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Deconstructing Corporate Governance: Absolute Director Primacy

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DECONSTRUCTING CORPORATE GOVERNANCE: ABSOLUTE DIRECTOR PRIMACY

René Reich-Graefe[*]

ABSTRACT

Microtheoretical models of the corporation which focus on corporate governance attempt to answer two deceptively simple, but fundamentally elusive questions: 'Who are in control of the corporation?' and 'Whose interests ultimately control those in control of the corporation?' Both questions remain partially unanswered within the models developed to date by corporate theoreticians. This Article proposes a radically new model: '*absolute director primacy*.' Existing microtheoretical models conceive that we only need to—and, indeed, can—determine the controlling interests guiding corporate decisionmaking in order to prove the existence of control over the decisionmaking latitude of corporate boards. The *absolute director primacy model* reverses this thinking: The corporate board—as the private-sector equivalent of a modern *Leviathan*—has absolute and infinite decisionmaking latitude in order to control the business and affairs of the corporation. Nothing within corporate law provides any meaningful modicum of predictive ability regarding director behavior ex ante or director accountability ex post. As a result, model-immanent explanations of the phenomenon of general investor confidence pre-investment in the face of absent director accountability post-investment become logically impossible. Thus, the *absolute director primacy model* not only posits a complete absence of ex-post director accountability but accepts the complete ex-ante indeterminability of director decisionmaking. Accordingly, the *absolute director primacy model* further posits that largely unexplained and currently unaccounted-for *protolegal* variables control both director behavior and the microtheoretical models of the firm that attempt to explain and predict such behavior.

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Aut tace, aut loquere meliora silentio. [Be silent unless to speak is better than silence.]

—Salvator Rosa (1615-73), *Self Portrait* (National Gallery, London)

I. OPENING SKETCHES

Whether we like it or not:[1] "the genius of American corporate law"[2] is autocratic and elitist—and, possibly, totalitarian.[3] Such qualities are most pronounced when the genius is employed by discreet structurations of economic concentration operating in the form of the modern Berle-Means corporation.[4] Corporate law—commonly regarded as a well-functioning

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1. As has been observed before, (at least, some) "[w]affling is obligatory to law-review writing." *See* J. Mark Ramseyer, *Economizing Legal D-B8*, 2 BERKELEY BUS. L.J. 25, 29 n.12 (2005).

2. ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1, 151 (1993); Fred S. McChesney, *The "Trans Union" Case:* Smith v. Van Gorkom, *in* THE ICONIC CASES IN CORPORATE LAW 231, 256 (Jonathan R. Macey ed., 2008) [hereinafter McChesney, *The "Trans Union" Case*]. *Cf.* STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 3 (2008) [hereinafter BAINBRIDGE, THEORY AND PRACTICE]. Even though the reference is to American corporate law, it is often claimed, as part of the so-called 'convergence debate,' that such genius of American corporate law is more and more universally accepted. *See, e.g.*, Stephen M. Bainbridge, *Director v. Shareholder Primacy in the Convergence Debate*, 16 TRANSNAT'L LAW. 45, 45 (2002) [hereinafter Bainbridge, *Convergence Debate*]; Henry Hansmann & Reinier Kraakman, Essay, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439, 468 (2001) [hereinafter Hansmann & Kraakman, *The End of History*].

3. *Cf.* Kenneth J. Arrow, *Scale Returns in Communication and Elite Control of Organizations*, 7 J.L. ECON. & ORG. 1, 6 (1991) (describing how elite control of organizations is necessary in order to achieve economies of scale within the communication and decision flows of organizations); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 557 (2003) [hereinafter Bainbridge, *The Means and Ends*] (comparing the central decisionmaker in large public corporations to "an autocrat"); *id.* at 555 (stating that "public corporations are not participatory democracies, but hierarchies in which decisions are made on a fairly authoritarian basis"); Robert C. Clark, *Contracts, Elites, and Traditions in the Making of Corporate Law*, 89 COLUM. L. REV. 1703, 1718-26 (1989) (discussing (disguised) elite rulemaking in corporate law as one of the sources for corporate law rules); Ronald J. Gilson & Reinier Kraakman, *Clark's Treatise on Corporate Law: Filling Manning's Empty Towers*, 31 J. CORP. L. 599, 604 (2006) [hereinafter Gilson & Kraakman, *Clark's Treatise*] (inquiring whether corporate boards are "mediating plutocrats"); *id.* at 604 n.21 (asking whether "we want to encourage an institution that is disproportionately white, male and conservative to make social policy?"); Jeswald W. Salacuse, *Corporate Governance, Culture, and Convergence: Corporations American Style or With a European Touch?*, 9 L. & BUS. REV. AM. 33, 56 (2003) ("[T]he CEO in the modern American corporation is like that of a third-world autocrat.").

4. The legal and economic nature of the publicly held corporation, with widely disbursed shareownership and an almost complete separation of ownership and control, was first thoroughly analyzed and established as a distinct subject of corporate law study by Adolf Berle and Gardiner Means. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND

enabling framework[5] for economic liberty and private-party entrepreneurship[6]—is the principal legal vehicle utilized in order to remove large areas of economic activity from free-market forces and to internalize and concentrate such activity in planned economies under an absolutist, hierarchical command-and-control structure.[7] These market-insulated, planned economies[8] are not centralist state economies (in which case the

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PRIVATE PROPERTY 84–89, 119–25 (1932). *But see* FRANK H. KNIGHT, RISK, UNCERTAINTY AND PROFIT 291 (1921) ("The typical form of business unit in the modern world is the corporation. Its most important characteristic is the combination of diffused ownership with concentrated control."). *See also* STEPHEN M. BAINBRIDGE, CORPORATE LAW 3–5, 72 (2d ed. 2009) [hereinafter BAINBRIDGE, CORPORATE LAW]; JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS 39–40 (2d ed. 2003); Bainbridge, *Convergence Debate*, *supra* note 2, at 46; William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 739–40, 753–59 (2001) [hereinafter Bratton, *Century's Turn*]; Oliver Hart, *An Economist's View of Fiduciary Duty*, 43 U. TORONTO L.J. 299, 303 n.9 (1993) [hereinafter Hart, *An Economist's View*]; David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 214; Charles R.T. O'Kelley, *The Entrepreneur and the Theory of the Modern Corporation*, 31 J. CORP. L. 753, 754 (2006) [hereinafter O'Kelley, *Theory of the Modern Corporation*]; Arthur R. Pinto, *An Overview of United States Corporate Governance in Publicly Traded Corporations*, 58 AM. J. COMP. L. 257, 259–60 (2010). On the legacy of Berle and Means and their groundbreaking research, see generally Kelli A. Alces, *Revisiting Berle and Rethinking the Corporate Structure*, 33 SEATTLE U. L. REV. 787 (2010); William W. Bratton, Jr. & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and* The Modern Corporation, 34 J. CORP. L. 99 (2008) [hereinafter Bratton & Wachter, *Corporatist Origins*]; William W. Bratton & Michael L. Wachter, *Tracking Berle's Footsteps: The Trail of* The Modern Corporation*'s Last Chapter*, 33 SEATTLE U. L. REV. 849 (2010); Charles R. T. O'Kelley, *Berle and the Entrepreneur*, 33 SEATTLE U. L. REV. 1141 (2010); Harwell Wells, *The Birth of Corporate Governance*, 33 SEATTLE U. L. REV. 1247 (2010). Hence the moniker 'Berle-Means corporation' in order to designate such type of public corporation, as well as the term 'Berle-Means paradigm' in order to describe the intellectual framework that has informed the study of large publicly-held corporations ever since. *See*, *e.g.*, O'Kelley, *Theory of the Modern Corporation*, *supra* at 759; Bratton, *Century's Turn*, *supra* at 737.

5. William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1400 (1993) [hereinafter Allen, *Contracts and Communities*]; Edward B. Rock & Michael L. Wachter, *Norms & Corporate Law: Introduction*, 149 U. PA. L. REV. 1607, 1608, 1617 (2001) [hereinafter Rock & Wachter, *Norms & Corporate Law*].

6. *See*, *e.g.*, Ronald J. Gilson, *Separation and the Function of Corporation Law*, 2 BERKELEY BUS. L.J. 141, 147 (2005) [hereinafter Gilson, *Separation and Function*] (pointing out that "markets encourage a management and governance structure that fits the corporation's business" and that "[c]orporate law has nothing to add to the process"); Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES MAG., Sept. 13, 1970 [hereinafter Friedman, *Social Responsibility*].

7. *Cf.* ERIC HOBSBAWM, THE AGE OF EXTREMES 103 (1994) (describing how intellectuals and policy makers early in the 20th century already observed that an economy dominated by huge corporations made nonsense of the term 'perfect competition'). *See also* Stephen M. Bainbridge, *Competing Concepts of the Corporation (a.k.a. Criteria? Just Say No)*, 2 BERKELEY BUS. L.J. 77, 81 (2005) [hereinafter Bainbridge, *Just Say No*]; Bainbridge, *The Means and Ends*, *supra* note 3, at 555; Melvin A. Eisenberg, *The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 827–28 (1999); O'Kelley, *Theory of the Modern Corporation*, *supra* note 4; Rock & Wachter, *Norms & Corporate Law*, *supra* note 5, at 1617.

8. *Cf.* D. H. ROBERTSON, THE CONTROL OF INDUSTRY 85 (1923) (stating that firms are "islands of conscious power in this ocean of unconscious co-operation [namely, the market], like lumps of butter coagulating in a pail of buttermilk"); G.B. Richardson, *The Organisation of Industry*, 82 ECON. J. 883, 883 (1972) (describing firms in general as "islands of planned co-

orthodox view would classify them as socialist or nonmarket economies).[9] They are what economists and corporate theorists call 'firms.'[10] And the modern Berle-Means corporation, the type of firm with the largest concentration of economic power and the greatest amount of economic separation from the market,[11] has become the functional *aliud* of nonmarket economies in the sphere of post-capitalist[12] industrial organization. Operating in tandem with global economies of scale,[13] the genius of

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ordination in a sea of market relations"). *See also* Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 393 (1937).

> These, then, are the reasons why organisations such as firms exist in a specialised exchange economy in which it is generally assumed that the distribution of resources is "organised" by the price mechanism. A firm, therefore, consists of the system of relationships which comes into existence when the direction of resources is dependent on an entrepreneur.

Id.; Walter W. Powell, *Neither Market Nor Hierarchy: Network Forms of Organization*, 12 RES. ORGAN. BEHAV. 295, 297 (1990); Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1621 (2001) [hereinafter Rock & Wachter, *Islands of Conscious Power*].

9. *Cf.* Robert G. Eccles & Harrison C. White, *Price and Authority in Inter-Profit Center Transactions*, 94 AM. J. SOC. S17, S18 (1988) (comparing firms with planned economies); Michael J. Meurer, *Law, Economics, and the Theory of the Firm*, 52 BUFF. L. REV. 727, 737 (2004).

> The nature of the firm puzzles economists because the classic hierarchical firm displaces the price signals used to guide economic activity in the market with the same kind of fiat that guides economic activity in planned economies. The parallel between a firm and a planned economy is strong. The control rights to its assets are held collectively, as are the returns from these assets. It is puzzling to find capitalist economies so fully embracing an apparently inefficient mode of organization.

Meurer, *supra* (footnote omitted).

10. *Cf.* Rock & Wachter, *Islands of Conscious Power*, *supra* note 8. There is, of course, also a colloquial, plain-English meaning of the 'firm' which similarly describes a business enterprise. *See*, *e.g.*, MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 438–39 (10th ed. 1996).

11. *Cf.* Coase, *supra* note 8, at 388 (asking "in view of the fact that it is usually argued that co-ordination will be done by the price mechanism, why is such organization necessary?" and then explaining that the "firm . . . consists of the system of relationships which comes into existence when the direction of resources is dependent on an entrepreneur"). *See* COX & HAZEN, *supra* note 4, at 40; Allen, *Contracts and Communities*, *supra* note 5, at 1398; Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 464 (1992); Mark Granovetter, *Business Groups and Social Organization*, *in* THE HANDBOOK OF ECONOMIC SOCIOLOGY 429, 429 (Neil J. Smelser & Richard Swedberg eds., 2000) [hereinafter Granovetter, *Business Groups*]; Meurer, *supra* note 9; Powell, *supra* note 8, at 296–97; Rock & Wachter, *Islands of Conscious Power*, *supra* note 8. *See also* Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691, 692 (1986) (differentiating between specific rights and residual rights in order to explain firm boundaries); Oliver D. Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119, 1119 (1990) (setting forth a framework for addressing the question of "when transactions should be carried out within the firm and when through the market").

12. *Cf.* Lawrence E. Mitchell, *Trust and Team Production in Post-Capitalist Society*, 24 J. CORP. L. 869 (1999) [hereinafter Mitchell, *Trust and Team Production*].

13. *Cf.* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 4; ROBERT CHARLES CLARK, CORPORATE LAW 2 (1986) [hereinafter CLARK, CORPORATE LAW].

American corporate law has enabled economic behemoths of private ordering that not only rival but regularly exceed the productivity and financial wherewithal of nation-state economies.[14]

Consider an oft-cited example in this context: Wal-Mart Stores, Inc. (Wal-Mart).[15] As the world's largest, fully-integrated retailing business,[16] Wal-Mart accumulates to nothing more than a *fiction* in the legal realm[17]—a corporation organized under the laws of the State of Delaware.[18] Its almost four billion outstanding shares of common stock[19] are principally traded on the New York Stock Exchange,[20] but its almost 300,000 shareholders[21] will never be able to touch[22] what they own[23]—in most cases, not even in the

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14. *See*, *e.g.*, Allison D. Garrett, *The Corporation as Sovereign*, 60 ME. L. REV. 129, 131 (2008); Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, *in* THE ICONIC CASES IN CORPORATE LAW 1, 10 (Jonathan R. Macey ed., 2008) [hereinafter Stout, *Why We Should Stop Teaching* Dodge v. Ford].

15. *See*, *e.g.*, Garrett, *supra* note 14, at 146–48; Kent Greenfield, *New Principles For Corporate Law*, 1 HASTINGS BUS. L.J. 87, 101 (2005); Benedict Sheehy, *Corporations and Social Costs: The Wal-Mart Case Study*, 24 J.L. & COM. 1, 33–49 (2004); Stout, *Why We Should Stop Teaching* Dodge v. Ford, *supra* note 14, at 10.

16. *See Corporate Facts: Wal-Mart by the Numbers*, WALMARTSTORES.COM, 2 (Mar. 2010), http://walmartstores.com/download/2230.pdf [hereinafter *Wal-Mart Corporate Facts*].

17. The corporation is a human invention, a fictitious 'legal' person. *See*, *e.g.*, Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 518, 636 (1819) ("A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law."); BLACK'S LAW DICTIONARY 307 (5th ed. 1979) (listing "artificial person" within the definition of corporation); BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 1; CLARK, CORPORATE LAW, *supra* note 13, at 15; Allen, *Contracts and Communities*, *supra* note 5; Bernhard Grossfeld, *Management and Control of Marketable Share Companies*, *in* 13 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW ch. 4, § 2, at 4 (Alfred Conard & Detlev Vagts eds., 2006); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976); Christopher D. Stone, *The Place of Enterprise Liability in the Control of Corporate Conduct*, 90 YALE L.J. 1, 3 (1980) ("*persona ficta*"); Stout, *Why We Should Stop Teaching* Dodge v. Ford, *supra* note 14, at 11. Arguably, all of corporate law (indeed, all of law) is a human invention and, therefore, fictitious. *Cf.* CLARK, CORPORATE LAW, *supra* note 13, at 15.

18. Wal-Mart Stores, Inc., Annual Report (Form 10-K), at 1 (Apr. 1, 2009), *available at* http://ccbn.10kwizard.com/xml/download.php?format=PDF&ipage=6245246 [hereinafter Wal-Mart Form 10-K 2009].

19. As of March 27, 2009, Wal-Mart Stores, Inc. had 3,915,118,871 shares of common stock outstanding. *See id.* at 1.

20. *See* Wal-Mart Stores, Inc.: Listing Profile, NEW YORK STOCK EXCHANGE, http://www.nyse.com/about/listed/wmt.html (last visited Apr. 14, 2011); Wal-Mart Form 10-K 2009, *supra* note 18, at 18.

21. As of March 27, 2009, Wal-Mart had 298,263 common stock shareholders of record. *See* Wal-Mart Form 10-K 2009, *supra* note 18, at 18; WAL-MART STORES, INC., 2009 ANNUAL REPORT 56, *available at* http://walmartstores.com/download/3661.pdf [hereinafter WAL-MART 2009 ANNUAL REPORT].

22. Or see, hear, feel, smell or taste—not that they would really care to. *Cf.* Stout, *Why We Should Stop Teaching* Dodge v. Ford, *supra* note 14, at 11 (stating that "[c]orporations are purely legal creatures, without flesh, blood, or bone"). Since the corporation is a human invention, there is no way of truly reifying the same. *See* WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 117–18 (10th ed. 2007); Bainbridge, *The Means and Ends*, *supra* note 3, at 552–53; Grossfeld, *supra* note 17. Though it should be noted that, etymologically, the word 'firm' (from the Latin '*firmare*' [= to make firm]

form of a physical share certificate.[24] What makes this legal fiction tangible, however, and indeed a vast economic *reality* is that Wal-Mart owns, controls and operates an enormous empire of productive resources which generates superlatives in the global marketplace on an Olympian scale: net sales of $401.2 billion in its 2008 fiscal year;[25] a market capitalization of close to $220 billion at the end of 2008 (ranking Wal-Mart, at the time, the third-largest publicly listed enterprise by market capitalization in the world);[26] sourcing and moving 5.5 billion cases of merchandise[27] through a fully integrated supply chain into 7,873 stores worldwide;[28] all of which facilitated by a global sales force of 2.1 million people[29] serving about four million customers weekly[30] in fifteen different countries of operation.[31] To put it differently: Wal-Mart serves as the nerve center—the central hub

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and '*firmus*' [= firm, solid]—similarly, for example, in German '*Firma*') has exactly that reifying and solidifying meaning. It also means the signature or name under which the business operates, another distinct and exclusive way to denote the idea of something autonomously existing in the marketplace above and beyond the existence of the individual firm participants. *See*, *e.g.*, MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 438–39 (10th ed. 1996). *See also* Hale v. Henkel, 201 U.S. 43, 76 (1906) ("A corporation is, after all, but an association of individuals under an assumed name and with a distinct legal entity."); HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 18–19 (1996) (defining the firm as "the common signatory of a group of contracts" and continuing that "[i]n small firms organized as sole proprietorships, the individual proprietor signs these contracts [but i]n a corporation or a partnership, the party that signs the contracts is a legal entity").

23. There is debate among strands of current corporate theory as to whether shareholders can indeed 'own' the corporation. The 'contractarian' model of corporate theory denies that such is the case. *See*, *e.g.*, Bainbridge, *The Means and Ends*, *supra* note 3 *passim*; Eisenberg, *supra* note 7, at 825–26 (arguing that shareholders own the corporation since they possess most of the incidents of ownership or property rights; thus, stock ownership is private property); Friedman, *Social Responsibility*, *supra* note 6 (stating that "[i]n a free enterprise, private-property system, the corporate executive is an employee of the owners of the business" and "[i]nsofar as his actions . . . reduce returns to stockholders, he is spending their money").

24. Many of Wal-Mart's shareholders will hold their shares issued in 'street name,' i.e., through their bank, broker, trustee or other financial agent. These financial intermediaries will be registered as the shareholders of record and the share certificates will be made out in their name rather than in the name of the actual, i.e., beneficial holders, of Wal-Mart common stock and will be endorsed in blank. *See*, *e.g.*, COX & HAZEN, *supra* note 4, at 485; RICHARD W. HAMILTON & RICHARD A. BOOTH, BLACK LETTER OUTLINES: CORPORATIONS 888 (5th ed. 2006).

25. Wal-Mart Form 10-K 2009, *supra* note 18, at 3. It should be noted that the fiscal year of Wal-Mart Stores, Inc. ends on January 31 each calendar year. *See id.* at 3; WAL-MART 2009 ANNUAL REPORT, *supra* note 21, at 56. Nevertheless, for ease of comparison with various national and the international gross domestic products hereinafter, I shall treat Wal-Mart's fiscal year ended January 31, 2009 to have coincided with the 2008 calendar year.

26. *See* FT Global 500: Market Values and Prices, FIN. TIMES, 1 (Dec. 31, 2008), http://media.ft.com/cms/b5e2c024-dd89-11dd-930e-000077b07658.pdf.

27. *See Walmart: A Leader in Logistics*, WALMARTSTORES.COM, 1 (May 2009), http://walmartstores.com/download/2336.pdf.

28. Wal-Mart Form 10-K 2009, *supra* note 18, at 3–9; WAL-MART 2009 ANNUAL REPORT, *supra* note 21, at 55.

29. Wal-Mart Form 10-K 2009, *supra* note 18, at 11; WAL-MART 2009 ANNUAL REPORT, *supra* note 21, at 2.

30. *See Wal-Mart Corporate Facts*, *supra* note 16, at 2.

31. Wal-Mart Form 10-K 2009, *supra* note 18, at 3.

firm[32]—of a private enterprise that can lay claim to being the largest-scale and most efficient human-built real-time supply-chain operation that ever existed.

If, for a moment, one only focuses on Wal-Mart's 2008 net sales as a benchmark and compares those net sales on a dollar-for-dollar basis, the staggering result is that Wal-Mart concentrated in such fiscal year an economic productivity which equaled approximately 2.8% of the 2008 gross domestic product (GDP) of the United States.[33] In other words: all it took in 2008 were fewer than thirty-six companies the size of Wal-Mart to eclipse the entire productivity of the United States—the nation with the highest productivity in the world[34]—as measured by gross domestic product.[35] And the *entire* human productive output of our planet—as measured in 2008 world GDP by the International Monetary Fund (IMF)—was the equivalent of only 151 Wal-Marts.[36] The 2008 net revenues generated by Wal-Mart exceeded the *individual* 2008 GDPs of OECD member countries like Greece, Denmark, Ireland or Portugal, respectively.[37] Wal-Mart's 2008 productivity matched the *combined* aggregated GDPs of the bottom seventy-three countries of the 181 national economies ranked by the IMF according to gross domestic productivity in 2008.[38] If Wal-Mart Stores, Inc. were a nation state, it would have been the twenty-sixth largest national economy in the world in 2008.[39] Thus, for a private enterprise, Wal-Mart concentrates and wields vast amounts of economic and sociopolitical power while it distributes vast amounts of economic wealth

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32. For a description of the concept of the 'hub firm' used by economists in order to describe what lawyers would usually call the top holding company in a corporate group, see generally Bernard Baudry & David Gindis, *The V-Network Form: Economic Organization and the Theory of the Firm* (Oct. 10, 2005), *available at* http://ssrn.com/abstract=795244.

33. The 2008 U.S. GDP was $14,264.6 billion. News Release, U.S. Dep't of Commerce, Bureau of Economic Analysis, Gross Domestic Product: First Quarter 2009 (Final) / Corporate Profits: First Quarter 2009 (Revised), Table 3 (June 25, 2009), http://www.bea.gov/newsreleases/national/gdp/2009/pdf/gdp109f.pdf. Wal-Mart's $ 401.2 billion net sales in fiscal 2008 divided by $14,264.6 billion equals approximately 0.2812557 (or 2.812557%).

34. *See* World Economic Outlook Database April 2009, INT'L MONETARY FUND, http://www.imf.org/external/pubs/ft/weo/2009/01/weodata/index.aspx (last visited Apr. 15, 2011) [hereinafter World Economic Outlook Database] (listing relevant information that may be downloaded in spreadsheet form).

35. 100% (i.e., all of the 2008 U.S. GDP) divided by 2.8125569% (i.e., Wal-Mart's comparative productivity in fiscal 2008 measured by net sales) equals approximately 35.55483549.

36. The 2008 world GDP, as measured by the IMF, was $60,689.812 billion. World Economic Outlook Database, *supra* note 34. Wal-Mart's $401.2 billion net sales in fiscal 2008 divided by $60,689.812 billion equals approximately 0.00661066 (or 0.661066%). 100% (i.e., all of the 2008 world GDP) divided by 0.661066% (i.e., Wal-Mart's comparative productivity in fiscal 2008 measured by net sales) equals approximately 151.27071785.

37. World Economic Outlook Database, *supra* note 34.

38. *Id.*

39. *Id.*

as well as vast amounts of social costs.[40] As an inevitable result, "the ugly problem of political legitimacy raises its head."[41]

Given this economic megapolity, the core question, thus, becomes: where do the legal *fiction* of Wal-Mart Stores, Inc.—seemingly innocently, as if a mere formality, and ephemerally created and existing under Delaware corporate law[42]—and the economic *reality* of Wal-Mart's global

40. *See* BERLE & MEANS, *supra* note 4, at 352 (arguing that large public corporations were competing with and threatening to supplant the modern state as the dominant form of social organization because of their "concentration of power in the economic field comparable to the concentration of religious power in the mediaeval church or of political power in the national state").

41. Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 604 n.21. *See also* Gilson, *Separation and Function*, *supra* note 6 (pointing out that "markets encourage a management and governance structure that fits the corporation's business" and that "[c]orporate law has nothing to add to the process"); Friedman, *Social Responsibility*, *supra* note 6 (arguing that "the doctrine of 'social responsibility' involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses"). *Cf.* Henry Hansmann & Reinier Kraakman, *What is Corporate Law?*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 1, 18 (Reinier Kraakman et al. eds., 2004) [hereinafter Hansmann & Kraakman, *What is Corporate Law?*] ("As a normative matter, the overall objective of corporate law—as of any branch of law—is presumably to serve the interest of society as a whole."); Mitchell, *Trust and Team Production*, *supra* note 12, at 870 (describing the understanding of corporate organization in terms of team production not only as a "tale . . . of economics alone" but also as "to conceive of the corporation as a political institution" and "as a social institution"); Randall S. Thomas, *What is Corporate Law's Place in Promoting Societal Welfare?: An Essay in Honor of Professor William Klein*, 2 BERKELEY BUS. L.J. 135, 135 (2005) ("It strikes me that the overall goal of good corporate law should be to assist private parties to create wealth for themselves and the economy in a manner that does not inflict uncompensated negative externalities upon third parties."); Steven M.H. Wallman, *Understanding the Purpose of a Corporation: An Introduction*, 24 J. CORP. L. 807, 809–10 (1999) [hereinafter Wallman, *Purpose of a Corporation*] (concluding that corporate governance must be aimed at maximizing "societal wealth over the long term"). To me, it is not clear what should be "ugly" about this problem, other than that it perhaps taints the (perceived or aspired) purity and sanctity of corporate theoretical models. I would simply argue that a *pure* (i.e., non-normative) corporate law (or any law for that matter) does not—and, because it is a complete human fiction anyhow, logically cannot—exist. The perceived 'ugliness' may, therefore, have more to do with personal attitudes and preferences (and I mean this only descriptively); some observers simply may "get real 'squirrelly,'" Lawrence Raful, *What Balance in Legal Education Means to Me: A Dissenting View*, 60 J. LEGAL EDUC. 135, 135 (2010), when they hear what must sound to them as being "diffuse" and "confusing" at best, *cf.* Oliver E. Williamson, *Calculativeness, Trust and Economic Organization*, 36 J.L. & ECON. 453, 469 (1993), or as being "new age stuff" at worst, *cf.* Raful, *supra*. *See also* Douglas A. Kysar, *Sustainability, Distribution, and the Macroeconomic Analysis of Law*, 43 B.C. L. REV. 1, 22 (2001) ("More than one commentator has speculated that the disappearance of limits in macroeconomics serves as a theoretical expedient to avoid difficult questions of distribution."); Ian B. Lee, *Efficiency and Ethics in the Debate About Shareholder Primacy*, 31 DEL. J. CORP. L. 533, 575 (2006) ("The terms 'morality' and 'justice' may raise red flags for readers skeptical of deontology and inclined toward consequentialism."); Lawrence E. Mitchell, *Understanding Norms*, 49 U. TORONTO L.J. 177, 203 (1999) ("Norms are fuzzy because people are fuzzy and life is fuzzy.") (footnote omitted); Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697, 1699 (1996) ("Norms are fuzzy.").

42. The legal fiction of a corporation in corporate law (whether in Delaware as in the case of Wal-Mart Stores, Inc. or in other jurisdictions within the United States and internationally) is created and governed by three discrete categories or sources of law: (i) the 'internal' law of the corporation itself set forth in its so-called constituent or charter documents (certificate or articles

productive empire intersect (if not, collide)? And the answer may be: within what can be described as the dichotomous dimensions of corporate legal theory.[43] These dichotomies provide American corporate law with a principal range of ultimately dialectic jurisprudential foundations which collectively translate the real world of Wal-Mart's business enterprise into what appears to be a rather simple and straight-forward legal construct—namely, the corporate legal entity.

This construct—as most everything else in American private law—is based on the acquired interest preferences of a libertarian, free-enterprise-oriented society.[44] It has evolved over time—as has arguably all of corporate law (often guided, even if unaware, by principles of transaction cost economics)[45]—in order to provide cost-efficient 'prefab,' 'off-the-rack'[46] governance mechanisms designed to standardize the regulation and

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of incorporation and by-laws); (ii) the applicable corporate code in the corporation's jurisdiction of incorporation; and (iii) the corporate case law and legal precedents in the corporation's jurisdiction of incorporation that either deal with the interpretation and application of the relevant internal law and/or corporate code provisions or otherwise supplement those provisions in the absence of any internal law or code guidance. *See*, *e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 7 n.1; Stout, *Why We Should Stop Teaching* Dodge v. Ford, *supra* note 14, at 5.

43. Allen, *Contracts and Communities*, *supra* note 5, at 1403–04 (pointing out the dichotomy between a positivistic, utilitarian, rules-bound worldview of corporate law and a flexible, moralistic, standard-based one); Millon, *supra* note 4, at 201 (describing three dimensions/dichotomies as relevant to theories of the corporation: (i) corporation as an entity versus corporation as an aggregation of individuals without separate existence; (ii) corporation as an "artificial creation of state law" versus "corporation as a natural product of private initiative"; and (iii) corporate law as a subject of public interest concerns versus corporate law governing solely the private relations between owners and managers).

44. *Cf.* O'Kelley, *Theory of the Modern Corporation*, *supra* note 4. The classical and then neoclassical economic position is that the political, economic, and legal systems need to provide (i) strong legal protection of the entrepreneur's property right to own and control productive assets, as well as (ii) strict limits on the power of state actors to regulate and control economic activity. *Cf.* Harold Demsetz, *The Theory of the Firm Revisited*, 4 J.L. ECON. & ORG. 141, 159–60 (1988).

45. The field of transaction cost economics (TCE), a part of new institutional economics (NIE), was developed by Oliver Williamson (who also coined the term 'new institutional economics'). *See*, *e.g.*, OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975) [hereinafter WILLIAMSON, ANALYSIS AND ANTITRUST IMPLICATIONS]; OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING (1985); Oliver E. Williamson, *Introduction*, *in* THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT 3 (Oliver E. Williamson & Sidney G. Winter eds., 1991); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233 (1979); Oliver E. Williamson, *Transaction Cost Economics Meets Posnerian Law and Economics*, 149 J. INST. & THEORETICAL ECON. 99 (1993); Oliver E. Williamson, *Why Law, Economics, and Organization?*, *in* THE ORIGINS OF LAW AND ECONOMICS: ESSAYS BY THE FOUNDING FATHERS (Francesco Parisi & Charles K. Rowley eds., 2005). *See also* Allen, *Contracts and Communities*, *supra* note 5, at 1399; Rudolf Richter, *The New Institutional Economics: Its Start, Its Meaning, Its Prospects*, 6 EUR. BUS. ORG. L. REV. 161, 163–65, 174–75 (2005) (discussing the development of NIE by Oliver Williamson).

46. COX & HAZEN, *supra* note 4, at 42; Allen, *Contracts and Communities*, *supra* note 5; Bainbridge, *The Means and Ends*, *supra* note 3, at 559; Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 783 (2006).

solution of irreducible interest conflicts which define the corporate endeavor,[47] in particular, in its publicly held variant with widely-dispersed shareownership and an almost complete separation of ownership and control.[48]

In its continued evolution, the construct of the Berle-Means corporation—both as a legal entity and as an economic concentration of productive resources in the form of specific investments of dozens of different firm constituencies—is a priori forced to navigate among, and wrestle with, irradicable and irreducible dialectic dichotomies. Those include—*a minore ad majus*:

- the fundamental agency problem of managerial primacy (the allocation of control with, and the resultant *discretion* of, corporate decisionmakers) and shareholder/stakeholder primacy (the allocation of controlling property and/or contract rights with, and the resultant *accountability* to, specific firm participants);[49]

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47. *Cf.* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 3–4; COX & HAZEN, *supra* note 4; Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 21, 22 (Reinier Kraakman et al. eds., 2004) [hereinafter Hansmann & Kraakman, *Agency Problems*].

48. *See* Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 923 (1984) [hereinafter Romano, *Metapolitics*]. *See also* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 3–4 ("The conflicts of interest created by [the] separation of ownership and control drive much of corporate law . . . ."); BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 6 (discussing the effects of the separation of ownership and control under the heading "The Central Problem of Corporate Governance"); Alces, *supra* note 4, at 787 (describing the separation of ownership and control and the resultant agency cost problem as "a central concern of the law of corporate governance"); O'Kelley, *Theory of the Modern Corporation*, *supra* note 4 (stating that the "central problem of the modern corporation" is found in its "separation of ownership and control"); Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 740 (1997) ("The essence of the agency problem is the separation of management and finance, or—in more standard terminology—of ownership and control."). The separation of ownership and control as the defining, characteristic notion of (most) public corporations was first thoroughly described by Adolf Berle and Gardiner Means. BERLE & MEANS, *supra* note 4. *But see* KNIGHT, *supra* note 4 ("The typical form of business unit in the modern world is the corporation. Its most important characteristic is the combination of diffused ownership with concentrated control."). *See also* BAINBRIDGE, CORPORATE LAW, *supra* note 4; COX & HAZEN, *supra* note 4; Bratton, *Century's Turn*, *supra* note 4; Hart, *An Economist's View*, *supra* note 4; Millon, *supra* note 4; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4.

49. *See*, *e.g.*, STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 207 (2002) ("Establishing the proper mix of discretion and accountability . . . emerges as the central corporate governance question.") [hereinafter BAINBRIDGE, CORPORATION LAW AND ECONOMICS]; Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 84 (2004) [hereinafter Bainbridge, *Abstention Doctrine*]; Margaret M. Blair & Lynn A. Stout, *Team Production in Business Organizations: An Introduction*, 24 J. CORP. L. 743, 743 (1999) [hereinafter Blair & Stout, *Team Production*] (describing the agency cost problem of monitoring managers and motivating them to act as faithful agents as "the central economic problem to be faced in a public corporation" for those following the principal-agent model of the firm); Dooley, *supra* note 11, at 524–25; Darian M. Ibrahim, *Individual or Collective Liability for Corporate Directors?*, 93 IOWA L. REV. 929, 947–48 (2008); Lawrence E. Mitchell, *Trust. Contract. Process.*, *in* PROGRESSIVE CORPORATE LAW 185, 188–89 (Lawrence E. Mitchell ed., 1995) [hereinafter Mitchell, *Trust. Contract. Process.*]; Pinto, *supra* note 4, at 266; Larry E. Ribstein,

- shareholder wealth (maximum *market value*) and stakeholder welfare (maximum *societal value*);[50]
- market and hierarchy;[51]
- Aristotelean notions of rectification (*corrective justice*) and fairness (*distributive justice*);[52]
- market liberalism (*private liberty*) and utilitarianism (*social utility*);[53] and
- the dialectics between the private/internal/market and the public/external/regulatory spheres of institutional power over the governance of the corporation (*market* and *polity*).[54]

The first two dichotomies are what can be termed 'microdichotomies' because they inhere in corporate law and corporate law only. In contrast thereto, the remaining four dichotomies can be described as 'macrodichotomies.' They are present in all areas of private law, including corporate law.[55]

In what aims to be an essentially descriptive (i.e., positive rather than normative) account, Part II.A. of this Article will trace the first two dialectic

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Why Corporations?, 1 BERKELEY BUS. L.J. 183, 198 (2004) [hereinafter Ribstein, *Why Corporations?*]; Shleifer & Vishny, *supra* note 48, at 742–44.

50. *See*, *e.g.*, William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264–65 (1992) [hereinafter Allen, *Schizophrenic Conception*]; Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 639–40 (2006); Gilson, *Separation and Function*, *supra* note 6, at 143 (stating that "the criteria for good corporate law are limited to a single overriding goal: facilitating the maximization of shareholder wealth"); Hansmann & Kraakman, *What is Corporate Law?*, *supra* note 41; Mitchell, *Trust and Team Production*, *supra* note 12, at 870; Thomas, *supra* note 41; Wallman, *Purpose of a Corporation*, *supra* note 41. *See also* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 599 (describing as a critical fact for the intellectual vigor of corporate law that "all of the interesting and challenging issues involve the resolution of conflicts between corporate participants").

51. *See*, *e.g.*, WILLIAMSON, ANALYSIS AND ANTITRUST IMPLICATIONS, *supra* note 45; Oliver E. Williamson, *The Logic of Economic Organization*, 4 J.L. ECON. & ORG. 65, 73 (1988) (arguing that is "necessary to identify and describe the principal governance structures—firms, market, hybrid modes—to which transactions might feasibly be assigned"). *See also* Meurer, *supra* note 9, at 729–30; Powell, *supra* note 8, at 297; Rock & Wachter, *Islands of Conscious Power*, *supra* note 8, at 1631; Baudry & Gindis, *supra* note 32, at 1.

52. *See*, *e.g.*, Gregory C. Keating, *Distributive and Corrective Justice in the Tort Law of Accidents*, 74 S. CAL. L. REV. 193, 194–95 (2000); Ernest J. Weinrib, *Corrective Justice in a Nutshell*, 52 U. TORONTO L.J. 349, 349 (2002); Ernest J. Weinrib, *Liberty, Community, and Corrective Justice*, 1 CAN. J.L. & JURISPRUDENCE 3, 4–5 (1988); Richard W. Wright, *The Principles of Justice*, 75 NOTRE DAME L. REV. 1859, 1868, 1889–92 (2000).

53. *See*, *e.g.*, Allen, *Contracts and Communities*, *supra* note 5, at 1396; Romano, *Metapolitics*, *supra* note 48, at 926.

54. *See*, *e.g.*, Bainbridge, *The Means and Ends*, *supra* note 3, at 549; Bratton, *Century's Turn*, *supra* note 4, at 760–61; Millon, *supra* note 4, at 202; Richter, *supra* note 45, at 177 (describing Douglass North's concept of new institutional economics of history as aiming "at a general theory of the interaction between polity and economy").

55. More precisely, the third dichotomy, market and hierarchy, is a hybrid realm in that it evidences both micro- and macrodichotomous characteristics.

dichotomies: *discretion* vs. *accountability*,[56] and *market value* vs. *societal value*.[57] Both, as microdichotomies, fundamentally inform current corporate theory (and, thus, the genius of American corporate law). They represent the main, overarching focal points of corporate governance—as well as of most of today's debate in corporate legal theory. Both correspond with attempts to answer two deceptively simple, but fundamentally elusive and, therefore, at least partially unanswered questions of corporate governance (the first such question is, in essence, a *procedural* and *positive* question; the second a *substantive* and *normative* one):[58]

1. "Who Control(s)?"; and

2. "Whose Interest(s) Control(s)?".

We have come a long way since the time that the governance and inner workings of corporate entities were regarded as a kind of 'black box' (in the sense of observable inputs, 'hidden inner magic,' observable outputs, and end of story).[59] We have also come a long way since the thrust of corporate law has been equated to "towering skyscrapers of rusted girders, internally welded together and containing nothing but wind."[60] We have come to

56. *See supra* note 49 and accompanying text.

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

58. *See* BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 10; Bainbridge, *The Means and Ends*, *supra* note 3, at 549–50 (asking "(1) as to the means of corporate governance, who holds ultimate decisionmaking power? and (2) as to the ends of corporate governance, whose interests should prevail?"). *See also* CLARK, CORPORATE LAW, *supra* note 13, at 690 ("*Who decides* how the corporation's general purpose is to be accomplished?"); Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 408 (2001) [hereinafter Blair & Stout, *Director Accountability*] (asking "(1) what the law requires of directors, (2) whose interests boards should serve, and (3) how boards actually work").

59. *Cf.* Allen, *Contracts and Communities*, *supra* note 5, at 1398 (stating that, until recently, "the internal operation of corporate actors was no more interesting than the internal operation of human actors"); Meurer, *supra* note 9, at 729–30 (describing the original theories of Coase and Williamson as treating the firm "like a black box in which authority avoids transaction costs" and concluding that "[m]odern research on the firm opens up the black box and gives a better account of how firms are organized and the costs and benefits of firm governance"); O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 757 (stating that the firm is a 'black box' in classical and neoclassical perfect competition theory); Powell, *supra* note 8, at 296 (describing the paradigm shift developed by Ronald Coase in 1937, conceiving of the firm as a governing structure, thus, "breaking with orthodox accounts of the firm as a 'black box' production function"); Stone, *supra* note 17, at 8 (claiming that regulatory enforcement intervention imposes direct and selective constraints on how investors and managers work out various internal firm relationships and the 'black box' prerogative of the enterprise's interior is, thus, overcome).

60. Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962). *See also* Lyman P.Q. Johnson, *Faith and Faithfulness in Corporate Theory*, 56 CATH. U. L. REV. 1, 1 (2006) (stating that corporate law scholarship was "[v]irtually nontheoretical until the mid-1970s"); O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 763 (stating that after the Berle-Means era, "corporation law scholarship, if not 'dead,' was certainly viewed as an intellectual backwater"); Romano, *Metapolitics*, *supra* note 48 (confirming that "[u]ntil recently, corporate law has been an uninspiring field for research even to some of its most astute students.").

regard and explore—as the central objective function of corporate law[61]—its need to provide an efficient governance system for the internal functionality of the incorporated firm which allows such firm to survive and prosper (i.e., the formerly 'hidden inner magic').[62]

For the firm to be able to do just that (i.e., to survive and prosper), the corporate governance system must: (i) allocate authority for making adaptive decisions on behalf of the firm within some (core) group of decisionmakers (thus, answering the question "*Who Control(s)?*");[63] and (ii) if at all possible, define the norms and interests that should guide such internal decisionmakers in their decisionmaking (thus, solving the question "*Whose Interest(s) Control(s)?*").[64]

In order for the firm to be able to do so efficaciously[65] and with continued success of adaptation, survival, and prosperity (in other words, in order to assure firm *sustainability*), the corporate governance system must provide a framework that allows the firm to unceasingly strive to achieve an optimal dynamic equilibrium[66]—both: (a) among *competing interests* of firm participants (for example, shareholders, directors, managers, employees, unions, customers, financial creditors, suppliers, etc.)—again, if such balancing is possible (and, in particular, ex ante predictable);[67] and (b) between *discretion* and *accountability* of firm management (i.e., the decisionmakers).[68] Put differently, the corporate governance system needs

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61. *Cf.* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 611.

62. *Cf.* Bainbridge, *The Means and Ends*, *supra* note 3, at 552; Rock & Wachter, *Islands of Conscious Power*, *supra* note 8, at 1622.

63. *Cf.* Dooley, *supra* note 11, at 466; Susanna K. Ripken, *Corporations Are People Too: A Multi-Dimensional Approach to the Corporate Personhood Puzzle*, 15 FORDHAM J. CORP. & FIN. L. 97, 127–28 (2009) (discussing the treatment of the corporation's internal decision structure (CID Structure) as developed by philosopher Peter French in PETER A. FRENCH, COLLECTIVE AND CORPORATE RESPONSIBILITY ch. 4 (1984) and Peter A. French, *The Corporation as a Moral Person*, 16 AM. PHIL. Q. 207, 211 (1979)).

64. *See*, *e.g.*, BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 10, 21; CLARK, CORPORATE LAW, *supra* note 13, at 690; Allen, *Contracts and Communities*, *supra* note 5; Bainbridge, *The Means and Ends*, *supra* note 3, at 552; Dooley, *supra* note 11, at 466. *See also* Rock & Wachter, *Islands of Conscious Power*, *supra* note 8 (explaining that a "theory of the firm can also help us figure out . . . the role the law plays in facilitating or interfering with solutions [among firm participants]").

65. Regarding my preference for the term 'efficaciousness' over 'efficiency' in this context, which captures the idea of a corporate governance structure that has the *power* to produce efficiencies over time and under ever-changing circumstances, see Richter, *supra* note 45, at 175.

66. *Cf.* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 599 (describing the interactions of firm participants "in equilibirium" within the corporate firm which involves the ongoing "resolution of conflicts between corporate participants"); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 27 (1991).

67. *Cf.* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 599.

68. *See supra* note 49 and accompanying text. *See also* KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 78 (1974) [hereinafter ARROW, THE LIMITS OF ORGANIZATION] ("If every decision of A is to be reviewed by B, then all we have really is a shift in the locus of authority

to balance and reconcile (i) the need to protect each group of firm participants from potential downside risks created by opportunistic behavior of other groups of firm participants,[69] and (ii) the need to encourage firm managers to act as entrepreneurs and to incur operational risks in order to increase firm value outputs. It is in this regard that we are talking about the central agency (cost) problem of the modern public corporation as the logical result of its separation of ownership and control.[70] But the problem (and the academic inquiry into such problem), by necessity, has been broadening for a long time.[71] Corporate decisionmakers must be seen, at least functionally, as economic agents aiming (and maybe even charged) to serve and benefit the welfare of all of the firm's participants, not only its shareholders.[72]

My first conclusion—developed in Part II of this Article—to the two fundamental questions of "*Who Control(s)?*" and "*Whose Interest(s) Control(s)?*" is that, for the former question, we have arrived at a fairly

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from A to B and hence no solution to the original problem."); BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 11.

> Neither discretion nor accountability can be ignored because both promote values essential to the survival of business organizations. Unfortunately, they are ultimately antithetical: one cannot have more of one without also having less of the other. At some point, directors cannot be made more accountable without undermining their discretionary authority.

Bainbridge, *The Means and Ends*, *supra* note 3, at 573 (footnote omitted); Dooley, *supra* note 11, at 470.

69. *See* Blair & Stout, *Team Production*, *supra* note 49, at 746.

70. *See*, *e.g.,* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 3–4; *id.* at 75 ("Much of corporate law is best understood as a mechanism for containing . . . agency costs."); COX & HAZEN, *supra* note 4; Blair & Stout, *Team Production*, *supra* note 49; Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1807 (2001) [hereinafter Blair & Stout, *Trust*]; Phillip I. Blumberg, *Corporate Responsibility and the Social Crisis*, 50 B.U. L. REV. 157, 177 (1970); Hansmann & Kraakman, *Agency Problems*, *supra* note 47; Millon, *supra* note 4, at 221; Marcel Kahan, *The Limited Significance of Norms for Corporate Governance*, 149 U. PA. L. REV. 1869, 1877–78 (2001); O'Kelley, *Theory of the Modern Corporation*, *supra* note 4; Rock & Wachter, *Islands of Conscious Power*, *supra* note 8, at 1624; Shleifer & Vishny, *supra* note 48, at 740–48 (discussing the agency problem as the central problem of corporate governance). *See also* Richter, *supra* note 45, at 179 (stating that the central problem of Williamsonian transaction cost economics is ex-post opportunism).

71. The problem, arguably, has been broadening since Adolf Berle and Gardiner Means published THE MODERN CORPORATION AND PRIVATE PROPERTY in 1932. *Cf.* BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 4–5 (describing Berle and Means' treatise as "what still may be the most influential book ever written about corporations"); Romano, *Metapolitics*, *supra* note 48, at 923 (describing the same as the "last major work of original scholarship").

72. *See*, *e.g.*, Gilson, *Separation and Function*, *supra* note 6, at 146 (observing that "one cannot run a successful business without taking seriously the role of non-shareholders whose contributions are important to the corporation's success"); Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 604 n.21 (acknowledging that distributional/allocational concerns are underlying central board functions, at least within the Blair/Stout Team Production Model discussed *infra*). *See also supra* note 41 and accompanying text.

good idea of an answer in the form of partially overlapping[73] director primacy models developed by Margaret Blair and Lynn Stout[74] on the one hand, and Stephen Bainbridge[75] on the other. It seems evident from those director primacy models that the maxim of corporate law with regard to the first (procedural) question of corporate governance is to establish centralized, autocratic decisionmaking within the corporate structure.[76] Indeed, corporate law squarely situates the board of directors at the very top of a hierarchical, centralist command-and-control structure that controls the corporate business and affairs.[77] However, when we approach the second

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73. Professor Bainbridge acknowledges that his director primacy model partially overlaps with the Blair/Stout Team Production Model when he states that such "team production model somewhat resembl[es] director primacy, but also differ[s] from director primacy in key respects." Bainbridge, *The Means and Ends*, *supra* note 3, at 551.

74. Blair & Stout, *Director Accountability*, *supra* note 58; Margaret M. Blair & Lynn A. Stout, *Specific Investment and Corporate Law*, 7 EUR. BUS. ORG. L. REV. 473 (2006) [hereinafter Blair & Stout, *Specific Investment*]; Margaret M. Blair & Lynn A. Stout, *Specific Investment: Explaining Anomalies in* Corporate Law, 31 J. CORP. L. 719 (2006) [hereinafter Blair & Stout, *Explaining Anomalies in* Corporate Law]; Blair & Stout, *Team Production*, *supra* note 49; Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) [hereinafter Blair & Stout, *Corporate Law*]; Blair & Stout, *Trust*, *supra* note 70, at 1735. *See generally* Stephanie Ben-Ishai, *A Team Production Theory of Canadian Corporate Law*, 44 ALBERTA L. REV. 299 (2006); Allen Kaufman & Ernie Englander, *A Team Production Model of Corporate Governance*, ACAD. MGMT. EXECUTIVE, Aug. 2005, at 9; Lynn M. LoPucki, *A Team Production Theory of Bankruptcy Reorganization*, 57 VAND. L. REV. 741, 743 (2004); Alan J. Meese, Essay, *The Team Production Theory of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629 (2002); Mitchell, *Trust and Team Production*, *supra* note 12; D. Gordon Smith, *Team Production in Venture Capital Investing*, 24 J. CORP. L. 949 (1999). *See infra* Part II.A.3 (discussing the Blair/Stout team production model).

75. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 49; BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2; Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1 (2002) [hereinafter Bainbridge, *Nexus of Contracts*]; Bainbridge, *Abstention Doctrine*, *supra* note 49; Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006) [hereinafter Bainbridge, *Limited Shareholder Voting Rights*]; Bainbridge, *Just Say No*, *supra* note 7; Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006) [hereinafter Bainbridge, *Shareholder Disempowerment*]; Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791 (2002) [hereinafter Bainbridge, *Corporate Takeovers*]; Bainbridge, *The Means and Ends*, *supra* note 3; Bainbridge, *Convergence Debate*, *supra* note 2; Stephen M. Bainbridge, *Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency*, 1 J. BUS. & TECH. L. 335 (2007) [hereinafter Bainbridge, *Much Ado About Little*]; Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769 (2006); Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1 (2002) [hereinafter Bainbridge, *Group Decisionmaking in Corporate Governance*]. *See also* Ribstein, *Why Corporations?*, *supra* note 49, at 196–98. *See generally* Brett H. McDonnell, *Professor Bainbridge and the Arrowian Moment: A Review of* The New Corporate Governance in Theory and Practice, 34 DEL. J. CORP. L. 139 (2009). *See infra* Part II.A.4 (discussing the Bainbridge director primacy model).

76. *Cf.* CLARK, CORPORATE LAW, *supra* note 13, at 21; Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89, 95 (2004) [hereinafter Gevurtz, *Origins of the Corporate Board*]; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 756.

77. *See*, *e.g.*, DEL. CODE ANN. tit. 8 § 141(a) (West 2010) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of

(substantive) question of corporate governance, my views move into starker contrast with the two director primacy models as currently developed. The Blair/Stout team production model[78] insists that the board of directors remains somehow accountable to the productive team and all of its participants—namely as a 'trustee' and 'fiduciary' to whom team members have ceded control.[79] The Bainbridge director primacy model assumes that the same shareholder wealth maximization principle employed in shareholder primacy models[80] must remain the fundamental norm in order

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directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."); REV. MODEL BUS. CORP. ACT § 8.01 (1984) ("All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation managed by or under the direction, and subject to the oversight, of its board of directors . . . ."); BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 3, 72, 74 ("[T]he board is at the apex of the corporate hierarchy . . . ."); COX & HAZEN, *supra* note 4, at 149 ("A corporation's board of directors is legally the supreme authority in matters of the corporation's regular business management.") (footnote omitted); Gevurtz, *Origins of the Corporate Board*, *supra* note 76, at 92–94; Lynn A. Stout, *On the Proper Motives of the Corporate Directors (Or, Why You Don't Want to Invite* Homo Economicus *to Join Your Board)*, 28 DEL. J. CORP. L. 1, 2 (2003) [hereinafter Stout, *Proper Motives*].

It should be noted that, in practice, most operational decisions—both day-to-day decisions as well as many long-term policy decisions—are taken by corporate officers and other senior-management employees of the corporation pursuant to authority delegated by the board of directors. *See*, *e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 73, 89; COX & HAZEN, *supra* note 4, at 136. Often, the corporation's chief executive officer (CEO) must be seen as the principal decisionmaker of the corporation. *See* O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 756. The absolute director primacy model developed in this Article includes all decisionmakers, including all officers of the corporation as well as its senior management employees, whose decisionmaking authority is derivative from the original and *sui generis* decisionmaking power granted to the board of directors by state corporation statutes. Such inclusive treatment of officers and senior management employees correlates with the legal constraints established by corporate law for purposes of director accountability, namely fiduciary duties, which are also applied by state corporation statutes to corporate officers, and by agency law rules to senior management employees, in a similar fashion. Finally, under the preferred board model in the United States, it is also of significance in this regard that the CEO regularly functions in a dual capacity: both as the most senior officer of the corporation and as the chairman of the corporation's board of directors. Thus, the CEO—and often many other senior officers of the corporation—is a (inside) board director in the first place. Notwithstanding this proliferation and delegation of corporate decisionmaking power, it has been said that "[i]n today's business environment, the buck ultimately stops in the boardroom, not the corner office." Stout, *Proper Motives*, *supra* note 77, at 3. Accordingly, I feel justified to commingle the director and officer/management spheres of decisionmaking and, therefore, to solely focus on director decisionmaking behavior for purposes of this Article. *See* Hart, *An Economist's View*, *supra* note 4, at 299 n.2.

78. The Blair/Stout team production model can be seen as a progeny of the seminal article by Michael Jensen and William Meckling in 1976 that "accelerated the deconstruction of the corporation." Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 599; Jensen & Meckling, *supra* note 17, at 305.

79. Blair & Stout, *Director Accountability*, *supra* note 58, at 425 (fiduciary); Blair & Stout, *Corporate Law*, *supra* note 74, at 291 ("In the eyes of the law, corporate directors are a unique form of fiduciary who, to the extent they resemble any other form, perhaps most closely resemble trustees.") (footnote omitted); Blair & Stout, *Team Production*, *supra* note 49, at 746 (trustee). *See also* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 880 (stating that "directors occupy a trustee-*like* position").

80. *See infra* Part II.A.1 (discussing the shareholder primacy model).

to guide—and to constrain where necessary—the ultimate decisionmaker (i.e., the board of directors).[81]

I am convinced otherwise. My second conclusion, developed in Part II of this Article, therefore posits that a satisfactory answer to the second, substantive question of corporate governance ("*Whose Interest(s) Control(s)?*") remains indeterminable within current models of corporate theory—in particular when today's variant theoretical constructs of the corporate form are 'marred' with a realistic and pragmatic[82] (i.e., not aspirationally or doctrinally oriented) analysis of American corporate law as it is currently 'on the books.'[83] In my view, *nothing* within corporate law—whether conceptualized and phrased as property rights or as 'contractual'[84] interests—seems to achieve a meaningful modicum of predictive ability[85] for decisionmaker behavior ex ante and, thus, inherent therein,

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81. Bainbridge, *Convergence Debate*, *supra* note 2, at 48; Bainbridge, *Nexus of Contracts*, *supra* note 75; Bainbridge, *The Means and Ends*, *supra* note 3, at 551, 592; Bainbridge, *Shareholder Disempowerment*, *supra* note 75. *See also* O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 756 n.19.

82. It has been stated in a somewhat different context that "[c]orporate law at its heart is an exercise in pragmatism, . . . a device not a model." Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 600. It should be noted, however, that most devices are usually designed and built after some modeling.

83. *Cf.* Wallman, *Purpose of a Corporation*, *supra* note 41, at 809, 813–14.

84. The nexus-of-contracts (or contractarian) theory of the firm developed by economists, *see infra* Part II.A.2, uses the words 'contract' and 'contractual' in a broader sense to include "non-consensual rational economic relationships" that are premised on implicit, self-governing arrangements between firm participants which do not constitute actual contracts in the legal sense. *See*, *e.g.*, HAMILTON & BOOTH, *supra* note 24, at 330; Bainbridge, *Nexus of Contracts*, *supra* note 75, at 10–11; Eisenberg, *supra* note 7, at 822–23; Rock & Wachter, *Islands of Conscious Power*, *supra* note 8, at 1640–41; Rock & Wachter, *Norms & Corporate Law*, *supra* note 5, at 1613. Accordingly, within this Article I indicate such broader contractarian use of the words 'contract' and 'contractual' by enclosing them in single quotation marks.

85. Predictive ability and accuracy is, of course, the main criterion by which positive (descriptive) economic models are evaluated. *See*, *e.g.*, MILTON FRIEDMAN, ESSAYS IN POSITIVE ECONOMICS 11–12 (1953) ("But economic theory must be more than a structure of tautologies if it is to be able to predict and not merely describe the consequences of action; if it is to be something different from disguised mathematics.") (footnote omitted).

> Positive economics submits itself to the rigor of scientific method. Submission means that the model's value is to be judged not only by its internal consistency and adherence to accepted principles, but also by its ability to predict the occurrence of events in the real world. It must be possible to derive from the model behavioral implications, at least some of which must be empirically falsifiable and therefore testable.

Fred S. McChesney, Book Review Essay, *Positive Economics and All That—A Review of the Economics Structure of Corporate Law* by Frank H. Easterbrook & Daniel R. Fischel, 61 GEO. WASH. L. REV. 272, 278 (1992) (reviewing FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991)); McChesney, *The "Trans Union" Case*, *supra* note 2; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 755, 757. *See also* BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 2–3; Bainbridge, *Nexus of Contracts*, *supra* note 75, at 1; Bainbridge, *Just Say No*, *supra* note 7; Lawrence E. Mitchell, *The Importance of Being Trusted*, 81 B.U. L. REV. 591, 596 (2001) [hereinafter Mitchell, *Importance of Being Trusted*].

accountability of decisionmakers ex post. There is *no* quantum of control in corporate law which would ensure the general inviolability of any firm participant interest at any given point in time. Put differently—whether we like it or not—a disinterested corporate board is *uncontrollable* in absolute terms within the law.[86]

In this regard, the business judgment rule[87]—applied ex post[88]—can be viewed as a decided refusal by corporate law to provide model-immanent meaning to the second, substantive question of corporate governance.[89] Obviously, there are market mechanisms ex post[90] that do address agency

86. *Cf.* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 226 ("In practice, however, cases in which the business judgment rule does not shield operational decisions from judicial review are so rare as to amount to little more than aberrations."); Rock & Wachter, *Islands of Conscious Power*, *supra* note 8, at 1623 (describing the business judgment rule as "assuring that enforcement [of the duty of care] is almost entirely nonlegal"); Stout, *Proper Motives*, *supra* note 77, at 6 ("The business judgment rule . . . allows a director who makes even a minimal effort to become 'informed' to make foolhardy decisions all day long, without fear of liability."); *id.* at 7 ("[I]t is only a slight exaggeration to suggest that a corporate director is statistically more likely to be attacked by killer bees than she is to have to ever pay damages for breach of the duty of care.").

87. The business judgment rule—as the central instrument of judicial review of alleged violations of director fiduciary duties (care, loyalty, obligation of good faith)—operates as a presumption (whether in the form of a standard of review or in the form of a judicial abstention doctrine) that "in making a business decision the directors of a corporation have acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). *See*, *e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (citing *Aronson*, 473 A.2d at 812); BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 109–10; COX & HAZEN, *supra* note 4, at 184–85; STEPHEN A. RADIN, 1 THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 11–23 (6th ed. 2009); Stout, *Proper Motives*, *supra* note 77, at 6.

88. *Cf.* Allen, *Contracts and Communities*, *supra* note 5, at 1404 (stating that fiduciary duties tend to be analyzed in a "particularistic *ex post* style").

89. Rock & Wachter, *Islands of Conscious Power*, *supra* note 8, at 1623 (describing the business judgment rule as "a jurisdictional rule that facilitates a self governing [norm-based] relationship by preventing parties from turning to third-party adjudicators" and "assuring that enforcement [of the duty of care] is almost entirely nonlegal"). *See also* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 110 (concluding that pursuant to the effects of the business judgment rule, corporate directors are given a "carte blanche to make decisions that might turn out badly, but no discretion to make selfish decisions."); Blair & Stout, *Team Production*, *supra* note 49, at 746 (stating that, as a matter of law, corporate directors remain "insulated from the direct command and control of [shareholders] or any other corporate constituents"); Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1470 (2006) [hereinafter Ribstein, *Accountability and Responsibility*]; Stout, *Proper Motives*, *supra* note 77, at 6 (stating that the business judgment rule "allows a director who makes even a minimal effort to become 'informed' to make foolhardy decisions all day long, without fear of liability").

90. *See*, *e.g.*, Bainbridge, *The Means and Ends*, *supra* note 3, at 562; Blair & Stout, *Explaining Anomalies in* Corporate Law, *supra* note 74, at 724; Blair & Stout, *Corporate Law*, *supra* note 74, at 252; Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105, 119–20 (2006); Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POLITICAL ECON. 110, 112 (1965); Millon, *supra* note 4, at 230; Pinto, *supra* note 4, at 276–79. *See generally* Daniel P. Forbes & Frances J. Milliken, *Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups*, 24 ACAD. MGMT. REV. 489 (1999).

These post-investment, corrective market mechanisms include, for example, (i) the so-called market for corporate control or hostile-takeover market—which, of course, depends on the

costs in the form of wasteful managerial shirking and/or rent-seeking.[91] However, those after-the-fact correctives, in my judgment, do not help *in any way* with firm investments to be made confidently ex ante.[92] And, from all we can tell, those investments are made—daily and literally millions of times over[93]—and with a good measure of predictive accuracy therefore allowing investor confidence and economic efficiency ex ante.[94]

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general financial feasibility of corporate mergers and takeovers in a given economy and industry, *see*, *e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 74, (ii) product-market competition, *see*, *e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 75; COX & HAZEN, *supra* note 4, at 37; Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6. J. LEGAL STUD. 251, 289 (1977), (iii) manager-market competition, *see*, *e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 75; COX & HAZEN, *supra* note 4, at 37, and (iv) shareholder activism by institutional and other investors with significant enough stockholdings (though there is much debate about the extent of which the 'rational apathy phenomenon' also applies to those large-scale investors), *see*, *e.g.*, CLARK, CORPORATE LAW, *supra* note 13, at 390–92; Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 524–25 (1990); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991); Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 796 (1993); Robert D. Rosenbaum, *Foundations of Sand: The Weak Premises Underlying the Current Push for Proxy Rule Changes*, 17 J. CORP. L. 163 (1991). Furthermore, monitoring costs are still high due to the limited transparency provided by only minimum forward-looking disclosure requirements under current federal securities rules. *See*, *e.g.*, Michael R. Siebecker, *Trust & Transparency: Promoting Efficient Corporate Disclosure Through Fiduciary-Based Discourse*, 87 WASH. U. L. REV. 115, 128–36 (2009). *See generally* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999); Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 CORNELL INT'L L.J. 493 (2005).

91. *See*, *e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 75; Allen, *Contracts and Communities*, *supra* note 5; Blair & Stout, *Explaining Anomolies in Corporate Law*, *supra* note 74, at 763–71; Blair & Stout, *Team Production*, *supra* note 49, at 745; Stout, *Proper Motives*, *supra* note 77, at 5.

92. These correctives may help to encourage some normative agenda across the spectrum ex ante (and, thus, incentivize firm managements across the spectrum to comply with such agenda), but they do not help the particular investor who ends up with a particular, disincentivized or 'non-incentivizable' firm management and who is forced to (financially) suffer through the corrective mechanism(s) coming to the 'rescue' in her particular case in an attempt by the market to reinforce the normative agenda across the spectrum. In other words, these correctives distribute highly inefficient monitoring costs asymmetrically. Unless our investor hedges against such particularized risk by a widely diversified portfolio, why would she confidently invest ex ante? *See* Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 795 (2007) (describing how stock, counter-intuitively, can become an illiquid investment "when exploited shareholders try to sell en masse") [hereinafter Stout, *Mythical Benefits*].

93. For example, the average daily trading volume on the New York Stock Exchange (NYSE) for NYSE-listed companies in 2009 totaled 7,982,926 trading transactions *per diem*, comprising an average of 2,179,775,581 shares traded for a total average consideration of $46,670,638,331. Daily NYSE Group Volume in NYSE Listed, 2009, NYSE FACT BOOK ONLINE, http://www.nyxdata.com/nysedata/asp/factbook/viewer_edition.asp?mode=table&key=3002&category=3 (last visited Apr. 14, 2011). *See also* Blair & Stout, *Trust*, *supra* note 70, at 1737.

94. *Cf.* Bainbridge, *Just Say No*, *supra* note 7; Michael B. Dorff, *Does One Hand Wash the Other? Testing the Managerial Power and Optimal Contracting Theories of Executive Compensation*, 30 J. CORP. L. 255, 257 (2005) ("To induce investors to buy stock *ex ante*, corporate governance law must be designed to give confidence that managers will seldom cheat

I believe that an *absolute director primacy model* as developed herein provides a clear answer to the procedural question of corporate governance ("*Who Control(s)?*")—even though it is an answer that I suspect we may not like. At the same time, the *absolute director primacy model* should also free us from our fruitless searches for model-immanent (perhaps even law-immanent) answers to the substantial control question of corporate governance ("*Whose Interest(s) Control(s)?*"). In my view and quite plainly, there has to be 'something' else in order to explain the phenomenon of general investor confidence pre-investment in the face of absent manager accountability post-investment[95]—to explain why the genius of American corporate law, though elitist and autocratic, does not regularly also turn totalitarian, and why a board of directors, though *uncontrollable* within corporate law, does not regularly also turn *out-of-control* within corporate reality. In other words: I believe that we have not (yet) solved the second, substantive question: "*Whose Interest(s) Control(s)?*". And I have a strong intuition that what we are really looking for—the so far elusive 'something' else—is not only exogenous[96] (i.e., situated outside of current microtheoretical models of the firm), but is essentially *protolegal*.[97] In this

and that when they do cheat they will generally be detected and punished."); William Klein, *Criteria for Good Laws of Business Association*, 2 BERKELEY BUS. L.J. 13, 16 (2005).

95. *Cf.* Stout, *Proper Motives*, *supra* note 77, at 8 (asking why directors "seem to mostly live up to our trust"); *id.* at 9 ("Rational investors would never cede control of tens of trillions of dollars of assets to purely self-interested boards, given the tissue-paper thin protection offered by the rules of fiduciary duty, and the limits of social sanctions.").

96. *Cf.* Oliver Hart, *Norms and Theory of the Firm*, 149 U. PA. L. REV. 1701, 1702 (2001) [hereinafter Hart, *Norms and Theory*].

97. Ingredients that are relevant variables in such *protolegal* context are, for example: trust; trustworthiness; loyalty; notions of public duty; responsibility; fairness; good faith; sense of morality; reputation; integrity; confidence. *See*, *e.g.*, Allen, *Contracts and Communities*, *supra* note 5, at 1402 (trust, loyalty); Bainbridge, *The Means and Ends*, *supra* note 3, at 550–51 n.21 (guardianship, duty); George W. Dent, Jr., *Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance*, 44 HOUS. L. REV. 1213, 1221 (2008) (trust); Hart, *An Economist's View*, *supra* note 4, at 306 (reputation, integrity); Hart, *Norms and Theory*, *supra* note 96 (honesty, trust); *id.* at 1703 (decency, fairness); *id.* at 1714 (reputation, trustworthiness); Mitchell, *Trust and Team Production*, *supra* note 12 (trust, loyalty, duty); O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 767 (integrity); *id.* at 769 (confidence); Rock & Wachter, *Norms & Corporate Law*, *supra* note 5, at 1608 (corporate culture); *id.* at 1609 (trust); *id.* at 1611 (credibility); *id.* at 1613 (reputation); Smith, *supra* note 74, at 969 (firm reputation); Stout, *Proper Motives*, *supra* note 77, at 1 (altruism); *id.* at 7 (reputation); *id.* at 8–9 (sense of honor, responsibility, sense of obligation; integrity, trustworthiness); *id.* at 20 (character). Good faith, loyalty (and, implicitly, trust and trustworthiness), and notions of duty—as *protolegal* variables—are obviously all ingredients that have become heavily reflected in director fiduciary duties, i.e., in legal mandates imposed by corporate law. The law, however, is—at best—still struggling with these variables. For example, see the recent difficulties encountered by the Delaware Supreme Court attempting to wrestle down some positive, definitional meaning of 'good faith' in *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006), and *Stone v. Ritter*, 911 A.2d 362 (Del. 2006). It is, thus, helpful to remind oneself that, in economic parlance, *protolegal* variables may turn out to be "observable, but not verifiable." *See* Hart, *Norms and Theory*, *supra* note 96. *See also* Blair & Stout, *Director Accountability*, *supra* note 58, at 419 n.35; Rock & Wachter, *Norms & Corporate Law*, *supra* note 5, at 1617.

maybe limited but significant regard, it can be said that we are still much more at the beginning of the history of corporate law than at its end.[98]

II. MICROTHEORETICAL MODELS OF THE FIRM

Microtheoretical models of the firm focus on the internal cohesion, adaptability, and survival of the firm as a generator and maximizer of productive output and economic wealth and, thus, largely ignore distributive concerns[99]—namely, whether the externalized costs of generating and maximizing economic wealth are fairly and effectively distributed[100] and whether the resultant economic wealth itself is fairly and effectively distributed.[101] Firm boundaries are sharp, removing firms from the larger societal context (including the market) like "islands of planned co-ordination in a sea of market relations."[102] Corporate control and the predictability of returns on firm-specific investments are the fundamental concerns.

Two main and fully interdependent dichotomies are involved and exhaust the field both theoretically and practically. First, one of the fundamental agency (cost) problems of corporate law[103] raises its head: "*Who Control(s)?*". As has been discussed above, theory and practice here oscillate between *manager primacy* (i.e., the allocation of control with, and the resultant *discretion* of, corporate decisionmakers)[104] and *investor primacy* (i.e., the allocation of controlling property and/or 'contract' rights

98. *See* Hansmann & Kraakman, *The End of History*, *supra* note 2. *See also* Henry Hansmann, *How Close is the End of History?*, 31 J. CORP. L. 745 (2006); Adam Winkler, *Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History*, 67 LAW & CONTEMP. PROBS. 109, 132–33 (2004).

99. *Cf.* Hansmann & Kraakman, *What is Corporate Law?*, *supra* note 41; Mitchell, *Trust and Team Production*, *supra* note 12, at 870; Romano, *Metapolitics*, *supra* note 48, at 924; Wallman, *Purpose of a Corporation*, *supra* note 41. *See* Garrett, *supra* note 14, at 137 (stating that the "nexus of contracts theory provides a basis for the director primacy theory and the shareholder primacy theory, both of which explain the balance of power within the corporation, rather than the role of corporations as participants in broader governance processes such as foreign relations, adjudication, and law making").

100. *See*, *e.g.*, Eisenberg, *supra* note 7, at 824; Lee, *supra* note 41, at 538–39; Sheehy, *supra* note 15, at 3, 17–20. *See also* Thomas, *supra* note 41.

101. *Cf.* Allen, *Contracts and Communities*, *supra* note 5, at 1396 (discussing how the distribution of gains and losses is "a secondary concern" in the classical liberal economic model); Millon, *supra* note 4, at 201–02 (discussing the dichotomy between corporate law's "external perspective, paying explicit regard to the relations between the corporation and the rest of society" on the one hand and "corporate law's focus as internal, dealing primarily with the governance problems that arise inside the corporation" on the other hand).

102. *See supra* note 8 and accompanying text.

103. *See supra* note 70 and accompanying text.

104. It should be noted that the concept of 'manager primacy' is used here in a broader sense to include, most prominently, the board of directors. *See* discussion *supra* note 77. I do not mean to refer to managerialist models of the firm which were prevalent until the 1970s and 1980s. *See*, *e.g.*, William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 WAKE FOREST L. REV. 619, 690 (2006); Hansmann & Kraakman, *The End of History*, *supra* note 2, at 444; Stout, *Proper Motives*, *supra* note 77, at 2–3.

with, and the resultant *accountability* to, firm participants making specific investments into the corporate venture).[105] Second, we have come to understand that this first dichotomy is strongly interdependent with a second inquiry: "*Whose Interest(s) Control(s)?*". Here, corporate practice and theory have developed a second dichotomy between *shareholder/owner income* (i.e., the goal of the corporate endeavor is to achieve maximum *market value* and, thus, is aimed at maximizing shareholder wealth at all cost) and *stakeholder welfare* (i.e., the goal of the firm is to achieve maximum *societal value* and, thus, is aimed at optimizing the respective distributive values of all firm participants and third parties involved by allocating resources and externalizing costs as fairly/efficiently as possible).[106]

A. PLOTTING MODELS WITHIN MICRODICHOTOMIES

Much of the basic modeling work has, of course, already been done by others. In his 2003 article on *Director Primacy: The Means and Ends of Corporate Governance*,[107] Stephen Bainbridge has also already developed the basic graphic framework for plotting the two microdichotomies of corporate law that are of interest here—namely the allocation of corporate decisionmaking power and the distribution of corporate value-creation benefits (as well as, inescapably, of value-creation costs).[108] As far as I can tell, however, no one has used this graphic framework in order to also plot current microtheoretical models of the firm more systematically and in depth. Table 1 and the discussion that follows in this Part II.A. attempts such plotting task.

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105. It should be noted that interest asymmetries not only exist among various constituencies of firm participants (e.g., shareholders) but also within the same constituency of firm participants. Thus, for example, shareholders as a group will be looking at a return on their firm investment which is functionally discreet and different from other firm participants. But, at the same time, shareholders among each other will often have very different short-term or long-term targets on when and how they would like to achieve their individual returns on their respective firm investments. Similar intra-firm participant interest differentiations, of course, apply to employees, suppliers, customers, etc.

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

107. Bainbridge, *The Means and Ends*, *supra* note 3, at 548. *See also* BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 49; BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2; Bainbridge, *Abstention Doctrine*, *supra* note 49; Bainbridge, *Corporate Takeovers*, *supra* note 75; Bainbridge, *Group Decisionmaking in Corporate Governance*, *supra* note 75; Bainbridge, *Just Say No*, *supra* note 7; Bainbridge, *Limited Shareholder Voting Rights*, *supra* note 75; Bainbridge, *Much Ado About Little*, *supra* note 75; Bainbridge, *Nexus of Contracts*, *supra* note 75.

108. *Cf.* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 599.

Figure 1: Plotting Corporate Microdichotomies[109]

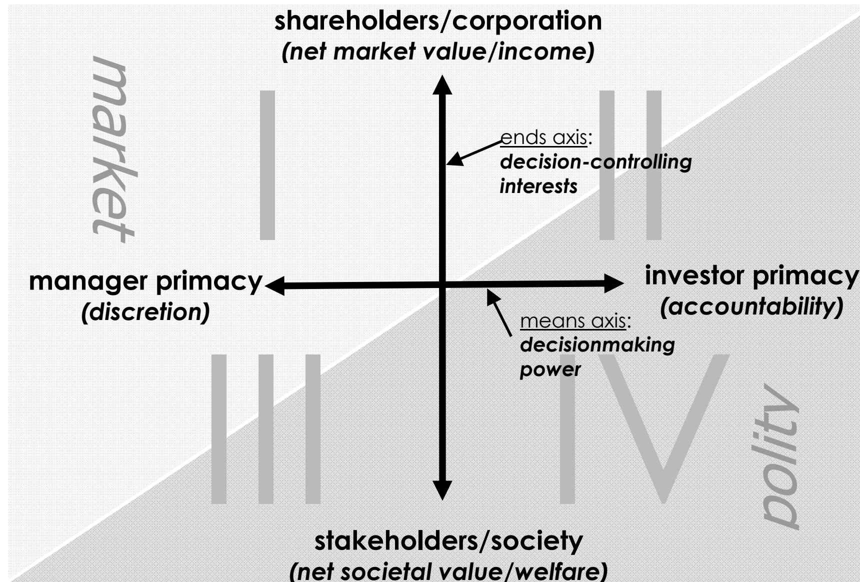

Figure 1 describes the core conceptual framework. Table 1 demonstrates how the four microtheoretical models of the firm which are at the center of today's corporate theory debate[110] can be plotted within Figure 1 and, therefore, can be juxtaposed and compared to each other.

109. *Cf.* Bainbridge, *The Means and Ends*, *supra* note 3, at 548. The author has received reprint permission for the original chart from Northwestern University School of Law, Northwestern University Law Review, which permission expressly includes the changes that have been made by the author to the original chart.

110. The main four models in today's academic discussion can be labeled as 'shareholder primacy,' 'contractarian,' 'team production,' and 'director primacy.' *See generally* Bainbridge, *Convergence Debate*, *supra* note 2 (discussing shareholder-primacy and director-primacy models); John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837 (1999) (discussing team-production models); Dent, Jr., *supra* note 97 (discussing team-production and director-primacy models); Fisch, *supra* note 50 (discussing shareholder-primacy models); Lee, *supra* note 41 (discussing shareholder primacy and team production models); J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice*, 27 YALE J. ON REG. 283, 315–26 (2010) (discussing all four models as well as "agency theory" and "progressive corporate law theory"). For a more general discussion of those firm models, see generally Eisenberg, *supra* note 7, at 819; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 753–77; Wallman, *Purpose of a Corporation*, *supra* note 41.

Table 1: Current Microtheoretical Models of the Firm

Model	*"Who Controls?"*	*"Whose Interest(s) Control(s)?"*	*Main Locus in Figure 1*
Shareholder Primacy	board (by delegation of, and with accountability to, shareholders)	shareholders (indirectly, all firm participants exert some influence since shareholders are residual claimants)	**Quadrant II**
Contractarian	'nexus' of explicit and implicit 'contracts' (no individual group of firm participants controls)	shareholders (indirectly, all firm participants exert some influence since shareholders are residual claimants)	**Quadrant II** (with, perhaps, a bit of **Quadrant IV**)
Team Production	board (as a mediating hierarch by delegation of, and with accountability to, all firm participants)	all firm participants (directly as a team)	**Quadrants II & IV**
Director Primacy	board (as a decisionmaker by fiat)	shareholders (indirectly, all firm participants exert some influence since shareholders are residual claimants)	**Quadrant I** (with, perhaps, a bit of **Quadrant II**)

Obviously, there are significant degrees of oversimplification involved in this plotting exercise but such is inevitable if one tries to gain any meaningful overview. Models are only as good as the reach of their conceptual and predictive wherewithal is far.[111] They involve (if not, require) the breaking down of complexity and the reassembly of (complex) reality in more abstract but, thus, more manageable structural pieces.[112] By necessity, models are different from reality—smaller, simpler, more limited

111. *Cf.* BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 2–3.
112. *See* Bainbridge, *Nexus of Contracts*, *supra* note 75, at 9.

than reality.[113] But they aspire to replicate essential parts of reality, hence, to make reality explainable and predictable.[114] All models discussed here venture to explain the reality of corporate governance. The (merely) narrative claims made in this Part II.A. are that: (i) some models are more accurate than others; and (ii) all models are (necessarily) incomplete in their attempt to answer the second microdichotomous question, "*Whose Interest(s) Control(s)?*".

1. The Shareholder Primacy Model

Who Controls: Board (by delegation of, and with accountability to, shareholders as owners of the firm).

Whose Interest(s) Control(s): Shareholders (indirectly, all firm participants exert some influence since shareholders are residual claimants).

Main Locus: Quadrant II (shareholder interests control; board of directors/management is fully accountable).

Description. It has been claimed that as a matter of norms, efficiency, and fact, the world of corporate law converges around the 'standard' shareholder-centered model of the business corporation.[115] In this model, shareholder primacy describes and defines the maximization of shareholder wealth as the objective function, purpose, and controlling interest of the corporation.[116] Thus, the only value we need in order to evaluate the fairness and efficiency of corporate law is a "uni-criterion":[117] *shareholder gains*. Shareholders are the residual owners (claimants) of the firm—they receive only what is left after every other claimant has been satisfied in full.[118] As ultimate owners of the corporation, the corporation is their

113. *Cf.* BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 2–3; Bainbridge, *Nexus of Contracts*, *supra* note 75, at 9. In other words, models are constructions, and it is important to keep in mind that life (i.e., reality) is serial, not constructed.

114. *Cf.* HAMILTON & BOOTH, *supra* note 24, at 331.

115. Hansmann & Kraakman, *The End of History*, *supra* note 2, at 440–41. *See also* Blair & Stout, *Team Production*, *supra* note 49, at 744 (claiming that law professors have come to adopt the shareholder primacy model as "the dominant paradigm for understanding the modern corporate enterprise"); Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 601; Millon, *supra* note 4, at 224 (stating that "the shareholder primacy principle has been the fundamental postulate of corporate law"); Wallman, *Purpose of a Corporation*, *supra* note 41, at 807.

116. *See*, *e.g.*, MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962) [hereinafter MILTON, CAPITALISM AND FREEDOM]; Bernhard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1921 (1996) ("The efficiency goal of maximizing the company's value to investors [is] . . . the principal function of corporate law."); Gilson, *Separation and Function*, *supra* note 6, at 143; Friedman, *Social Responsibility*, *supra* note 6. *See* Allen, *Schizophrenic Conception*, *supra* note 50; Fisch, *supra* note 50.

117. Gilson, *Separation and Function*, *supra* note 6, at 143.

118. The equity investors of a firm (i.e., the shareholders in a corporation) are regarded as the firm's residual claimants because all debt investors' claims against the firm, once liquidated, have to be satisfied first before any remaining (i.e., residual) profits left after the firm's obligations to debt investors have been paid may be distributed to the equity investors. In others words, shareholders are only entitled to the residuum of profits, if any, after everyone else has been paid.

'property.'[119] Therefore, their collectivized interest in the prosperity and survival of the firm is congruent and identical with the firm's interest overall. Firm value is, ipso facto, shareholder value (and vice versa). In the words of the late economist and Nobel Laureate, Milton Friedman:

> [T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.[120]

As a theoretical construct developed from neoclassical economic models, the shareholder primacy model carries significant strengths (as well as popularity among corporate scholars).[121] It is logically created from the unbundling of firm ownership and firm control in the Berle-Means corporation,[122] and neatly divides the playing field into only two groups of firm participants who matter: those whose interests control the corporate endeavor—namely, principals/owners/shareholders—and those who are controlling the decisionmaking within the corporate endeavor on behalf of principals/owners/shareholders—namely, agents/managers/directors.[123]

And, over time,[124] corporate law seems to have devised the unique controlling mechanism which binds the latter to the former: fiduciary duties

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See, *e.g.*, Blair & Stout, *Team Production*, *supra* note 49; Wallman, *Purpose of a Corporation*, *supra* note 41, at 810.

119. *See*, *e.g.*, Blair & Stout, *Team Production*, *supra* note 49.

120. MILTON, CAPITALISM AND FREEDOM, *supra* note 116. *See, e.g.*, Kenneth B. Davis, Jr., *Discretion of Corporate Management to Do Good at the Expense of Shareholder Gain—A Survey of, and Commentary on, the U.S. Corporate Law*, 13 CAN.-U.S. L.J. 7, 8 (1988) ("The bedrock principle of U.S. corporate law remains that maximization of shareholder value is the polestar for managerial decisionmaking."); Garrett, *supra* note 14, at 138 ("The moral imperative for corporations is to make money. Under this view of the *raison d'être* for corporations, choosing socially responsible action over profit maximizing action is immoral.") (footnotes omitted). *See also* Friedman, *Social Responsibility*, *supra* note 6.

121. Blair & Stout, *Team Production*, *supra* note 49, at 744 (claiming that law professors have come to adopt the shareholder primacy model as "the dominant paradigm for understanding the modern corporate enterprise").

122. *See* BERLE & MEANS, *supra* note 4. *But see* KNIGHT, *supra* note 4 ("The typical form of business unit in the modern world is the corporation. Its most important characteristic is the combination of diffused ownership with concentrated control."). *See also* BAINBRIDGE, CORPORATE LAW, *supra* note 4; COX & HAZEN, *supra* note 4; Bainbridge, *Convergence Debate*, *supra* note 2; Blair & Stout, *Team Production*, *supra* note 49; Bratton, *Century's Turn*, *supra* note 4; Hart, *An Economist's View*, *supra* note 4; Millon, *supra* note 4; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4; Pinto, *supra* note 4.

123. For this reason, the shareholder primacy model is also often called the 'principal-agent model' of the corporation. *See, e.g.*, Blair & Stout, *Team Production*, *supra* note 49; Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 603. *See also* Garrett, *supra* note 14, at 135–36.

124. The dialectic development of fiduciary duties and, thus accountability, of corporate managers 'over time' was at the core of the so-called 'Berle-Dodd debate' between Adolf A. Berle, Jr. and E. Merrick Dodd, Jr. in the wake of the Great Depression. *See* A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) [hereinafter Berle, *Corporate Powers*] (presenting Berle's thesis that "all powers granted to a corporation or to the management of a corporation . . . are necessarily and at all times exercisable only for the ratable

of care and loyalty and the obligation of good faith which together circumscribe the responsibility of corporate directors to shareholders and prevent (under normal circumstances) the kind of delicts[125] self-interested or inattentive directors as agents can be expected ex ante to commit without the existence of such controlling mechanism.[126] The fact that fiduciary duties are only owed to shareholders must mean that shareholder value must be the ultimate measuring stick of corporate control (at least, in a zero-sum situation where all other firm inputs are of equal importance/weight).[127] The classic statement in corporate law that appears to bind corporate directors to shareholders as the corporate constituent with the controlling, overriding interest is found in *Dodge v. Ford Motor Co.*,[128] a 1919 Michigan Supreme Court case cited by proponents of controlling shareholder interests,[129]

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benefit of all the shareholders as their interest appears"); A. A. Berle, Jr., *For Whom Corporate Managers* Are *Trustees: A Note*, 45 HARV. L. REV. 1365 (1932) [hereinafter Berle, *Corporate Managers*] (providing a response to Dodd's challenge of Berle's theory); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932) [hereinafter Dodd, *Corporate Managers Trustees*] (challenging Berle's theory); E. Merrick Dodd, Jr., *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 U. CHI. L. REV. 194 (1935) [hereinafter Dodd, *Is Effective Enforcement Practicable?*] (providing a response to Berle's response). For an overview of the Berle-Dodd debate, see generally Allen, *Schizophrenic Conception*, *supra* note 50, at 265–66; Bratton & Wachter, *Corporatist Origins*, *supra* note 4, at 122–34; Fisch, *supra* note 50, at 646–48; A. A. Sommer, Jr., *Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33, 36–39 (1991); Joseph L. Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964). *See also* Stout, *Proper Motives*, *supra* note 77, at 22 (stating that "[t]he debate between the 'shareholder primacy' view and 'stakeholder' models of the corporation dates back at least seventy years, and [that] it remains unresolved today") (footnote omitted). In an interesting twist to today's prevailing views on shareholder primacy, Adolf Berle explicitly conceded defeat of his shareholder primacy model to Dodd's stakeholder-oriented model once *A.P. Smith Manufacturing Co. v. Barlow*, 98 A.2d 581 (N.J. 1953), *appeal dismissed*, 346 U.S. 861 (1953), was decided. *See* ADOLF A. BERLE, JR., THE 20TH CENTURY CAPITALIST REVOLUTION 169 (1954) [hereinafter BERLE, CAPITALIST REVOLUTION]; Bainbridge, *The Means and Ends*, *supra* note 3, at 561 n.70.

125. Fiduciary duties are traditionally seen as delictual obligations, i.e., their breach resonates in tort, not in contract. *See*, *e.g.*, *ENEA v. Superior Court*, 132 Cal. App. 4th 1559, 1566–67 (Cal. Ct. App. 2005) (describing fiduciary duties as "delictual" duties "imposed by law" and that "their breach sounds in tort"); DeMott, *supra* note 79, at 887. *But see*, Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 244 (2009) ("All fiduciary relationships are, at some level, contractual."); *id.* at 270–71 ("Even though all fiduciary relationships are contractual, not all contractual relationships are fiduciary.").

126. *See* O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 762; Rock & Wachter, *Islands of Conscious Power*, *supra* note 8, at 1661.

127. *Cf.* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 603; John H. Matheson & Brent A. Olson, *Corporate Law and the Longterm Shareholder Model of Corporate Governance*, 76 MINN. L. REV. 1313, 1327 (1992).

128. Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

129. *See*, *e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 220–21; MARJORIE KELLY, THE DIVINE RIGHT OF CAPITAL 52–53 (2001); Bainbridge, *Convergence Debate*, *supra* note 2, at 46; Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 601 (1992) [hereinafter Mitchell, *A Theoretical and Practical Framework*]; Wallman, *Purpose of a Corporation*, *supra* note 41, at 815.

almost without fail,[130] as the ultimate legal tenement of shareholder primacy:[131]

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.[132]

Critique. What is centrally problematic about the shareholder primacy model, in essence, is that it contradicts—in a multitude of aspects—the reality of American corporate law as it is currently 'on the books.'[133]

a. Complete Absence of Explicit Statements of Shareholder Primacy

As a starting point, state corporation statutes refrain from saying anything explicit about the purpose of business corporations with regard to the creation or maximization of either profits in general or shareholder wealth in particular.[134] The same is true with the standard constituent documents of the corporation (i.e., its certificate, or articles, of incorporation, and by-laws).[135] Such silence on the very topic of shareholder value which falls most squarely within the ambit of the shareholder primacy model is perhaps surprising on first blush. However, it is conceptually necessary and logical. Simply put, there are (too) many ways to go about increasing (or, more precisely, attempting to increase) the

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130. Stout, *Why We Should Stop Teaching* Dodge v. Ford, *supra* note 14, at 2 (stating that the decision is "almost invariably cited" and is "routinely employed as the *only* legal authority for this proposition"); Wallman, *Purpose of a Corporation*, *supra* note 41, at 815.

131. It is, of course, interesting and important to note—as Lynn Stout recently has, *see* Stout, *Why We Should Stop Teaching* Dodge v. Ford, *supra* note 14—that this statement by the Michigan Supreme Court (i) is devoid of any reference or citation of applicable precedent in order to support the statement and, thus, the shareholder primacy model decreed therein, *id.* at 4–5; *see also* Millon, *supra* note 4, at 223, (ii) is judicial *dicta* only, Stout, *Why We Should Stop Teaching* Dodge v. Ford, *supra* note 14, at 2, 3–4; *see also* Wallman, *Purpose of a Corporation*, *supra* note 41, at 815, and (iii) comes from a marginal jurisdiction as far as American corporate law is concerned, Stout, *Why We Should Stop Teaching* Dodge v. Ford, *supra* note 14, at 3 (stating that "Michigan . . . is a distant also-ran in the race between and among the states for influence in corporate law").

132. *Dodge*, 170 N.W. at 684. *See also* Katz v. Oak Indus. Inc., 508 A.2d 873, 879 (Del. Ch. 1986) ("It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders.").

133. *See* Wallman, *Purpose of a Corporation*, *supra* note 41, at 809, 813–14. *See also* Blair & Stout, *Team Production*, *supra* note 49, at 744 (describing the principal-agent model as painting "a potentially misleading portrait of the modern business firm").

134. CLARK, CORPORATE LAW, *supra* note 13, at 678–79. *See also* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738 (2005) ("Corporate managers have never had an enforceable legal duty to maximize corporate profits."); Rock & Wachter, *Islands of Conscious Power*, *supra* note 8, at 1643–44.

135. Stout, *Why We Should Stop Teaching* Dodge v. Ford, *supra* note 14, at 5.

profits for a particular business corporation at any particular point in time in any future particularized context,[136] and the open-ended texture of the statutes and constituent documents simply reflects and documents such ex ante indeterminability. At the same time, such open-ended texture also provides for the necessary decisional flexibility and maneuverability of firm management in order to take adaptive steps on behalf of the corporation which will ensure its survival and prosperity and will, thus, ensure continued firm sustainability.

b. Director Fiduciary Duties Run Primarily to the Corporation, Not Its Shareholders

Shareholder primacy models assume that fiduciary duties are indeed owed directly—and exclusively—by corporate directors to the corporation's shareholders and that, therefore, corporate directors are, indeed, immediately responsible to shareholders who only delegated their own authority to conduct their personal business as principals and owners of the corporation to corporate directors as their fully accountable agents.[137] As far as we can tell, this is not the law anywhere:[138] director fiduciary duties are owed primarily to the corporation as a whole (whether perceived as a separate entity or a mere aggregation or nexus of firm inputs), not to shareholders per se.[139] In this regard, it can be said that the shareholder primacy model commits a *petitio principii* fallacy: the model attempts to prove shareholder value as the decision-controlling interest by assuming and emphasizing shareholder-only-owed duties as evidence of ultimate

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136. *Cf.* Gilson, *Separation and Function*, *supra* note 6, at 146 (observing that "one cannot run a successful business without taking seriously the role of non-shareholders whose contributions are important to the corporation's success").

137. *See*, *e.g.*, Hart, *An Economist's View*, *supra* note 4, at 303; Wallman, *Purpose of a Corporation*, *supra* note 41, at 807.

138. Wallman, *Purpose of a Corporation*, *supra* note 41, at 813.

139. *See*, *e.g.*, Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989) (holding that "[i]t is basic to our law that the board of directors . . . owe [sic] fiduciary duties of care and loyalty to the corporation and its shareholders."). *See also* Blair & Stout, *Corporate Law*, *supra* note 74, at 290; Mitchell, *A Theoretical and Practical Framework*, *supra* note 129, at 630–40; Stout, *Mythical Benefits*, *supra* note 92, at 804; Stout, *Proper Motives*, *supra* note 77, at 23; Wallman, *Purpose of a Corporation*, *supra* note 41, at 809, 813–14.

Though it must be noted that no other firm participant has standing in order to sue corporate directors for breaches of fiduciary duties *on behalf of the corporation*, thus, claiming *injury to the corporation*. This, however, appears to be more a reflection of the institutional competence of courts (or their lack thereof as well as their unwillingness) to address threats to the corporation in terms of shareholder interests. The courts' inquiry remains limited to whether directors' actions or inactions were in the best interest of the corporation, not whether shareholders would be (hypothetically) better off, or the corporation's share price would be higher, if certain actions had not been taken or certain inactions had been omitted (for example, if nightlights had been installed at the baseball stadium, *see* Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. 1968)). *See* Blair & Stout, *Director Accountability*, *supra* note 58, at 426–30. The business judgment rule limits the courts' institutional competence (or better, willingness and appetite) for such a broad and open-ended second-guessing inquiry even further. *Id.*

shareholder primacy. However, it turns out that shareholder-only-owed fiduciary duties do not exist in corporate law.[140]

c. As a Rule, Director Decisionmaking Is Absolute

Even if one were to situate fiduciary duties as running immediately between corporate directors on the one hand and the shareholders of the corporation, in aggregate, on the other hand, American corporate law almost never finds a delictual breach of such fiduciary obligations of directors.[141] The legal standards for duty-compliant director conduct are extremely low (in the absence of blatant director self-interests that remained unsanitized at the corporate level),[142] while the procedural hurdles that even a derivative shareholder claim with merit needs to overcome are extremely high (again, in the absence of blatant director self-interests that remained unsanitized at the corporate level). These substantive and procedural corporate law standards combine to make director liability a genuine rarity[143]—often even a judicial aberration—rather than a robust tool of director accountability and, thus, a fair and efficient mechanism of corporate control.

If the board decision is not inflicted by any non-insulated self-interest of the acting directors (which board decision corporate law would then invalidate for breach of the fiduciary duty of loyalty),[144] virtually *everything*—every motive and every end underlying directorial decisionmaking—can become a permissible purpose in order to justify the board decision as long as a judicial review within the parameters of the business judgment rule presumption[145] can *independently* and *sua sponte* devise a minimum proper rationale for why the board decision appears to be made in good faith and in the reasonable belief of having been in the best interest of the corporation (and, thus, indirectly also in the best interest of protecting firm wealth maximization goals in the short-[146] and/or long-

140. An early conceptualization of this aspect was at the core of the so-called 'Berle-Dodd debate' between Adolf A. Berle, Jr. and E. Merrick Dodd, Jr. in the wake of the Great Depression and their dialectic development of fiduciary duties and, thus accountability, of corporate managers. *See supra* note 124 and accompanying text.

141. *See supra* note 125 and accompanying text.

142. *See*, *e.g.*, DEL. CODE ANN. tit. 8, § 144 (West 2010); N.Y. BUS. CORP. Law § 713 (McKinney Supp. 2010).

143. *See supra* note 86 and accompanying text. *See also* Stout, *Mythical Benefits*, *supra* note 92, at 798 ("[T]he duty of care (famously hamstrung by the business judgment rule) is far less effective at preventing director shirking.").

144. *See*, *e.g.*, Blair & Stout, *Team Production*, *supra* note 49, at 746.

145. For an explanation of the business judgment rule, see *supra* note 87.

146. *See*, *e.g.*, Kamin v. American Express Co., 383 N.Y.S.2d 807 (N.Y. Sup. Ct. 1976), *aff'd*, 387 N.Y.S.2d 993 (N.Y. App. Div. 1976) (considering the serious short-term effects that a reduction of net income would have had on the market value of the publicly traded American Express Company stock).

term[147]).[148] In other words, within the confines of the business judgment rule, the board's decisionmaking is absolute.[149] There is no "judicial backstop"[150] (because there is no *legal* backstop) in order to provide and enforce director accountability—neither ex ante nor ex post.

d. No Shareholder Participation Rights

In the Berle-Means corporation, shareholders are prevented from any meaningful active participation in the management of the corporation. They are neither entrepreneurs nor passive owners with ultimate intervention or step-in rights who, therefore, in one way or the other would actively participate in the management of the business and affairs of the corporation. Widely-dispersed shareownership coupled with relatively small (if not, minute) holdings of individual shareholders (even in the case of large institutional shareholders with multi-million-dollar investments) have transformed legions of shareholders into faceless, passive, and non-dominant investors subject to 'rational apathy,'[151] whose respective investments are entirely controlled by professional managers.[152] Investment entry and investment exit (i.e., what is also known as 'voting with your feet'[153]—namely purchasing more shares when one likes the business performance of the corporation and disposing stock when one is unhappy with such performance) are the sole indirect and non-legal participation and control avenues available. In particular, even though shareholders technically elect the board of directors, shareholders have no factual control

147. *See generally* Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. 1968) (considering the long-term interests of the Chicago Cubs franchise corporation in its property value at Wrigley Field which might demand all efforts to keep the neighborhood from deteriorating).

148. *See*, *e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971); Brehm v. Eisner, 746 A.2d 244, 264 n.66 (Del. 2000); BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 114.

149. *See*, *e.g.*, Helfman v. Am. Light & Traction Co., 187 A. 540, 550 (N.J. Ch. 1936) ("In a purely business corporation . . . the authority of the directors in the conduct of the business of the corporation must be regarded as *absolute* when they act within the law, and the court is without authority to substitute its judgment for that of the directors.") (emphasis added). *See also supra* note 89 and accompanying text.

150. *See* Rock & Wachter, *Norms & Corporate Law*, *supra* note 5, at 1613; *id.* at 1617 (judicial safety net); Mitchell, *Importance of Being Trusted*, *supra* note 85, at 614 (legal backstop).

151. Bainbridge, *Convergence Debate*, *supra* note 2, at 50; Blair & Stout, *Director Accountability*, *supra* note 58, at 433.

152. *See*, *e.g.*, Blair & Stout, *Team Production*, *supra* note 49; Millon, *supra* note 4, at 214–15; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 760–61; Stout, *Proper Motives*, *supra* note 77, at 3.

153. Blair & Stout, *Director Accountability*, *supra* note 58, at 434. Sometimes also referred to as 'voting with your wallet,' *see*, *e.g.*, Stout, *Mythical Benefits*, *supra* note 92, at 802, as doing the 'Wall Street walk,' *see*, *e.g.*, Stout, *Proper Motives*, *supra* note 77, at 3, or as adopting the 'Wall Street Rule,' *see*, *e.g.*, Bainbridge, *Nexus of Contracts*, *supra* note 75, at 21.

(and, arguably, no legal control) over the boardroom setup, over who makes it onto the board of directors, and who does not.[154]

There are three main reasons for this often underappreciated phenomenon. First, during the board nomination process, current directors will *self-nominate* as a slate or handpick and nominate a new board candidate as part of the slate in case a current board member has earlier resigned or otherwise will no longer be a board member post-election.[155] In this regard, corporate boards of Berle-Means corporations are *de facto* self-perpetuating.[156]

Furthermore, board elections occur pursuant to the *proxy system* prescribed for the publicly listed corporation by federal law. The proxy statement published by the corporation and mailed to all of its shareholders of record will list the self-nominated slate of board candidates for election (i.e., the current directors and any hand-picked successor)—*and no one else*. Any outside (insurgent) board candidate wishing to engage in a proxy contest has to prepare her own proxy materials at prohibitive production costs and faces even more prohibitive proxy solicitation costs trying to reach out to a largely passive shareholder base in an effort to garner support for herself as an alternative board candidate.[157] With shareholders mostly being rationally apathetic and passive investors who are accustomed to the absence of any genuine participation rights in the corporation, a proxy solicitation contest—in the vast majority of cases and as a matter of routine—results in favor of the corporation and its own proxy request for its incumbent directors.[158] The incumbent directors of the corporation are simply able to collect enough proxies from shareholders who will not attend the shareholders meeting at which the board election takes place in person

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154. *See*, *e.g.*, Lucian Ayre Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43, 45–46 (2003); Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675 (2007).

155. Blair & Stout, *Director Accountability*, *supra* note 58, at 434.

156. BERLE & MEANS, *supra* note 4, at 87–88. *See also* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 72 ("In practice, of course, even the election of directors (absent a proxy contest) is predetermined by the existing board nominating the next year's board."); *id.* at 73 ("Although shareholders . . . retain the right to elect directors, the incumbent board controls the election process, and thus the firm."); Dent, Jr., *supra* note 97, at 1219.

157. Lucian Arye Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CALIF. L. REV. 1071, 1085–87 (1990); Kahan, *supra* note 70, at 1894; Stout, *Mythical Benefits*, *supra* note 92, at 789.

158. *See* Peter Dodd & Jerold B. Warner, *On Corporate Governance: A Study of Proxy Contests*, 11 J. FIN. ECON. 401, 407–11 (1983) (examining a sample of firms experiencing proxy contests for seats on their board of directors and finding that dissident shareholders usually fail to obtain a majority of board seats in a given proxy contest); Kahan, *supra* note 70, 1894; Stout, *Proper Motives*, *supra* note 77, at 3.

(which is, in almost all cases, a vast majority of shareholders) and, thus, as proxyholders for such shareholders proceed to re-elect themselves.[159]

Lastly, most board elections in publicly listed corporations do still follow the so-called *plurality voting system*. Unlike a majority voting system, where 'yes' and 'no' votes will be cast *and* counted for each individual candidate (who would then require a majority of affirmative votes from all votes cast for her to be elected), the plurality system only allows shareholders to vote either 'yes' or to 'withhold' their votes. Withheld votes are *not* counted as 'votes cast.' Thus, all votes cast that will remain as 'votes cast' after this convenient legal 'technicality' is applied are the 'yes' votes.[160] As a matter of state corporate law, only 'votes cast' determine the outcome of the election. 'Plurality' in this context then only means that those board nominees who accumulate the most 'yes' votes for themselves out of all 'votes cast' will be elected. Since in most board elections the board nominees are nominated as a slate and there is no competition for open board seats (i.e., there are only as many open board seats as there are board nominees), every board nominee is guaranteed a seat and will be elected onto the board as long as she has received one single 'yes' vote out of all 'votes cast'. And to further ensure that there is at least one 'yes' vote for each board nominee (actually, that there are a lot of 'yes' votes for each board candidate), proxy cards are usually set up in a way that one can only vote 'yes' for the entire slate of (self-)nominated board candidates and can only 'withhold' individual votes from particular board candidates (the latter, of course, are not considered 'votes cast'). Thus, as long as one single shareholder is voting 'yes' for the entire slate of board candidates and there is no outside candidate running (which is almost never the case for the reasons discussed above), everyone has received at least one 'yes' vote and is voted in.

Obviously, this is a far cry from any kind of a democratic election process.[161] It does not mesh well with any notion of genuine shareholder

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159. *See* BERLE & MEANS, *supra* note 4, at 277; Blair & Stout, *Corporate Law*, *supra* note 74, at 311 ("[S]hareholders in public corporations do not in any realistic sense elect boards. Rather, *boards elect themselves*."); Stout, *Mythical Benefits*, *supra* note 92, at 789.

160. Even totalitarian states holding pro forma elections (for example, those that were held under communist rule in former Warsaw Pact countries) cannot get away with this—though, I am sure, their rulers would love to.

161. *Cf.* CLARK, CORPORATE LAW, *supra* note 13, at 95 (describing one typical response by practitioners and commentators to shareholder voting rights as "the whole institution of shareholder voting is a fraud, or a mere ceremony designed to give a veneer of legitimacy to managerial power, and that in a more forthright world the institution would simply be dropped"); Bainbridge, *The Means and Ends*, *supra* note 3, at 555; Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 849–50 (2005); Daniel J.H. Greenwood, *Markets and Democracy: The Illegitimacy of Corporate Law*, 74 UMKC L. REV. 41, 41 (2005) (stating that "corporate law is chosen by the very corporate managers who ought to be controlled by it, and created by lawyers, legislatures and judges unanswerable to the people whose lives are affected by it"). *Cf.* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) (citing Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984)) ("If the stockholders are displeased with the

primacy and majoritarian shareholder control: Shareholders in Berle-Means corporations do not control who the individual directors are—who, post-election, will go on to control their respective firm investments.[162] And they have no legal means—in the reality of corporate practice—to even replace directors who act consistently in a manner that disagrees with a majority of shareholders' views on how to maximize corporate profits and shareholder gains.[163]

e. Directors Are Not Agents

A further critique of the shareholder primacy model is directed at the fact that the authority of board directors is not derived from (and, therefore, limited by) any delegating act, any transfer of actual authority by the shareholders (as principals), to the directors to transact the shareholders' business on behalf of such shareholders (as agents).[164] Rather, all corporation statutes create and place ultimate authority to run the firm (as statutory authority or authority as a matter of law)[165] squarely—and exclusively—in the hands of the corporation's board of directors.[166] That also means that directors are not legal agents—neither of shareholders nor of the corporation.[167] They are *sui generis* a decisionmaking body (or organ) of the corporation and are not subject to direct control or supervision by *anyone*, including the firm's shareholders.[168] Furthermore, the authority of corporate directors to direct and control the affairs of the corporation for

action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.").

162. *Cf.* Blair & Stout, *Director Accountability*, *supra* note 58, at 434 ("The net result is that, as a practical matter, the casting of shareholder votes in most public corporations is a meaningless rite."). The strongest signal that can be sent by shareholders in this regard (other than, of course, voting with their feet—often, at a significant loss to their return on their investment) is an accumulation of withheld votes as has happened with Disney's then CEO, Michael Eisner, in 2004 when Eisner received about 45% withheld votes at the annual shareholder meeting. *See* Laura M. Holson, *2 Disney Directors to Withhold Board Votes at Annual Meeting*, N.Y. TIMES, Feb. 9, 2005, at C7.

163. Obviously, those shareholders can (and do) vote with their feet—which normally would result in a prolonged decrease of the corporation's share price and which could thereby make the corporation a takeover target since it seems to be undervalued because of 'bad' management, which in turn, would force the incumbent directors to better manage in the first place and listen more carefully to disgruntled shareholders. However, this is a market mechanism, not a legal mechanism of shareholder 'influence'—it cannot constitute genuine shareholder 'control' if one has to exit one's investment first (usually, at a loss in value then) in order to bring changes for which there will be no longer any financial return.

164. *Cf.* Stout, *Mythical Benefits*, *supra* note 92, at 804.

165. *Cf.* Millon, *supra* note 4, at 215.

166. DEL. CODE ANN. tit. 8 § 141(a) (West 2010); REV. MODEL BUS. CORP. ACT § 8.01 (1984). *See also* CLARK, CORPORATE LAW, *supra* note 13, at 690; HAMILTON & BOOTH, *supra* note 24, at 505; Blair & Stout, *Team Production*, *supra* note 49, at 746.

167. *Cf.* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 76; HAMILTON & BOOTH, *supra* note 24, at 506; Blair & Stout, *Director Accountability*, *supra* note 58, at 423; Blair & Stout, *Corporate Law*, *supra* note 74, at 290; Stout, *Mythical Benefits*, *supra* note 92, at 804.

168. Blair & Stout, *Corporate Law*, *supra* note 74, at 290.

and on behalf of the corporation is also original (as opposed to, delegated and, thus, derivative) and *sui generis*.[169]

f. Directors Control Shareholder Return

One area of complete director discretion which is specifically set forth in state corporation statutes is the declaration of dividends.[170] There is no statutory mandate for declaring dividends and, in today's world, a board can refuse any shareholder request for dividend declarations without fear of liability. There is good reason for such absolute board discretion: In its absence, opportunistic, predatory and even cannibalistic shareholder wealth 'maximization' would be the norm and would ultimately destroy the corporation rather than allow its continued prosperity and survival. For example, aggressive speculative shareholders would invest for a powerful stake, pressure boards into dividend payments in order to milk as much firm value out of the corporation short-term, leave the corporation with insufficient financial maneuverability for innovation and adaptation long-term, and then would either dump the stock before it has no value left or forfeit it entirely and move on to their next target. Their investment strategy would become a *de facto* (partial) liquidation strategy. Corporate law decidedly estopps such opportunistic shareholder behavior by at least curtailing (if not, not recognizing) shareholder primacy and by creating *absolute director primacy* for the declaration of dividends as a matter of law,[171] thereby discouraging intershareholder opportunism.[172]

g. Charitable Giving

Corporations can make charitable contributions—none of which directly benefit shareholders (quite the opposite is true: they directly and adversely affect shareholders as far as their bottomline is concerned) and,

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169. *Cf.* Manson v. Curtis, 119 N.E. 559, 562 (N.Y. 1918); Burrill v. Nahant Bank, 43 Mass. 163, 166–67 (1840); BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 74.

> The model behind corporate law's treatment of authority is one of a unilaterally controlled flow of authority from a single wellspring of power rather than a bubbling up and flowing together of many individual sources of personal power. The state has power; it chooses to delegate it to the board of directors of a corporation.

CLARK, CORPORATE LAW, *supra* note 13, at 22; Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, *in* PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 55, 56 (John W. Pratt & Richard J. Zeckhauser eds., 1985) [hereinafter Clark, *Agency Costs Versus Fiduciary Duties*] (stating that "directors are not agents of the corporation but are *sui generis*") (emphasis added); Morton J. Horwitz, Santa Clara *Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 216 (1985).

170. *See*, *e.g.*, DEL. CODE ANN. tit. 8, § 173 (West 2010).

171. *Cf.* Stout, *Mythical Benefits*, *supra* note 92, at 796 (describing the opposite example where corporate stakeholders would be reluctant to make firm-specific investments in public companies "run by widely dispersed but powerful shareholders, some of whom might be tempted to pump up share price by making opportunistic threats").

172. *Id.* at 808.

arguably, most of which have not even any indirect (tangible or intangible) positive effect on the corporation.[173] For some time, it seemed unclear whether charitable contributions would, indeed, be permissible (or whether they would rather be *ultra vires*, thus, resulting in director liability for allocating corporate assets to non-corporate purposes), but once *A.P. Smith Manufacturing Co. v. Barlow* was decided in 1953,[174] their legality has no longer been in question.[175]

h. Inevitable Shareholding Asymmetries

The Berle-Means corporation inevitably evidences shareholder asymmetries (or schisms) since shareholders—widely dispersed among various spectrums (sophistication, financial wherewithal, diversification, pooling, appetite for risk, short-, mid- and long-term return expectations, tax treatment, etc.) are by no means a homogeneous group.[176] Within any current group of shareholders at any point in time, individual shareholder interests will necessarily vary (and, as evidenced by shareholder *majority* decisions and the absence of *unanimous* shareholder decisions—for example, on corporate mergers—will regularly contradict each other); shareholders may favor short-term vs. long-term investment strategies; their holding of fractional interests in the corporation may differentiate among various classes (and series) of common stock and preferred stock (with according differences on shareholder returns that are attributable to the relative economic rights of such different varieties of stock); most shareholders will have different investment entry points (with, for example, some shareholders purchasing stock at $.50 to the dollar after the corporation has encountered losses and other shareholders purchasing the same stock at $1.50 to the dollar during the same corporation's heavily oversubscribed initial public offering).[177] Obviously, proponents of the

173. *Cf.* Hart, *An Economist's View*, *supra* note 4, at 308 (finding charitable contributions controversial because they can be a "form of self-aggrandizing or self-promoting behaviour by management").

174. A. P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 581 (N.J. 1953), *appeal dismissed*, 346 U.S. 861 (1953).

175. Indeed, Adolf Berle, the most vocal opponent at the time of the broad field now known as 'corporate social responsibility' (in which corporate charitable giving is often regarded as a tool for corporations to "do the right thing"), conceded defeat of his shareholder primacy model because of this decision. BERLE, CAPITALIST REVOLUTION, *supra* note 124. *See also* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 222–23; Bainbridge, *The Means and Ends*, *supra* note 3, at 561 n.70. The debate between Adolf Berle and Merrick Dodd in the 1930s established the roots of 'corporate social responsibility' as a normative alternative to shareholder value models of the firm. *See supra* note 124 and accompanying text.

176. *See* Hart, *An Economist's View*, *supra* note 4, at 307; Stout, *Why We Should Stop Teaching* Dodge v. Ford, *supra* note 14, at 9.

177. *Cf.* Bainbridge, *Nexus of Contracts*, *supra* note 75, at 21; Bainbridge, *Shareholder Disempowerment*, *supra* note 75, at 1745; Wallman, *Purpose of a Corporation*, *supra* note 41, at 808 n.5 (asking which shareholders are enjoying primacy, "[t]oday's or tomorrow's (presumably

efficient capital markets hypothesis (ECMH) try to solve this asymmetry by declaring that shareholder wealth maximization translates into maximizing the current share price of the corporation in order to harmonize, for example, present and future shareholder interests.[178] However, in my judgment, such solution significantly broadens the corporate end (away from any shareholderist model, that is) and simply restates the core purpose of the business corporation, namely that it should aspire to be as profitable as possible at any future point in time based on corporate actions taken or not taken today. It is simply the statement of a wealth maximization ideal with no impact on necessarily disparate actual shareholder interests (and the resultant potential for intershareholder opportunism) tomorrow or at any point thereafter, or the significance of such disparate actual interests on the actions taken or not taken by corporate directors today.

i. Nonshareholder Constituency Statutes

To date, over thirty states have adopted so-called nonshareholder constituency statutes as part of their respective state corporate statutes, thereby amending the existing statutory fiduciary duty framework for corporate directors.[179] Under such constituency statutes, directors are permitted (in Connecticut, even required) to consider both the short- and long-term effects of their decisions on not only the shareholders of the corporation but also on a varying list of other constituents of the firm, such as employees, suppliers, customers, creditors, and the local communities in which the corporation operates.[180] Arguably, more than half of the state corporation statutes have thus adopted a managerialist (rather than shareholder-centric) view of the corporation where senior management is given broad discretion to give due and fair consideration to all factors of production (stakeholder interests) that constitute the firm.[181] Recognizing the respective interests of such nonshareholder firm participants—or stakeholders—is not surprising[182] but rather emphasizes that shareholder

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not yesterday's)?," "[a]bitrageurs or long-term shareholders?," or "[t]ax-exempt institutions or taxable individuals?").

178. Hart, *An Economist's View*, *supra* note 4, at 306; Wallman, *Purpose of a Corporation*, *supra* note 41, at 808.

179. *See*, *e.g.*, Anthony Bisconti, Note, *The Double Bottom Line: Can Constituency Statutes Protect Socially Responsible Corporations Stuck in* Revlon *Land*, 42 LOY. L.A. L. REV. 765, 768 n.13 (2009) (counting 32 states with corporate constituency statutes). *See also* Hart, *An Economist's View*, *supra* note 4, at 305 n.17; Wallman, *Purpose of a Corporation*, *supra* note 41, at 810.

180. *See*, *e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 223–25; Wallman, *Purpose of a Corporation*, *supra* note 41, at 810.

181. Allen, *Contracts and Communities*, *supra* note 5, at 1403.

182. What is a bit surprising (or, at least, counter-intuitive on first blush) are the circumstances of how constituency statutes came about as legislative amendments to state corporate statutes, designed to insulate board directors from personal liability in corporate takeover battles. "In many cases, the force behind these [amendments seem to have] been incumbent management" in efforts

interests are never at the center (or, depending on semantics, are always at the center) of a sound business decision of a given board of directors. My final point of critique addresses this semantic conundrum.[183]

j. Inevitable Firm Investment Asymmetries

By economic necessity, the interests of a Berle-Means corporation—as a whole and as a going concern—cannot be congruent with and identical to the interests of its shareholders (or, as a semantic alternative, the interests of the corporation can only be completely congruent and identical—at all times—with the interests of its shareholders). The corporation provides a mechanism for shareholders to gain returns on their investment. But that is the case with any other firm participant. In this regard, the wealth-maximization or profit-seeking motive of the corporation is a means to an end, not an end in itself.[184] And the end is not shareholder wealth maximization, it is wealth maximization for all firm participants who otherwise would not be willing to invest in the first place if their respective interests to gain returns on firm-specific investments would have to yield to specific shareholder interests routinely and as a matter of law (assuming, for a moment, that shareholder interests could indeed be expressed *una voce*).

There is also (obviously) an even larger end in benefiting society as a whole[185] by conducting entrepreneurial activity within the corporate form rather than relying solely on market competition and contractual arrangements. Indeed, market forces push for such entrepreneurial activity to be organized within a firm—a hierarchical structure sheltered, as far as its inner organization is concerned, from market forces to a certain extent which gives it a competitive advantage over non-firm structures of entrepreneurial organization. Ronald Coase's famous 1937 inquiry into the

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to fight off hostile takeovers. Hart, *An Economist's View*, *supra* note 4, at 305 n.17. Accordingly, they must be regarded as entrenchment tools for corporate boards, helping such boards to insulate themselves even more from a (predatory) market for corporate control than the reach of the business judgment rule may have insulated them before, and clearly—as night and day or black and white—declaring shareholders (and their interests and purported primacy) as merely *inter pares*. *See* Hart, *An Economist's View*, *supra* note 4, at 305 n.17; Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 122–37 (1987) (focusing on the developments in Connecticut).

183. This semantic conundrum relates to my earlier description of the shareholder primacy model above: Firm value is, *ipso facto*, shareholder value (and vice versa). While this may be a correct statement in complete abstract terms (i.e., a mere theoretical application of the profit-seeking motive of the for-profit business corporation), I believe it makes a distinct difference in corporate reality when you tell management: "create shareholder value!" instead of "create firm value!" (*or*—not and!—vice versa). The almost constant lamentations of corporate managers over the pressures created by mandatory quarterly financial reports and the expectations of stock analysts that inevitably go with it—all of which often relegate long-term strategic management of the corporation to an afterthought—appear to be good evidence of such difference in profit-seeking commands.

184. *See supra* note 134 and accompanying text.

185. *See supra* note 41 and accompanying text.

nature of the firm provides exactly this explanation.[186] As far as microtheoretical models of the firm reach, we can say that all firm inputs—all firm-specific investments and, thus, all firm participants—matter for purposes of productive gains.[187] And it is clear from the plain and straightforward rules of American corporate law 'on the books' that directors are permitted (if not, required) to routinely and diligently consider the interests of all factors of production (i.e. all firm participants) and, therefore, of corporate constituencies other than shareholders,[188] in order to decide on behalf of all firm participant interests (i.e., the interest of the corporation as a whole—whether regarded as a separate entity or a mere aggregation of firm inputs) what is in the best interest of the whole construct organized and sheltered from the market in the form of the incorporated firm.

k. Conclusion

Shareholder wealth maximization is not an answer, an end in itself, but just a repetition of the second, substantive question of corporate governance ("*Whose Interest(s) Control(s)?*") cleverly disguised as an answer. Because of the residual claimant position of shareholders[189] and the for-profit motive of the business corporation,[190] it is perhaps reflexively appropriate to subject the best-interest decisionmaking of corporate directors under an 'umbrella label' of shareholder wealth maximization. But this is only semantics—a mere labeling exercise (probably a convenient, somewhat self-hypnotic labeling exercise) in order to not have to ask the fundamental question of how maximization is to be done in any particularized context; how the diverse, short-, mid- and long-term interests of a highly dispersed and asymmetrical shareholder base that expects at least some return on its investment translate into actions taken by a board of directors that not only pays nominal, ceremonial homage to such a mixed bag of interests but, in

186. *See supra* note 11 and accompanying text. *See also* Coase, *supra* note 8, at 393 ("Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-co-ordinator, who directs production.").

187. *See supra* note 136 and accompanying text.

188. *See*, *e.g.*, Wallman, *Purpose of a Corporation*, *supra* note 41, at 810.

189. *See* CLARK, CORPORATE LAW, *supra* note 13, at 18–19.

> [A]lthough the corporation has numerous and perhaps all-encompassing duties to these [stakeholders other than shareholders], it is the shareholders who have the claim on the residual value of the enterprise, that is, what's left after all definite obligations are satisfied, and the managers have an affirmative open-ended obligation to increase this residual value, rather than the wealth of some other affected group (including themselves).

Id.; Hart, *An Economist's View*, *supra* note 4, at 303.

190. *Cf.* COX & HAZEN, *supra* note 4, at 3.

fact, actuates them properly in the board decisionmaking process; and, most fundamentally and crucially, how director behavior can be properly incentivized in order to do exactly that—to pay not only nominal, ceremonial homage but, indeed, to act in the best interest of the corporation over and over and over again. The argument that is usually proffered against stakeholderist models of the corporation by shareholder primacists—namely that "a broad definition of [director] fiduciary duty is essentially vacuous, because it allows management to justify almost any action on the grounds that it benefits *some* [*stakeholder*] *group*"[191]—can and must be applied, *mutatis mutandis*, to the shareholder wealth maximization model itself: It is essentially vacuous because the substantive and procedural interplays of the fiduciary duty of care and the business judgment rule allow management to justify virtually *any* action on the grounds that it benefits *shareholders as a group*.[192]

To put it more bluntly: It can be said that shareholder primacy is a not a (legal) mandate but more of a shorthand cloak designed to (perhaps conveniently) cover what is really going on. In a model of corporate governance, it is a simple trick that is rephrasing the question as an answer but is logically no answer at all but a ruse. The shareholder primacy model—through its critical reliance on the shareholder wealth maximization norm as the controlling and critical variable—pretends to explain the real world phenomenon of investor confidence ex ante.[193] Given, however, that shareholder wealth maximization has no discernable meaning ex ante (and also does not provide for any discernable director accountability ex post under current American corporate law rules), its predictive ability—if we are indeed to rely, at least, on the rhetoric of shareholder value[194]—must come from somewhere else and combine with this rhetoric in order to make the model functional. In my judgment, how the model's functionality is achieved (and through what kind of an *instrumentarium*), how the model operates precisely step-by-step, how shareholder value is tied effectively to board decisionmaking and genuinely controls the latter—all of these questions, to date, are left entirely open and unexplained.

2. The Contractarian Model

Who Controls: 'Nexus' of explicit and implicit contracts (no individual group of firm participants controls the firm).

Whose Interest(s) Control(s): Shareholders (indirectly, all firm participants exert some influence since shareholders are residual claimants).

191. Hart, *An Economist's View*, *supra* note 4, at 303 (emphasis added).
192. *See supra* note 89 and accompanying text.
193. *See supra* note 95 and accompanying text.
194. *Cf.* Blair & Stout, *Director Accountability*, *supra* note 58, at 407.

Main Locus: Quadrant II; with, perhaps, a bit of **Quadrant IV** (shareholder interests control; other firm participants interests are recognized in the majoritarian bargaining defaults which constitute corporate law; board of directors/management is fully accountable).

Description. In 1976, the destruction of the formalistic corporate-law construct of the firm began in earnest[195] when Michael Jensen and William Meckling published their now seminal article on the theory of the firm, describing therein the corporation as an intricate 'nexus' (or network)[196] of interdependent interactions and complex (mostly implicit) 'contracting'[197] relationships among various participants investing resources within the business of the firm.[198] The contractarian (or nexus-of-contracts) model of the corporate firm was conceived. At its heart, it accepts that firm participants whose interests intersect within the corporate nexus are all endowed with relative bargaining positions and relative investment/wealth values. They then simply engage in a combination of explicit and implicit contractual and quasi-contractual arrangements in order to create the construct (or nexus) of the firm.[199] As a result, the corporation is merely a consensual ordering of relations among firm participants which, accordingly, is to be governed by such voluntary private-party ordering and no mandatory governmental regulation.[200] All that corporate law then does is to provide a dispositive (or permissive)[201] structure—as a majoritarian

195. *Cf.* Klausner, *supra* note 46, at 781 (describing the impact of the contractarian theory of the firm as "providing a conceptual starting point—a clearing of the analytic underbrush—for further work").

196. Allen, *Contracts and Communities*, *supra* note 5, at 1401.

197. *See supra* note 84 and accompanying text.

198. Jensen & Meckling, *supra* note 17, at 305. Of similar importance was Eugene Fama's 1980 article on the same topic, Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POLITICAL ECON. 288 (1980) [hereinafter Fama, *Agency Problems*]. Jensen and Meckling's article was based on earlier work published by Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972), and Fama and Jensen later collaborated in another important contribution, Eugene F. Fama & Michael C. Jensen, *The Separation of Ownership and Control*, 26 J.L. & ECON. 301 (1983). *See also* BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 49, at 27–33; Eisenberg, *supra* note 7, at 819; Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 599; Millon, *supra* note 4, at 229; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 763.

199. *See*, *e.g.*, Ind. Harbor Belt R.R. Co. v. Am. Cyanamid Co., 916 F.2d 1174, 1182 (7th Cir. 1990) ("A corporation is not a living person but a set of contracts the terms of which determine who will bear the brunt of liability."); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 17 (1991) ("All the terms in corporate governance are contractual in the sense that they are fully priced in transactions among the interested parties."); Allen, *Contracts and Communities*, *supra* note 5; Henry N. Butler & Larry E. Ribstein, *The Contract Clause and the Corporation*, 55 BROOK. L. REV. 767, 770 (1989); Hart, *An Economist's View*, *supra* note 4, at 306.

200. *See*, *e.g.*, COX & HAZEN, *supra* note 4, at 42; Bainbridge, *The Means and Ends*, *supra* note 3, at 551; Garrett, *supra* note 14, at 137; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 755. *See also supra* note 44 and accompanying text.

201. *Cf.* HAMILTON & BOOTH, *supra* note 24, at 331 (explaining how corporate law, in large part, is a set of permissive default rules subject to alteration by firm participants).

default[202]—through which the relative investment/wealth values of firm participants, held together by the contractarian nexus of the firm, are constantly created, divided, re-created, adjusted, and sometimes (perhaps, oftentimes) also destroyed[203]—though the latter would likely have to be seen as a failure of proper 'contracting' or as the materialization of the transactional and stochastic risks created by necessarily 'incomplete' long-term relational[204] contracts.[205]

Thus viewed, corporate law is simply our response to a pragmatic problem of creating and dividing economic rents while reducing transaction costs to a minimum.[206] And, like a general partnership (at least, pursuant to the position taken under the original Uniform Partnership Act of 1916), the corporation is nothing more than a mere aggregation of individual firm participants who own the factors of production within the organizational

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202. The majoritarian default describes the neoclassical view that corporate statutes, as legislative and dispositive-only default provisions, merely provide those standard provisions necessary for ordering the corporate nexus which a majority of firm participants would have chosen and contracted for anyhow if contracting with all other firm participants could occur with limited to no transaction costs and maximum completeness. Therefore, corporate law constitutes nothing else but the sum total of all standardized terms of implicit contracts which economists posit would be entered into over and over again by rational investors under similar circumstances if actual negotiation and drafting of those terms were indeed possible. *See*, *e.g.*, COX & HAZEN, *supra* note 4, at 42; HAMILTON & BOOTH, *supra* note 24, at 330–31.

203. *Cf.* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 600 (discussing how particular changes since the mid-1980s in the overall financial and commercial environment in which corporations operate have "altered the relative value and bargaining endowments of those whose interests intersected through the metaphorical corporate nexus," and concluding that corporate law "provides the structure through which both the creation and division of value takes place").

204. Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978).

205. In a firm nexus that is characterized by operational uncertainty and complexity as well as by bounded rationality of its participants, it is inevitable that the long-term 'contractual' arrangements made by such participants are necessarily incomplete (i.e., they do not address, and provide ex ante solutions for, all possible contingencies). *Cf.* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 226; Allen, *Contracts and Communities*, *supra* note 5, at 1400, 1405; Hart, *Norms and Theory*, *supra* note 96. In other words, uncertainty exists because of the "lack of knowledge of what the future will bring, [i.e., because of the lack of knowledge] of all stochastic variables." Richter, *supra* note 45, at 175 n.22. *See*, *e.g.*, Alces, *supra* note 125, at 241–42; Bainbridge, *The Means and Ends*, *supra* note 3, at 556 n.44; Meurer, *supra* note 9, at 739. *See also* Dooley, *supra* note 11, at 465 ("If there were no bounded rationality, including no limitations on human foresight or the ability to acquire and process information, individuals could write completely specified contingent contracts."); Diego Gambetta, *Can We Trust Trust?*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 213, 218 (Diego Gambetta ed., 1988) ("If we were blessed with an unlimited computational ability to map out all possible contingencies in enforceable contracts, trust would not be a problem.") (reference omitted).

206. EASTERBROOK & FISCHEL, *supra* note 199, at 5 (stating that the corporate contract will provide for governance structures that are "most beneficial to investors, net of the costs of maintaining the structure"); Allen, *Contracts and Communities*, *supra* note 5; Fama, *Agency Problems*, *supra* note 198, at 289–90. *See also* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 600; Eisenberg, *supra* note 7, at 823 (stating that the nexus-of-contract theory of the firm conceives the corporation simply as "the product of market forces").

structure of the firm[207] and proceed to explicitly and implicitly contract with each other for their cooperative use by the firm (i.e., everyone)—a natural product of private-party initiative and market competition without much, if any, of a separate (entity) existence in the law.[208] Accordingly, if the corporate governance structure provided by the default provisions[209] of corporate statutes does not satisfy the circumstances of a particular firm, the firm participants (in particular, shareholders) can contract out of them and can create an individualized, customized corporate charter that reflects the particular nexus of such firm—at least, as long as transaction costs of contracting are assumed to be zero or negligible.[210]

Critique. The contractarian model has always run into problems when confronted with the real world.[211] It is premised on the simplifying (but surreal) assumption of the "Coasean World"[212] of an ideal market comprised of perfectly rational and omniscient economic decisionmakers: everyone in the market knows everything there is to know about prices, demand, product quality, firm organization, etc., and has the ability to infinitely contract according to changing needs.[213] In reality, the

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207. *See* Hale v. Henkel, 201 U.S. 43, 76 (1906) ("A corporation is, after all, but an association of individuals under an assumed name . . . ."); Fama, *Agency Problems*, *supra* note 198, at 289–90.

208. *See*, *e.g.*, EASTERBROOK & FISCHEL, *supra* note 199, at 12; Allen, *Contracts and Communities*, *supra* note 5; Bainbridge, *The Means and Ends*, *supra* note 3, at 548; Millon, *supra* note 4, at 201–02, 211, 213. *See also* Klausner, *supra* note 46, at 779 ("At its broadest theoretical level, this transformation reconceived the corporation as a contractual entity and reconceived corporate law as a largely passive adjunct to the contracting process that creates a corporation."). Indeed, it can be argued that the nexus-of-contracts conception of the corporation is not a theory of the firm at all, it is a theory of why there is *no* firm (since the Coasean solution to the boundary-of-the-firm problem has been evaporated and all direction of firm affairs now only occurs under contracting/negotiation/market paradigms). *See* Eisenberg, *supra* note 7, at 832; Millon, *supra* note 4, at 229.

209. Klausner, *supra* note 46, at 780; Rock & Wachter, *Norms & Corporate Law*, *supra* note 5, at 1617.

210. Klausner, *supra* note 46, at 780, 796. *But see* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 607.

211. *See*, *e.g.*, Klausner, *supra* note 46, at 779 (concluding that "while the contractarian theory was a useful starting point for economic analysis of corporate law, more recent research demonstrates that as a description of reality, or a basis for policy prescription, the theory falls short"). *See also In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 938 (Del. Ch. 2003).

> Delaware law should not be based on a reductionist view of human nature that simplifies human motivations on the lines of the least sophisticated notions of the law and economics movement. *Homo sapiens* is not merely *homo economicus*. We may be thankful that an array of other motivations exist that influence human behavior; not all are any better than greed or avarice, think of envy, to name just one. But also think of motives like love, friendship, and collegiality, think of those among us who direct their behavior as best they can on a guiding creed or set of moral values.

Id.

212. Klausner, *supra* note 46, at 796.

213. *See* HAMILTON & BOOTH, *supra* note 24, at 331; KNIGHT, *supra* note 4, at 197 ("Chief among the simplifications of reality prerequisite to the achievement of perfect competition is . . .

fundamental corporate governance structures and mechanisms commonly adopted by Berle-Means corporations in the United States (i.e.,

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the assumption of practical omniscience on the part of every member of the competitive system."); Allen, *Contracts and Communities*, *supra* note 5, at 1396, 1405.

> The only management task that seems to remain, and which is the focus of attention in the firm of traditional price theory, is the selection of profit-maximizing quantities of outputs and inputs. But, since the required information for doing this is also freely in hand, and the required calculations are costless to make, the model strips management of any meaningful productivity in the performance of even these tasks. The *cost of maximizing* is ignored or implicitly assumed to be zero. De facto, the resources that might be required to make maximizing decisions are treated as if they are not scarce.

Demsetz, *supra* note 44, at 143 (footnote omitted). *But see* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 607; Hart, *An Economist's View*, *supra* note 4, at 300 ("The neoclassical theory of the firm, although useful, portrays the modern business enterprise in caricature terms."); Mitchell, *Importance of Being Trusted*, *supra* note 85; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 757; Ripken, *supra* note 63, at 165; Sheehy, *supra* note 15, at 22.

See also ROBIN PAUL MALLOY, LAW AND ECONOMICS: A COMPARATIVE APPROACH TO THEORY AND PRACTICE 53–55 (1990) (summarizing the assumptions underlying neoclassical economic theory, including (i) that economic actors always behave rationally and in a self-interested manner, and (ii) that economic actors have complete and perfect information available in their pursuit of economic opportunities); Douglass C. North, *Structure and Performance: The Task of Economic History*, 16 J. ECON. LIT. 963, 964 (1978) (summarizing the same assumptions as "(1) perfectly competitive markets, (2) perfectly specified and costlessly enforced property rights, (3) neutral government, and (4) unchanging tastes"). The artifice of those test conditions (as well as their cumulative effect) has, of course, been famously parodied by economist and Nobel laureate George Stigler in his *Conference Handbook*. George J. Stigler, *The Conference Handbook*, 85 J. POL. ECON. 441 (1977). According to his *Handbook*, all we need to say here for support of the point made above is "9-13-14-16-23-24-30" which numerical labels stand for, respectively:

> 9. The conclusions change if you introduce uncertainty.
>
> . . .
>
> 13.The market cannot, of course, deal satisfactorily with that externality.
>
> 14. But what if transaction costs are not zero?
>
> . . .
>
> 16. Of course, if you allow for the investment in human capital, the entire picture changes.
>
> . . .
>
> 23. The motivation of the agents in this theory is so narrowly egotistic that it cannot possibly explain the behavior of real people.
>
> 24. The flabby economic actor in this impressionistic model should be replaced by the utility-maximizing individual.
>
> . . .
>
> 30. The paper is rigidly confined by the paradigm of neoclassical economics, so large parts of urgent reality are outside its comprehension.

Id. at 442–43.

predominantly, the Delaware General Corporation Law)[214] are static and uniform: firm participants make no contractual commitments to change or maintain such statutory default structures and mechanisms during either the formation phase, the public offering phase, or the remaining lifespan phase of the corporation[215] and, but for protecting incumbent management from hostile takeovers, charter documents show very little diversity and deliberate contracting away from default rules.[216] As Michael Klausner succinctly put it after a review of over 600 charters of corporations involved in either an initial public offering or a spinoff: "Corporate charters come in one flavor: plain vanilla."[217]

In addition, leading contractarian scholars also adopt the traditional shareholder primacy argument that shareholders, as the firm's residual claimants are, thus, assumed to act as ultimate principals in a set of explicit and implicit agency contracts that hire the firm's productive resources, thereby establishing the nexus that makes up the firm.[218] Shareholders therefore retain a special position within the nexus—*primus inter pares* among the corporation's other constituencies—and enjoy a 'contract' with the firm (nexus) that grants them ownership-like rights, including as beneficiaries of fiduciary obligations owed to them by directors.[219] In other words, shareholder primacy is simply a majoritarian 'contractual' default rule.[220]

As such, the contractarian model has positive (i.e., descriptive and empirical) value[221]—in particular, for pointing out that the central, critical participant within the firm nexus is its manager who puzzles together (and

214. *See*, *e.g.*, Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1592 (2002) (finding from his analysis of an empirical sample of over 6,000 firms that went public between 1978–2000, that over seventy percent of those firms incorporated in Delaware during the second half of this period). *See also* Lucian A. Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383 (2003); Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 527 (2001); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 226 (1985); Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32 (2004); Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choices: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795 (2002).

215. *See* Klausner, *supra* note 46, at 781–82.

216. *See* Klausner, *supra* note 46, at 790. There are empirical studies that support this finding. John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CALIF. L. REV. 1301 (2001). *See generally* Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs*, 17 J.L. ECON. & ORG. 83 (2001); Laura Casares Field & Jonathan M. Karpoff, *Takeover Defenses of IPO Firms*, 57 J. FIN. 1857 (2002).

217. Klausner, *supra* note 46, at 790 (footnote omitted).

218. *See*, *e.g.*, Allen, *Contracts and Communities*, *supra* note 5; Blair & Stout, *Team Production*, *supra* note 49; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 755.

219. Bainbridge, *The Means and Ends*, *supra* note 3, at 548; Blair & Stout, *Director Accountability*, *supra* note 58, at 410.

220. Eisenberg, *supra* note 7, at 833. *See also* Blair & Stout, *Director Accountability*, *supra* note 58, at 416–17 (discussing the preference for shareholder primacy in contractarian corporate theory).

221. *Cf.* Hart, *An Economist's View*, *supra* note 4, at 300; Klausner, *supra* note 46, at 779, 796.

constantly, re-puzzles and re-juggles) all 'contractual' inputs for purposes of corporate adaptation and success.[222] However—notwithstanding the normative prescriptive force of its neoclassical-economics-derived, minimalist account of what corporate law should be[223]—not much modeling and conceptualizing help can be expected when one ventures into the second (substantive) question of corporate governance, "*Whose Interest(s) Control(s)?*".[224] Indeed, the reversion to shareholder wealth maximization as the central decision-guiding norm of corporate decisionmakers short-circuits and avoids answering such a normative question (as has been pointed out before[225]).[226] A realistic (rather than idealistic) view of the corporation must recognize that firms are much more than the result of 'contracts,' (i.e., actual bargains, explicit or implicit) which result in their respective organizational structures and internal order and provides the necessary inner cohesion for what are often hundreds of thousands of individual factors of production in a single Berle-Means corporation.[227] Unless, of course, we rubricate (wholesale, that is) all those critical variables which are necessary and currently unexplained for in microtheoretical models (for example, 'trust,' 'loyalty,' and similar socio-contextual,[228] behavior-oriented and reciprocal[229] variables[230] based on pre-coded 'expectations,' 'counter-expectations,' and 'expectation-expectations' and aimed at reducing social complexity[231]) as implicit actual

222. *See* HAMILTON & BOOTH, *supra* note 24, at 332.

223. *Cf.* Allen, *Contracts and Communities*, *supra* note 5, at 1405; Eisenberg, *supra* note 7, at 824, 836; Klausner, *supra* note 46.

224. *Cf.* Eisenberg, *supra* note 7, at 836 ("[T]he nexus-of-contracts conception, as a positive description, has no normative implications.").

225. *See supra* text accompanying notes 189–194.

226. *Cf.* O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 766.

227. *Cf.* Allen, *Contracts and Communities*, *supra* note 5, at 1402; Stout, *Mythical Benefits*, *supra* note 92, at 797–98. Included in such 'much more' would be, at a minimum, any non-legally enforced reciprocal arrangements in the form of social norms (i.e., protolegal variables as, for example, trust), the distribution of property rights within the firm and, thus, among the means of production, the bureaucratic rules of the internal governance organization of the firm, and the hierarchical, command-and-control structure of the firm's organization in the form of unilateral directions by superiors to subordinates made by fiat rather than through negotiation. *See*, *e.g.*, Eisenberg, *supra* note 7, at 836.

228. *See* Stout, *Proper Motives*, *supra* note 77, at 13. In addition, it is clear that at least some part of what we consider 'corporate law' consists of mandatory rules that are not subject to enforceable contractual deviations. *See*, *e.g.*, Eisenberg, *supra* note 7, at 823–24.

229. *Cf.* Ernst Fehr & Simon Gächter, *Fairness and Retaliation: The Economics of Reciprocity*, 14 J. ECON. PERSPECTIVES 159, 159 (2000) ("Reciprocity means that in response to friendly actions, people are frequently much nicer and much more cooperative than predicted by the self-interest model; conversely, in response to hostile actions they are frequently much more nasty and even brutal."). *See also* Eisenberg, *supra* note 7, at 822 (stating that, pursuant to the nexus-of-contract conception of the firm, "the corporation is a nexus of reciprocal arrangements").

230. *See supra* note 97 at accompanying text.

231. *Cf.* NIKLAS LUHMANN, LOVE AS PASSION: THE CODIFICATION OF INTIMACY (Jeremy Gaines & Doris L. Jones trans., 1986).

bargains, ergo 'contracts.'[232] In case of such a presupposition exercise, however, the nexus-of-contracts model of the firm still owes us a good explanation as to what those 'contracts' exactly are and how they come into being and become part of the nexus.[233]

3. The Team Production Model

Who Controls: Board (as a mediating hierarch by delegation of, and with accountability to, all firm participants).

Whose Interest(s) Control(s): All firm participants (directly as a team).

Main Locus: Quadrants II & IV (all stakeholders interests control, not only shareholder interests; board of directors/management remains accountable as a mediator who needs to give all firm interests involved their relative weight and distributional merit).

Description. In 1999, Margaret Blair and Lynn Stout introduced a new way of thinking about corporate governance,[234] formulating their 'team production' theory of the firm.[235] It is designed as a logical (and complementary) progression from the nexus-of-contracts model of the firm

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> You cannot live without forming expectations with respect to contingent events and you have to neglect, more or less, the possibility of disappointment. You neglect this because it is a very rare possibility, but also because you do not know what else to do. The alternative is to live in a state of permanent uncertainty and to withdraw expectations without having anything with which to replace them.

Niklas Luhmann, *Familiarity, Confidence, Trust: Problems and Alternatives*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 94, 97 (Diego Gambetta ed., 1988). *See also* Blair & Stout, *Trust*, *supra* note 70, at 1796; Geoffrey P. Miller, *Norms and Interests*, 32 HOFSTRA L. REV. 637 (2003); Mitchell, *Trust. Contract. Process.*, *supra* note 49, at 191; Lynn A. Stout, *The Investor Confidence Game*, 68 BROOK. L. REV. 407, 410–15 (2002) [hereinafter Stout, *Investor Confidence*].

232. *Cf.* Eisenberg, *supra* note 7, at 823 (preferring the term "nexus of reciprocal arrangements" over "*nexus of contracts*").

233. *Cf.* Klausner, *supra* note 46, at 781–82 (pointing out that "non-legal economic or reputational sanctions" outside of the legally enforceable "corporate contract" as defined in contractarian theory are necessary in order to explain the governance structures and mechanisms of the firm); *id.* at 797 ("By failing to account for transaction costs, the contractarian theory fails to explain the reality of either the content of firms' corporate governance commitments or the process by which those commitments are formed."). In addition, the nexus-of-contracts model of the firm still owes us a good explanation as to why those 'contracts' should be legally enforceable on a wholesale basis, in particular, given the fact that the large, publicly-held incorporate firm creates a wide range of adverse third-party effects (i.e., negative externalities). *See*, *e.g.*, Eisenberg, *supra* note 7, at 824; René Reich-Graefe, *Deconstructing Corporate Governance: Director Primacy Without Principle?*, 16 FORDHAM J. CORP. & FIN. L. 465 (forthcoming 2011) (discussing negative externalities, i.e., social costs, generated by the corporate endeavor).

234. *See* Mitchell, *Trust and Team Production*, *supra* note 12, at 870.

235. Blair & Stout, *Corporate Law*, *supra* note 74. *See also supra* note 74 and accompanying text. It should be noted that Armen Alchian and Harold Demsetz, as economists, first described the firm organization requiring multiple productive inputs and producing nonseparable outputs that are not easily attributable to their respective productive inputs as a "team production." *See* Alchian & Demsetz, *supra* note 198, at 779–81.

in that it views corporate law as a mechanism for filling in gaps in situations where team participants in the firm have found explicit contracting too difficult or even impossible given the very real transaction costs of such explicit contracting.[236] At its core, the team production model is premised on three factual features which are all prevalent in the corporate firm. First, the economic production (i.e., the creation of firm value) requires a team of firm participants (i.e., two parties or more).[237] Second, every firm-participant team member makes an illiquid, firm-specific or 'team-specific' investment into the corporate venture.[238] The idea of a 'team-specific' investment is that the productive factor invested will have a significantly higher value and likelihood for return when used within the team framework than when compared with its second-best use.[239] And lastly, firm 'rents'—i.e., the economic output-gains of the firm as a result of team production—are often joint and, thus, nonseparable along the same lines that firm inputs (i.e., the team-specific investments) were separable from each other prior to their injection into the firm. In other words, it proves difficult to attribute any particular portion of the gains to any particular team member's contribution.[240] A further structural problem is created by the fact that firm-specific investments are often sunk—i.e., neither the original investment nor any return the investment may have generated or may generate in the future can be easily and unilaterally extracted from the firm by the investing firm participant.[241]

Firm-specific investments are obviously essential for the creation of value by the firm. They will only be made if the correlation between the investment and the probability of its return (i.e., its divisional share of the

236. Blair & Stout, *Corporate Law*, *supra* note 74, at 254.

237. Blair & Stout, *Director Accountability*, *supra* note 58, at 419; Blair & Stout, *Corporate Law*, *supra* note 74, at 249; Blair & Stout, *Team Production*, *supra* note 49, at 745. *See also* Alchian & Demsetz, *supra* note 198, at 779. Investments become 'team-specific,' at least, in part, since they do not have much if any value in the external market (e.g., time, energy, ideas invested, financial capital spent on specialized equipment, renting factory space, etc.) and their inherent value therefore remains latent, i.e., it depends on whether or not the team production exercise is successful in producing valuable outputs which then generate returns on the team's total investment that can then be somehow shared by the team members. *See* Blair & Stout, *Director Accountability*, *supra* note 58, at 420.

238. Blair & Stout, *Director Accountability*, *supra* note 58, at 419; Stout, *Mythical Benefits*, *supra* note 92.

239. Blair & Stout, *Team Production*, *supra* note 49, at 745.

240. Blair & Stout, *Director Accountability*, *supra* note 58, at 419; Blair & Stout, *Team Production*, *supra* note 49, at 745; Blair & Stout, *Corporate Law*, *supra* note 74, at 265–66. *See also* Alchian & Demsetz, *supra* note 198, at 779.

241. Blair & Stout, *Director Accountability*, *supra* note 58, at 420 (stating that the resources which team members have invested in the firm "often cannot be recouped once team production has begun" and that "team members cannot protect their interest by threatening to withdraw these resources and sell them to some third party in the marketplace"); Blair & Stout, *Team Production*, *supra* note 49, at 745 (explaining that "investors cannot easily recover the full value of their money after it has been spent on specialized equipment and salaries" and that those investors "must wait until team production begins before they see a return on their investment").

value created, even if nonseparable) over time is sufficiently predictable and satisfactory ex ante. Therefore, it seems appropriate and necessary for team production members (i.e., the firm participants making team-specific investments) to delegate exclusive authority in order to organize firm inputs, distribute firm outputs, and resolve interest conflicts among team production members to the board of directors as a mediating hierarch,[242] (i.e., a kind of referee).[243] The board is accordingly charged with a complex balancing act aimed at serving all stakeholder interests in the firm (including those of shareholders).[244] It is charged by each and every team member to: (i) mediate among the competing interests and demands of all the stakeholders and their respective investments involved; and (ii) "protect [all stakeholders'] return on their [respective] investments from post-investment opportunistic behavior" and illicit return-seeking (or return-protecting) by other stakeholders.[245] Given the nexus of firm-specific assets invested by team participants, the board serves as a 'trustee'[246] (or 'fiduciary'[247] or 'trusted mediator'[248]) for the entire firm as a productive whole but remains insulated from any direct command and control of any group or class of team participants.[249] What is enough is that, structurally, board governance offers firm participants the promise of "business continuity"[250] (and, thus, of a continued stream of returns on investment for everyone).

Critique. The board as a mediating hierarch is an economic agent for all firm participants. Unlike the shareholder primacy model, the team

242. Blair & Stout, *Director Accountability*, *supra* note 58, at 408, 421; Blair & Stout, *Corporate Law*, *supra* note 74, at 250.

243. *Cf.* Bainbridge, *The Means and Ends*, *supra* note 3, at 593; O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 756.

244. *See* Blair & Stout, *Team Production*, *supra* note 49, at 744; Wallman, *Purpose of a Corporation*, *supra* note 41.

245. Blair & Stout, *Director Accountability*, *supra* note 58, at 421 (describing the ideal scenario in which the board as a mediating hierarch decides which team member receives what share of the surplus "with an eye toward maximizing the total surplus, while ensuring that each team member receives a large enough share to induce her to invest optimally in team production in the first place"); Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 603. *See* Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163, 170 (1991) (stating that the "interests of the corporation also include the interwoven interests of its various constituencies, such as shareholders, employees, customers, the local community, and others" and that "these constituencies' interests are balanced by the board of directors acting in the best interests of the corporation as a whole, as opposed to the best interests of any one particular constituency").

246. Blair & Stout, *Corporate Law*, *supra* note 74, at 291; Blair & Stout, *Team Production*, *supra* note 49, at 746. *See also* DeMott, *supra* note 79 (stating that "directors occupy a trustee-*like* position").

247. Blair & Stout, *Director Accountability*, *supra* note 58, at 425; Blair & Stout, *Corporate Law*, *supra* note 74, at 291.

248. Blair & Stout, *Director Accountability*, *supra* note 58.

249. *Id.* at 408, 421; Blair & Stout, *Team Production*, *supra* note 49, at 746.

250. Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 110 (1979). *See also* Stout, *Mythical Benefits*, *supra* note 92, at 797.

production model correctly assumes that the board must be equipped with unlimited allocational and distributional powers in order to mediate conflicts among the various corporate constituencies.[251] The board must be able to attract and allocate team-specific investments as well as distribute correlative benefits as it sees fit. And it is an often underestimated fact that every single board decision does both—allocates resources and distributes (future) benefits—simultaneously and often with allocative and distributive effects to multiple if not (at least, indirectly) all firm participants.[252] The result is that no agent-participant group can have an overriding interest that would bind the board to act in any particular way. Indeed, the board can act (i.e., mediate) in any way it wishes since the collective interests of all firm participants are, at best, inextricably diffuse.[253] Correspondingly, Blair and Stout argue that directors are not subject to direct control or supervision by anyone, including the firm's shareholders.[254]

Notwithstanding this unlimited, near-absolute power to mediate,[255] the team production model insists that the board of directors remains somehow accountable to the productive team and all of its participants, namely as a 'trustee' and 'fiduciary' to whom team members have ceded control.[256] But the model only assumes, and does not explain, how such accountability

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251. In fairness, it should be noted that the Blair/Stout Team Production Model is not only a microtheoretical model but also genuinely macrotheoretical in that it ventures explicitly and conceptually into the inevitably allocational and distributional spheres of the decisional governance of the corporation. In this regard, it can be said that the Team Production Model is dualistic in nature (as is, of course, the nature of the firm, *cf.* Eisenberg, *supra* note 7, at 827–30) in that it combines microtheoretical and macrotheoretical conceptions of the firm—at a minimum, in a descriptive manner. This Article is only concerned with the microtheoretical spheres of the theory of the firm. I have discussed the macrotheoretical implications of the Blair/Stout Team Production Model—and how they relate and contrast with the macrotheoretical sphere of the absolute director primacy model (which sphere is currently, shall we say, still 'under construction')—in a separate article. *See* Reich-Graefe, *supra* note 233.

252. What I mean here is that it is (too) often overlooked that, in the reality of the going-concern operation of the firm, there is *no bifurcation whatsoever* between the time the board acts hiring productive resources in order to create value and the time the board acts in order to distribute to the firm's value participants the cash flows resulting from the creation of value. Every time the board (or upper management) acts, including when it hires productive resources, it instantly allocates and distributes currently available as well as future cash flows among all firm participants. Thus, on a daily basis, future cash flows are pre-booked, pre-committed and pre-spent—when money comes in, some of it (or all of it, or even more than it) has already gone out. Accordingly, there is no factual distinction possible between wealth creation and wealth distribution; both occur simultaneously once the corporation becomes a going concern.

253. *Cf.* Blair & Stout, *Director Accountability*, *supra* note 58, at 436 ("As a solution to the contracting problems associated with team production, the mediating board is obviously messy.").

254. Blair & Stout, *Director Accountability*, *supra* note 58, at 408, 421; Blair & Stout, *Team Production*, *supra* note 49, at 746; Blair & Stout, *Corporate Law*, *supra* note 74, at 254, 290.

255. Blair & Stout, *Corporate Law*, *supra* note 74, at 251 (stating that at the peak of the corporate hierarchy "sits a board of directors whose authority over the use of corporate assets is virtually absolute").

256. *See supra* note 79 and accompanying text. *See also* Blair & Stout, *Director Accountability*, *supra* note 58 (trusted mediator).

would be rooted in either the theory or the practice of corporate law.[257] Indeed, Margaret Blair and Lynn Stout themselves admit that "team members who feel they deserve a larger share of the gains from team production must ultimately either appeal to the directors or abandon their team-specific investment by exiting the firm."[258] As discussed above, those post-investment correctives—which depend either on directors being willing to listen to (and to even act upon) 'appeals' or on the possibility to 'abandon' an investment that could easily be sunk and, thus, simply 'non-abandonable' or only 'abandonable' at significant costs that not only could wipe out any return on the investment but a significant portion or, in some circumstances, all of the investment itself[259]—do not seem to help in any way with firm investments to be made confidently ex ante and with sufficient predictive accuracy.[260] Ultimately, one feels returned to *square one*: there does not appear to be "a clear way in principle to evaluate the performance of those in charge of the deployment of corporate assets, if their duty is to balance the claims made upon the corporation by a variety of contesting claimants."[261]

Given such circularity in their model, Blair and Stout undertake a bold step which, in my view, clearly opens a pathway into the right direction for purposes of modeling with more accuracy (and, thus, predictability) the governance structure of the publicly-held corporate firm. Without admitting that their team production model is descriptively circular (i.e., team members willingly cede control to the board because, structurally, as a mediating hierarch the board is best equipped to do the right thing, to mediate among and, thereby, protect their respective returns on

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257. Blair & Stout, *Director Accountability*, *supra* note 58, at 437.

> The mediating hierarchy model suggests that directors must be accountable to all the firm's residual claimants. Moreover, directors are accountable for maximizing the total value of the residual claimants' interests in the firm. But because the inputs and outputs of team production are to some extent unverifiable—meaning they cannot be readily identified and measured by an outside party such as a court—there is *no way* to set a substantive standard for gauging how good a job the board is doing.

Id. (emphasis added); *id.* at 437–38 (stating that procedural performance standards for directors would cause them as rationally selfish actors to "jump mindlessly through the appropriate procedural hoops, rather than motivating them to actually do a good job").

258. Blair & Stout, *Team Production*, *supra* note 49, at 746.

259. Which will already result from exiting the team-specific investment and contributing it thereafter to its non-team-specific second-best use.

260. These correctives may help to encourage some normative agenda across the spectrum ex ante (and, thus, incentivize firm managements across the spectrum to comply with such agenda), but they do not help the particular investor who ends up with a particular, disincentivized or 'non-incentivizable' firm management and who is forced to (financially) suffer through the corrective mechanism to come to the 'rescue' in her particular case in an attempt by the market to reinforce the normative agenda across the spectrum. In other words: these correctives distribute highly inefficient monitoring costs asymmetrically. Unless our investor hedges against such particularized risk by a widely diversified portfolio, why would she confidently invest ex ante?

261. Allen, *Contracts and Communities*, *supra* note 5, at 1406.

investment—but "there is *no way* to set a substantive standard for gauging how good a job the board is doing,"[262] thus, there is no way to know pre-investment whether the board is going to do a good job in order to feel comfortable enough to invest and cede control in the first place),[263] Blair and Stout set out to 'borrow' legitimacy (and, apparently, with it accountability) from outside (corporate) law. They admit that "directors enjoy enormous legal discretion in how they choose to manage and allocate corporate resources"[264] but also posit that there is a "possible important curb on director behavior"[265] which is, however, *nothing* that the law provides in terms of accountability. Such important curb (or constraint) on the directors' "virtually absolute"[266] authority and discretion over the (mis)use of corporate assets is found in the "directors' internalized *belief* that they *ought to behave* in a careful, loyal and trustworthy fashion."[267]

That is quite a statement. And I believe that it is absolutely correct. As I explain more fully in my closing sketches below (as well as, in more detail, elsewhere),[268] our current microtheoretical models of the firm—including the Blair/Stout team production model—leave us with an uncomfortably wide gap within each of our respective models as regards their predictive ability and, thus, their overall accuracy.[269] Blair and Stout point us into the right direction with their focus on trust and (intrinsic) trustworthiness of corporate directors as underlying safeguards of team-specific investments in firms.[270] However, such focus is not an integral, organic, and constituent part of their team production model. It is entirely exogenous—a *quick fix* of such model, borrowed from outside of the model in order to make the model work conceptually. Since the fix, in substance, constitutes what I call '*protolegal variables*,' such focus is definitely also borrowing from outside the realm of corporate law. There is an a priori realm of normative substance that pre-exists and controls corporate law without being any part of it. Thus, in my view, Blair and Stout have correctly figured out that corporate law is *completely irrelevant* for purposes of director accountability. Or to say it differently: corporate *law* has no answer—no inner normative intelligibility—when it comes to the second, substantive

262. Blair & Stout, *Director Accountability*, *supra* note 58, at 437 (emphasis added).
263. And, therefore, otherwise normatively vacuous.
264. Blair & Stout, *Director Accountability*, *supra* note 58, at 438.
265. *Id.*
266. Blair & Stout, *Corporate Law*, *supra* note 74, at 251.
267. Blair & Stout, *Director Accountability*, *supra* note 58, at 438 (emphases added).
268. Reich-Graefe, *supra* note 233.
269. And I mean a 'wide gap'—we can safely drive entire trucks through it—both ways—at the same time—at high speed. We only have a beginning of an inkling of an understanding as to why directors on corporate boards behave the way they behave and why we cannot find any functional accountability mechanism within our corporate law that gauges "how good a job the board is doing." *See* Blair & Stout, *Director Accountability*, *supra* note 58, at 437.
270. Blair & Stout, *Director Accountability*, *supra* note 58, at 438–43; Blair & Stout, *Trust*, *supra* note 70, at 1735.

question of corporate governance ("*Whose Interest(s) Control(s)?*"). As a result, this question can only be answered by recourse to a protolegal realm in which variables like those pointed out by Blair and Stout (in particular, 'trust' and 'trustworthiness') provide the only operational mechanisms of director accountability that we seem to have available (even though they are limited and probably not genuine).

4. The Director Primacy Model

Who Controls: Board (as a decisionmaker by fiat).

Whose Interest(s) Control(s): Shareholders (indirectly, all firm participants exert some influence since shareholders are residual claimants).

Main Locus: Quadrant I; with, perhaps, a bit of **Quadrant II** (shareholder interests control; board of directors/management is a *sui generis* decisionmaker with almost unlimited powers and very little accountability within corporate law).

Description. The director primacy model developed by Stephen Bainbridge in a series of articles[271] over the last decade asserts that corporate directors are the holders of all corporate power[272] who can institute any and all adaptive firm changes by fiat[273] and who are controlled only by the principle that the proper end of any exercise of their power is shareholder wealth maximization.[274] However, this check on directors' central decisionmaking power is essentially an unenforceable "contractual obligation to maximize the value of the shareholders' residual claim."[275]

For the first time in microtheoretical models, the board of directors is boldly acknowledged as a *sui generis* body within the corporation,[276] not 'hired' but free from any legal strictures of delegation or fiduciary relation to a higher, ultimate firm constituent (whether shareholders or other stakeholders). The board is no longer an agent for anyone, not even the corporation (or the team) itself.[277] Its decisionmaking authority is statutory (thus, original and non-delegated) and unlimited within the law. Director primacy, thus, means "the centralization of essentially nonreviewable

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271. *See supra* note 75 and accompanying text. *See also* Wayne O. Hanewicz, *Director Primacy,* Omnicare*, and the Function of Corporate Law*, 71 TENN. L. REV. 511 (2004).

272. Bainbridge, *The Means and Ends*, *supra* note 3, at 550.

273. *Id.* at 552. *Cf.* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 76.

274. Bainbridge, *The Means and Ends*, *supra* note 3, at 550–51; Bainbridge, *Convergence Debate*, *supra* note 2, at 47–48. *See also* O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 756 n.19.

275. Bainbridge, *The Means and Ends*, *supra* note 3, at 551, 555, 606.

276. BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 74; Bainbridge, *The Means and Ends*, *supra* note 3, at 555–56; Bainbridge, *Convergence Debate*, *supra* note 2, at 51. *But see* sources cited *supra* note 169.

277. *Cf.* BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 76.

decisionmaking authority in the board of directors"[278] so that the "board has virtually unconstrained freedom to exercise business judgment."[279]

Critique. Professor Bainbridge remains consequent and loyal to his contractarian roots[280] in answering the second, substantive question of corporate governance—namely, "*Whose Interest(s) Control(s)?*"—in the identical fashion that the contractarian model of corporate law has answered such question (and the shareholder primacy model answered it even before the contractarian model). Thus, the same critique applicable to the shareholder primacy model and described above must be levied here. In essence, there is no contractual (whether explicit or implicit), quasi-contractual or 'contractarian' obligation on the board of directors to maximize shareholder value. This is merely an idea—possibly even an efficient idea in order to *orient* director decisionmaking overall—but it is by no means the law. It is impossible to find that there is a *legal* director accountability mechanism in place (i.e., a mechanism that is a feature of our corporate law 'on the books') because of a mere 'contractarian' idea which is acknowledged by all as (virtually) *unenforceable* within the law.

Thus, Bainbridge's director primacy model deserves full credit for correctly pointing out the "virtues of fiat"[281] as exercised by the corporate board for purposes of corporate decisionmaking efficiency. But if such decisionmaking power by fiat—sanctioned by corporate law as nonreviewable decisionmaking *authority* by discretionary fiat—indeed cannot be "trumped by either shareholders or courts,"[282] the director primacy model still owes us an explanation with regard to the normatively inevitable 'vices of fiat.' The power of fiat of the board as a central decisionmaker may not be used only to effectively address uncertainty and complexity for purposes of mandating adaptive responses to future circumstances facing the corporate endeavor and challenging its continued prosperity and survival. It may also be used opportunistically (or may opportunistically not be used at all) by a corporate board shirking its functional capabilities. Bainbridge acknowledges that a complete theory of the firm requires one to explain how the 'virtues of discretion' are balanced

278. Bainbridge, *Shareholder Disempowerment*, *supra* note 75, at 1749. *See also* Bainbridge, *Nexus of Contracts*, *supra* note 75, at 7 ("At the core of the director primacy model therefore lies the normative claim that the virtues of fiat, in terms of corporate decisionmaking efficiency, can be ensured only by preserving the board's decisionmaking authority from being trumped by either shareholders or courts.").

279. Bainbridge, *The Means and Ends*, *supra* note 3, at 605.

280. *Cf.* Bainbridge, *Nexus of Contracts*, *supra* note 75, at 7; Bainbridge, *The Means and Ends*, *supra* note 3, at 550.

281. Bainbridge, *Nexus of Contracts*, *supra* note 75, at 7, 31 ("virtues of discretion"); Bainbridge, *The Means and Ends*, *supra* note 3, at 573.

282. BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 75; Bainbridge, *The Means and Ends*, *supra* note 3, at 605; Bainbridge, *Nexus of Contracts*, *supra* note 75, at 7.

"against the need to require that discretion be used responsibly."[283] However, he then only posits that opportunism is simply "deterred by the prospect of *ex post* sanctions, obviating the necessity of drafting a complete contract *ex ante*."[284] Given that, as a matter of corporate law, the board's decisionmaking authority is nonreviewable by either shareholder or courts, one seems to be left wondering what those ex post sanctions provided by corporate law could be which deter board shirking within the director primacy model. Certainly, the unenforceable, aspirational, and 'contractarian' idea of shareholder wealth maximization does not qualify as such a deterrent.

It comes as no surprise, then, that Bainbridge has to revert to the same 'quick fix' in order to fill the gap in his model which Blair and Stout utilized for the identical purpose in their team production model. He analogizes corporate boards to production teams in which "mutual monitoring and peer pressure provide a coercive backstop for a set of interpersonal relationships founded on trust and other noncontractual social norms."[285] Again, as in the team production model, these "key"[286] social norms coupled with reciprocal group monitoring of *moral* (i.e., not *legal*) norm compliance provide the necessary "institutional constraint on agency costs."[287] In other words, boards—as Platonic guardians and self-monitoring hierarchs[288]— "*voluntarily* limit their discretion with respect to the proper ends of corporate governance by embracing the shareholder wealth maximization norm."[289] Thus, I argue that, ultimately, the Bainbridge director primacy model ends up at exactly the same conclusion that the Blair/Stout team production model appears to arrive at (even though both models, at least, implicitly deny that they get to such conclusion by not making it explicitly)—namely, that corporate *law* has nothing to provide when it comes to the second, substantive question of corporate governance ("*Whose Interest(s) Control(s)?*").

B. AN ABSOLUTE DIRECTOR PRIMACY MODEL

Table 2 outlines, in a nutshell, how the *absolute director primacy model* radically differs from the four current microtheoretical models of the firm

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283. Bainbridge, *Nexus of Contracts*, *supra* note 75, at 31. *Accord* BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 73; Bainbridge, *The Means and Ends*, *supra* note 3, at 573.

284. Bainbridge, *Nexus of Contracts*, *supra* note 75, at 20. *See also* BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 74 ("[T]here must be some system of ex post governance: some mechanism for detecting and *punishing* shirking.") (emphasis added).

285. Bainbridge, *Nexus of Contracts*, *supra* note 75, at 28; BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 101.

286. BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 101.

287. Bainbridge, *Nexus of Contracts*, *supra* note 75, at 29. *Accord* BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 102 ("important constraints on behavior").

288. BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 103.

289. Bainbridge, *The Means and Ends*, *supra* note 3, at 580 (emphasis added).

discussed above and why, in general, microtheoretical models (i.e., those that concentrate on the inner workings of the firm[290]) are unable to explain and predict why the genius of American corporate law does not (more) regularly deteriorate into totalitarian corporate boards which misuse their absolute decisionmaking authority to the detriment of every other firm participant involved.

Table 2: Absolute Director Primacy Model

Model	**"*Who Controls?*"**	**"*Whose Interest(s) Control(s)?*"**	***Main Locus in Figure 1***
Absolute Director Primacy	board (as a decisionmaker by fiat, i.e., as a modern *Leviathan*)	indeterminable within current models because of directors' absolute decisionmaking power	**Quadrants I & III**

None of the microtheoretical models of the firm discussed above ventures into Quadrant III in Figure 1. The *absolute director primacy model* does and fills Quadrant III, as well as Quadrant I, in their entirety. It thereby posits not only that the board of directors is a *sui generis* decisionmaker with unlimited authority within corporate law (thus, restating—but more radically—what Stephen Bainbridge has already developed in his director primacy model), but also, and more importantly, that, as a matter of corporate law, there is no overriding firm participant interest that controls outcomes or guides the board decisionmaker. When comparing the *absolute director primacy model* to the Blair/Stout team production model on the one hand and Bainbridge's director primacy model on the other hand, one could summarize that: (i) the Blair/Stout model provides a good descriptive (but no normative) answer to the second question of corporate governance, "*Whose Interest(s) Control(s)?*"; (ii) the Bainbridge director primacy model provides a good descriptive (but, likewise, no normative) answer to the first question of corporate governance, "*Who Controls?*"; and (iii) both such answers are now combined and synthesized in the *absolute director primacy model*. Put graphically, the combination of Quadrants II & IV of the team production model with Quadrant I of the director primacy model results in Quadrants I & III of the *absolute director primacy model*. Noticeably, the *absolute director primacy model* can be viewed as the exact opposite of the team production model. Whereas team production insists on decisionmaker accountability and, thus, occupies Quadrants II & IV, the *absolute director primacy model* denies that any meaningful modicum of

290. *Cf.* Millon, *supra* note 4, at 202.

director accountability exists in American corporate law. Consequently, it is situated—at least, for the time being—in all of Quadrants I & III.

By locating the *absolute director primacy model* in Quadrants I & III, I obviously am rejecting the notion that any accountability mechanism exists in American corporate law that would allow firm participants, prior to making their firm-specific investment, to predict with some accuracy how the board of directors will behave in certain situations—thus, how the return on their investment as well as its probability are going to be controlled by such decisionmaker behavior. By necessity and design, the law of fiduciary duties of corporate decisionmakers is open-ended—both with regard to its means as well as its ends.[291] Under the business judgment rule,[292] directors can act in any way they see fit and without having to worry about any judicial review and second-guessing as long as the court, in applying the business judgment rule presumption, can on its own—*sua sponte*—provide some (even the most remote) rational basis for why the board of directors might have believed—honestly and in good faith—that its decision was (ultimately) in the best interest of the corporation.[293] Therefore, directors are granted full discretion to act opportunistically—unfettered by any further legal constraint—and to favor any particular cause or firm participant interest over any and all others at any point in time as long as: (i) no controlling economic self-interest of directors is actualized (and remains unsanitized) in the decision; (ii) basic process due care is complied with; and (iii) some rudimentary (and, possibly, entirely hypothetical) rational explanation can be construed as to why the prevailing consensus at the time of the board action might have been that the corporation could ultimately benefit in some (tangible or intangible) shape or form.[294]

The difference between the *absolute director primacy model* and the four microtheoretical models discussed above is therefore as follows: Each of the four models posits that, in one form or the other, one only needs to determine the controlling interests or norms guiding corporate decisionmaking. Once such a determination of decision-guiding interests has been accomplished, it controls the exercise of decisionmaking latitude (i.e., it controls the decisionmakers themselves) and, therefore, not only

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291. *Cf.* CLARK, CORPORATE LAW, *supra* note 13, at 677; Allen, *Contracts and Communities*, *supra* note 5, at 1398.

292. For an explanation of the business judgment rule, see *supra* note 87.

293. Apart from sale or liquidation scenarios (in which major assets of the corporation would be squandered away by the board for trifles), it seems impossible to come up with any short-, mid- or long-term operational decision that we as lawyers cannot trace back to some half-baked rational motivation (and, of course, it does not matter whether such motivation was actually underlying the board decision or is merely hypothetical). Therefore, all operational decisions—as long as they comply with process due care and are made by disinterested directors—receive the absolutist protective shield of the business judgment rule.

294. *See*, *e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 110; Blair & Stout, *Team Production*, *supra* note 49, at 746; Stout, *Proper Motives*, *supra* note 77, at 6.

results in ex-post accountability but, because of such existant accountability mechanism, provides pre-investment predictability and post-investment risk measurability—all with varying degrees as per the applicable model.

The *absolute director primacy model* reverses this thinking. What we can determine is where decisionmaking control is situated and that it should be considered *sui generis* and absolute. Once this determination has been made, it controls the actuation of firm participant interests *in any manner*, thus, in an autocratic and inherently unpredictable manner. Therefore, the *absolute director primacy model*—for the time being—not only results in a complete lack of ex-post accountability but, because of such lack of an accountability mechanism, also results in total ex-ante indeterminability.

III. CLOSING SKETCHES

The *absolute director primacy model* developed herein leads to three main conclusions (though they may be preliminary):

1. The first conclusion can be equated to an answer for the first (procedural) question of corporate governance: "*Who Control(s)?*". We may not like the answer, but I am convinced that the board of directors of a Berle-Means corporation is the private-sector equivalent of a modern *Leviathan*.[295] Neither shareholders in aggregate nor the corporation itself but the *board* is the corporate sovereign—both *de facto* and *de jure*. Its decisionmaking is by fiat[296] and its decisionmaking authority to run the corporation's business as it sees fit is absolute,[297] original,[298] infinite,[299] and,

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295. *Cf.* Allen, *Contracts and Communities*, *supra* note 5, at 1396.

> Under the liberal-utilitarian model, the law creating and protecting property rights and the law enforcing contracts is the law of greatest importance to our welfare. The legal value of the highest rank in this classical liberal view is, I suppose, human liberty, and the greatest evil is oppression by the leviathan state.

Id. (footnote omitted).

296. Such authoritative decisional determination by the board is—in the genuine meaning of the term 'fiat'—both dictatorial and, *ipse dixit*, valid. It is non-reviewable and, *ipso facto*, irrebuttably assumed to be right (which, of course, is exactly the effect of the courts' application of the business judgment rule). *See*, *e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("The business judgment rule exists to protect and promote full and free exercise of the managerial power granted to Delaware directors.") (citing Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981)); BAINBRIDGE, THEORY AND PRACTICE, *supra* note 2, at 38–45.

297. *Cf.* HOWARD H. SPELLMAN, A TREATISE ON THE PRINCIPLES OF LAW GOVERNING CORPORATE DIRECTIONS 5 (1931) ("[M]odern decisions tend toward an emphasis of the directors' *absolutism* in the management of the affairs of large corporations; the board of directors has achieved a super-control of corporate management and of the corporations legal relations . . . .") (emphasis added); Horwitz, *supra* note 169, at 214 ("But modern corporate legislation, passed during the first quarter of the twentieth century, ratified a new '*absolutism*' that courts themselves had already begun to bestow upon corporate directors.") (emphasis added). *See also* Blair & Stout, *Corporate Law*, *supra* note 74, at 251.

298. *See supra* note 169 and accompanying text.

299. *Cf.* Mitchell, *Trust. Contract. Process.*, *supra* note 49, at 190.

thus, *sui generis*.[300] Comparable to the Hobbesian *bellum omnium contra omnes* within the sovereign state,[301] the corporate entity or aggregation is ineluctably characterized by perpetual conflicts among self-interested corporate constituents.[302] In order to manage—not solve (since they are insolvable)—those conflicts which present a perennial, systemic risk to the internal cohesion, adaptability, and, thus, prosperity and ultimate survival of the firm, corporate law has to allocate infinite and absolute decisionmaking authority within one core group of corporate constituents who are thus called upon to attend to, and decide with non-reviewable finality, all those matters of firm sustainability on behalf of the whole—i.e., the corporation (whether seen as a separate entity or as an aggregation of firm participants).[303] American corporate law is unmistakably clear as to who such single core group of corporate constituents is: the board of directors.[304]

> The power and control that are present in all fiduciary relationships is exaggerated in the corporation where the indeterminate length of the enterprise and the practically infinite array of investment opportunities for the corporation make any possibility of specified limitations on directors' power or ongoing control by the stockholders unrealistic.

Id.

300. *Sui generis* decisionmaking authority of corporate directors means that their decisionmaking power is non-derivative. In particular, shareholder primacy models incorrectly assume that the decisionmaking authority of corporate boards is derivative (i.e., delegated to corporate boards by the shareholder franchise—at least, through the mechanism of board elections during which shareholders vote). This assumption ignores the *de lege lata* reality of board authority. *See* Dooley, *supra* note 11, at 467 (describing the problem of allocating authority within the corporate firm as "the universally recognized requirement for the establishment of, and vesting of *supreme* authority in, the board of directors") (emphasis added).

> At some point at the beginning of the twentieth century, American legal opinion began decisively to shift to the view that "the powers of the board of directors . . . are identical with the powers of the corporation." Earlier, the dominant view, as expressed by the United States Supreme Court, was that "when the charter was silent, the ultimate determination of the management of the corporate affairs rests with its stock holders."

Horwitz, *supra* note 169, at 214 (citations omitted).

301. That is, "war of all against all." THOMAS HOBBES, LEVIATHAN OR THE MATTER, FORM AND POWER OF A COMMONWEALTH, ECCLESIASTICALL AND CIVIL, ch. XIII, at 64 (2d ed., 1886) ("Hereby it is manifest, that during the time men live without a common power to keep them all in awe, they are in that condition which is called war; and such a war, as is of every man, against every man."); THOMAS HOBBES, ELEMENTA PHILOSOPHICA DE CIVE, Præfatio (1642) ("[C]onditionem hominum extra societatem civilem (quam conditionem appellare liceat statum naturae) aliam non esse quam bellum omnium contra omnes; atque in eo bello jus esse omnibus in omnia."). *Cf.* Peter J. Burke & Jan E. Stets, *Trust and Commitment Through Self-Verification*, 62 SOC. PSYCHOL. Q. 347, 347 (1999).

302. *Cf.* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 599.

303. ARROW, THE LIMITS OF ORGANIZATION, *supra* note 68, at 69 ("Under conditions of widely dispersed information and the need for speed in decisions, authoritative control at the tactical level is essential for success."); Allen, *Contracts and Communities*, *supra* note 5; Bainbridge, *The Means and Ends*, *supra* note 3, at 552; Dooley, *supra* note 11, at 466.

304. BAINBRIDGE, CORPORATE LAW, *supra* note 4, at 72 (stating that: (i) shareholders have "virtually no power to control" the business and affairs of the corporation; (ii) the board of

"The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."[305]

A corporate board can act completely opportunisticly and unfettered by legal constraints once it refrains from: (i) gross negligence in its decisionmaking process (which gross negligence would additionally have to be well documented and information thereof would have to be widely disseminated);[306] (ii) bad faith conduct (which bad faith conduct would also have to be well documented and information thereof would have to be widely disseminated);[307] and (iii) purely self-interested transactions that are seen as disloyal under the law.[308] In the Berle-Means corporation, a well-advised corporate board always meets those minimal standards. Accordingly, in light of our American corporate law 'on the books,' a disinterested corporate board is virtually uncontrollable.

2. My second conclusion is less straightforward. It relates to the second (substantive) question of corporate governance: "*Whose Interest(s) Control(s)?*". As outlined above, this question circumscribes the second core function of any corporate governance system. After having allocated absolute, original, infinite, and *sui generis* authority for making adaptive decisions for firm sustainability in a core group of decisionmakers (as per my first conclusion above, the board of directors), the corporate governance system should also define the norms and interests that should guide the internal decisionmakers in their decisionmaking. Otherwise, any exercise of authority would *always* be arbitrary. An *uncontrollable* board of directors would also always be '*out-of-control*.' Similarly, the autocratic board of directors would also be better described as a totalitarian institution of governance.

Thus, the extent to which the board of directors as sovereign may exercise its authority on behalf of the corporation—even if absolute,

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directors and senior management "effectively controls;" and (iii) "[a]s a doctrinal matter, moreover, corporate law essentially carves this separation into stone"); COX & HAZEN, *supra* note 4, at 149 (stating that the board of directors "is legally the supreme authority in matters of the corporation's regular business management"). *See also* Franklin A. Gevurtz, *The European Origins and the Spread of the Corporate Board of Directors*, 33 STETSON L. REV. 925, 925 (2004) ("Around the world, the legal norm is that corporations are managed by, or under the direction of, a board of directors.") (footnote omitted).

305. DEL. CODE ANN. tit. 8, § 141(a) (2010). *See also* REV. MODEL BUS. CORP. ACT § 8.01 (1984). Under the corporation statutes of all states, corporations are managed by or under the direction of a board of directors as the statutory default rule. *See*, *e.g.*, Dent, Jr., *supra* note 97, at 1216; Gevurtz, *Origins of the Corporate Board*, *supra* note 76, at 92; Ribstein, *Why Corporations?*, *supra* note 49, at 188.

306. *See*, *e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985); Stout, *Proper Motives*, *supra* note 77, at 6.

307. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006); Stone v. Ritter, 911 A.2d 362 (Del. 2006).

308. *See*, *e.g.*, Blair & Stout, *Team Production*, *supra* note 49, at 746.

infinite, and *sui generis*—must be conditional on 'something.' In Thomas Hobbes's *Leviathan* model, it is natural law that obligates, thus, controls the sovereign—though such condition is to be understood as a *moral*, not a *legal*, obligation. In other words, it is a *protolegal* obligation, unenforceable in a court of law. I cautioned above that it might not be possible—at least, not within the confines of our current corporate governance system in itself—to locate the norms and interests which ultimately bind (or, at least, guide) *absolute director primacy* to the best interests of the corporation. My second conclusion, therefore, is that a satisfactory answer to the second, substantive question of corporate governance is logically *indeterminable* within current microtheoretical models of the firm. We have to consider model-transcending *protolegal* variables[309] (for example, any applicable 'moral' obligations)—as perhaps only transient bases of ex-ante determinability and ex-post accountability—and explain their external, exogenous influence[310] over current microtheoretical models of the firm,[311] in order to properly model the firm-internal intricacies of corporate governance with sufficient predictive ability.

3. Finally, as my third conclusion, I need to declare that all of this leaves the *absolute director primacy model* (at least, for the time being) with a fundamental, yet unexplained, dilemma[312]—namely, the somewhat preliminary and uncomfortable result that the board of directors in a Berle-Means corporation is not only autocratic, it can be totalitarian if, when, and where it so pleases.[313] As a matter of corporate law, the board of directors is akin to an 'unguided missile.' If there are no recognizable and enforceable decision-guiding norms or principles within corporate law, many—if not,

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309. "In the parlance of economics," there is, however, the risk that these variables turn out to be "observable, but not verifiable." Hart, *Norms and Theory*, *supra* note 96. *See also* Blair & Stout, *Director Accountability*, *supra* note 58, at 419 n.35; Rock & Wachter, *Norms & Corporate Law*, *supra* note 5, at 1617.

310. *Cf.* Hart, *Norms and Theory*, *supra* note 96.

311. *Cf.* Allen, *Contracts and Communities*, *supra* note 5, at 1397 (describing how proponents of the social model of human interaction see the utility of law resting "in part on presupposition of shared norms including those of fairness and trust").

312. *Cf.* Blair & Stout, *Trust*, *supra* note 70 (calling this dilemma a "riddle" of corporate law); Stout, *Proper Motives*, *supra* note 77, at 8 (describing this dilemma as a "basic mystery").

313. *Cf.* Blair & Stout, *Trust*, *supra* note 70, at 1791 ("The net result is that, as a practical matter, a negligent director is more likely to be hit by lightning after leaving her board meeting than she is to pay damages."); Jones, *supra* note 90, at 117 ("Independent directors face an infinitesimal risk of paying personally for damages to the corporation caused by their breach of fiduciary duty."); Mitchell, *Trust. Contract. Process.*, *supra* note 49, at 190 (stating that "directors have largely unlimited power over the corporation and its affairs"); Stout, *Proper Motives*, *supra* note 77, at 6–7. *See also* Alces, *supra* note 125, at 242.

> It is dangerous and costly to assume that fiduciary duties function well in the corporate context. The assumption may give shareholders a false sense of security or a belief that they are able to discipline management effectively when in fact, because of the very limited nature of corporate governance duties, they are not.

Id.

infinite—avenues are available in order to make adaptive corporate decisions. This, inevitably, creates significant room for opportunism (since it is uncertainty which always opens the realm of opportunism—good or bad) and, thus, economic agency costs.[314] In turn, as a firm participant, one seems to be relegated to only something like 'hope'[315] (or—more to the point—'trust,' 'loyalty,' and similar socio-contextual,[316] behavior-oriented and reciprocal[317] variables[318] based on pre-coded 'expectations,' 'counter-expectations,' and 'expectation-expectations' and aimed at reducing social complexity[319])—whether reasonable or not—that directors know what they do, that they have internalized the correct moral compass,[320] and, thus, will 'do the right thing'[321] more often than not.[322] But 'hope'—maybe even ill-founded in many cases—is not something that we can and should accept as a satisfactory explanation and basis for the daily phenomenon of general investor confidence pre-investment in the face of absent director accountability post-investment.[323] The question simply becomes: if profit-maximizing is not enforced by corporate law, why does it nonetheless happen—as a matter of almost overwhelming routine—in today's corporate reality?[324] An attempt at answering this question must therefore, in my

314. *See* Stout, *Proper Motives*, *supra* note 77, at 4 (stating that, if we only consider financial rewards to directors, i.e., make assumptions based only on rational selfish behavior of directors, "directors seem to have little reason to break a sweat in the boardroom").

315. *Cf. Id.* at 18 (stating that "we must inevitably rely on directors' internalized sense of responsibility as their primary if not their *sole* motive for exercising judgment and care") (emphasis added).

316. *See Id.* at 13.

317. *See supra* note 229 and accompanying text.

318. *See supra* note 97 and accompanying text.

319. *See supra* note 231 and accompanying text.

320. *Cf.* Elhauge, *supra* note 134, at 740 ("internalized moral norms"); Stout, *Proper Motives*, *supra* note 77, at 23 ("internal gyroscope").

321. *Cf.* Blair & Stout, *Director Accountability*, *supra* note 58, at 439; Nadelle Grossman, *Director Compliance with Elusive Fiduciary Duties in a Climate of Corporate Governance Reform*, 12 FORDHAM J. CORP. & FIN. L. 393, 465–66 (2007); Rock & Wachter, *Norms & Corporate Law*, *supra* note 5; Stout, *Proper Motives*, *supra* note 77, at 9, 23. *See also* Meurer, *supra* note 9, at 740 (stating with regard to the problem of unforeseeable contingencies in transaction-cost-theory 'contracting' that "this begs the questions of how a firm gets managers to be pure profit maximizers").

322. To complicate things further, much of what happens in the corporate boardroom (and can be hoped for to happen in the boardroom) depends on the particular corporation and follows the (aspirational and prevailing) procedures, standards, and practices for director behavior of such specific corporation. *See*, *e.g.*, Rock & Wachter, *Norms & Corporate Law*, *supra* note 5.

323. *Cf.* Mitchell, *Trust. Contract. Process*., *supra* note 49, at 191 ("Why would anybody invest money in a corporation, an institution over which she has no control?"); Stout, *Proper Motives*, *supra* note 77, at 3, 8, 9.

324. *See* Schlanger v. Four-Phase Sys. Inc., 555 F. Supp. 535, 538 (S.D.N.Y. 1982) (stating with regard to investors who trade shares in well-developed markets in reliance on the integrity of the price set by the market that "it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity" and wondering "[w]ho would knowingly roll the dice in a crooked crap game?"). Or formulated differently, the question is not only "*why* do shareholders in public companies have so little power?", *see* Stout, *Mythical Benefits*, *supra* note 92, at 792, but: why do

judgment, thoroughly investigate the external, exogenous *protolegal* influences—designated as *controlling* and *compelling*[325] variables under the *absolute director primacy model* developed herein—on the inner workings of the firm.[326]

Apparently, many of us are also more than a bit uncomfortable[327] with the apparent absence of director accountability within American corporate law. Professor Bainbridge, for example, has repeatedly described the board of directors as "a sort of Platonic guardian" similar to the philosopher-kings in Plato's *Republic*.[328] Those philosopher-kings always seem to see it fit to rule "for the public good, not as though they were performing some heroic action, but simply as a matter of *duty*."[329] Perhaps even more brazenly, there is "Frank Knight's mythic entrepreneur," a "free market superhero,"[330] who is the ultimately *responsible* manager owning and controlling her (sole-proprietor) business and doing what is right out of sheer self-motivation and self-respect, thus, without any legal mandate being required or operational.[331]

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shareholders in public companies have so little power *and still invest?* Why do investors who know that they have almost no power over their investment ex post (other than investment exit with a predictable loss of value) still confidently decide to invest without any ex ante bargained-for accountability in place? *Cf.* Stout, *Mythical Benefits*, *supra* note 92, at 801 (pointing out "an often overlooked fact of business life: investors are not forced to purchase shares in public corporations at gunpoint"); *id.* at 803 ("Is it possible that shareholders, like Ulysses, sometimes see advantage in 'tying their own hands' and ceding control over the corporation to directors largely insulated from their own influence?").

325. *See* Stout, *Proper Motives*, *supra* note 77, at 14.

326. *Id.* at 9. Of course, such investigation has already been commenced in both: (i) "the economic literature on norms in organizations"—usually rubricated under the heading of "self-enforcing" or "self-governing" contracts, Hart, *Norms and Theory*, *supra* note 96, at 1703; Rock & Wachter, *Norms & Corporate Law*, *supra* note 5, at 1609; 1613, and (ii) the legal academia focused on the co-existence of (corporate) law and norms and the latter's influence on (and, maybe, over) the former—the so-called "law and norms" literature. *See*, *e.g.*, Rock & Wachter, *Islands of Conscious Power*, *supra* note 8.

327. *Cf.* Blair & Stout, *Team Production*, *supra* note 49, at 744 (describing a "growing sense of unease among many corporate scholars, a sense that the principle-agent model may not tell the whole story").

328. Bainbridge, *Nexus of Contracts*, *supra* note 75, at 8, 33; Bainbridge, *Convergence Debate*, *supra* note 2, at 51; Bainbridge, *The Means and Ends*, *supra* note 3, at 550–51 n.21.

329. Bainbridge, *Nexus of Contracts*, *supra* note 75, at 8 n.28 (quoting PLATO, THE REPUBLIC 289–90 (Benjamin Jowett trans., Random House 1991)) (emphasis added); Bainbridge, *Convergence Debate*, *supra* note 2, at 51 n.38; Bainbridge, *The Means and Ends*, *supra* note 3, at 551 n.21. This guardianship concept seems to correlate with "[n]eoclassical [economic] theory [which] views the firm as a set of feasible production plans . . . over [which] a selfless and compliant manager [presides]." Hart, *An Economist's View*, *supra* note 4, at 299. Similarly, Adolf Berle viewed "the emergence of independent corporate managers as a [beneficial] development . . . [namely], a mechanism for producing truly public-regarding servants." Romano, *Metapolitics*, *supra* note 48, at 923–24 (citing BERLE & MEANS, *supra* note 4, at 356). *See also* ADOLF A. BERLE, JR., POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN AMERICAN POLITICAL ECONOMY 2–3, 8 (1959).

330. Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 605.

331. *See* KNIGHT, *supra* note 4, at 270. *See also* BERLE & MEANS, *supra* note 4, at 356 (arguing that society could recognize corporate management with absolute powers that were constraint only

Obviously, we cannot find evidence of Platonic guardians or Knightian entrepreneurs in our American corporate law as it is currently 'on the books' (nor can we find much evidence of them in the reality of corporations and corporate boards in order to be sufficiently comforted that we could, and do, live without any accountability mechanism at work).[332] Rather, I suspect that we are again talking—if even so briefly, peripherally, and nonchalantly—about model-external *protolegal* variables which we seem to presuppose and import wholesale into our corporate governance system without any apparent need to explain or account for such variables underlying our respective models. In other words, we just 'borrow' legitimacy (and, apparently, with it accountability) from outside the law in order to close the uncomfortably wide gap left within our models of the firm as regards their predictive ability and, thus, their overall accuracy.[333] Unless we are prepared to accept that the corporate board of directors, by law, is designed as an 'unguided missile' that lacks inner legitimacy and intelligibility (all of which I am neither ready nor willing to accept), we should set out and determine, deconstruct and explain those *protolegal* variables which our microtheoretical models of the firm critically depend upon and which make corporate governance and the genius of American corporate law autocratic and elitist but not—at least, not as a matter of regular course—also totalitarian.[334]

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by management's sense of morality and public duty); O'Kelley, *Theory of the Modern Corporation*, *supra* note 4, at 758, 761.

332. *Cf.* McDonnell, *supra* note 75, at 157 ("Bainbridge is no fool—he is well aware that director self-monitoring is far from a complete solution to the agency problem.").

333. *See supra* note 85 and accompanying text.

334. Or to say it more bluntly: I assume that most of us expect countries like Greece, Denmark, Ireland, or Portugal, *see supra* text accompanying note 37,—or, for that matter, any country—to have a stable, maybe tripartite, form of national government where sturdy checks and balances exist among the branches of government and where the rule of law is firmly established—at least, in principle and as a matter of due course. In comparison thereto, I do not understand why most of us seem to be fine with the fact that an economic behemoth like Wal-Mart can be a pure-bred oligopoly where a mere sixteen individuals (i.e., its board of directors)—with, arguably, an overwhelmingly large degree of financial, class and career 'inbreeding'—can decide the affairs of an economic undertaking that rivals some of the largest and most sophisticated national economies in the world—all without much legal oversight, if any. Either corporate boards, as decisionmakers by fiat, lack legitimacy—or our corporate law, conferring absolute primacy and by-fiat decisionmaking authority to corporate directors, lacks legitimacy. *Cf.* CLARK, CORPORATE LAW, *supra* note 13, at 22.

That is, unless we can find a way to explain legitimacy as well as its sources. We therefore need to embark on a serious deconstruction exercise if we want to satisfactorily explain the societal value of putting the twenty-eighth largest economy on this globe in 2008 in the hands of sixteen elitist, absolutist and possibly totalitarian decisionmakers without any measurable legal accountability. *Cf.* Gilson & Kraakman, *Clark's Treatise*, *supra* note 3, at 604 n.21 (asking whether "we want to encourage an institution that is disproportionately white, male and conservative to make social policy?"); Stout, *Proper Motives*, *supra* note 77.