Team Production and the Progressive Corporate Law Agenda

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INTRODUCTION

At this symposium, Cynthia Williams and Kent Greenfield presented critiques of the currently dominant economic model for the public corporation. That model uses much of neoclassical economic theory to describe the pre-eminent business entity as a nexus of private contracts whose purpose is to maximize shareholder wealth.[1] Instead, both Williams and Greenfield present counter-narratives in which corporations are public as well as private entities and have some obligation to serve socially responsible goals. In presenting these alternative views, Williams and Greenfield contribute to the body of scholarship that some academics have termed progressive corporate law, many of whose proponents have characterized themselves, or are described by others, as communitarians.[2] The Williams and Greenfield articles both discuss some of the merits of the new Team Production Model ("TPM") of the public corporation.[3] Williams's focus is on the

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[1] Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as a Regulatory Tool*, 35 U.C. DAVIS L. REV. 581 (2002); Cynthia Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705 (2002); *see* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 12 (1991) (describing neoclassical economic mode of corporation as nexus of contracts). The view that shareholders own the corporation is not universally held by the neoclassicists. For example, Stephen M. Bainbridge, a self-described conservative neoclassical economic theorist, argues that no one actually owns the corporation. Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1428 (1993).

This model is dominant because the application of neoclassical microeconomics and the analysis of agency costs "gives shareholder primacy view an apparently rational and mathematical justification." Eric W. Orts, *A North American Legal Perspective on Stakeholder Management Theory*, *in* PERSPECTIVES ON COMPANY LAW 2, 169 (Fiona MacMillan Patfield ed., 1997). The nexus of contracts shareholder primacy model has also been dominant because it seems to provide "an internally consistent, self-correcting paradigm for a corporate economy." Michael Bradley et al., *The Purpose and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 LAW & CONTEMP. PROBS. No. 3, at 36 (Summer 1999).

[2] *See* Gregory A. Mark, *Some Observations on Writing the Legal History of the Corporation in the Age of Theory*, *in* PROGRESSIVE CORPORATE LAW 82 (Lawrence E. Mitchell ed., 1995) ("Among the most important responses to the work of law and economics scholars has been that of, for want of a better term, communitarian scholars. These scholars have absorbed the traditional concepts of duty and fair dealing and both defended them and sought to expand their meaning to constituencies other than common shareholders."). Eisenberg has referred to the movement as "progressive" or "communitarian" and described it as contractarian but implicitly relational and non-hierarchical. *See* Melvin A. Eisenberg, *The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 833 (1999) [hereinafter Eisenberg, *Nexus of Contracts*].

[3] *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) [hereinafter Blair & Stout, *Team Production*].

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importance of disclosure for improved corporate social responsibility, and Greenfield's focus is on the importance of procedural fairness. Both recognize that TPM is a powerful economic theory that helps shift the emphasis of corporate law away from an overly narrow concern merely for shareholders. TPM is useful for a broader understanding of corporate social responsibility. In this Article I will expand on their discussion to suggest how TPM can be used to advance the progressive corporate law agenda.

Except for the mandatory nature of fiduciary duties[4], or at least their enforcement by courts as a default rule,[5] very little of importance in corporate law is mandatory.[6] Thus, the greatest practical effect of corporate law may be expressive in helping to generate norms of behavior.[7] In performing this normative role, corporate law's report card is mixed. Corporate law, as largely enunciated in judicial opinions, has often been successful at explicating fiduciary duties and encouraging responsible behavior.[8] On the other hand, the rhetoric of shareholder wealth maximization has dulled the recognition that the long-term viability of the enterprise, which is more than merely the sum of its purported contractarian constituents, is the board's paramount obligation.[9] This rhetoric helps to generate behavior that is unnecessarily adversarial and harmful to long-term relationships among corporate constituents.[10] Corporate law does not forbid corporate managers from

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[4] *See* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1275 (1999).

[5] *See* Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1210-12 (1995).

[6] Bernard S. Black, *Is Corporate Law Trivial?: A Political & Economic Analysis*, 84 NW. U. L. REV. 542, 593 (Winter 1990).

[7] *See* Eisenberg, *Corporate Law and Social Norms*, *supra* note 4, at 1278-87; Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1016 (1997).

[8] Eisenberg, *Corporate Law and Social Norms*, *supra* note 4, at 1266-72.

[9] *See* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989) (permitting board to consider maintaining company culture in deciding to reject offer of greater financial value to shareholders). This case was decided in Delaware, a state that has not adopted a constituency statute. Twenty-nine states have recently adopted such legislation, which expressly authorizes boards to consider the welfare of corporate stakeholders other than shareholders. *See* Ronn S. Davids, *Constituency Statutes: An Appropriate Vehicle for Addressing Transition Costs?*, 28 COLUM. J.L. & SOC. PROBS. 145, 147-48 (1995); Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 16 (1992). Blair and Stout argue that boards only have a duty to maximize the offering price to shareholders when it becomes clear that a formerly publicly held corporation is about to become essentially a privately held firm. Blair & Stout, *Team Production*, *supra* note 3, at 309.

[10] Blair & Stout, *Team Production*, *supra* note 3, at 212.

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directing corporations to obey the law to the same extent as a "natural person,"[11] and to "consider the ethical ramifications of corporate policy."[12] Where corporate law fails is in not adequately expressing the importance of obeying the law and making ethical considerations. Too much of corporate law's rhetoric of shareholder wealth maximization undercuts incentives for corporations to consider legal and ethical issues. My suggestion is that conscious implementation of TPM can help to address this problem.

If courts accept that TPM defines the correct role for corporate boards, the expressive function of these cases will help generate beneficial norms of behavior. Public corporations may become more profitable because management's focus will be more long-term and increased trust among constituents can reduce transaction costs. Furthermore, constituents' increased voice in a more deliberative mode of corporate governance will provide more relevant information to the ultimate decision makers. Better information and improved decision making can provide, greater flexibility that is essential in a global economy that is increasingly competitive and in which change occurs ever faster.[13]

TPM is a new and compelling model of corporate governance that is still in the early stages of development. This Article presents my view of how the model can be applied. The Article also corrects some current misconceptions about what the model necessarily represents.[14] My goal is to suggest, as a descriptive matter, that TPM does at least as good and probably a better job than any other economic model at describing the dynamics of corporate governance. The model's description of public corporations is becoming even more accurate as corporate boards over the past fifteen years have become increasingly active[15] and as corporate law has recognized that the purpose of the board is to serve as the

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[11] Victor Brudney, *The Role of the Board of Directors: The ALI and Its Critics*, 37 U. Miami L. Rev. 223, 239 (1983) (citing PRINCIPLES OF CORP. GOVERNANCE & STRUCTURE: RESTATEMENT & RECOMMENDATIONS (Tent. Draft No. 1, 1982)).

[12] Melvin A. Eisenberg, *Corporate Philanthropy Symposium: Corporate Conduct That Does Not Maximize Shareholder Gain, Legal Conduct, Ethical Conduct, the Penumbra Effect, Reciprocity, the Prisoner's Dilemma, Sheep's Clothing, Social Conduct, and Disclosure*, 28 STETSON L. REV. 1, 5 (1998) [hereinafter Eisenberg, *Corporate Conduct*].

[13] See John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law*, 78 Minn. L. Rev. 1443 (1994) (discussing greater competition in global economy and need for flexibility)

[14] *See* discussion *infra* notes 105-06 and accompanying text. Several commentators including Hansmann and Kraakman believe that TPM requires subordinating the interests of the entity to that of stakeholders.

[15] *See* Eisenberg, *Corporate Law and Social Norms*, *supra* note 4, at 1278-1287 (discussing increased diligence and care by directors of public corporations).

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ultimate monitor of senior management.[16]

TPM tells a coherent story about how the law allows corporations to act. More importantly, as a normative matter, if courts and commentators consciously apply the model, and if directors are encouraged to act as disinterested, mediating hierarchs, such changes in behavior could yield profound benefits for large public corporations.[17] For this to happen, courts must play an important role in helping to generate new norms of director behavior. Judges must expressly recognize TPM's prescription for how boards should behave and must write judicial opinions that clarify how directors should do their jobs.[18] The benefits that could flow from a meaningful application of TPM would include having large public corporations treat their constituents with greater fairness, which would engender greater trust among constituents. Corporations applying TPM would be more likely to obey the law and consider the ethical implications of their actions. These two effects would provide benefits that would extend beyond the entity and its constituents. Under TPM, boards would consider legal and ethical issues while continuing to pursue their existing goal of ensuring long-term profitability for the corporation. The independent and disinterested board would recognize that part of its function is to check exploitive opportunism by any constituents, including powerful senior inside managers. Consequently, the result could be a corporation that not only treated its constituents, and the larger society, more fairly, but which was also more profitable because of the value created by the resulting enhanced trust and cooperation.

A goal of this Article is to try to enlist the support of some distinguished scholars of corporate law for the application of some form of TPM to problems of corporate governance. Accordingly, I will suggest that TPM can be used to help check the endemic problem of opportunism by corporate managers and also to generate mechanisms to make corporations more ethical and law-abiding. Currently, the unchecked power of inside senior managers is the greatest obstacle to corporations behaving in a socially responsible manner, obeying the laws, and treating their constituents fairly. Opportunistic managers can

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[16] *See* Brudney, *supra* note 11, at 238.

[17] *See* Edward L. Rubin, *The New Legal Process, the Synthesis of Discourse, and the Microanalysis of Institutions*, 109 HARV. L. REV. 1393, 1433 (1996) (suggesting that legal scholarship is necessarily mixture of positive and normative discourse).

[18] There is a rich, recent literature on the expressive function of caselaw in generating norms. *See, e.g.*, Eisenberg, *Corporate Law and Social Norms*, *supra* note 4, at 1269-70; Rock, *supra* note 7, at 1016.

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personally benefit if corporations act illegally or behave unethically based on a cost-benefit analysis. Leading corporate law scholars, who are skeptical about the power of the market, or other mechanisms, to control inside senior corporate management, include Melvin A. Eisenberg, who participated at this symposium, Victor Brudney and Robert Clark. These scholars are natural allies for supporting the application of some form of TPM.[19]

I. THE TEAM PRODUCTION MODEL

The TPM was recently developed by Margaret M. Blair and Lynn A. Stout and provides a useful theoretical framework for understanding corporate governance.[20] Blair and Stout reject the agency model of corporate law, which states that corporate managers are the agents of shareholder principals. They argue that the agency model is defective because shareholders have forfeited too much control to be considered owners, and can hardly be principals when they are powerless to direct or control their so-called agents.[21] Instead, corporate governance is derived not from a primary emphasis on reducing agency costs but instead on solving the "team production" problem. The team production problem arises because the different constituents of a public corporation invest firm-specific resources to produce a non-separable output. Therefore, the key problem is how to allocate the output. Because it is impossible to agree in advance on how to divide the wealth resulting from these joint efforts, the participants prefer to relinquish

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[19] Professor Eisenberg has argued that the purpose of the corporation is to make profits while acting "decently" towards employees and communities. 61 ALI Proc. 421, 454-55. Harvard Law School Dean Robert Clark was an early critic of the contractarian model. He suggested that courts use moralistic rhetoric in describing management's fiduciary duties at least in part because the duties are so hard to enforce. *See* Robert C. Clark, *Agency Costs versus Fiduciary Duties, in* PRINCIPALS & AGENTS: THE STRUCTURE OF BUSINESS 78-79 (John W. Pratt & Richard J. Zeckhauser eds., 1985). Clark suggests that prevailing legal rules do not adequately reduce the danger of unfair self-dealing by corporate managers. ROBERT C. CLARK, CORPORATE LAW, § 5.4, at 184-85 (1986) Victor Brudney has described management's duties as "porous" and the shareholder derivative suit remedy as an "iron lung." *See* Brudney, *supra* note 11, at 227, 232. Brundey has also written that the rhetoric of the dominant contractarian view is used to legitimize "managerial discretion. . .to serve itself at the expense of the investors." Victor Brundey, *Corporate Governance, Agency Costs, and the Rhetoric of Contract,* 85 COLUM. L. REV. 1403, 1404 (1985).

[20] The following summary is drawn from an earlier article that I wrote about TPM and the role of corporate lawyers. Peter C. Kostant, *Exit, Voice and Loyalty in the Course of Corporate Governance and Counsel's Changing Role,* 28 J. Soc. Econ. 203, 222-28 (1999); *see* Blair & Stout, *Team Production, supra* note 3, at 21-22.

[21] *See* Blair & Stout, *Team Production, supra* note 3, at 21-22.

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control of the enterprise to an independent third party whose duty is to represent the entire enterprise and to allocate rewards among the investing team members. TPM describes the modern public corporation as an entity in which the corporate constituents, or stakeholders, such as shareholders, managers, employees, suppliers, customers, and even local communities have made firm specific investments and have given the exclusive power to allocate outputs and resolve disputes to the board of directors. The board is an independent, non-stakeholder, mediating hierarch that must act in the best interests of the corporate entity.[22] A key insight of Blair and Stout's TPM is that all stakeholders, including shareholders, give up control to the board, not for the benefit of the board but for their own benefit; because this is the most efficient way to govern a complex public corporation.[23] The board acts as trustees; they hold in trust with the ultimate power to administer the combination of material and intellectual properties that stakeholders have contributed to the public corporation. TPM recognizes the board as an independent mediating hierarch that all stakeholders calculate will endeavor to treat them fairly.[24] This reduces transaction costs that might interfere with the formation of complex productive organizations that involve long-term relationships.

Blair and Stout explain that all stakeholders are prepared to surrender power and make firm specific investments in public corporations to achieve the enormous benefit of team production. Stakeholders accept that an independent mediating hierarch will protect them in situations for which they cannot expressly contract in advance. The structure of large public corporations necessarily keeps shareholders, and other stakeholders, weak so that the board can make unfettered allocations, and truly function as the independent mediating hierarch. In practice, the board's power is virtually absolute as long as directors honor their

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[22] The existence of an independent mediating hierarch is necessary because in its absence *ex ante* agreements among team members as to the allocation of outputs would promote shirking while *ex post* efforts would result in unproductive and wasteful rent seeking behavior. Team Production Model (TPM) does not deny the importance of reducing agency costs. It just argues that reducing these costs is not the primary problem that modern public corporate structure has developed to solve.

[23] *See* Blair & Stout, *Team Production*, *supra* note 3, at 259-62; John C. Coates, *Measuring the Domain of Mediating Hierarchy: How Contestable are U.S. Public Corporations?*, 24 J. CORP. L. 837, 837-39 (1999) (noting that TPM can justify or rationalize important aspects of corporate law, at least for public corporations and is appealing from a distributional perspective).

[24] In this context, fairly would seem to mean in a manner that would maximize long-term benefits to the entity. The very vagueness of what is meant by "fairly" recognizes the impossibility of making complicated contracts and the reality of bounded rationality.

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duties of loyalty to the entity and refrain from engaging in tainted self-dealing.[25] Directors are legally permitted to favor one group of stakeholders over another but only if this is in the long-term interest of the corporate entity.[26] Thus, the TPM provides a new and more inclusive paradigm of corporate governance in which stakeholder voice and loyalty are crucial. Applying TPM can help to introduce more meaningful "governance" into corporate governance and to provide some of the benefits commonly resulting from a political system.

II. PROGRESSIVE CORPORATE LAW: THE HOLISTIC APPROACH

A. Corporate Communitarians

Progressive corporate law scholars generally acknowledge the importance of corporate law in protecting corporate non-shareholder interests, whether or not these interests are covered by explicit contracts.[27] This group, of which I am a member along with Williams and Greenfield, might describe one goal of our scholarship in language similar to how Clifford Geertz described his own work in interpretive anthropology, that of being "marked less by a perfection of consensus than by a refinement of debate. What gets better is the precision with which we vex each other."[28]

There is no uniformity among progressives but we share a concern that corporate law should treat public corporations as at least quasi-public institutions that must be viewed holistically as more than the sum

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[25] Thus, the board cannot be coerced or captured by shareholders or by any group of stakeholders. This rationale helps to explain why procedural barriers to derivative suits are great; why recovery flows, not to the shareholders that bring the suit, but to the entity (an approximation of all the stakeholders) and why, in practice, recovery is virtually only possible for breach of the fiduciary duty of loyalty (narrow self-dealing that harms the entity). Directors are nearly immune from liability for violations of the fiduciary duty of care because the business judgment defense preserves their independence and broad discretion. If shareholder plaintiffs were able to win derivative suits against a board that acted in good faith and without self-dealing, then shareholders could coerce the board away from independently serving the corporate entity and treating all corporate stakeholders fairly.

[26] The right of the board to reject hostile takeovers at a substantial premium that would benefit many of the current shareholders of a public corporation demonstrates this.

[27] *See* Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856, 857 n.1 (1997) (calling movement more accurately labeled as "communitarian" than "progressive" and being loath to concede the term "progressive").

[28] CLIFFORD GEERTZ, THE INTERPRETATION OF CULTURES 29 (1973).

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of their privately ordered constituencies. Progressives are also concerned with the interests of corporate constituencies who cannot adequately protect themselves by contract. Progressive legal scholars tend to consider norms of behavior, especially as they involve fairness and social responsibility, and how such norms interact with legal rules. In doing this, our work increasingly utilizes insights from the behavioral sciences.

The use of labels can be distracting, and even misleading, but it may be useful to examine how the label "communitarian" applies to "progressive" corporate law scholarship. There are several reasons why this field may be able to avoid some of the theoretical weaknesses for which broader communitarian thought has been criticized.[29] For example, one critic of communitarianism, Stephen Holmes, described the "Community Trap" as the yearning for a community that is never specifically defined but idealized as having existed in a mythic past or is to be achieved in a Utopian future.[30] Corporate communitarians do not do this because, while corporations are admittedly incorporeal legal fictions, their palpable existence as legal institutions provides some grounding in concrete reality to define a corporate community. Ironically, it is the hard-headed neoclassicists who theorize the public corporation into a kind of phantom by treating it as nothing more than an aggregate of individual selfish interests. In contrast, progressives recognize public corporations as meaningful entities with social responsibilities both to their constituents and as members of society. Holmes also suggests that communitarians are often guilty of confusing "theory as therapy." This confusion occurs when they ignore or reject the need for coercion to achieve their aims and suggest that merely recognizing cognitive mistakes and changing language can somehow transform the world.[31] Corporate communitarians avoid this weakness because corporate law already contains powerful instruments of coercion, including the mandatory provisions of corporate law such as broad and meaningful fiduciary duties. In contrast, neoclassicists would like to dispense with mandatory corporate duties. Furthermore, communitarian corporate scholars are not attempting to transform some amorphous liberal society. Instead, the focus is on existing and

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[29] *See* RICHARD POSNER, THE PROBLEMS OF JURISPRUDENCE 414 (1990).

[30] STEPHEN HOLMES, THE ANATOMY OF ANTILIBERIALISM 176-84 (1993). For Holmes, the six major theoretical weaknesses of communitarianism generally are what he calls: the phantom community; the myth of the social; either/or false dichotomies; to and fro; the shifting target; and theory as therapy. *Id.*

[31] *Id.* at 182-84.

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extremely powerful legal institutions — the public corporations.

The target of corporate communitarians is not the broad, modern political theory of "liberalism" but rather a much smaller doctrine that is almost a parody of 19th century laissez faire liberalism. Indeed, some neoclassicists describe modern public corporations as amoral, wealth maximizing engines in a manner that would embarrass a Social Darwinist believer in the "old tooth and claw ethic."[32] Therefore, while Stephen Holmes suggests that many communitarians misuse the selfish/selfless distinction,[33] the currently dominant academic model of corporate law is such a caricature of selfishness that the ameliorative mechanisms that corporate communitarians propose can seem real, grounded, and morally refreshing. Thus, the goals of progressive corporate law are neither indeterminate nor unrealizable. Serious application of TPM offers at least the possibility that public corporations can achieve some meaningful increase in fairness for all corporate constituents. Such fairness can be accomplished without changing legal rules, but by encouraging directors and all corporate constituents to act in accordance with TPM under the existing law. New norms of trust and cooperation can be generated in part by a meaningful application of these legal rules. To further these goals, corporate communitarians need not propose vague theories about some mythical community but rather apply knowledge derived from empirical studies of socially contingent cooperative behavior.

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[32] GEORGE GAYLORD SIMPSON, THE MEANING OF EVOLUTION 301 (1968); *see also* Kent Greenfield & John E. Nilsson, *Gradgrind's Education: Using Dickens and Aristotle to Understand (and Replace?) the Business Judgment Rule*, 63 BROOK. L. REV. 799 (1997) (exploring absurdity of abstract, mechanical decision making).

[33] HOLMES, *supra* note 30, at 179-80. Richard Posner acknowledges Holmes's critique of communitarianism and adds three reasons why he believes that legal communitarianism must fail: people are too selfish; altruistic achievements must be destabilized by the increased payoffs for cheaters; and there is a radical indeterminacy of the goal. Posner, *supra* note 29, at 414, 417. These criticisms fail, at least in the corporate context, because there is no empirical proof of the first two and, as discussed below, much solid evidence to the contrary of the value of norms of trust and fairness. As to Posner's concern about indeterminate goals, as for Holmes's complaints about the propensity of communitarians to seek wholly unrealizable ideals, I can suggest that at least my proposals for the progressive agenda are neither indeterminate nor unrealizable.

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B. Corporate Social Responsibility: Williams on the Importance of Disclosure and Transparency

In her article, Cynthia Williams provides a thoughtful overview of the current theories of corporate governance.[34] She is skeptical of the claims of what she calls "strong convergence optimists" that we are nearing the end of corporate law history because a single, standard shareholder-oriented corporate law model is prevailing in all developed market jurisdictions.[35] Williams criticizes the ability of a shareholder wealth maximization norm to hold corporate managers accountable.[36] This traditional doctrine of shareholder maximization provides that shareholders are the owners of the corporation because they are the sole residuary claimants.[37] In reality, all too often the shareholders' residuary claim to corporate profits is illusory.[38] The purported duty of managers to maximize shareholder wealth can be almost meaningless because the business judgment rule gives corporate managers enormous discretion in deciding how to try to generate profits. Indeed, whether wealth maximization has even been attempted, let alone achieved, is epistemologically unknowable. [39]

Williams suggests that corporate management's unmitigated focus on maximizing shareholder wealth can be harmful both for corporate social responsibility[40] and the corporation's long-term value to shareholders.[41] Williams argues for greater transparency and the need for broad and candid disclosure by corporate managers in facilitating corporate social

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[34] Williams, *supra* note 1, at 711-17.

[35] *Id.* at 711-12 nn.12, 13 (citing Henry Hansmann & Renier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001)).

[36] *See id.* at 708.

[37] *See id.* at 719 n.35.

[38] The shareholders' "residuary" claim may sometimes be comparable to that of a naïve investor who is entitled to a huge percentage of a Hollywood movie's net profits, while sophisticated insiders get so fat off the gross that there is no net profit.

[39] How can we ever know if Microsoft's management is maximizing shareholder value rather than just doing a very good job? Suppose that I suggest that, if I were Bill Gates, I would truly maximize Microsoft's wealth because I would teach a bar review course on the side and contribute my earnings to the corporate coffers. Does this mean that Bill Gates is failing to maximize Microsoft's profits because he does not do the same (assuming that the time Gates could spend teaching law is not spent on activities that benefit Microsoft)? This is a variation on the old joke about the elderly tailor who announces that, if he were Rockefeller, he would be richer than Rockefeller because he would continue to make suits on the side. *See* Peter C. Kostant, *Breeding Better Watchdogs: Multidisciplinary Partnerships in Corporate Legal Practice*, 84 MINN. L. REV. 1213, 1229 n.66 (2000).

[40] Williams, *supra* note 1, at 708.

[41] *Id.* ("the predominant view at least requires an ultimate sovereign, a condition that does not exist in the increasingly global economy.").

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responsibility and that this is increasingly important in a global economy in which accountability is more difficult to achieve. This disclosure should address not only financial but also social and environmental issues and would help to increase meaningful accountability of management.[42] Candor could play an important role in fostering the creation of beneficial norms of behavior. Additionally, broader disclosures are feasible because companies can be held socially accountable without explicitly changing the structure of corporate law or of corporate governance.[43]

In a prior article, Williams argued that it is important for corporations to obey the law; and she also provided evidence that some academics have increasingly attacked this seemingly obvious requirement.[44] In her current article, Williams acknowledges that traditional theorists generally accept limits on shareholder primacy not only for compliance with contracts but also in obeying bodies of law that are outside corporate law itself. The traditional approach is nevertheless inadequate because it fails to foster meaningful corporate social responsibility. The problem is even more severe because if most theorists recognize a corporate duty to obey the law, many senior corporate managers do not appear to share this understanding. For example, in 1996, a study by a large accounting firm indicated that 47% of the corporate executives surveyed would intentionally misstate corporate financial statements in order to show a greater profit.[45] Williams also points to scholars who do not believe that compliance with the law is necessary. She describes what she terms the "irresponsible" position of some extreme nexus of contracts theorists that "managers not only may but also should violate the rules when it is profitable to do so."[46]

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[42] *Id.* at 709 n.8 (citing Cynthia A. Williams, *The Securities & Exchange Commission & Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999)).

[43] *Id.* at 777 (suggesting that this would require no change in how directors and managers exercise their fiduciary duties).

[44] Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. REV. 1265, 1266-69 (1998).

[45] *See* Quinton F. Seamons, *Audit Standards and Detection of Fraud Under the Private Securities Litigation Reform Act of 1995*, 24 SEC. REG. L.J. 259, 273 n.33 (citing Dawn Blalock, *Study Shows Many Execs Are Quick to Write Off Ethics*, WALL ST. J., Mar. 26, 1996, at C1). This figure does not include executives who exaggerate because of psychological mechanisms. *See* Donald C. Langevoort, *The Epistemology of Corporate Securities Lawyering: Beliefs, Biases and Organizational Behavior*, 63 BROOK. L. REV. 629, 638-48 (1997) (discussing cognitive psychology of corporate reporting).

[46] Williams, *supra* note 1, at 715 (quoting Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155, 1177 n.57 (1982). *See also* Kent Greenfield, *Ultra Vires Lives! A Stakeholder Account of Corporate* Illegality (with Notes

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Williams praises the new TPM[47] description of the public corporation because TPM removes the outsider stigma from non-shareholder corporate constituents and suggests instead that "all constituents other than shareholders cannot fairly be treated as outsiders to the corporate enterprise."[48] TPM may be able to reduce some illegal corporate behavior because independent boards have a decreased stake in garnering risky but illegal profits. Directors can check managerial opportunism, and by giving a greater voice to corporate constituents, better monitor corporate activities. Finally, the board would balance the needs of constituencies that were communicated to them as a result of greater disclosure to these constituencies.[49] This theme is developed in my discussion of the application of TPM to the process of corporate governance in Part III.C of this Article.

C. Corporate Social Responsibility: Greenfield on Corporate Law as Regulatory Tool

Kent Greenfield's article complements Williams's because he writes about different mechanisms that could be employed to make corporations more socially responsible. While Williams's focus is on the importance of transparency and disclosure, Greenfield uses insights from regulatory theory and the developing literature on behavioral law and economics to suggest ways in which corporations can behave with greater fairness and thereby generate greater trust. Greenfield argues that increased corporate fairness can be achieved without significant economic loss and even with the possibility of greater profitability.

A recognition of the public nature of corporate law is a cornerstone of progressive corporate law theory. The neoclassical theorists exaggerate the importance of private contracting and market forces in corporate law, and largely ignore the importance of the disparity of bargaining power among corporate constituents caused by pre-existing entitlements and wealth. Greenfield argues that the concept of corporate law as private is outmoded because the revered free markets are "shot through with government" acting both as regulator and as the source of corporate

on How Corporate Law Could Reinforce International Legal Norms), 87 VA. L. REV. 1248, 1279 (2001) (suggesting doctrine of ultra vires could be used to enjoin illegal activities).

[47] *See* Blair & Stout, *Team Production*, *supra* note 3; Georgetown University Law Center/ Sloan Conference on Team Production in Business Organizations, Mar. 4-5, 1999.

[48] Williams, *supra* note 1, at 718.

[49] Williams, *supra* note 1, at 777.

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welfare.[50] Neoclassical theorists welcome government intervention but generally only when it favors the existing allocation of wealth and power. Alluding to the discredited legal doctrine from the early Twentieth Century, the government may not interfere with freedom of contract Greenfield terms the effort to privatize corporate law as "Lochnerization."[51] To correct this view of government's role, Greenfield suggests that "corporate law should be considered as any other regulatory tool and evaluated on the basis of whether it can bring about preferred policy outcomes in a cost effective way."[52]

The traditional argument suggests that corporations should be internally governed only by market forces, and constituents harmed by market failure should look to the political arena and government regulation for redress. This contractarian view is not convincing. Powerful corporate executives are part of a dual elite not divorced from government but are instead often acting in tandem with the government.[53] Corporate executives have a tremendous advantage in capturing the government and the law-making apparatuses because they control "oversized" corporate citizens that are well-organized, immortal, and have access to enormous "public" funds consisting of corporate revenues.[54] Thus, non-shareholders who follow the neoclassical prescription by looking to the political process outside the corporation are making a "sucker's bet." They would do better to look to internal reform of the corporation. Power inequality may continue to exist within the corporation but TPM's internal political process has the potential for greater fairness than looking to the political arena outside the corporation.

Greenfield is at the forefront of scholars who apply concepts from behavioral law and economics to problems of corporate law and

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[50] Greenfield, *supra* note 1; CHARLES E. LINDBLOM, THE MARKET SYSTEM 65, 159 (2001) (citing how government can aid corporations with import quotas, tariffs, licensing laws and "inventive restrictions" and by providing enormous subsidies to business).

[51] Greenfield, *supra* note 1, at 591-97. Current arguments that efforts to regulate corporations will necessarily decrease investment and lead to bankruptcy have a venerable tradition. As Lindblom has written, "historically . . . the same objection [was made to] regulation of child labor, work hours, occupational safety and against every other extension of the hand of the state." LINDBLOM, *supra* note 50 at 168-69.

[52] Greenfield, *supra* note 1 at 589.

[53] LINDBLOM, *supra* note 50, at 65-75.

[54] *Id.* at 236. "The effect of granting the enterprise a citizen's rights in addition to the rights already enjoyed by participants in the enterprise is to confer great special power on groups of enterprise executives, who can make use of corporate assets and personnel in addition to exercising the rights and powers they enjoy as individual citizens." *Id.* at 239.

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governance.[55] Along with Margaret Blair and Lynn Stout, Greenfield rests many of his arguments on empirical evidence drawn from the social sciences.[56] Studying human behavior provides an alternative view from economic theories based on a denuded model of individual, rational, self-interested behavior.[57] Even if models based on the traditional view of Homo Economicus are useful for understanding markets,[58] the importance of markets for corporations has been overstated.[59] To some extent, the application of microeconomics to corporate law has been an attempt to replace meaningful analysis of these complex institutions with a theory of a nexus of contracting groups, each of which behaves, not surprisingly, like Homo Economicus.[60] Corporations are much more than aggregates of contracts. As institutions they are "islands of command in a market sea."[61] Corporate entities, while not immune from market forces, are "a rival to rather than an instrument of market system coordination."[62] They must be recognized as more than just the sum of contracting market transactions.

Greenfield favors the TPM of the corporation and approves of how the model recognizes the need to look beyond fairness only to shareholders and to consider all corporate constituents.[63] Greenfield criticizes traditional corporate scholars who suggest that corporate law itself should be viewed as outside politics and that non-shareholder corporate constituents must look to private contracts, regulatory mechanisms

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[55] Blair and Stout have recently examined the literature of empirical work on trusting behavior to suggest how trust and trustworthiness can help to solve agency cost problems in the corporation. Trust does not replace market incentives or legal rules, but must be viewed as an important additional factor that can be substantially increased. Market incentives and legal rules can also be applied in ways that harm corporations by decreasing trust. *See* Margaret M. Blair & Lynn A. Stout, *Symposium Norms & Corporate Law: Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PENN. L. REV. 1735, 1774 (2001) [hereinafter Blair and Stout, *Trust*].

[56] See Blair & Stout, *Trust*, *supra* note 55; Greenfield, *supra* note 1, at 583-88.

[57] Greenfield, *supra* note 1, at 583-88.

[58] LINDBLOM, *supra* note 50, at 14.

[59] Political economist Charles Lindblom has suggested that even market systems cannot be understood as governed by abstract market forces but must be examined as a "system of human behavior." LINDBLOM, *supra* note 50, at 64.

[60] *See* Eisenberg, *Nexus of Contracts*, *supra* note 2, at 830 ("To describe firms purely as a set of reciprocal arrangements misses the extent to which firms are organized by bureaucratic rules and operate by hierarchical directions issued by superiors to subordinates.").

[61] LINDBLOM, *supra* note 50, at 75.

[62] *Id.*

[63] Greenfield, *supra* note 1, at 612-13, 623-24.

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outside corporate law, or the political process to seek redress for their grievances. The traditional argument ignores the harsh fact that this view of corporate law fixes these mechanisms for the benefit of the powerful inside senior managers that purport to be the loyal agents of the largely powerless shareholders.

Greenfield examines how human beings are motivated to behave within firms. He argues that changes in corporate governance will create positive effects by using two mechanisms of corporate law. He discusses the ability of corporate law to build cooperation through fairness, and the power of corporate law to facilitate the equitable sharing of corporate wealth.[64] If a corporation's employees perceive the firm's actions as procedurally fair, their performance and compliance with rules will improve.[65] The literature on social dilemma games suggests that one important way to foster cooperation is for the parties to provide an equitable procedure for the distribution of the group's surplus. Greenfield observes that, "corporate law may indeed have something of a comparative advantage when it comes to determining fair process," because for many years the key duties of corporate law have been procedural.[66]

I disagree with Greenfield's suggestion that to make corporate law a regulatory tool to address social ills, corporate law must relax the profit maximization norm and must provide both a specific fiduciary duty to workers and direct worker representation on corporate boards. While I have qualms about the theoretical basis for these suggestions, my greatest opposition to these proposals is that policy makers will never adopt them.[67] The reforms of corporate governance this Article suggests are more modest than Greenfield's, but are, I believe, capable of being realized, if boards act in the robust fashion prescribed by TPM.

The TPM's description of the public corporation is more accurate and at least as economically sophisticated as the current traditional paradigm.[68] More importantly, as a normative prescription, TPM has the potential to change current power arrangements within the firm. It can

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[64] *Id.*

[65] *Id.* at 642.

[66] *Id.* at 612; Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (discussing how business judgment rule is procedural rule).

[67] For an interesting analysis of why this will not occur *see* Mark J. Roe, Political Preconditions to Separating Ownership from Control: The Incompatibility of the American Public Corporation with Social Democracy (1999) (unpublished manuscript, on file with author).

[68] *See* discussion *infra* notes 108-126 and accompanying text (discussing Millon's critique of TPM as a descriptive theory).

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protect the long-term value of the corporation, while treating all corporate constituents with greater fairness. TPM is expressly political, and the political processes that develop as a result of deliberations within the corporation have the potential to provide greater fairness. Scholars like Eisenberg are disturbed by what I believe is exaggerated and unnecessary rhetoric surrounding the abandonment of wealth maximization. While the duty to maximize corporate wealth may be mythical, and merely a "figleaf" covering naked, unchecked managerial power, many fear the loss of that figleaf.[69]

Greenfield goes too far when he suggests that "existing corporate law affirmatively discourages (and may even make actionable) the directors taking into account any considerations of fairness, equity, just desserts, or group identity, other than those necessary to maximize the shareholders' wealth."[70] I agree that directors must aspire to serve the long-term interests of the entity, but the law certainly allows directors to consider fairness and reciprocity.[71] The real problem is not one of legal prohibition. Rather, the issue is finding a way to make managers of large public corporations actually behave in a manner that the law merely allows. In discussing the importance of loyalty in corporate governance, Eisenberg has aptly observed that loyalty is "not likely to run to a set of contracts."[72] The dominant model of the corporation as a nexus of contracts fails to control powerful insiders and fails to describe an entity whose constituents would be motivated to develop norms of fairness. In contrast, the TPM provides for an independent board that can check opportunistic abuses by powerful inside senior managers, and which can give voice and procedural fairness to all constituents. There is no certainty that corporations will apply TPM in this manner, or that if applied, it will inevitably be successful. This Article simply suggests that TPM, while not a panacea, may yield substantial ameliorative results. Groups of stakeholders will sometimes suffer for what directors, in good

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[69] A former SEC commissioner has described constituency statutes, which expressly permit directors to consider the interests of constituencies other than shareholders, as a "figleaf" for boards to cover power they use in their interests in the name of constituencies who are powerless to monitor or challenge actions purportedly taken for their benefit. Letter from Joseph A. Grundfest, Securities and Exchange Commissioner, to Mario Cuomo, Governor, New York (June 6, 1989), *quoted in* Ronn S. Davids, Note, *Constituency Statutes: An Appropriate Vehicle for Addressing Transition Costs?*, 28 COLUM. J.L. & SOC. PROBS. 145, 188 (1995).

[70] Greenfield *supra* note 1 at 635.

[71] *See* Steven M.H. Wallman, *Understanding the Purpose of a Corporation: An Introduction*, 24 J. Corp. L. 807, 812 (1999).

[72] Eisenberg, *Nexus of Contracts*, *supra* note 2, at 835.

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faith, believe is necessary for the long-term value of the entity. There is no way to completely satisfy all the constituencies: equity holders, debt holders, managers, workers, suppliers and local communities.[73] Nevertheless, it is possible to follow procedures of fairness that help to prevent unnecessary and opportunistic harm. As Greenfield has described, recognition of the fairness of these procedures can pay dividends of increased trust and cooperation. There is strong empirical evidence that "how an institution treats people appears to be a much more important determinant of trustworthiness than whether the institution delivers favorable decisions."[74]

III. CORPORATE SOCIAL RESPONSIBILITY: HOW UNDERSTANDING AND APPLYING THE TEAM PRODUCTION MODEL CAN HELP GENERATE NEW NORMS OF CONDUCT

A. Independent Directors are More Likely to Act in Compliance with the Law and Ethical Constraints

The TPM posits that the board of directors of public corporations must act as an independent mediating hierarch in order to solve the team production problem.[75] The emphasis on independence is crucial. Blair and Stout implicitly recognize that the powerful inside senior corporate officers are stakeholders because these managers have the power to act for their own interests. Traditionally, the senior inside managers, and especially the CEOs, have completely dominated the board of directors. If this were still the case TPM would be a dubious model for the practice of corporate governance. In fact, as a result of a confluence of factors over the past fifteen years, the passive, captive, pseudo-independent board of directors is no longer the norm for large public corporations. Today's boards are more independent and active than ever before, and because TPM discusses how boards are intended to act, its application can help to solidify this trend toward even more active and independent

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[73] Indeed, it is never possible to satisfy all shareholders. *See* Wallman, *supra* note 71, at 807-11 (discussing different shareholder preferences including risk and length of investment period).

[74] Greenfield, *supra* note 1, at 613 (citing Tom R. Tyler & Peter Degoey, *Trust in Organizational Authorities: The Influence of Motive Attributions on Willingness to Accept Decisions*, *in* TRUST IN ORGANIZATIONS: FRONTIERS OF THEORY AND RESEARCH 331, 346 (Roderick M. Kramer & Tom R. Tyler eds. 1996)).

[75] *See* Blair & Stout, *Team Production*, *supra* note 3, at 276-87; *see also* Coates, *supra* note 23, at 839 (suggesting that TPM only applies to subset of public corporations whose directors are not controlled by dominant shareholders).

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boards. While corporate law casebooks have defined "management" as directors and senior officers, TPM helps to distinguish independent, disinterested directors from powerful self-interested officers.[76]

Because the TPM requires a great deal of boards of directors, some scholars criticize the model as being unrealistic. Critics ask why any group of disinterested directors should expend the effort necessary to be fair, loyal and effective? If directors are really independent and cannot act in their own self-interest, what would motivate them to avoid capture by powerful self-interested inside senior managers, who in fact select the boards, or by powerful institutional shareholders that have the power to remove directors or fail to re-elect them? The senior officers have the real operational power because they work full time for the corporation and have access to key information. Accordingly, some critics suggest that these insiders should continue to do what TPM suggests should be done by the board. These are difficult criticisms, but I will suggest some preliminary responses.

The independent and disinterested nature of the board in TPM means that they are not stakeholders. Accordingly, the board cannot legally obtain a larger share of the corporation's wealth by behaving opportunistically.[77] Under TPM, the board's reputation would be for independence and fairness, as well as for the profitability of the enterprise. The board's lack of a financial stake, in part, makes them especially jealous of their reputation and less likely to engage in conduct that might harm the corporation in order to enrich themselves. Edward Rock, in a memorable phrase, has called their relative immunity from venality, "the silver-lining of the agency cost cloud."[78] The independent board's preservation of its favorable reputation has both instrumental and non-instrumental dimensions. Rock has stressed the instrumental side in arguing that directors care deeply about being recognized within the fairly small financial community for doing their jobs well.[79] For this reason, the rich narratives contained in Delaware court opinions that describe how boards should behave have profoundly shaped norms of

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[76] A current weakness of TPM is the extent to which directors are not truly independent because even non-employee directors own considerable amounts of corporate stock. Corporate law needs to address the question of how to make independent directors disinterested.

[77] CLARK, CORPORATE LAW, *supra* note 19, § 3.4, at 124, 298-99. (discussing fiduciary duty of loyalty); Blair & Stout, *Team Production*, *supra* note 3, at 118-20. Courts do enforce the director's duty not to self-deal in actions for breach of the fiduciary duty of loyalty. The expansive protection of the business judgment rule does not apply if directors self-deal.

[78] Rock, *supra* note 7, at 1104.

[79] *Id.* at 1013-14.

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director behavior. Independent directors are very susceptible to the impact of what has been called the expressive function of caselaw in shaping their norms of behavior. Directors will work hard to act the way courts say that they should.[80] Fear of financial liability is not the driving force. Instead, directors want to retain good reputations, which provides them the pleasure of high status and may also lead to business opportunities that may bring long-term financial rewards.[81]

Melvin Eisenberg agrees with Rock that the expressive function of law has been very important in helping to generate recent changes in the norms of director conduct. For Eisenberg, non-instrumental factors have been the most important. He points out that over the past fifteen years, directors have become much more careful and energetic in doing their jobs because they have internalized a set of norms that dictates their behavior.[82] Thus, whether the norms are instrumental or internalized or some combination of the two, in recent years, directors are behaving more like the active and independent board that TPM requires. If judicial opinions in the future present rich narratives and specific examples of how TPM's directors should behave, this kind of conduct by boards would likely increase.[83]

Ensuring that corporations obey the law is difficult to achieve. Commentators have suggested that the greatest practical problem for

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[80] *Id.* at 1016, 1045 (calling these opinions "sermons" and "morality plays").

[81] Kostant, *supra* note 20, at 230. Directors would certainly enjoy receiving favorable publicity and avoiding negative press. *See* Eisenberg, *Corporate Law and Social Norms*, *supra* note 4, at 1268 ("The business press. . . has become increasingly willing, and indeed eager, to report on the shortcomings of directors and officers.").

[82] Eisenberg, *Corporate Law and Social Norms*, *supra* note 4, at 1278-1287. A leading case that establishes the monitoring role of the board of directors is *In re Caremark Int'l*, 698 A.2d 959 (Del. Ch. 1996). In a more recent opinion, a federal district court in New York described Delaware corporate law after *Caremark* as allowing a board's sustained failure of oversight in monitoring or a knowing violation of law to establish the lack of good faith that would remove the protection of the business judgment rule. *See In re* Oxford Health Plans, Inc., Sec. Lit., 192 F.R.D. 111 (S.D.N.Y. 2000). In *McCall v. Scott*, 239 F.3d 808, 817-19 (6th Cir. 2001) the Court of Appeals for the Sixth Circuit interpreted *Caremark* not to require that directors have intentionally acted to harm the corporation. Moreover, failure to monitor might go beyond a violation of the duty of care, and therefore, bar the protection of Delaware's shield statute because certain kinds of reckless disregard of the duty of care could constitute a lack of good faith necessary for the protection of a charter provision. *See* DEL. CODE ANN. tit. 8, § 102(b)(7)(2001). The Court distinguished recklessness as conscious disregard from recklessness as gross negligence. In *Benjamin v Kim*, 1999 U.S. Dist. LEXIS 6089, at 47 (S.D.N.Y. 1999), the court held that a claim of directorial liability based upon ignorance of liability creating activities within the corporation if the plaintiff shows there was a sustained or systematic failure to exercise oversight.

[83] See Eisenberg, *Corporate Law and Social Norms*, *supra* note 4, at 1291(discussing expressive effect of judicial opinions).

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corporate social responsibility is getting corporations to act in accordance with established public policies, like compliance with the law.[84] Eisenberg argues that the ALI's Principles of Corporate Governance continues to require corporations to obey the law to the same extent as a "natural person."[85] He believes that the ALI Principles of Corporate Governance "surely add[s] nothing to the common law."[86] Unfortunately, this suggestion falls short for two reasons. First, the Principles are not unequivocal about this duty, and some scholars and judges have suggested that corporations may view laws not as a limit on corporate behavior but as a mere cost of doing business. Thus, in deciding whether or not to obey the law, corporate managers may perform a cost-benefit analysis and consider such factors as the likelihood of detection and amount of penalties compared with potential profits.[87] Perhaps more importantly, even if the positive duty that corporations must obey the law was clear, society would have great difficulty in ensuring that corporations actually obey the law. In fact, it is much easier to make individuals law-abiding. Culpable corporate agents are harder to identify than individuals, and corporations are not subject to personal sanctions.[88] By their very nature, corporations cannot have "personal values" that could motivate them to obey the law.[89] The problem is exacerbated by a non-nuanced duty of managers to maximize shareholder wealth which further helps to undermine compliance with the law. Thus, Dean Robert Clark has observed that, under our current legal system, managers often distort the sense of their fiduciary duties to defend non-compliance "by complaining that the devil of fiduciary duties to shareholders made them do it."[90] In fact, corporate managers do not generally admit to breaking the law. Instead, they argue that the law does not apply, or that it is somehow invalid. Norms of socially harmful conduct are justified by managers rationalizing about "the unfortunate fact that if they do not take advantage of lax legal enforcement, they may be ousted by aggressive managers who will."[91]

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[84] CLARK, CORPORATE LAW, *supra* note 19, §16.2, at 685 ("Professor Christopher Stone. . .has argued vigorously and persuasively that the main problem in making corporation's socially responsible is the problem of enforcement of defined public policies").

[85] *See* Eisenberg, *Corporate Conduct*, *supra* note 12, at 2.

[86] Brudney, *supra* note 11, at 239.

[87] Williams, *supra* note 44, at 1265.

[88] Brudney, *supra* note 11, at 240.

[89] *Id.*

[90] CLARK, CORPORATE LAW, *supra* note 19, §16.2, at 686.

[91] *Id.*

Under a TPM corporate governance regime, public corporations would be more likely to obey the law because the independent mediating hierarch would not benefit financially from breaking the law and would therefore have little incentive to risk reputational damage. As a practical matter, TPM's open deliberations are less likely to permit pernicious cost benefit analyses about the likelihood and penalties of getting caught. Even though corporate entities cannot have "personal" values that would encourage obeying the law, something like these values may emerge during open deliberations. This discourse would help to prevent harms from illegal activities that would affect those outside the corporation, and would be an even stronger deterrent against harm to corporate constituents. Opportunistic behavior by powerful insiders against other corporate constituencies has been termed "sharking."[92] Similarly, Cynthia Williams describes the all too frequent and illegal corporate refusals to bargain with newly elected unions or to harass union supporters.[93]

Inside senior managers are too self-interested to behave in the salutary fashion of TPM's independent board. Insiders lack the motivation to favor compliance with the law and to consider ethical concerns permitted by Section 2.01 of the ALI's Principles of Corporate Governance. Instead, as self-interested parties to the incomplete corporate "contracts," they may often endeavor to engage in opportunism, which was defined by economist Oliver Williamson as acting in their own self-interest with "guile."[94] Examples of managerial opportunism would include withholding material information or engaging in illegal "earnings management."[95] In recent years, the best method of controlling this kind of misconduct has been corporations' adoption of the "monitoring-board model as an obligational norm."[96] It is only a small step from the monitoring board model to TPM's more robust independent boards that will actively and openly deliberate about serving the best long-term interests of the entity within the bounds of the law.

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[92] Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L.& POL'Y REV. 265, 268 (1998) (discussing unfair conduct by senior managers that often involves injuries to other classes of equity or debt holders).

[93] Williams, *supra* note 44, at 1282. These would violate Section 2.01(b)(i) of the National Labor Relations Act.

[94] *See* Oliver E. Williamson, *Calculativeness, Trust and Economic Organization*, 36 J.L. & ECON. 453, 458 (1993).

[95] *See* Kostant, *supra* note 39, at 1232 (listing examples of illegal opportunism).

[96] *See* Eisenberg, *Corporate Law and Social Norms*, *supra* note 4, at 1278-82 (discussing universal acceptance of monitoring model).

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Similarly, corporate law allows managers to consider ethical values, but it does too little to encourage them to actually do so. Unethical conduct may occur when insider senior managers, or other powerful constituents, treat less powerful constituents opportunistically. Under TPM, such opportunism would be more difficult to conceal. Moving from the illegal to the unethical, Eisenberg suggests that the ALI's Principles of Corporate Governance permit corporate directors to consider the ethical ramifications of corporate policy.[97] In reality, the problem is not that the law might prohibit ethical considerations but how to encourage directors to make them.[98] Eisenberg suggests that "[w]e don't want a society in which people are encouraged to become amoral when they become corporate executives."[99] True enough, but the difficult issue is how corporate governance can generate norms that prevent corporate immorality.[100]

Eisenberg's examples of permissible ethical corporate behavior that may appear to be non-profit maximizing underscore the pervasive problem of encouraging ethical board decision making.[101] Thus, a corporation may "make reasonable provision for a faithful long-term employee who has made a contribution to the business, and is forced by ill health to retire before his benefits are vested."[102] This hypothetical comes from the Principles of Corporate Governance and not from an actual case, perhaps because while permissible, such examples are hard to find. In contrast, Eisenberg points to an actual case in which a large public corporation was legally permitted to give its CEO, who was already eligible to retire, extremely valuable options to purchase one million shares of stock.[103] This case represents a good example of

[97] *See* Eisenberg, *Corporate Conduct, supra* note 12, at 5-6 (discussing ethical conduct principle as second limitation of maximization principle).

[98] Often markets cannot discipline executives who do not behave ethically. Product markets generally do not effect such managers' decisions as plant location, working conditions, or how to dispose of chemical waste. LINDBLOM, *supra* note 50, at 64. Instead, "market ethics turns the inhuman quid pro quo into a moral virtue." *Id.* at 206. Thus, Lindblom believes that Swiss bankers and American tobacco executives are not inherently unethical people. Rather they are just responding to market incentives to do wrong. *Id.* at 169.

[99] *See* Eisenberg, *Corporate Conduct, supra* note 12, at 5.

[100] I do not believe that the problem is the rare case like *Adams v. Smith*, 153 S.2d 221, 224 (Ala. 1963), in which the Alabama Supreme Court held that gifts to widows of former corporate officers constituted an invalid waste of corporate assets. The problem is not that ethical conduct is prohibited but rather how to encourage what the law merely permits.

[101] Eisenberg, *Corporate Conduct, supra* note 12, at 5-6.

[102] *Id.*

[103] *Id.* at 9. The case, *Zupnick v. Goizueta*, 698 A. 2d. 384 (Del. Ch. 1997), involves the

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permissible reciprocity, but CEO's and other powerful insiders hardly need this protection. Eisenberg praises Warren Buffet's reasonable "social" considerations. Buffet rejects "gin rummy managerial behavior (discard your least promising business at each turn)" and "would rather have our overall results penalized a bit than engage in that kind of behavior."[104] These are admirable corporate ethics, but hardly a practical program for reform, because few corporate managers share Buffet's ethics.

TPM can help to achieve the practical result of greater corporate morality through instituting the mechanism of enhanced voice to constituents other than powerful inside managers and institutional shareholders. Independent boards can operate in an arena where more constituencies are heard and fair treatment can be recognized by these constituencies. Directors may increasingly apply ethical considerations that the law currently allows, and ethical conduct may become the new norm of organizational behavior. Eisenberg suggests that corporate governance should operate within a "channel" of ethical and law-abiding behavior.[105] Unfortunately, the channel is currently blocked, and TPM may provide the best mechanism to dredge it clear. Increased cooperation among corporate constituents would be generated if each constituent group believed the board of directors followed open and non-capricious procedures, gave constituent representatives an opportunity to be heard before making decisions, and made decisions to maximize the corporation's long- term value without harming anyone unnecessarily.

B. Response to Some Criticisms of TPM

Henry Hansmann and Reinier Kraakman seem to mischaracterize TPM when they describe it as merely a reformulation of the old manager-oriented model of the corporation that was popular in the 1960s.[106] They suggest that TPM's managers would be "untethered" and that "the managers' own interests would often come to have disproportionate prominence in their decision making."[107] This criticism ignores a crucial aspect of TPM, its separation of a disinterested board

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CEO of Coca Cola.

[104] Eisenberg, *Corporate Conduct, supra* note 12, at 22.

[105] *Id.* at 17-18.

[106] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 448 (2001).

[107] *Id.* at 448-49.

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from powerful senior inside managers. TPM's board would not have a stake in the corporation's wealth that they could advance or favor. If the board chose to act to benefit themselves, and not in a good faith effort to maximize long-term corporate value, the directors would be liable in shareholder derivative suits for violating their fiduciary duty of loyalty.[108]

David Millon has written the most detailed and thoughtful criticism of TPM,[109] which he terms a "new economic theory of the corporation and of corporate law" which advocates an independent board of directors that can prevent opportunistic exploitation by any of the corporate constituencies.[110] He suggests that the "TPM's economic rationale for board independence is thus the source of its power as a critique of the traditional shareholder primacy principle."[111] Unfortunately, Millon concludes that despite its exciting possibilities, TPM ultimately fails both as a description of corporate governance and as a normative proposal for reform of the public corporation.[112] There is merit in his criticisms, but I largely disagree with both of Millon's conclusions.

Millon first provides criticism of TPM as a positive theory. He points to weaknesses in TPM's description of public corporations, but these shortcomings do not seem fatal. TPM does a better job of describing the public corporation in the United States, especially as it is evolving, than does the more fanciful neoclassical model of the corporation as a nexus of contracts[113] or the related model of shareholder/principals and management/agents.[114] TPM provides a coherent and sophisticated economic model of the corporation.[115] This sophistication is important because if economists suffer from "physics envy,"[116] too many corporate legal theorists have "economics envy" and are mesmerized by mathematical formulae. Until recently the neoclassicists have had a

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[108] *See* CLARK, CORPORATE LAW, *supra* note 19, §3.5, at 136-40.

[109] *See* David Millon, *New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001 (2000) (discussing Blair & Stout's TPM and explaining its significance).

[110] *Id.*

[111] *Id.* at 1008. "[T]heir analysis appears to fly in the face of the orthodox view of corporate law's primary purpose." *Id.* at 1010.

[112] *Id.*

[113] *See, e.g.*, Eisenberg, *Nexus of Contracts*, *supra* note 2, at 830-31.

[114] *See, e.g.*, Clark, *supra* note 19.

[115] *See supra* discussion at 20-26.

[116] PAUL KRUGMAN, PEDDLING PROSPERITY, at xi (1984) (repeating the suggestion that "If you are a good economist . . . you are reborn as a physicist. But if you are an evil, wicked economist, you are reborn as a sociologist.").

monopoly on sophisticated economic models for the corporation and that goes a long way in explaining their dominance.

Millon discusses what he believes are descriptive failures of TPM. He is skeptical of TPM's description of the shareholders' derivative suit as a mechanism that could both serve to protect the independence of the board and yet have serious procedural hurdles intended to impede its effectiveness. He asserts that it is problematic for a single doctrine to pursue mutually inconsistent purposes.[117] Millon's criticism would be a telling defect if corporate law were a perfectly designed artifact, but this is hardly the case. Rather corporate law appears to have evolved by some combination of economic efficiency, luck (both good and bad), and historical quirks ending up as one of the many possible formulations that would work reasonably well.[118] Derivative suits may have a somewhat contradictory nature because these remedies began as a means for courts of equity to protect minority shareholders of small corporations. Over time, derivative suits afforded protection to some shareholders, but were sometimes brought as strike suites by opportunistic lawyers. In any event, the threat of derivative suits never interfered with the discretion of an independent board, but if the board abused its position by self-dealing, successful derivative suits could be brought for violations of the duty of loyalty. Consequently, derivative suits that question the discretion of directors, generally under the rubric of violations of the duty of care, almost always fail, while claims against directors alleging harm to the corporation by breaches of trust, violations of the duty of loyalty, sometimes succeed. If shareholders' derivative suits are successful, the recovery flows to the corporate entity.[119] Therefore, shareholders can only act for the benefit of the corporation. Millon correctly observes that shareholders are under no duty to bring derivative suits in which they have no interest,[120] but this only means

[117] Millon, *supra* note 109, at 1012.

[118] I take this "Tolstoyan" view of the capricious flow of history, and also accept that once a path has been taken, it becomes difficult to change even if it is more inefficient than some alternative. *See* LEO TOLSTOY, WAR AND PEACE (1994). The "is" is hardly a conclusive argument for the "ought." In a wonderful 1950s song, Flanders and Swan described the cannibal's analytic explanation for the inevitability of cannibalism: "If God didn't want us to eat people, He wouldn't have made us out of meat. Flanders and Swan, *The Reluctant Cannibal*, *on* A Drop of Hilarity from Flanders and Swan (EMI 2001). Mark J. Roe, Strong Managers, Weak Owners, The Political Roots of American Corporate Finance (1994) (studying path dependence in development of American corporate law).

[119] Millon correctly observes that some derivative suits may harm certain constituencies on occasion. Millon, *supra* note 109, at 1014.

[120] *Id.* at 1013.

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that derivative suits are an imperfect mechanism for protecting the corporation.[121] His criticism that other stakeholders will generally benefit "only incidentally rather than by design"[122] from a shareholders' derivative suit does not lessen the reality that shareholders are the best proxy for the entity itself when managers threaten the entity with harm.

Millon also suggests that TPM's description of derivative suits is not accurate because "if the goal of corporate law is to free the board to divide rents from production among the various team members, one would more readily expect that *all* constituencies would lack standing to sue."[123] This is not a telling criticism because corporate law does not have a single goal but instead has developed to offer solutions to various unfolding problems. If no constituencies had standing to sue managers who harmed corporations by breaching fiduciary duties, the problem would be completely rather than merely partially unsolved.[124]

Millon questions whether TPM can explain "the content of corporate law in its current form."[125] In fact, TPM provides a convincing rationale for how corporate governance is changing: boards are becoming more independent and activist and less of a rubber stamp.[126] TPM may not be completely accurate because "current law makes it possible for the shareholders to exert pressure on management to promote the shareholders' own interests, potentially at the expense of other stakeholders,"[127] but TPM also gives directors the legal right to ignore this pressure in favor of the long-term interest of the corporate entity.[128]

In discussing shareholders' voting rights, Millon suggests that "if corporate law were committed equally to all the members of the team, either all affected parties would have a right of approval or no one would."[129] This is a criticism of what I term a "strong" variant of TPM that would place all stakeholders on "an equal footing." In my understanding, TPM does not expect the board to treat stakeholders equally. The board's duty is to make decisions that favor the long-term

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[121] *See* Brudney, *supra* note 11, at 232, 239 (calling cumbersome remedy of shareholder's derivative suit an "iron lung").

[122] Millon, *supra* note 109, at 1013.

[123] *Id.* at 1015.

[124] Blair & Stout, *Trust*, *supra* note 55, at 1783 n.126.

[125] Millon, *supra* note 109, at 1009.

[126] *See* Eisenberg, *Corporate Law and Social Norms*, *supra* note 4, at 1265 (discussing changes in directors' behavior over last ten years and stressing increased independence and diligence).

[127] Millon, *supra* note 109, at 1015.

[128] See Blair & Stout, *Team Production*, *supra* note 3, at 301 n.126.

[129] Millon, *supra* note 109, at 1019.

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profitability of the corporation and in the process not to harm any constituents unnecessarily. Similarly, the current business judgment rule, which Millon says may "display an ambivalent commitment to shareholder primacy,"[130] allows the board to consider the long-term profitability of the corporation.[131]

The most important part of Millon's article critiques TPM as a normative theory. Millon concludes that even if corporate law does not necessarily favor TPM, the law contains sufficient "doctrinal inefficacy" to permit TPM to operate under existing corporate law.[132] Nonetheless, he believes that TPM is defective as a normative theory. Millon reaches this pessimistic conclusion because under TPM's political solution, which equates politics with power,[133] the power to capture the board continues to rest with the shareholders, who remain the most powerful stakeholders. Hostile tender offers remain a threat to boards that do not favor short-term shareholder value. TPM, as a political model, recognizes that boards can be pressured to reward rent seeking allocations, and shareholders are definitely in the best position to reap these benefits. Thus, Millon concludes that TPM is unlikely to improve the status quo.[134]

These are powerful criticisms, and Millon's pessimistic conclusion may well turn out to be correct.[135] Nevertheless TPM offers at least a

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[130] *Id.* at 1017.

[131] *See* Blair & Stout, *Team Production, supra* note 3, at 309. Blair and Stout suggest that the long term consideration may end only when it is clear that the entity's survival as a public corporation is no longer a possibility. *Id.* at 309.

[132] Millon, *supra* note 109, at 1021.

[133] *Id.* at 1024-30. While Millon disapproves of TPM's political strategy, another communitarian corporate scholar, Lynne Dallas, has suggested a new paradigm quite similar to TPM. Lynne L. Dallas, *Working Toward a New Paradigm, in* PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995). In her Stakeholder-Centered Paradigm utilizing a Power Coalition theory (Dallas's Power Coalition), Dallas correctly criticizes some traditional transaction cost economics analysis of the corporation for failing to recognize that the firm-specific investments of human assets can equal or exceed the capital investment of shareholders. *Id.* at 49. She argues that the stakes of non-shareholder constituencies justify changes in the governance structure of corporations that would recognize and protect them, and which would be less adversarial and more cooperative and participatory. *Id.*

The TPM recognizes the limitations of bounded rationality, incomplete contracting and opportunism as requiring an independent board of directors as mediating hierarch to play the role required in Dallas's Power Coalition. Indeed, Blair and Stout perhaps do not go far enough in stressing that to be independent the board must recognize that inside senior managers may be the most self-interested stakeholders. *See generally* Blair & Stout, *Team Production, supra* note 3.

[134] Millon, *supra* note 109.

[135] It is by no means certain that a team production board would be able to avoid being

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possible mechanism for significant improvement in how corporations treat their constituents. As Greenfield suggests, traditionalists argue that government regulation of corporations should occur outside of corporate law. Corporations themselves should somehow be outside politics, and corporate constituents other than shareholders should seek redress through the political process outside corporate governance.[136] In reality, the political arena has largely been captured by senior corporate management. On the other hand, TPM shifts the political arena to the corporation itself and attempts to take ultimate control from senior inside managers who are interested in their own self-aggrandizement. Thus, TPM gives control to a disinterested board that has the power to respond to stakeholder voice. Other constituents may be outgunned in this political arena by managers and powerful shareholders, but outgunned is better than unarmed.

TPM, as an expressly political model, has the potential to develop a new and meaningful political exchange inside the corporation, a more nuanced political relationship, rather than one of naked, self-interested power that Millon fears may emerge. To date, most corporate governance scholarship has focused on the importance of market forces or "exit" and on legal rules.[137] Scholars have largely ignored the mechanism of political force or "voice,"[138] which can be at least as important as economic forces and legal rules.[139] TPM places voice at the

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captured. Blair and Stout are too sanguine and are perhaps whistling past the graveyard when they suggest that directors have "almost absolute freedom from the direct control of shareholders, senior executives, or other potential 'stakeholders' in the firm." Blair & Stout, *Trust*, *supra* note 55, at 1756 n.42. In the recent past, and to a substantial degree in the present, senior executives, and especially the chief executive officer, have held the real power in the public corporation. Nevertheless, directors are becoming more independent, active and powerful, and the conscious application of the TPM can be used to try and make them act like the disinterested mediating hierarch clearly distinct from insider managers.

[136] Greenfield, *supra* note 1, at 592-94.

[137] *See* Kostant, *supra* note 20; *see also* ALBERT O. HIRSCHMAN, EXIT, VOICE AND LOYALTY - RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS AND STATES (1970).

"Exit" occurs either by customers no longer buying a product, or by members leaving an organization. The study of exit has been the domain of economists who examine completion in markets. Exit alone may be an ineffective mechanism for correcting an organization's problems.

[138] "Voice" is best defined as any attempt to change rather than escape from an unsatisfactory situation. It may be individual or collective and may range from grumbling to violence. The study of voice has been the domain of political scientists. Kostant, *supra* note 20, at 207-08.

[139] *See* Kostant, *supra* note 20, at 209-13 (suggesting that contractarians have tended to overlook importance of voice because if rights are defined by contract there is little incentive to complain and because focus of corporate law has been on shareholders whose liquidity allows them easy exit); Margaret M. Blair & Lynn A. Stout, *Response to Peter C.*

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center of corporate governance, not as a replacement for legal rules or market forces, but as an important complement to them. While the importance of voice as an ameliorative response to organizational decline has long been recognized,[140] recent findings in behavioral law and economics suggest that enhanced voice can help facilitate unprecedented improvements for the governance of public corporations. Voice, in the expressly recognized politics of TPM is not merely about naked power, and may be able to provide greater benefits than Millon predicts.

C. Ameliorative Voice, Enhanced Loyalty and the Efficacy of Trust

In an earlier article I made preliminary suggestions about how TPM, as a normative matter, could help generate the ameliorative mechanisms of voice and loyalty.[141] For the instrumental part of this story, loyalty is a calculative bet on recovery that tends to activate voice and discourage exit.[142] Corporate constituents who recognize that the board, as the ultimate decision maker, will follow fair procedures, and at least consider their interests, are more likely to be loyal and to exercise voice. Increased voice means that the board will have the benefit of more information and may potentially govern better. Access to greater amounts of information from disparate sources can also provide the board with a greater check on the abuse of power by inside managers.[143] Increased voice helps to neutralize exit and increase loyalty. Therefore,

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Kostant's Exit, Voice and Loyalty in the Course of Corporate Governance and Counsel's Changing Role, 28 J. SOC. ECON. 251, 251-52 (1999).

[140] HIRSCHMAN, *supra* note 137, at 120 (connecting political and economic to study choices and possible interactions between articulation (voice) and desertion (exit) as ameliorative mechanisms).

[141] Kostant, *supra* note 20, at 228-33.

[142] *Id.* at 208.

[143] *Id.* at 234-36. Part of TPM's power is that it separates traditional "management" into senior inside managers, the most powerful stakeholders, who have both motive and opportunity to behave opportunistically from independent non-stakeholder, boards of directors. Powerful, independent boards at least have the potential to control inside managers. Under the traditional dominant model, the control mechanisms to hold managers accountable: shareholder voting, derivative lawsuits and hostile takeovers are woefully inadequate. As I discussed in a prior article, exercise of the economic mechanism exit by shareholders selling their stock in the financial markets does not adequately discipline inside managers. *See id.* at 209-12 (discussing inadequacy of stock price as signal; lack of ongoing need to tap capital markets; and existence of "faux" exit, buyer for every seller of fungible stock). *See also* Brudney, *supra* note 11, at 227-28 (suggesting that management may not have recognized legal obligations "however porous" or preferred that they remain "murky and nebulous" and attributing second characterization to Chief Reporter for ALI Principles of Corporate Governance, Melvin A. Eisenberg.

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TPM, which provides a meaningful forum for constituency voice, can help keep more knowledgeable and perceptive constituents in a position to contribute to ameliorating harmful situations rather than remaining silent or bailing out.[144]

One reason the governance of large public corporations has changed over the past fifteen years is that institutional investors have increased their use of voice.[145] These powerful investor groups may try to use their voice quietly and keep their communications secret in order to further their own narrow self-interests, but the overall result should still yield a net benefit to all constituents. First, as a practical matter, secrets are hard to keep in large public corporations whose managers must abide by an increasingly stringent fiduciary duty of candor[146] and who are scrutinized by a robust financial press.[147] Second, large institutional investors may not be liquid because selling large blocks has a negative effect on the value of their shares and because of the increasingly common practice of indexing. Accordingly, the interests of these investors are more long-term, and therefore, they are capable of forming

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[144] Another advantage of encouraging voice by all corporate constituents is that the efficacy of their voice will vary depending on circumstances, so it is best for all to be included. *See* Kostant, *supra* note 20, at 229. Non-shareholder corporate constituents do not have the same ease of exit as shareholders in a public corporation and the long-term nature of their stake makes them repeat players with time for trust to develop. The relative absence of the exit option makes them more likely to employ voice, especially if they believe that the independent board will at least consider what they or their representatives suggest.

[145] Reasons for the increase in voice include 1992 reforms of the SEC proxy rules and changes in the power and organization of institutional investors. *See* John C. Coffee, Jr., *The SEC and the Institutional Investor: A Half-Time Report*, 15 CARDOZO L. REV. 837, 840 & n.17 (1994).

[146] The Delaware Supreme Court recently reaffirmed the board of director's fiduciary duty of candor in *Malone v. Brincat*, 722 A. 2d 5, 9 (Del. 1998). For a discussion of the importance of strict fiduciary duties for candid disclosure *see generally* Faith Stevelman Kahn, *Fiduciary Duty, Limited Liability, and the Law of Delaware: Transparency and Accountability: Rethinking Corporate Fiduciary Law's Relevance to Corporate Disclosure*, 34 GA. L. REV. 505 (2000); Therese Maynard, *Spinning in a Hot IPO - Breach of Fiduciary Duty of Business as Usual*, WM. & MARY L. REV. (forthcoming 2002). *Malone*, 722 A.2d at 5 and subsequent cases establish two fiduciary disclosure duties. First, directors owe a fiduciary duty to disclose fully and fairly all material information within the board's control when the board seeks shareholder approval for an action. *Id.* at 10. Second, directors always violate a fiduciary duty of good faith and loyalty when they knowingly disseminate false information. *Id.* at 12. *See* Goodwin v. Live Entm't, Inc., No. 15765 1999 Del. Ch. LEXIS 5, 17-18 (Del. Ch. 1999); McMillan v. Intercargo Corp., No. 16963 1999 Del. Ch. LEXIS 95, 16 (Del. Ch. 1999); Solomon v. Armstrong, 747 A.2d 1098, 1128 (Del. Ch. 1999); Reilly v. Transworld Healthcare, Inc., 745 A.2d 902, 915 (Del. Ch. 1999).

[147] *See* Louis Lowenstein, Corporate Governance and the Voice of the Paparazzi (Apr.2, 1998) (unpublished manuscript, on file with author).

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greater loyalty with corporations that provide them with a voice. Finally, as a normative matter, if the board recognizes and affirmatively fulfills its role under TPM, it will work to avoid capture by any group of constituents. By following fair procedures of deliberation and disclosure, such boards can encourage corporate constituents to be more loyal, vocal, and cooperative.[148]

In the context of discussing fair procedures of the board under TPM, it is important to define fair. Again, it is not possible for the board to satisfy all stakeholders. The crucial issue is not necessarily the substantive result but the procedure the corporation employs. Research has shown that even criminal defendants will accept an unfavorable result if they believe that the procedure was fair.[149] For these defendants, fairness usually means that those in authority listened to them and treated them with respect. Because team production is a legal as well as an economic model, it is well situated to deal with procedure. Law has unique institutional competence to design mechanisms of procedural fairness. TPM is at least symbolically a contractarian model in which corporate constituents agree to be bound by the decisions of an independent mediating hierarch because it is in their interest.[150] Because the TPM contract is symbolic, it may avoid some of the pitfalls of more rigid contractarian analysis.[151]

Because TPM's "contract" is for a fair allocation, it avoids some of the harsh individual selfishness of the neoclassical orientation. The rhetoric of the neoclassical contractarians has had an unfortunate effect on corporate governance.[152] In an earlier article, I suggested that because the TPM is contractarian, one might look at the corporate governance process as deliberating toward justice as fairness in a Rawlsian sense.[153] The philosopher John Rawls has derived a basis for the concept of justice

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[148] HIRSCHMAN, *supra* note 137, at 37 (suggesting that belief in efficacy of voice generates loyalty).

[149] *See* Greenfield, *supra* note 1, at Part III.B.2 and III.C (discussing work of social psychology on importance of perception of procedural fairness).

[150] Blair & Stout, *Team Production*, *supra* note 3, at 278. TPM is contractarian because the constituents constructively agree to cede decisional authority to the independent board to solve the team production problem of fairly allocating rents.

[151] *See* RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 151 (1977) (suggesting that "hypothetical contract is not simply a pale form of an actual contract; it is no contract at all."); *see also* Teemu Ruskola, *Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective*, 52 STAN. L. REV. 1599, 1707 (2000) (arguing that contractarian definition of fiduciary duty is ultimately utilitarian not a contract argument).

[152] *See* Brudney, *supra* note 19, at 1430.

[153] *See* Kostant, *supra* note 20, at 236-37.

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from principles of fairness. For the public corporation, this may be a rather truncated application of Rawls because it might not include Rawls's max-min duty, the duty to go on maximizing the minimum that anyone would receive until the wealth of the entirety diminishes so that the position of the worst off worsens. On the other hand, perhaps Rawls's max-min doctrine could apply to corporate governance and thereby make it more fair. Ironically, the economic theory of the traditional contractarians may provide some support for TPM's board to succeed in optimizing the allocations. A recent article by a group of financial theorists suggested that "the proposition that maximizing the residual claim of a public corporation in turn maximizes the claims of all stakeholders is a more general application of the so-called 'market value rule' of corporate finance."[154] Fama and Miller "demonstrate that under conditions of perfect markets, the market value rule maximizes the value of all the firm's outstanding securities, provided, of course, that the firm's securities holders are free to compensate one another for the effects of operating decisions that increase the wealth of one group but not another."[155] "It is a short step to generalize this proposition to stakeholders. Thus, assuming that side payments among stakeholders are possible, pursuing the marker value rule ensures that the values of all stakeholders' claims are maximized."[156]

While markets, of course, are not perfect, they can be quite efficient, and TPM's board can act to reduce the transaction costs of contracts among stakeholders, thus making contracting even more effective. The board can help reduce transaction costs in the four areas that Coase identified as interfering with optimal results from bargaining.[157] First, the board can reduce the cost of bargaining by providing easily available forums in which constituents can exercise voice. Second, problems of asymmetrical information can be reduced by providing candid information to all constituencies or their representatives. Third, the problem of too many parties can be addressed by establishing procedures to deal with constituent representatives. Finally, the problem of free riders can be reduced by respecting fair procedures that can help to generate norms of cooperational trust that would reduce collective action problems. Thus, if agreements were reached under TPM the board could abide by allocations agreed to by stakeholders.

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[154] Bradley et al., *supra* note 1, at 38.

[155] *Id.*

[156] *Id.*

[157] GARY MINDA, POSTMODERN LEGAL MOVEMENTS 77 n.66 (1995).

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The importance of employing fair procedures is implicit in TPM, but academics have written little about how such procedures would work. Nevertheless, corporate scholars are beginning to examine seriously the role of trust in various transactions. TPM's ability to generate trust is one reason why it may produce substantial benefits. Trust is socially contingent behavior that depends on how people believe that others will treat them.[158] Thus, trusting is often a learned behavior and can be either expanded or destroyed by various kinds of social interactions. Trust that increases cooperation among corporate constituents could be highly efficient, and Blair and Stout suggest that once trust has developed, it can be effective in the opaque areas of corporate governance where there is little accountability because legal sanctions and market incentives often do not work well.[159] TPM's board can generate trusting behavior by showing corporate constituents how to recognize that the board believes fairness and cooperation are valuable and important, and that the board will adhere to fair and open procedures. The board can also help characterize the social content of corporate behavior. This is important because research has shown that describing an experiment as a "cooperation" game, rather than as a "competition" game, can yield more cooperative results.[160] TPM's independent board has a "bully pulpit" from which to preach about cooperation and frame the nature of the corporation in more humane and cooperative terms.

Fair procedures that are consistent with and complementary to the currently existing mechanisms of accountability and cooperation of corporate governance may develop. Edward Rubin has identified a developing normative legal discourse that he has termed the "New Legal Process."[161] This scholarship focuses on the microanalysis of institutions and expressly recognizes the importance of political power.[162] The study and application of TPM is consistent with Rubin's New Legal Process because TPM places procedure at the center of the solution to problems of governance, and because it looks to the development of norms within institutions.[163] TPM expands insights from the transaction cost

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[158] Blair & Stout, *Trust*, *supra* note 55, at 1772; Greenfield, *supra* note 1, at 613; *see* Lawrence E. Mitchell, *Trust and Team Production in Post-Capitalist Society*, 24 J. CORP. LAW 869, 910-11 (1999) (recognizing that trust is important in defining how TPM can operate).

[159] Blair & Stout, *Trust*, *supra* note 55, at 1780.

[160] *Id.* at 1768.

[161] Rubin, *supra* note 17, at 1393.

[162] Unlike the "New Legal Process," the old legal process doctrine, beginning in the 1940s and 1950s, claimed to be apolitical. MINDA, *supra* note 157 at 31-34. TPM expressly recognizes that law and politics must interact.

[163] Rubin, *supra* note 17, at 1425-27.

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economics of New Institutional Economics to examine the need for an independent board of directors to act as internal adjudicator of the incomplete contracts among corporate constituents.[164] Decisions made within corporations are subject to institutionalized expectations and social norms, and these norms can change over time. The process by which boards can help to generate new norms will be determined by many factors, including how the board selects policies to encourage, how it responds to the constituents' exercise of voice, and the procedures the board utilizes to generate trust and cooperation. Rubin has suggested that the methodology and substance of the new synthesis discourse will concern balancing issues of economic efficiency and social justice.[165] These are important concerns of TPM, which expressly recognize that law and economics and politics must interact within the public corporation.[166]

In developing proposals for implementing TPM, the crucial issue is how trust can be generated. The presence or absence of trust is not a given. Preferences for trust are exogenous and are generated in a social setting.[167] Studies indicate that it is easier to destroy trust than to build it, and Blair and Stout point to evidence that trust cannot be developed by rhetoric alone but that mere rhetoric can destroy it.[168] For this reason, the dominant characterization of the relationship among corporate constituents as largely adversarial or even the rhetoric of selfish, contracting parties has been destructive of trust and cooperation.[169] Shareholders will not trust a board that does not acknowledge an aspiration to act in the long-term interests of the corporation, but all constituents will trust a board that acts openly and in good faith to further the goals of the entity in which all constituents have, at least,

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[164] *See* Oliver E. Williamson, *Calculativeness, Trust, and Economic Organization*, 36 J.L. & ECON. 453, 458 (1983). For a discussion of the relationship between TPM and transaction cost economics, *see* Kostant, *supra* note 20, at 227-28.

[165] Rubin, *supra* note 17, at 1432; *see also* Mitchell, *supra* note 158, at 874, 910 (discussing how trust can affect relationships and group identities in ways far more important than simply monitoring performance and how trust can foster information sharing to avoid workers exit).

[166] The independent board of directors can choose tradeoffs between possible short-term gains and perceptions of fairness in the interest of fostering cooperation for long-term profitability. Even if decision making that tries to satisfy pluralistic constituencies is sub-optimal, it can still be better than what the market could provide with real world transaction costs.

[167] Blair & Stout, *Trust*, *supra* note 55, at 1767-73.

[168] *Id.* at 1776.

[169] Brudney, *supra* note 19, at 1403-04.

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some stake.[170] To date, the strongest general criticism of TPM is arguably that there is no metric for deciding how to choose among conflicting claims.[171] The model of TPM that this Article advocates has its emphasis on fair procedures to further the long-term interest of the corporate entity that may be able to achieve a reasonable "organizational equilibrium."[172] Because the prevailing view of corporate governance is that boards already have a duty to act in the best long-term interests of the corporation, TPM does not require changes in the positive law. Instead, it represents a broad program to make corporate governance more cooperative and fair. In part, because "commands frequently offend and motivate people to evade,"[173] to the extent that TPM increases cooperation by making corporations less authoritarian, TPM may even improve employee productivity. While much "folklore" favors a "strict quid pro quo" of carrots and sticks, empirical evidence about worker motivation does not support this position.[174] TPM's potential for increasing cooperation may be an important factor in generating the kind of willing, flexible and problem solving workforce that economic historian David Landes describes as necessary for success in the emerging competitive global economy.[175]

Greater cooperation may even result in greater corporate profitability. Millon has suggested that TPM would allow constituents to engage in wasteful "horse trading."[176] In my more optimistic view, the result may be more like "horse breeding" because the board's deliberations can generate greater cooperation and trust and thus potentially greater profits. There is little doubt that acting fairly, and having a deserved reputation for acting fairly, is an excellent business strategy.

I would like to end with the story of *Taunton v. Royal Insurance Company*,[177] an old and currently obscure English case that I hope will

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[170] There is an extensive literature that supports the counter-intuitive principle that people are more concerned with fair treatment than in the actual result. Greenfield, *supra* note 1, at 613-16 (discussing work of Tyler and others).

[171] JOEL SELIGMAN, CORPORATIONS CASES AND MATERIALS 124-25 (1995).

[172] *See* David B. Wilkins, *Do Clients Have Ethical Obligations to Lawyers?" Some Lessons from the Diversity Wars*, 11 GEO. J. LEGAL ETHICS 855, 874 n.70 (1998) (discussing Hill and Jones' suggestion of "organizational equilibrium").

[173] *See* LINDBLOM, *supra* note 50.

[174] *Id.* at 144. Lindblom suggests that, "people at the end of the twenty-first century may look back with astonishment at our era's discrepancy between democratic principle and autocratic practice in the corporation." *Id.* at 244.

[175] *See* DAVID LANDES, THE WEALTH AND POVERTY OF NATIONS 486-90 (1999).

[176] Millon, *supra* note 109, at 1038.

[177] 71 Eng. Rep. 413, 415 (1864); *see* PHILLIP I. BLUMBERG, CORPORATE RESPONSIBILITY IN A CHANGING SOCIETY 51 (1972). I am grateful to Professor Blumberg for suggesting the

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become paradigmatic for how corporate boards will behave in accordance with TPM's prescriptions. In January 1864, gunpowder accidentally exploded on a gunboat on the River Mersey. The Royal Insurance Company had insured 81 houses that were destroyed by the resulting fire. The fire insurance policies excluded damages caused by explosions, other than by gas explosions that were then rather common. The board of directors of the insurance company had the discretion to act "as might be most for the welfare of the company" and "immediately resolved to pay claims arising from the explosion, but without acknowledging any legal liability to do so." A shareholder brought suit to enjoin the company from paying these claims. The Vice Chancellor denied relief and allowed the board to behave ethically, in part because the insureds might possibly have believed themselves covered for this kind of catastrophe. The Court concluded that the board could "act in this liberal way" and that the payments were "conducive to the welfare of the society, and a legitimate mode of promoting the objects of the concern." In the end, the Royal Insurance Company went on to become one of the largest and most profitable insurance companies in the world.

CONCLUSION

In the most recent edition of his casebook, Robert Hamilton suggests that, "models of the public corporation are neither right nor wrong. They should guide policy decisions only to the extent they are accurate or descriptive."[178] TPM's view of the public corporation in which the board must mediate among various constituents who are in fact all residual claimants, provides a good description of what corporate law allows and of the direction in which many large public corporations seem to be moving as boards become more independent and active. If the independent boards of public corporations consciously adopt this model of corporate governance, the instrumental loyalty and calculative trust of corporate constituents may begin to merge with non-instrumental, internalized norms of trusting and behaving in a trustworthy fashion. This behavior could foster greater cooperation and could help to check some of the harmful opportunism by powerful insiders that the current contracting and monitoring regime cannot prevent.[179] A recent, comprehensive survey of developments in

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importance of this case to me.

[178] ROBERT W. HAMILTON, CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 29 (7th ed. 2001).

[179] Blair & Stout, Trust, *supra* note 55, at 1780.

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corporate governance concluded that the contractarian model could not cure the problem of abuse of corporate constituents and that the "deepest challenge . . . is to find a way to enact communitarian sentiments in a contractarian world."[180] The TPM may contain the seeds of the solution to this great problem of corporate law.

[180] Bradley et al., *supra* note 1, at 86.

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