencies is likely to become a legal fiction for the erosion of shareholder rights."); Oesterle, *supra* note 75, at 139 (fears that managers charged with protecting other constituencies will defeat takeover bids in their own self-interest); Ribstein, *supra* note 61, at 150 ("[T]here is no more reason to assume that managers would use their entrenchment for the benefit of the stakeholders than that they would act in the shareholders' interests."); Steinberg, *Some Thoughts on the Regulation of Tender Offers*, 43 MD. L. REV. 240, 257 (1984) ("Legislative or judicial acceptance of the asserted protection of such noninvestor interests without careful scrutiny would provide a smoke screen masking target managements' actual motives."). *But see* Conard, *Theses For a Corporate Reformation*, 19 U. CALIF. DAVIS L. REV. 259, 295-96 (1986) (proposing adoption of federal stakeholder statute without judicial intervention because "[t]he self-interest of executives and powers of shareholders can be counted on to restrain excessive orgies of altruism").

315. *See, e.g.*, Gilson, *supra* note 8, at 126 (gives management "*power* to consider stakeholders' interests, but does not make them *accountable* if the stakeholders believe that their interests are given too little weight").

316. Johnson, *supra* note 244, at 39 (State efforts fail to protect nonshareholder constituencies because "it does not genuinely and completely supplant the traditional focus of that law on the narrow investor-manager relationship, a task that is much too radical for the present."); Note, *supra* note 11, at 855 ("[F]iduciary duty laws do not help employees . . . if a corporation's management either supports a tender offer or closes up shop and moves somewhere else.").

317. *Grundfest Challenge*, *supra* note 65, at 423.

318. Butler, *supra* note 276, at 420 ("Managers who obtain some protection against investor opportunism through the grant of discretion to resist bids may use the powers so created to appropriate quasi-rents from other investors in the firms.").

these statutes do not mandate that directors consider nonshareholder constituents, these groups probably do not have standing to enforce these statutes.[319] Thus, the "may" formulation may not safeguard the interests of labor in plant closings.[320]

Even if directors were inclined to favor nonshareholder interests, competitive pressures would impede such tendencies.[321] That is, directors have an incentive to "hang back" when it comes to corporate social responsibility because they may not be able to compete if other corporations escape these costs.[322] A corporation that makes expenditures not mandated by the law to help workers in plant closings may suffer a decline in its short-term stock prices, causing it to become a potential takeover target. Indeed, while corporations usually are concerned about their reputations in the community, the current restructuring era has created a more cost-conscious atmosphere which has eroded basic ethical business practices.[323]

To ensure that corporations compensate displaced workers in layoffs and plant closings, the current corporate governance scheme must be reformed. Directors should not be allowed to hide behind the shield of the stakeholder statutes. Instead, directors should owe affirmative obligations to displaced workers and bear the burden of proving that they have fulfilled their responsibilities. A legal standard is needed that both shields the shareholders from managerial self-interest and safeguards the employees' investments from expropriation.[324] Accordingly, the directors' fiduciary duty to the corporation's employees during fundamental restructuring events requires formal recognition. Although such a fiduciary duty would represent a substantial shift in the law, the overview of recent takeover cases and statutes demonstrates that some precedent exists to support this obligation.

Before examining specific reform proposals, Part III discusses the normative question: Should the law require corporations to compensate employees for their reliance upon implicit contracts? In exploring this issue, it is necessary to identify the policies and principles justifying such a change in the law.[325] Rec-

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319. Greene & Junewicz, *supra* note 289, at 734 ("Possible consideration is certainly not a surrogate for participation."); Hansen, *supra* note 260, at 20.

320. *But see* Hanks, *supra* note 288, at 1229-30 (statutes may give constituencies standing to sue); Hanks, *supra* note 17, at 25 ("It would not be surprising for a court to hold that the board is obligated to consider the wisdom and propriety of exercising any power available to it."); Newlin & Gilmer, *The Pennsylvania Shareholder Protection Act: A New State Approach to Deflecting Corporate Takeover Bids*, 40 BUS. LAW 111, 114 (1984) (constituencies may demand they be considered "so that what was designed as a shield may be a sword as well.").

321. R. POSNER, *supra* note 216, at 395.

322. *See, e.g.*, R. CLARK, CORPORATE LAW 687 (1986).

323. *But cf.* Dunfee, *Professional Business Ethics and Mergers and Acquisitions*, in ETHICS, *supra* note 24, at 18 ("Higher levels of ethical behavior should reduce the costs of long-term contracting, limit the direct losses resulting from opportunistic behavior, and improve productivity through greater responsibility and commitment.").

324. *Cf.* Coffee, *Corporate Web*, *supra* note 9, at 79 (analogizing federal pension plans to the legal standard needed to protect shareholders and ensure equitable distributions of wealth); Johnson, *Who Are They For?*, *supra* note 11, at 783 ("Divergence of interests raises the possibility that current decision-making mechanisms do not equip beleaguered corporations to achieve what is best for share-holders while also suitably serving the interests of other claimants.").

325. Coffee, *Shareholders Versus Managers*, *supra* note 91, at 78 ("Should the law take cogni-

ognizing a fiduciary duty to the employees challenges one of the basic premises of corporate law, the maximization of shareholder wealth. Thus, this Article turns to a discussion of the proper objectives of the corporation.[326]

III. EVALUATING THE CORPORATE OBJECTIVE: WHETHER THE LAW SHOULD RECOGNIZE A FIDUCIARY DUTY TO PROTECT EMPLOYEES' RELIANCE ON IMPLICIT CONTRACTS

Academicians and practitioners debate the topic of appropriate corporate objectives with renewed interest during periods of economic disruption,[327] such as the 1930s[328] and 1970s.[329] The current restructuring era also has revived the discussion Professors Berle and Dodd first explored over fifty years ago.[330] The question of the proper corporate objective involves a political issue, the resolution of which depends upon one's social outlook.[331] In evaluating whether the law should protect employees' reliance upon implicit contracts, much depends upon whether one's sympathies lie with the corporation's shareholders or with its employees. Most nexus-of-contracts theorists tend to favor a free market approach which allows transactors to allocate the risks associated with corporate restructuring. Others advocate the corporation's pursuit of social goals such as accommodating the interests of employees affected by corporate change. These positions must be examined further in analyzing whether the corporation's nexus of contracts should be restructured to recognize a fiduciary duty to displaced workers.

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zance of an implicit contract between the shareholders and managers of the public corporation, which may have been disrupted by these developments?"); Singer, *supra* note 10, at 651 ("What interests do we want the market to protect? What consequences do we want to foster?").

326. Engel, *supra* note 312, at 3 (the goal of corporate activity must be articulated clearly in discussing reform proposals).

327. Buxbaum, *Corporate Legitimacy, Economic Theory, and Legal Doctrine*, 45 OHIO ST. L.J. 515, 517-20 (1984); Epstein, *Societal, Managerial, and Legal Perspectives on Corporate Social Responsibility—Product and Process*, 30 HASTINGS L.J. 1287, 1287 (1979); Johnson, *Corporate Life*, *supra* note 24, at 874-75.

328. For the exchange between Professors Berle and Dodd, see Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932) [hereinafter Dodd, *Managers Are Trustees*]; Dodd, *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 U. CHI. L. REV. 194 (1935).

329. R. NADER, M. GREEN & J. SELIGMAN, TAMING THE GIANT CORPORATION (1976) (advocating federal chartering system to force corporations to be sensitive to public needs); C. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR xii (1975) ("Corporations have long since become, for better or for worse, the most effective 'private' forces to do both widespread good and widespread harm. For this reason, to solve society's problems is, in no small measure, to come to grips with the corporation problem."); Conard, *supra* note 289, at 959-61 (advocating use of public interest directors).

330. *See, e.g.*, Davis, *supra* note 243, at 491 (debate over role of corporate takeovers "has rekindled the 1930s/1960s debates over whether shareholders should be the exclusive beneficiaries of the corporations' largesse."); Lipton, *Corporate Governance*, *supra* note 11, at 4 (Berle and Means discussed "age of the professional business manager.").

331. *See, e.g.*, R. CLARK, *supra* note 322, at 677; Engel, *supra* note 312, at 1 ("[T]he topic of corporate social responsibility cannot be debated except against the background of a general political theory.").

A. *The Shareholder Wealth Maximization Approach to Corporate Contracts*

Most nexus-of-contracts theorists focus almost exclusively upon the shareholders' contract with the corporation. According to this free-market perspective, the shareholders bear the residual risk of corporate activity in return for a promise that the directors will maximize the value of their investments.[332] Shareholders, however, cannot devise contractual restrictions to prevent managerial shirking because predicting and resolving the many contingencies that arise in a long-term relationship is impossible. Due to the difficulty in drafting such contracts, and because market mechanisms do not work perfectly, corporate law provides a standardized contract provision that the directors owe shareholders a fiduciary duty to maximize their wealth.[333] Illustrating this view, Judge Easterbrook maintains that the fiduciary obligation is "a standby or off-the-rack guess about what parties would agree to if they [had] dickered about the subject explicitly."[334] Under the fiduciary duty term, shareholders rely upon the courts to deter directors from engaging in conduct that would breach the shareholders' contract with the corporation.[335]

Freemarket proponents advocate that there is no need to examine the issue of corporate social responsibility[336] because the law should enforce only explicit contracts between the corporation and its constituents.[337] These commentators assert that employees do not bargain for fiduciary protection because they are not exposed to the same type of injury as the shareholders.[338] Employees volun-

332. *See, e.g.*, Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAGAZINE, Sept. 13, 1970, at 33; Easterbrook & Fischel, *Contract*, *supra* note 87, at 1447; Macey, *supra* note 19, at 180.

333. *See, e.g.*, Butler & Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 28 (1990).

334. Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 436 (7th Cir. 1987), *cert. denied*, 485 U.S. 901 (1988). Commentators have developed the contractual view of fiduciary duty from the Coase Theorem, which provides a law and economics analysis for choosing legal rules. Under the Coase Theorem, in the absence of transaction costs, parties will bargain for an efficient outcome regardless of the legal rule. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960). If there are positive transaction costs, parties may not be able to bargain to achieve an efficient result. In the presence of these costs, the government, in establishing legal rules, should attempt to approximate the result that private parties would reach if they could contract without significant transaction costs. *See, e.g.*, Anderson, *Conflicts of Interest: Efficiency, Fairness and Corporate Structure*, 25 UCLA L. REV. 738, 781 (1978) (corporate code promotes both efficiency and fairness by providing standardized rules). Professor Demott rejects this view of fiduciary duty. Demott, *supra* note 86, at 885-89 (This formulation of fiduciary duty is "literally unprecedented in prior Anglo-American caselaw.").

335. Butler & Ribstein, *supra* note 333, at 29.

336. Easterbrook & Fischel, *Contract*, *supra* note 87, at 1446 ("An approach that emphasizes the contractual nature of a corporation removes from the field of interesting questions one that has plagued many writers: What is the goal of the corporation?"); Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1273 (1982) (same); Jensen & Meckling, *supra* note 80, at 311 (issue of corporate social responsibility "seriously misleading . . . [because t]he firm is not an individual").

337. Easterbrook & Fischel, *Contract*, *supra* note 87, at 1447; Macey, *supra* note 19, at 179; Ribstein, *supra* note 61, at 141. Professor Rose responds to this type of argument as follows: "To put it baldly, the ex ante perspective generally means sticking it to those who fail to protect themselves in advance against contingencies that, as it happens, work out badly for them." Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 592 (1988).

338. Easterbrook & Fischel, *Contract*, *supra* note 87, at 1436 (shareholders have more need for monitoring because they have residual claim); Ribstein, *supra* note 61, at 173 (fixed claimants are exposed to a narrower range of harm from shareholders than are shareholders from managers).

tarily enter into at-will employment arrangements;[339] thus, courts should not force corporations to provide noncontractual severance payments to displaced workers.[340] Indeed, to imply that term into the labor contract gives the workers something for which they did not negotiate and forces shareholders to pay twice for the workers' inefficiency.[341] Rather, the risk of displacement is part of free society and any attempt to minimize it is anticompetitive.[342]

By emphasizing that the law should enforce only explicit agreements, this free market perspective tends to overlook that nonshareholder constituents also enter into long-term relationships with the corporation.[343] Professor Williamson has recognized that, similar to shareholders, nonshareholder constituents cannot foresee all the possible circumstances that may arise throughout their associations with the corporation.[344] He acknowledges that their written contracts may be incomplete and occasions for opportunistic conduct may occur.[345] Like most nexus-of-contracts theorists, Professor Williamson favors a free market approach, asserting that if opportunistic behavior ensues, the parties will invent a structure to mitigate this threat.[346] Professor Williamson argues that nonshareholder constituents will develop governance mechanisms, such as board representation, at the beginning of their relationship to alleviate problems that cannot be addressed specifically in a formal agreement.[347] The most important factor in determining whether a corporate constituent needs a special governance structure is the degree to which the group invests in firm-specific assets.[348] Professor Williamson assumes that workers with general purpose skills do not need such protection because they easily can find employment elsewhere, and workers with firm-specific skills can unionize to safeguard their investments.[349]

Thus, the free market proponents conclude that the law should not acknowledge the implicit contracts of employees by making different assumptions about the shareholders' and employees' relative abilities to allocate risk contrac-

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339. *See, e.g.*, Epstein, *supra* note 128, at 953.

340. *Id.* In addressing the possibility that this approach may harm employees, Judge Easterbrook and Professor Fischel assert: "This is not a reason to treat corporate law as if it ought to care about these allocations, however; the risk aversion of managers [and employees] is a regrettable cost of the corporate form, not a reason to select a rule other than the wealth-maximizing one." Easterbrook & Fischel, *Contract*, *supra* note 87, at 1441.

341. Scheffman, *The Economics and Ethics of Adjusting to a New Competitive Environment: Mergers and Takeovers*, in ETHICS, *supra* note 24, at 107.

342. *See, e.g.*, Easterbrook & Fischel, *supra* note 75, at 1190 n.83 ("Such behavior is more characteristic of medieval guilds than of free markets.").

343. *See* Bratton, *Critical Appraisal*, *supra* note 78, at 417; Williamson, *supra* note 106, at 1201.

344. Williamson, *supra* note 106, at 1201.

345. *Id.* at 1202 (contract may "drift out of alignment" due to informational disparities).

346. *Id.*; Bratton, *Critical Appraisal*, *supra* note 78, at 449 (Thus, some recognize relational contingency yet at the same time "strain to leave the individual dominant.").

347. Williamson, *supra* note 106, at 1197.

348. *Id.* at 1202.

349. *Id.* at 1207. Professor Williamson states: "Such workers can quit and be replaced without productive loss to either worker or firm." *Id.* Generally, Professor Williamson favors severance payments to safeguard workers' firm-specific investments and to ease transitional costs. *Id.* at 1217. He recognizes that his approach ignores transitional costs: "Unemployment insurance may provide a necessary buffer. We may want to create some barriers to deter termination without cause and reduce transition costs." *Id.* at 1208 n.31.

tually.[350] These assumptions state political propositions that reveal a great deal about the free market proponents' social vision of the corporation's role in society.[351] The free market approach draws a sharp line between the business affairs of the corporation and the public concerns of the state.[352] In other words, the corporation should operate in an atmosphere that stresses the individual's freedom to transact in pursuit of self-interest.[353] Free market proponents share Holmes's bad man perception of the law[354] with respect to legal rules that restrict people's ability to contract; that is, legal rules should only establish negative duties not to harm others.[355]

Although these nexus-of-contracts scholars acknowledge that the firm is a bundle of implicit and explicit contractual associations, they continue to maintain that the corporation owes an exclusive fiduciary duty to maximize the shareholders' wealth because shareholders are the sole residual risk-bearers.[356] Employees, however, also bear a great deal of firm-specific risk. If the firm consists of mutually dependent alliances among corporate constituencies, why is shareholder wealth maximization the only goal?[357] Moreover, the traditional contractual solution fails to protect the employees against the consequences of corporate restructuring. Accordingly, the free market analysis raises the question why fiduciary duties are cost-beneficial only as to stockholders.[358] As corporations seek to compete internationally, the notion of the employees' implicit contracts becomes significant because firms may rearrange their relationships in a more efficient manner if the law imposes a legal duty to compensate workers for their investments in the corporation.[359]

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350. These commentators have great faith that the market eventually will adjust to alleviate the harsh consequences that corporate restructuring produces for nonshareholder constituencies. Professor Macey states:

> [T]he contracting process that creates a corporation is capable of addressing the difficulties raised by the prospect of fundamental corporate change. The theory of the firm implies that the various participants in a corporate enterprise will trade rights and obligation among themselves, taking account of their respective skills and abilities as well as the corporation's needs.

Macey, *supra* note 19, at 181.

351. Bratton, *Critical Appraisal*, *supra* note 78, at 419.

352. Singer, *supra* note 10, at 633.

353. Epstein, *supra* note 128, at 955.

354. The commentators in the Critical Legal Studies Movement have characterized this position as a kind of "alienated individualism." *See* Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1745 (1976) (rules abandon people to the wiles of the bad and mean spirited).

355. Singer, *supra* note 10, at 634.

356. M. AOKI, *supra* note 18, at 10-11; Coffee, *Corporate Web*, *supra* note 9, at 12.

357. As Professor Aoki questions, if the firm is viewed "as a sort of coalition of financial as well as human resource-holders, can there be such a thing as *the* single, well-defined objective of the firm?" M. AOKI, *supra* note 18, at 11.

358. Bratton, *supra* note 228, at 145.

359. M. AOKI, *supra* note 18, at 5 (questions whether "extra gain can be generated by shifting risk among constituents of the firm").

B. The Social Relations Approach to Corporate Contracts

1. Arguments in Favor of Protecting Displaced Workers

The social relations approach provides the basis for a very different view of the employees' contracts with the corporation.[360] While some commentators praise Professor Williamson for bringing a relational outlook to corporate contracts, others criticize his theory for excluding from its analysis elements such as power imbalances, political struggles, and cultural influences.[361] In contrast to the free market perspective, the social relations model has a broad philosophy that encompasses these noneconomic factors.[362] Shifting the spotlight away from the shareholder wealth maximization issue, this method concentrates upon the nature of the associations that have evolved.[363] Under this approach, obligations grow out of mutual respect and confidence that long-term commitments require parties to maintain. The social relations view leaves room to evaluate the employees' dependence upon the corporation that develops through implicit contracts. In this light, it is possible to assess whether a corporation should owe its employees a fiduciary duty to protect their investments during corporate restructurings.

Historically, the employment-at-will doctrine has governed the relationships between employer and employee.[364] Contrary to the free market proponents, Professor Summers argues that the at-will doctrine has no basis in contract law because the courts fail to determine what the parties intended.[365] He asserts that an employee would not want to enter into an at-will arrangement because it leaves the employee at the mercy of the employer.[366] To a limited extent, labor law is moving away from the employment-at-will philosophy.[367] In a few cases, the courts have used tort and contract doctrines to find that

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360. Prior corporate law literature offered no basis for informed and critical evaluation of the social relations view of contract. Bratton, *Critical Appraisal*, *supra* note 78, at 447; Linzer, *supra* note 179, at 403.

361. Gordon, *Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law*, 1985 WIS. L. REV. 565, 570, 575 n.27 (these elements of contractual relations perspective espoused by Stewart Macaulay and Ian Macneil).

362. *See* I. MACNEIL, THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS 10-35, 84-90 (1980); Macneil, *Values in Contract: Internal and External*, 78 NW. U.L. REV. 340, 361-66 (1983). Thus, this relational approach to corporate contracts is just as political as the free-market view. As Professor Bratton states, "[e]nhanced relational sensitivity in corporate law would not make these normative decisions easier. It would introduce no formulaic solutions for general acceptance and application. . . . [It] would permit a range of theoretical conceptions of firms . . . to bear on the contracting behavior of particular parties." Bratton, *Critical Appraisal*, *supra* note 78, at 432.

363. Singer, *supra* note 10, at 652-63.

364. This rule first was enunciated without any judicial support by H.G. Wood in MASTER AND SERVANT § 134, at 272 (1877). He rejected the English doctrine that implied the employment term was for a year.

365. Summers, *supra* note 179, at 1099. *But see* Epstein, *supra* note 128, at 954 ("[T]he contract at will is sought by both persons." (citing Payne v. Western & Al. R.R., 81 Tenn. 507, 518-19 (1884), *overruled on other grounds*, Hutton v. Watters, 132 Tenn. 527, 544, 179 S.W. 134, 138 (1915))).

366. Summers, *supra* note 179, at 1108.

367. *See, e.g.*, Beermann & Singer, *Baseline Questions in Legal Reasoning: The Example of Property in Jobs*, 23 GA. L. REV. 911, 946-56 (1989); Blades, *supra* note 133; Linzer, *supra* note 179; Minda & Raab, *Time for an Unjust Dismissal Statute in New York*, 54 BROOKLYN L. REV. 1137, 1167 n.106 (1989); Murg & Scharman, *Employment at Will: Do the Exceptions Overwhelm the*

employees' job rights are safe from arbitrary or unreasonable termination.[368] Some commentators believe that the courts should acknowledge that the contract of employment includes a right of future employment based upon the employees' reasonable expectations.[369]

Related to the erosion of the employment-at-will doctrine, some commentators advocate that workers who invest physical and human capital in an enterprise should have property rights in their jobs.[370] So far, these arguments have not met with much success in court.[371] For example, in *Local 1330, United States Workers v. United States Steel Corporation*,[372] the Sixth Circuit Court considered whether property law principles could be extended to protect employees' reliance interests in their jobs. United States Steel had operated two steel plants in Youngstown, Ohio for over seventy years. When the plants became obsolete, U.S. Steel proposed to demolish them. In an effort to save its members' jobs and their community, the union attempted to purchase the plants from U.S. Steel. The corporation refused to negotiate with the workers in an attempt to avoid competition; the union brought suit to force U.S. Steel to sell the plants. The question arose whether a property right had evolved from the community's long-term reliance upon the continued operation of the plants. Although the court was sympathetic to the workers' plight, it ultimately decided that there was no precedent to create such a property right. The court explained that it lacked the authority to modify state property law to conform to the dic-

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Rule?, 23 B.C.L. REV. 329, 329-32 (1982); Peck, *Unjust Discharges from Employment: A Necessary Change in the Law*, 40 OHIO ST. L.J. 1, 10-13 (1979).

368. *See, e.g.*, Fortune v. National Cash Register Co., 373 Mass. 96, 103-04, 364 N.E.2d 1251, 1255-56 (1977) (employee fired before earning commission); Monge v. Beebe Rubber Co., 114 N.H. 130, 133, 316 A.2d 549, 551-52 (1974) (employee fired for refusing to date supervisor); Harless v. First Nat'l Bank, 246 S.E.2d 270, 273-76 (W. Va. 1978) (employee fired for whistle blowing). *But see* Foley v. Interactive Data Corp., 47 Cal. 3d 654, 671-82, 765 P.2d 373, 380-88, 254 Cal. Rptr. 211, 218-27 (1988) (refusal to broaden exceptions for lack of good cause for termination).

369. *See, e.g.*, Summers, *supra* note 179, at 1099.

370. *See, e.g.*, Glendon & Lev, *Changes in the Bonding of the Employment Relationship: An Essay on the New Property*, 20 B.C.L. REV. 457, 475-83 (1979); Hermann & Sor, *Property Rights in One's Job: The Case for Limiting Employment at Will*, 24 ARIZ. L. REV. 763, 816 (1982); Linzer, *supra* note 179, at 329; Comment, *Towards a Property Right in Employment*, 22 BUFFALO L. REV. 1081, 1108-10 (1973).

371. *See, e.g.*, Hass v. Darigold Dairy Prods. Co., 751 F.2d 1096, 1099 (9th Cir. 1985); Cooper v. General Motors Corp., 651 F.2d 249, 250-51 (5th Cir. 1981); Baker v. Newspaper & Graphic Communications Union, Local 6, 628 F.2d 156, 159-60 (D.C. Cir. 1980); Charland v. Norge Div., Borg-Warner Corp., 407 F.2d 1062, 1064-65 (6th Cir.), *cert. denied*, 395 U.S. 927 (1969); Vaughn v. Chrysler Corp., 382 F. Supp. 143, 144 (1974). *But see* Zdanok v. Glidden Co., 288 F.2d 99 (2d Cir. 1961), *aff'd*, 327 F.2d 949, 952 (1964) (in construing labor-management contract, pension rights "earned" and vested even though explicit time in contract not satisfied). For commentary on *Zdanok*, see Aaron, *Reflections on the Legal Nature and Enforceability of Seniority Rights*, 75 HARV. L. REV. 1532, 1542-54 (1962); Blumrosen, *Seniority Rights and Industrial Change:* Zdanok v. Glidden Co., 47 MINN. L. REV. 505 (1963); Lowden, *Survival of Seniority Rights Under Collective Agreements:* Zdanok v. Glidden Co., 48 VA. L. REV. 291 (1962). Employees have obtained procedural protection under the fourteenth amendment before their jobs can be terminated under the "new property" theory. Perry v. Sindermann, 408 U.S. 592, 601 (1972) (de facto tenure policy created expectation of continual employment and may constitute sufficient "property" interest to require hearing before dismissal); Board of Regents v. Roth, 408 U.S. 564, 578 (1972) (no past custom of granting tenure to enable a finding of more than mere desire for continual employment; thus no procedural due process required). *But see* Bishop v. Wood, 426 U.S. 341, 347-48 (1976) (ordinance classifying police chief as "permanent employee" not sufficient to create property right under *Roth*).

372. 631 F.2d 1264, 1279-80 (6th Cir. 1980).

tates of morality because that change should come from the legislature.[373]

Criticizing this case, Professor Singer contends that the court "wrongly defined the issue as a search for the 'owner' of the property."[374] Instead, Professor Singer uses a social relations approach to demonstrate why the court should have acknowledged the workers' right to purchase the plant from U.S. Steel.[375] He illustrates how a wide range of legal principles supports the notion of employees' reliance interest in property.[376] To establish this property right, Professor Singer notes that the fiduciary obligations of the directors of U.S. Steel would have had to be expanded beyond that of maximizing shareholder wealth.[377] The union argued that U.S. Steel should be forced to sell the plants to the community because the directors owed the workers an obligation to act in a socially responsible manner.[378] This argument failed because the existing legal doctrines did not support adequately an expansion of corporate law to include these factors.[379] At the time, Ohio did not have a stakeholder statute.[380]

The idea that employees should have property rights in their jobs and the literature disparaging the employment-at-will doctrine have developed independently of the nexus-of-contracts scholarship. These approaches, however, complement each other and serve as a basis for the stakeholder model of corporate social responsibility. In contrast to the traditional legal model of the corporation, under the nexus of contracts view, the question of who owns the corporation is irrelevant. This approach does not distinguish sharply between the interests of employees and shareholders.[381] The social relations perspective of the corporation's nexus of contracts opens up new possibilities by assessing the characteristics shared by stockholders and employees in their associations with the corporation.

Similar to the shareholders, employees cannot place all the terms of their relationship with the corporation in a written contract because it is too costly.[382] In addition, as employees continue to work for a firm, they share in the residual

373. *Id.* at 1281-82.

374. Singer, *supra* note 10, at 621. The "new property" approach finds many entitlements among people not traditionally viewed as owners. *See, e.g.*, Reich, *The New Property*, 73 YALE L.J. 733, 778-86 (1964).

375. Singer, *supra* note 10, at 699-701; *see also* Di Norcia, *supra* note 24, at 251 (restructuring should balance employee, management, and shareholder interests).

376. Singer, *supra* note 10, at 663-701. Professor Singer notes:

> It matters very little whether the reliance interest in property is conceptualized as a doctrine of property law, contracts, torts, trusts, labor law, corporate law, or anything else. The divisions between these areas of the law exist merely for convenience, and it seems that rigid categorization hampers analysis.

Id. at 700 n.309.

377. *Id.* at 711-12.

378. *See* Local 1330, U.S. Workers v. United States Steel Corp., 631 F.2d 1264, 1279-80 (6th Cir. 1980).

379. Millspaugh, *supra* note 18, at 492-93 (discussing how arguments for judicial intervention to restrain United States Steel were based on cases discussing legislative restraints on business).

380. The case was decided in 1986, two years before Ohio enacted its stakeholder statute. OHIO REV. CODE ANN. § 1701.59(E)(1)-(3) (Anderson Supp. 1990).

381. *See supra* note 87 and accompanying text.

382. Coffee, *Takeover Reform*, *supra* note 8, at 448.

risk with the shareholders.[383] Risk-averse employees rely upon implicit contracts by which they choose lower wages at the beginning of the association in return for a degree of job security.[384] Labor increases the value of the corporation; wages, however, do not compensate fully employees for their work product.[385] So viewed, employees make an investment in the corporation that can be measured by the present value of the discounted earnings stream they expect to receive.[386] Through implicit contracts, an employee builds up a reliance interest in the firm.[387] The longer the employee works for a company, the more the firm becomes his only means of livelihood.[388] Unlike shareholders who can sell their shares and hold diversified portfolios, employees are tied to the corporation and the risk that it assumes.[389] As Professor Summers asserts:

> If the corporation is conceived in relatively narrow terms as an operating institution combining all factors of production to conduct an ongoing business, then the employees who provide the labor are as much members of that enterprise as the shareholders who provide the capital. Indeed, the employees may have made a much greater investment in the enterprise by their years of service, may have much less ability to withdraw, and may have a greater stake in the future of the enterprise than many of the stockholders.[390]

In this way, workers effectively become partners with the shareholders in the enterprise.[391] Accordingly, lawful termination of the employment relationship should not extinguish the employees' rights in the corporation. Shareholders should still be entitled to the corporations' residual profits; yet, when a plant closes or employees are laid off, the corporation should compensate the employees for their investments.[392] This analysis calls for a transfer of an entitlement from the shareholders to employees which undercuts the concept of shareholder wealth maximization.[393]

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383. *See, e.g.*, Coffee, *Corporate Web*, *supra* note 9, at 17 (employees' interests resemble the residual interests of shareholders, but without the contractual guarantees); Di Norcia, *Mergers, Takeovers, and a Property Ethic*, 7 J. BUS. ETHICS 109, 115 (1988) (employees bear more risk than shareholders in transfer of control decisions).

384. *See supra* notes 92-104 and accompanying text.

385. *Id.*

386. *See, e.g.*, Coffee, *Corporate Web*, *supra* note 9, at 17.

387. Stone, *Employees as Shareholders Under State Non Shareholder Constituence Statutes*, 21 STETSON L. REV. (1990) (forthcoming) (implicit contract theory explains common perception that it is unfair to layoff longtime employees in their senior years).

388. *See supra* notes 39-40 and accompanying text.

389. *See* Stone, *supra* note 387, at 18-19.

390. Summers, *Codetermination in the United States: A Projection of Problems and Potentials*, 4 J. OF COMP. CORP. L. & SEC. REG. 155, 170 (1982); *see also* A. Chayes, *The Modern Corporation and the Rule of Law*, in THE CORPORATION IN MODERN SOCIETY 39, 40-41 (Mason ed. 1960); Booth, *State Takeover Statutes Revisited*, 88 MICH. L. REV. 120, 126 (1989) (noting that many stockholders probably would sell out for a small payment); Stone, *supra* note 88, at 157.

391. *See, e.g.*, Conard, *The Supervision of Corporate Management: A Comparison of Developments in European Community and United States Law*, 82 MICH. L. REV. 1484, 1464 n.157 (1984); Rosen, *supra* note 33, at 1148.

392. Stockholders continue to occupy a place of prominence, but their interests and desires are no longer absolutely decisive for the determination of corporate conduct. Buono & Bowditch, *supra* note 50, at 130; Johnson, *Corporate Life*, *supra* note 24, at 884.

393. Davis, *supra* note 243, at 518 (The concept of implicit contract is a "useful tool for purposes

The notion of maximizing the shareholders' return reduces appreciation for the law by allowing shareholders to profit by imposing social costs upon workers in layoffs and plant closings.[394] In this regard, the law tends to favor the wealthy at the expense of the working class.[395] As Professor Dodd stated over fifty years ago: "[C]apitalism is worth saving but . . . it can not permanently survive under modern conditions unless it treats the economic security of the worker as one of its obligations and is intelligently directed so as to attain that object."[396] Since the mid 1970s, the problem of plant shutdowns has created pressure for reform because employees are treated as "mere replaceable parts in the overall production or service function."[397] Perhaps the situation has become so severe that courts will begin to protect the worker because he has been "caught up in a system of industrial relations that transcends the immediate contracting situation."[398]

Indeed, other countries do not simply accept displaced workers as a cost of allocating scarce resources.[399] The notion of an implicit employment contract corresponds to the Japanese view of employment in which workers retain their jobs for life and the corporation is operated primarily for the benefit of the employees.[400] Many commentators advocate that American corporations would gain much by adopting some of the Japanese labor philosophy.[401] Specifically, by changing the attitude toward human resources, managers may persuade the work force to be more cooperative and productive.[402] Currently, managers are

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of legitimizing the redistribution of value from shareholders to stakeholders against charges of waste. . . . Efficiency and distributional considerations are simultaneously satisfied because the redistribution is the result the parties themselves implicitly bargained for.").

394. Professor Conard states:

> The doctrine that corporations must maximize shareholder gain works several kinds of mischief. It diminishes respect for law by erecting an exclusive value system in which few persons earnestly believe. It is invoked by executives and directors to relieve themselves of discussing the problems that society as a whole depends on them to solve.

Conard, *supra* note 314 at 277; Johnson, *Corporate Life*, *supra* note 24, at 883 ("[T]he assertion that the interests of capital providers should trump all others in corporate affairs is at once consistent with and repugnant to our cultural traditions.").

395. Johnson, *Corporate Life*, *supra* note 24, at 935 (While corporate law generally has escaped the critical legal studies movement, the takeover debate may "take on the polarizing overtones of pitting the privileged against the unprivileged."); Kay & Griffen, *supra* note 165, at 226-27 (1983) (Corporate restructurings may cause rank and file workers to "challenge the blatant exploitation caused by present corporate policies" and by re-examining the tradeoff made in the "negotiated class struggle.").

396. Dodd, *Managers Are Trustees*, *supra* note 328, at 1151. Even Professor Berle speculated that shareholders "may emerge . . . with a primary property right over residual income, but subordinated to a number of claims by labor . . . which cut down that residue." Berle, *supra* note 314, at 1371-72.

397. Buono & Bowditch, *supra* note 50, at 141.

398. Blumrosen, *supra* note 371, at 529.

399. *See, e.g.*, Gould, *supra* note 194, at 50-54.

400. *See, e.g.*, Reich, *Labor Law, Reform, and the Japanese Model* (Book Review), 98 HARV. L. REV. 697, 705 (1985); Di Norcia, *supra* note 24, at 245; Sethi & Bhalla, *supra* note 24, at 210.

401. *See, e.g.*, Sethi & Bhalla, *supra* note 24, at 209.

402. Brudney, *supra* note 153, at 153 (Coffee "raises complex problems of social psychology and organization theory that transcend the takeover phenomenon and indeed go beyond privately owned enterprise—how to stimulate and how to constrain management in order to induce optimal performance."); *see, e.g.*, Di Norcia, *supra* note 24, at 251 (Japanese and European experience with labor relations during intense restructuring is instructive; the workforce is more cooperative if you inform

beginning to realize that collaboration, and not the traditional adversarial employer-employee relationship, may lead to more efficient operations.[403] While some corporations are adopting progressive labor policies, the current restructuring era has created competitive pressures that give each firm the incentive to "hang back," that is, to ignore the workers' interests in order to enhance short-term stock prices.

It is therefore necessary to recognize a legal duty to compensate displaced workers in plant closings and layoffs under the stakeholder model of corporate social responsibility. This model provides the foundation for reconstructing the corporation's nexus of contracts into a different set of rights and responsibilities by recognizing that directors have a fiduciary duty to protect displaced workers.[404] This duty would represent a substantial change in the law. At this point it is appropriate to consider arguments against this type of legal obligation.

2. Responses to Arguments Against Compensating Displaced Workers

a. The "Landlord Will Raise the Rent" Argument: Regulation Will Hurt Those It Is Trying to Help

Opponents of regulation contend that plant closing restrictions ultimately will harm employees in two respects. First, they maintain that the government should not interfere with corporate restructuring because, if left alone, the corporation eventually will create more jobs by opening new plants elsewhere.[405] This Article does not dispute that restructuring will result in long-term benefits for the economy. These new opportunities, however, fail to assure that workers faced with job displacement are compensated for their investments in the corporation.[406]

Second, free marketers argue that requiring severance payments would be analogous to a tax on labor. Employers would shift this tax to employees in the form of lower wages, negating any benefit to the workers from the severance payments. Professor Kennedy refers to this argument as "the landlord will raise the rent" argument.[407] The free market proponents assert that regulation will restrict the workers' ability to choose freely the risks and rewards available in

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them about decisions that affect their livelihood.); Sethi & Bhalla, *supra* note 24, at 210 ("[I]n spite of cost-cutting efforts, [U.S. industry] has not succeeded in improving its competitiveness, while Japan, with its lifetime employment practices, has enhanced its competitive position in the world market.").

403. *See, e.g.*, Karmel, *supra* note 289, at 173.

404. *See, e.g.*, Johnson, *State Takeover Statutes: Constitutionality, Community, and Heresy*, 45 WASH. & LEE L. REV. 1051, 1056-57 (1988) ("One significant incident of this vision of corporate law is to embrace, at least implicitly, the larger social and political repercussions felt in local communities as capital market forces drive corporate action."). *But see* Booth, *supra* note 390, at 125 (The stakeholder concept ignores the fact that the nexus of contracts approach is based upon the free market and "jumps to the conclusion that since a firm is a collection of relationships more or less formal, it should not be so easy for it to be dismantled by unscrupulous corporate raiders who pander to the greed of fickle shareholders.").

405. *See, e.g.*, Hanks, *supra* note 17, at 23 (stakeholder statutes make equity investment in those states less attractive, thus harming nonshareholders).

406. *See, e.g.*, B. BLUESTONE & B. HARRISON, *supra* note 9, at 50.

407. Kennedy, *supra* note 189, at 604-09.

the job market.[408]

For two reasons, however, mandating severance payments is efficient. First, the employees bargain for this right under their implicit contracts. Second, by continuously engaging in opportunistic breach, corporations destroy the market for implicit employment contracts.[409] If this destruction occurs, workers will turn to costly contractual provisions to prevent opportunistic breach by the corporation.[410] These written contracts may be a more costly solution to the problem than recognizing a fiduciary duty to protect displaced workers.

The extent to which workers would pay for plant closing restrictions through lower wages depends on the employers' elasticity of response to the regulation.[411] The elasticity may be low if the employer does not have a ready supply of labor.[412] In addition, requiring protection in the form of severance payments may provide employees with greater bargaining power at the collective bargaining table generally so that employers would not be able to lower wages.[413]

The workers' failure (or inability) to negotiate for severance payments causes harm to third parties because unemployment has ripple effects on the surrounding communities.[414] For this reason, one could argue that the law paternalistically should prevent the employees from giving in to the temptation to contract away this obligation for higher wages in the short-run.[415] This Article takes the position, however, that workers should be able to opt out of the legal assistance if the procedural practices surrounding the waiver demonstrate that the employees fully understand the terms of the contract.

b. The Moral Hazard Argument: Providing Job Security Creates an Incentive to Shirk

Opponents of plant closing laws suggest that regulation providing employees with job security creates an incentive to shirk,[416] and that this so-called

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408. *See, e.g.*, Macey, *supra* note 19, at 185.

409. Singer, *supra* note 10, at 717 & n.350.

410. Coffee, *Shareholders Versus Managers*, *supra* note 91, at 109 ("[C]hange-of-control severance compensation is probably less expensive than the risk premium that managers would demand once the 'old' equilibrium in the executive labor market shifts because the implicit contract has been breached.").

411. *See* B. BLUESTONE & B. HARRISON, *supra* note 9, at 184-85 (states lower response by offering incentives to plants to locate); Folbre, Leighton & Roderick, *supra* note 37, at 195 (imposing cost on firm may lower cost to society as a whole); Singer, *supra* note 10, at 720-21 (Wage response depends on "elasticity of supply and demand" in labor and product market.).

412. Singer, *supra* note 10, at 721.

413. Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 834 (1983); Singer, *supra* note 10, at 783; Stone, *supra* note 88, at 105.

414. Singer, *supra* note 10, at 717 n.350.

415. *Id.*

416. *See, e.g.*, Macey, *supra* note 19, at 194 ("Giving workers an incentive scheme that makes them indifferent to the success or failure of a firm is irrational."); Ribstein, *supra* note 61, at 146 ("The parties must tread a fine line between incentive problems resulting from entrenchment and the risk of opportunistic firing by the employer."); *cf.* Haddock, Macey & McChesney, *supra* note 118, at 713 ("Long-term guarantees may control the potential for opportunism by one party, but contracts that guarantee the other party's income invite shirking, i.e., opportunism by *that* party.").

"moral hazard" problem will increase the probability that the plant will close.[417] This argument, however, fails to take into account more progressive theories of labor management. For example, one theory suggests that managers are more effective if they create an environment that stresses support and encouragement rather than constant threats of dismissal.[418] The current restructuring era has reduced employee morale, loyalty, and productivity.[419] Thus, protecting displaced workers may improve management-labor relations overall[420] and lead to an increase in productivity that will enhance international competitiveness.[421]

In sum, mandating severance benefits would ensure a more equitable and efficient transition policy for long-term restructuring. This policy, however, provides only a general objective. Part IV transforms this notion into conventional legal terminology for institutional reform.[422]

IV. Protecting Displaced Workers: The Fiduciary Duty Approach Versus a Legislative Solution

This Part evaluates two very different means to achieve the goal of corporate social responsibility. The first method seeks internal reform of the corporate structure by changing the corporation's objectives.[423] This Part analyzes a proposal to expand the directors' fiduciary duties to protect employees during fundamental corporate changes. Next, this Part explores the second manner of corporate reform which applies external measures to regulate corporate activity.

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417. *See, e.g.*, Macey, *supra* note 19, at 193-94.

418. Buono & Bowditch, *supra* note 50, at 141; Coffee, *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1621 (1989) (citing D. MCGREGOR, THE HUMAN SIDE OF ENTERPRISE (1960)).

419. *See, e.g.*, Fogg, *Takeovers: Last Chance for Self-Restraint*, 63 HARV. BUS. REV. 30, 32 (Nov.-Dec. 1985); Drucker, *A Crisis of Capitalism*, Wall St. J., Sept. 30, 1986, at 32, col. 3.

420. *See, e.g.*, M. AOKI, *supra* note 18, at 5 ("[O]pen management-union confrontation is increasingly regarded as counterproductive."); Fedrau & Balfe, *Cooperative Labor-Management Worker Adjustment Programs*, 41 LAB. L.J. 138, 139 (1989) (corporations that sponsor employee transition programs improve labor relations).

421. *See* Weber & Taylor, *Procedure for Employee Displacement: Advance Notice of Plant Shutdown*, 36 J. BUS. 302, 305 (1963).

422. As Professor Chayes stated over thirty years ago: "It is not always easy to identify such constituencies, nor is it always clear what institutional forms are appropriate for recognizing their interests. The effort to answer those questions is among the most meaningful tasks of the American legal system." A. CHAYES, *supra* note 390, at 41.

423. For example, many commentators have proposed that corporations should have public interest directors similar to the European system of codetermination. *See, e.g.*, R. NADER, M. GREEN & J. SELIGMAN, *supra* note 329, at 125; Conard, *supra* note 289; Summers, *Codetermination in the United States: A Projection of Problems and Potentials*, 4 J. COMP. CORP. L. & SEC. REG. 155 (1982) (discussing employee representation on boards); Note, *Employee Codetermination: Origins in Germany, Present Practice in Europe, and Applicability in the United States*, 14 HARV. J. LEGIS. 947 (1977) (analyzing Western European codetermination systems);. For additional commentary proposing union representation on the board, see Hopt, *New Ways in Corporate Governance: European Experiments with Labor Representation on Corporate Boards*, 82 MICH. L. REV. 1338, 1348-52 (1984); Comment, *An Economic and Legal Analysis of Union Representation on Corporate Boards of Directors*, 130 U. PA. L. REV. 919 (1982) (addressing conflicts between union and corporate duties); Note, *Serving Two Masters: Union Representation on Corporate Boards of Directors*, 81 COLUM. L. REV. 639 (1981) (same). This approach has never been adopted widely in the United States. Lipton, *Corporate Governance*, *supra* note 11, at 45 (Policy-making at managerial level may transform the board into a quasi-legislature; this solution is too broad for the problem.).

When the profit maximization goal fails to produce socially acceptable behavior, the legislature can install penalties to steer corporations down the desired path.[424] This scheme involves enacting statutes that require specific corporate actions such as providing advance notice and severance pay.[425] This analysis lays the groundwork to compare the advantages and disadvantages of the fiduciary duty approach with legislative solutions.

A. Recognizing a Fiduciary Duty to Alleviate the Impact of Corporate Restructuring Upon Labor

In considering whether directors should protect the interests of displaced workers, it is first necessary to explore basic principles of fiduciary law. This examination provides a basis upon which to analyze whether doctrinal barriers prevent a recognition of a fiduciary obligation to employees. This discussion also lays a foundation for defining the properties of the directors' fiduciary duty to employees during fundamental corporate changes by exploring the nature of this fiduciary relationship, the form of appropriate relief for its breach, and the scope of judicial review.

1. An Overview of the Nature of Fiduciary Obligation

Fiduciary law is a remarkably nebulous doctrine.[426] A logical starting point in clarifying this area is a discussion of when and why fiduciary duties arise.[427] In many cases, no specific instance can be singled out to confirm when fiduciary duties commence because the relationship often evolves over time.[428] Under traditional and more restrictive interpretations, "a fiduciary is a person who undertakes to act in the interest of another"[429] or a person who accepts entrusted property of another.[430] Contemporary academic analysis, however, stresses that the law establishes fiduciary duties to defend the weaker party in various relational circumstances.[431] Often, the vulnerable party confers discre-

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424. Engel, *supra* note 312, at 34.

425. Most conservative scholars favor regulation that reinforces profit-maximizing behavior. *See* Easterbrook & Fischel, *Contract*, *supra* note 87, at 1447-48; Macey, *supra* note 19, at 175.

426. DeMott, *supra* note 86, at 879 ("Fiduciary obligation is one of the most elusive concepts in Anglo-American law.").

427. Professor DeMott explains that two questions arise in examining a fiduciary relationship: "[I]n what circumstances does fiduciary obligation apply?" and "what does the obligation require a person to do?" *Id.* at 882. Justice Frankfurter has stated: "[T]o say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary?" SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943).

428. DeMott, *supra* note 86, at 911.

429. Scott, *The Fiduciary Principle*, 37 CALIF. L. REV. 539, 540 (1949). *But see* DeMott, *supra* note 86, at 910-11 (Scott's definition too limited).

430. DeMott, *supra*, note 86, at 912 (citing J. SHEPHERD, LAW OF FIDUCIARIES 96 (1981)).

431. Bratton, *The Economics and Jurisprudence of Convertible Bonds*, 1984 WIS. L. REV. 667, 732 (1984) (notes other commentators go further "defining the fiduciary obligation as the 'exercise of judgment on behalf of another' " (quoting Jacobson, *Capturing Fiduciary Obligation: Shepards' Law of Fiduciaries*, 3 CARDOZO L. REV. 519, 527 (1982))); DeMott, *supra* note 86, at 909-10 ("[C]ourts impose fiduciary constraints whenever one person's discretion ought to be controlled because of characteristics of that person's relationship with another."); Frankel, *supra* note 413, at 807 (risk of abuse of power triggers the application of fiduciary law).

tionary decisionmaking power upon the stronger fiduciary to use his superior knowledge on the weaker party's behalf.[432] Accordingly, in determining whether a fiduciary relationship exists, courts question whether the association involves mutual trust and confidence or whether it entails arm's length negotiations.[433] Because fiduciary affiliations contain an imbalance of power, possibilities for abuse arise. Consequently, fiduciary law operates to restrict overreaching in long-term relationships when contract or market mechanisms are inadequate to deter the more powerful party from engaging in opportunistic conduct.[434] Courts often use the language of moral obligation to support restricting the stronger party on the weaker party's behalf.[435]

Courts increasingly respond to changing social conditions by fashioning new fiduciary relationships. Professor Frankel maintains that "[t]he twentieth century is witnessing an unprecedented expansion and development of the fiduciary law."[436] Professor Frankel provides two explanations for this trend: a general decrease in legal and social restraints and an overall increase in power from the specialization of services and the pooling of capital.[437]

Corporate fiduciary obligations continue to develop,[438] with courts finding that majority stockholders owe fiduciary duties to minority stockholders,[439] and in close corporations, that stockholders owe fiduciary duties to each other.[440] As previously discussed, courts also have embellished directorial fiduciary re-

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432. Professor Anderson explains: "Fiduciaries are typically decisionmakers; their specialized function is that of recommending or making decisions of a discretionary nature about the management or investment of the property of others. Such decisions cannot easily be subjected to detailed standards or guidelines; instead, they require educated judgment about uncertain, problematical issues." Anderson, *supra* note 334, at 757; Frankel, *supra* note 413, at 809 (expressing same point).

433. *See, e.g.*, Bratton, *Critical Appraisal*, *supra* note 78, at 451 (fiduciary obligation facilitates mutual trust); DeMott, *supra* note 86, at 911 (expressing same point).

434. *See, e.g.*, Bratton, *Convertible Bonds*, *supra* note 11, at 737; Frankel, *supra* note 413, at 811.

435. *See, e.g.*, DeMott, *supra* note 86, at 891.

436. Frankel, *supra* note 413, at 796. Professor Frankel goes on to state: "[S]ociety is evolving into one based predominately on fiduciary relations. The body of law governing fiduciary relations can affect and be affected by this social trend." *Id.* at 798; *see also* A. CONARD, R. KNAUSS & S. SIEGEL, AGENCY-PARTNERSHIPS 334 (4th ed. 1987). Even more generally, Professor Kennedy explores how rigid rules give way to change that tends to socialize society. Kennedy, *supra* note 354, at 1687. Professor Rose notes in the property area that the law tends to shift from clear entitlements to ambiguous rules that involve equitable second-guessing. Rose, *supra* note 337, at 578 (refers to this occurrence as the substitution of "mud" rules for "crystal" rules); *see also* Singer, *supra* note 10, at 653 ("Many of the legal developments of the twentieth century can be described as recognition of obligations that emerge over time out of relationships of interdependence.").

437. Frankel, *supra* note 413, at 802-04.

438. Coffee, *supra* note 418, at 1621.

439. *See, e.g.*, Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969); Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971); Trans World Airlines, Inc. v. Summa Corp., 374 A.2d 5 (Del. Ch. 1977). For an expanded discussion, see R. CLARK, *supra* note 322, § 11.4, at 488-90; *id.* § 12.3.5, at 525.

440. *See, e.g.*, Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, 848-49, 353 N.E.2d 657, 662 (1976); Donahue v. Rodd Electrotype Co., 367 Mass. 578, 592-93, 328 N.E.2d 505, 515 (1975); Smith v. Atlantic Properties, Inc., 12 Mass. App. Ct. 201, 422 N.E.2d 798, 801 (1981); Meiselman v. Meiselman, 309 N.C. 279, 289, 307 S.E.2d 551, 557-58 (1983). For a more detailed discussion, see H. O'NEAL & R. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 9.30 (3d ed. 1988). Some commentators suggest that a corporation owes a fiduciary duty to creditors. McDaniel, *supra* note 294, at 265-312; McDaniel, *Bondholders*, *supra* note 268, at 442-50. *But see* Simons v. Cogan, 549 A.2d 300, 303 (Del. 1988) (no fiduciary duty to bondholders because creditors are protected by indenture).

sponsibilities by requiring that directors become well-informed and, in certain cases, by mandating specific actions such as redeeming poison pills.[441] Outside the corporate setting, courts continually create fiduciary duties in nontraditional areas. These circumstances involve long-term commercial relationships in which the weaker party accepts a risk that may lead to opportunism by the more powerful party.[442] For example, in the franchise and distributorship contexts, courts place fiduciary controls on the more powerful party's freedom to end the association.[443] In some instances, courts have held that fiduciary restraints prevent partners at will from terminating the arrangement.[444]

Similarly, but to a more limited extent, in *Jordan v. Duff & Phelps*[445] the Seventh Circuit, in an opinion authored by Judge Easterbrook, recognized a fiduciary restriction on the ability to end an at-will employment relationship.[446] In *Jordan* the question arose whether the corporation's entitlement to repurchase the stock of an employee upon termination of employment imposed on the corporation a duty to disclose an impending merger under Rule 10b-5.[447] Specifically, the issue involved whether the corporation had a fiduciary relationship with the shareholder/employee when the shareholder status was dependent upon the continuation of employment. The Seventh Circuit found a duty to disclose based upon an implied fiduciary duty that the stock would not be bought back in an opportunistic fashion.[448] Thus, Judge Easterbrook implied that a narrow fiduciary duty arose from the at-will employment arrangement.[449]

441. DeMott, *supra* note 7, at 21 ("To this extent, directors as fiduciaries resemble other types of fiduciaries, like trustees and guardians, whose positions are conventionally held to impart affirmative obligations to be informed.").

442. For example, courts have held that banks may owe fiduciary duties to its customers. *See, e.g.*, Security Pac. Nat'l Bank v. Williams, 213 Cal. App. 3d 927, 262 Cal. Rptr. 260, 278 (Cal. Dist. Ct. App. 4 1989); Barrett v. Bank of Am., 183 Cal. App. 3d 1362, 1369, 229 Cal. Rptr. 16, 20-21 (Cal. Dist. Ct. App. 4 1986). *But see* Price v. Wells Fargo Bank, 213 Cal. App. 3d 465, 477, 261 Cal. Rptr. 735, 740-41 (Cal. Dist. Ct. App. 1 1989) (no fiduciary relationship); Victoria Bank & Trust Co. v. Brady, 779 S.W.2d 893, 902 (Tex. App. 1989) (expressing same point).

443. Courts have found a fiduciary duty when a franchisor arbitrarily terminates a franchise relationship. Arnott v. American Oil Co., 609 F.2d 873, 882-84 (8th Cir. 1979), *cert. denied*, 446 U.S. 918 (1980); *see, e.g.*, General Business Machs. v. National Semiconductor Datachecker/DTS, 664 F. Supp. 1422, 1425-26 (D. Utah 1987) (whether fiduciary relationship exists matter for the jury); ABA Distribs., Inc. v. Adolph Coors Co., 542 F. Supp. 1272, 1285-86 (W.D. Mo. 1982). *But see* Power Motive Corp. v. Mannesmann Demag Corp., 617 F. Supp. 1048, 1051-52 (D. Colo. 1985) (criticizing cases finding fiduciary relationship as inconsistent with prior law). *See generally* Brown, *Franchising—A Fiduciary Relationship*, 49 TEX. L. REV. 650 (1971) (favoring fiduciary restrictions on franchisor); Gellhorn, *Limitations on Contract Termination Rights—Franchise Cancellations*, 1967 DUKE L.J. 465, 478-95 (1967) (discussing direct limitations on contract terminations); *cf.* DeMott, *supra* note 86, at 887 ("In short, having the right to terminate a relationship does not establish the absence of fiduciary constraints on transactions connected with the termination.").

444. *See, e.g.*, Page v. Page, 55 Cal. 2d 192, 196, 359 P.2d 41, 44, 10 Cal. Rptr. 643, 646 (1961) (power to terminate partnership at will, "like any other power held by a fiduciary, must be exercised in good faith").

445. 815 F.2d 429 (7th Cir. 1987), *cert. denied*, 485 U.S. 901 (1988).

446. *Id.* at 438.

447. *Id.*

448. *Id.*

449. Coffee, *supra* note 418, at 1663 n.193. *But see* DeMott, *supra* note 86, at 887 ("[T]he employer's ability in *Jordan* to terminate the plaintiff's employment and thereby oblige him to sell his shares to the corporation is irrelevant to the employer's obligation, as fiduciary, to disclose information to the selling shareholder.").

Judge Posner dissented, contending that a fiduciary obligation to disclose the merger did not exist because an employee at will could be fired at anytime.[450]

Jordan and the other commercial cases in which the courts have found fiduciary relationships demonstrate that the dominant party does not always owe responsibilities to the weaker party. The dependent party, however, does not necessarily owe corresponding duties to the dominant party.[451] Rather, the courts mold particular obligations to fit the circumstances.[452] These cases also reveal that fiduciary obligations do not depend upon the parties' agreement, but are imposed by the law to control overreaching behavior.[453]

Because courts have found fiduciary duties in commercial contexts, fiduciary principles must be distinguished from the duty of good faith in contracts.[454] The two duties are comparable in that both involve ad hoc, ex post facto, judicial intervention against one-sided, opportunistic performance of contracts.[455] Courts often use the amorphous duty of good faith in cases in which a traditional fiduciary relationship does not apply;[456] but three main differences exist between them. First, the duty of good faith focuses more on the contract's terms to protect the parties' from opportunism. In contrast, fiduciary relationships arise from a broad range of circumstances over the history of the parties' association.[457] Indeed, fiduciary duties have a tendency toward contract avoidance.[458] Second, the duty of good faith involves a lower degree of selflessness and morality than fiduciary duty.[459] That is, the duty of good faith entails a promise not to destroy the benefits that the other party expects from the contract.[460] Thus, the duty of good faith consists of a duty of fair dealing which requires contracting parties to act in accordance with the accepted customs of the marketplace.[461] Fiduciaries, however, must place the beneficiaries' interests

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450. *Jordan*, 815 F.2d at 446-47 (Posner, J., dissenting).

451. *See, e.g.*, Frankel, *supra* note 413, at 801 (fiduciary relations are designed to satisfy weaker parties' needs).

452. *See, e.g.*, DeMott, *supra* note 86, at 910; Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 73; Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1, 1-3 (1975).

453. *See, e.g.*, DeMott, *supra* note 86, at 887 (Express agreements do not "control their obligations to each other as dispositively as it does under a contract analysis."); Frankel, *supra* note 413, at 820 ("Once a relation is established, . . . its classification as fiduciary and its legal consequences are primarily determined by the law rather than the parties.").

454. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979) (good faith and fair dealing); U.C.C. § 1-203 (1990) ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."). For an expanded discussion of the duty of good faith in contracts, see Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 (1980); Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963); Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968). For a more extended discussion of the differences between the duty of good faith and fiduciary duty, see Coffee, *supra* note 418, at 1653-64; DeMott, *supra* note 86, at 892-908.

455. Bratton, *supra* note 228, at 148.

456. Coffee, *supra* note 418, at 1655.

457. Eisenberg, *supra* note 198, at 1468.

458. *Id.*; Bratton, *supra* note 431, at 736.

459. Bratton, *supra* note 431, at 738-739.

460. *See, e.g.*, Bratton, *Corporate Debt Relationships*, *supra* note 11, at 148.

461. U.C.C. § 2-103(1)(b) (1990) (Good faith means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.").

ahead of their own even though the costs exceed the benefits.[462] A fiduciary is "held to something stricter than the morals of the market-place" and must follow "the punctilio of an honor the most sensitive."[463] Overall, the courts impose fiduciary obligations rather than rely upon the duty of good faith when the harm from opportunism is severe[464] and a stronger deterrent is needed to prevent an abuse of discretion.[465] Finally, there is a procedural difference. If the vulnerable party alleges a breach of fiduciary duty, the fiduciary must demonstrate that the transaction was fair. In contrast, the party claiming a breach of the duty of good faith bears the burden of establishing that the other party did not fulfill the obligation.[466]

Given the lofty obligations of a fiduciary, the question arises whether it is theoretically possible to have dual or conflicting fiduciary duties.[467] Examples can be found. In the corporate area, courts apply a test of fairness when reviewing decisions involving the competing interests of majority and minority shareholders.[468] Outside the corporate context, a general principle of agency law states that an agent cannot fully serve two principals.[469] If, however, the dual agency is disclosed to both principals, and both agree, an agent can represent antagonistic interests.[470] In these cases, the agent must act to protect adverse parties equally.[471] Similarly, in the trust area, if a trust has two or more beneficiaries, the trustee must deal impartially with all of them.[472] The fiduciary obligation to act "fairly," "equally," and "impartially" basically requires the fiduciary to maintain an equitable balance among the various competing concerns.[473]

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462. Goetz & Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1128 (1981).

463. Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

464. Anderson, *supra* note 334, at 758 ("[T]he relative costs which [fiduciaries'] cheating may impose on those whose property they manage are frequently much greater than the relative costs that can be imposed without detection or remedy in simpler contractual exchanges."); Burton, *supra* note 454, at 373 (duty of good faith controls opportunism).

465. Coffee, *supra* note 418, at 1658 n.177 ("Fiduciary law also has been inherently prophylactic, while contract law has not.").

466. *See, e.g.*, DeMott, *supra* note 86, at 900.

467. Booth, *supra* note 390, at 128 ("unwise" to test "notion that a fiduciary can serve only one master").

468. *See, e.g.*, Pavlidis v. New England Patriots Football Club, Inc., 675 F. Supp. 688, 695 (D. Mass. 1986) (directors owe minority shareholders fiduciary duty in squeeze-out merger); Weinberger v. UOP Inc., 457 A.2d 701, 710-11 (Del. 1983) (in merger between parent and partially owned subsidiary, directors of the parent and subsidiary are fiduciaries with respect to minority shareholders). *See generally* 2 H. O'NEAL & R. THOMPSON, O'NEALS' OPPRESSION OF MINORITY SHAREHOLDERS § 7.17 (1985).

469. RESTATEMENT (SECOND) OF AGENCY §§ 392, 394 (1957).

470. McDaniel, *supra* note 294, at 269 (citing W. SEAVEY, HANDBOOK OF THE LAW OF AGENCY § 147 (1964)).

471. *Id.*

472. CAL. CIV. CODE § 2375 (West 1991); RESTATEMENT (SECOND) OF TRUSTS § 183 (1957); *see also* Comment, *The Practice of Dual Agency in California: Civil Code Sections 2373-2382*, 21 U.S.F. L. REV. 81, 87-89 (1986) (noting California practice of allowing a real estate licensee to represent multiple principals upon disclosure of such intent and receipt of principals' consent).

473. A. SCOTT, 3A SCOTT ON TRUSTS § 232, at 4.

2. Defining Directors' Fiduciary Duty to Displaced Workers

General fiduciary principles support extending directorial fiduciary obligations to employees in some circumstances.[474] This fiduciary duty should arise in recognition of the significant investments of time and human capital that employees make in the corporation. Often employees have no influence over the directors' decisions because they are relatively unsophisticated and cannot obtain relevant information; a disparity in bargaining power exists between corporations and employees as evidenced by the unilateral nature of plant closings and relocations.[475] Because employees become economically dependent upon the continued existence of the employment relationship, they place their trust and confidence in the directors to use their business expertise to manage their "property" on their behalf. Employees have only one job and cannot diversify their risk; thus, they are particularly vulnerable to directors abusing their discretion because contract and market mechanisms are inadequate to deter opportunistic breach of implicit employment contracts.[476]

The scope and content of the directors' fiduciary duties could be redefined to require directors to defend the employees' interests during fundamental corporate changes. There is no need, however, to abandon most of the existing framework of corporate law in creating a fiduciary duty to employees.[477] During normal operating conditions, the interests of shareholders and employees coincide. Hence, the employees receive indirect protection when directors maximize shareholder wealth. The shareholders' and employees' interests clash, however, in plant closings and layoffs. As discussed previously, the stakeholder statutes may leave the resolution of this conflict to the directors' discretion; the

474. Judge Easterbrook and Professor Fischel have recognized the possibility that the directors owe employees fiduciary duties: "[We] do not necessarily rule out arguments that directors owe fiduciary duties to employees and other groups. Under some circumstances employees are investors in the firm; they invest their human capital, to the extent that they become specialists and obtain skills that are less valuable to other employers." Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 699, 703 n.15 (1982). Professor Coffee responded as follows: "Such a rule, if intended, might also deny directors the ability to close or relocate a plant if the private gains were less than the social loss. This line of argument quickly converts the corporate director into an unelected and unaccountable public servant." Coffee, *supra* note 178, at 1217 (citation omitted). Later, Professor Coffee asserted:

> Another significant aspect of the implicit contracting perspective is that it forces us to see the board of directors in a very different light. Although the law has traditionally viewed the board of directors as the agent of the shareholders, an alternative perspective sees the board's role not as that of agent, but as that of mediator.

Coffee, *Takeover Reform*, *supra* note 8, at 448 (citation omitted).

475. *See supra* note 209 and accompanying text. *But see* Epstein, *supra* note 128, at 954 ("With employment contracts we are not dealing with the widow who has sold her inheritance for a song to a man with a thin mustache.").

476. Goetz & Scott, *supra* note 462, at 1142 ("In order to maintain the appropriate disincentives to engage in socially disfavored activity, the risk of cheating or other opportunistic behavior must be borne, therefore, by the party with the discretionary power to terminate the contract.").

477. Gilson & Kraakman, *supra* note 274, at 267 n.65 (shareholder primacy necessary to prevent total disregard of corporate purpose); Oesterle & Norberg, *Management Buyouts: Creating or Appropriating Shareholder Wealth?*, 41 VAND. L. REV. 207, 222 n.67 ("Once the primacy of shareholders' interests is dismissed, a wide array of traditionally unacceptable corporate actions can be justified as furthering some corporate constituency's interests."). *But see* Johnson, *Corporate Life*, *supra* note 24, at 888 n.88 (view that there is a need to change drastically corporate law mistakenly lumps takeover doctrine with traditional corporate law precepts).

law, however, should go a step further to ensure that directors take the actions that are necessary to compensate employees for their investments in the corporation.

In allocating the risks and rewards of corporate restructuring, directors should balance the competing factors of the shareholders' desire to maximize their return and the employees' past reliance on implicit contracts.[478] Analogizing from trust law, trustees must act impartially when they are required to allocate investment proceeds among various types of beneficiaries. In the same manner, employees with fixed claims are comparable to life tenants, and shareholders with residual claims are similar to remaindermen.[479] Directors should act in accordance with what is reasonable and equitable in view of the different concerns of stockholders and employees.[480] Many corporate commentators have questioned directors' competence to balance these concerns,[481] maintaining that this obligation forces directors into the role of public servants.[482] In contrast, scholars in the organizational management field contend that managers are in the best position to reduce the harm to employees resulting from the process of restructuring.[483]

The duty of good faith also would prevent the opportunistic breach of implicit employment contracts.[484] This doctrine, however, is not as well suited as fiduciary principles to compensate employees for their investments in the corporation. The fiduciary duty to displaced workers arises not from the employment at-will contract, but rather from the directors' ability to exercise their decision making power over employees' lives. A fiduciary duty would require directors' conduct toward employees to rise above currently accepted customs of the marketplace in order to safeguard employees' noncontractual expectations. In sum, fiduciary duty, with its moral undertones and high degree of selflessness, better describes the obligation that directors should owe employees faced with job dislocation.

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478. *Cf.* M. AOKI, *supra* note 18, at 126-27 (under the corporative managerialism model of the firm, neutral managers make decisions to mediate the interests of shareholders and employees).

479. McDaniel, *supra* note 294, at 269 (suggesting analogy to recognize fiduciary duty to bondholders); Singer, *supra* note 10, at 721 ("The company is no longer the fee simple owner of the property; the workers have a contingent future interest in the property."). *But see* Mahoney, *supra* note 305, at 26 (trustee analogy fails because the settlor of a trust specifies preferences in advance).

480. McDaniel, *supra* note 294, at 270 (analogizing from trust area to propose a fiduciary duty to protect bondholders).

481. *See, e.g.*, Easterbrook & Fischel, *supra* note 75, at 1191 n.85 ("[A]lthough management, at least in nonconflict-of-interest situations, is best situated to determine what actions will maximize the return to shareholders, it is hardly qualified or authorized to balance shareholders' interests against the uncertain effects of an acquisition on various vaguely defined noninvestor groups."); Oesterle, *supra* note 75, at 140 (Even if management is well intentioned, "[p]redicting abuse by a bidder is problematic, and fashioning an appropriate response within the psychological turmoil of a hostile tender offer is even more so.").

482. *See, e.g.*, Davis, *supra* note 243, at 519 (similar to managerialist view of directors).

483. *See, e.g.*, Buono & Bowditch, *supra* note 50, at 126, 142; Freeman, *Managing Stakeholders: A Question of Ethics*, in *The First International Symposium*, *supra* note 16, at 17, 19-23.

484. *But see* Conard, *Take Charge*, *supra* note 223, at 47 ("To other constituencies, managers do not owe a *fiduciary* duty. But they owe duties of fair dealing.").

3. Determining the Appropriate Form of Relief for Displaced Workers

The fiduciary obligation to employees would require directors to honor implicit contracts in plant closings and layoffs.[485] In providing relief to employees, shareholders' rights must be considered as well; directors should not go so far as to force a corporation to retain workers or keep a plant open. At a minimum, however, any corporation that closes a plant or orders a mass dismissal should pay severance benefits according to the employee's years of service and should continue health care insurance for a period of time.[486] Older workers who have given the corporation many years of service deserve the greatest assistance, especially workers over fifty who have the most difficult time finding alternative employment. For these workers, directors should fully vest pension funds. The workers' ability to find replacement work also should be considered. For example, where employees have made firm-specific investments of human capital that cannot be used elsewhere, the corporation should implement job-retraining programs and provide workers with transfer rights and relocation pay.[487]

This fiduciary duty also should include an obligation for the directors to safeguard pension plan assets during hostile battles for control and internal recapitalizations. In some cases, the employees should be informed, consulted, and even given the right to negotiate over plant shutdowns.[488] In other situations, a corporation should attempt to provide unions with successorship protection for their collective bargaining agreements. Severance packages should be preplanned with approval by a majority of outside directors to avoid the use of these benefits as poison pills.[489]

4. Ensuring Accountability: The Scope of Judicial Review of Directors' Decisions to Compensate Workers in Corporate Restructurings

The problem of how to enforce the directors' fiduciary duty to employees remains. Employees should be permitted to sue for failure to fulfill this fiduciary duty[490] because fear of liability would deter directors from abusing their discre-

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485. This notion is in accord with the basic restitutionary principle that governs remedies for breaches of fiduciary duty. DeMott, *supra* note 86, at 900.

486. *See* Singer, *supra* note 10, at 742.

487. *See, e.g.*, B. BLUESTONE & B. HARRISON, *supra* note 9, at 238.

488. *See* Macey, *supra* note 19, at 193 ("Courts would face the difficult task of distinguishing ex post contractual opportunism from legitimate renegotiations in light of unforeseen circumstances."); Singer, *supra* note 10, at 742.

489. The court would need to consider such factors as whether the plan has a double trigger and whether it would apply in both friendly and hostile acquisitions. *See, e.g.*, Block, *supra* note 183, at 397-402; Robertson, *supra* note 177, at 199-200. In situations where the severance package was not preplanned, the context of management's decision would be important too. A court should give directors greater discretion where the compensation package is negotiated "as part of the terms of a takeover it ultimately will approve rather than asserting those losses as grounds for rejecting a takeover it opposes." Davis, *supra* note 243, at 520. In addition, such factors as a majority of outside directors on the board and the presence of golden parachutes should persuade courts to allow the change-in-control provisions.

490. Professor Macey argues that courts should police ex post contractual opportunism by parties seeking to exploit firm-specific capital investments. Macey, *supra* note 19, at 176. A derivative suit would not be feasible for the same reasons that it is not feasible in a bondholder context. *See* Tauke, *Should Bonds Have More Fun? A Reexamination of the Debate Over Corporate Bondholder*

tion. In addition, this right would force directors to assume a greater awareness and respect for the needs of employees.[491]

Recognition of a fiduciary duty to employees would empower courts to police corporate restructuring events to determine whether the corporation treated displaced workers fairly. Thus, the standard of review becomes critical. The courts could employ the business judgment rule, affording directors wide latitude in mediating between the interests of employees and stockholders.[492] This degree of judicial deference, however, would reduce the effectiveness of the proposed fiduciary duty to employees for two reasons. First, the absence of meaningful judicial evaluation would allow directors to favor wrongly one group over another.[493] In some cases, directors may reduce employees' severance packages to maximize shareholder returns. Under other circumstances, directors improperly may prefer employees over shareholders by establishing benefits that amount to poison pills. Second, granting directors even greater leeway to make business decisions would increase agency costs by facilitating inefficient managerial behavior and encouraging excessive risk aversion by management. Hence, the market for corporate control would lose most of its force as a deterrent to managerial shirking.

In contrast, application of a test of fairness to evaluate whether directors have compensated displaced employees in layoffs and plant closings adequatele would provide equitable and efficient protection of employees' interests. Courts face similar problems when reviewing directors' decisions to engage in transactions that may benefit the majority stockholders at the expense of the minority stockholders and when reviewing trustees' decisions to allocate investment proceeds among beneficiaries. In these situations, directors and trustees are not given the benefit of the business judgment rule; rather, courts examine the fiduciaries' decisions by conducting a degree of substantive review.[494] Such judicial scrutiny may lower agency costs because employees are uniquely situated to review executive inefficiency and self-serving behavior. Because the directors' fiduciary duty to employees is limited to circumstances involving plant closings and layoffs, there would be no need for sweeping judicial second-guessing.

A variety of remedies for breach of fiduciary duty is available, with restitution being the most common.[495] Courts would face some difficulty in determining whether employees were compensated adequately for their investments in

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Rights, 1989 COLUM. BUS. L. REV. 1, 46 n.102 (conflict with shareholders; the employees cannot be said to represent the corporation).

491. Blades, *supra* note 133, at 1414 (discussing exceptions to employment-at-will doctrine).

492. *Cf.* Coffee, *Corporate Web*, *supra* note 9, at 107-09 (Directors should be given a wide range of discretion in the takeover situation to protect middle managers.).

493. *See* Davis, *supra* note 243, at 518 ("If we are really dealing with a contract, then its interpretation and application should be left to target management's business judgment. It may not be wise to go this far, however."); Note, *supra* note 11, at 856 ("Such strengthened Fiduciary Duty law would probably operate only as shields for the managers against shareholders, and not as swords for employees or others against managers.").

494. 3A A. SCOTT & W. FRATCHER, THE LAW OF TRUSTS § 232, at 7 (4th ed. 1988) (absent specific controls within the trust instrument, the trustee has considerable discretion in maintaining the balance among competing interests of beneficiaries).

495. Sealy, *supra* note 452, at 73.

individual cases.[496] They would need to take into account how long the employee had worked for the corporation, the nature of the employee's skills, and the employee's ability to find alternative employment.

B. Legislative Solutions to Protect Displaced Workers

Most commentators who recognize that industrial relocation imposes significant costs on workers prefer a legislative solution.[497] Federal law provides limited relief to workers who suffer from plant closings by providing notice. Several states also have plant closing laws that require notice and severance protection.[498] The desirability of an objective standard to measure how to compensate employees suggests that the federal government should statutorily define plant closing benefits to include items such as monetary compensation, vesting of pension funds, and job retraining programs.[499]

C. A Comparison of the Fiduciary Duty and Legislative Approaches: Evaluating the Merits of Ex Ante and Ex Post Relief

This section evaluates the costs and benefits of recognizing a fiduciary solution to protect displaced workers versus enacting a legislative solution that itemizes displacement assistance. The fiduciary duty response represents a marked departure from the conventional method of regulating corporate conduct. Legislatures usually endeavor to alter corporate behavior by external measures that require specific action. In contrast, the stakeholder model of the corporation seeks internal reform of the corporate structure by changing the legal role of corporate directors. This role may enable courts to require directors to ascertain the social costs of corporate restructuring on employees and to provide restitution.

Some commentators flatly assert that the courts should not recognize a fiduciary duty to employees because the resulting costs clearly exceed the benefits.[500] Weighing the advantages and disadvantages of plant closing restrictions is a political question.[501] The debate is fueled by disagreement both over what

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496. McDaniel, *supra* note 294, at 257 (judicial review to determine the fairness of an allocation of gain between bondholders and stockholders raises complex valuation questions); Cornell & Shapiro, *Corporate Stakeholders and Corporate Finance*, FIN. MGMT. 5, 8-9 (Spring 1987) (financial literature is beginning to consider the importance of implicit claims).

497. Macey, *supra* note 19, at 180; *Ruder Says Commission Should Oppose Expansion of Non-Shareholder Rights*, 21 Sec. Reg. & L. Rep. (BNA) 1504, 1504.

498. *See supra* note 13 and accompanying text.

499. Previous plant closing bills favored mandated severance pay provisions based on a formula that takes into account levels of pay and years of service. Barron, *Causes and Impact of Plant Shutdowns and Relocations and Potential Non-NLRA Responses*, 58 TUL. L. REV. 1389, 1403 (1984).

500. *See, e.g.*, Ribstein, *supra* note 61, at 118-21.

501. Professor Singer states:

> Just about everyone thinks that knowing the costs and benefits of adopting one legal regime over another gives us information that helps us in making the rule choice. Controversy arises when we differ about (1) what counts as a cost and a benefit; (2) how to value costs and benefits . . .; [and] (3) how confident we can be that we have accurately measured costs and benefits . . . .

Singer, *supra* note 10, at 632.

counts as a cost and over the relative importance of different types of evidence.[502] This Article contends that relief should be formulated to provide workers with the most equitable and efficient type of remedy.[503] From this perspective, an examination of the alternatives of internal versus external regulation focuses upon the following issues: Will precise regulations that dictate specific forms of relief provide the best method of compensating displaced workers? Or, will ex post judicial review of directors' decisions to safeguard employees' interests better protect displaced workers?

In examining these questions, institutional capability must be considered.[504] One of the major concerns of corporate scholars is whether corporate law should be made at the federal or state level and whether it should be formulated by legislatures or judges.[505] Overall, federal legislation tends to be preferable to state legislation because corporations can relocate to escape state restrictions;[506] the higher cost of relocating outside of the United States makes the avoidance of federal laws more difficult.[507] Although Congress continues to study the question of whether takeovers result in job loss,[508] it is unlikely to take further action because plant-closing legislation recently was passed. Thus, in practical terms, the responsibility to provide further protection to displaced workers falls to the states.

A state court may be better able than the legislature to protect displaced workers from layoffs and plant closings for several reasons. First, legislatures do not have specific case-by-case information. Recognizing a fiduciary duty allows judges to formulate standards over time through an evolutionary process not available to legislatures. The state legislatures appear to have recognized this

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502. *See* Folbre, Leighton & Roderick, *supra* note 37, at 186. The authors state:

> Those who believe that workers have, or should have, a right to substantial job security will obviously place a high value on policy measures that mitigate the effects of job loss. Those who stress employers' right to operate their businesses without any interference from the state will obviously value the absence of regulation.

Id.

503. The reversal of offer and asking price may have an enormous impact on the efficiency determination. *See, e.g.*, Singer, *supra* note 10, at 722-23.

504. Coffee, *supra* note 418, at 1626 ("[F]rom a policy perspective, the permissibility of deviations from the traditional standards of corporate law should be judged primarily in terms of the competence of courts or other agencies to monitor these departures and prevent opportunism.").

505. Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395, 1413 (1989).

506. Macey, *supra* note 19, at 197. Although corporations can relocate overseas to escape federal legislation, Professor Macey believes that the new federal plant-closing law will not be a decisive factor for most domestic firms debating whether to relocate overseas. *Id.* States compete for corporate charters and debate continues about whether states tend to favor shareholder wealth maximization, R. WINTER, GOVERNMENT AND THE CORPORATION 28-42 (1978), or whether they compete to favor managerial self-interest. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 665-66, 670 (1974).

507. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265, 272 (1990).

508. *See, e.g.*, *Sens. Sanford, Sasser Introduce Bill to Limit Takeovers, Leveraged Buyouts*, 22 Sec. Reg. & L. Rep. (BNA) 265 (Feb. 23, 1990) (six-months severance pay for plant closing after takeover); *Domenici Bill Would Require Notice when Plant Closing Is Linked to Takeover*, 20 Sec. Reg. & L. Rep. (BNA) 1031 (July 1, 1988) (90-days advance notice or severance pay to workers who will lose their jobs within 18 months after takeover).

and have enacted stakeholder statutes that leave to the courts the question of how the principle of corporate social responsibility should be applied in specific instances. Second, courts are not subject to the pressure of interest groups and are more independent than state legislatures, which tend to have a strong bias favoring management.[509] As Professor Johnson notes, the "common law method provides a channel by which the beliefs of a wide segment of society can be brought to bear on . . . significant social issues."[510]

Along similar lines, the choice between statutory relief and the fiduciary duty solution requires analysis of the costs and benefits of the legislature's prescribing a remedy ex ante or the court's determining the appropriate relief ex post. First, legislatures would find it difficult to anticipate all the problems that arise in plant closings and layoffs, leaving the workers subject to opportunistic conduct. Statutes would be overinclusive in some cases and underinclusive in others.[511] Conceivably, the federal government could create a highly structured set of rules to alleviate the consequences of job dislocation. Complex regulations, however, would impede directors' ability to respond to the situation severely.[512] Corporate scholars who favor internal reform of the corporation argue that if the corporations' institutional structure remains unchanged, the reasons prompting the need for government regulation may lead to more regulation.[513] Thus, external regulation is inadequate because it results in layer upon layer of rules that impose unnecessary costs.[514] Further, statutes provide a blunt form of relief that cannot remedy opportunistic behavior effectively.[515] Recognizing a fiduciary duty to displaced workers would allow for judicial monitoring to confront and evaluate transactions as they arise. Courts traditionally have played an important role in policing long-term relational contracts;[516] from its ex post perspective, a court can determine if the more dominant party has taken advantage of the weaker party in the relationship unfairly.[517] In addition,

509. Davis, *Judicial Review of Fiduciary Decisionmaking—Some Theoretical Perspectives*, 80 Nw. U.L. REV. 1, 55 (1985).

510. Johnson, *Who Are They For?*, *supra* note 11 at 878.

511. *See, e.g.*, Linzer, *supra* note 179, at 416. Professor Macey contends: "[Plant closings] involve particular problems [that] require detailed (and costly) contractual solutions. Public-law solutions prove unsuitable in this setting, because each case presents unique problems."

512. Weiss, *Social Regulation of Business Activity: Reforming the Corporate Governance System to Resolve an Institutional Impasse*, 28 UCLA L. REV. 343, 345-46 (1981).

513. *Id.* at 345 (advocating that two-thirds of a corporation's directors should be proponents of "altruistic capitalism," which balances the public interest against the pursuit of maximum profits).

514. Macey, *supra* note 19, at 193.

515. Professor Davis notes the "preference for general principles over specific standards in light of the richness and variety of the factual situations presented by the conduct of corporate managements." Davis, *supra* note 510, at 53; *cf.* Hetherington & Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 37 (1977) ("Given the limitations of human foresight and knowledge, any attempt to describe the majority's duties and obligations precisely is likely to leave the minority vulnerable to some overlooked form of exploitation while, at the same time, seriously impairing the efficiency of the firm by fettering management.").

516. *See, e.g.*, Coffee, *supra* note 418, at 1619; Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521, 589-90 (1981).

517. Coffee, *supra* note 418, at 1622; *see also* Rose, *supra* note 337, at 592 ("[T]he ex ante perspective generally means sticking it to those who fail to protect themselves in advance against contingencies that, as it happens, work out badly for them.").

ex post settling-up provides a comparative benefit over ex ante adjustment because it measures compensation on a situation-specific basis.[518]

While the fiduciary duty solution provides a case-by-case remedy, its flexibility also creates uncertainty.[519] Thus, it is necessary to respond to the contention that the costs of litigating and second-guessing business decisions may outweigh any social benefits derived from imposing a fiduciary duty. Professor Macey argues that the increase in shareholder uncertainty will deter investment and ultimately result in fewer workers being hired.[520] In response, the current system that allows companies to close plants without showing concern for affected employees produces substantial uncertainty for displaced workers. As Professor Singer notes, the question is not only whether regulation creates more or less uncertainty, but how that uncertainty is distributed.[521] Indeed, imposing a fiduciary duty on directors to prevent the corporation from externalizing the costs of displacement may prevent some socially inefficient transactions.

In sum, ex post judicial review is efficient even though it creates uncertainty ex ante. Courts have an advantage over legislatures in monitoring long-term relational contracts because the courts can determine the appropriate form of remedy on a case-by-case basis. True, recognizing a fiduciary duty to displaced workers may lead to greater uncertainty and litigation.[522] Legislation avoids these problems by providing clear rules about the corporation's liability. Consequently, to take advantage of the benefits of both types of solutions, states may want to facilitate corporate planning by providing statutory safe harbors for directors to use in providing relief to displaced workers, while concurrently permitting judicial expansion of the directors' fiduciary duties to displaced workers.

CONCLUSION

Widespread layoffs and plant closings have focused national attention on the problems of displaced workers. Due to increasing competitive pressures, corporations are making radical labor cutbacks that demonstrate a decreasing concern for employees. Traditional corporate law ignores the impact of layoffs

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518. Coffee, *Corporate Web*, *supra* note 9, at 37-38 n.101. Ex post settling up is attractive because

> [c]ontracting is after all costly, and many doubt that contractual provisions drafted on an ex ante basis can be adequately specific to cover all or even most contingencies or to relate sensibly the amount of compensation promised to the amount that would have been paid on an ex post settling-up basis.

Id.

519. Rose, *supra* note 337, at 579 (shift from crystal to mud rules "sharply alter[s] the *clarity* of the relationship between the parties").

520. Macey, *supra* note 19, at 201; *cf.* Easterbrook & Fischel, *Contract*, *supra* note 87, at 1447; Hanks, *supra* note 17, at 22; *see also* R. McKenzie, Restrictions on Business Mobility 54-59 (1979) (restrictions on business movements will retard ecomomic development of all regions of the country, decrease wages in many nonunionized labor markets, and cause wealth transfers and losses).

521. Singer, *supra* note 10, at 728.

522. Indeed, recognizing a fiduciary duty may hurt employees if they must bring suit to enforce rights. Gordon, *supra* note 361, at 572 ("Parties with a lot of resources . . . do not mind general equitable standards even if the substance of such standards cuts against them because they cannot practically be enforced without a lot of expensive evidence.").

and plant closings on employees, viewing the corporation as an entity operated by management for the primary good of the shareholders. Other participants in corporate affairs are assumed to contract for protection. This contractual approach, however, fails to recognize that less than twenty percent of the workforce is unionized. In addition, several legal and practical impediments prevent unions from shielding their members from the consequences of job dislocation.

Over one-half of the states recently have enacted stakeholder statutes that are worded broadly to allow directors to consider nonshareholder interests in making business decisions. Although these statutes have not been tested in the courts, they are a potential source of protection to displaced workers. The statutes, in addition to general fiduciary principles, could serve as a basis for expanding the directors' fiduciary duties to employees in the context of fundamental corporate changes. These statutes parallel a view of the corporation in which many nonshareholder constituents have entitlements in the firm. Employees' entitlements arise because they rely on implicit contracts when they enter into long-term relationships with corporations. Through these implicit contracts, employees make substantial investments in the corporations, exposing them to a considerable amount of risk. To a large extent, shareholder gains in corporate restructurings may arise from the breach of implicit employment contracts and losses of the value of employees' human capital.

Using fiduciary duty principles, courts could play a more intrusive role in the corporation-employee relationship, similar to the role they play in protecting the interests of shareholders. Recognizing a fiduciary duty to employees would be efficient because, if restructuring is to be successful, the implementation process must treat employees fairly.