

# Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship

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## BOOK REVIEW

### COMMUNITY AND STATISM: A CONSERVATIVE CONTRACTARIAN CRITIQUE OF PROGRESSIVE CORPORATE LAW SCHOLARSHIP

*Stephen M. Bainbridge*<sup>†</sup>

PROGRESSIVE CORPORATE LAW. *Edited by Lawrence E. Mitchell.* Boulder, Colo.: Westview Press, 1995. Pp. xx, 313.

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## INTRODUCTION

Over the last few decades, law and economics scholars have mounted a largely successful hostile takeover of the corporate legal academy. Although both traditionalists and leftists have fought separate rear-guard actions against the law and economics movement for many years, the principal resistance is currently offered by a group of relatively young academics loosely centered around the corporate law faculties of the Washington & Lee and George Washington law schools. George Washington University law professor Lawrence Mitchell has brought together ten of the most prominent of these scholars in a new volume that provides a useful introduction to the genre.<sup>1</sup>

Reviewing a collection of essays is never an easy task, but the task here is made especially complex by the remarkable diversity among *Progressive Corporate Law's* contributing authors. These scholars are far more firmly united by what they oppose—Chicago-style law and economics—than by what they support.<sup>2</sup> Nonetheless, at least some of *Progressive Corporate Law's* authors are groping towards a common set of ideas, albeit one that is perhaps more accurately labelled as “communitarian” than “progressive.”<sup>3</sup> This Essay, therefore, does not purport to offer a comprehensive review of *Progressive Corporate Law* or any specific article therein, but rather uses some of those articles as a jumping-off point for an extended critique of progressive communitarian theories of corporate law.

I have been privileged to participate in both formal and informal conversations with some of the nation's best progressive corporate law scholars.<sup>4</sup> Although most corporate law scholars, including most in

<sup>1</sup> PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995). I am loath to concede the term “progressive” to Professor Mitchell, given my perception that it is simply a code word used by the political left to take advantage of the positive connotations most Americans associate with the idea of progress. Cf. David Horowitz, *Socialism Never Dies*, WKLY. STANDARD, Apr. 1, 1996, at 37 (noting “the arrogant historicism of the Left, which is convinced that its agendas are ‘progressive’ and that its progress is the destiny of mankind”). I nevertheless use it herein, both out of deference to Professor Mitchell's choice of terminology and for lack of a better term.

<sup>2</sup> Virtually all of the essays in *Progressive Corporate Law* take a negative view of law and economics, with the notable exception of Eric Orts's insightful article on multinational corporations. See generally Eric W. Orts, *The Legitimacy of Multinational Corporations*, in PROGRESSIVE CORPORATE LAW, *supra* note 1, at 247, 253-55. I do not otherwise address Orts's excellent essay, because he deals with a sui generis set of issues.

<sup>3</sup> See *infra* Part III.

<sup>4</sup> See, e.g., Symposium, *New Directions in Corporate Law*, 50 WASH. & LEE L. REV. 1373 (1993).

the law and economics camp, purport to embrace an apolitical objectivity, my disagreement with progressive corporate law scholars is explicitly political. This Essay continues and refines our on-going dialogue by candidly articulating a conservative version of the law and economics account of corporate law.<sup>5</sup>

Although the debate between conservative contractarianism and progressive communitarianism ultimately takes place mainly on the plane of moral philosophy and political theory, much of the progressive critique of contractarianism claims to sound in economic theory. Many of *Progressive Corporate Law's* authors deny contractarianism's validity and/or its utility as an economic model. The first two Parts of this Essay, therefore, are devoted to evaluating the economic arguments regarding contractarianism. Part I of this Essay critiques the progressive attack on the prevailing law and economics theory of the firm. Part II does likewise to the progressive attack on the rational choice model underlying mainstream law and economics. Because the arguments on both sides are well-developed in the literature, these Parts focus on analyzing the specific spin *Progressive Corporate Law's* authors give the debate. In Part III, the heart of the essay, I explore the communitarian alternative to the law and economics theory of the firm and propose a conservative variant on the basic contractarian model.

## I

### THE NEXUS OF CONTRACTS THEORY OF THE FIRM

The law and economics movement remains the most successful example of intellectual arbitrage in the history of corporate jurisprudence. It is virtually impossible to find serious corporate law scholarship that is not informed by economic analysis. Even those corporate law scholars who reject economic analysis spend most of their time responding to those of us who practice it, as *Progressive Corporate Law* itself abundantly illustrates. Perhaps the most telling evidence of the success of law and economics in our field, however, is that many leading corporate law judges and lawyers now rely upon economic analysis extensively. Both judicial opinions and practitioner publications are

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<sup>5</sup> Calling oneself a conservative contractarian is not a redundancy, despite what some of *Progressive Corporate Law's* authors seem to believe. Most practitioners of law and economics embrace a world view more closely akin to nineteenth century liberalism than to the Burkean conservatism followed by those to whom I refer as "conservative contractarians." I therefore use the term "conservative contractarian" to identify scholars who gloss accepted economic theories of the firm with the principles of Tory conservatism. See *infra* notes 119-28 and accompanying text.

filled with the jargon of law and economics. This is a claim no other modern school of jurisprudence can make.<sup>6</sup>

*Progressive Corporate Law's* contributing authors, if pressed hard enough, would most likely not deny the relevance of economic principles to the study of corporate law. To the contrary, many of them make explicit use of selected economic tools. It is thus not economics per se to which they object, but rather to the specific economic models of firms and human behavior embraced by the law and economics school of corporate law and, sub silentio, to the unwillingness of those in the mainstream of law and economics to acknowledge those writing outside the prevailing paradigm.

Most law and economics scholars embrace a model of business organizations known as the "nexus-of-contracts theory of the firm."<sup>7</sup> These so-called "contractarians" model the firm not as a single entity, but as an aggregate of various inputs acting together with the common goal of producing goods or services. Employees provide labor. Creditors provide debt capital. Shareholders provide equity capital, bear the risk of losses, and monitor the performance of management. Management monitors the performance of employees and coordinates the activities of all the firm's inputs. The firm is simply a legal fiction representing the complex set of contractual relationships between these inputs. In other words, the firm is not an individual thing, but rather a nexus or web of explicit and implicit contracts establishing rights and obligations among the various inputs making up the firm.

As a matter of intellectual interest, the debate over the contractual nature of the firm is over. As Delaware Chancellor William Allen opines, the contractarian model is now the "dominant legal academic

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<sup>6</sup> Douglas Branson rejects the notion that contractarianism is the dominant mode of thinking in modern corporate law. Instead, according to Branson, the nexus-of-contracts theory is "returning to its proper place as [a] useful analysis for some purposes." Douglas M. Branson, *The Death of Contractarianism and the Vindication of Structure and Authority in Corporate Governance and Corporate Law*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at 93, 94. To paraphrase Mark Twain, Branson's report of contractarianism's demise is greatly exaggerated. Indeed, Branson's views are contradicted by his fellow essayists. See, e.g., Gregory A. Mark, *Some Observations on Writing the Legal History of the Corporation in the Age of Theory*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at 67, 72 (asserting that the nexus-of-contracts theory is the "dominant [voice] in current corporate law literature"); Joel Seligman, *Foreword* to *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at ix (acknowledging the dominance of law and economics). The dominance of the economic paradigm in modern corporate jurisprudence is likewise recognized by no less an authority than Delaware Chancellor William Allen. William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1399 (1993).

<sup>7</sup> Thomas S. Ulen, *The Coasean Firm in Law and Economics*, 18 J. CORP. L. 301, 318-28 (1993). See generally Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989) (analyzing the various roles played by investors, managers, and others in the corporate setting).

view.”<sup>8</sup> This is not to say that the contractarian view has pre-empted the field, as *Progressive Corporate Law* itself demonstrates, but only that the debate is fully played out. Contractarians and noncontractarians no longer have much of interest to say to one another; indeed, they barely speak the same language. To shift metaphors, those who adhere to the nexus of contracts model pass those who do not like so many ships in the night, with only an occasional exchange of broadsides to enliven the proceedings.

If I may extend the maritime metaphor, the various essays comprising *Progressive Corporate Law* amount to one long, rolling broadside against the contractarian vessel. The remainder of this Part evaluates their marksmanship on several fronts. The first two are fairly minor: (1) the claim that the nexus of contracts model is not an accurate description of corporate law, and (2) the claim that contractarianism is little more than apologetics for corporate managers. The third progressive critique is somewhat more serious and is, therefore, the principal focus of this Part: almost all of *Progressive Corporate Law*'s contributing authors regard contractarianism as an incomplete description of economic reality. This assertion is true but, upon close examination, scarcely passes the “so what?” test.

#### A. The Mandatory Rules' Red Herring

The nexus of contracts model has important implications for a range of corporate law topics, the most obvious of which is the debate over the proper role of mandatory legal rules. Contractarians contend that corporate law is generally comprised of default rules, from which shareholders are free to depart, rather than mandatory rules. As a normative matter, contractarians argue that this is just as it should be.<sup>9</sup>

In *Progressive Corporate Law*, Douglas Branson rejects this contractarian view and argues instead that mandatory rules pervade corporate law.<sup>10</sup> This attack is far from fatal. In the first instance, most contractarians probably regard the theory's normative claim as being the more important of the two. As such, we cheerfully concede the existence of mandatory rules, while deploring that unfortunate fact. In the second, as Bernard Black persuasively argues, many mandatory corporate law rules are trivial in nature.<sup>11</sup> Finally, nontrivial

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<sup>8</sup> Allen, *supra* note 6, at 1400.

<sup>9</sup> See, e.g., FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 15 (1991); Larry E. Ribstein, *The Mandatory Nature of the ALI Code*, 61 GEO. WASH. L. REV. 984, 989-91 (1993).

<sup>10</sup> See Branson, *supra* note 6, at 94-95.

<sup>11</sup> Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542 *passim* (1990). The triviality argument provides a partial response to William Bratton's observation that most contractarian scholars do not propose a sweeping

mandatory rules are often subject to evasion by choice of form and jurisdiction.<sup>12</sup> Thus, the progressives' focus on mandatory legal rules is little more than a red herring.

### B. Contractarianism as Apologetics

In *Progressive Corporate Law's* most vociferous essay, Douglas Branson charges that contractarianism amounts to little more than paid apologetics for "the wishes and desires of the titans of corporate America."<sup>13</sup> Granted, much of contractarian scholarship is devoted to defense of the status quo. In contrast, "[i]t is a characteristic of 'traditional legal scholarship' generally, and corporate legal scholarship in particular, that . . . a question . . . [is] worth exploring only insofar as the analysis and solution of the problem lead necessarily to a proposal for doctrinal reform . . . ."<sup>14</sup> Conservative contractarians recognize, however, that "change may not be salutary reform: hasty innovation may be a devouring conflagration, rather than a torch of progress."<sup>15</sup> Defense of the status quo provides a necessary check on reformists' zeal.

The preceding paragraph took a quotation from Jason Scott Johnston somewhat out of context, which is perhaps justifiable on grounds that it so aptly captured the point I was trying to make. In

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repeal of mandatory fiduciary duties. Bratton attributes this failure to "doubts about both contractarian assumptions and their underlying ethical presuppositions." William W. Bratton, *Game Theory and the Restoration of Honor to Corporate Law's Duty of Loyalty*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at 139, 152. Yet, the contractarian position on mandatory fiduciary duties may simply indicate a belief that such rules are subject to evasion through choice of form or, to the extent that some duties appear across the spectrum of possible organizational forms, that they are trivial in the sense that they embody rules virtually everyone would demand in the event of actual bargaining.

Conservative contractarians might tolerate mandatory fiduciary duties even if Bratton could demonstrate that such duties are non-trivial. For the conservative contractarian, Tory principles can trump economic analysis. Among such principles is the bedrock notion that "[c]ustom, convention, and old prescription are checks both upon man's anarchic impulse and upon the innovator's lust for power." RUSSELL KIRK, *THE CONSERVATIVE MIND: FROM BURKE TO ELIOT* 9 (7th rev. ed. 1995). Of course, adherence to this Tory principle is often consistent with economic analysis. In fact, one might recast the Tory appreciation of custom in economic terms by describing it as an instinctive respect for the power of path dependence.

Conservative contractarians thus are loath to try unwinding a century or more of common-law development. In turn, Bratton is correct to acknowledge that "an everyday conservatism" is reflected in the alleged contractarian failure to advocate a more expansive reform program. Bratton, *supra*, at 152.

<sup>12</sup> See Ribstein, *supra* note 9, at 1019.

<sup>13</sup> Branson, *supra* note 6, at 93. In her recent review of *Progressive Corporate Law*, Deborah DeMott, likewise noted the charge that contractarianism's "net import is to legitimate the current range of management power and discretion." Deborah A. DeMott, *Trust and Tension Within Corporations*, 81 CORNELL L. REV. 1308, 1331 (1996).

<sup>14</sup> Jason Scott Johnston, *The Influence of The Nature of the Firm on the Theory of Corporate Law*, 18 J. CORP. L. 213, 221 (1993).

<sup>15</sup> KIRK, *supra* note 11, at 9.

context, Johnston's remark makes another point applicable to the present discussion. The 1932 publication of Adolf Berle and Gardiner Means' book *The Modern Corporation and Private Property* began the modern era of corporate governance scholarship.<sup>16</sup> Berle and Means demonstrated that public corporations were characterized by a separation of ownership and control: the firm's nominal owners, the shareholders, exercised virtually no control over either day-to-day operations or long-term policy. Instead, control was vested in the hands of professional managers, who typically owned only a small portion of the firm's shares. Separation of ownership and control developed, according to Berle and Means, because stock ownership became dispersed among many shareholders, no one of whom owned enough shares to materially affect the corporation's management.

Scholars writing in the Berle-Means tradition often commit the fallacy of treating the separation of ownership and control as a problematic feature of public corporations.<sup>17</sup> As a result, they devote their energies to seeking doctrinal solutions to this perceived failing of corporate governance. In contrast, contractarianism offers a metaphor in which the separation of ownership and control is not a problem, but rather simply a necessary, and arguably unremarkable, attribute of the modern public corporation.<sup>18</sup> As a result, contractarian corporate law scholars can focus on endeavors such as understanding why certain corporate governance devices evolved as they did, rather than on trying to cobble together yet another doctrinal solution to the separation of ownership and control.<sup>19</sup> Contrary to Branson's view,<sup>20</sup> this is not mere apologetics, but rather an effort to understand the "is" before plunging headfirst into the "ought."

### C. The Incompleteness of Contractarianism

Most of *Progressive Corporate Law's* authors contend that the contractarian model is an incomplete theory of interpersonal relation-

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<sup>16</sup> ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

<sup>17</sup> "Agency costs" is the modern terminology, but Berle and Means identified the basic problem over forty years before that term was invented. "The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge . . ." *Id.* at 6. Preventing such divergences, or at least minimizing their effects, has been the primary concern of post-Berle and Means scholarship. The obligatory modern citation is Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 328-30 (1976).

<sup>18</sup> See Stephen M. Bainbridge, *The Politics of Corporate Governance*, 18 HARV. J.L. & PUB. POL'Y 671, 671-78 (1995) (reviewing MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994)).

<sup>19</sup> In other words, the contractarian model permits an approach to corporate law scholarship that focuses on the use of economic models to explain why existing patterns of corporate law and governance came into being. See, e.g., Johnston, *supra* note 14, at 232-35.

<sup>20</sup> See *supra* note 13 and accompanying text.

ships within a firm.<sup>21</sup> If contractarianism claimed to be a depiction of economic reality, this argument might have some traction. In my view, however, contractarianism claims only to offer a richer metaphor than do traditional entity-based theories and, as such, a more useful heuristic for understanding corporations.<sup>22</sup> The progressive critique of contractarianism thus fails at the starting gate.

The progressive critique becomes even less persuasive when one examines its specific charges. In order to evaluate the progressives' line of argument, we must make some fine distinctions: first, the distinction between the default rules provided by corporate statutes and organic rules adopted by specific corporations in their articles, bylaws, and employment policies; second, between actual and hypothetical bargains, as well as process and outcome bargaining. The latter set of distinctions is the main reason progressives and contractarians pass one another like ships in the night; in each pair, progressives focus on the former issue, while contractarians focus on the latter.

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<sup>21</sup> See, e.g., Lynne L. Dallas, *Working Toward a New Paradigm*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at 35, 48; David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at 1, 5; Lawrence E. Mitchell, *Preface* to *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at xiii, xiv-xv. In her review of *Progressive Corporate Law*, Deborah DeMott takes a similar position. DeMott, *supra* note 13, at 1331-32. Indeed, Bratton goes as far as to deny the very validity of the contractual metaphor: "This business of coming up with [a] crude efficiency structure by staring at one's navel and then calling it a contract signed onto by real world parties has got to stop." Letter from William Bratton, Professor of Law, Rutgers Law School, to Stephen M. Bainbridge, Professor of Law, University of Illinois College of Law (Apr. 8, 1996) (on file with author) [hereinafter Bratton's April 8th letter].

<sup>22</sup> As such, contractarianism has important implications for the way in which we think about intra-corporate relationships. Consider, for example, David Millon's contention that contractarian theory "rests on an underlying commitment to the sanctity of shareholder property rights." Millon, *supra* note 21, at 4. Millon's critique implicates the traditional reification of the corporation—treating the corporation as an entity or, more precisely, as a thing capable of being owned, separate from its various constituents. *Id.* at 2 (accusing contractarians of dismissing out of hand "the idea of the corporation as a real entity—a distinctive 'thing' having an existence separate from its component parts"). However, Millon elsewhere concedes the fictional nature of corporate personhood. David Millon, *Personifying the Corporate Body*, 2 *GRAVEN IMAGES* 116, 116-17 (1995) [hereinafter Millon, *Personifying the Corporate Body*]. Millon's disagreement with contractarians thus is not so much about the entity status of the corporation, as it is about the extent to which the corporation should be described in non-contractual terms.

In any case, nexus-of-contracts theory rejects traditional entity-based theories. Because shareholders are simply one of the inputs bound together by the web of voluntary agreements, ownership should not be a particularly meaningful concept in nexus-of-contracts theory. Someone owns each input, but no one owns the totality. Instead, the corporation is an aggregation of people bound together by a complex web of contractual relationships. The contractarian account thus rests not on an out-moded reification of the corporation, but on the presumption of validity a free market society accords voluntary contracts.

### 1. *Default Rules and Hypothetical Bargains*

As noted above, contractarians contend that corporate law consists mainly of default rules. Put another way, in the nexus-of-contracts model, corporate statutes and decisions amount to a standard-form contract voluntarily adopted—perhaps with modifications—by the corporation's various constituencies. William Bratton's essay offers the most fully developed critique of this contractarian story in *Progressive Corporate Law*. At the core of Bratton's thesis is a game theory-based argument that contractarianism fails to account for defects in the bargaining process.<sup>23</sup> Bratton contends that reciprocal economic relations of the sort found within a corporation differ from arm's-length bargains, because groups must develop loyalty, trust, and good will in order to succeed.<sup>24</sup> Bratton further argues that because good will is fragile in nature, corporate law should, and does, strive to promote intragroup trust "by imposing a norm of honor on those in authority."<sup>25</sup> This ideal of honorable behavior drives Bratton's attack on contractarianism. Bratton opines that contractarians ignore the trust-promoting function of corporate law, because "rational [economic] actors do not bring norms of honor to the ordering of their affairs."<sup>26</sup> According to Bratton, contractarians recognize "only one motivation—conscious self-interest."<sup>27</sup> Furthermore, among contractarians, "[t]here survives no separate impulse to protect trust reposed."<sup>28</sup>

At least insofar as conservative contractarians are concerned, Bratton's allegations overstate the case. It is not the importance of trust and honor with which I quibble, but rather the means by which Bratton and his colleagues propose to promote those virtues.<sup>29</sup> Yet, even assuming the charge to be well-taken, *arguendo*, I remain unpersuaded.

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<sup>23</sup> Bratton, *supra* note 11, at 153.

<sup>24</sup> *Id.* at 145.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 141.

<sup>27</sup> *Id.* at 151.

<sup>28</sup> *Id.* at 152.

<sup>29</sup> See *infra* Part III.B. Bratton's position looks at first blush to be quite Burkean. He not only advocates a return to the early traditions of corporate law, but expresses concern for ideals, like honor and duty, to which conservatives traditionally lay claim. As I argue below in more detail, however, Bratton's argument is too statist for a conservative's tastes. See *infra* notes 155-57 and accompanying text. To be sure, Bratton suggests using extant commercial norms to define the scope of honorable conduct, which somewhat minimizes the statist implications of his approach. Unfortunately, this move suffers from two flaws. First, Bratton's own game-theory analysis implies that commercial norms are essentially indeterminate. Bratton, *supra* note 11, at 154-56. Second, there remains the risk that the state could declare existing corporate practice unacceptable as Judge Hand famously did in *The T.J. Hooper*, 60 F.2d 737, 740 (2d Cir. 1932).

Consider Bratton's contention that the nexus-of-contracts model "has a significant shortcoming" in that it "gives us *ex ante* contracts across-the-board and thereby makes corporate governance entirely contractual without providing a description of the process by which corporate actors make contracts."<sup>30</sup> Here we confront the distinction between actual and hypothetical bargaining. Contractarians concede, or at least should concede, that actual bargaining over rules such as limited liability is precluded by transaction cost barriers, but they contend that this is precisely why corporate statutes provide a set of off-the-rack rules amounting to a standard-form contract.<sup>31</sup>

If transaction costs are zero, the substantive content of a corporate law rule does not matter greatly.<sup>32</sup> If, for example, the law imposed full personal liability on shareholders, but limited liability is the efficient rule, shareholders and creditors would contract around the rule through private bargaining. In the face of transaction costs, however, the rule's substantive content begins to matter very much. Indeed, if transaction costs are high, bargaining around the rule becomes wholly impractical, forcing the parties to live with an inefficient rule. Because the public corporation setting gives rise to prohibitively high transaction costs, parties cannot depend on private contracting to achieve efficient outcomes. Instead, a legally-imposed rule must function as a substitute for private bargaining. Identifying the party for whom getting one's way has the highest value thus becomes the critical question. In effect, corporate legal scholars ask: "If the parties could costlessly bargain over the question, which rule would they adopt?"<sup>33</sup> By imposing a rule to which parties would agree if they could bargain, society facilitates private ordering.

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<sup>30</sup> Bratton, *supra* note 11, at 154.

<sup>31</sup> David Millon criticizes the nexus-of-contracts model on the ground that the bargaining takes place against a background of entitlements. Millon, *supra* note 21, at 22-24. This is another situation in which progressives and contractarians tend to talk past one another. In a zero transaction cost world, no such background entitlements would be necessary. Suppose you have an idea and I have money (or labor). We reach agreed-upon terms of exchange. If we had perfect information and zero transaction costs, our bargain could be complete. In the real world, these conditions are not met and our bargain is necessarily incomplete. Some background legal rules are necessary to fill out the inevitable gaps in our agreement. Millon and I are in agreement up to this point. Where we diverge, however, is that I, as a conservative contractarian, regard corporate law default rules not as entitlements but as our best guess as to what parties would rationally agree to in the absence of any pre-existing set of imposed terms. If standard form agreements are properly thought of as contracts, the existence of a background set of default rules thus does not undermine the essentially contractual nature of corporate law.

<sup>32</sup> This follows from a straightforward application of the Coase Theorem. The obligatory cite for this proposition is R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 2-15 (1960).

<sup>33</sup> Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1430 (1993). As I have argued else-

Bratton appreciates this argument but contends that hypothetical bargaining does not allow meaningful predictions about the rules parties would choose in a zero-transaction-cost environment. He instead urges decisionmakers to look for legal norms in long-standing doctrine and real-world practice rather than in law and economics journals.<sup>34</sup> Although I am in complete sympathy with Bratton's basic argument that honor and trust are important social norms, I nevertheless conclude that he both overstates hypothetical bargaining's flaws and understates the drawbacks to his proposed alternative.

Bratton, drawing on the game theory tenet that games lacking a single, first best equilibrium instead have multiple equilibria,<sup>35</sup> posits that one cannot use the hypothetical bargaining method to develop default rules for corporate law problems because the possibility of multiple solutions renders the hypothetical bargain indeterminate.<sup>36</sup> Granting that some, but not all, games have multiple equilibria,<sup>37</sup> where does that leave us? Corporate law decisionmakers still need some filter for determining which rules to adopt. The process of legal reasoning by which such rules are developed should be replicable, and the rules themselves should promote certainty and predictability.<sup>38</sup> How does Bratton propose to develop such rules? In the context of fiduciary duty rules, the subject of his essay, Bratton endorses a system of "muddy defaults" through which judges evaluate a fiduci-

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where, a rule of limited liability plausibly emerges from this hypothetical bargaining process.

<sup>34</sup> Bratton's April 8th letter, *supra* note 21. In an important series of articles, Ian Ayres and Robert Gertner have also taken issue with the hypothetical bargain methodology. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989); Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U. CHI. L. REV. 1391 (1992). A critique of this analysis requires more space than permitted in this context. Suffice it here to say that Ayres himself admits that this analysis qualifies, but does not refute, the hypothetical bargain methodology. Ayres, *supra*, at 1419.

<sup>35</sup> Bratton, *supra* note 11, at 153.

<sup>36</sup> Bratton also observes that information asymmetries may preclude parties from bargaining to an efficient result even in a zero-transaction-cost environment. *Id.* This point is not very telling, however, if we treat information asymmetries as a form of transaction cost in response to which contractarians can deploy the usual array of responses to high transaction costs, such as the use of hypothetical bargaining to develop default rules or the use of intermediaries (such as underwriters) to lower transaction costs.

<sup>37</sup> In the real world, we obviously cannot predict the outcome of any particular bargain with complete certainty. In many circumstances, however, we can predict with a high degree of confidence the expected outcome of many bargains. Consider a simple variant of the Monty Hall game. I offer you the following deal: you can have \$5 or take the curtain. There is a 50% chance that \$10 is behind the curtain and a 50% chance that there is nothing behind the curtain. I cannot know *ex ante* whether you will take the curtain or the \$5, but rational choice theory allows me to predict that most people will take the sure \$5 because most people are risk-averse.

<sup>38</sup> See, e.g., *Harff v. Kerkorian*, 324 A.2d 215, 220 (Del. Ch. 1974) ("It is obviously important that the Delaware corporate law have stability and predictability.").

ary's action ex post.<sup>39</sup> In doing so, judges should promote trust<sup>40</sup> by looking "to intuitive fairness determinations well-informed by the circumstances of the case and heavily influenced by the burden of proof allocation, but only loosely informed by knowledge of general business practices."<sup>41</sup>

Although the above-quoted passage downplays the role of real world practice, another passage more clearly implies that corporate law should be based on the social norms reflected in real-world business practices.<sup>42</sup> Our subsequent correspondence confirmed that this is Bratton's intent.<sup>43</sup> In any case, I chose to focus on that aspect of his proposal because an emphasis on real-world business norms, along with an admirable respect for old precedents, is all that prevents Bratton's methodology from collapsing into an invitation for judges to make up the rules as they go along.<sup>44</sup>

I concede the relevance of social norms to the adjudicative process, but I nevertheless remain unpersuaded by Bratton's proposal. Consider a classic fiduciary duty case, *Globe Woolen Co. v. Utica Gas & Electric Co.*<sup>45</sup> This was an interested director transaction, in which one John F. Maynard served as a director for the defendant at the same time he was plaintiff's principal stockholder, president, and director.<sup>46</sup> Maynard was actively involved in negotiating a contract between plaintiff and defendant, which proved to be unprofitable for the latter.<sup>47</sup> Surely we can all agree on a moral norm relevant to the facts at bar: don't cheat. One hopes that real-world business norms in fact proscribe cheating. But what is cheating in this context? Certainly Maynard should have disclosed all facts within his knowledge. But did he need to refrain from voting? Would approval by independent directors have sufficed, or should they also have sought shareholder ratification? Do we need to analyze the transaction for objective fairness? Moral norms are very useful in defining broad rules of general application, and even for defining narrow rules applicable to issues involv-

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<sup>39</sup> Bratton, *supra* note 11, at 164.

<sup>40</sup> *See id.* at 165.

<sup>41</sup> *Id.*

<sup>42</sup> *See id.* at 168 ("The norm's transfer from business practice to the law facilitates its communication to the large number of actors involved in production in firms.")

<sup>43</sup> Bratton's argument is reminiscent of Holmes' well-known observation: "The life of the law has not been logic: it has been experience." OLIVER WENDELL HOLMES, JR., *THE COMMON LAW* 1 (Mark DeWolfe Howe ed., Back Bay Books 1963) (1881). But Holmes later opined that "the man of the future is the man of statistics and the master of economics." OLIVER WENDELL HOLMES, *The Path of the Law*, in *COLLECTED LEGAL PAPERS* 167, 187 (1920).

<sup>44</sup> I assume that all agree such a system would be undesirable. *See* Stephen M. Bainbridge, *Social Propositions and Common Law Adjudication*, 1990 U. ILL. L. REV. 231, 233-39.

<sup>45</sup> 121 N.E. 378 (N.Y. 1918).

<sup>46</sup> *See id.* at 378.

<sup>47</sup> *See id.* at 378-79.

ing moral questions, but they are blunt instruments poorly suited to this sort of fine detail work. Would it shock the conscience, for example, if the votes of an interested director counted in determining whether shareholder ratification of a conflicted interest transaction was effective? Few of us, with the possible exception of Justice Cardozo, have such a well-developed sense of commercial morality that we can feel confident announcing, *ex cathedra*, an answer to that question.<sup>48</sup>

In contrast, law and economics provides a plausible and straightforward policy-based account of conflicted interest transactions pursuant to which full disclosure and approval by independent directors suffice to insulate such transactions from judicial review.<sup>49</sup> Given the difficulty of identifying dominant commercial practices, the best we

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<sup>48</sup> Seeking answers to these questions in real-world business practice also seems likely to impose unacceptably high tertiary costs. We are not talking about trade usages, after all. This brings up an interesting observation: to the extent he relies on real-world practice, Bratton's methodology resembles that of Karl Llewellyn. As Alan Schwartz and Bob Scott explain:

Llewellyn believed that a major purpose of the [Uniform Commercial] Code was to resolve disputes according to the best "commercial morality." He meant by this, as a methodological matter, that courts should deduce moral norms from the customs of "good" merchants. An obvious objection to this methodology . . . is that courts lack the expertise to observe and evaluate merchant practice. . . .

Llewellyn . . . believed that moral norms can be derived from actual practices. But "oughts" cannot be derived from "what is." For example, the question whether a particular business practice reflects "the observance of reasonable commercial standards of fair dealing in the trade" cannot be answered by the existence of the practice itself. The evaluator must have some moral criteria, derived independently of the practice, by which to decide what practices are "reasonable" and "fair." This means that a major purpose of the Code is, from the viewpoint of interpretation, no purpose at all; for to tell the courts to derive moral norms from merchant practices is to tell them nothing useful—there is no "there" there.

ALAN SCHWARTZ & ROBERT E. SCOTT, *COMMERCIAL TRANSACTIONS: PRINCIPLES AND POLICIES* 17-18 (2d ed. 1991) (footnotes omitted). (For an argument that economic analysis provides the necessary criteria for interpreting the Code, see *id.* at 21-28.) Bratton might well concede the point, but would insist that notions of trust, fairness, and honor supply the requisite criteria. But that takes us back to the problem of judges making it up as they go along, according to the whims of individual morality, which is a form of statism.

<sup>49</sup> See Michael P. Dooley, *Two Models of Corporate Governance*, 47 *BUS. LAW.* 461, 486-95 (1992). Lawrence Mitchell argues that the procedural/contractual understanding of fiduciary law Dooley advocates erodes social trust. Lawrence E. Mitchell, *Trust. Contract. Process.*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at 185, 186-87. Mitchell further rejects the contractarian preference for a process-oriented approach to fiduciary duty on the ground that courts are not in a position to detect process manipulations. *Id.* at 206. This is consistent with his view that the business judgment rule exists because courts are poorly equipped to detect breaches of duty. *Id.* at 192-93. As I have argued elsewhere, however, the business judgment rule rests on an entirely different set of concerns, namely, the importance of preserving the board's discretionary authority from judicial review. Courts in fact appear to be quite capable of detecting process flaws that lead to substantively problematic results. Stephen M. Bainbridge, *Independent Directors and the ALI Corporate Governance Project*, 61 *GEO. WASH. L. REV.* 1034, 1068-80 (1993).

can hope for is an educated guess about the rule most actors would choose if they could bargain, which the nexus-of-contracts model offers. Until Bratton or someone else comes up with a model having greater predictive power, contractarianism's place at the top of the jurisprudential heap remains safe.

## 2. *Organic Rules and Outcome Bargaining*

Contractarians treat the corporation's organic rules as if they arose through the trading of rights and duties among the corporation's various constituencies and, accordingly, treat those rules as though they represent a bargain in which claims on the corporation were sold to their highest-valuing user.<sup>50</sup> The bargains struck will vary from firm to firm, depending on a variety of factors, including the risk preferences of each of the firm's constituencies and the thickness of the markets in which the bargain is struck.<sup>51</sup> Because the various contracts making up the firm thus differ little from contracts created through voluntary exchange, they enjoy a presumption in their favor, and ought to be enforced in the same way other mutually beneficial contracts are enforced.<sup>52</sup>

Lawrence Mitchell rejects the contractarian account because the corporation's constituencies do not and cannot bargain:

The idea that the bylaws of a public corporation were somehow bargained for by the stockholders in a manner that can be said to give rise to intent is troubling. In the first place, most public corporation stockholders have never read the corporation's bylaws, if they even are aware of their existence. While it is possible to argue that the stockholders should have read the bylaws, to which they became bound by their purchasing stock, this in no way suggests any sort of bargaining process that gives rise to mutual intent. At best they can be said to have accepted the bylaws as one characteristic of the entire corporation, within the context of corporate laws holding that directors are fiduciaries of the corporation and its stockholders.<sup>53</sup>

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<sup>50</sup> See Jonathan R. Macey, *Externalities, Firm-Specific Capital Investments and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173, 179.

<sup>51</sup> See *id.*

<sup>52</sup> See Ulen, *supra* note 7, at 322.

<sup>53</sup> Mitchell, *supra* note 49, at 207. David Millon makes a similar argument on behalf of the corporation's nonshareholder constituencies:

Particular kinds of conduct likely to be harmful to nonshareholders may be difficult to foresee and to specify contractually with adequate precision. This may result from informational advantages enjoyed by management, which has direct access to confidential strategic plans and has no incentive to disclose them voluntarily to employees or other nonshareholder constituencies. Workers may be totally unaware of plans to shut down a plant and shift production to another location, and may have been misled by statements or other behavior seemingly suggesting a long-term commitment to their welfare. Even if there is some sense that such shifts are always possible, even in the face of management indications to the contrary, employees

This argument fundamentally misconceives the contractarian project by ignoring the distinction between outcome and process bargaining. A bargain can be understood in two distinct ways: as a process, which is how Mitchell appears to understand it, or as an outcome. As Mitchell correctly notes, there is no bargaining process between a shareholder and the public corporations in which he invests. But there is an outcome—the set of organic rules contained in the articles and bylaws as drafted by the corporation's founders or directors—that can fairly be described as a bargain. A bargain involving only an outcome is just as much a contract as a bargain involving both a process and an outcome.

Perhaps I can be forgiven for trying to make the point by borrowing a favorite tool of leftist scholars: storytelling. A while back I flew into LAX and headed out to a car rental lot. There was a huge line growing faster than it was being served, so there were many impatient travellers behind me by the time I reached the front. The agent handed me a long, detailed standard form agreement. Did I bargain over the agreement's terms? No, of course not. Did I even read the agreement? No, of course not. Was the agreement nevertheless a binding contract? Although some cases have treated particularly oppressive clauses of such agreements as contracts of adhesion, the fact that I did not read it would likely not be enough to prevent enforcement of the agreement as a binding contract.<sup>54</sup> If accepting a standard form agreement from a car rental company can be conceptualized as a form of bargaining, why isn't the same true of the unversed shareholder who blithely accepts the corporation's bylaws?<sup>55</sup> Shareholders accept the trade-offs inherent in the standard form contract offered by the corporation, just as I accepted the trade-offs inher-

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are much less likely to bargain for protection than they would be if they knew of management's actual plans to close a plant or of a more general corporate policy to lay off workers whenever it is in the shareholders' interest to do so.

Millon, *supra* note 21, at 5-6. These observations are true, but not unique to the corporate context. Mid-stream changes are a problem in any long-term relational contract, because all such contracts are subject to uncertainty, complexity, and opportunism. Millon's argument only has traction if (1) there is some exogenous reason workers and similar non-shareholder corporate constituencies should be privileged vis-a-vis parties to other relational contracts and (2) Millon can demonstrate that expanding corporate law's regulatory purview is a better means of addressing mid-stream modifications than, say, labor law reform.

<sup>54</sup> See, e.g., *Hertz Corp. v. Home Ins. Co.*, 18 Cal. Rptr. 2d 267, 269 n.2 (Ct. App. 1993) ("[W]hen a policy contains sufficiently clear language, it matters not that the insured in fact failed to read it.") (citations omitted).

<sup>55</sup> See Ribstein, *supra* note 9, at 990 (noting that the concept of contract includes voluntary agreements established by default legal rules and standard form agreements).

ent in the standard form rental agreement offered me by the car rental company.<sup>56</sup>

### 3. Summary

In sum, the progressives are correct in asserting that contractarianism is incomplete, but so what? Admittedly this distinction is not always acknowledged in the contractarian literature, but I suggest that the nexus-of-contracts model is properly viewed as a metaphor rather than as a positive account of economic reality. Contractarianism is analogous to Newtonian physics, which no longer claims to be an accurate representation of the laws of physics, but yet provides a simple model that adequately explains a large and important set of physical phenomena.

Given this, most of *Progressive Corporate Law's* authors are asking the wrong questions about the nexus-of-contracts model. A theory is properly judged by its predictive power with respect to the phenomena it purports to explain,<sup>57</sup> not by whether it is a valid description of an objective reality.<sup>58</sup> As such, "the relevant question to ask about the 'assumptions' of a theory is not whether they are descriptively 'realistic,' for they never are, but whether they are sufficiently good approximations for the purpose in hand."<sup>59</sup> As demonstrated above, *Progressive Corporate Law's* authors have failed to disprove contractarianism's claim of predictive sufficiency.<sup>60</sup> Further, if it takes a theory to beat a theory, we shall see in Part III that the progressives have also failed to offer a credible alternative to the nexus of contracts model.

## II

### ECONOMIC MAN

As with any theory claiming predictive power, the contractarian model rests on a theory of human behavior. "Economic Man" is an autonomous individual who makes rational choices that maximize his

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<sup>56</sup> Mitchell further asserts that uncertainty means that contract cannot fully substitute for trust as a basis for intra-corporate relationships. Because complexity and bounded rationality preclude complete contracting under uncertainty, trust is necessary for social relations to persevere. Mitchell, *supra* note 49, at 197. The corporate contract, however, has two attributes that allow it to deal with uncertainty. One is authority, that is, the delegation of power to a central agency authorized to rewrite the terms of the corporate contract in the face of changed circumstances. The other is the right of exit, or voice, embodied in the free transferability of shares to a prospective acquiror. At least insofar as shareholders are concerned, exit is a low-cost option.

<sup>57</sup> See MILTON FRIEDMAN, *The Methodology of Positive Economics*, in *ESSAYS IN POSITIVE ECONOMICS* 23, 27 (1985).

<sup>58</sup> See *id.* at 30 ("[I]mportant and significant hypotheses will be found to have 'assumptions' that are wildly inaccurate descriptive representations of reality . . .").

<sup>59</sup> *Id.*

<sup>60</sup> See *supra* Part I.C.1-2.

satisfactions.<sup>61</sup> In *Progressive Corporate Law*, Lynne Dallas criticizes the Economic Man model for failing to account for social justice concerns, specifically the equitable distribution of wealth.<sup>62</sup> Theresa Gabaldon likewise complains that Economic Man is a morally unattractive "guiding myth."<sup>63</sup> Moreover, William Bratton argues that Economic Man is an incomplete model of human behavior.<sup>64</sup>

To clear up a frequent misconception at the outset, it is important to emphasize that the Economic Man is not "driven by purely pecuniary incentives."<sup>65</sup> Because rational choice theory encompasses all incentives to which humans respond, including such things as risk aversion and even a generalized sense of fairness, the progressive critique loses much of its traction. Empirical research on human decisionmaking tends to show behavior that is inconsistent with purely selfish behavior, but is nevertheless consistent with rational choice theory.<sup>66</sup> Much of the progressive critique of the Economic Man model is thus directed at a caricature, rather than the real economic model.

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61 RICHARD A. POSNER, *THE PROBLEMS OF JURISPRUDENCE* 353 (1990). For a very useful summary of rational choice theory, and the recent empirical work on it, see Thomas S. Ulen, *Rational Choice and the Economic Analysis of Law*, 19 L. & SOC. INQUIRY 487 (1994).

62 Dallas, *supra* note 21, at 44.

63 Theresa Gabaldon, *Experiencing Limited Liability: On Insularity and Inbreeding in Corporate Law*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at 111, 117-18.

64 Bratton, *supra* note 11, at 166-67.

65 POSNER, *supra* note 61, at 382. Given that Economic Man is driven by incentives, the progressive critique of Economic Man actually turns out to be quite surprising. Judge Posner claims that Economic Man "is a person whose behavior is completely determined by incentives; his rationality is no different from that of a pigeon or a rat." *Id.* This is a perspective on human nature essentially identical with that of the evolutionists: man is merely an animal, morally indistinguishable from any other animal. As such, it is a world view one might reasonably expect progressives to be comfortable with. Cf. Herbert Hovenkamp, *The Mind and Heart of Progressive Legal Thought*, 81 IOWA L. REV. 149, 151-52 (1995) (linking the rise of progressive legal thought to Reform Darwinism).

66 See Ulen, *supra* note 61, at 498. Consider, for example, the progressive communitarian assumption that trustworthiness regularly requires one to act against one's interest. See, e.g., Marleen A. O'Connor, *Promoting Economic Justice in Plant Closings: Exploring the Fiduciary/Contract Law Distinction to Enforce Implicit Employment Agreements*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at 219, 223 (arguing that goodwill trust is neither purely instrumental nor self-interested). However, game theorists have identified some very strong incentives for individuals to behave cooperatively. Consider, for example, that one powerful strategy in an infinitely repeated game is to play on a tit-for-tat basis. Player 1 begins by cooperating, and then chooses in each subsequent round to play as Player 2 did on his previous choice. In effect, tit-for-tat can train the opposing player to be cooperative. See J. KEITH MURNIGHAN, *BARGAINING GAMES* 81-84 (1992). In other words, trustworthy behavior is not only honorable, it is also useful. As such, there is no inconsistency between the notion that people "irrationally" honor their commitments and a model of human behavior based on rational choice. See James Q. Wilson, *What is Moral, and How Do We Know It?*, COMMENTARY, June 1993, at 37, 39-40. Consistently trustworthy behavior sends a message about reliability that pays long-term benefits under many, albeit not all, market conditions.

The progressive critique becomes even less troubling when we admit that the Economic Man, like the nexus-of-contracts model, is simply an abstraction developed as a useful model for predicting the behavior of large numbers of people. Conservatives do not deny the unreality of Economic Man. A pure Economic Man "would be a feral monster with no partners or customers."<sup>67</sup> As such, the model is not intended to describe real people embedded in a real social order.<sup>68</sup>

Admitting that Economic Man is merely a partial explanation of human behavior is no more fatal to the law and economics movement than is the same admission with respect to contractarian theory.<sup>69</sup> If it takes a theory to beat a theory, moreover, critics of the rational choice model may fairly be asked to put forward an alternative methodology that can better assist us in understanding the real world effects of legal rules.<sup>70</sup> As I argue in the next Part, communitarianism fails to offer any more robust insights into law than economics.

### III

#### THE PROGRESSIVE ALTERNATIVE

Although *Progressive Corporate Law's* authors are united in their rejection of the contractarian model and of the Economic Man model, they achieve less unity in offering an alternative theory of the firm. To the extent a common theme can be identified it is the tendency towards a leftist version of communitarianism. David Millon's chapter provides the most detailed treatment of the communitarian alternative to contractarianism. According to Millon, communitarians argue that relationships within the corporation are not arm's-length market relationships, but rather are based on trust and mutual interdependence.<sup>71</sup> In their view, this requires corporate decisionmakers to be sensitive to the needs of all the corporation's constituencies; fair dealing requires that intracorporate relationships not be unilaterally abrogated to benefit shareholders.<sup>72</sup> In my view, Millon's treatment

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<sup>67</sup> Jeffrey Hart, *In Dispute: Dream Weaver*, NAT'L REV., Mar. 25, 1996, at 60.

<sup>68</sup> Cf. MICHAEL NOVAK, *TOWARD A THEOLOGY OF THE CORPORATION* 16 (2d ed. 1990) (making the same point about economic analysis in general).

<sup>69</sup> See POSNER, *supra* note 61, at 366. I leave to others with greater expertise in non-market areas of the law the question of whether economic analysis is a useful positive tool in those areas. For a defense of an affirmative answer, see *id.* at 367-70.

<sup>70</sup> Gabaldon rejects the rational actor model in favor of anecdotal story-telling. Gabaldon, *supra* note 63, at 120. The difficulty with this approach is that the creation of public policy requires us to make predictions about the behavior of large numbers of people. Rational pursuit of self-interest is a more likely candidate for this job than any story told by progressive academics. Gabaldon acknowledges this problem, but claims that it can be solved by checking the validity of her stories against "common sense." *Id.* However, like beauty, common sense is very much an eye-of-the-beholder concept.

<sup>71</sup> Millon, *supra* note 21, at 9.

<sup>72</sup> See *id.* at 10.

of the communitarian argument justifies characterizing him as a progressive with significant communitarian tendencies, leavened with an awareness of communitarianism's flaws.

Several of *Progressive Corporate Law's* other authors write from a perspective that is communitarian in all but name. Lynne Dallas, for example, offers a so-called "power coalition theory," the rhetoric of which is essentially communitarian.<sup>73</sup> Lawrence Mitchell denies being a communitarian, although he expresses sympathy for that view.<sup>74</sup> Mitchell's admitted communitarian sympathies come into play as he emphasizes the concept of trust as a social virtue. Mitchell does so because it promotes "a society emphasizing cooperation and cohesion," which he prefers to "one that breeds conflict and enmity."<sup>75</sup> Marleen O'Connor likewise lays great emphasis on the role of trust in corporate relationships.<sup>76</sup> In a personal correspondence, William Bratton expressly disclaimed both the communitarian and progressive labels.<sup>77</sup> Although Bratton thus may represent the right wing of the progressive corporate legal academy, there is arguably enough overlap between his views and those of *Progressive Corporate Law's* unabashedly progressive authors to justify his inclusion with them.

In this Part, I first consider whether the progressive brand of communitarianism offers a viable alternative to the contractarian model from either a descriptive or a predictive perspective. I conclude that it does not. I then contrast progressive communitarianism to the Tory communitarianism of modern conservatives. I conclude that conservatives are more likely to find common ground with contractarians than with progressives.

#### A. Testing the Progressive Communitarian Theory of the Firm

Traditional forms of legal scholarship were primarily backward-looking. One reasoned from old precedents to decide a present case, seemingly without much concern (at least explicitly) for the effect of today's decision on future behavior. Yet, law is necessarily forward-looking. To be sure, a major function of our legal system is to resolve present disputes, but law's principal function is to regulate future behavior. Contractarianism (like law and economics generally) suc-

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<sup>73</sup> Dallas, *supra* note 21, at 49-50 (discussing dependencies taken into account by the power coalition theory); *id.* at 51 (asserting that the power coalition theory is set on the basis of morality and recognizes that people are members of communities rather than economically-rational, autonomous individuals).

<sup>74</sup> Mitchell, *supra* note 49, at 199.

<sup>75</sup> *Id.*

<sup>76</sup> O'Connor, *supra* note 66, at 223.

<sup>77</sup> Letter from William Bratton, Professor of Law, Rutgers Law School, to Stephen M. Bainbridge, Professor of Law, University of Illinois College of Law (Apr. 12, 1996) (on file with author) [hereinafter Bratton's April 12th letter].

ceeded because it offers a tool for exploring and predicting human responses to regulation. Unless progressive scholars can provide an alternative paradigm that offers judges and lawyers a more robust model for making such predictions, their movement will remain of little every-day use to the legal system.

The progressive jurisprudence represented by *Progressive Corporate Law* has thus far failed to answer this challenge. As we have seen, the main alternative to contractarianism offered therein is a communitarian model in which people relate to one another through trust and mutual interdependence. As I argue in this section, however, communitarianism is unlikely to prove a very fruitful alternative to the law and economics model.<sup>78</sup>

### 1. *The Descriptive Power of Progressive Corporate Communitarianism*

Although a conservative contractarian willingly concedes that his economic models do not accurately depict the real world, he urges his progressive communitarian friends to remove the beam from their eyes before attempting to take the splinter out of his. For example, the progressive communitarian account of the shareholder-corporate relationship is almost wholly unrecognizable. Recall that progressive communitarians emphasize notions of trust and mutual interdependence between corporate constituents. According to Marleen O'Connor, for example, trust evolves over time in a relationship as the parties prove themselves to be trustworthy.<sup>79</sup> Further, she opines, trust arises as feelings of fellowship develop.<sup>80</sup> In today's market, however, individuals increasingly hold widely diversified portfolios, usually through pension or mutual funds.<sup>81</sup> For such investors, corporate stock evidences not a relationship of trust and mutual interdependence, but a commodity little different from pork bellies.

This observation relates back to the distinction drawn above between process and outcome bargains. A diversified shareholder typi-

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<sup>78</sup> Criticizing progressives for failing to offer a plausible alternative to the law and economics model of human behavior is perhaps slightly unfair, because doing so does not seem to be their main goal. Instead, the progressive project is nothing less than a wholesale remaking of society, such that retaking corporate law from the contractarians thus seems to be more a means than an end. Cf. Mitchell, *supra* note 21, at xiv (arguing that unlike earlier corporate social responsibility scholars, many of *Progressive Corporate Law's* authors are less concerned with imposing social constraints on corporations than with remaking corporations in the progressive image).

<sup>79</sup> O'Connor, *supra* note 66, at 223.

<sup>80</sup> *Id.* In fairness, it should be acknowledged that O'Connor's essay focuses on workers' rights, not the shareholder-corporate relationship. However, other essays in the book rely upon the communitarian model to explain the shareholder-corporation relationship. See Bratton, *supra* note 11, at 140; Mitchell, *supra* note 49, at 184.

<sup>81</sup> See ROE, *supra* note 18, at 125 (presenting tabular data indicating that in 1993 46.9% of the equity market was controlled by pensions, and mutual funds and insurers).

cally buys shares without paying much more attention to the corporate contract than one pays to the car rental lease agreement. The investor's lack of concern is premised not on trust of corporate management, but on comparison of the risk involved in failing to familiarize oneself with the corporation's organic documents to the opportunity cost of doing so.

The one situation in which the corporate-shareholder relationship might fairly be characterized as one of trust and mutual interdependence is the closely-held corporation. Only here do we find the degree of mutual interaction likely to give rise to the sort of evolutionary process O'Connor describes. In the close corporation context, however, the transaction costs of bargaining are far lower than in a public corporation. The contractarian model thus seems especially apt for the close corporation context.

In contrast, the communitarian model posits that:

the retired teacher in California who has invested in Union Carbide stock through participation in California Public Employee Retirement System, the factory worker in Pennsylvania, and the relatives of a dead peasant in central India all belong to a single community characterized by ties of mutual interdependence and a history of cooperative activity.<sup>82</sup>

Tellingly, David Millon elsewhere opines that the communitarian argument as applied to such firms strains credulity past the breaking point.<sup>83</sup> The conservative contractarian concurs with Millon that any effort to ascribe communitarian values to multinational corporations is doomed.<sup>84</sup> Instead, the conservative contractarian finds communi-

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<sup>82</sup> Millon, *Personifying the Corporate Body*, *supra* note 22, at 127. Deborah DeMott's review of *Progressive Corporate Law* correctly points out that the communitarian project fails to account for changes in both the workforce and the investor community. DeMott, *supra* note 13, at 1323-24.

<sup>83</sup> Millon, *Personifying the Corporate Body*, *supra* note 22, at 127. As Millon in effect concedes, there is a fundamental flaw in any effort to develop a communitarian account of the large public corporation. Roberta Romano explains why the leftist vision embraced by most of *Progressive Corporate Law's* authors is essentially inconsistent with large public corporations:

Adherents of this vision maintain that the decentralization of corporate organizations, involving direct participation in firm decisionmaking by all members, is a prerequisite for establishing fully participatory political structures. For a decentralized communitarian system to work, societal units, being predicated on the economic and political equality of their members, must possess attributes of smallness and sameness. These characteristics cannot survive within large hierarchical corporations, whose dynamics undermine and destabilize the egalitarian basis of social relationships.

Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 948 (1984) (footnotes omitted).

<sup>84</sup> Russell Kirk was notably critical of large corporations. *E.g.*, RUSSELL KIRK, *THE POLITICS OF PRUDENCE* 117-24 (1993) (blaming the large automakers for many of Detroit's ills). In contrast, Michael Novak has tried very hard to impart a communitarian gloss to the business corporation. *E.g.*, NOVAK, *supra* note 68, at 29 ("In the economic sphere today

tarian values in smaller settings: neighborhoods, churches, social clubs, and even in pockets of the internet.

## 2. *The Predictive Power of Progressive Corporate Communitarianism*

As discussed above, the law and economics school's predictive models of human behavior are, more or less, subject to testing.<sup>85</sup> The predictions generated by these models are generally "borne out by the empirical evidence."<sup>86</sup> What does the progressive communitarian approach offer as a replacement? Consider a concrete example taken from the core of the progressive communitarian project: the corporate law rights of nonshareholder constituencies. I adopt an admittedly somewhat awkward phrase, "stakeholderism," for those who support the idea that corporations should be responsive to the interests of workers, consumers, and communities, not just to those of shareholders. Many of *Progressive Corporate Law's* authors embrace some version of this stakeholderist ideal.<sup>87</sup>

Corporate law is concerned almost solely with the rights and interests of shareholders and, to a far lesser extent, creditors. The issue here is whether the regulatory purview of corporate law should be expanded to include the corporation's relationships with other corporate constituencies. Should directors be empowered, or even required, to consider the effect of their decisions on constituencies other than shareholders? Contractarians believe that nonshareholder constituencies are adequately protected through contract and/or general welfare law. Accordingly, corporate law should not be called upon to provide these constituencies with extra protections.<sup>88</sup> Stakeholderists emphatically reject this claim.<sup>89</sup>

Most stakeholderist scholarship focuses on the corporate law rights of employees.<sup>90</sup> According to the stakeholderists, perceptions of procedural justice are important to corporate efficiency. Granting employees a voice in corporate decisionmaking promotes a sense of

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sociality seems far more prevalent than individualism."). As we shall see below, Novak's argument becomes more plausible if we treat the corporation not as a single community, but as a collection of many smaller communities.

<sup>85</sup> See *supra* notes 34-49 and accompanying text.

<sup>86</sup> Ulen, *supra* note 61, at 488-89.

<sup>87</sup> See, e.g., Millon, *supra* note 21, at 4-10; O'Connor, *supra* note 66, at 219-24; Lewis D. Solomon, *On the Frontier of Capitalism: Implementation of Humanomics by Modern Publicly Held Corporations—A Critical Assessment*, in *PROGRESSIVE CORPORATE LAW*, *supra* note 1, at 281, 281-85.

<sup>88</sup> See, e.g., Bainbridge, *supra* note 33, at 1443-44.

<sup>89</sup> See, e.g., Millon, *supra* note 21, at 4-10.

<sup>90</sup> Notable exceptions include important articles on bondholders by Lawrence Mitchell and William Bratton. William W. Bratton, Jr., *Corporate Debt Relationships: Legal Theory in a Time of Restructuring*, 1989 DUKE L.J. 92; Lawrence E. Mitchell, *The Fairness Rights of Corporate Bondholders*, 65 N.Y.U. L. REV. 1165 (1990).

justice, increasing trust and commitment within the enterprise, and, in turn productivity.<sup>91</sup> The theory seems to hold that having a say in corporate decisionmaking leads workers to view their efforts as part of a collaborative undertaking, rather than as just a job. In turn, this leads to enhanced job satisfaction, which results in a greater intensity of effort and ultimately to a more efficient firm.

Although this view of employee involvement has become nearly hegemonic among the stakeholderists, it is perhaps most closely associated with my friend Marleen O'Connor, who has done much of the progressives' heavy lifting in this area. In a series of articles, she has argued for various changes in corporate and labor law designed to protect and empower workers.<sup>92</sup> At the core of her argument is Leibenstein's concept of x-inefficiency: the gap between the firm's actual productive output and the output level that could be achieved under ideal circumstances.<sup>93</sup> The size of this gap is supposedly correlated to the extent to which a firm includes its employees in the decisionmaking process. As the theory goes, workers who view their jobs as part of a collaborative process will work harder than workers who are subjected to traditional hierarchical monitoring.<sup>94</sup>

This presents an opportunity to test the predictive power of progressive communitarianism. If the stakeholderist models are valid, there should be empirical evidence demonstrating a link between employee participation in corporate decisionmaking, worker morale, and firm productivity.<sup>95</sup>

One major review of the empirical literature concludes that results of employee involvement studies are all over the map, ranging from no benefit, to inconclusive results, to findings of substantial gains.<sup>96</sup> A frequently cited meta-review of twenty-nine studies likewise

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<sup>91</sup> See, e.g., Dallas, *supra* note 21, at 44.

<sup>92</sup> E.g., O'Connor, *supra* note 66; Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899 (1993) [hereinafter O'Connor, *Human Capital*].

<sup>93</sup> HARVEY LEIBENSTEIN, *INSIDE THE FIRM: THE INEFFICIENCIES OF HIERARCHY* 32 (1987); see also O'Connor, *supra* note 66, at 224.

<sup>94</sup> See O'Connor, *supra* note 66, at 224.

<sup>95</sup> Despite the plethora of empirical studies published on employee involvement in corporate decisionmaking, much of the evidence is of dubious worth. Many studies are anecdotal in nature. Failures tend to be under-reported. See GUILLERMO J. GRENIER, *INHUMAN RELATIONS: QUALITY CIRCLES AND ANTI-UNIONISM IN AMERICAN INDUSTRY* 9 (1988). Hidden costs that should be reflected in a valid cost-benefit analysis are ignored. See JOHN L. COTTON, *EMPLOYEE INVOLVEMENT* 64 (1993). Moreover, many studies derive their conclusions from self-appraisal by managers. See *id.* at 46. Given that those same managers presumably were responsible for adopting employee participation programs in the first place or report to those who adopted them, management-derived data is likely to be biased. All of these flaws tend to undermine any claim that the communitarian model of the employment relationship has empirical support.

<sup>96</sup> See COTTON, *supra* note 95, at 14-17 (reviewing various meta-analyses of the empirical research published in this area).

found only fourteen that reported measurably positive effects of employee participation on productivity, two that found negative effects, and thirteen that were inconclusive.<sup>97</sup> In sum, there seems to be no conclusive evidence that employee involvement in corporate decision-making leads to any identifiable long-term economic benefits.<sup>98</sup>

Stakeholderists are likely to object on the grounds that empirical research on voluntary ad hoc participation programs tells us relatively little about the likely effect of legally mandated worker involvement in corporate governance. Instead, the stakeholderists commonly point to Japan and Germany, and assert that their firms are more efficient than United States firms, precisely because those nations mandate employee involvement.<sup>99</sup> Although admirers of German and Japanese corporate systems claim they promote long-term commitments to the firm and investments in firm-specific assets by workers, this claim is not supported by the evidence.<sup>100</sup> Despite conventional wisdom about German and Japanese competitive success, American enterprise in many respects is winning the global competitiveness war.<sup>101</sup> Over the last decade, in fact, the U.S. economy has performed as well or better than those of Japan or Germany.<sup>102</sup> As a result, Japanese and German growth rates no longer exceed the U.S. rate, for example, as they did during the post-war recovery period.<sup>103</sup>

On close examination, moreover, the evidence on employee involvement in Germany and Japan falls far short of making a compel-

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<sup>97</sup> See U.S. DEP'T OF LABOR, *HIGH PERFORMANCE WORK PRACTICES AND FIRM PERFORMANCE* 5-9 (1993). In general, the Department of Labor concludes that employee involvement is most likely to have positive effects when linked with other high performance programs (such as skills training and pay for performance). *Id.* at 15. This may suggest that such programs have effects swamping those of employee involvement policies. See also THOMAS A. KOCHAN ET AL., *THE TRANSFORMATION OF AMERICAN INDUSTRIAL RELATIONS* 153-77 (2d ed. 1994) (summarizing case studies showing generally positive but variable results). But see Arnold E. Perl, *Employee Involvement Groups: The Outcry over the NLRB's Electromation Decision*, 44 LAB. L.J. 195, 204-06 (1993) (summarizing studies finding positive economic effects of those programs).

<sup>98</sup> It is also noteworthy that some prominent employee involvement experts express skepticism about claims that this approach has any positive productivity effect. See, e.g., GRENIER, *supra* note 95, at 6-10 (raising doubts about the efficacy of quality circles); RAYMOND L. HOGLER & GUILLERMO J. GRENIER, *EMPLOYEE PARTICIPATION AND LABOR LAW IN THE AMERICAN WORKPLACE* 103 (1992) (finding that "despite acclaim for the improved productivity achieved through employee participation and 'Quality Circles,' the evidence to support the proposition is not altogether convincing, particularly in nonunion workplaces"); David I. Levine, *Public Policy Implications of Imperfections in the Market for Worker Participation*, 13 ECON. & INDUS. DEMOCRACY 183, 185 (1992) (noting that most employee involvement plans are unsuccessful, but claiming that those few following Levine's criteria succeed).

<sup>99</sup> See, e.g., O'Connor, *Human Capital*, *supra* note 92, at 912-13.

<sup>100</sup> See ROE, *supra* note 18, at 254-56.

<sup>101</sup> See Hobart Rowen, *Challenging Convention on Productivity*, WASH. POST, Nov. 22, 1992, at H1.

<sup>102</sup> See *Stakeholder Capitalism*, ECONOMIST, Feb. 10, 1996, at 23, 23-24.

<sup>103</sup> See *id.* at 24.

ling case for the progressive communitarian account. Employee involvement is both less pervasive and less successful in Japan than the proponents of mandatory employee participation acknowledge.<sup>104</sup> According to one report only one-third of the quality circles used by Japanese firms have proven successful over time.<sup>105</sup> Another report opines that Japanese employee participation programs have the function of promoting organizational learning, but tend to withhold meaningful power from employees.<sup>106</sup> German-style codetermination has been found to have the least impact on productivity and employee attitudes of any participatory management scheme.<sup>107</sup> Indeed, while studies of codetermination often have been inconclusive, some have shown it to have negative productivity results.<sup>108</sup> Finally, although countries practicing stakeholderism ought to enjoy high and stable employment, both the United States and England have lower unemployment rates than Germany (albeit not lower than Japan).<sup>109</sup>

Interestingly, stakeholderism is currently under attack in both Germany and Japan. In Germany, the combined pressures of high production costs and international competition have encouraged large German firms to shift production abroad to less regulatory states.<sup>110</sup> There is also growing political pressure to deregulate German labor laws.<sup>111</sup> A similar pattern has been observed in Japan.<sup>112</sup> Even more strikingly, some large Japanese firms appear to be shifting their focus to shareholder wealth maximization.<sup>113</sup>

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<sup>104</sup> *The Economist* points out that although Japan consistently invests more of its GDP than other countries, the German investment rate is comparable to that of the United States and England. *Id.* Conceding that GDP does not pick up investments in firm-specific human capital, this nevertheless tends to undermine the progressive communitarian argument.

<sup>105</sup> See COTTON, *supra* note 95, at 78.

<sup>106</sup> Motohiro Morishima et. al., *Industrial Democracy in Selected Pacific Rim and European Countries 12* (Presentation at the Conference on Industrial Democracy Issues for the 21st Century, University of Illinois at Urbana-Champaign College of Law, Apr. 12, 1995) (copy on file with author).

<sup>107</sup> See COTTON, *supra* note 95, at 232.

<sup>108</sup> See *id.* at 118-21. One especially surprising study found that, for German firms that became subject to codetermination by virtue of a 1976 statute, productivity declined but profitability increased. See Michael A. Gurdon & Anoop Rai, *Codetermination and Enterprise Performance: Empirical Evidence from West Germany*, 42 J. ECON. & BUS. 289, 298-300 (1990). The authors do not clearly explain this seeming contradiction. A more recent study of German firms affected by the 1976 statute found that they suffered declines in both productivity and profitability while experiencing no decline in labor costs. See Felix R. FitzRoy & Kornelius Kraft, *Economic Effects of Codetermination*, 95 SCANDINAVIAN J. ECON. 365, 368-73 (1993).

<sup>109</sup> See *Stakeholder Capitalism*, *supra* note 102, at 24.

<sup>110</sup> See *id.* at 25.

<sup>111</sup> See *id.*

<sup>112</sup> See *id.*

<sup>113</sup> See *id.*

One should not succumb to the temptation to score a debater's point by arguing that this evidence points to the inescapable superiority of American corporate governance and industrial relations. The impact of corporate governance rules on productivity and competitiveness is undoubtedly swamped by other economic and political factors.<sup>114</sup> At the very least, however, this evidence tends to undermine any claim that the stakeholderist story has predictive power.

The communitarian model's lack of predictive power is especially apparent when one begins to evaluate progressive proposals for expanding corporate law's regulatory jurisdiction to include the rights of nonshareholder constituencies. Marleen O'Connor, for one, argues in favor of a multifiduciary duty running from directors to workers.<sup>115</sup> Space does not permit me to rehash the arguments I have made elsewhere against the creation of such a duty.<sup>116</sup> It suffices to note David Millon's observation that multifiduciary duties of this sort are inherently indeterminate.<sup>117</sup> Ironically, the need for a more determinate alternative ultimately leads Millon to embrace a modified form of contractarianism.<sup>118</sup>

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<sup>114</sup> Roberta Romano persuasively argues both that perceived disparities between U.S. and Japanese or German productivity are incorrectly overstated in favor of the latter and that there is no evidence to support the claim that any such disparities are causally linked to corporate governance arrangements. Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 YALE L.J. 2021, 2023-26 (1993).

<sup>115</sup> O'Connor, *supra* note 66, at 219-21.

<sup>116</sup> Bainbridge, *supra* note 33, at 1432-46 (explaining how multi-fiduciary model would encourage managerial misconduct); see also Michael E. DeBow & Dwight R. Lee, *Shareholders, Nonshareholders and Corporate Law: Communitarianism and Resource Allocation*, 18 DEL. J. CORP. L. 393, 418-22 (1993) (discussing the increased transaction costs and loss of efficiency that would result from adopting the progressive corporate communitarian agenda).

In addition to the points made in my earlier article, and those made by DeBow and Lee, however, a word should be said about path dependency. Stakeholderists rarely give much credence to the power of path dependency. For example, Lynne Dallas acknowledges that legal rules, social and cultural norms, and self-interest encourage management fidelity to shareholder wealth maximization, but contends that managers might willingly pursue non-wealth maximization goals, if "legal rules, social norms, or cultural values change." Dallas, *supra* note 21, at 46. This argument ignores the basic fact that the United States started at a different point than did Japan and Germany, which favored a different path. Institutions grew up in all three economies in response to the initial choice, deepening path dependency. As to the role of path dependency in corporate law, see Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641, 643-62 (1996). In sum, path dependence confirms Montesquieu's observation that law cannot be expected to develop universal patterns:

For men's circumstances vary mightily one from another—affected by climate, by soil, by extent of country, by historic experience, by customs and habits, by strategic situation, by commerce and industry, by religion, by a multitude of other influences. Therefore every people develop their own particular laws, and rightly so.

KIRK, THE ROOTS OF AMERICAN ORDER 352 (1991) (discussing Montesquieu's theory of law).

<sup>117</sup> Millon, *supra* note 21, at 13; cf. O'Connor, *supra* note 66, at 230-34.

<sup>118</sup> Millon, *supra* note 21, at 22-30.

## B. Communitarians to the Left; Communitarians to the Right

At this point it is necessary to define the term "conservative contractarian." I intend the phrase to embrace only those corporate law scholars who accept the nexus-of-contracts model (and Economic Man) as the operational theory of the firm. But how does the conservative contractarian differ from mainstream contractarians? The answer lies in the scholar's political world view. Most contractarians, at least insofar as corporate law is concerned, are liberals in the classical sense.<sup>119</sup> The link between contractarianism and classical liberalism arguably derives from the essentially atomistic perspective of the nexus-of-contracts model. Contractarianism regards the corporation as a legal fiction created by the bargains struck between consenting individuals.<sup>120</sup> The fact that the autonomous individual is the basic analytical unit of both world views<sup>121</sup> makes it quite natural for those who embrace one to accept the other.<sup>122</sup>

In contrast, the conservative contractarian is informed by the Burkean tradition that rejects the cult of the autonomous individual. Tory conservatism envisions a community of the spirit, bound together by chains of custom, prescription, loyalty, and honor.<sup>123</sup> Conservatives believe that only someone "bemused by reductions and abstractions" would doubt that "within a (largely) market economy there are going to be all sorts of non-economic groupings and activi-

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<sup>119</sup> Consider Mark Roe's observation that "[m]any [corporate and business law scholars] have an underlying policy preference for limiting government directives." Roe, *supra* note 116, at 667-68. Consider also Richard Posner's rejection of natural law. See Phillip E. Johnson, *Nihilism and the End of Law*, FIRST THINGS, Mar. 1993, at 19, 20-21 (presenting a conservative critique of Posner's position on natural law). Although Posner is a contractarian, he is not, by any meaningful definition of the term, a conservative. Russell Kirk's classic "canons of conservative thought" include six elements: (1) belief in a transcendent order and natural law; (2) rejection of egalitarianism and utilitarianism; (3) support for class and order; (4) belief in the linkage between freedom and private property; (5) faith in prescription and custom; and (6) recognition that change is not necessarily salutary reform. KIRK, *supra* note 11, at 8-9. Posner fails at least two-and-a-half of these tests. Instead, as are many other contractarians, Posner is most accurately described as a pragmatic classical liberal. RICHARD A. POSNER, *OVERCOMING LAW* 23 (1995).

<sup>120</sup> See Romano, *supra* note 83, at 933.

<sup>121</sup> Judge Posner explicitly links the common law's tendency towards wealth maximization with nineteenth century "laissez-faire ideology, which resembles [the] wealth maximization" norm of law and economics. POSNER, *supra* note 61, at 359.

<sup>122</sup> Hence, David Millon's observation that communitarian corporate law scholars are distinguished by their focus on "the sociological and moral phenomenon of the corporation as community," as opposed to the "individualistic, self-reliant, contractarian stance" of mainstream corporate scholars. Millon, *supra* note 21, at 1. William Bratton similarly characterizes contractarians as social Darwinists concerned with forcing society to evolve into a model in which everyone is capable of self-protection and is fully self-reliant. Bratton, *supra* note 11, at 150-52.

<sup>123</sup> See, e.g., KIRK, *supra* note 11, at 483-88 (discussing the conservative reaction against the decline of community); KIRK, *supra* note 84, at 22-23 (listing upholding of voluntary communities as one of ten basic conservative principles).

ties that exercise a powerful influence on life as it is actually lived."<sup>124</sup> In all aspects of life, including intracorporate relations, there always occur relationships of trust, unspoken understandings, settled expectations, and commitments that must be honored.<sup>125</sup> It is precisely for this reason that I rejected above any suggestion that either the nexus-of-contracts model or Economic Man represented a fully realized social construct.<sup>126</sup> The conservative contractarian accepts these models as first approximations, useful for predicting the behavior of large masses of people, but nothing more. More importantly, the conservative contractarian further concedes that economic efficiency must sometimes give way to virtue.<sup>127</sup>

In evaluating a legal regime, the conservative contractarian is thus concerned not only with efficiency, but also with social order and individual virtue.<sup>128</sup> The conservative contractarian does not inquire only into the Pareto optimality<sup>129</sup> of a given regime, but also asks of it such questions as: Does this regime empower people to lead more virtuous lives? Does this regime promote ordered liberty, tyranny, or license?

At first blush, it may seem that the conservative contractarian has much in common with the authors of *Progressive Corporate Law* and, indeed, there is a subtle and perhaps amusing irony at work here. In at least some rhetorical respects, there is a surprising degree of similarity between progressive communitarianism and the philosophical underpinnings of modern social conservatism. For example, there is a particularly strong communitarian impulse among religious conservatives,<sup>130</sup> who place great importance upon local communities and other mediating institutions as buffers against the encroaching powers of the central state and the debased elites who set the moral tone of secular society.<sup>131</sup>

<sup>124</sup> Hart, *supra* note 67, at 60.

<sup>125</sup> *Id.*; accord Francis Fukuyama, *The Economics of Trust*, NAT'L REV., Aug. 14, 1995, at 42, 42-43.

<sup>126</sup> See *supra* Parts I, II.

<sup>127</sup> Cf. KIRK, *supra* note 84, at 122 ("A society that thinks only of alleged Efficiency, regardless [of] the consequences to human beings, works its own ruin.").

<sup>128</sup> As to the conservative understanding of order, see KIRK, *supra* note 116, at 3-5. For a discussion of the conservative understanding of virtue, see *id.* at 99.

<sup>129</sup> A Pareto optimal situation is one which is Pareto efficient; i.e., one in which it is impossible to make one person better off without making another person worse off. See ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 12 (2d ed. 1997).

<sup>130</sup> Cf. Mark G. Malvasi, *Quem Patrem? M.E. Bradford's Southern Patrimony*, MOD. AGE, Winter 1996, at 143, 147 ("He knew the calamity that the autonomous self could visit upon the rest of mankind when liberated from a sense of responsibility to society and to God."). Of course, not all conservatives accept the communitarian vision. See, e.g., J. Budziszewski, *The Problem With Communitarianism*, FIRST THINGS, Mar. 1995, at 22.

<sup>131</sup> On the communitarian streak in modern social conservatism, see Michael W. McConnell, *The Counter-Revolution in Legal Thought*, POL'Y REV., Summer 1987, at 18. The

The communitarian themes in the progressive critique also bear a striking resemblance to the renewed social conservative interest in virtue. Virtue expressly comprises a willingness to act against personal interest, something Economic Man never does. Because Economic Man is both an autonomous individual and a purely rational calculator, the model of human behavior it provides leaves conservatives unsatisfied, precisely because it fails to account either for important social intermediating institutions or for virtue.<sup>132</sup>

The communitarian movement holds an obvious attraction for social conservatives. In their world view, intermediating institutions such as churches, schools, and social clubs develop citizens holding a shared set of values: virtue, trust, responsibility, and the like. Inculcation of these values often runs afoul of the state-sanctioned cult of the autonomous individual. Conservative communitarians deplore the rise of this rights-based "culture which 'dignifies with high moral purpose what often amounts to low private interests or desires.'"<sup>133</sup> It is ironic that the progressives represented in *Progressive Corporate Law* should embrace a set of communitarian ideals in the economic sphere that could easily lead to results in the social sphere they would presumably abhor.

On close examination, of course, the parallels between progressive and conservative communitarianism break down. Despite some superficial rhetorical similarities between the two camps, conservatives and progressives embrace different, largely incompatible values. Where Tories worry about virtue, progressives worry about self-actualization.<sup>134</sup> Where Tories worry about private property rights, progressives worry about the impact of humans on the environment.<sup>135</sup> As we shall see, these differences come to a head in contrasting attitudes towards the proper role of state, which is precisely why the main-

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world view I have in mind here is exemplified, at its very highest level, by Russell Kirk's critique of Locke:

Except for some references to "tacit consent" by later generations to the social compact, Locke has nothing to say about the Christian view of society as a bond between God and man, and among the dead, the living, and those yet unborn. There is no warmth in Locke, and no sense of consecration. His social compact is a far cry from the words in Genesis, "I do set my bow in the cloud, and it shall be a token of a covenant between me and the earth." Utility, not love, is the motive of Locke's individualism. Locke's isolated individual, a kind of social atom, has the possibility of life, of liberty, of property. But what sort of life, and liberty for what?

KIRK, *supra* note 116, at 287.

<sup>132</sup> Cf. KIRK, *supra* note 84, at 118-19 ("That same infatuation with 'rationalism' which terribly damages communal existence also produces an unquestioning confidence in the competitive market economy and leads to a heartless individualism . . .").

<sup>133</sup> George Weigel, *Capitalism for Humans*, COMMENTARY, Oct. 1995, at 34, 37.

<sup>134</sup> See, e.g., Solomon, *supra* note 87, at 283-84.

<sup>135</sup> See, e.g., *id.* at 285.

stream contractarian, not the progressive communitarian, turns out to be the natural ally of the conservative contractarian.<sup>136</sup>

Here then is the essential conservative contractarian: one who seeks to reconcile conservative principle and economic theory by duplicating Russell Kirk's ability "consistently to favor free markets, private property, competition, and at the same time to champion virtue."<sup>137</sup> That this path is not always easy, nor always generative of clear answers, does not reduce its import to conservative contractarianism.

### 1. *Finding Statist Snakes in the Communitarian Grass*

While the conservative contractarian does not deny the importance of trust between, say, worker and firm for the effective internal functioning of corporations, he notes that trust arises from shared values.<sup>138</sup> Consider an almost wholly ignored bit of evidence from the stakeholderism debate. As we have seen, progressive communitarians focus extensively on the role of trust in the employment relationship.<sup>139</sup> Yet they fail to acknowledge evidence that worker participation in corporate decisionmaking is most effective in homogeneous work forces.<sup>140</sup> This evidence is consistent with the work of economic and political theorists who opine that trust is most likely to arise within homogeneous groups.<sup>141</sup> If we may assume that most of *Progressive Corporate Law's* authors share Lewis Solomon's apparent support for the Left's diversity agenda,<sup>142</sup> the progressive communitarian agenda would seem to suffer from a serious internal weakness.

Even within a homogeneous group, of course, individual interests are likely to be varied and in conflict. If nothing else, the basic eco-

<sup>136</sup> See *infra* Part III.B.2.

<sup>137</sup> William F. Campbell, *An Economist's Tribute to Russell Kirk*, INTERCOLLEGIATE REV., Fall 1994, at 68, 69.

<sup>138</sup> Lawrence Mitchell concedes that "trust may require shared values," without grappling with the implications of the relationship between these two entities. Mitchell, *supra* note 49, at 195.

<sup>139</sup> See *supra* Part III.A.

<sup>140</sup> See Robert Drago, *Share Schemes, Participatory Management and Work Norms*, 23 REV. RADICAL POL. ECON. 55, 59 (1991).

<sup>141</sup> For a theoretical demonstration that trust- and reputation-based systems of exchange can lead to a market being monopolized by a small group, "possibly sharing ethnic identity," see Marcel Fafchamps, *Market Emergence, Trust, and Reputation* (Apr. 1996) (unpublished manuscript, on file with author). Donald McCloskey likewise notes that the importance of trust to market exchange may explain why members of the same ethnic group are able to deal so profitably with one another. Donald McCloskey, *Bourgeois Virtue*, AM. SCHOLAR, Spring 1994, at 177, 183-84. J. Budziszewski argues that because the polity is a community of communities a strategic mutual accommodation can be reached only by those sub-communities whose value systems share some common ground. "For instance Catholics, Orthodox, evangelical Protestants, and religious Jews might be able to reach such an accommodation." Budziszewski, *supra* note 130, at 26.

<sup>142</sup> Solomon, *supra* note 87, at 298-99 (appraising Ben & Jerry's diversity).

nomic principle of scarcity suggests a certain amount of intragroup competition for scarce resources. These conflicts are inevitably more pronounced in the absence of familial or tribal ties. If contractarians fail to give due weight to the value of trust, perhaps it is because progressives have failed to offer a plausible account of why a corporation's various constituencies should trust one another.<sup>143</sup> Put another way, trust is a virtue with significant social benefits. Most people probably benefit from behaving in a trustworthy manner most of the time, which means trust also has considerable survival value. Precisely because trust is a virtue, however, the question arises: Can we assume virtuous behavior on the part of the unwashed masses of a secular society?

According to Donald McCloskey, "It is usual to praise a pagan or a Christian virtue and then to complain how much we moderns lack it. Shamefully we bourgeois are neither saints nor heroes. The age is one of mere iron—or aluminum, or plastic—not pagan gold or Christian silver."<sup>144</sup> No realistic social order can assume "heroic or even consistently virtuous behavior" by its citizens.<sup>145</sup> All men have sinned.<sup>146</sup> Everybody puts self-interest ahead of altruism some of the time. Hence, trust is a commodity that is not easily bought. Or, as Ronald Reagan famously opined, "trust, but verify."

A realistic social order must be designed around principles that fall short of ideal virtues.<sup>147</sup> Effective legal rules and reliable predictions about human behavior must be based upon the fallen state of human beings, which is precisely what economic analysis does and progressive communitarianism fails to do. Communitarianism demands a standard of behavior that most members of an unredeemed society are unable or unwilling to meet most of the time.<sup>148</sup> Hence it is not surprising that failed communitarian utopias abound in world history.<sup>149</sup>

The basic bone of contention between conservative and progressive scholars thus remains the old problem of the perfectibility of human nature.<sup>150</sup> Conservatives blame human misery on causes

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<sup>143</sup> Progressive communitarians resemble the political type Romano defines as "organists," who avoid the problem described here by simply denying the possibility of either intra- or even inter-group conflict. Romano, *supra* note 83, at 931-32. We shall see that this approach requires some rather unrealistic assumptions about human nature. See *infra* Part III.B.2.b.

<sup>144</sup> McCloskey, *supra* note 141, at 178.

<sup>145</sup> NOVAK, *supra* note 68, at 28.

<sup>146</sup> See Romans 5:12.

<sup>147</sup> See NOVAK, *supra* note 68, at 28.

<sup>148</sup> See POSNER, *supra* note 61, at 416.

<sup>149</sup> See *id.*

<sup>150</sup> David Millon elsewhere offered a different take on the root issue that divides contractarians and communitarians. Millon, *Personifying the Corporate Body*, *supra* note 22, at

which lurk naturally within the souls of men: pride, vanity, jealousy, greed, and insatiable or unruly desires. Conservatives are skeptical about the prospect of human perfectibility and suspicious of utopian projects, mostly because they must be "conducted by imperfect . . . human beings, [who are] always dangerously unfit to remake the world."<sup>151</sup> In contrast, progressives "believe that education, positive legislation, and alteration of environment can produce men like gods; they deny that humanity has a natural proclivity toward violence and sin."<sup>152</sup>

If we conservatives are right, the progressive communitarian agenda for corporate law cannot be attained without invoking the state's monopoly on coercive force. As we shall see, many of *Progressive Corporate Law's* authors propose defining a set of honorable or trustworthy conduct to which corporate actors will be expected to adhere. Who would get to define the standard of conduct? What should we do about inevitable breaches of that standard? The answers to these questions reveal the essentially statist nature of the progressive agenda in *Progressive Corporate Law*. Because this is a serious charge, let us consider the evidence author by author.

According to David Millon, communitarians posit that corporations have obligations to employees and other nonshareholder constituencies that extend beyond mere contractual obligation.<sup>153</sup> By taking this position, Millon's communitarians must be willing to use the state's coercive power to enforce such obligations against nonconsenting shareholders and their managerial representatives. Indeed, Millon acknowledges that communitarians "would be eager to entertain arguments for law reform aimed at addressing bargaining outcomes that are substantively unfair."<sup>154</sup> In other words, they are willing to use the state's judicial arm to rework voluntary arrangements created through bargains that they find to be oppressive.

William Bratton cogently anticipates the argument that trust is a fragile commodity, which leads inexorably to the need for a "coercive backstop."<sup>155</sup> Or, as Bratton explains, "Doubts about the prevalence

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125-26. Millon identifies two models of human nature: Economic Man and the trusting soul of the communitarian vision. According to Millon, the debate between communitarians and contractarians is not amenable to resolution because both models are grounded in reality. *Id.* Although I concur with Millon that the debate is unlikely to be resolved, I assert that the proper debate is not between Economic and Communitarian man, but between the liberal and conservative perspectives on the perfectibility of human nature.

<sup>151</sup> Leon R. Kass, *Farmers, Founders, and Fratricide: The Story of Cain and Abel*, *FIRST THINGS*, Apr. 1996, at 19.

<sup>152</sup> KIRK, *supra* note 11, at 10.

<sup>153</sup> Millon, *supra* note 21, at 7-9.

<sup>154</sup> *Id.* at 9; see also *id.* at 11 ("[a]dditional legal structures must reinforce and supplement whatever gains people can achieve through contract.").

<sup>155</sup> Bratton, *supra* note 11, at 165.

of honor in the population can be mitigated by a backstop regime of legal protection that enforces honor."<sup>156</sup> In effect, Bratton proposes empowering the state to define what constitutes honorable behavior, and bringing the state's monopoly on the use of coercive force to bear on those who deviate from the state-imposed code.<sup>157</sup>

Lawrence Mitchell unabashedly asserts that "[a]t this point in our history, the dominant institution is the state,"<sup>158</sup> thereby relegating to insignificance the host of intermediary institutions that protect individual liberty against state encroachment. This does not seem to trouble Mitchell, so long as the state uses its monopoly on coercive force to achieve the chosen progressive ends of trust and community. According to Mitchell, the state currently privileges individual autonomy over "the values of community built upon the foundation of trust."<sup>159</sup> But what is the alternative? Authoritarian enforcement of community values? Apparently so, for Mitchell, acknowledging the vulnerability of trust to self-interest, proposes legal changes designed to reinforce trust.<sup>160</sup> Despite his disclaimers of loyalty to liberal principles,<sup>161</sup> Mitchell's position is inevitably statist. As does Bratton, Mitchell essentially proposes to define a code of conduct deemed trustworthy and to empower the state to require adherence to that standard.

Marleen O'Connor expects firms to recognize that "employee participation in workplace governance is valuable because it achieves human values by enhancing worker dignity."<sup>162</sup> As such, her argument resembles "New Left visions of participatory democracy, in which, as the critical legal scholar Karl Klare has put it, 'the struggle [is] to make the workplace a realm of free self-activity and expression.'"<sup>163</sup> Despite its democratic rhetoric, this view of worker empowerment contains within it the seeds of statism. Consider O'Connor's proposal to use fiduciary law's "socializing power to promote and reinforce trust and honesty in business transactions."<sup>164</sup> As is the case with

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<sup>156</sup> *Id.* at 160.

<sup>157</sup> In correspondence, Bratton has expressed pragmatic political views that reject the statist extremes of the progressive and communitarian ideals. He nevertheless continues to embrace a relatively active role for the state in regulating the behavior of corporate officers and directors. Bratton's April 12th letter, *supra* note 77.

<sup>158</sup> Mitchell, *supra* note 49, at 185.

<sup>159</sup> *Id.* at 186.

<sup>160</sup> *Id.* at 204-05.

<sup>161</sup> *Id.* at 205.

<sup>162</sup> O'Connor, *supra* note 66, at 234.

<sup>163</sup> David Brody, *Workplace Contractualism in Comparative Perspective*, in *INDUSTRIAL DEMOCRACY IN AMERICA: THE AMBIGUOUS PROMISE* 176, 177 (Nelson Lichtenstein & Howell John Harris eds., 1993) (quoting Karl E. Klare, *Judicial Deradicalization of the Wagner Act and the Origins of Modern Legal Consciousness, 1937-1941*, 62 MINN. L. REV. 265, 338-39 (1978)).

<sup>164</sup> O'Connor, *supra* note 66, at 232.

Bratton and Mitchell, O'Connor wants the state to define an acceptable code of corporate conduct and enforce obedience thereto.

To be fair, one cannot charge these modern progressives with precisely the same statist faults associated with the old Left. Instead of nationalization, the stakeholderists among them advocate regulation designed to protect nonshareholder constituencies and, in particular, to encourage their participation in corporate governance. But the difference is only in degree, not in kind. Instead of the state directly regulating corporate decisionmaking, as old-time leftists urged, these progressives seek to provide state-sponsored constituency groups (such as labor unions or environmentalists) the power to exercise some yet to be defined degree of control over corporate decisions.

The stakeholderists thus bring to mind Richard Epstein's observation that the Left no longer advocates direct government ownership of production. Instead, it operates on two different levels:

At a personal level, [modern socialism] speaks to the alienation of the individual, stressing the need for caring and sharing and the politics of meaning. At a regulatory level, it seeks to identify specific sectors in which there is market failure and then to subject them to various forms of government regulation.<sup>165</sup>

This is an especially apt description of Lewis Solomon's article. Solomon identifies a hierarchy of five sets of human needs, the highest of which is self-actualization.<sup>166</sup> "Moving from the premise that the development of human potential constitutes a key societal goal, humanomics looks to the restructuring of economic and political institutions to attain maximum human growth, autonomy, and participation."<sup>167</sup> Is this not precisely what Epstein describes as the first level of modern socialism?

Solomon's essay also forcefully illustrates Michael Novak's prediction that environmentalism may well replace socialism as the principal opponent of democratic capitalism.<sup>168</sup> According to Solomon, human development and ecological preservation are linked: "Humanomics as a political economy model may rest on a less affluent global lifestyle and more self-sufficient patterns of local production and consumption."<sup>169</sup>

<sup>165</sup> RICHARD A. EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD* 23 (1995).

<sup>166</sup> Solomon, *supra* note 87, at 283.

<sup>167</sup> *Id.* at 284.

<sup>168</sup> MICHAEL NOVAK, *THE SPIRIT OF DEMOCRATIC CAPITALISM* 435-36 (2d ed. 1991).

<sup>169</sup> Solomon, *supra* note 87, at 285. The irony, which is almost (but not quite) lost on Solomon, is that his two chosen models for the Humanomics firm are producers of luxury, high-cost consumer non-durables, namely, Ben & Jerry's (gourmet ice cream) and the Body Shop (cosmetics). *Id.* This illustrates Novak's observation that "antipathy to capitalism" is highest among certain elites: "aristocrats, clergy, scholars, artists, and of course government officials." NOVAK, *supra* note 168, at 434-35. Some of those listed are precisely

Stakeholderism is in some respects even more invidious than traditional socialism. Instead of economic power being exercised directly by the central government, state control would be dispersed throughout the economy.<sup>170</sup> This amounts to "the nationalization of people instead of companies, as individuals are subsumed by their officially designated communities."<sup>171</sup>

## 2. *Ordered Liberty and Corporate Law*

David Millon charges that "[b]ecause the corporate law contractarians offer nothing more than vaguely articulated libertarianism as the basis for their insistence on the primacy of contract in defining all intracorporate relationships, corporate law communitarians find the contractarians' normative agenda to be morally deficient, and quite obviously so."<sup>172</sup> I do not propose to rehash at great length the arguments against the statism that pervades the progressive communitarian agenda for corporate law, but a brief response to Millon's criticism seems both appropriate and necessary. The great difficulty with the progressive variant of communitarianism is that, if taken to its extreme, it views individuals as little more than cells of a larger organism. Just as doctors kill cells to prevent cancer from spreading, communitarianism readily justifies state intrusion into the private sphere in the name of some communal good.<sup>173</sup> As I explain below, this is precisely why conservatives have always balanced the communitarian elements of conservative philosophy with a strong commitment to ordered liberty. For conservative contractarians, the state's role is limited to that of a facilitator of private gain-seeking through provision of default rules. Hence, conservatives reject the progressive claim that the corporation is a creature of the state subject to regulation in the "public interest."

### a. *On Being Anti-Statist Without Being Anti-Community*

It may be argued that I overstate the statist elements of progressive communitarian thought. After all, it may be said, law by definition sets a standard that is enforced by the state. Yet this objection

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the sort of folks who have both the wealth to consume such products and the liberal bent to buy them from "socially responsible" companies.

<sup>170</sup> Cf. Rich Lowry, *Staking out the Center*, NAT'L REV., May 6, 1996, at 21, 22 (making a similar point with respect to Labour Party stakeholderism).

<sup>171</sup> *Id.* The links between stakeholderism and socialism should not be surprising, as the intellectual roots of stakeholderism can be found in Christian socialism. *See id.* at 21.

<sup>172</sup> Millon, *supra* note 21, at 7. William Bratton treats the ethical presuppositions of law and economics contractarianism with greater respect, acknowledging its anti-statist roots. Bratton, *supra* note 11, at 152.

<sup>173</sup> Ironically, the same is true of strict adherence to law and economics's wealth maximization norm. *See* POSNER, *supra* note 61, at 376-77.

simply illustrates the extent to which the nanny state has lulled us into allowing state mandates to displace private ordering.<sup>174</sup>

The difference between conservative and progressive communitarians is captured by the distinction between virtue and principle ethics.<sup>175</sup> Principle ethics are practiced by those who tend to propose rules as solutions to problems. In a principle-dominated ethical system, leading a moral life consists mainly of complying with society's mandated code of conduct. In contrast, virtue ethics reject codes of conduct in favor of context-based individual judgment. In a virtue-based ethical system, leading a moral life consists mainly of the habitual private exercise of truthfulness, courage, justice, mercy, and the other virtues.

Principle ethics seem especially attractive to progressive communitarians, who cannot envision a society in which trust and other virtues are solely a matter of private morality. Recall Professor Mitchell's preference for "a society emphasizing cooperation and cohesion" over "one that breeds conflict and enmity."<sup>176</sup> Why assume that these are the only conceivable states of society? Can we not imagine a society free of enmity or conflict, but which also values freedom from cohesion enforced by positive law? Can we not imagine a society of rugged individualists in which conflict is precluded by wary mutual respect? In other words, can we not imagine a society that resembles the American West (or, perhaps more accurately, John Ford's vision thereof)? Even if Mitchell's two alternatives are the only possible states of society, why must we assume that state-coerced cooperation and cohesion is preferable to the risk of conflict that comes from leaving morality to private virtues?

Principle ethics pose a double threat to ordered liberty, as they displace not only private ordering of economic relationships, but personal virtue as well. In principle-based ethical systems, individuals are not allowed to define for themselves what constitutes trustworthy or honorable behavior, but instead must comply with judges' and/or bureaucrats' definitions of honor.<sup>177</sup>

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<sup>174</sup> Timely reactions to this phenomenon abound in both the academic and, more importantly, popular literature. See, e.g., EPSTEIN, *supra* note 165; PHILIP K. HOWARD, *THE DEATH OF COMMON SENSE: HOW LAW IS SUFFOCATING AMERICA* (1994).

<sup>175</sup> For a brief but useful introduction to these concepts, see Robert F. Cochran, Jr., *Lawyers and Virtues*, 71 NOTRE DAME L. REV. 707 (1996) (book review).

<sup>176</sup> Mitchell, *supra* note 49, at 199.

<sup>177</sup> Principle ethics create an inescapable dissonance between the progressive communitarians' description of trust and their law reform proposals. For example, Marleen O'Connor claims that trust is contextual. O'Connor, *supra* note 66, at 223. If so, the ways in which trust evolves and the resulting conduct norms are likely to vary from person to person and from firm to firm. As such, a one-size-fits-all state-sanctioned code of behavior cannot fit everyone and may not fit anyone. George Bernard Shaw's take on the Golden Rule seems apt: "Do not do unto others as you would have them do unto you. They may

Conservative contractarians claim it is possible to embrace communitarian values without having to embrace the statist baggage progressive communitarianism brings with it. American culture once partook of a dynamic interaction between individualistic and communitarian tendencies that produced a rich associational life.<sup>178</sup> If America is becoming a low virtue society, as conservatives believe,<sup>179</sup> it is precisely because of the sort of statism the stakeholderists propose to foist upon us in the name of trust. Indeed, it can be argued that the decline in social trust began when the rich set of mediating institutions famously praised by Tocqueville was caught, like the Romans at Cannae, between the nanny state on one side and judicial hijacking of the state's monopoly on the use of coercive force to advance a hyper-legalistic cult of the autonomous individual on the other.<sup>180</sup> Conservatives reject both prongs of modern liberalism in favor of achieving communitarian goals through private ordering. The conservative pessimism about human nature thus does not lead to statism, but instead to promoting intermediating institutions that build "a citizenry regulating itself from within according to a shared public 'language of good and evil.'"<sup>181</sup>

Conservatives believe that religious communities are critical to the creation of such a virtuous citizenry. Virtue is an adaptive response to the instinctive human recognition of, and need for, a transcendent moral order codified in a body of natural law.<sup>182</sup> People are most likely to act virtuously when they believe in an external power, higher and more permanent than the state, who is aware of their shortcomings and will punish them in the next life even if they escape retribution in this life.<sup>183</sup>

Civic virtue is also created by secular communities. As James Q. Wilson observes, "[S]omething in us makes it all but impossible to justify our acts as mere self-interest whenever those acts are seen by others as violating a moral principle."<sup>184</sup> Rather, "[w]e want our actions to be seen by others—and by ourselves—as arising out of appro-

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have different tastes." KENNETH J. ARROW, *THE LIMITS OF ORGANIZATION* 24 (1974) (quoting Shaw).

<sup>178</sup> See Fukuyama, *supra* note 125, at 43; Weigel, *supra* note 133, at 36-37.

<sup>179</sup> See, e.g., Fukuyama, *supra* note 125, at 43.

<sup>180</sup> See, e.g., Peter L. Berger, *Trusting Laws, Trusting Others*, *FIRST THINGS*, Apr. 1996, at 12, 12-13 (attributing decline of social trust to proliferation of laws); see also EPSTEIN, *supra* note 165, at 323-25 (describing the tendency of the state to destroy voluntary communities).

<sup>181</sup> Weigel, *supra* note 133, at 37.

<sup>182</sup> Belief in natural law promulgated by a transcendent moral order is a key tenet of conservatism. See KIRK, *supra* note 11, at 8. For an analysis of the human instinct for faith, see PAUL JOHNSON, *THE QUEST FOR GOD* 6-17 (1996).

<sup>183</sup> Cf. *Proverbs* 1:7 ("The fear of the Lord is the beginning of knowledge.").

<sup>184</sup> Wilson, *supra* note 66, at 39.

priate motives."<sup>185</sup> Voluntary communities strengthen this instinct in two ways. First, they provide a network of reputational and other social sanctions that shape incentives. Virtuous communities will rely upon such sanctions to encourage virtue among their members. Second, because people care more about how they are perceived by those close to them, communal life provides a cloud of witnesses about whom we care and whose good opinion we value, thus encouraging us to strive to comport ourselves in accordance with communal norms.<sup>186</sup>

The nanny state is a poor substitute, at best, for the virtue-inculcating power of faith and voluntary community. We may fear the faceless bureaucrat, but he does not inspire us to virtue. Conduct rising above the lowest common moral denominator cannot be created by state action. But while the state cannot make its citizens virtuous, it can destroy the intermediary institutions that do inculcate virtue: "Communities can be destroyed from without; but they cannot be created from without; they must be built from within."<sup>187</sup>

I am not arguing for a libertarian utopia in which the state has no role in regulating corporate governance. Contractarian scholars endorse the state's role in providing necessary and appropriate default rules.<sup>188</sup> As Edmund Burke once observed, moreover, there is "a limit at which forbearance ceases to be a virtue."<sup>189</sup> At that limit, the state properly steps in.

The differences in attitude about state regulation between contractarians and progressives thus are more accurately characterized as ones of degree, not of kind. Yet, they are nonetheless critical. As we have seen, progressive communitarians favor an activist role for the state in enforcing mandatory codes of honorable or trustworthy conduct.<sup>190</sup> The stakeholderists among them favor a drastic expansion of corporate law's regulatory jurisdiction to encompass mandatory rules governing the relationships between the corporation and its various nonshareholder constituencies. Conservative contractarians simply argue for a far less ambitious state role.

<sup>185</sup> *Id.*

<sup>186</sup> *Cf. Hebrews 12:1* ("Therefore since we are surrounded by such a great cloud of witnesses, let us throw off everything that hinders and the sin that so easily entangles, and let us run with perseverance the race marked out for us.").

<sup>187</sup> EPSTEIN, *supra* note 165, at 324.

<sup>188</sup> See, e.g., Stephen M. Bainbridge, *Insider Trading under the Restatement of the Law Governing Lawyers*, 19 J. CORP. L. 1, 36-39 (1993) (arguing for a mandatory rule against insider trading by lawyers, while conceding that it is a close issue).

<sup>189</sup> EDMUND BURKE, *Observations on a Late Publication, intituled "THE PRESENT STATE OF THE NATION"* (1769), reprinted in 1 BURKE'S WRITINGS AND SPEECHES 271, 273 (London, John C. Nimmo 1899).

<sup>190</sup> According to Judge Posner, "[C]ommunitarians want an activist state that will promote social solidarity, whether directly or by inculcating qualities (of altruism, civic virtue, or whatever) conducive to people's pulling together rather than pursuing selfish or narrowly familial goals." POSNER, *supra* note 61, at 414.

It is difficult to imagine a state-sanctioned honor code that both rises above the lowest common moral denominator and can be maintained without an oppressively high level of state coercion. Assume arguendo the validity of the communitarian claim that law has a socializing effect,<sup>191</sup> such that a legal regime designed to promote mutual interdependence and trust actually causes people to behave more virtuously. As the number of honorable and trustworthy people rises, the gains from cheating also rise.<sup>192</sup> If most people are trustworthy most of the time, transactions will be premised on trust, which makes dishonorable behavior profitable precisely because it permits the dishonest to take advantage of their naively trusting business associates. Accordingly, the state must step in to provide Bratton's "coercive backstop."<sup>193</sup>

This point is illustrated by Marleen O'Connor's discussion of *Charter Township of Ypsilanti v. General Motors Corp.*<sup>194</sup> In that case, General Motors reneged on certain commitments made to a town in which one of its plants had been located. O'Connor approvingly cites the lower court's statement that "[m]y conscience will not allow this injustice to happen."<sup>195</sup> By doing so, this judicial agent of the state tried to impose his personal definition of trust and honor on a voluntary arrangement, invoking the state's monopoly on the use of coercive force to mandate compliance by others with his personal code of ethics. He made no serious effort to link his conscience with moral norms having demonstrably substantial support in the community, as our common law system requires,<sup>196</sup> or to wrestle with the very serious policy concerns his action raises.

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<sup>191</sup> The argument that law has a socializing effect is advanced in *Progressive Corporate Law* by both Lawrence Mitchell, *supra* note 49, at 203, and Marleen O'Connor, *supra* note 66, at 233-34, who essentially claim that people will learn to behave in trustworthy ways if fiduciary law expects it of them. The rhetoric of fiduciary duty cases has the rather obvious economic effect of deterring cheating, see MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 578-79 (1995), and, of course, those cases "are actually concerned with conduct that falls far short of a standard of selflessness," *id.* at 579. But even setting those objections aside, one may still doubt whether law has the socializing force O'Connor and Mitchell ascribe to it. Their argument rests on the flawed progressive premise of human perfectibility. Experience teaches that judge-made law has a very limited power to effect social change. See generally GERALD N. ROSENBERG, THE HOLLOW HOPE: CAN COURTS BRING ABOUT SOCIAL CHANGE (1991) (examining when and how American courts have attempted to effect social change).

<sup>192</sup> See POSNER, *supra* note 61, at 417.

<sup>193</sup> Bratton, *supra* note 11, at 165.

<sup>194</sup> *Charter Township of Ypsilanti v. General Motors Corp.*, No. 92-43075-CK, 1993 WL 132385 (Mich. Cir. Ct. Feb. 9, 1993), *rev'd*, 506 N.W.2d 556 (Mich. Ct. App. 1993).

<sup>195</sup> O'Connor, *supra* note 66, at 229.

<sup>196</sup> For a defense of that proposition, see MELVIN ARON EISENBERG, THE NATURE OF THE COMMON LAW 15 (1988).

My opposition to this sort of lawmaking is premised on the principle of sphere sovereignty.<sup>197</sup> Social institutions—including both the state and the corporation—are organized horizontally, none subordinated to the others, each having a sphere of authority governed by its own ordering principles. Expansion of any social institution beyond its proper sphere necessarily results in social disorder and opens the door to tyranny. The trouble with the state thus is not its existence, but its expansion beyond those functions prescribed by custom and convention, which were legitimized by ancient usage, into the pervasive nanny state perpetually grasping at new aspects of social life to drag into its slaving maw.

From a perspective founded on sphere sovereignty, the progressive project's basic flaw is its willingness to invoke the coercive power of the state in ways that deny the rights of mankind acting individually, or collectively through voluntary associations, to order society. Although the conservative contractarian is unwilling to sacrifice virtue at the altar of efficiency, he is equally unwilling to sacrifice ordered liberty at the altar of community.<sup>198</sup> A conservative properly insists that individuals be left free to define for themselves what conduct shall be deemed trustworthy or honorable, rather than being forced to comply with, say, Professor Mitchell's code of ethics. Liberty is best preserved if the state's monopoly on the use of coercive force is invoked only rarely and, as a general rule, only to deal with serious moral questions. Otherwise, the state should confine itself to creating a public square where the virtuous can act honorably, while keeping a wary eye on the rest of society. This is precisely what the contractarian

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<sup>197</sup> Sphere sovereignty is a staple of Protestant social thought. See J. Budziszewski, *The Problem with Conservatism*, FIRST THINGS, Apr. 1996, at 38, 42. Sphere sovereignty posits that society consists of multiple entities—such as the state, churches, families, and corporations—each having a distinct identity. It stipulates that these entities do not derive their respective rights and powers from one another, but rather each has its own internal well-spring of authority. Sphere sovereignty further asserts that each social entity has its own function. Although each entity must confine its activities to the sphere demarcated by its social function, each entity is sovereign within that sphere. See generally Johan D. van der Vyver, *Sovereignty and Human Rights in Constitutional and International Law*, 5 EMORY INT'L L. REV. 321, 342-55 (1991) (discussing sphere sovereignty). By its very nature, sphere sovereignty thus assumes a limited state. In particular, the state has no right to interfere with the internal governance of social entities outside its sovereign sphere, such as churches and corporations. See *id.* at 352.

The Catholic principle of subsidiarity leads to similar results. Unlike sphere sovereignty's horizontal ordering of society, subsidiarity orders society vertically, with the state above "lesser" institutions, such as the corporation. The state nevertheless transgresses its moral authority when it absorbs or takes away the legitimate authority of lower institutions. See Budziszewski, *supra*, at 42; see also Budziszewski, *supra* note 130, at 24 ("[S]ubsidiarity is *pro*-community, but *anti*-collectivist.").

<sup>198</sup> Put another way, the conservative contractarian believes that the problem in both the economic and the social sphere is not too little state interference, but too much. Cf. Weigel, *supra* note 133, at 36 ("[A]nti-statism is not the same thing as anti-communitarianism.").

approach to corporate law promotes: a state that regulates corporate governance largely by providing default rules subject to contractual opt-outs.<sup>199</sup>

b. The Corporation v. Leviathan

The preceding Part focused on the relationship between statism and virtue in rather general terms. Let us now turn our attention to the specific: how does state regulation of corporate governance affect the social institutions that inculcate virtue in free citizens? This question decomposes into two subsidiary issues. First, is the corporation itself an intermediary institution with virtue-inculcating functions? Second, if the corporation itself does not inculcate virtue, can the corporation help protect other voluntary communities that do fulfill that function?

We have seen that it is difficult to describe the large public corporation as a community of shared values. Such corporations in fact resemble the nanny state—a large, impersonal bureaucracy with the power to terrorize, but no ability to nurture. Yet, even so, the corporation may harbor within it sub-groups that amount to communities of shared values. Granted, a corporation's shareholders, creditors, and customers almost by definition cannot form communities. The host of familiar collective action problems that prevent shareholders from participating in corporate decisionmaking, for example, precludes them from developing any sense of community. Instead, true communities are most likely to arise among those who work for the corporation:

In the economic sphere today sociality seems far more prevalent than individualism. In democratic capitalist nations various social organisms, including the business enterprise and the corporation, have replaced or supplemented old loyalties to family and clan. Some persons today are closer to their colleagues in the workplace than to their family.<sup>200</sup>

One's co-workers thus provide precisely the cloud of witnesses so essential to the inculcation of civic virtue.<sup>201</sup>

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<sup>199</sup> Millon observes: "For the mainstream contractarians, private ordering through contract is presumptively legitimate because it best serves their efficiency objective." Millon, *supra* note 21, at 22-23. For conservative contractarians, this is precisely backwards: we regard efficiency as a presumptively legitimate norm precisely because it best serves our preference for private ordering through contract.

<sup>200</sup> NOVAK, *supra* note 68, at 29.

<sup>201</sup> Indeed, one might even argue that communities existing within the corporation help promote religious virtue: "For many millions of religious persons the daily milieu in which they work out their salvation is the communal, corporate world of the workplace." *Id.* at 47.

To concede the existence of workplace communities, of course, does not necessitate that we accept the progressive argument for legal change designed to promote a utopian vision of industrial relations. To the contrary, if the corporation harbors within it communities that inculcate virtue in the firm's workers, then any state interference with the corporation's internal governance that tends to interfere with these communities' virtue-instilling functions becomes indistinguishable from, and no less tolerable than, state interference with any other virtue-inculcating institution.<sup>202</sup>

Let us assume, however, that the modern public corporation has no power whatsoever to inculcate virtue in those who are employed by it. Even so, minimizing state regulation of corporate governance is essential to the preservation of a free, yet virtuous society. Viewed from a sphere sovereignty perspective, subordination of economic institutions to the state poses a grave threat to personal liberty.<sup>203</sup> Society includes a host of communities with the potential to inculcate virtue and other communal values: churches, schools, fraternal organizations, and the like. Although it may be unrealistic to think of a large multinational corporation as constituting such a community, it is perfectly plausible to think of the corporation as an intermediary institution standing between the individual and Leviathan.<sup>204</sup> In other words, although the development of virtuous citizens is arguably best performed by smaller institutions with roots in the local community, the corporation can still act as a vital countervailing force against the state. Resistance to expanding the realm of mandatory corporate law rules thus responds to the "notion that the prevailing moral threat in our era may not be the power of the corporations but the growing power and irresponsibility of the state."<sup>205</sup>

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<sup>202</sup> It is certainly true that corporations themselves can take actions that destroy their internal communities, as Deborah DeMott's review of *Progressive Corporate Law* illustrates in her discussion of the downsizing phenomenon. DeMott, *supra* note 13, at 1319-21. But Leviathan has truly triumphed if the state may do what it will with every voluntary community that fails to live up to some bureaucrat's idea of proper communal norms. In other words, DeMott errs in suggesting that contractarians "might well argue that legal intervention is unnecessary because managers have an incentive not to downsize unwisely." *Id.* at 1326. Even assuming the incentive argument to be demonstrably false, the conservative contractarian still opposes legal intervention in order to preserve economic liberty for its own sake.

Moreover, even if we concede that downsizing is a sufficiently serious departure from a moral norm sufficiently well-accepted to justify legal intervention, we need not conclude that corporate law provides an appropriate vehicle for state action. Changes in general welfare laws, such as plant-closing legislation, are a demonstrably better solution to the downsizing problem than are changes in internal corporate governance. See Bainbridge, *supra* note 33, at 1431-45.

<sup>203</sup> See, e.g., NOVAK, *supra* note 68, at 32-34.

<sup>204</sup> See, e.g., *id.* at 3-4.

<sup>205</sup> *Id.* at 34.

Sphere sovereignty assumes that a limited state is an essential attribute of ordered liberty. In a society premised on sphere sovereignty, private property and freedom of contract are thus important not just in their own rights, but rather because they provide essential limitations on the power of the state.<sup>206</sup> As Russell Kirk observed, conservatives are persuaded that "freedom and property are closely linked: separate property from private possession, and Leviathan becomes master of all."<sup>207</sup> In the present context, we must amend this sentiment to encompass freedom of contract, but the point remains intact.

As a societal decisionmaking norm, the economic freedom to pursue wealth does more than just expand the economic pie. A legal system that pursues wealth maximization necessarily allows individuals freedom to pursue the accumulation of wealth. Economic liberty, in turn, is a necessary concomitant of personal liberty; the two have almost always marched hand-in-hand.<sup>208</sup> Moreover, the pursuit of wealth has been a major factor in destroying arbitrary class distinctions by enhancing personal and social mobility.<sup>209</sup> At the same time, the manifest failure of socialist systems to deliver reasonable standards of living has undermined their viability as an alternative to democratic capitalist societies in which wealth maximization is a paramount societal goal.<sup>210</sup> Accordingly, it seems fair to argue that the economic liberty to pursue wealth is an effective means for achieving a variety of moral ends.<sup>211</sup>

In turn, the modern public corporation has become a powerful engine for focusing the efforts of individuals to maintain the requisite sphere of economic liberty. Those whose livelihood depends on corporate enterprise cannot be neutral about political systems. Only democratic capitalist societies permit voluntary formation of private corporations and maintain a sphere of economic liberty within which they may function. This gives those who value such enterprises a powerful incentive to resist both statism and socialism.<sup>212</sup> Because tyranny is far more likely to come from the public sector than the private, those who for selfish reasons strive to maintain both a democratic cap-

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<sup>206</sup> See *id.* at 45.

<sup>207</sup> KIRK, *supra* note 11, at 9.

<sup>208</sup> See NOVAK, *supra* note 68, at 44-45.

<sup>209</sup> See *id.* at 42.

<sup>210</sup> Consider Michael Novak's observation that democratic-capitalist nations can feed themselves, while socialist ones can't. *Id.* at 37. For an argument that wealth creation (if not its maximization) is a moral imperative, see *id.* at 38.

<sup>211</sup> Cf. POSNER, *supra* note 61, at 382. DeBow and Lee cogently argue that the shareholder wealth maximization norm promotes efficient resource allocation on a society-wide basis, which they plausibly assert redounds to the benefit of consumers—the largest non-shareholder constituency of them all. DeBow & Lee, *supra* note 116, at 416-18.

<sup>212</sup> See NOVAK, *supra* note 68, at 57.

italist society and, of particular relevance to the present argument, a substantial sphere of economic liberty therein, serve the public interest.<sup>213</sup> As Michael Novak observes, private property and freedom of contract were "indispensable if private business corporations were to come into existence."<sup>214</sup> In turn, the corporation gives "liberty economic substance over and against the state."<sup>215</sup>

### c. *A Public Choice Perspective*

Even those not persuaded by the theoretical arguments against the progressive communitarian agenda might find pause when push comes to legislative shove. Progressive critics of neoclassical economics often fail to take into account the secondary unintended effects of economic regulation. Because the secondary effects are often counter to and larger than the primary intended effects, much social legislation makes matters worse, not better. This is so even if the public choice arguments made below are discounted, because the law of unintended consequences inevitably follows from the bounded rationality of human minds.

Although conservative contractarians value concepts of trust, honor, and virtue, the pragmatists among us are highly dubious of the legislative ability to promote such values. In our society, questions of distributive justice have been taken out of the hands of individuals and reserved for the government, in particular the legislative branch. This is just as well, because judicial powers are poorly suited to redistribution.<sup>216</sup> In contrast, the judicial branch's powers are well-suited to enforcing wealth-maximizing rules.<sup>217</sup> Indeed, there is a considerable body of literature supporting the proposition that the common law has what Judge Posner calls an "implicit economic logic."<sup>218</sup>

Economic analysis of the legislative process, however, gives one a disheartening perspective on legislative solutions to distributive problems. Public choice is the branch of law and economics relevant here. Public choice's basic tenet is that well-defined, politically influential interest groups use their power to obtain legal rules that benefit themselves at the expense of larger, more diffuse groups.<sup>219</sup> In other

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<sup>213</sup> See *id.* at 34.

<sup>214</sup> *Id.* at 45.

<sup>215</sup> *Id.*

<sup>216</sup> See POSNER, *supra* note 61, at 388.

<sup>217</sup> As Judge Posner argues, "[W]ealth maximization is an especially useful tool for guiding common law adjudication." Richard A. Posner, *Law and Economics Is Moral*, 24 VAL. U. L. REV. 163, 170 (1990).

<sup>218</sup> RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 251 (4th ed. 1992).

<sup>219</sup> See, e.g., DANIEL A. FARBER & PHILIP P. FRICKEY, *LAW AND PUBLIC CHOICE* 23-24 (1991).

words, legislative decisions are not driven by distributive justice, but by interest group pressures.

I emphatically do not claim that all legislative choices are driven solely by interest group pressures. Public choice theory has enormous explanatory power, but it has difficulty accounting "for ideological politicians like Reagan and Thatcher."<sup>220</sup> Any sensible account of modern politics must consider not only legislators' naked self-interest, but also the possibility that ideology and morality matter to legislators as well, even when their beliefs put them at odds with important interest groups.

I am merely claiming that we need to be suspicious of legislators who claim to be acting in the name of distributive justice. Ideology and morality often serve as cover for self-interest. Worse yet, "human nature may incline even one acting in subjective good faith to rationalize as right that which is merely personally beneficial."<sup>221</sup> Before we conclude that a nakedly contractarian outcome is socially undesirable, let us be very careful to ensure that legislatively reversing that outcome does not lead to an even more undesirable result.<sup>222</sup>

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<sup>220</sup> *Id.* at 24.

<sup>221</sup> *City Capital Assocs. v. Interco, Inc.*, 551 A.2d 787, 796 (Del. Ch. 1988) (emphasis omitted).

<sup>222</sup> Gregory Mark postulates a tension between contractarianism and public choice theory. One of the basic tenets of public choice is that cohesive and well-organized interest groups engage in private rent-seeking through the legislative process. Mark applies this principle to corporate law rules, positing that corporate constituencies with interest group power will seek private gain through lobbying for specific default rules. Mark, *supra* note 6, at 81-82. His point is valid, but the problem would be far worse if we embraced the communitarian vision of corporate law.

Corporate constituencies seek rents either through changes in corporate law itself or through changes in general welfare legislation. We might refer to these as "internal" and "external" rent seeking, respectively. Under present law, internal rent seeking is hard to disguise. Shareholder wealth maximization is still the dominant corporate governance norm and, as such, provides a single yardstick against which private-regarding legislation can be measured. See Bainbridge, *supra* note 33, at 1423-25. In contrast, many progressives favor some sort of "multi-fiduciary" regime, in which the board of directors is responsible to all corporate constituents. Under this model, it would be easier for special interest groups to cut legislative deals, because private-centered legislation would be evaluated using multiple, vague standards. Indeed, the communitarian model invites special interest legislative competition by getting corporate law into the business of regulating multiple constituencies.

In any case, Mark's claim that the contractarian model is in tension with public choice theory rests on a flawed understanding of the former. No sensible contractarian claims that state laws are perfect default rules. To the contrary, the deleterious effects of interest group rent-seeking is a major theme of the contractarian literature.

### C. A Reality Check: The Progressive Agenda v. Long-Term Political Trends

I now turn to the pragmatic claim that the progressive agenda is out of step with modern political reality.<sup>223</sup> Although corporate social responsibility remains a favorite issue of liberal political figures, such as President Clinton and former Labor Secretary Robert Reich, one can plausibly argue that the principal political constraint on free market policies currently comes from populists like Pat Buchanan and Ross Perot. As political commentator Bill Schneider has observed, the United States has become "ideologically populist, and operationally libertarian."<sup>224</sup> Hardly the stuff of which progressive dreams are made.<sup>225</sup>

Although the Perot and Buchanan phenomena provide strong evidence for the continuing political vitality of antifinance populism, this carries virtually no positive implications for the progressive agenda. While public suspicion of business may be growing,

there is no sign yet that the bogey-man of 'big business' comes even close to the monstrosity of 'big government' in the public imagination. A [recent] Gallup Poll . . . found 64% of Americans saw big government as the biggest threat to the future of the country, while only 24% cited big business . . . .<sup>226</sup>

This is not an attempt to prognosticate the 1998 elections; my point is only that the long-term trends appear to work against statist solu-

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<sup>223</sup> DeBow and Lee offer a different, but equally pragmatic, argument against the statism of progressive corporate communitarianism:

[T]he communitarians come close to confusing the *possibility* of government intervention through corporate law with its advisability. . . . But just because government *can* make any demands it wishes of investors does not mean that it *should*. Compliance with ambitious government edicts comes at a price. At the limit, it involves a price that investors could simply refuse to pay.

DeBow & Lee, *supra* note 116, at 423. They go on to explain that the relative ease with which investors can exit from corporate investments that turn sour because government regulation makes it hard for government to regulate corporations. *Id.*

<sup>224</sup> John H. Fund, Editorial, *PITT. POST-GAZETTE*, Oct. 23, 1994, at F1.

<sup>225</sup> David Millon appears to see the first flashes of political support for the progressive agenda in the nonshareholder constituency statutes. Millon, *supra* note 21, at 11-12. Lynne Dallas likewise believes that state adoptions of nonshareholder constituency statutes reflects changing norms about shareholder wealth maximization. Dallas, *supra* note 21, at 54. Both ignore the statutes' well-known origins as special interest legislation designed to protect corporate managers from hostile takeovers.

<sup>226</sup> Alan Murray, *Merger Wave May Put Spotlight on Antitrust*, *WALL ST. J.*, Apr. 8, 1996, at A1.

tions.<sup>227</sup> *Progressive Corporate Law's* authors thus are seriously out of step with the zeitgeist.<sup>228</sup>

### CONCLUSION

Progressive legal thought historically has contained two features of present import. First, progressives believe that government regulation allocates resources more fairly (and even more efficiently) than do markets. Second, progressives reject populist democracy in favor of bureaucratic direction. In the progressives' ideal world, public policy is set by government bureaucrats who are guided by academic experts in law, economics, and the social sciences.<sup>229</sup> Although they left behind the modern nanny state as their legacy, the naive faith of early progressives that the government could do a better job of allocating resources than do markets withered in the face of the law and economic analysis of the legislative process.<sup>230</sup> However, a new generation of progressive scholars has arisen, like a shoot sprouting from a seemingly dead trunk.

The core issues of concern to this new generation are hardly original. Just as sunspots come in cycles, so too does the corporate social responsibility debate. In the 1930s, we had the Berle-Dodd debate.<sup>231</sup> In the 1950s, Berle and others revisited the issue.<sup>232</sup> In the 1970s,

<sup>227</sup> Consider the observation that President Clinton captured the political initiative in 1995 "with a nimble two-step: embracing the cause of limiting government . . . , while rejecting the specific GOP plan to get there as 'extreme.' In effect, Clinton installed himself with centrist voters as the legitimate defender of the center-right consensus . . . ." Ronald Brownstein, *As Democrats Unite, GOP Divides, Campaign is Breaking 40-Year Mold*, L.A. TIMES, July 1, 1996, at A5.

<sup>228</sup> DeBow and Lee cogently argue that the communitarian agenda for corporate law cannot succeed for two reasons. First, state legislatures that adopt inefficient communitarian laws will experience emigration of corporations to states with more efficient laws. DeBow & Lee, *supra* note 116, at 405-09. Their argument in this regard is a straightforward and perfectly plausible adaptation of the race to the top hypothesis. Second, they contend that a federal law of corporations emphasizing inefficient communitarian values would be unavailing because entrepreneurs would move off-shore or to less-heavily regulated organizational forms (such as LLCs). *Id.* at 409-15. This prong of their argument is a straightforward and perfectly plausible application of the triviality hypothesis. I find nothing to quibble with in DeBow and Lee's argument, but would add that 60-plus years of experience with the dual federal-state regulatory scheme has taught us two things: (1) Congress is exceedingly unlikely to adopt a federal law of corporations of any sort, communitarian or otherwise; and (2) this is a very good thing as a matter of both economic efficiency and federalism. See Stephen M. Bainbridge, *Redirecting State Takeover Laws at Proxy Contests*, 1992 WIS. L. REV. 1071, 1138-43.

<sup>229</sup> See Hovenkamp, *supra* note 65, at 149.

<sup>230</sup> See *id.* at 157-58.

<sup>231</sup> Compare Adolf Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931), and Adolf Berle, *For Whom Corporate Managers Are Trustees*, 45 HARV. L. REV. 1365 (1932), with Merrick Dodd, *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 U. CHI. L. REV. 194 (1935).

<sup>232</sup> See, e.g., ADOLF BERLE, *THE 20TH CENTURY CAPITALIST REVOLUTION* (1954).

there was a major fracas over corporate social responsibility.<sup>233</sup> Finally, today we have the nonshareholder constituency debate. The twenty-year spacing is particularly interesting, because it accounts for just about one academic generation. Each generation of new scholars seems compelled to rehash the same set of problems. To be sure, each iteration adopts a new terminology, focuses on a slightly different facet of the problem, and develops some new ideas. But, all-in-all, we have been here before.<sup>234</sup> The central issue remains whether corporation law is a species of public or private law. As an intellectual matter, the debate is unlikely to ever be finally resolved. To the contrary, I can predict with confidence another outbreak sometime around the year 2015.

This is not to suggest that the debate is bootless. George Weigel wisely observes that both democracy and free markets are learned behaviors: "The institutions of a free polity and a free economy can indeed endure for generations—but only if the people become democrats and democratic capitalists, over and over again."<sup>235</sup> By prompting us to relearn the lessons of the past, the stakeholderists thus perhaps unwittingly promote a renewal of commitment to the idea of free markets.

As far as this go-round is concerned, the progressive agenda is unlikely to make much headway. First, it fails to offer legal decisionmakers a model for predicting human behavior that seems capable of displacing those successfully employed by mainstream law and economics scholars. Second, and far more importantly, its communitarian elements or, more precisely, the means by which those elements are to be achieved, run counter to the spirit of a democratic capitalist society. And even if the progressive notion that community can be built through government edict were not outright erroneous, it is at least out of step with the zeitgeist. We are hardly in the midst of a

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<sup>233</sup> See, e.g., Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, at 32; see also Kenneth Davis, *The Case for and against Business Assumption of Social Responsibilities*, in *MANAGING CORPORATE SOCIAL RESPONSIBILITY* 35, 40-44 (Archie B. Carroll ed., 1977).

<sup>234</sup> I made this point in Bainbridge, *supra* note 33, at 1435 n.40. David Millon appears to respond to my argument when he contends that the present generation of communitarians are concerned with internal corporate relationships rather than with the corporation's external relationship to society. "Critics therefore have missed an important difference when they assert that communitarian arguments are merely a rehash of earlier corporate social responsibility claims in the Dodd or Nader mode. In contrast to these perspectives, the communitarian stance is inward-looking and domestic in its focus." Millon, *Personifying the Corporate Body*, *supra* note 22, at 126. One need only note the substantial overlap between the issues on which modern communitarians concentrate and those that animated prior iterations of the corporate social responsibility debate: the rights of nonshareholder constituencies, worker protection and empowerment, environmental protection, and the like, to see that the differences between old and new progressives are few.

<sup>235</sup> Weigel, *supra* note 133, at 34.

progressive era. Barring an unlikely political realignment, the progressive agenda is destined to remain a matter of solely academic interest.