Symposium Introduction

Corporations and the Role of the State: Putting the "Law" Back into "Private Law"

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The dominant theme of current corporate law scholarship is, ironically, that corporate law doesn't, or shouldn't, do very much. The leading academic approaches to corporate law view business firms as sets of private relationships. For example, the traditional fiduciary model sees the firm as a principal-agent relationship between shareholders and managers, and the contractarian model sees the firm as a set of consensual market transactions. According to this view, corporate law is "private" law: it is, and should be, normatively neutral and limited to helping private parties effectuate their preferred goals.

This "private" view of law's role is reflected in the emerging focus on non-legal norms and corporate law, demonstrated by the University of Pennsylvania Law Review's fascinating recent symposium on the topic.[1] Despite some protestations to the contrary,[2] most of the Penn commentators argue that norms are as important (or more important) than legal rules in determining behavior. Thus much of the Penn symposium focuses on the ways that law can facilitate norm-based governance. Edward Rock and Michael Wachter, for example, argue that

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[1] Symposium, *Norms & Corporate Law*, 149 U. PA. L. REV. 1607-2191 (2001).

[2] *See, e.g.*, Marcel Kahan, *The Limited Significance of Norms for Corporate Law*, 149 U. PA. L. REV. 1869 (2001).

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the economic actors organize into firms to create a "jurisdictional boundary" between legally and non-legally enforceable transactions. Corporate law's purpose, they argue, is to facilitate the private ideal of non-legal governance.[3] That is, the purpose of private law is literally self-effacing.

The papers in this Symposium take a different view of the role of law. When I organized this Symposium under the broad category of Corporations Theory and Corporate Governance Law, I expected a grab bag of theoretical and normative approaches. The resulting papers, however, happened to coalesce into a counterpoint to the dominant view of corporate law as "private" law. The papers published here unfashionably accept, implicitly or explicitly, an active normative role for the state.[4] This collection may represent a new countercurrent in scholarship — or the last gasp of statism.

Stephen Choi's contribution to this Symposium, a critique of Regulation FD, follows the classic view that the normative priority of corporate law is to enforce managers' fiduciary duty to shareholders.[5] He believes that regulation can, and should, solve agency problems that have not been addressed through norms or contracting. In the Reg FD context, the residual agency problem is the alignment of management's selective disclosure policies with shareholder interests. Professor Choi makes specific suggestions for regulatory reform to improve this alignment. On the one hand, the normative agenda of Choi's article contrasts with the strong contractarians' rejection of the hierarchical agency model. Strong contractarians hold that so-called agency "problems" like those Choi attempts to solve are actually examples of shareholders and managers contracting to "opt out" of default fiduciary duties.[6] According to that approach, legal intervention like Choi suggests constitutes inefficient state interference that contravenes contractual intent. On the other hand, Choi's view that shareholder

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[3] Edward B. Rock and Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1654-55 (2001).

[4] A few papers presented at this Symposium in February 2001 did not focus on the role of the state, but are for various reasons not published here. For example, Mel Eisenberg presented a fascinating paper on non-legal norms of employee conduct that was, appropriately enough, originally presented at the Penn norms symposium. *See* Robert Cooter & Melvin A. Eisenberg, *Fairness, Character, and Efficiency in Firms*, 149 U. PA. L. REV. 1717 (2001).

[5] Stephen J. Choi, *Selective Disclosures in the Public Capital Markets*, 35 UC DAVIS L. REV. 533 (2002)

[6] *See, e.g.*, Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990).

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interests are the central concern of corporate law contrasts with the "social responsibility" view of the firm taken by symposium contributors Kent Greenfield, Frank Gevurtz, Peter Kostant, and Cynthia Williams.

The "private" view of corporate law attempts to distinguish it from regulatory law, which can legitimately concern itself with public interests. Professor Greenfield's paper, however, argues that this distinction is artificial.[7] In the real world, the state's role in business and industry is politically disputed. So-called regulatory laws, such as the minimum wage, often achieve public goals by altering corporate contractual relationships. Greenfield sees no reason why so-called corporate law should be any different. He advocates three corporate governance reforms to improve income distribution in favor of workers: relaxing the duty of profit maximization, extending managers' fiduciary duties to include workers, and mandating worker representation on corporate boards. Greenfield argues that such reforms would not only improve the distribution of wealth, but also improve overall efficiency by creating a cooperative atmosphere that will improve workers' loyalty and productivity.

Professor Gevurtz, in his reply to Greenfield, has similar faith in the law's potential power and authority over corporations.[8] He does not believe that reforming corporate governance rules holds much promise, however. Gevurtz is especially skeptical of Greenfield's focus on reforming managers' fiduciary duties. He doubts that existing duties actually constrain management behavior, either through enforceability or rhetorical influence. According to Gevurtz, the business judgment rule already makes the nominal duty to shareholders an unenforceable "marshmallow." Thus relaxing the duty is unlikely to affect wages. Assigning management a new fiduciary duty to workers would be pointless because in practice, the business judgment rule would probably undermine the new duty in the same way. Furthermore, if a fiduciary duty to workers had any teeth, it would create uncomfortable conflicts with the nominal duty to shareholders. Gevurtz argues that expanding the implied covenant of good faith and fair dealing in labor and employment contracts is more likely to benefit workers. This apparently modest suggestion packs powerful implications for the role of law. It demonstrates the amount of room courts have to determine the content

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[7] Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool*, 35 UC DAVIS L. REV. 581 (2002).

[8] Franklin A. Gevurtz, *Getting Real About Corporate Social Responsibility: A Reply to Professor Greenfield*, 35 UC DAVIS L. REV. 645 (2002).

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of "private" corporate relationships even when those relationships are spelled out by conventional explicit contracts.

While Greenfield and Gevurtz ask what legal tools can make corporations socially responsible, Professor Kostant seeks a normative justification for a social responsibility agenda.[9] Like Choi, Kostant accepts the view that the law should advance the purpose of the firm as a private institution. But he rejects the idea that that purpose is to maximize shareholder wealth. The shareholder wealth model delegitimizes, and even prohibits, managers' efforts to consider the social and ethical implications of corporate policy. According to the team production theory, however, managers' real duty is not to favor any particular corporate constituents, but to balance competing constituent interests for the long-term benefit of the enterprise as a team. Kostant argues that socially responsible corporate behavior benefits the team because it creates value by fostering trust and cooperation. Thus he argues, the team production theory justifies socially conscious corporate behavior, explains the extent to which it already occurs, and encourages managers to engage in it.

All the authors in this Symposium seem to agree that the state, through law, can and should play a key role in realizing the purpose of corporations, whatever that may be. In her contribution, however, Professor Williams points out that economic globalization is undermining states' ability to exercise this influence over multinational corporations.[10] While others have noted how globalization contributes to international regulatory competition,[11] Williams argues that economic globalization can allow corporations to slip between the jurisdictional cracks and operate beyond the reach of *any* state's laws. In such cases, corporations can operate free from any limits on their pursuit of profits. While free-marketers might see this situation as nirvana, Williams is concerned about the potentially destructive social effects of unfettered profit-seeking. Williams suggests that the lack of enforceable social *responsibilities* may be alleviated by greater social *accountability.* Williams would facilitate accountability via improved disclosure about the social

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[9] Peter C. Kostant, *Team Production and the Progressive Corporate Law Agenda,* 35 UC DAVIS L. REV. 667 (2002).

[10] Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization,* 35 UC DAVIS L. REV. 705 (2002).

[11] *See* David Charny, *Competition Among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the "Race to the Bottom" in the European Communities,* 32 HARV. INT'L L. J. 423 (1991).

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impact of corporate policy.[12]

My paper critiques the contractarian model of the firm for obscuring the normative role of corporate law.[13] The metaphor of the firm as contract originated in economic models based on consensual reciprocal relationships that economists call "contracts." One problem with the metaphor as used in legal scholarship is its conflation of the economist's concept of "contract" with the legally enforceable relationships that lawyers call "contracts." For terminological clarity, I refer to the former as Rs and the latter as Ks. Not all Rs are legally enforceable. Moreover, not all Ks are formed by consent. Using metaphor analysis borrowed from cognitive science, I argue that the conflation of K and R misleadingly suggests that individual consent is the justification for the legal enforceability of corporate law terms. The law sometimes imputes rights and duties that it enforces as Ks even when they are not the product of consent.[14] Some terms of corporate law, such as limited liability (especially with respect to involuntary creditors), might be called Ks even though they are not Rs. Furthermore, as Gevurtz's discussion of good faith and fair dealing points out, the content of even an explicit K is in part left up to legal interpretation. Property law includes rules that apply to third parties without their consent. For example, the law prohibits me from trespassing on your property even though you and I have no consensual relationship. Thus I suggest a property-based metaphor for corporate law to express the view that law does more than effectuate private preferences.

In short, I agree with Greenfield that corporate law is not simply "private law." Even if corporate law purports to limit itself to effectuating private preferences, it constitutes the state's imposition of normative judgments about social welfare. First, even if corporate relationships are freely negotiated, they reflect bargaining power based on the unequal distribution of property, wealth, and legal entitlements. Second, even if bargained-for results accurately and fairly reflect individual preferences, the law still needs a normative justification for

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[12] *See also* Cynthia A. Williams, *The Securities Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999).

[13] Thomas W. Joo, *Contract, Property, and the Role of Metaphor in Corporations Law*, 35 UC DAVIS L. REV. 779 (2002).

[14] *Cf.* John C. Coffee, *The Mandatory/Enabling Balance in Corporations Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1622 (1989) (a court must "to some uncertain extent serve as arbiter to determine how the powers granted to management by the corporate charter may be exercised under uncertain circumstances").

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deferring to private preferences instead of public welfare.[15] Third and finally, even accepting that the law should defer to private preferences, those preferences are expressed through incomplete contracts, so deferring to them requires figuring out what they are.[16] It is by definition up to regulators, judges, and lawmakers, not the parties, to decide whether (and how) the law fills gaps in a contract. Even when the law tries to fill gaps by purporting to simulate what the parties would have agreed to, the state is necessarily taking a guess. That guess is based on a normatively loaded vision of human behavior.[17] For example, the rational choice model assumes that when the parties leave gaps in contracts, the law can fill the gap with the economically efficient term. But that model attributes to parties an unrealistic preference for overall wealth maximization and indifference to wealth distribution. Unlike a real person, that is, the hypothetical rational person prefers a larger pie regardless of the size of the slice he or she gets. Moreover, assuming that gaps can be filled so easily effectively assumes incomplete contracts right out of existence. Indeed, if parties' unexpressed intent were really that easy to determine, explicit contracting would be a tremendous waste of time and effort.[18]

The Legal Realists taught us (and Critical Legal Studies reminded us) that the boundary between the public, or legally regulable, and the private, or nonregulable, is an arbitrary one.[19] Moreover, the distinction is illusory, because the decision not to regulate is just as influential, and just as politically loaded, as regulation. Nonetheless, legal theorists continue to rely on the distinction.[20] It is implicit in the prevailing view

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[15] *See* Robert H. Mnookin, *The Public/Private Dichotomy: Political Disagreement and Academic Repudiation*, 130 U. PA. L. REV. 1429, 1436 (1982).

[16] By suggesting that the distribution of the corporate surplus — a key aspect of corporate governance — can depend on doctrines of contract interpretation, Gevurtz shows that even facially "complete" contracts can be incomplete and subject to state intervention.

[17] Of course, the vast majority of disputes are not adjudicated, but even so, bargaining takes place in the shadow of the law. That is, the law's normative orientation (or at least the parties' understanding of it) will influence the outcome of non-legal bargaining.

[18] The Coase Theorem suggests that it doesn't matter if the state guesses wrong as to the parties' intent, because the parties will bargain around it to an efficient result. But as Coase himself has pointed out, this result obtains only under the unrealistic condition of zero transaction costs. And even if parties bargain around inefficient laws to reach efficient reallocations, an initial legal entitlement has significant *distributive* effects.

[19] Ironically, in view of the emphasis on the public/private distinction in the U Penn Law Review's "Norms & Corporate Law" symposium, the best collection of post-Realist critiques of the distinction appears in another Penn symposium. *See University of Pennsylvania Law Review Symposium on the Public/Private Distinction*, 130 U. PA. L. REV. 1289-1602 (1982).

[20] According to Morton Horwitz, the arbitrary nature of the public/private distinction

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that effectuating private preferences is the natural goal of corporate law. As the papers in this Symposium argue, however, such an approach necessarily implicates law in important political judgments. While it may be too much to expect agreement on the normative goals of corporate law, it may be possible to reach consensus that the state can never remain normatively neutral when it designs and implements corporate law.

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was accepted in American legal thought by 1940. The postwar fear of totalitarianism and rise of neoconservatism, however, led to the rejection of the idea of an overarching public interest. Morton Horwitz, *The History of the Public/Private Distinction*, 130 U. PA. L. REV. 1423 (1982).

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