CORPORATE LAW OR THE LAW OF BUSINESS?: STAKEHOLDERS AND CORPORATE GOVERNANCE AT THE END OF HISTORY

ADAM WINKLER*

I

INTRODUCTION

Corporate law is said to be witnessing "the end of history."[1] The long battle between the conservative, private, shareholder-wealth-maximization school of corporate legal thought and the progressive, public, stakeholder-protection/social-responsibility school is now over.[2] The victor, it is claimed, is the conservative school, also known as the "nexus-of-contracts" approach,[3] which holds that corporations should be run for the exclusive benefit of shareholders (what is often termed "shareholder primacy"). To contractarians, the state's role in corporate governance is primarily to provide efficient default rules from which shareholders can choose to depart,[4] and the few mandatory legal rules that do exist to restrain corporate behavior are subject to evasion by choice of form.[5] The terms of corporate activity are thus effectively set by markets,

---

This Article is also available at http://law.duke.edu/journals/lcp.

* Acting Professor, UCLA School of Law.

Thanks to Iman Anabtawi, Stephen Bainbridge, Steve Bank, Stuart Banner, Melissa Bomes, Jim Cox, Scott Cummings, Victor Fleischer, Maximo Langer, Gia Lee, Gary Rowe, Lynn Stout and Fred Tung. Excellent research assistance was provided by Katie Kamlowsky and Tim McHale, under the supervision of Linda O'Connor and courtesy the Hugh & Hazel Darling Law Library Research Assistant Program.

1. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

2. A detailed overview of these two schools of corporate legal thought is provided in David Millon, *Frontiers of Legal Thought: Theories of the Corporation*, 1990 DUKE L.J. 201.

3. A sampling of influential works: FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991); NICHOLAS WOLFSON, THE MODERN CORPORATION: FREE MARKETS VERSUS REGULATION (1984); Henry Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON U. L. REV. 99 (1989); William A. Klein, *The Modern Business Organization: Bargaining Under Constraints*, 91 YALE L. J. 1521 (1982).

4. *See generally* Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990) (arguing that private contract, not government regulation, will dictate the most efficient set of corporate laws).

5. *See* Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856, 860-61 (1997) (arguing that "mandatory rules are often subject to evasion by choice of form and jurisdiction").

not by law.[6] Progressive corporate law, with its preference for state-imposed mandatory rules to limit excessive pursuit of profit and its promotion of employee, customer, and community voice in corporate governance,[7] has been vanquished.[8] Even progressive corporate lawyers bemoan the end of corporate law's history; they concede that shareholder primacy—not the interests of employees, consumers, or larger communities—has come to dictate corporate practice at the dawn of the twenty-first century.[9]

Are the reports of progressive corporate law's demise exaggerated? This article offers a legal history of how the progressive-inspired ideals of stakeholder protection and corporate social responsibility through mandatory legal rules have shaped the law affecting corporations. This history uncovers two patterns in progressive corporate law reform, discussed in Part II, both of which caution against a rush to declare the ultimate triumph of shareholder primacy.[10]

The first pattern is that progressive ideals have, in fact, successfully influenced several important areas of corporate law, such as the allowance of charitable giving and the adoption of constituency statutes, which allow management to protect non-shareholder constituencies even at the expense of shareholders. These victories, however, have had notably mixed results. While corporate charitable giving generates large wealth transfers from firms to non-profits, it is achieved through expanded managerial discretion that permits self-dealing and opportunism in allocation decisions. Constituency statutes have also expanded managerial discretion, making stakeholder protection a matter of choice, not legal obligation. To the extent progressive ideals have come to be reflected in corporate law, it has come at the cost of increasing the potential for managerial opportunism.

The second pattern reveals the vibrancy of stakeholder protection and corporate social responsibility outside of "corporate law." While some progressives have attempted to protect stakeholders by changing corporate law, others have looked to

6. *See* Bernard Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542 (1990) (arguing that corporate law consists mainly of negotiable default rules and that the extant mandatory rules are subject to easy evasion).

7. *See generally* RALPH NADER, MARK GREEN & JOEL SELIGMAN, TAMING THE GIANT CORPORATION (1976); PROGRESSIVE CORPORATE LAW (Lawrence Mitchell ed., 1991).

8. *See* Hansmann & Kraakman, *supra* note 1, at 439 ("There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value.").

9. *See* Dalia Tsuk, *Corporations Without Labor: The Politics of Progressive Corporate Law*, 151 U. PA. L. REV. 1861, 1867 (2003) (arguing that progressives' ideological opposition to class led to the blossoming of "a vision of the corporation that focused on the interests of shareholders vis-à-vis managers ultimately to the exclusion of all other corporate constituencies"); Millon, *supra* note 2, at 228-29 (shareholder primacy has "defined the boundaries within which serious debate . . . [can take] place").

10. The end-of-history claim is also subject to challenge on the ground that prevailing corporate law norms make directors, not shareholders, primary. It is the directors who are invested with discretion over virtually all corporate decisions, and the prevailing "Wall Street Rule" offers shareholders little more than the opportunity to sell their shares. *See generally* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003) (arguing for director primacy in corporate law). *See also* Lynn A. Stout & Margaret Blair, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 253 (1999) (proposing that directors of public corporations exist to protect not shareholders per se, but all of a firm's stakeholders); G. Mitu Gulati, William A. Klein & Eric M. Zolt, *Connected Contracts*, 47 UCLA L. REV. 887, 895 (2000) (challenging the notion of shareholder primacy by focusing on the interrelation of other corporate participants).

other legal regimes to regulate corporate behavior. From securities and labor law reforms in the New Deal to the social welfare laws of the 1960s and 1970s, progressives have advocated for a diverse and broad array of mandatory legal rules designed to limit corporate conduct perceived as harmful to non-shareholder constituencies. These various bodies of law—what might be termed the "law of business"—reflect progressive principles of stakeholder protection and, though outside of corporate law, are powerful forces shaping the choices available to corporate management concerning basic operational and organizational decisions: whom to hire, fire, and promote; which products to produce and how best to produce them; how to set up the workplace; and how to allocate and invest firm assets. All of these decisions are made under the mandatory legal rules embodied in employment and labor law, workplace safety law, environmental law, consumer protection law, and pension law. Such rules, because they often apply to all businesses, are not susceptible to easy evasion through choice of form. As a result, those charged with governing a corporation find their decision tree considerably trimmed and their discretion decidedly diminished by mandatory legal rules enacted in the name of protecting stakeholders.

That the recognition of these two patterns has implications for both progressive corporate law reformers and for proponents of shareholder primacy is argued in Part III. For progressives, these patterns suggest a direction for orienting their efforts to reform corporations for the benefit of stakeholders. Rather than try to change corporate law—which, in the past, has often meant expanded managerial discretion and mixed results for stakeholders—progressives might be better off attempting to protect stakeholders through the broader law of business. The legal foundations for protecting stakeholders, and the willingness to use mandatory legal rules in their service, are already in place outside of corporate law and provide strong footing upon which to build. The direction recommended by this history may be especially useful now that we are again confronted with the possibility of corporate reform in the wake of the Enron, WorldCom, and Tyco scandals.

With regard to shareholder primacy, the historical patterns of progressive corporate reform show that claims of victory for shareholders over stakeholders depend on an artificially narrow view of the law affecting corporate management. What is commonly termed corporate law—the law bound together in state corporations codes or corporate law treatises—is not alone in shaping corporate governance. Stakeholders exert their voice through legal mechanisms adopted largely outside of corporate law. Indeed, contractarians themselves have recognized this, arguing that one reason to exclude stakeholders from corporate law is their protection in the broader law of business. Stakeholder success outside of corporate law indicates the limited significance of any claimed victory of shareholders over stakeholders within corporate law. Victory for shareholders on the battlefield of corporate law should not be mistaken for victory in the larger legal war over corporate social responsibility and stakeholder protection. That larger war is occurring on numerous other battlefields—from employment law to environmental law—and the battles are more closely contested than claims about the end of history imply.

Whatever its explanatory power in corporate law, shareholder primacy is far from an accurate description of the law of business or of corporate practice. After a century of regulation outside of corporate law, progressives have found numerous ways to enhance the social responsibility of corporations and protect the workers, consumers, and communities affected by corporate behavior. Free market principles and shareholder primacy have not won the day; they exist in corporate law alongside the many other areas of the law of business that do interfere with the free market and restrain corporate management in the interests of corporate stakeholders.

II

A BRIEF HISTORY OF PROGRESSIVE LEGAL REFORM OF CORPORATIONS

A. Securities and Labor Law Reform in the New Deal

In the first decades of the twentieth century, a progressive cohort formed to combat the radical transformations in corporate law that began in the late 1800s. Those changes formalized what we now refer to as the separation of ownership from control in modern corporations. Typical nineteenth century corporations were owned by individuals, small groups, or families who also managed the firm's daily operations.[11] Significant corporate law reforms taking hold around the turn of the century included the allowance of holding companies,[12] the demise of the doctrines of *ultra vires* and *quo warranto*,[13] the adoption of general incorporation laws and the business judgment rule,[14] the watering down of shareholder inspection rights,[15] and the diminishment of shareholder voting power.[16] These corporate law reforms loosened the traditional bonds that secured managerial decisionmaking to shareholder interests and caused corporate lawyers to fret that increased managerial autonomy and weakened owner oversight would lead to self-dealing and opportunistic behavior by professional managers. In 1894, William Cook, the author of a corporate law treatise widely used around the turn of the century, wrote that developments in corporate law were permit-

11. ADOLF A. BERLE JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4 (rev. ed. 1991).

12. *See* Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 195 (1985) (arguing that New Jersey's 1889 regulation of holding companies marked the end to the use of corporate law to prevent consolidation).

13. When a corporation was a special franchise from the state, the government could bring a *quo warranto* action against it for nonfeasance. The courts began to depart from this doctrine in the 1870s. The substantive doctrine of *ultra vires* forbade the corporation to exceed the corporation's authority. *See* Herbert Hovenkamp, *The Classical Corporation in American Legal Thought*, 76 GEO. L.J. 1593, 1658-64 (1988).

14. *See id.* at 1667-69 (describing the rise of the business judgment rule).

15. *See* ARTHUR W. MACHEN JR., A TREATISE ON THE MODERN LAW OF CORPORATIONS WITH REFERENCE TO FORMATION AND OPERATION UNDER GENERAL LAWS 892-94 (1908) (noting that a shareholder can only inspect the corporation's books if he can make a *prima facie* case of fraud or mismanagement).

16. *See* Horwitz, *supra* note 12, at 200-02 (describing the demise of the rule of unanimous consent, which was required for fundamental changes in the nineteenth century).

ting managers to turn modern firms into "efficient instruments of fraud, speculation, plunder and illegal gain."[17] *Laissez-faire* allowed management to do too much.

The fear of managerial corruption was only strengthened in the decades after Cook's treatise: the New York Life Insurance scandal of 1905 prompted widespread reforms in the organizational structure of insurance corporations,[18] the Pujo Commission investigations of 1912-13 detailed widespread mismanagement in Wall Street firms,[19] and the Crash of 1929 convinced even holdouts of the need for more oversight of corporate management. In 1932, the well-publicized Pecora Hearings in Congress collected irrefutable evidence of market manipulation by corporate officers and investment bankers.[20]

Progressive lawyers, including Louis Brandeis, Felix Frankfuter, and Adolf Berle, vigorously condemned the unbridled authority corporate managers were able to exercise over investors. Ownership and control, as detailed most famously in Berle and Means' 1932 *The Modern Corporation and Private Property*,[21] had been pushed far apart. The absence of effective oversight over corporate leaders, Brandeis argued, led to an unhealthy concentration of wealth and corrupt manipulation of markets.[22] Shareholders were not the only ones harmed; employees were left jobless and consumers were left without goods. In the wake of the stock market crash and the attendant collapse of the economy, one could not avoid the conclusion that corporations were more than private investment vehicles for shareholders: they had an impact on "whole districts, . . . bring[ing] ruin to one community and prosperity to another."[23] Firms, according to Berle and Means, brought together "workers, consumers, and suppliers of capital,"[24] giving rise to "new responsibilities towards the owners, the workers, the consumers, and the State [that] thus rest upon the shoulders of those in control."[25]

Although some argued in favor of reforming corporate law—Berle and Means, for example, sought to reorient officers' fiduciary duties to promote public ends[26]—progressives were busy creating a whole new body of law to protect against corporate excess. The key to harnessing the market without reigning in economic growth, according to Brandeis, was transparency; corporations ought to be required to disclose

---

17. WILLIAM W. COOK, A TREATISE ON STOCK AND STOCKHOLDERS, BONDS, MORTGAGES, AND GENERAL CORPORATION LAW 896 (3d ed. 1894).

18. *See* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 63-78 (1994).

19. *See* LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY: AND HOW THE BANKERS USE IT 1-2, 12-15, 47 (1914).

20. Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency* 112 HARV. L. REV. 1197, 1223-26 (1999).

21. BERLE & MEANS, *supra* note 11.

22. *See* BRANDEIS, *supra* note 19, at 62-63, 69-72 (arguing that disclosure, or "publicity," is necessary to reform excessive wealth concentration and corrupt opportunism in finance).

23. BERLE & MEANS, *supra* note 11, at 46.

24. *Id.* at 349.

25. *Id.* at 7.

26. *Id.* at 311-12 (arguing that owners have surrendered control over their investments, controlling managers have insufficient claim to control, and the "community" has "paramount interests" to which other interests must yield).

their financial dealings to the market.[27] Disclosure would help shareholders, but it would also help bring public pressure to bear on corporations. Analogizing disclosure to sunlight, Brandeis thought its presence would go far in disinfecting corporate ethics.[28] Responsible for overseeing the enactment of the Securities Act, Frankfurter drew inspiration from Brandeis and promoted disclosure to discourage managerial fraud and to enable a measure of social control over corporate activity.[29] Firms had multiple stakeholders, and shareholders were thought to be a proxy to protect those larger interests. The Act's legislative history, and that of its companion, the Securities Exchange Act of 1934,[30] reflect these progressive concerns. Corporate officials were expected to act as trustees for investors, a principle stemming from state law fiduciary duties but now requiring extra-corporate law regulation. Moreover, the public was clearly an intended beneficiary of the drafters' efforts;[31] they too would be protected by a regime of managerial restraints imposed from the outside.

Although some perceived the securities laws as hostile to large corporations,[32] the rise of these legal regimes legitimated large firms by reducing the dangers to public investment in corporate stock, thus encouraging the flow of capital from individuals to firms through reliable, transparent markets. To mainstream progressives, the large corporation was not inherently evil, but the concentrated economic power of top executives that came with it needed to be disciplined by shareholders to the benefit of other corporate stakeholders. As a result, the large corporation was not inhibited in its growth. Instead, the markets for corporate securities were rendered more transparent, the information flowing to the market from firm management was less misleading, and corporate business became more stable for workers, consumers, and creditors.

The New Deal involved other significant legal transformations designed to tame corporate power by curbing the autonomy of management and protecting stakeholders, such as employees and consumers. While consumers enjoyed the protections of federally guaranteed "fair" competition through the creation of the Federal Trade Commission, the employees gained security through labor law reforms. The National Labor Relations Act,[33] passed in 1935, gave workers a federal legal right to unionize and engage in collective bargaining, even against the will of their employers, who were now barred from interfering with such efforts.[34] As Professor Dodd points out, "[i]t is plain that these regulations . . . involve important limitations on the right of

27. *See* Williams, *supra* note 20, at 1212-14.

28. *See* BRANDEIS, *supra* note 19, at 62 ("Sunlight is said to be the best of disinfectants[.]").

29. *See* Williams, *supra* note 20, at 1221-22 (analyzing Frankfurter's role in the Securities Act).

30. Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78mm (2000)). For the 1933 Act, see Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (2000)).

31. *See generally* Williams, *supra* note 20 (analyzing the legislative history of the Acts). An even fuller account can be found in JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE (1982).

32. *See* Hovenkamp, *supra* note 13, at 1685.

33. National Labor Relations Act, ch. 372, §1, 49 Stat. 449 (1935) (current version at 29 U.S.C. §§ 151-66 (2004)).

34. *See* LAWRENCE FRIEDMAN, A HISTORY OF AMERICAN LAW 665 (2d ed. 1985).

stockholders and managers acting in their interests to treat the enterprise as the private property"[35] of stockholders.

The evolution of the common law further curtailed employer discretion. Under the doctrine of master and servant, employees enjoyed few protections from their employers' "absolute right of discharge" that served to anchor managerial control over wages, hours, and nearly all other workplace matters.[36] By the end of the New Deal, however, the law had transformed an employee into "an entity separate from the master, and potentially self-determining"[37] inside the employment relationship. With the old order broken down, "private industry was exposed to the diverse intrusions that would characterize relations between business and government in succeeding decades: minimum wages, equal employment measures, occupational health and safety, plant-closing laws."[38]

In all, the progressive impulse pushed through a remarkable array of legislation outside of corporate law that nevertheless imposed non-trivial limitations on managerial discretion. Shareholders benefited in many ways, but they were not the only corporate constituency to do so. The new beneficiaries included consumers and, especially, employees—groups that continue to enjoy legal protections from managerial discretion as a result of New Deal legislation.

B. Corporate Charity and Corporate Law

The growth of large national corporations in the first decades of the twentieth century made evident the impact that boardroom decisions had on diverse corporate stakeholders, including consumers and the larger communities dependent upon industry. One way to soften that impact was to encourage corporations to contribute some of their resources to charity. Corporate law, however, traditionally prohibited charitable contributions; such expenditures were *ultra vires*—beyond the powers of the corporation—because they were designed to benefit the public at large rather than incorporators.[39] Progressives argued successfully to reform corporate law and permit management to make charitable contributions.

In his famous 1932 debate with Adolf Berle, published in the Harvard Law Review, E. Merrick Dodd called for the expansion of corporate fiduciary duties to protect the interests and needs of the whole society, not just shareholders.[40] Dodd believed that firms were required to adopt policies benefiting employees, consumers,

---

35. E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1150 (1932).

36. KAREN ORREN, BELATED FEUDALISM: LABOR, THE LAW, AND LIBERAL DEVELOPMENT IN THE UNITED STATES 176 (1991).

37. *Id*. at 161.

38. *Id*. at 210.

39. *See* Millon, *supra* note 2, at 218.

40. *See* Dodd, *supra* note 35, at 1148 (noting that corporations have a social service, as well as a profit-making, function). For Berle's contribution, see A.A. Berle Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); *For Whom Corporate Managers are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932) [hereinafter "*Note*"].

and the broader community, even at the expense of profits.[41] His argument was not purely normative; in the wake of the crash of 1929, the public demanded that much, and corporate executives themselves subscribed to this capacious view of social responsibility.[42]

Dodd's view of corporate social responsibility was countered by a conservative philosophy of shareholder primacy espoused by Berle.[43] Corporations, Berle argued, were merely investment vehicles managed exclusively in the interests of shareholders.[44] Although Berle was sympathetic to Dodd's objectives—as evidenced by his call for corporate law to be redirected to serve community interests in *The Modern Corporation and Private Property*[45]—they diverged in their understanding of *current* corporate law doctrine, with Berle insistent that shareholders alone held cognizable claims to fiduciary obligations at present.[46] The shareholder primacy norm was determinatively articulated as a doctrinal rule of corporate law by the famous decision in *Dodge v. Ford Motor Company*.[47] Criticizing Henry Ford's "general purpose and plan to benefit mankind" by lowering prices and making cars available to the masses, the Michigan Supreme Court insisted that a "business corporation is organized and carried on primarily for the profit of stockholders" and that "[t]he powers of the directors are to be employed for that end."[48] Although management retained discretion over the "choice of means to attain that end,"[49] fiduciary principles required them to work for the benefit of shareholders rather than for employees or the larger community.

Professor David Millon, among others, concludes that Dodd's view of corporate social responsibility was defeated by the conservative philosophy represented in *Dodge*.[50] But if shareholder primacy has reigned supreme through much of the history of corporate law, at least one element of the progressive agenda did take root: the allowance of corporate charity. In 2000, corporations gave over ten billion dollars to charity, even though such giving has only the most tenuous connection to shareholder

41. *See* Dodd, *supra* note 35, at 1154-58.

42. *See* E. Merrick Dodd Jr., *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 U. CHI. L. REV. 194, 206 (1934) (citing to the Address of Owen D. Young, January 1929, *in* JOHN H. SEARS, THE NEW PLACE OF THE STOCKHOLDER 209 (1929)).

43. *See* Berle, *Note*, *supra* note 40, at 1367 (arguing that one "can not abandon emphasis on 'the view that business corporations exist for the sole purpose of making profits for their stockholders'" until an adequate substitute is found).

44. *See id*.

45. *See* BERLE & MEANS, *supra* note 11, at 311-12.

46. *See* Berle, *Note*, *supra* note 40, at 1367, 1370 (arguing that "responsibility to the community has not yet appeared").

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

48. *Id*. at 684.

49. *Id*.

50. "[D]efenders of shareholder-centered, privatized vision of corporate activity in corporate law were able to defeat claims about corporate social responsibility. At least until recently, this theory of the corporation has continued to wield that power." Millon, *supra* note 2, at 203. This view was not shared by Berle, who reflected back twenty years later and concluded: "The argument has been settled (at least for the time being) squarely in favor of Professor Dodd's contention." *See* Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1209 (2002) (quoting ADOLF A. BERLE JR., THE 20TH CENTURY CAPITALIST REVOLUTION 169 (1954)).

interests.[51] A startling recent example of such giving was the wave of corporations that gave huge contributions to the September 11 relief efforts.[52] While a cynic might decry such spending as clever marketing or well-managed public relations, executives would be hard pressed to show that their brands were enhanced by their post-September 11 gifts. More importantly, executives would not even try to do so. Instead, they would emphasize their explicit intent to benefit the community and the victims' families rather than maintain that they were pursuing profit for shareholders during a time of national mourning.

Corporate charity remains formally tied to shareholder profit maximization. Companies account for charitable gifts as marketing expenses and courts may require executives to justify their contributions as being in the long run interests of the firm. The law on the books, however, is far from strict in its requirement of shareholder primacy. Take the landmark corporate charity case found in every corporate law casebook, *A.P. Smith Manufacturing Co. v. Barlow*,[53] decided in 1953. Upholding a fire hydrant and valve manufacturer's donations to Princeton University, the New Jersey Supreme Court was willing to accept the extremely tenuous tie to shareholder interests offered by management—that the contribution would produce goodwill for the company.[54] Even here, the meat of the court's discussion focuses on the benefits to a broader community. In an opinion laden with the fear of communism,[55] the court contended that corporate charity was necessary for the "vigor of . . . democratic institutions."[56] "It seems to us," the court wrote, "that just as the conditions prevailing when corporations were originally created required that they serve public as well as private interests, modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities within which they operate."[57]

Corporate charity still has some limits. Nevertheless, those very limits suggest that corporate charity is permitted not because it helps shareholders but because it helps other corporate constituencies. At mid-century, New Jersey adopted statutory corporate code provisions setting a ceiling for charitable contributions of one percent of firm capital.[58] Current Delaware corporate law imposes a ceiling established by a "reasonableness"[59] test; the courts hold contributions to be reasonable if the amount

51. Victor Brudney & Allen Ferrell, *Management and Control of the Modern Business Corporation: Corporate Speech and Citizenship: Corporate Charitable Giving*, 69 U. CHI. L. REV. 1191, 1197 (2002).

52. *See* David Bank, *Corporate Giving Fell 12% in '01 As Recession Took Toll on Charity*, WALL ST. J., June 21, 2002, at B2 (noting that corporations gave over $400 million to September 11 relief funds in 2001, even as corporate charitable contributions fell overall).

53. A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581 (N.J. 1953).

54. *Id.* at 583.

55. *Id.* at 586 (the Court refers to "vicious . . . threats from abroad;" "if need be the matter may be viewed strictly in terms of actual survival of the corporation in a free enterprise system").

56. *Id*.

57. *Id*.

58. 1930 N.J. Laws 105.

59. *See* Kahn v. Sullivan, 594 A.2d 48 (Del. 1991) (holding that federal tax law guides the determination of whether corporate charitable contributions are "reasonable").

can be deducted under section 170 of the Internal Revenue Code,[60] which allows contributions of up to ten percent of pre-tax profits.[61] Such limits make no sense from a shareholder-centered perspective. If it is mandatory that charitable giving be in the interests of shareholders, why impose any ceilings at all? Corporate law has no caps on marketing or public relations expenses; business judgment alone limits the allocation of firm resources for expenditures intended to benefit shareholders. These legally imposed limits on corporate charity make sense only if current norms of corporate law recognize charitable giving to be for stakeholders other than shareholders.

While the allowance of charitable contributions is an example of progressive impulses taking hold in corporate law, it is also an example of the mixed results that occur when corporate law is reformed by expanding managerial discretion. For all the social benefits that stem from billions in annual corporate charity—and they are profound—corporate executives too often take liberties with corporate money and, in the name of charity, bestow benefits upon themselves. Sponsorship of cultural institutions and events, such as playhouses, museums, and operas, is perhaps the most common example. Would this continue if executives no longer were given the front-row tickets that come with such generosity?[62] More egregious examples are not hard to find. Less than a mile from the author's office is the Armand Hammer Museum and Cultural Center, built thanks to eighty-five million dollars in financing from the shareholders of Occidental Petroleum, the company controlled by Hammer.[63] Hammer had tried to place his personal art collection in the Los Angeles County Museum of Art, which objected to the Occidental Chairman's insistence that a life-size likeness of him be displayed with the art permanently (among other onerous conditions on the gift). Miffed, Hammer decided to build his own museum on the shareholders' dime, although the resulting institution bears his own name and not that of the company. When the Delaware courts refused to intervene with construction of Hammer's temple of opportunism, it became clear just how the cloak of charity could be used by corporate managers to pursue selfish objectives.

Such mixed results should not come as a surprise. Progressive corporate reformers often tend to favor changing corporate law in ways that expand managerial discretion. Since shareholders exercise their influence through the capital markets, some think it is necessary to shield management from the dictates of stock valuation in order to allow management to show their concern for other constituents. Expanding managerial discretion, however, inevitably risks managerial opportunism. Freed from scrutiny, management can serve themselves—and they often do. Corporate managers, it

60. Internal Revenue Code, 25 U.S.C. § 170(b)(2).

61. *See Kahn*, 594 A. 2d 48.

62. Sponsorships of cultural institutions should not be sold short. They offer other benefits to executives, including access to social networks, prestige, and social standing. *See* Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 615-19 (1997).

63. *See Kahn*, 594 A.2d, at 52-57. The museum, which opened in 1990, has been managed by UCLA—the author's employer—since 1994. The museum's history is available at http://www.hammer.ucla.edu/information_ about.htm.

seems, all too frequently resemble Oscar Wilde's caricature of disciplinary weakness: "I can resist everything except temptation."[64]

C. Corporate Social Responsibility and Social Welfare Laws in the 1960s and 1970s

In the 1960s and 1970s, progressives sought to reform the behavior of corporations by creating new legal regimes outside of corporate law. This era saw an unprecedented wave of what might be termed social welfare laws that were designed in part to benefit corporate stakeholders. Unlike corporate law reforms, however, social welfare legislation of this period sought to cabin managerial discretion over important aspects of hiring, operations, and production. Although this vast array of social welfare legislation is not corporate law *per se*, it remains a vibrant constraint on managerial decisionmaking, adopted in the name of non-shareholder constituencies of corporations. While corporate lawyers tend to avoid discussing this broader law of business, any attempt to understand how the law shapes and controls corporate decisionmaking will be incomplete without addressing social welfare legislation of this period.

By the mid-1960s, critics of corporate social responsibility were vocal in condemning corporate law reforms allowing corporate charity and the larger pattern those reforms represented: the promotion of non-shareholder interests. No critic was more vocal than University of Chicago economist Milton Friedman. In *Capitalism and Freedom*, Friedman argued that claims that corporations should go "beyond serving the interest of their stockholders"[65] were misguided. He continued by stating, "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits."[66] To Friedman—like the *A.P. Smith Manufacturing*[67] court before him—nothing less than the survival of democracy was at stake: "Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."[68] But there was also a practical problem: profit maximization gave executives a clear direction in running their businesses, but how were they to define social responsibility?[69]

To progressives, this problem was less of a concern in practice: corporate officials could first try to remedy the social problems caused by their own corporations. As the "dominant nongovernmental institution," the corporation bore "large responsibility for the quality and tone of American life," argued Abram Chayes in 1959.[70] Because of its broad social impact, only a distorted view of the firm would see shareholders as the

---

64. OSCAR WILDE, LADY WINDERMERE'S FAN 15 (1st Collected ed. 1969).

65. MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962); *see also* Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970 (Magazine), at 33.

66. FRIEDMAN, *supra* note 65, at 133.

67. A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581 (N.J. 1953).

68. FRIEDMAN, *supra* note 65, at 133.

69. *See id.*

70. Abram Chayes, *The Modern Corporation and the Rule of Law, in* THE CORPORATION IN MODERN SOCIETY 25, 26-27 (Edward S. Mason ed., 1959).

sole constituency group. "A more spacious conception of 'membership,' and one closer to the facts of corporate life, would include all those having a relation of sufficient intimacy with the corporation or subject to its power in a sufficiently specialized way."[71] Some progressive corporate lawyers and activists sought to reward these constituencies—employees, consumers, or the larger public—by reforming the internal mechanisms of corporate governance through codetermination,[72] or exerting their voice through politically motivated proxy fights in corporate elections.[73]

Despite these efforts, corporate governance mechanisms remained relatively immune to non-shareholder constituencies. But progressives recognized another way to empower employees, consumers, and the larger public: legislation outside of corporate law. As Chayes noted, since the late nineteenth century "antitrust and public regulation have, broadly speaking, been the characteristic response of American politics, government, and law to the problems posed by the modern corporation."[74] Employees—at least those which were unionized—had gained "a 'say' in the governance of the corporation" already, thanks to laws protecting collective bargaining.[75]

Following this model, the late 1960s saw "an unprecedented wave of policy innovation"[76] in the form of social welfare—or quality of life—legislation, as Congress and state legislatures granted broad new protections to workers, consumers, and communities harmed by big business. According to Scott Bowman, "The apparent intransigence and arrogance of certain corporations in refusing to acknowledge or remedy numerous problems associated with public health and safety had nurtured a growing public suspicion that corporations were not socially responsible."[77] Curtailing corporate executives' discretion on whom to hire and promote, how to operate their machinery and equipment, and what products were safe to sell, the laws of this era amounted to "extensive restrictions on business freedom."[78] These laws were not part of corporate law, but they profoundly influenced corporate behavior nonetheless—and did so in the name of non-shareholder constituencies.

Consumers were one stakeholder group increasingly in need of new legal protections from corporate managers. Consumers, according to progressive Ralph Nader, were among those harmed directly by corporate irresponsibility. Nader's *Unsafe At Any Speed*—an exposé of built-in safety problems in cars—showed that consumers

71. *Id*. at 41.

72. "Codetermination" refers to corporate governance structures that give a formal role to labor, alongside of capital, in decision-making. *See* Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, *in* EMPLOYEES AND CORPORATE GOVERNANCE 163 (M. Blair & M. Roe eds., 1999).

73. *See* John J. Flynn, *Corporate Democracy: Nice Work If You Can Get It*, *in* CORPORATE POWER IN AMERICA 94, 104 (Ralph Nader & Mark J. Green, eds., 1973); DAVID VOGEL, FLUCTUATING FORTUNES: THE POLITICAL POWER OF BUSINESS IN AMERICA 95 (1989) (noting the use of proxy fights to reform corporate behavior in the public interest).

74. Chayes, *supra* note 70, at 37.

75. *Id*. at 41-42.

76. James Q. Wilson, *American Politics, Then and Now*, COMMENTARY, Feb. 1979, at 40.

77. SCOTT R. BOWMAN, THE MODERN CORPORATION AND AMERICAN POLITICAL THOUGHT: LAW, POWER, AND IDEOLOGY 143 (1996).

78. Deborah A. Ballam, *The Evolution of the Government-Business Relationship in the United States: Colonial Times to Present*, 31 AM. BUS. L.J. 553, 635 (1994).

were vulnerable to cold calculations by automobile executives willing to sacrifice lives in the pursuit of profit.[79] The ensuing harassment of Nader by General Motors caused a scandal, launched Nader's career, resulted in congressional hearings, and eventually proved to be the opening of the era's floodgate of regulation against corporate excesses.[80] Between 1966 and 1972, federal laws were enacted that expanded consumers' rights and limited companies' ability to introduce into the market harmful products: the National Traffic and Motor Vehicle Act, the Consumer Product Safety Act, the Poison Prevention in Packaging Act, the Fair Packaging and Labeling Act, the Federal Meat Inspection Act, the Child Protection Act, and the Flammable Fabrics Act, to list the most important. These laws did not purport to change fiduciary duties. They protected consumers by taking off the table a whole range of options that corporate management had traditionally been within its lawful discretion to choose.

Workers, too, gained expansive new protections from the potentially damaging effects of corporate management's exercise of business judgment. Reflecting concerns about the hazardous conditions of the workplace, Congress passed the Occupational Safety and Health Act (OHSA) in 1970.[81] OSHA aimed to lessen the "mounting toll of industrial injuries"[82] attributable to companies that, in the pursuit of profits for shareholders, sacrificed the health and lives of employees. Also during this period, corporate business confronted new limitations on their hiring and promotion practices in the form of antidiscrimination laws barring companies from discriminating on the basis of race, sex, and religion.[83]

This pattern of restricting corporate management through reforms enacted outside of corporate law also resulted in new protections for communities affected by corporate behavior. The way to protect such communities was not through corporate law reforms, but through the implementation of, for example, environmental laws. As the public awareness of the dangers associated with pollution grew, the blame was placed squarely on big business–the power, petroleum, chemical, and steel industries. By 1972, environmentalism had become a "national obsession"[84] and Congress had passed the Water Pollution Control Act, the Federal Environmental Pesticide Control Act, the Clean Air Act Amendments of 1970, and the Environmental Protection Act. This last law, enacted by unanimous vote, also created a strong, large federal regulatory agency charged with protecting the public health[85] and authorized with "broad powers over a wide range of business decisions."[86]

79. *See* RALPH NADER, UNSAFE AT ANY SPEED: THE DESIGNED-IN DANGERS OF THE AMERICAN AUTOMOBILE (1965).

80. *See* VOGEL, *supra* note 73, at 43-46.

81. 29 U.S.C. §§ 651-78 (1994).

82. VOGEL, *supra* note 73, at 84.

83. *See*, *e.g.*, Civil Rights Act of 1964, Title VII, codified at 42 U.S.C. § 2000(e) et seq. Friedman himself criticized the trend toward antidiscrimination protections for workers as "interference with the freedom of individuals to enter into voluntary contracts with one another." FRIEDMAN, *supra* note 65, at 111.

84. VOGEL, *supra* note 73, at 65.

85. *Id*.

86. *Id.* at 59, 67-69.

The public, it seems, was not as troubled as Friedman about identifying the social responsibility of business. By the early 1970s, more than eighty percent of Americans polled believed that business should provide special leadership in rebuilding inner cities, eliminating racial discrimination, and wiping out poverty.[87] The way to insure that corporations provided such leadership had become clear: reform labor law, consumer protection law, and environmental law, regardless of corporate law's fiduciary duties. Granted, reforms arising in these other areas of law—the broader law of business—did not change corporate law, and applied to all business forms, not merely corporations. Nevertheless, they did amount to legal reforms that fundamentally shaped corporate behavior. To understand the significance—or lack thereof—of the claim that corporate law is witnessing the "end of history" and of the ultimate adoption of shareholder primacy, one must at least recognize that other stakeholders have found protection from corporate management through other areas of law.

D. Takeovers and Stakeholders

The debate between the proponents of shareholder primacy and those preferring stakeholder protection continued into the 1980s, brought to the fore by a vibrant market for hostile takeovers. This decade marked the emergence of the strongest theoretical defense of shareholder primacy: the nexus-of-contracts model of corporate law. At the same time, however, progressive-inspired ideals of stakeholder protection came to be further reflected in corporate law through the adoption of constituency statutes and the allowance of anti-takeover defenses. Here we find, once again, reforms in corporate law that reflect progressive values, but achieved through the mechanism of expanded managerial discretion.

Despite the broad array of limitations placed on corporate management's decisionmaking authority by social welfare laws—or perhaps because of them—corporate legal theory increasingly narrowed its focus to emphasize the primacy of shareholder value as the guiding light of the executive suite.[88] Spurred by the law and economics movement, corporate law scholarship overwhelmingly adopted the view that a corporation was a nexus of voluntary contractual relationships among many inputs—including shareholders, employees, creditors, consumers—each capable of relying on markets, rather than legal rules, to protect their interests.[89] Corporate executives, according to this theory, should seek to maximize shareholder wealth; executives who do otherwise will disappoint shareholders, who will sell their shares, causing share prices to drop and inviting a takeover. Corporate law, under this framework—one so successful that it can be fairly said to dominate the field of corporate law scholar-

87. *See id.* at 42.

88. Among the classics in the shareholder primacy literature are: EASTERBROOK & FISCHEL, *supra* note 1; Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981); Michael C. Jensen & William L. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 94 YALE L.J. 857 (1984); Kenneth E. Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927 (1983).

89. *See* Bainbridge, *supra* note 5, at 859.

ship[90]—exists to help shareholders make effective use of market mechanisms to secure returns on investment.

Ironically, just as the shareholder primacy school of corporate legal thought was taking over in law schools, corporate law was moving, at least in part, in a direction more accommodating to progressive goals. A surge in hostile takeover activity, being financed with debt, often led to worker layoffs and plant closings. The resulting widespread public discomfort prompted states across the nation to adopt laws that for the first time officially sanctioned corporate management to consider the effect of their decisions on stakeholders.[91] Such sanction came in two forms: corporate constituency laws and anti-takeover defenses.

Absent codetermination, progressive corporate lawyers found solace in the rise of corporate constituency statutes—laws that either required or allowed corporate management to exercise their fiduciary duties with regard to the effects on employees, customers, and larger communities of interest. The first constituency statute was passed in 1983 by Pennsylvania, followed by twenty-eight other states over the following decade.[92] While most of these laws are permissive—allowing but not requiring directors to take into account the non-shareholder constituencies—at least one state, Connecticut, obliges management consideration of "interests of the corporation's employees, customers, creditors and suppliers, and . . . community and societal considerations including those of any community in which any office or other facility of the corporation is located."[93] By formally attempting to broaden the corporate fiduciary duty of care, constituency statutes may be fairly said to embody, at least in part, the longstanding progressive ideal of respect for the many groups necessarily impacted by corporate behavior.

Even in states without constituency statutes—such as the all-important hub of corporate law, Delaware—the law has evolved to effectively allow directors to consider factors other than shareholder value in some situations, such as defending against takeovers. The landmark Delaware case of *Paramount Communications v. Time* held that Time's directors could refuse to put a tender offer up to a shareholder vote, even when shareholder wealth would be maximized (at least in the short-run) by the sale.[94] In place of the profitable tender offer, made by Paramount Communications, Time's directors agreed to merge their company with Warner Brothers in a deal that left Time's shareholders as minority shareholders in a company heavily burdened by debt created by the merger. Time's directors argued that the Warner deal was better for the corporation than the Paramount deal. According to the court, "[t]he board's prevailing belief was that Paramount's bid posed a threat to Time's control of its own destiny and retention of the 'Time Culture'"[95]—the latter being the company's identification

---

90. *See id*. at 859-60.

91. *See* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 24 (1992).

92. *Id.* at 27. Roe puts the number of states at 40 by the 1990s. *See* ROE, *supra* note 18, at 151.

93. CONN. GEN. STAT. ANN. §§ 33-313(e)(3) & (4).

94. Paramount Communications v. Time, 571 A.2d 1140, 1153 (Del. 1990).

95. *Id.* at 1148.

with "journalistic integrity."[96] The court upheld the directors' decision and reasoned that directors have broad authority to manage the firm in accordance with their long-term vision of what is best for the corporation.[97] That authority included the power to adopt defensive measures in a takeover contest with the "impact on 'constituencies' other than shareholders"[98] in mind. Professor Lynn Stout, referring to the benefit to stakeholders of this evolution in corporate law, suggests that the "Delaware courts seem to have come down rather firmly on Dodd's side of the Berle-Dodd debate."[99]

The effects of this two-pronged attack (the adoption of constituency statutes and the allowance of corporate takeover defenses) on shareholder primacy have nevertheless disappointed progressives. While giving voice to the interests of non-shareholder groups—and quieting hostile takeover activity—these laws are notable mainly for the their legacy of expanding managerial discretion. Like the allowance of corporate charitable activity, these corporate law reforms have, in the end, allowed managers to protect themselves in the name of protecting customers, employees, and communities of interest. Now officers can use these reforms as cover for their own entrenchment in the seats of corporate power, further immunizing their opportunism and shirking from scrutiny. If a hostile bid is made that appears to benefit shareholders, management can take defensive measures and claim its actions benefit employees. If employees are harmed, management can claim its actions benefit customers. If all of these groups complain, management can claim its actions are done to benefit a unique corporate culture. No matter what the action, there is likely to be someone for whom management can claim the mantle of protection.[100]

Progressives should hardly be surprised by this result. As a matter of political history, corporate executives have often been behind state anti-takeover laws. According to Professor Mark Roe, corporate managers pressured state legislatures to adopt protective legislation—frequently in response to specific takeover attempts on their own firms.[101] When Minnesota's influential Dayton Hudson Corporation, the company behind the Target retail stores, itself became a target in 1987, company officials were able to persuade the state legislature to hold a special session that resulted, in only hours, in anti-takeover reform.[102] Arizona-based Greyhound took a similar approach to combating a takeover that year.[103] According to one state representative, "Greyhound said, 'Jump,' and we said 'How high.'"[104] In 2003, corporate management exercised its power again, when the Taubman family, which owns the controlling block of the Taubman Centers shopping mall empire, persuaded the Michigan legislature to

96. *Id.* at 1144 n.4.

97. *Id.* at 1153-54.

98. *Id.* at 1153.

99. Stout, *supra* note 50, at 1204.

100. *See* Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1432-36 (1993) (describing the inherent defects of a multi-fiduciary model of director/officer duties).

101. *See* ROE, *supra* note 18, at 161.

102. *Id.*

103. *See id.*

104. *See id.*

pass an anti-takeover law designed explicitly to terminate a takeover attempt by rival mall owners Simon Property Group and Westfield America Trust.[105] This last effort could hardly be viewed as a victory for Michigan workers: Taubman Centers has no malls in the state and "only a small number of employees" there.[106]

Constituency statutes and anti-takeover defenses suggest that shareholder primacy is far from the only value reflected in contemporary corporate law. Stakeholders, especially employees, are explicitly recognized by constituency statutes and implicitly protected through anti-takeover defenses–both at the expense of shareholders. Yet while constituency laws and anti-takeover defenses may be effective at discouraging hostile takeovers, they accomplish this feat through expanding managerial discretion, which has proven fraught with risks associated with opportunism.

III

PROGRESSIVES IN PERSPECTIVE: IMPLICATIONS

Two potentially important implications of the brief legal history offered above and of the patterns that it uncovers are, first, that progressives seeking to reform corporate behavior in the wake of recent corporate scandals ought to be wary of changing corporate law, at least to the extent such reforms result in more managerial discretion, and ought to consider reforms adopted externally through the broader law of business. Second, corporate governance can be better understood if one incorporates into it the law of business, which over and above corporate law remains an important influence on corporate activity.

A. Progressives and Enron: Moving Away from Corporate Law Reform

In 2001, the operation and management of major corporations once again became a subject of intense public concern. The poor accounting practices and mismanagement of Enron, WorldCom, Adelphia Cable, and other public corporations renewed the debate over how to reign in corporate officials who are too willing to use firms to line their own pockets to the detriment of shareholders, workers, consumers, and communities.[107] Congress has passed one major reform bill, Sarbanes-Oxley, and over thirty-five states are considering or have passed legislation to redress the failures of the capital markets in disciplining corporate officials. In spite of these reforms, however, the conventional wisdom is that more needs to be done.

What direction should future reforms take? Lawrence Mitchell, among the leading progressive corporate scholars in the United States, offers a series of potential re-

105. *See* Andrew Ross Sorkin, *Michigan Senate Approves Change in Takeover Laws*, N.Y. TIMES, Sept. 19, 2003, at C4.

106. *Id*. Managers may be using anti-takeover defenses to benefit themselves or to benefit other stakeholder groups. In *Do Antitakeover Defenses Decrease Shareholder Wealth? The Ex Post/Ex Ante Valuation Problem*, 55 STAN. L. REV. 845 (2002), Lynn Stout shows how anti-takeover defenses can increase shareholder value, even if shareholders are denied the opportunity to sell their shares to a bidder offering a premium, by protecting the firm-specific investments of non-shareholder groups.

107. *See generally* FRANK PARTNOY, INFECTIOUS GREED: HOW DECEIT AND GREED CORRUPTED THE FINANCIAL MARKETS (2003) (detailing how opportunism and a lack of transparency in the capital markets have propelled recent corporate scandals).

it will "demean and directly undermine . . . lawyers' prime professional responsibility."[116]

Yet these reporting requirements are far from radical. In fact, a longstanding provision of the ABA's own Model Rules requires *trial* lawyers who discover client or witness perjury to take remedial action, including reporting to the trial judge if necessary to remedy the false testimony.[117] Corporate lawyers are just objecting to having a similar obligation—actually, a lesser duty because they are not required to report out, as trial lawyers are, but are merely permitted to do so—when a client or witness lies to a different governmental body.

The suggestion that the SEC could require corporate lawyers to obey similar standards as trial lawyers is not meant as a panacea to fraudulent corporate accounting and securities reporting.[118] Rather, it is but one potential chink in the armor of managerial opportunism that would have to accompany other reforms outside of corporate law—including Sarbanes-Oxley's prohibition of accounting firms doing consulting work for firms they audit, regulations to limit conflicts of interest among stock analysts, pension reform to diversify 401(k)s and prevent lockups, and regulation of derivatives.[119] Reformers might also consider enacting corporate fraud laws that bar companies from intentionally misleading employees—much as current law bars them from misleading shareholders—potentially discouraging outrageous conduct like that of Enron executives who misled employees about retirement funds.[120] Perhaps most promising would simply be to beef up the prosecution of corporate misconduct and increasing the penalties attached to securities fraud.

These suggestions are just that, and any particular proposal must be thoroughly vetted to ensure its potential for success. In light of the history of progressive reforms of managerial behavior through corporate law, current reform efforts would do well to continue to look to the broader law of business.

B. Corporate Governance Reconsidered

According to corporate law professors Margaret Blair and Mark Roe, "[I]n recent years legal and finance scholars who have studied the institutions of control and governance in large corporations have focused on the relationship between shareholders and managers, particularly on the problem of getting managers to act as faithful agents for shareholders."[121] In a recent article, professor Dalia Tsuk explains how this nar-

116. *See* Jonathan D. Glater, *A Legal Uproar Over Proposals To Regulate The Profession*, N.Y. TIMES, Dec. 17, 2002, at C1.

117. MODEL RULES OF PROF'L CONDUCT R. 3.3, cmt. 10 (2002).

118. There is ample reason to suspect that the SEC reporting rules themselves will not radically change the relationship between lawyers and their corporate clients. *See, e.g.*, Stephen M. Bainbridge & Christina J. Johnson, *Managerialism, Legal Ethics, and Sarbanes-Oxley Section 307*, 2004 MICH. ST. L. REV. 299, 315-19 (2004).

119. For some early efforts, *see* 15 U.S.C. § 78 (2003); 17 C.F.R. § 242.500 et seq. (2003).

120. For a persuasive proposal, *see generally* Kent Greenfield, *The Unjustified Absence of Federal Fraud Protection in the Labor Market*, 107 YALE L.J. 715 (1997).

121. Margaret M. Blair & Mark J. Roe, *Introduction*, *in* EMPLOYEES & CORPORATE GOVERNANCE 1 (M. Blair & M. Roe eds., 1999).

row definition of corporate governance came about, tracing how "legal scholars and political theorists helped remove the interests of workers . . . from the core concerns of corporate law and theory."[122] But even if corporate law has marginalized workers—and other stakeholders—the history offered above suggests that the law generally has institutionalized significant (if imperfect) protections for stakeholders against corporate management.

Despite the common conception of corporate governance as pertaining to shareholder-management relations, the actual decisionmaking of corporate officers is heavily constrained by legal rules from outside of corporate law. To understand what a corporate manager's decision matrix looks like, one must avoid succumbing to corporate law myopia: the exclusive focus on corporate law as the body of law that determines the options available to corporate decisionmakers.[123] One must take into account environmental law, labor law, civil rights law, workplace safety law, and pension law, lest one be left with a distorted and incomplete view of how the law actually shapes those corporate decision matrices. Basic business decisions—whom to hire, which products to produce, how to produce, how to market, and how to structure firm finances—are all profoundly affected by the law of business, over and above the demands of corporate law or the capital markets. In the nineteenth century, most of these basic decisions were left to the discretion of corporations; the twentieth century evinces a pattern of cabining that traditional discretion for the benefit of stakeholders, but mainly through legal rules external to corporate law. Where federal regulation of business was once minimal, now it is extensive.[124] One telling measure of the impact of the law of business is the over $200 billion in annual costs to firms of compliance with legal regulation.[125] Discussions of corporate governance that ignore such an important constraint on corporate decision-making cannot be complete.

Corporate legal scholarship does not entirely ignore the broader law of business. Contractarian scholars have long pointed to the existence of external regulation as part of the justification for why shareholders should be the exclusive beneficiaries of managerial duties under corporate law.[126] Corporate law treatises often mention in passing that corporate governance is necessarily affected by external regulations, such as labor law or environmental law.[127] But noticing such laws exist is not the same as integrated analysis and study of them, little of which has emerged in corporate law

122. Tsuk, *supra* note 9, at 1864.

123. *Cf.* Paul L. Caron, *Tax Myopia, or Mamas Don't Let Your Babies Grow Up to be Tax Lawyers*, 13 VA. TAX REV. 517, 518-19 (1994) (describing "tax myopia" as the common, improper trend to view tax law as a self-contained body of law without reference to the other areas of law that ought to inform tax discourse).

124. *See* STEPHEN BREYER, REGULATION AND ITS REFORM 1 (1982) (noting that one measure of regulation, pages in the *Federal Register*, shows remarkable growth, from 2,599 pages in 1936 to 65,603 in 1977).

125. DAN BERTOZZI JR. & LEE F. BERGUNDER, BUSINESS, GOVERNMENT AND PUBLIC POLICY: CONCEPTS AND PRACTICES 72 (1990).

126. *See, e.g.*, STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 428-29 (2002).

127. *See, e.g.*, ROBERT CHARLES CLARK, CORPORATE LAW 30 (1986) (noting the regulatory impact on corporation by law other than corporate law).

discourse.[128] Excluding the broader law of business might be justifiable as a matter of corporate law teaching; four units are easily filled with the doctrines relating to entity formation, shareholder-management relations, proxy voting, mergers, and derivative suits. Lines must be drawn, and specialization demands as much.

Integration of the broader law of business into the study of corporate governance reveals the pervasiveness and breadth of the regulatory determinants of corporate conduct. Explanations that rest exclusively on private contracting, capital market discipline, or even basic fiduciary duties explain only what happens within the boundaries of the law—*i.e.*, the decisions made among lawful alternatives. The decision-making space left to corporate managers by the law of business is increasingly small, and we will miss important trends in "corporate governance" writ large if our view is myopic. For example, Robert Thompson and Hillary Sale have recently argued that "the most visible means of regulating corporate governance" is federal securities laws, not state corporate law.[129] Steven Bank argues that one often overlooked influence on corporate governance is federal tax law.[130] Perhaps such arguments suggest that the braoder law of business is just that—too broad—to integrate into corporate governance discussions. But they also suggest that the broader law of business's impact on corporate decision-making and management is too profound to overlook.

One objection to integrating the larger laws of business into the corporate law discourse is that such laws, even if they affect corporate governance, apply to all business forms—from sole proprietorships to partnerships—and not specifically corporations, the nominal topic of corporate law. All business entities, not merely those organized in the corporate form, were subject, especially in the 1960s and 1970s, to "a series of political setbacks without parallel in the postwar period."[131] The rapid decline of public confidence in the social responsibility of business during this period did not differentiate between corporations and other forms of big business. Between 1968 and 1977, the percentage of Americans who believed that "business tries to strike a fair balance between profits and the interests of the public" declined from 70 to 15 percent.[132] Accordingly, perhaps it is justified to say that reforms in the law of business are not really about corporations and corporate stakeholders per se. Such a distinction, however, hardly matters to a corporate officer faced with mandatory legal rules that diminish her discretion over operations, employment, production, and financial structure—or to a shareholder whose money helps pay the annual compliance costs. That a legal requirement is imposed both on corporations and other businesses does not render the interference with corporate decision-making any less onerous.

---

128. *See generally* Carl Landauer, *Beyond the Law and Economics Style: Advancing Corporate Law in an Era of Downsizing and Corporate Reengineering*¸ 84 CAL. L. REV. 1693 (1996) (noting that progressive corporate lawyers have tended to ignore environmental and labor law's impact on corporate governance).

129. Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism*, 56 VAN. L. REV. 859, 860 (2003).

130. *See* Steven A. Bank, *Tax, Corporate Governance, and Norms*, 61 WASH. & LEE L. REV. (forthcoming 2004). *See also*, Marjorie E. Kornhauser, *Corporate Regulations and the Origin of the Corporate Income Tax*, 66 IND. L. J. 53 (1990).

131. VOGEL, *supra* note 73, at 59.

132. *See id.* at 7.

Moreover, most big business is corporate in form and the corporation has long served as the symbolic embodiment of American business.[133] Even if employee-, customer-, and community-protective laws apply to all business forms, corporations are generally the intended target. In the 1960s, progressive activists such as Staughton Lynd argued that "[o]ur inevitable enemy . . . is the corporation."[134] In 1971, the more mainstream voice of *Newsweek* recognized that similar public sentiment stretched well beyond the New Left. In a cover story entitled "The American Corporation Under Fire," the magazine detailed the pressures on corporations to ameliorate the quality of life for their worker, consumer, and community stakeholders.[135] Although corporate stakeholders are not the only ones to benefit from such public outrage with the corporation, protective legislation provides them with new protections nonetheless. And corporate decision-makers remain constrained to act in stakeholders' interests by mandatory legal rules, even if those rules apply to other business forms, too.

The notion of the corporation as a symbolic embodiment of big business partially answers the inevitable question why stakeholder protection was not adopted primarily through corporate law, rather than through the broader law of business. Another part of the answer is institutional: the federal government was the source of the most significant reforms, and corporate law is state law. Congress did not have jurisdiction over state corporate law to create managerial obligations to stakeholders. Such jurisdiction would have required initial legislation federalizing incorporation, which has never proven politically successful. Although the 1970s saw a predictable resurgence of the age-old push for federal incorporation, this wave, like the one Theodore Roosevelt rode in the early twentieth century,[136] quickly petered out.

Congress and surrogate administrative agencies followed Roosevelt's lead and regulated corporations through other bodies of law, where federal authority was more firm. Congress could not require state corporations to grant employees a voice in operations or a vote for directors, but it could require businesses to engage in collective bargaining with employees under strict rules granting employees rights traditionally denied to them under state law. Unionized employees thus gained a voice in corporate governance. Congress could not require state corporations to favor community interests over those of shareholders, but it could mandate that businesses not discharge excessive toxic material into the environment. Communities thus gained protection from corporate officials' tendency to increase profits by polluting. In this case, stakeholder voice was exercised through public law, not negotiation with management or a formal vote for directors.[137] Perhaps even more significant for political development, these

133. *See* PETER F. DRUCKER, CONCEPT OF THE CORPORATION 6 (1946) (contending that the large corporation is "the institution which sets the standard for the way of life and the mode of living of our citizens; which leads, molds, and directs; . . . around which crystallize our social problems and to which we look for their solution.")

134. Quoted in VOGEL, *supra* note 73, at 57.

135. *The American Corporation Under Fire*, NEWSWEEK, May 24, 1971, at 74.

136. *See* MARTIN J. SKLAR, THE CORPORATE RECONSTRUCTION OF AMERICAN CAPITALISM, 1890-1916 §§ 192-202 (1988) (analyzing the progressive era movement for federal incorporation).

137. Similarly, campaign finance law has sought to protect shareholders from managerial decisions to use firm funds to support political candidates. Again, the protection comes from outside of corporate law, but its aim of protecting shareholders is well illustrated by the history leading up to the first federal campaign finance

laws effectively achieved the federalization of corporate governance law—at least significant parts of it—and accomplished indirectly what Roosevelt was unable to do directly.

To say that stakeholders found protection in the broader law of business does not mean that all such laws run contrary to the profit-seeking interests of shareholders. To the contrary, through much of the twentieth century, government and business have cooperated and symbiotically grown together.[138] In fact, regulation often ends up serving the interests of shareholders or managers, even if it is originally justified as serving other stakeholders.[139] Moreover, it is usually a mistake to assume that the interests of shareholders are necessarily antagonistic to those of other stakeholders.[140] Shareholders benefit from public regulation that makes stakeholder contributions of capital—human or otherwise—more reliable and less subject to arbitrary management decisions.

Public regulation also has several features that make it attractive as a means of protecting the interests of stakeholders: First, straightforward changes in corporate law are subject to evasion by investors choosing alternative business forms, such as limited liability partnerships. Second, mandatory rules imposed from without are more durable than contractual bargains subject to future negotiation. Third, granting employees a formalized voice in corporate governance through the mechanisms available to shareholders—such as voting for directors or expanded fiduciary duties—might not prove effective;[141] indeed, shareholders themselves often find that voting power and fiduciary principles provide little bulwark against management.[142] Finally, enacting stakeholder protection through the law of business rather than corporate law may be more efficient.[143] Public regulation is far from perfect, of course; the deadweight loss tied to interest group capture, log-rolling politics, and other pathologies of lawmaking takes away from the benefits that accrue to corporate stakeholders.[144] Whether one prefers public regulation to markets or vice versa, the pattern of stakeholder-protective legislation interfering with corporate decision-making is clear.

In Robert Charles Clark's *Corporate Law* treatise, the author justifies his decision to omit the broader law of business—even while noting its obvious impact on corporate governance—on the ground that "traditionally, the subject of corporation law and

---

law regulating corporations, the Tillman Act of 1907. *See* Adam Winkler, *"Other People's Money": Corporations, Agency Costs, and Campaign Finance Law*, 92 GEO. L. J. (forthcoming 2004) (detailing how the Tillman Act, and other campaign finance laws, are partially based on the idea of protecting shareholders from managerial corruption).

138. *See* Ballam, *supra* note 78, at 621-24, 635 (1994).

139. For an insightful illustration of seemingly pro-community laws serving the interests of managers, see Steven Bank, *Corporate Managers, Agency Costs, and the Rise of Double Taxation*, 44 WM. & MARY L. REV. 167 (2002) (discussing double taxation of corporate earnings).

140. *See* Stout, *supra* note 50, at 1196.

141. *See* BAINBRIDGE *supra* note 126, at 429 ("By virtue of their inherent ambiguity, fiduciary duties are a blunt instrument. There can be no assurance that specific social ills will be addressed by the boards of the specific corporations that are creating the problematic externalities.").

142. *See id.* at 428 ("Shareholders have no meaningful voice in corporate decisionmaking."); Stout, *supra* note 50, at 1191.

143. *See* BAINBRIDGE, *supra* note 126, at 428-29.

144. *See* BREYER, *supra* note 124, at 2-4 (describing some of the criticisms of regulation).

securities laws are simply defined to deal only with relationships between shareholders and managers (directors and officers)."[145] Corporate law, then, only purports to address only shareholder/management issues and not every conceivable law that influences, even profoundly, corporate behavior. If Clark's treatise is accurate that corporate law self-consciously limits its focus to shareholder/management relations, we can better understand the emptiness of claims that corporate law's history is at an end and that shareholder primacy has won out over the progressive school. If corporate law is, by definition, only about shareholders and management, then there is no space in it for a discussion of restraints on corporate governance adopted in the name of stakeholder protection and enforced through mandatory legal regimes other than corporate law.

Of course such restraints still exist. Their impact on corporate management is not transformed or minimized by their categorization as labor law or environmental law rather than corporate law. To the extent corporate law, so narrowly defined, favors shareholders and default rules over stakeholders and mandatory rules, it is largely due to this artificial distinction between legal regimes affecting corporate management that essentially defines progressives out of the game. There is little wonder progressives are thought to be losing battles over the corporation.

IV

CONCLUSION

It is not hard to imagine why conservative corporate lawyers claim to have vanquished all of the non-shareholder-centered schools of thought in corporate law. Much of the body of laws included in corporate law textbooks and in corporations codes—though certainly not all of it—emphasizes the centrality of shareholders to corporate governance and corporate operational practices, while ignoring management's responsibilities to workers, consumers, and larger communities of interest. If one teaches from those books year-in and year-out, it is easy to believe that corporations are run primarily, if not exclusively, to benefit shareholders and that, as Friedman concluded, the social responsibility of business is solely to make profit.[146]

Yet progressive concern with the social responsibility of business—protecting stakeholders—has been much more successful than corporate lawyers usually recognize. Corporate law has not really reached consensus around the value of shareholder primacy, but has evolved to permit corporate charitable contributions and to expand fiduciary duties through constituency statutes. While these progressive-inspired reforms of corporate law have benefited their intended subjects—companies give billions to charity and hostile takeover activity has been nearly eliminated—such reforms have also opened the door for new forms of managerial opportunism. Consequently, progressives ought to think carefully about protecting employees, customers, and communities through corporate law reforms, at least where managerial autonomy is augmented.

145. CLARK, *supra* note 127, at 30.

146. *See supra* notes 65-68 and accompanying text.

Once one looks beyond the corporate law codes and the corporations casebooks, one finds that businesses already face numerous legal requirements to protect non-shareholder constituencies. In the 1920s and 1930s, securities laws and collective bargaining laws were adopted to protect the American economy and its workers from the corruption of Wall Street. In the 1960s, a great blossoming of legislative reform was enacted to restrain corporate management and serve the interests of stakeholders: consumer protection laws, environmental laws, antidiscrimination laws, and occupational safety laws. These areas of law continue to thrive—despite their details varying with shifts in the prevailing political winds—and remain non-trivial constraints on corporate management.

Stakeholder protection and corporate social responsibility are alive and well in the United States. But to see the full extent of these progressive ideals, one has to look outside of corporate law as it is traditionally defined, and look to the broader law of business. It is only by ignoring the success of progressives that one could conclude that corporate law's history is at an end, and perhaps the only meaningful lesson of such claims is that they rest on an artificially narrow understanding of corporate governance. Surely, corporate managers themselves, who must operate within the broader law of business, are aware of the legally imposed duties to protect workers, consumers, and larger communities. Perhaps it is time corporate lawyers—conservative and progressive alike—caught up to this reality.