



Case Western Reserve Law Review

Volume 58 | Issue 4

2008

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Recommended Citation

Kent Greenfield, *Defending Stakeholder Governance*, 58 Case W. Res. L. Rev. 1043 (2008)

Available at: <https://scholarlycommons.law.case.edu/caselrev/vol58/iss4/9>

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PANEL 1: STAKEHOLDER THEORY AND THE RELATIONSHIPS BETWEEN HOST COMMUNITIES AND CORPORATIONS

DEFENDING STAKEHOLDER GOVERNANCE*

Kent Greenfield[†]

Corporations are collective enterprises, drawing on investments from various stakeholders who contribute to the firm's success. For a business to succeed over time, it must induce people and institutions to invest money, whether in the form of equity or loans. It must induce people to invest their labor, intelligence, skill, and attention by joining the firm as employees or managers. It must induce local communities to invest infrastructure of various kinds. None of these investors—for investors they all are—contributes its input out of altruism or obligation. They all do so because they believe that the corporation provides the mechanism for gathering all of those inputs and using them to produce goods and services that can be sold for profit. These investors invest because they believe the corporation provides them a way to benefit from that collective action, by sharing in some way from the financial surplus that is created. The investments are structured differently, and the returns on some are riskier and more variable than others. But they are all investments, and all of these investors have a stake in the success of the company.

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† Professor of Law and Law Fund Scholar, Boston College Law School. The author thanks Tim Glynn, George Dent, and Joseph Singer for their comments and critiques. Thanks also to the editors of the Case Western Reserve Law Review for the opportunity to expand and publish my conference remarks. Liam Davis Crane provided excellent research assistance.

When corporations are seen in this way, as mechanisms for bringing together various investments in order to produce goods and services for profit, the fundamental problems of the corporate form are brought to the fore. One problem is how to induce investment from the various contributors to the firm. The other is how to allocate the financial surplus that is created.

The solution to these two problems, according to the view of mainstream corporate law doctrine and scholarship, is that we need to worry only about the investment of one of the many investors, namely that of shareholders. Shareholders are induced to invest by offering them various legal protections, most prominently the right to be the beneficiary of management's fiduciary obligations. The second problem—the allocation of the corporate surplus—is solved in an analogous way. Shareholders receive the protection of the legal rule that holds management to an obligation to shift as much of the surplus to the shareholders as possible.

The other investors in the firm—employees, communities, creditors—are left to contract with the firm at arm's length. They get whatever they get from the firm according to how much they can negotiate from the firm. They have only those protections and only that portion of the surplus they bargain for.

Stakeholder governance is the notion that the concerns of all the firm's investors should be brought into the governance of the firm. This notion is based on a recognition that non-shareholder stakeholders are investors, too, and have interests that should be taken into account by the firm's management. It is based on a conviction that, as law is used to overcome impediments to shareholder investment, law can be used to overcome impediments to investment by other stakeholders. Support for stakeholder governance also springs from the belief that it provides a mechanism to protect the interests of stakeholders that is more efficient, as a regulatory matter, than other forms of legal support and protection. Finally, stakeholder governance grows from a confidence that corporations themselves will be better managed in the long term when management is held to consider the interests of all key investors of the firm, not just a small subset of them.

Professor George W. Dent, Jr. has given me the credit of offering a careful, if hyperbolic, critique of my past work in support of stakeholder governance.¹ While there are significant areas of

¹ See George W. Dent, Jr., *Stakeholder Governance: A Bad Idea Getting Worse*, 58 CASE W. RES. L. REV. 1107, 1107 (2008) (comparing proposals of stakeholder governance reform to "Dracula," "an ogre," "utopia," and "fantasies").

agreement, action on which would represent important progressive reform,² he does not mince words in criticizing the bulk of my arguments and that of other stakeholder theorists such as Professor Timothy Glynn, who also appeared at this Symposium and whose writing appears in this volume. Dent's critiques fall into several categories, and I will seek to answer them in turn. His most prominent critiques, however, suffer from the same flaw. On the one hand, he decries the lack of shareholder power within the corporate form, corporate doctrine, and securities regulation. He calls for legal reforms to protect shareholder prerogatives and shareholder wealth.³ The government must step in, he says in effect, in order to protect shareholders from the vagaries of the market. On the other hand, in the face of overwhelming evidence that various stakeholders of the corporation—employees in particular—are also suffering, he concedes the need but urges a trust in the market as the response. Stakeholders should trust in the market even if it is inefficient, defective, or slow in responding. Shareholders, in contrast, may call on government assistance because, after all, the market is inefficient, defective, and slow in responding. To the extent government protection is necessary for stakeholders, they should seek help from outside corporate governance.

Corporate law is a powerful legal tool to restrain and channel the power of businesses, the largest of which embody economic power rivaling that of nations.⁴ The extensive framework of corporate law has long been used to protect shareholders, even while it left aside the interests of other contributors to corporate success.⁵ The existence of

² See *id.* at 1108 (agreeing that economic inequality is undesirable, that CEO pay is too high, and that “employees and other stakeholders have an interest in the success of their company”); *id.* at 1127 (urging employees be given more information about hazards in the workplace, more regulation of hazards, and “broader exceptions to limited liability”); *id.* at 1127, 1122 (discussing the possibility of limiting insurance coverage for managers to encourage more responsibility); *id.* at 1138 (agreeing that internal affairs doctrine is problematic and has not led to a “race to the top”).

³ See Dent, *supra* note 1, at 1120–21, 1128–29, 1133, 1142. See also *infra* note 69 for a more detailed analysis and critique of Dent's argument in this regard.

⁴ In a comparison, using 2002 data, of major corporations (listed by sales) and countries (listed by gross domestic product), fifty-two of the largest one-hundred entities were corporations and forty-eight were countries. By this measure, Wal-Mart is larger than Sweden or Norway; General Motors was slightly larger than Saudi Arabia; Exxon Mobil was the size of Turkey; Home Depot was larger than New Zealand. See SARAH ANDERSON ET AL., *FIELD GUIDE TO THE GLOBAL ECONOMY* 69 (2d ed. 2005).

⁵ But corporate law has not always ignored the interests of non-shareholder stakeholders. See ROBERT KUTTNER, *THE SQUANDERING OF AMERICA: HOW THE FAILURE OF OUR POLITICS UNDERMINES OUR PROSPERITY* 145 (2008) (“As late as the 1890s, many states demanded that corporations serve public purposes and strictly regulated their internal governance in exchange for the limited liability granted to general corporations in their charters.”); see also MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1870–1960: THE CRISIS OF LEGAL*

corporate law is itself a testament to the belief that law is essential for the market to work. This simple, straightforward notion of corporate law being *law*, constructed by judges, regulators, and legislators, works a profound shift in the debate about how to protect stakeholders. The debate changes from whether law or the market best protects the interests of the various contributors to the corporation to *what kind of law* is needed.

Despite our different perspectives, it seems we are both pragmatists in the sense that we agree that “the proper question is whether [shareholder control] works better than any other option.”⁶ He believes it does; I believe it does not. We also differ on what data we use to answer that question—whether we look at the fortunes of shareholders alone or to all the stakeholders. Reading between the lines, it appears that Dent believes we can answer that question by looking at whether shareholders are better off under shareholder primacy than under other governance systems.⁷ If shareholder welfare is the only criteria, then a corporate governance system aimed at maximizing shareholder wealth is likely to be a good match. If, however, social welfare is the goal, then the claim that stakeholder governance is likely to be an efficacious regulatory tool in addressing the needs of non-shareholder stakeholders is quite strong.

This Essay responds to Professor Dent’s critiques, with a focus on the need for greater protection for employees within corporate governance. Dent rightly points out that stakeholder governance theorists often do not carefully define who stakeholders are.⁸ Dent also argues that the selection of stakeholder representatives would be

ORTHODOXY 75–78 (1992) (describing process in late nineteenth century of corporations being increasingly considered private creations rather than creatures of the state).

⁶ Dent, *supra* note 1, at 1119; see also *id.* at 1120 (agreeing that corporations, and corporate law, are created in the interests of society as whole and that the questions are “how corporations can best serve society, and what corporate governance structure best enables corporations to accomplish this goal”).

⁷ *Id.* at 1125 (“[L]owering profits by reducing inefficiency helps no one. Altering corporate governance to lower returns to shareholders is also dubious because capital is international and can move abroad.”); *id.* at 1120 (after agreeing that the question is how best to serve society, saying that an attack on shareholder welfare is “an attack on capitalism”).

⁸ *Id.* at 1107–08. But this definitional problem is not as difficult as Dent makes out. As I have argued elsewhere, building on the work of other scholars, one definition of stakeholders that is workable and makes economic sense is to define stakeholders as those who contribute firm-specific assets and skills to the firm. See KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS & PROGRESSIVE POSSIBILITIES* 142–44 (2006) [hereinafter GREENFIELD, *FAILURE OF CORPORATE LAW*]. See generally Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) (describing the value of corporate governance in overcoming the reluctance of various stakeholders to make firm-specific investments in the firm).

so difficult so as to doom the idea from the start.⁹ But neither the definitional nor the implementation issue presents particular difficulties for the argument that the interests of *employees* should and can be taken into account in corporate governance. Employees are clearly stakeholders of the firm, and the selection of employee representatives on the board would be straightforward and, compared to selecting shareholder representatives, achievable at relatively low cost.¹⁰ Isolating the debate to employees allows the discussion to focus on what the real disagreement is: whether corporate law should focus only on shareholder gain or not. If stakeholder theorists are persuasive as to employees, we can then discuss whether the definitional and implementation problems with regard to other stakeholders make it too difficult to go that far. If, however, stakeholder theory is not convincing even with regard to employees, the definitional and implementation problems are simply beside the point.

I. THE NEED FOR EMPLOYEE PROTECTION

If the current mix of regulation and market were working to everyone's benefit and satisfaction, any argument in favor of additional protection for corporate stakeholders would be a non-starter. But that is not the situation in which we find ourselves, as Professor Dent largely concedes.¹¹ At the time of this writing, our economy is in crisis, and we find ourselves in a full-blown recession.¹² Sadly, this is the first time in recent history that we find

⁹ See Dent, *supra* note 1, at 1118 (“[T]he problem of implementation is inherent in stakeholder theory.”).

¹⁰ Election of employee representatives could be achieved with the creation of a separate class of stock, which would be distributed to employees that met the agreed conditions, one share per employee. The articles of incorporation would state the number of directors elected by that class. Elections could be held annually, as with shareholder votes. For a description of the various methods used in Europe to elect employee representatives to company boards, see Norbert Kluge, *Co-Determination in Europe*, in REBECCA PAGE, CO-DETERMINATION IN GERMANY – A BEGINNER’S GUIDE 31 (3d ed. 2006), available at http://www.boeckler.de/pdf/p_arbp_033.pdf. For an excellent overview, see THE EUROPEAN COMPANY – PROSPECTS FOR WORKER BOARD-LEVEL PARTICIPATION IN THE ENLARGED EU 64–65 (Norbert Kluge & Michael Stoltz eds., 2006), available at http://www.seeurope-network.org/homepages/seeurope/file_uploads/booklet2006.pdf [hereinafter THE EUROPEAN COMPANY] (chart of co-determination forms around Europe).

¹¹ See Dent, *supra* note 1, at 1108 (“In the last twenty-five years, too much of our economic gains have gone to the wealthiest Americans; income for most Americans has stagnated. The resultant deepening of economic inequality is disturbing.”). Dent denies, however, that these trends have anything to do with corporate governance. *Id.* That is the point on which we disagree.

¹² See Edmund L. Andrews, *Sharp Drop in Jobs Adds to Grim Economic Picture*, N.Y. TIMES, Mar. 8, 2008, at A1; Peter S. Goodman, *Slump Moves from Wall St. to Main St.*, N.Y. TIMES, Mar. 21, 2008, at A1; Floyd Norris, *More Evidence That the Recession Has Already*

ourselves at the end of a period of growth for the economy when the economic well-being of the typical American did not also improve.¹³ So as we dip into recession or worse, it is reasonable to fear that the economic fortunes of most Americans will decline further.

Even before the beginning of this downturn, the economic situation for most wage earners in the United States was, at best, stagnant and, for many, dire. As I have recently set out in more detail elsewhere,¹⁴ recent economic data show that while the total reported income in the United States has been growing at a healthy rate, average income is *falling* for nine out of ten Americans.¹⁵ Unfortunately, this stagnation is not a new phenomenon. The income for Americans at the bottom of the pay scale has stayed essentially flat for thirty years, and “real household income for the typical [American] family has declined over the last seven years.”¹⁶ These declines are especially troubling when compared to the growth in labor productivity in the United States, which had increased almost 40% in the fifteen years prior to 2004.¹⁷ There is little doubt that these data will worsen in the current economic climate.

Arrived, N.Y. TIMES, Oct. 25, 2008, at B3, available at <http://www.nytimes.com/2008/10/25/business/25charts.html>.

¹³ See Cafferty File, *Is the American Dream Dead or Just Wounded?*, <http://caffertyfile.blogs.cnn.com/2008/06/10/is-the-american-dream-dead-or-just-wounded/> (June 10, 2008, 17:21 EST) (“From the end of the 2001 recession through [2007] . . . [was] the first time since World War II that the typical family was worse off at the end of an economic expansion than at the beginning.”); Paul Krugman, *The Great Wealth Transfer*, ROLLINGSTONE.COM, Nov. 30, 2006, http://www.rollingstone.com/politics/story/12699486/paul_krugman_on_the_great_wealth_transfer (“For the first time in our history, so much growth is being siphoned off to a small, wealthy minority that most Americans are failing to gain ground even during a time of economic growth”); Jodie T. Allen and Andrew Kohut, *Pinched Pocketbooks: Do Average Americans Spot Something that Most Economists Miss?*, PEW RESEARCH CTR. FOR THE PEOPLE & THE PRESS, Mar. 28, 2006, <http://pewresearch.org/pubs/13/pinched-pocketbooks> (“[n]ot only have the bottom 90 percent of American workers failed to keep up with productivity growth [from 2001–2004], many have been harmed by it.” (quoting Ian Dew-Becker and Robert J. Gordon, *Where Did the Productivity Growth Go? Inflation Dynamics and the Distribution of Income* 77 (Brookings Papers on Economic Activity 2: 2005), available at http://www.brookings.edu/es/commentary/journals/bpea_macro/forum/200509bpea_gordon.pdf) (alteration in original)).

¹⁴ See Kent Greenfield, *Reclaiming Corporate Law in a New Gilded Age*, 2 HARV. L. & POL. REV. 1, 2–5, 10–16 (2008) [hereinafter Greenfield, *Reclaiming*].

¹⁵ See also David Cay Johnston, *Income Gap is Widening, Data Shows*, N.Y. TIMES, Mar. 29, 2007, at C1.

¹⁶ John Irons, *Snapshot for September 5, 2007: Typical Families See Income and Earnings Decline*, ECONOMIC POLICY INSTITUTE, Sept. 5, 2007, http://www.epi.org/content.cfm/webfeatures_snapshots_20070905.

¹⁷ See LAWRENCE MISHLE ET AL., THE STATE OF WORKING AMERICA 2006/2007 fig.3N (2007), available at http://www.epi.org/datazone/06/prody_comp.pdf (chart showing “Productivity and Median and Average Compensation, 1973–2004”).

Poverty data are also relevant. As of 2005, the wages for about one out of four American workers are so low that they fall below the poverty line, and this proportion has increased over the last few years.¹⁸ The data are worse for women and people of color—nearly 30% of working women earn poverty wages, as do a third of African American workers and almost four in ten Hispanic workers.¹⁹

The economic difficulties of most Americans become more stark when compared to the drastic improvements in the economic well-being of the richest Americans. Since 1979 the richest 20% of Americans have seen their income grow by almost 50%;²⁰ the richest 1% of Americans have had their household income more than double in the same period.²¹ In fact, for the first time since just before the stock market crash of 1929, “the richest of the rich”—the wealthiest one one-hundredth of 1% of Americans—claim 5% of all reported personal income.²² In fact, the richest 10% of Americans, those Americans making roughly \$100,000 or more per year, now claim almost half of all reported personal income.²³ The richest 300,000 Americans together “make almost as much income as the bottom 150 million Americans.”²⁴

The situation is even worse when one focuses on wealth, as opposed to income. While the bottom 90% of Americans account for 57.5% of the nation’s personal income, they control less than 30% of the nation’s personal net worth and less than 20% of net financial assets owned by individuals.²⁵ By comparison, the top 1% of income earners bring in 17% of the nation’s personal income but own over 40% of net individual financial assets.²⁶

Of course, statistics vary over time, but the trends are sufficiently clear that one can persuasively argue that “the early years of the 21st century [are] truly another Gilded Age.”²⁷

¹⁸ See *id.* at tbls.3.8–3.10 (tables showing “Share of All Workers Earning Poverty-Level Hourly Wages, 1973–2005” (available at http://www.epi.org/datazone/06/poverty_wages.pdf)).

¹⁹ *Id.*

²⁰ *Id.* at 62, fig.10.

²¹ *Id.*

²² Louis Uchitelle, *The Richest of the Rich, Proud of a New Gilded Age*, N.Y. TIMES, July 15, 2007, at A1, chart. These data may in fact underreport the inequality, because a greater percentage of income for the wealthiest individuals comes from investment income, which is typically underreported in income tax returns. See also Johnston, *supra* note 15 (noting that the IRS “captures only about 70 percent of business and investment income, most of which flows to upper-income individuals, because not everybody accurately reports such figures”).

²³ Johnston, *supra* note 15.

²⁴ *Id.*

²⁵ MISHEL ET AL., *supra* note 17, at 249 tbl.5.1.

²⁶ *Id.*

²⁷ Uchitelle, *supra* note 22.

It is reasonable to believe that the lack of economic stability and wellbeing for a majority of Americans has *something* to do with corporations, since corporations are the primary source of private wealth creation in the U.S. economy. (Approximately 60% of the nation's income comes from the corporate sector.²⁸) If these trends are related to corporations, then they must be related to how they are regulated and governed. As I have said elsewhere, I believe that part of the problem is the short-term focus of corporate management, which is a function of market, norm, and law. Another part of the problem is the profit maximization norm, which is taken to mean a focus on shareholder returns, as opposed to other, broader definitions of profit or wealth. This focus on wealth, narrowly construed and temporally limited, tends to make corporations ignore social harms as well as the potential of social benefits. It tends to incentivize the transfer of as much wealth from labor to capital as possible. It tends to lead corporations to act with disregard toward non-shareholder stakeholders. It inures to the benefit of the most well-off Americans, and hurts the rest.²⁹ I believe we can do better, using corporate law as a progressive regulatory tool to provide broader benefits to society, without eroding the ability of corporations to build wealth.³⁰

The next two sections will address a pair of Professor Dent's criticism of this thesis, namely that: (1) shareholders deserve primacy because they own the firm; and (2) while shareholders deserve even greater legal protection than they now receive, other stakeholders should depend on their market power to redress any difficulties they face. I will then turn to a final critique, that any attempt to help employees and other stakeholders would be counterproductive.

II. THE MISTAKEN ANALOGY OF SHAREHOLDERS AS OWNERS

One of the time-honored, but mistaken, ways to argue for shareholder primacy is to analogize shareholders to owners. If they are owners of the firm, then it is a straightforward argument that managers' fiduciary duties run to them and that they should exercise control over the firm. The argument is circular: that because shareholders are owners, they should be treated as such, and other stakeholders, who are not owners, should not be treated as owners. Professor Dent consistently makes this mistake. He assumes that shareholders are best seen as owners of the corporation, and then uses

²⁸ MISHEL ET AL., *supra* note 17, at 82.

²⁹ For a more in-depth argument on this point, see Greenfield, *Reclaiming*, *supra* note 14, at 10-16.

³⁰ See generally GREENFIELD, *FAILURE OF CORPORATE LAW*, *supra* note 8.

that analogy to explain why they should be treated as owners and why other stakeholders should not. The analogy cannot be the basis for shareholder primacy. The argument for shareholder supremacy, if it is to succeed, needs to start somewhere other than with an assumption that imbeds in it the notion of shareholder supremacy. As Joseph Singer has written, “To assume that we can know who property owners are, and to assume that once we have identified them their rights follow as a matter of course, is to assume what needs to be decided.”³¹

A. Ownership, Investment, and the Socialism Bugaboo

Professor Dent is bold in his assertion of the property analogy, asserting that the “control rights of stockholders can be compared to the property rights of a homeowner.”³² The rights of stakeholders are akin to the rights of neighbors—people who are affected by the condition of the property but who do not have any direct say in what the owner does with her property. With some narrow exceptions, says Dent, “the owner may do as she pleases with her property.”³³ Shareholders are the same: “[I]ikewise, shareholders are supposed to control the firm.”³⁴ He equates directors with trust fiduciaries, who “control[] other people’s money,”³⁵ saying explicitly that “corporate directors are fiduciaries for the shareholders’ money.”³⁶

I agree that this is a fairly accurate description of what current doctrine sets out. But as Dent is sure to understand, one cannot defend current doctrine by restating it as the conclusion. The very question an honest discussion about corporate governance is trying to answer is, in property terms, who “owns” the firm. Are shareholders the only owners, or is the corporation best seen as having multiple “owners”? That is, if the questions of whether management owes a duty to employees and other stakeholders, and whether employees and other stakeholders are to be represented on the board, turn on who owns the firm, then to posit shareholders as owners is to answer both questions.

Elsewhere, Dent makes another common mistake, conflating the term “investor” with shareholder, implicitly making the same limiting

³¹ Joseph William Singer, *The Reliance Interest in Property*, 40 STAN. L. REV. 611, 637–38 (1988).

³² Dent, *supra* note 1, at 1114.

³³ *Id.*

³⁴ *Id.*; see also *id.* at 1119 (equating shareholders with “firm owners”).

³⁵ *Id.* at 1126 (noting “stakeholders contract with the firm and can either contract for limits on risk or demand compensation for the risk they assume”); *id.* at 1112 n.24 (“If there are net social benefits to cushioning employees from such harm, the cost of such cushioning should be borne socially—i.e., by the government—rather than by shareholders.”).

³⁶ *Id.* at 1122–23.

point as the ownership point above.³⁷ Shareholders invest, and therefore should have their interests protected. Other stakeholders are parties to contracts with the firm, or a firm “cost,”³⁸ and should protect their own interests through contract or by petitioning government to help them.³⁹

Of course, shareholders are not owners of the firm the same way homeowners own their house. They do not have the right of entry or the right of exclusion, and their right to control is severely limited.⁴⁰ Nor are shareholders the only investors in the firm. They contribute capital, to be sure, and they ought to have legal protections for that investment. But others invest as well, and so should they.

Dent so reifies the status of shareholders that he equates an attack on shareholder prerogatives as an attack on capitalism itself. After agreeing that corporate governance should be measured according to how society’s interests are served, he short-circuits any real consideration of the point by saying that anyone who supports a system of governance that does not “enhance shareholder welfare” attacks capitalism “[i]n effect.”⁴¹

It is difficult to know what he means by this, since none of the scholars who are thoughtfully and carefully presenting arguments in favor of stakeholder governance attack capitalism at all. No one is suggesting state ownership of the means of production, and Dent’s insinuation that stakeholder governance is part of a slide toward

³⁷ See, e.g., *id.* at 1108 (Even if CEO pay “comes entirely from the hides of investors, it breeds understandable resentment among employees.”).

³⁸ See *id.* at 1120 (“To an enterprise an employee is a cost . . .”).

³⁹ *Id.*

⁴⁰ Shareholders are allowed to inspect corporate records and in limited circumstances can force a corporation to act through a derivative suit, but these remedies require demand to be made upon the board and are difficult to win and often have limited effect. See DEL. CH. CT. R. 23.1 (explaining shareholders should petition the board of directors to act before a derivative suit can be brought to compel the corporation to act on behalf of the shareholders in a particular matter, or must explain why they failed to do so); see also DEL. CODE ANN. tit. 8 § 220 (2008) (stockholders upon written demand may inspect the corporation’s stock ledger, a list of its stockholders, and its other books and records; this inspection right is limited to usual hours for business); *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981) (holding that a special litigation committee can allow board of directors to reassert its authority over a derivative claim); Daniel J.H. Greenwood, *The Dividend Puzzle: Are Shares Entitled to the Residual?*, 32 J. CORP. L. 103, 145 (2006) (“Shareholders, unlike owners, have no legal right to control the corporation and specifically no right to demand that the corporation turn over corporate property—whether surplus or not—to them.”); Daniel J.H. Greenwood, *Introduction to the Metaphors of Corporate Law*, 4 SEATTLE J. SOC. JUST. 273, 278–84 (2005) (outlining the many ways in which shareholders do not have property rights in the corporation).

⁴¹ See Dent, *supra* note 1, at 1120; see also *id.* at 1112, n.24 (“If there are net social benefits to cushioning employees from such harm, the cost of such cushioning should be borne socially—i.e., by the government—rather than by shareholders.”). This is another example of how shareholder primacy is bound to work. Shareholders can manage the firm to spin off social costs, which can be left to government to address.

socialism (“why not have socialism?” he asks)⁴² comes close to name calling. He hastens to say that he does not accuse me or Professor Glynn of “being un-American,”⁴³ but that reads as damnation with faint praise indeed. To have the ideas of stakeholder advocates compared to Dracula, an ogre, fantasy, and utopia is one thing;⁴⁴ to be called a socialist, even implicitly, is a serious and unfair charge. I would have hoped that the debate about stakeholder governance would have moved beyond where we were a generation ago, when Milton Friedman attempted to use the socialism bugaboo to criticize the nascent corporate social responsibility movement.⁴⁵ Friedman was not successful then in stopping the trend toward holding corporations more accountable; the comparison of stakeholder advocacy with socialism is not any more persuasive now.

What stakeholder advocates call for is a greater democratization of corporate governance—to import into the governance of the firm the interests of stakeholders other than shareholders. How has shareholder and managerial autocracy been reified as the very embodiment of capitalism? Shareholder primacy equates with capitalism only if shareholders are considered the owners of the firm and its assets, and if their rights analogize with home owners and other owners of physical property. But if the corporation is seen as a cooperative entity, with all kinds of different investors, then the corporation itself can be seen as the owner of its assets, with the obligation to manage them for the benefit of the entity itself (and all its investors). The market is still private; the corporation is still private; the market still works to reward those who produce goods and services that can be sold for a profit; the market still brings about the “creative destruction” of those businesses who cannot so produce.⁴⁶ Readers of Dent’s critique can sleep soundly without fear of the socialist menace.

Once we clear the smoke of the argument that shareholder rights are the core of capitalism, what is the substantive basis for the claim for shareholder ownership in particular, and shareholder primacy in general? There are a number of different claims that stakeholder advocates make, many of which I have answered elsewhere.⁴⁷ Dent

⁴² *Id.* at 1119.

⁴³ *Id.* at 1141.

⁴⁴ *Id.* at 1107.

⁴⁵ See Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, (Magazine), at SM17 (equating loosening the corporation’s duty to shareholders with “pure and unadulterated socialism”).

⁴⁶ JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 81–86 (1942) (Chapter VII, entitled “The Process of Creative Destruction”).

⁴⁷ See GREENFIELD, FAILURE OF CORPORATE LAW, *supra* note 8, at 41–71; Kent

focuses on the argument that shareholders are “the primary residual claimants” of the firm.⁴⁸ This merits response.

B. Shareholders as Residual Claimants

Professor Dent presents the proposition that, as residual claimants, shareholders “have the greatest incentive to maximize the value of the firm.”⁴⁹ He argues that the financial interests of other stakeholders are “largely fixed and senior to those of the shareholders.”⁵⁰ While other stakeholders can be satisfied without making a profit, shareholders benefit only when the firm prospers. They enjoy “the perspective of the aggregate” because if the firm is managed in such a way as to benefit shareholders then the whole firm, and everyone associated with it, benefits.⁵¹

There are a number of ways to answer the residual claimant argument, but perhaps the most important is to point out that the rules of liquidation do not require a particular governance structure for a company as a going concern. There is nothing inherent in the right of equity investors to receive the financial residual of the company in the event of liquidation that automatically gives them the sole power to control the firm. Companies sometimes place creditor representatives on governing boards as a result of bond negotiations and the like,⁵² and the inclusion of employee representatives on company boards is routine in Europe.⁵³ The recognition that shareholders own the residual as a financial matter does not necessarily mean they should control the decisions of the firm. Dent cites Jonathan R. Macey, but Macey recognizes that residual claims do not necessarily lead to control: “[o]nce we view the shareholders as simply the residual claimants . . . it is far from self-evident that shareholders are necessarily entitled to control the firm,’ i.e., to have managers’ and directors’ fiduciary duties flow exclusively to them.”⁵⁴ One can

Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283 (1998).

⁴⁸ Dent, *supra* note 1, at 1113.

⁴⁹ *Id.* (quoting Jonathan R. Macey, *Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266, 1267–68 (1999)).

⁵⁰ *Id.*

⁵¹ *Id.* (quoting Bayless Manning, *Thinking Straight About Corporate Law Reform*, LAW & CONTEMP. PROBS., Summer 1977, at 3, 20–23); see also STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 469–70 (2002).

⁵² See Janus Hotels & Resorts Inc. 10KSB/A SEC Filing (April 28, 2000), excerpt available at <http://sec.edgar-online.com/2000/04/28/11/0001046386-00-000059/Section2.asp> (Arthur Lubell was a “creditor representative member of the Board of Directors”).

⁵³ See Kluge, *supra* note 10, at 31; THE EUROPEAN COMPANY, *supra* note 10, at 64–65.

⁵⁴ See Jonathan R. Macey, *An Economic Analysis of the Various Rationale for Making*

certainly imagine, for example, a company that acknowledges responsibilities to a number of stakeholders but still issues common stock that constitutes residual claims on the financial surplus of the company. Framed in contractual terms, one could easily write a corporate “contract” that does not link the residual claim on financial assets to be distributed in case of liquidation with a sole claim on the attentions of the directors.

The stronger argument for shareholder primacy asserts that because shareholders own the residual, their financial interests best track the interests of the firm as a whole. The best proxy for firm value is the size of the residual, the argument goes, so looking after the interests of shareholders is the best proxy for looking after the interest of the firm as whole.

At first glance, this argument is persuasive. But notice the implicit jumps in logic buried in the claim: The purpose of corporations, and corporate law, is to benefit society (as Dent agrees);⁵⁵ the best way to benefit society is to maximize the value of the firm; the best way to maximize value to the firm is for management to act as if only shareholders matter.

The last two jumps are contestable, and depend on political as well as financial judgments. First, it may not be that the best way to benefit society is to maximize the value of corporations. The building of wealth is a crucial goal of society, and corporations are a fundamental, indeed central, part of that effort. But other values matter as well, such as stability and fairness and sustainability. Moreover, as I have argued elsewhere,⁵⁶ left to their own devices corporations are indifferent between making profit by building wealth and making profit by extracting economic rents from society by externalizing social costs or merely shifting financial surplus from others to themselves. Also, even if firm value is maximized by creating wealth rather than shifting it around, social welfare is not maximized in my view (and apparently in Dent’s)⁵⁷ unless that wealth is widely distributed. The reasons for my belief in the importance of distribution are partly economic (because of the diminishing utility of

Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties, 21 STETSON L. REV. 23, 27 (1991) (citation omitted).

⁵⁵ Dent, *supra* note 1, at 1120 n.61.

⁵⁶ See GREENFIELD, FAILURE OF CORPORATE LAW, *supra* note 8, at 137.

⁵⁷ See Dent, *supra* note 1, at 1125 (saying it is “regrettable” that wealth is so concentrated, and suggesting that encouraging efficiency in corporations and redistributing wealth through taxes is the better public policy choice to reduce economic inequality); see also *id.* at 1142–43 (suggesting that maximizing share price should be the goal of progressives because employees will benefit).

money, widely shared wealth raises social welfare more than concentrated wealth), partly political (democracy thrives better in a society without huge economic disparities), and partly social (inequality creates the context for crime, social unrest, and other ills). If I am right about this, then for social welfare to be maximized we need to care not only about the creation of firm value but its allocation as well. And if allocation matters, then it is not clear at all that shareholder primacy leads to the correct regulatory mechanisms to achieve the balance of wealth creation and wealth distribution.⁵⁸

That brings us to the second of the two problematic assumptions above, i.e., that the best way to maximize firm value is for management to act as if only shareholder interests matter. This, too, is contestable, and for a very straightforward reason: the interests of shareholders and the firm do not in fact coalesce in all circumstances. (And more obviously, the interests of shareholders do not coalesce with the interests of other stakeholders.) Dent recognizes this,⁵⁹ but holds that it does not matter. Shareholders, because they hold the financial residual, benefit disproportionately when the firm does well. Because of limited liability, shareholders are disproportionately protected when the firm does poorly. That means that, if the firm is managed as if shareholder interests are all that matter, the firm will be managed to prefer risky endeavors that have high potential payoffs but are also high risk and have high variability. The more leveraged a firm is, the more shareholders will stand to benefit from such risky strategies and the less likely such strategies will actually maximize firm value.⁶⁰ (The financial crisis we are now experiencing is a wonderful example of this very thing.)

⁵⁸ The ownership of stock in the United States is very concentrated: the richest one-tenth of 1% of Americans receive over a third of the nation's total capital income, while the bottom 80% of Americans control less than 13%. See MISHLE ET AL., *supra* note 17, at 78–79, 80 fig.1S. For a more detailed treatment of this point, see Greenfield, *Reclaiming*, *supra* note 14, at 10–16.

⁵⁹ Dent, *supra* note 1, at 1111–12 (neither stakeholders nor shareholders have reason to heed interests other than their own); *id.* at 1117–18 (stakeholders present conflicts that are “glaring and overwhelming,” making “irreconcilable demands on corporate resources”); *id.* at 1121 (noting that employees are costs “to be reduced or eliminated whenever possible”); *id.* at 1125 (noting that beyond the short term, the interests of shareholders and stakeholders “diverge.”).

⁶⁰ Dent appears to concede this point. See Dent, *supra* note 1, at 1126 (“Because of limited liability and investment diversification, rational shareholders of a firm with substantial debt might prefer risky projects with negative net present value to safe projects with positive value.”); see also Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 905 (2005) (“To begin with, high leverage produces its own inefficiency distortions. For example, high leverage induces management whose wealth is tied to equity value to take excessive risks. The greater the leverage, the larger the costs of distortions arising from it.” (citing Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 333–37 (1976))); Mark

The description so far is simply a restatement of a financial truism. But from a broader perspective, the distinction grows. Shareholders typically invest in a number of different companies and thus have diversified portfolios. As a result, they do not care a great deal about the risks that any one particular firm is taking. Shareholders will prefer that the management of any particular company they invest in makes decisions that may provide high payoffs but risk bankruptcy over decisions that provide lower returns but have less risk of pushing the firm into liquidation. Indeed, shareholders are indifferent toward the liquidation risk of any particular company in which they invest as long as their portfolio as a whole maximizes their expected returns.⁶¹

By way of comparison, now consider a corporation whose management considers not only the interests of shareholders but of employees as well. Both shareholders and employees have residual interests in the firm, in that the investments of both will tend to be positively correlated with firm value.⁶² I have written about this extensively, but suffice to say here that employees have financial interests that rise and fall with the fortunes of the firm. Some employees' wage and salary claims (though not all) may be fixed in the short term, but employees also have both implicit and explicit claims against the enterprise that are more valuable when the company does well and are worth less (or nothing) when the company does poorly. Unfixed, explicit claims against the company might include pension plans, 401(k) accounts, or other retirement benefits. These can constitute a significant percentage of a worker's net worth and, as the collapse of Enron exemplified, can lose much or all of their value if the company fails. Unfixed, implicit claims might include understandings about job security or promotion policies, the development of firm-specific human capital, and the safety of working conditions. When a company's management makes good decisions for the enterprise as a whole, workers' fortunes improve even if their wages or salaries remain the same. When a company's management makes poor decisions for the enterprise, workers' fortunes decline even if their wages or salaries are

S. Beasley, Donald P. Pagach, & Richard S. Warr, *Information Conveyed in Hiring Announcements of Senior Executives Overseeing Enterprise-Wide Risk Management Processes*, 23 J. OF ACCT. AUDITING & FIN. (forthcoming 2008) (manuscript at 21, available at <http://ssrn.com/abstract=1010203>) (“[S]hareholders of highly leveraged firms may not want risk reduction as it reduces the value of the option . . .”).

⁶¹ See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 28 (1991) (“[T]he investor wants to maximize the value of his holdings, not the value of a given stock.”).

⁶² GREENFIELD, *FAILURE OF CORPORATE LAW*, *supra* note 8, at 54–59.

unchanged in the narrow sense. While shareholders are largely indifferent as to whether any particular firm fails, employees are vitally interested in the success of their employers.

Instead of being indifferent toward the liquidation risk of the company they work for, employees care deeply about the financial health of their firm because they face harsh consequences from unemployment if their firm suffers. If their company goes bankrupt, employees will typically lose their jobs, the value of any firm-specific skills, and sometimes retirement or pension benefits. Therefore, employees prefer that the management of a company they work for not make decisions with a high variance, even when such decisions have a high expected return. Employees instead prefer decisions that value stability and long-term growth.

So will the inclusion of employee interests into firm governance mean that firms will fail more often? Just the opposite. The inclusion of employees' interests into the fabric of corporate governance will encourage firms to be *more* dedicated to their own success. Because shareholders want companies to take risks that other stakeholders do not, there is little doubt that shareholder primacy results in more companies going under than if companies were required to take into account the interests of other stakeholders.

So the decision as to whether to include the interests of employees into the management calculus may depend on whether we want an economy that is fast growing and fast falling, high growth and high failure (which is pretty clearly the one we have), or an economy that grows more slowly and values stability over time. Once that is the question, there is little reason to believe that society as a whole is risk neutral with regard to corporate decisions. Of course society benefits from corporate growth, but it is also concerned with stability, and the avoidance of harm. It would be eminently reasonable for a society (especially those with mature economies such as those of the United States or Europe) to decide to forgo the possibility of very high corporate profits in order to avoid the disproportionate harm employees (or communities, or creditors) would suffer if risky business decisions do not pay off. This is especially true if only a subset of society—the affluent who still own the vast majority of shares—reap a disproportionate share of the gains if the risky decision does pay off. In other words, society as a whole (or, for that matter, any of us as individuals, in our daily lives) is not an absolute profit maximizer. There are other economic and non-economic “goods” we value. It would be odd, then, to assume without question that a major subset of our law—the area that regulates the internal

workings of some of the most powerful institutions in our culture—should be constructed to maximize only financial profit at all costs.⁶³

In any event, note that once the difference in risk aversion is considered, the argument for shareholder dominance depends on the claim that employees care *too much* about the fortunes of their firm. A proponent of the shareholder-centered view of corporate law would have to make the ironic argument that it is better for society as a whole for the decision making of each individual firm to be dominated by shareholders, who care little about the fortunes of each firm. On its own terms, this is hardly self-evident, and it is not what shareholder proponents typically say. As described above, the argument is usually that shareholders are the only ones that have the incentives to care about the success of the firm. That is certainly not the case. Employees, too, have incentives to care, and employees who depend on their company for their livelihood are bound to care more about the success and survival of their individual firm than do shareholders who own hundreds of stocks in diversified portfolios.

III. WHY THE MARKET IS NOT ENOUGH

Throughout Dent's critique, he repeatedly argues that corporate law should not be adjusted to take into account the interests of stakeholders because they should either protect themselves through contract or should be protected through other kinds of regulation. Meanwhile, Dent makes clear that he believes shareholders should receive increased protection from corporate governance law. I might be convinced by Professor Dent that shareholders merit increased protection, especially from executive managers' self-dealing and excessive compensation schemes. But it will not surprise the careful reader to learn that I believe stakeholders, particularly employees, deserve additional protection as well from corporate governance law. Once stakeholders are seen as investors, there is no reason to deny them the same access to corporate governance that shareholders receive. If shareholders need additional protection, the need for protection of other stakeholders is bound to be at least as great, given their marginalized status at present.

One of the notes Dent consistently plays is the "If stakeholders really wanted more protection they would contract for it" argument.

⁶³ Again, the current financial crisis would be a great case study to bolster the point made in the text, written before the crisis reached full steam. If companies had valued stability a bit more and been a bit more fearful of financial risk, it is unlikely that our economy would be in its present state.

Employee representation is not efficient, he says, because we do not observe employees negotiating for it as a part of their collective bargaining.⁶⁴ If employee representation were efficient, he asks, “why hasn’t it happened through private arrangements?”⁶⁵ Stakeholders do not need additional protection because they “contract with the firm and can either contract for limits on risk or demand compensation for the risk they assume.”⁶⁶ If stakeholders are not successful in reaching the bargain they want, they can withdraw their investment. “Employees can quit their jobs and customers can take their business to other suppliers if they are dissatisfied.”⁶⁷ Dent admits that employees in particular feel that the right to exit may be inadequate, but asserts that corporations do not “enjoy a bargaining advantage over employees.”

Dent asserts that the market adequately protects employees in part because “stockholders striving to maximize share value have significant incentives to treat employees decently.”⁶⁸ He is so sure of this coalescence of interests that he argues “it is doubtful that there is any systemic problem of mistreatment of workers to begin with.”⁶⁹ It is not an unfair paraphrase of Dent’s argument, then, to say that the market (that is, the right to contract) should be trusted as the primary mechanism to protect stakeholders. If stakeholders want protection, they should bargain for it. If they cannot win that right, they should go elsewhere.

Dent’s arguments about the market power of stakeholders in general and employees in particular seem fanciful to anyone keeping up with the state of working America in the early twenty-first century.⁷⁰ To argue, for example, that American workers should depend on collective bargaining to protect themselves, in an era in which unions represent less than 10% of the private work force, is to whistle past the graveyard. To suggest that the right to quit one’s job and seek out a different one provides anything close to the power of capital to move fluidly from market to market, country to country, is laughable. To suggest that employees need not worry because

⁶⁴ Dent, *supra* note 1, at 1126. Note that Dent wrote these arguments before the current crisis in the equity and credit markets. If the argument that players in the market can protect themselves was persuasive at all before the crisis, it certainly cannot be now.

⁶⁵ *Id.* at 1115.

⁶⁶ *Id.* at 1126.

⁶⁷ *Id.* at 1135.

⁶⁸ *Id.*

⁶⁹ *Id.* at 1128.

⁷⁰ An excellent resource is MISHEL ET AL., *supra* note 17 (cataloging socio-economic data from the standpoint of working America).

shareholders have their back is contradicted by Dent's own admissions elsewhere in his piece.⁷¹

Dent's advocacy of the market as the mechanism for self-help ends when he turns to shareholders, however. Dent believes shareholders should be protected by law because "[m]arkets operate within the law; misguided laws impair market efficiency," "markets are not frictionless," and "[m]arkets . . . take time."⁷² Thus, shareholders should receive additional protection through law,⁷³ including an expanded duty of care of corporate officers⁷⁴ and a right to nominate board members.⁷⁵

So Professor Dent and I do not differ in our belief that markets are a product of law and that regulation is often necessary to overcome market defects and, in his words, "to give effect to the public interest."⁷⁶ We simply differ in that he believes legal protections should be focused on shareholders, and I believe we should extend those protections to stakeholders, particularly employees.

To be fair, our disagreement is even less than that. At points in his critique, Dent concedes that employees and other stakeholders should be protected in various ways by regulation and law, just not by *corporate governance* law. He says that "[t]he market alone does not entirely solve the problem[s]" stakeholders face, and he proposes a few concrete, if mild, suggestions to assist them: better information about physical hazards,⁷⁷ "direct regulation of hazardous activities,"⁷⁸ and a more progressive tax policy⁷⁹ (so that, I presume, the wealth earned by shareholders can be redistributed to lower-income Americans).

These regulatory protections would be welcome, but Dent's proposal of them makes stark the question of why adjustments to corporate governance law are not on the table. Corporate law is law, too, and it may even be better suited than other regulatory initiatives to the end goal of protecting all the stakeholders of the firm, while maintaining the wealth-producing nature of corporations.⁸⁰

⁷¹ Dent, *supra* note 1, at 1111–12, 1117, 1120, 1125; see also *supra* note 59 and accompanying text.

⁷² George W. Dent, Jr., *Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance*, 44 HOUS. L. REV. 1213, 1249–50 (2008) [hereinafter Dent, *Academics in Wonderland*].

⁷³ Dent, *supra* note 1, at 1120–21 (favoring the "strongest possible shareholder rights").

⁷⁴ *Id.* at 1128–29, 1133.

⁷⁵ *Id.* at 1142.

⁷⁶ *Id.* at 1124.

⁷⁷ *Id.* at 1126.

⁷⁸ *Id.* at 1127.

⁷⁹ *Id.* at 1125.

⁸⁰ See GREENFIELD, FAILURE OF CORPORATE LAW, *supra* note 8, at 141–42; Greenfield,

IV. IS STAKEHOLDER GOVERNANCE COUNTERPRODUCTIVE?

A number of stakeholder theorists have argued for some time about the benefits, both realized and potential, of stakeholder governance.⁸¹ My own work has set out my arguments why stakeholder governance would both mitigate some of the pathologies of the corporate form⁸² and empower corporations to be an even greater progressive force in society by building wealth and broadly distributing it.⁸³ I have argued at some length how changes in corporate governance can be more efficient, as regulatory tools and in comparison with other public policy options available, in addressing certain difficult socio-economic issues such as stagnant wages and economic inequality.⁸⁴ I have also suggested ways in which stakeholder governance would improve the management of companies.⁸⁵ In addition, I have answered critiques of stakeholder governance based on the fear of globalization and on the worry that imposing greater responsibility on managers actually releases them

Reclaiming, *supra* note 14, at 22–28.

⁸¹ See Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications*, ACAD. MGMT. REV., Jan. 1995, at 65, 65–91 (quoting then-CEO of Sears, General Robert E. Wood, in 1950 saying, “All I can say is that if the other three parties named above [customers, employees, community] are properly taken care of, the stockholder will benefit in the long pull” (citation omitted)); see also John Nirenberg, *Profit by Doing the Right Thing*, THE NATION (Thailand), Dec. 9, 2002, available at 2002 WLNR 7731977 (“The big message of the [Business for Social Responsibility in the US] conference was that being responsive to stakeholders—not just stockholders—actually results in higher profits when it is part of an overall CSR strategy.”). For a current review of the state of the corporate social responsibility movement, see John M. Conley & Cynthia A. Williams, *The Corporate Social Responsibility Movement as an Ethnographic Problem* (UNC Legal Studies Research Paper No. 1285631, 2008), available at <http://ssrn.com/abstract=1285631>. See also Blair & Stout, *supra* note 8; David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223 (1991); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1992); Marleen A. O’Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899 (1993); Silvia Ayuso, Miguel Angel Ariño, Roberto Garcia Castro & Miguel A. Rodriguez, *Maximizing Stakeholders’ Interests: An Empirical Analysis of the Stakeholder Approach to Corporate Governance* (IESE Business School, Working Paper No. 670, 2007), available at <http://ssrn.com/abstract=982325>.

⁸² See Greenfield, *Reclaiming*, *supra* note 14, at 7–10, 21–28; Kent Greenfield, *Proposition: Saving the World with Corporate Law*, 57 EMORY L.J. 947, 964–74 (2008) [hereinafter Greenfield, *Proposition*].

⁸³ See Greenfield, *Reclaiming*, *supra* note 14, at 21–28; Greenfield, *Proposition*, *supra* note 82, at 978–81; see also GREENFIELD, FAILURE OF CORPORATE LAW, *supra* note 8, at 153–85.

⁸⁴ Greenfield, *Reclaiming*, *supra* note 14, at 21–23; Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool*, 35 U.C. DAVIS L. REV. 581, 640–44 (2002)

⁸⁵ Greenfield, *Proposition*, *supra* note 82.

from *any* responsibility.⁸⁶ There is little reason to rehash those arguments here.

I want to dedicate this last section to answering one point that Professor Dent emphasizes that I have not addressed in depth before, namely that greater protections for employees would be “counterproductive.”⁸⁷ If he is right, the arguments for stakeholder governance would of course be weakened. But I believe he is wrong on this point.

I take Professor Dent’s argument to follow this syllogism: employees benefit from a vibrant economy; employee protections make the economy less vibrant; therefore employees are hurt by employee protections. “[J]ob creation has been much better in economies that make it easier for employers to dismiss employees,” he says.⁸⁸ “Thus shareholder control is probably the best arrangement for each firm’s employees.”⁸⁹ By this logic, to seek to help employees is to hurt them.

There is some truth in what Dent says, to the extent that the protection of *any* investor can go so far as to retard economic vibrancy. If employees are protected from termination even when they perform poorly, the economy suffers. The economy also suffers when community protections are set so high that companies cannot build new factories or risk the sale of new products, or when protections for creditors are set so high that businesses cannot borrow money. But the economy also suffers when protections for *shareholders* are set too high, whether by having standards of disclosure too stringent, setting the fiduciary obligations of management too high, or—for what it’s worth—providing a guarantee for shareholder investment.⁹⁰

But sometimes protection for investors (of all kinds) can facilitate investment and thereby make the economy *more* vibrant. Dent recognizes this truth when it comes to shareholders, but he is blind to it with regard to the others who invest in the firm. That may be because of the distinction he makes between shareholders—who he sees as the sole investors—and the other stakeholders—who he sees as costs.⁹¹ But once we recognize the collective nature of the firm, it is much more difficult to make the distinctions he makes, and in fact

⁸⁶ Greenfield, *Reclaiming*, *supra* note 14, at 28–32.

⁸⁷ Dent, *supra* note 1, at 1121.

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ See *id.* at 1136–38 (proposing, as a thought experiment, a regime wherein each shareholder would be allowed “to recover the capital she invested in the corporation” at any time).

⁹¹ *Id.* at 1120–21.

his arguments about shareholders can be applied to employees as well.

Consider his point that legal protections for shareholders lower the cost of capital. Shareholder rights, he says, “will reassure investors that America is the safest place to put their money,”⁹² which will mean that more institutions and individuals will want to buy stock in U.S. companies, lowering the cost of capital for those companies. In other words, the protections for capital will make holders of capital more likely to invest.

The same argument would apply to others who invest in the firm. If legal protections lower the cost of capital, then legal protections should lower the cost of other investments as well. Take employees, for example. In a legal regime in which their investment gives them no say in corporate governance and no redress other than exit, and leaves them vulnerable to having their firm-specific skills exploited or expropriated, they will be less likely to invest their labor. A legal regime that disregards their interests will not—to borrow Dent’s phraseology—“reassure [workers] that America is the safest place”⁹³ to work, and they will seek to protect themselves, to the extent they can, in other ways. They may demand a higher wage; they may demand more explicit job security protections; they may moderate their effort; they may solicit their legislators to protect them in other ways.

My point is simply that whatever argument about the counterproductivity of legal protections for employees is available can be made vis-à-vis shareholders. And any argument about the benefit of legal protections toward shareholders can be made vis-à-vis employees.

The reason why this notion is so often missed is the lack of parallel structure in how the “counterproductivity argument” is typically made. Consider Dent’s passage where he discusses the benefits of shareholder protections and the cost of employee protections.⁹⁴ In the former, the *benefits* of the legal protections are the focus: legal protections lower the cost of capital, making the economy more vibrant. Ignored are the *costs* of the legal protection (SEC regulations, the fiduciary obligations of managers, the framework of shareholder voting, the structure of securities markets). When the frame shifts to employee protection, it is the *cost* of the protections that are mentioned. The benefits of that protection are left out of the equation.

⁹² *Id.* at 1121.

⁹³ *Id.*

⁹⁴ *Id.* at 1120–22, 1141–43.

As I said earlier, Dent might persuade me that greater shareholder protection is necessary, especially if the interests of long-term holders are prioritized over day traders and the like. But I would like to persuade him that he and other shareholder primacy theorists have undervalued the potential benefits of increased employee protection within the corporate form. He recognizes that employees deserve more protection than they now receive (though outside of corporate law), so he must also believe that such protections can be on balance beneficial, even if the protections themselves do cost something. He is a good enough economic thinker to recognize that, from the perspective of the firm as a whole, costs are costs. This is true whether they come in the form of “external” regulations of the corporation (mandating a minimum wage, for example, or protection from hazardous chemicals), or in the form of a mandate that the “internal” processes of the firm take into account the interests of employees by way of adjusting fiduciary duties or the structure of the board. My argument is simply that employees may be made better off, at a lower cost, through the use of corporate governance reforms than through other regulatory mechanisms.

CONCLUSION

Professor Dent and I agree that “[m]arkets operate within the law” and that we have not reached the best possible mix of corporate governance rules.⁹⁵ We disagree about which way to turn from here. I believe that adjustments in corporate law could be a powerful regulatory tool; he wants corporate law to focus even more on the rights and interests of shareholders. To do so would certainly represent a missed opportunity; it also might make matters worse. All of the investors in the corporation—not just shareholders—deserve better.

⁹⁵ Dent, *Academics in Wonderland*, *supra* note 72, at 1249.

