Preliminary Draft - Not For Publication 3/05

Markets and Democracy: The Illegitimacy of Corporate Law

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Corporate law does not conform to ordinary democratic norms: unlike human citizens, corporations may decide which law will govern their most fundamental acts of self-governance. The corporate law corporation choose in turn influences the corporate goals and decision-making processes that determine what the corporation looks for in corporate law in a reflexive system independent of ordinary political processes. This system seems on its face to violate the most fundamental principle of popular sovereignty–all non-Delaware citizens of the United States are excluded from even formal participation in the process of determining American corporate law, and even Delaware citizens are reduced to a largely formalistic ratification role of results coerced, to a large extent, by the market for corporate control and the internal norms of a self-replicating system of law that has escaped from political control.

Corporate law scholars have devoted many pages to debating whether the surrender of corporate law to a market for corporate reincorporation generates substantively good or bad results, but there has been virtually no discussion of whether this process can be squared with the American commitment to self-governance. This Article aims to address that latter issue–with its obvious implications for other areas in which we, consciously or unconsciously, decide to subordinate politics to markets or vice versa.

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Introduction

Corporate law defies basic democratic principles. While democratic theory insists that the governed should choose their governors, and even more importantly, their system of government, the American system of corporate law removes most important questions of corporate law from the political process. Citizens, acting through the political process as presently constituted, have effectively no say in constituting corporate law. The law and the corporations formed under it are instead products of a market that by historical accident has freed itself from political control.

Our corporate law is chosen by the very corporate managers who ought to be controlled by it, and created by lawyers, legislatures and judges unanswerable to the people whose lives are affected by it. Large corporations and Delaware determine the nation's corporate law, and the rest of us are not even "virtually represented." Under the Delaware system, corporate managers are entrusted with stewardship of enormous concentrations of wealth and power–in many instances both larger and more important in our daily lives than most governmental units–with little supervision or answerability to the political process. These autonomous power concentrations, in turn, are granted the strikingly unusual right to choose the law that governs them, thus guaranteeing that corporate law will continue to respect their independence from the will of the people. In short, we have created institutions of major importance and power and then set them on their way to do good or ill with little control or influence by the citizens whom, ultimately, they should serve.

Moreover, the primary legal guidance we do give the directors and managers of these autonomous entities is to direct them to act as honest agents and professionals. That is, ordinary principles of fiduciary duty and agency law require them to set aside their own values, interests and political views in favor of those of their client, the corporation itself (or sometimes its shareholders, taken as a legal fiction consisting solely of a desire to maximize the value of a particular company's common stock without regard for any competing economic or non-economic value).

Conventionally, this professionalism is viewed as the answer to the democratic republican critique of corporate law. So long as managers and directors are constrained to this professional role, the argument goes, we need not fear the enormous aggregations of power in their hands. As a result, much of corporate law centers on the so-called agency cost problem: how to keep managers working for the firm rather than merely themselves.

But even were managers to act in complete good faith according to the role norms of fiduciary responsibility, the republican problem would not be solved. Even role bound managers are not statesmen balancing the multifarious and conflicting interests of a diverse population in pursuit of an elusive public good. Indeed, they are not even agents representing human citizens. Rather, their client is a legal fiction, an abstraction deemed by the law (and the sociological structures in which managers are enmeshed) to have only one interest and one goal. Rather than balancing, managers acting in good faith simply ignore all but one of the goals and interests of the human citizens involved in the corporation.

Moreover, were the republican problem solved, the democratic one would remain. No one elected these non-philosophers king. The value conflicts they mediate–by ignoring them–are central political issues in any democratic society. Wealth maximization inevitably conflicts with other environmental, aesthetic, cultural or economic goal, or freedom, liberty, equality or justice. What to do when those values conflict ought to be the subject of political debate, not "expert" dictat, let alone concealed and decided always in favor of maximizing returns to shares.

In short, the current Delaware corporate law system creates institutions governed by managers and directors who are commanded to set aside all values but profit–and then to pursue law that maintains this peculiar institution without popular review.

The paper proceeds as follows:

Part I motivates the study, especially for readers inclined to accept the conventional wisdom that corporate law is empty and apolitical. Contrary to the mythology, I first contend, corporate law is centrally important in a republican democracy. Public corporations are vehicles by which we make difficult value choices in a value laden world. But under our current law, they make those choices independent of the values of the citizens who are affected by their decisions. Second, the common rhetorical strategies used to present corporations as powerless and passive–the metaphors of contract, property, agency, fictionality and individuality–cannot do the work demanded of them. Through the "mists of metaphor" a harsher reality peeks.[1] Corporations are power centers, loci of value struggles, political fora. They are not citizens but governance structures and not neutral but deeply influential–if illegitimate–participants in our political struggles.

The market-like evolutionary method of law creation of the race to the top/bottom is quite different from democracy, even in its debased interest-group competition form. One result is that Delaware corporate law commands the consent of the governed corporations (but not of the people who compose them) in a strong sense unattainable in ordinary democratic regimes governing human beings. This system, then, is not a democracy but a corporation-ocracy: we have given our corporations a strong citizenship denied to mere humans.

The free bargaining aspects of our current system of corporate law creation necessarily mean that the most powerful get the law they want. Indeed, the great race to the top/race to the bottom controversy can best be understood as a debate over whether managers or shareholders are more empowered by the economic and legal landscape and

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[1]Berkey v. Third Ave. Ry., 155 N.E. 58, 61 (1926) (describing veil piercing doctrine as "enveloped in the mists of metaphor").

thus more able to form corporate law in their own interest. In my view, the relative power of shareholders and managers is highly contingent (and greatly influenced by current corporate law). As a result, our current system does not head towards a single inevitable equilibrium, but rather has the potential for radical shifts. Thus, the dramatic shift in the allocation of corporate proceeds that characterized the 1980s (empowering shareholders) and then, differently, the late 1990s (empowering managers above all) were neither anomalies nor proof of the progressive nature of corporate law: the structured competition of corporate law creation cannot yield a determinate outcome.

Part II takes the next step. Were corporations citizens, the American corporate law system arguably would avoid some of the most troubling theoretical problems of democratic process, particularly the majoritarian difficulty and the social choice paradoxes. Similarly, it would avoid many of the potential practical problems of democratic action in a world of limited attention and limited citizen interest. Corporate law derives much of its ideological power and persuasiveness, it seems to me, from this picture: the entity, aggregate and property views of the corporation each suggest that corporations can be seen, metaphorically, as citizens. If they were citizens, our corporate law would not merely be democratically acceptable but extraordinarily successful. Corporate law would be our closest approximation to the liberal democratic ideal of a non-coercive state.

But the claim that corporations are citizens is false. Once corporations are understood as power sources, a part of our governance system rather than an object of it, then the market for law appears radically illegitimate, an example of the powerful seizing the power of the state to increase their own power. Rather than seeing corporations as Tocquevillian intermediate institutions restraining the state, we should see them as state-like themselves, part of the classic liberal nightmare of a state acting in its own interest not that of its citizens.

The contract view of the corporation and the micro-economic theory of the black box assert that the firm is simply a private transaction or set of transactions in the market, to which only restitutive, non-distributive, justice issues apply. For much the same reasons that have led us to reject laissez-faire generally, the claim that the market for corporate law is fair or non-coercive must fail.

Part III completes the picture by arguing that corporate law affects all of us, not just the corporations who are its alleged subjects. In the perfectly competitive equilibrium market of economic theory, all proceeds of corporate activity are imagined to go to consumers, with shareholders, employees and managers understood to be mere factors of production paid their marginal cost. But life is lived at disequilibrium. In disequilibrium markets, successful corporations should generate a surplus above those costs (even assuming that the relevant markets are competitive enough to make the concept of "cost" determinate). In ordinary language, corporations seek to produce a profit and sometimes do. The resulting producer's surplus is a pure rent, available for appropriation by any corporate participant without efficiency implications.

Corporate law, however, favors one side in the struggle over the surplus created by corporate (collective) activity. It holds that employees, suppliers, customers, bondholders and neighbors are all outsiders, with whom the corporation bargains at arms length. Following the "morals of the marketplace," it should therefore treat them as inputs to be exploited to whatever extent possible. For the corporation to voluntarily act in the interest of these factors of production solely because it cares about them would be an egregious breach of legally imposed duty. Corporate law, in turn, determines that certain other corporate participants–in the ordinary course, just shareholders–are the objects of a fiduciary duty; when the corporation acts in their interests it is acting in its own interests by legal definition.

The distinction between insiders and outsiders is central, deeply political and legal rather than economic. It is not an artifact of the market but rather defines the structure within which the market will function. In the imperfect markets of reality, that issue is centrally important. A corporation that is directed to maximize shareholder returns will systematically act differently than one that is directed to minimize customer costs, to maximize quality or job satisfaction, or to consider all these goals and to balance them in some political, legal or professional process. The argument that corporations are perfectly private fails, then, because it is the law—a law with no democratic credentials—that determines for whom and for what ends corporations act.

The decision about who is a member of a firm is thus an intensely political one, likely to affect almost every aspect of our collective life. The market generates an answer, or competing answers, under particular conditions. But those answers reflect market power–not justice, efficiency or even political victory. Moreover, the market-based system hinders the political debate that could properly balance the values of economic growth against its costs: increased relative inequality, mobility and change, and most importantly, the devaluing of human effort that comes from being understood as a means rather than an end.

I. The Illegitimate Origins Of Corporate Law

A. What Is At Stake

Corporate law matters. Corporate law structures the ways in which corporations make decisions, respond to the pressures or constraints of markets, constituents and other laws, allocate their surplus and balance conflicting moral or political demands.

Current corporate law directs corporate managers–the proximate decision-makers–to set aside all values other than share value maximization. More importantly, it directs those managers to view all participants in the corporation, with the sole exception of shareholders, as outsiders to be bargained with at arms-length or tools to be exploited (within the limits of the law) rather than, for example, fellow adventurers or partners in a common enterprise. In a kind of anti-Kantianism, people are always means, never ends in themselves, always exploited as if we had no value of our own. Managers following these rules will view their fellow citizens, both inside and outside the firm, much as oldfashioned imperialists viewed the colonized natives of a foreign territory. We, self-colonized, are merely tools to a greater end: an ever-rising stock market.

Corporate law structures the incentives of managers in a way largely consistent with this narrow understanding of their role, with one large exception: managers have both incentives and ability to betray their obligations to shareholders in the cause of pure self-interest. Our corporate law, then, creates an apparent dichotomy. On the one hand, managers stand as fiduciaries and professionals, who work selflessly for their masters, the shares (as good colonial officials exploited the natives incorruptibly for the benefit of their masters in the imperial center). On the other hand stand managers as self-interested kleptocrats, appropriating what is not theirs for their own self aggrandizement.[2]

Under current corporate law models, corporate law debates are largely about the extent to which corporate managers are constrained to place share value maximization above manager wealth maximization. Almost no one argues that the latter is a legitimate goal; the debate is rather whether it is a useful means to the primary, share centered, goal, or an unfortunate side effect of market and regulatory failure.

But the dichotomy of current corporate law is deceptive. Public corporations are more than their shares and their managers: they are also our jobs (and thus, for most of us, a primary focus of our creative and social lives), the architects of our cities, the sources of our salaries, medical benefits and pensions, our neighbors, the manufacturers of our consumer goods and the suppliers of our services. These values are not fully captured by the interests of either the shares or managers.

Corporations could be run with an eye to many values that drop out of our current system or appear only as external constraints. Thus, one could imagine a corporate law that directed corporate managers to maximize job creation or wages, or work-place creativity or autonomy, or product quality, or civic responsibility, or environmental quality, or family quality time or enhancement of republican self-definition, or encouraged consideration of the myriad ways in which those disparate goals conflict or support one another. In such a firm, share value might be a constraint rather than a goal, much as employee wages are a constraint on the share value maximizing firm: Shares would be allocated only so much of the firm's assets as is necessary to attract the minimum necessary amount of capital.

[2]Edmund Burke's denunciations of the East India Company, then, stand as early epitomes of the corporate form and its discontents. Edmund Burke (attributed), *Ninth Report of Select Committee, 25 June 1783*, reprinted in 5 WRITINGS AND SPEECHES OF EDMUND BURKE (P.J. Marshall, ed. 1981) 235-6, 242, 250,295 and generally (denouncing profits of Company employees made at expense of India and the company alike). Burke denounces the Company's system as leading to the destruction of India's economy without any gain to the Company (although its employees made great and famous fortunes), beginning from the fundamental premise that a project based on immorality is unlikely to generate great ethics in its participants: "For so longa s a System prevails, which regards the Transmission of great Wealth to this Country, either for the Company or the State, as its principal End, so long will it be impossible that those who are the Instruments of that Scheme, should not be actuated by the same Spirit for their own private Purposes. ... It is not reasonably to be expected, that a Public, rapacious and improvident, should be served by any of its Subordinates with Disinterestedness or Foresight." (Id. at 222).

A world in which corporate managers were directed to consider corporate participants as partners and their diverse goals as goals of the firm would look quite different from our own. Under current corporate law, it is always proper for corporations to cut "costs" at the expense of society as a whole, for example by failing to use the best available environmental protection technology, or at the expense of corporate participants specifically, for example by refusing to honor (legally non-binding) promises of long-term employment on good behavior or generous pension or medical benefits. Corporate law debate, instead, concerns the difficult issue of whether managers are *obliged* to cause their corporations to free ride in this manner whenever it is share value maximizing to do so, and whether (as a matter of corporate law) they may free ride even when according to non-corporate law norms they should not. At the limit, current corporate law norms suggest that corporations assess all law according to the share value maximization principle: They should violate even the criminal law if it is share-value maximizing to do so.[3]

Were corporate law different, corporate managers would make different decisions. If they were told they should consider other values, they would do so more often. If they were told to treat employees (or customers, pensioners, local governments, creditors or the biosphere) as partners rather than opponents, they would do so more often. To be sure, in order to manage a firm effectively, managers often must at least pretend to treat employees as members of the team. Generally, there is no other way to induce employees to work hard and effectively. However, current law reminds managers that such pretenses are only instrumental. Ultimately, managers are required to exploit employees (including themselves), not work for them.[4]

Similarly, asbestos and cigarette companies, nuclear power plant builders, forex and energy traders, accounting firms and the like are directed by current corporate law to ignore the possibility of truly massive liability: If the worst happens, the corporation's shares will not bear the bulk of the costs.[5] Even if something less than the worst happens, torts liability "counts" only to the extent that the courts translate collective disapproval into monetized damage awards–and that is not how courts work.[6] If corporations were

[3]*Compare* Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155, 1168 n. 36, 1177 n.57, (1982) ("(M)anagers not only may but also should violate the rules when it is profitable to do so."); EASTERBROOK & FISCHEL,THE ECONOMIC STRUCTURE OF CORPORATE LAW, 37-38 (similar) *with* Miller v. American Telephone & Telegraph, 507 F.2d 759 (1974) (holding that illegal acts, even though committed to benefit the corporation understood as its future share value, may amount to a breach of fiduciary duty). For further discussion of this issue, see Kent Greenfield, *Ultra Vires Lives*, 87 VA. L. REV. 1279, 1291-5 (2001) (criticizing contractarian view of corporation on ground that it requires managers to violate the law when it is profitable to do so).

[4]See, Daniel JH Greenwood, *Enronitis: Why Good Firms Go Bad*, 2004 COLUM. BUS. L. REV. 773, http://www.law.utah.edu/greenwood/html/Enronitis.htm.

[5]Interestingly, in Europe, where EC directives are less subject to a race to the top/bottom, corporate law includes mandatory protections for employees, creditors and even shareholders absent from U.S. state law or appearing only in the Federal securities regime (which is also less subject to the race). See, e.g., William Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEG. STUD. 303, 320-5 (1997).

[6]In torts as elsewhere in the law, courts generally treat verdicts as punitive–as expressing extreme outrage in an attempt to judge, reinforce or change the moral calculus made by a human actor. But corporations are not human actors, and to the

not invited to externalize costs through liberal limited liability rules, managers would do so less often.

Corporate law, then, affects how corporate managers make a series of difficult value choices, directing them to consider some values–principally share value maximization–and ignore others, or treat them only as means to the accredited end. Different ends would lead to different corporations. Accordingly, corporate law matters. And like other controversial issues that matter, it ought to be the subject of significant political debate. In fact, however, we see little political debate about corporate law.

To some degree, the silence surrounding corporate law results from an illusion of triviality. Corporate law often appears to be less important than it is as a result of over-simplified modeling. Corporate law discussion often take place against a background assumption of efficient, equilibrium markets. Clearly, were our markets perfect, little would be at stake in the wider debate I propose.

In a friction-free market at full equilibrium, all corporate participants, including shares and managers, would be paid only their marginal product, which would be equal to their marginal cost. In such a market, corporations would make no economic profit and would be fully constrained in all their actions: were they, for example, to pay shares more than other companies, they would have higher capital costs, resulting in higher production costs, causing failure in the product market. For familiar Coasian reasons, the law would be largely irrelevant, since parties that were allocated legal burdens would bargain to shift them to the most efficient cost bearers.

But in the real world, markets are never fully at equilibrium. Successful corporations do have surpluses to distribute, and our current corporate law culture (if not the law itself) directs that those surpluses be given to shares, even while inviting top managers to take some for themselves.[7] The predictable result is that top managers have become quite wealthy and shares have rapidly increased in value, while little of the economic growth of the last several decades has reached less powerful corporate participants. Moreover, contrary to the simplistic model of a fully effective market, many corporate participants have no ability to bargain to reallocate the law's burdens–most obviously, retirees and tort victims are just stuck with whatever corporate law allows them to claim against.

Similarly, corporate law is sometimes discussed as if all managers ignore their fiduciary duties. Current law gives managers plenty of room to cheat (that is, to place their own private interests above the ones that, as professionals, they are directed to consider). Given this weak law, if managers respected their duties only when forced to do so, the details of fiduciary duties as expounded by the law would not be very important.

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extent that they follow the profit motive, they are shameless. All that counts is the bottom line. Regulators used to human interactions will predictably and consistently under-regulate actors following an a-moral, maximizing mode of behavior.

[7]See, e.g., *Enronitis*, supra n. (discussing ideological mechanisms leading managers and boards to ever higher CEO pay).

But the model of managers as constant cheats is deeply implausible. If all managers were perfect cheats, the economy would collapse. Under current law, investors buy shares with only weak protections against self-interested managers. They must be assuming that the moral imperative–the law's (often unenforceable) demand that managers set aside their own interests to work for that of the shares–will be enough to cause managers to work for the shares. The necessary implication is that moral imperatives matter. If we told managers to do something else, they would–not in all instances, but in enough to matter.

The issues raised by corporate law are quintessentially political issues. We as a society value wealth maximization, but we also value how that wealth is distributed, quality of work, number of jobs, family time, environmental quality, safe products and perhaps even urban architecture. These values necessarily conflict in a disequilibrium market: the more of the corporate surplus that is given to shares, the less that is available for other corporate claimants. If corporations are told that it is "cost cutting" to find ways to renege on pension promises, but not "profit maximizing" to reduce dividends, it is predictable that they will do more of the former and less of the latter. (This is why the accounting treatment of stock option grants to top managers matters: If decision-makers are directed to view options as a "cost," they will give out fewer of them than if they are told they may see them as a pure free will offering costing their fiduciaries nothing). Because our values and interests conflict, and we will disagree on how to mediate those disagreements, choices must be made. And the choices are the classic choices of democratic politics.

Political decisions, however, should be debated in political fora. Possibly such a debate would ratify the status quo. We might conclude that directing managers to consider one goal and one goal alone of all the possible worthy aims in the world so simplifies their task and the tasks of those who must supervise them that it is worthwhile to pay the cost of ignoring other important needs and desires. But the political debate might go a different direction. We might conclude, for example, that we'd rather have our most important economic actors putting environmental considerations front and center, rather than treating them as constraints on profit maximization. We might conclude that at some point increased financial wealth is less important than quality of life issues, and we'd like the central decision-makers concerned with those issues on a day to day basis to consider quality of life directly rather than only as it impacts profits. Most importantly, we might conclude that at some point total wealth is less important than preserving the rough equality that is necessary for republican government: that the American social contract means that we should be willing to have major employers sacrifice some growth in return for job stability or job increases or more egalitarian wages.

None of these value conflicts are easy issues and in this Article I do not pretend to offer any account of how the political debate about them would or should proceed.[8] The point of this Article is more basic: We have created a process for creating corporate law that cuts off the debate about the goals and purposes of corporate law. The race to the bottom/top, driven by the anomalous right of corporations (meaning corporate managers) to choose their own law, eliminates the forum in which we, as citizens rather than as shareholders, ought to be arguing about when share values ought to be sacrificed for other republican, democratic, or simply civic values. We need a political debate and a democratic process for making a decision as self-governing citizens, not victims and perpetrators of self-colonization.

B. The Metaphors of Corporate Law

Commentators have attempted to legitimize this anomalous system by three related models: first, a contractual model, second, a property model and third an entity theory that confuses the corporation with individual citizens. All three models portray corporations in ways that make them appear private–more like citizens than government–and powerless.

1. Contract and market metaphors

The contractual model contends that corporations are private entities of concern mainly to those who contract with them. As Easterbrook and Fischel put it, "[b]ecause the choices do not impose costs on strangers to the contracts, what is optimal for the firms and investors is optimal for society."[9] Since corporations (on this model) appear purely voluntary, the appropriate role of the state is merely to enforce private agreements. In the most consistent form of the contractual model, the corporation tends to lose its corporeality: It is described as a mere nexus of contracts and dissolves into a moment in the market.[10]

The model of corporate law as contract is misleading on several levels. Perhaps most fundamentally, it trades on a simplistic and ideologically driven portrait of contract. In the corporate law model, contracts are fully negotiated free bargains between equals. But in the real world, bargains are rarely between equals, voluntariness is always a matter of degree, most terms are assumed or presumed rather than negotiated, and many agreements do "impose costs on strangers." For this reason, contract law in general is highly interventionist, and the contracts of most interest to ordinary citizens are highly

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[8]For some preliminary thoughts on the substance of the debate, see Daniel JH Greenwood, *Beyond the Counter-Majoritarian Difficulty*, 53 RUTGERS L. REV. 781 (2001) <http://www.law.utah.edu/greenwood/html/Rutgers.htm> (beginning to explain the theory of democracy as partnership), *Enronitis*, supra n. (discussing the contradictory requirements of corporate law and how to reform them).

[9]FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 6 (1991).

[10]See, e.g., Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985) and Bill Bratton's duo: William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471 (1989) and William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989). See also, Bratton's *The Economic Structure of the Post-contractual Corporation,* 87 NW. U. L.REV. 180 (1992) (reviewing Easterbrook & Fischel).

mediated by substantive law. Consumer, loan, insurance and employment contracts are read (to the extent that they are written at all) in light of strong substantive policies developed by both legislatures and courts.[11]

In contrast, corporate law is not interventionist at all. The process by which corporate law is made, especially the right of corporations to choose their own law, means that states do not impose substantive values in corporation law "contracts" to protect weaker contracting parties, let alone the many non-contracting parties deeply affected by corporate law's background rules. Were a state to try to introduce such values into corporate law, the stronger bargaining party would simply cause the corporation to use a different state's law.[12]

Theorists of the contractual model have largely conceded that state corporate law cannot impose protection on parties to the corporate contract. Instead, they have argued that the market participants will insist on law that adequately protects them. The contractual model, then, is not so much a claim that corporate law is like contract law—it clearly is not. Rather, it is a claim that the economic markets in which corporations participate will generate the appropriate legal regulation or guidance by their own processes. Market results, however, are always heavily mediated by market regulation; here, paradoxically, the claim is that the regulated market will generate its own proper regulation.

This market/contract model's claim to solve the democratic problem is false. Democracies have long known that markets can be tools for good or ill. That is why we attempt to suppress markets in, for example, protection rackets or cocaine. And markets generally fail to account for important values that are not reflected in price. That is why we have environmental regulations, child labor laws, tort law and criminal law. Markets also tend to contain incentives to self-destruction. That is why successful markets are surrounded by effective disclosure requirements, bars on fraud, and bans on monopoly. To allow a market–or a firm recharacterized as a market–to set its own rules is unlikely to reach results satisfactory to a self-governing people.[13] Or so we have presumed since the demise of Lochner.

2. Property metaphors

The second model uses the metaphor of property: A corporation is conceptualized as an asset–a thing–owned by an individual (or a group of individuals, a difference not seen as meaningful). As a subset of property law, corporation law is seen,

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[11]See, GRANT GILMORE, DEATH OF CONTRACT (1974).

[12]For further discussion of the mechanisms of the race to the top/bottom, see Daniel JH Greenwood, *The Mysterious Race to the Top/Bottom*, 2005 YALE L. & POL. REV., http://www.law.utah.edu/greenwood/html/Mysterious.htm.

[13]For further discussion, see generally, Daniel JH Greenwood, *Fictional Shareholders: 'For Whom is the Corporation Managed,' Revisited*, 69 S. CALIF. L. REV. 1021 (1996), http://www.law.utah.edu/greenwood/hmtl/FictionalShareholders.htm; Daniel JH Greenwood, *Essential Speech: Why Corporate Speech Is Not Free,* 83 IOWA L. REV. 995 (1998), http://www.law.utah.edu/greenwood/html/EssentialSpeech.htm.

then, as largely about agency issues: corporations are property managed by agents and the central issue is only whether the agents are acting in the interests of their principals.

This agency/property concept of the private corporation conflicts with the contractual/market model–agents are fiduciaries, governed by different norms than the ethics of the contractual marketplace[14]– but it shares with it the underlying claim that corporate law does not affect the rest of us. By portraying corporations as property, it suggests that protecting corporations is protecting the property-owners, and thus a system of law that allows corporations to choose precisely the protection they want is not problematic (or is problematic only to the extent that corporate agents use corporate law to lessen their obligations toward the "owners").

The property/agency model fails, however, to answer the democratic claim for two reasons. First, the "property" in question is fundamentally a set of social relations among people, many of whom are not parties to the alleged agent/principal relationship. Second, the metaphor conflicts with the law. Shareholders own shares, not the corporation. The shareholders, viewed alternately as principals or property owners, lack most of the rights ordinarily associated with either. As a consequence, the corporate agents lack a principal and the corporate property lacks an owner, so that protecting the corporation does not protect the humans associated with it, even those this theory characterizes as "owners."[15]

3. Individual person metaphors

Third, corporations are often conceptualized as individuals. In one variant, the firm is ignored altogether, reduced to the individuals thought to make it up (usually the shareholders, rather than the people who actually act for it), and it is assumed, without evidence, that the individuals and the entity are the same, or at least share interests. In the other variant, the firm itself is seen as an individual, as if it itself were a citizen to be protected from government and entitled to participate in the governing process, rather than a tool of the citizenry not dissimilar from the government itself. These two models–the aggregate and entity theories of corporate personality–are seen as radically opposed in the academic literature, and for some purposes they are. But in their most common forms, each sees the firm as an "intermediate institution" that must be protected to protect citizens and civil society from the state.[16]

On the aggregate view, protecting the corporation is seen as no more than shorthand for protecting the individual citizens (or shareholders) whom it "really" is. But this theory of corporate personality should be strikingly unpersuasive in a liberal democracy: just as liberal theory attacks the notion that the state can be identified with

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[14]Meinhard v. Salmon, 249 N.Y. 458 (1928); see discussion in *Enronitis*, supra n. ; *Mysterious Race*, supra n. (at Aktie Fn).

[15]For a fuller explication of this claim, see generally, *Fictional Shareholders*, supra n. .

[16]See, ALEXIS DE TOQUEVILLE, DEMOCRACY IN AMERICA, Bk 2, Ch VII (discussing importance to democratic regimes of intermediate institutions and civil society).

the citizens who make it up, so too it should question the naive idea that the corporation and its "citizens" can be conflated.[17]

In contrast, the entity model treats the firm itself as a citizen. Thus, it harks back to the pre-democratic view of the state as composed of estates or corporations each entitled to rights independent of (and often in opposition to) rights of the individuals who compose them. Like a medieval church or university, modern corporations maintain internal disciplinary and justice systems that are largely unreviewed by and independent of the state system. Paradoxically, then, this private model of the corporation claims to justify granting the corporation state-like powers.

The corporation as a state-within-the-state, however, can not be justified under any democratic theory, because this state-like entity defies all democratic norms internally. No corporation operates by the principle of one person, one vote. All economically significant corporations disenfranchise a substantial portion of the affected populace, while even shareholders vote according to the number of shares they hold. Moreover, standard corporate law sharply limits the control that even the "voters" have over "their" entity. The law bars them, in the absence of unanimous consent, from making fundamental value choices, such as for example, from balancing the pursuit of profit against other potential corporate goals (such as quality products, interests of non-shareholder participants or even the actual financial interests of the real human beings who own the shares). Moreover, it even bars them from electing directors pledged to particular interests: Directors, unlike ordinary politicians, are bound by law to pursue the interests of all (and only) shares, and courts will enforce this duty (subject to the often significant limitations of the business judgment rule) at the behest of any shareholder regardless of election results.[18] Theorists, therefore, usually resort to market-based explanations of why the corporation is unable to exert any power over its shareholders, employees and other participants.

The entity model must fail for the same reason as the aggregate model: Corporations are tools of human beings, not values in themselves. They are, that is, state-like rather than citizen-like. And their lack of internal democracy means that they have only weak claims to be alternative representative institutions in a federal or pluralistic system.

4. The metaphors of powerlessness

[17]For exploration of the likelihood of extreme differences between the actions of corporations and the desires of their participants, see generally, *Fictional Shareholders*, supra n. .

[18]See *Fictional Shareholders*, supra n. . Compare, John J. Brennan & Edward C. Johnson 3d, *No Disclosure: The Feeling Is Mutual*, 1/14/2003 WALL ST. J. A14 (Chairman and CEO of Fidelity and Vanguard mutual fund groups argue that institutional shareholders should be allowed to vote in shareholder elections without disclosing their votes to their own shareholders, so as to preserve their ability to exclude all considerations other than "the financial interests of our clients" (apparently understanding their clients as having no financial or non-financial interests other than their shareholdings in the mutual funds)); compare Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del 1985) (barring directors from considering interests of bondholders in approving sale of company, even where bondholders and shareholders were largely the same people).

Each of these metaphors takes much of its power from an underlying economic theory combining elements of all of them. In standard micro-economic theory, corporations are sometimes viewed as mere black boxes subject to consumer sovereignty through the product market, and therefore not power loci at all. If a corporation has no choice but to follow the market, the argument runs, then its internal organization is of no importance; corporate economic actors will behave the same as individual ones. In a reasonably competitive market, only the lowest cost producers will survive.[19] Accordingly, corporations will be compelled (if only the state will allow them) to adopt the lowest cost organizational form (including the lowest-cost corporate law).

The "genius" of the American system, then, is that the corporation's right to choose its state of incorporation creates a market for laws: an interstate competition which, in turn, precludes meddlesome reformers from imposing unnecessary costs on corporate organizational form.[20] In this model, then, the corporation is seen as a purely economic actor, important mainly as a producer of consumer goods, and properly subject to purely economic forces. The necessary conclusion is - that corporate law is best which governs least. Corporate law should simply allow the market free rein (or should it be reign?). Our competitive federalism does just that. To the extent that this model holds, corporate law is largely irrelevant and uninteresting. The only socially important regulation of corporate law will be by the product market itself; the only socially important law will be regulation of the underlying product market, not of corporations.[21] The argument is, in short, that political democracy is unnecessary because market control is sufficient.

But to state the argument in this way is to point to its implausibility: We have long since rejected the notion that unregulated markets can even exist, let alone that they

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[19]As Doug Kysar has recently pointed out, consumer markets are often legally structured so as to limit consumers' ability to influence the processes by which products are made, as opposed to the final product itself. Douglas Kysar, *Preferences for Processes: The Process/Product Distinction and the Regulation of Consumer Choice*, 118 Harv. L. Rev. 525 (2004). Just as first generation civil rights law attempts to force markets to ignore the status relations of market participants–to make Black money or work indifferentiable from White money or work–so too trade and other disclosure regulations make it difficult or impossible for consumers to distinguish between products produced with or without pollution, sound employee relations, appropriate respect for the spirit of the law and obligations of citizenship, Frankenscience, or other controversial processes. As in the standard models of introductory economics, the corporation is a black box, the internal workings of which remain inviolate. But as second generation civil rights activists routinely point out, this invisibility–useful as it is in attacking pre-modern status hierarchies–also conceals other important power relations. Minority groups usually want their differences respected, not merely rendered invisible. See, e.g., Daniel J.H. Greenwood, *Gendered Workers/Market Equality*, 12 TEX. J. WOMEN & L. 323 (2003); Karen Engle, *The Persistence of Neutrality: the Failure of the Religious Accommodation Provision to Redeem Title VII*, 76 TEX. L. REV. 317 (1996). Consumers, similarly, might care whether their food is produced with child labor, GMOs, pesticides or bovine growth hormones even if no residues show up in the final product–but courts commonly view such interests as illegitimate. See, e.g., International Dairy Foods Ass'n v. Amestoy, 92 F.3d 67 (1996); Daniel JH Greenwood, *First Amendment Imperialism (a response to Michael Walzer's Leary Lecture)*, 1999 UTAH L.REV. 659 (1999); Kysar, supra..

[20]See ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993); Bernard Black, Is *Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542 (1990).

[21]Taken seriously, this model would require that corporations be barred from influencing the substantive regulation of the product market. See, *Essential Speech*, supra n. .

inevitably lead to the best of all possible worlds (or even to a better world than a market limited and guided by politically plausible regulation). More fundamentally, the line between market and democracy is, in a democracy, one for democratic politics to determine, and so the "genius" of a system that lets the market decide when politics should apply is anti-republican and anti-democratic.

Each of these metaphors tends to distract attention from the basic democratic issue: corporations, which are not citizens, choose their own law. In a democracy, however, citizens must govern themselves and that includes controlling their social and economic creations. Americans have abdicated that self-governing function to a self-replicating legal structure that, following its own legally mandated norms, chooses the law that regulates it. This is neither democracy nor consumer sovereignty but a golem: a creature we created to be our servant that we are, instead, allowing to govern us.[22]

C. The Value of Democracy

Democracy is not, however, the only value in our politics. There might be good reasons for voters to choose to disenfranchise themselves, choosing the evolutionary model of corporate law over the deliberative-voting model of standard democratic law. For example, sometimes goals are best arrived at indirectly: Perhaps there is reason to believe that the non-democratic process of corporate law will produce results that would be more likely to be approved by a democratic process than a direct democratic process will. Or perhaps the non-democratic process is fairer for some reason than a democratic one. Or perhaps it is more likely to fulfill some other goal–such as wealth creation–to such a degree that a democratic decision would decide to restrict democracy. The peculiar anti-democratic status of corporate law, however, requires a special justification.

In the next sections I consider possible democratic arguments for this anti-democratic system. The conclusion, however, is that when we proceed beyond the rhetoric of private right, none of the available public defenses suffice.

II. The Political Critique

Were corporations citizens–the subjects and objects of a political system–our system of free choice of law for corporations would be an extraordinarily attractive solution to long standing problems in democratic theory. Corporations, and firms more generally, choose their own law quite free of external pressures and thus under conditions of freedom and non-coercion rarely found among democratic communities. Thus, taking corporations as entitled to the freedom and respect of citizens, corporate law could be described as the ultimate liberal solution to the problem of governmental coercion. But corporations are not citizens, and there is no reason in democratic theory, and little reason in any other context, why they should be treated as if they were. Firms are human tools

[22] For a fuller discussion of the significance of market and voting in democratic governance, see *Beyond the Counter-Majoritarian Difficulty*, supra n. .

created for human purposes; they ought to be created, regulated or given rights only to the extent that they serve those human purposes.[23]

Our publicly traded corporations are a major locus of power in society today. Measured by the wealth they control, the major firms are far larger than most governmental units. Measured by the degree to which they affect our lives, corporate decisions designing and delivering cars, clothes, word processors, telephone service or electricity have at least as much impact as do most local governmental activities. In terms of coercion, it is easier to escape local governmental taxation than to avoid paying fees to corporations such as Microsoft, cable companies or major food processors; hospital bills are more likely to threaten our way of life than governmental traffic tickets.

Those who work for major corporations are subject to a degree of potential violation of privacy that no governmental unit could contemplate: employers are permitted to monitor e-mail and phone conversations routinely, employees have no expectation of privacy with respect to their employers in their desks or medical records. For many people, losing a job or pension would be more traumatic than any encounter they are likely to have with the government. Corporate legal decisions–for example, to change seniority rules or reorganize production, switch types of pension plan, deny customers the right to share the software or music they have purchased or to commandeer portions of their hard drives for corporate purposes–can be profoundly determinative of important aspects of our lives. Even on the simplest measure, the ability to wield physical force, corporations are as powerful as other governmental units: private security forces employ more people than public police departments.

Traditional liberal theory teaches that we ought to be suspicious of government even in a democracy. Just because the government is responsive to the majority doesn't mean (simple readings of Rousseau notwithstanding) that it will consistently act in our individual or even collective interests.[24] American law treats corporations as if they were private bulwarks of power protecting us from the government: Thus, the Supreme Court has granted corporations constitutional rights to due process, free speech and so on, but refused to give us constitutional rights against them.[25] Popular culture has not always

[23]Although this article argues that corporations are not citizens and should not be treated as if they were, the point is not entirely non-controversial. See e.g., Kevin Groves, *No Vote For Corporations in B.C.*, 52 THE MUSE, 3/22/02 (describing attempt to allow corporations to vote in municipal elections); *Good corporate citizens or devil*, STARTUP May 2002 (quoting Jack Peake, Mayor of Lake Cowichan, BC, in connection with his proposal to grant corporations the vote, "It seemed to be reaction by people who see devils in corporations and don't want them to have a person's rights"). [note to editors: these two articles are on the internet; if you can't find them, you could substitute Aurora Inst. *Corporations could get the right to vote in B.C.*, Canada Newswire 3/7/02 (available on Lexis/Nexis), which is less colorful but describes the attempt].

[24]See, e.g., JOHN JACQUES ROUSSEAU, THE SOCIAL CONTRACT, chs 3, 6 (Everyman Edition at 27, 37) (describing circumstances under which the will of all might become the general will). Rousseau often seems quite pessimistic regarding the possibility of this near miraculous occurrence, which, he believes, is the essential foundation of freedom. Few nations will be free, and not often for long. *Id.*, ch 7(Everyman at 38) (legislator must transform man's nature to create freedom).

[25]Santa Clara v. Southern Pacific R.R., 118 U.S. 394, 396 (1886) (holding, without explanation, corporations to be protected persons within the meaning of the Fourteenth Amendment); Connecticut General Life Insurance Co. v. Johnson,

made such a sharp distinction: big government and big corporations, private and public bureaucracies, Washington and Wall Street often have been seen as indistinguishable enemies by populists of various varieties at least since the Jacksonian Era.

In my view, publicly traded corporations are far more analogous to government than to citizen. Like governments, they are basically bureaucratic enterprises performing a mission that may be given to them in some loose sense by the population as a whole, but which permits plenty of room for independent and potentially heavy-handed action.

This is the issue in this section: Is protecting corporations, by granting them the right to choose their own law, a way of protecting citizens, as conventional theory often suggests? Or, on the contrary, is allowing corporations to choose their own law closely analogous to allowing governmental units to choose their own law–that is, to escape from democratic control? If the latter, democratic republicans should be quite suspicious of the race to the bottom/top regardless of the efficacy of the particular results it reaches at any given time. Just as enlightened despotism remains despotic even if the despot really is enlightened, so too the decision to free a major governmental unit from popular control ought to be scary even if it does not seem to be substantively problematic at the moment. Corporate leaders, unlike judges and governmental bureaucrats, are not appointed by elected officials or answerable to them. To the extent that corporate law is determined by the race to the bottom/top, corporate managers do not even nominally follow norms set by the democratic process. They are, rather, analogous to autonomous self-perpetuating power structures: a sort of open aristocracy.

A. Corporate Law as Ideal Liberal Freedom: the entity theory

Two contrary senses in which corporate law seems to meet the requirements of liberal theory need to be distinguished. In this section, I discuss the entity theory.

Entity theory contends that the corporation itself is a citizen, entitled to a set of rights that go along with being a moral being entitled to respect and legal recognition. The theory's power rests on two pillars. First, corporations are entities, even if not citizens, and legal system does in fact grant them many rights of citizens. This combination of sociological and legal reality gives the normative claim a certain surface plausibility: If corporations *are* rights-bearing entities (and they are), perhaps they *should* be. Paradoxically, the fact that we give corporations rights they shouldn't have makes it appear reasonable to view them as the type of being that ought to have rights.

Second, if corporations were citizens, corporate law would grant them a type of freedom to which we all aspire. The internal affairs doctrine gives corporations, unlike human citizens, the right to choose their own law. That right, in turn, is one of the fundamental Western understandings of freedom.

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303 U.S. 77 (1937) (Black dissent) (questioning whether citizens ought to have rights against corporations under some circumstances); Wheeling Steel Corp. v. Glander, 337 U.S. 562 (1949) (Douglas dissent and Jackson's separate opinion) (further debating the issue).

The metaphor of citizenship thus powerfully supports the Delaware system. But the metaphor deceives. Corporations are not humans or ends in themselves. They are tools for our economic advancement; they shouldn't be treated as ultimate values any more than governments should be. As a normative matter, the metaphor is simply deceptive.

Since Hobbes, liberalism's ultimate defense of a limited government's right to coerce has been based on the claim that there is no "real" coercion, because in a just society, we can see the subject as having chosen the law at issue, or can say that the subject rationally should have chosen it in a fair bargain. That is, the subject either *has* consented in an actual agreement at least tacitly,[26] or rationally *would* consent in an hypothetical ideal agreement.[27]

The hypothetical rational agreement is embodied in the state of nature or its modern analogue, Rawls' original position, and the emergence of government from it. On this view, governments should limit themselves to matters which rational individuals in a fair bargaining position (such as the state of nature) would have approved. The power of this argument depends, of course, on the persuasiveness of the description of the conditions under which rational individuals would bargain and on the rationality of the bargain they would have made. For this reason, hypothetical consent arguments are often controversial.

In contrast, tacit consent arguments usually are variants on the position of the Laws of Athens as set out in Plato's Apology: A subject who does not emigrate (and in Locke's version, owns land), has tacitly consented to the laws as they stand.[28]

The problem with this theory of tacit consent is that the agreement it describes looks too coercive, too much like a contract of adhesion. In order to disapprove of an unjust law, the dissenting Socrates or his Lockean equivalent must accept exile. Emigration, however, is quite difficult (even leaving aside the sometimes fatal problem that it is impossible unless some other country is prepared to permit immigration[29]). Emigres must leave behind their country, friends and relatives, often their culture and language, jobs or profession. Indeed, Socrates argues that hemlock is preferable to exile. In short, to refuse consent requires so high a price that little moral value can be placed on a subject's failure to pay it.[30]

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[26]See generally, ROBERT NOZICK, ANARCHY, STATE AND UTOPIA (1974) (arguing that just state is one in which status quo is result of just agreements changing a just starting point); ROBERT PAUL WOLFF, IN DEFENSE OF ANARCHY (arguing that just state requires continuing consent); ROUSSEAU, supra n. (arguing that in just state law follows general will).

[27]See generally, JOHN RAWLS, A THEORY OF JUSTICE (1974) (arguing that just state is one that imaginary participants in a hypothetical fair state of ignorance rationally would agree to); POLITICAL LIBERALISM (setting out requirements for non-coercive state).

[28]PLATO, APOLOGY (presenting argument that accepting the benefits of the laws requires supporting them even when they are wrong); JOHN LOCKE, SECOND TREATISE ON GOVERNMENT (basing legitimacy on tacit agreement of subjects).

[29]See generally, HANNAH ARENDT, ORIGINS OF TOTALITARIANISM (arguing that the stateless are free of all human rights and, ultimately, freed of humanity, even life itself).

[30] Compare the Sinai midrash of Babylonian Talmud Shabbat 88a (translated in MICHAEL WALZER et al., I THE JEWISH POLITICAL TRADITION 28 (2001), discussed in *Counter-Majoritarian Difficulty*, supra n. at 792-3 n12), which interprets an

Of course, no actual government is the product of actual consent or meets the requirements that would be generated by hypothetical consent, if consent is taken even half-seriously. But corporations choose their (constitutive) law more freely and with fewer constraints than any human citizen. Citizens are limited to voting for representatives and, if they cannot accept the decisions the government makes for them, can only go into exile.

In contrast, corporations have far more freedom.

First, corporate constitutive law is remarkably flexible. Human citizens normally are allowed to organize their families in only a limited set of pre-established relationships. Standard corporate law, in contrast, is open to all sorts of unusual arrangements; virtually all of its key requirements are merely default rules, waivable at the option of the individual firm or its participants.[31] Even when the statute does not explicitly provide that its rules are optional, it is often relatively easy to plan around them. For example, corporate law begins with a presumption of a separation between equity ownership and management; with a presumption of entity-level taxation, and a presumption that corporate funds are available for corporate creditors before corporate investors. But the leveraged buyouts of the 1980s created corporations that avoided all three of these apparently compulsory aspects of corporate law even within the confines of the traditional statutes. By refinancing with high debt and low equity, firms were able to give high equity ownership (and associated votes) to managers, to virtually eliminate the corporate income tax (since most profits were paid out in the form of interest, deductible to the firm), and to ensure that investors (now classified as senior debt holders) received the first, instead of the last, claim on corporate income.

Second, any firm that determines that its host state's corporate law is insufficiently flexible to allow the firm to do what it wants to do can simply reincorporate elsewhere. The Internal Affairs Doctrine, accepted in general terms by every American state, eliminates the usual choice of law rule that a state applies its own law to its citizens and to economic activity within its boundaries. Instead, corporations may incorporate anywhere they choose, with no requirement of any other relationship with the incorporating state. No American state allows families to choose to follow the child protection law of another state just because the family decision-maker thinks that law

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odd preposition in the description of the events leading up to the giving of the Law at Sinai to mean that God threatened to bury the people under Mt. Sinai if they did not agree to his Law. The midrash points out that if God threatened the people of Israel with destruction at Sinai, then their consent to his covenant is not legally binding. Some readers respond by seeking some other time or place where consent might be given, either mythologically (as in the Book of Esther) or sociologically (taking consent to emerge from practice and sometimes explicitly holding that the law is binding because the actual people in actual communities accept the actual interpretations or interpreters) or both (as in the story of the oven of Akhnai, see Daniel JH Greenwood, *Akhnai*, 1997 UTAH LAW REVIEW 309-358 (1997) <http://www.law.utah.edu/greenwood/html/Akhnai.htm>); others, particularly in the high Middle Ages, contended that God's rule, at least, requires no consent.

[31] See discussion supra at III.B.1.b.

better; by accepting the Internal Affairs Doctrine they give corporations precisely that right.

Moreover, there seems to be no reason to worry about problems of monopoly in either suppliers or consumers of corporate law, despite recent suggestions that Delaware may have a commanding lead.[32] On the contrary, the "market" for corporate law is characterized by extreme competition. Corporate managers acting on behalf of corporations may choose among 50 state jurisdictions as well as, in most cases, foreign corporate law regimes.

It is true that the state incorporation statutes tend to cluster–at any given time, they mostly look alike, and when innovations are introduced, they tend to quickly spread or be eliminated, so that at any given time the range of choice may appear narrow. But this sort of "punctuated equilibrium," in which periods of stability alternate with change that spreads rapidly through a population, is characteristic of biological evolution as well as developed markets and not necessarily a sign of lack of competition. Indeed, most competitive markets rapidly settle on a dominant paradigm with variation limited to a few characteristics.

Third, the apparent lack of variation in corporate law is largely illusory. Unlike in biological evolution, market competitors are never entirely locked in by their history. A species must adapt to its immediate environment, even if it might be more successful adopting a different one; it can only climb the hill in front of it, not the larger one after the next valley. Firms, in contrast, are led by managers who can consciously decide to change the terms of competition. Accordingly, firms have options that would not be available in a natural selection.

If particular, if no corporate law meets the firm's desires, it can organize under a variety of alternative business forms. Firms need not elect to be governed by corporate

[32]See, e.g., Lucian Bebchuk, *Vigourous Race or Leisurely Walk: Reconsidering the Competition Over Corporate Charters*, 112 YALE L.J. 553 (2002) (empirical evidence suggests strong incentives to incorporate in Delaware). Probably the most important non-substantive reason to incorporate in Delaware is that everyone else does it. This cascade creates significant information benefits. First, because most major corporations use Delaware, there is more litigation in Delaware courts, more discussion of Delaware statutes, and simply more Delaware law. This presumably makes Delaware law somewhat more predictable, understandable or at least more structured than the less developed law of other states. In Delaware, unlike Utah, it is likely that something resembling your problem has already happened. Second, because Delaware law has the status of national corporate law, corporate attorneys throughout the country are likely to know and understand it, often as the only corporate law they know other than their own local law. Delaware law thus serves as the national "second language," similar to English as the language of international commerce. By adopting it as its first language, a corporation assures that its structure is understandable to everyone.

Delaware incorporation may also have useful signaling effect. By adopting Delaware law, a way for a firm, particularly one newly entering the capital market, can signal to investors its commitment to the national market. Like a budding professional seeking experience in the big city, a firm signals that it is prepared to play in the big leagues by incorporating in Delaware.

These reasons to prefer Delaware law, however, seem insufficient to lead a firm to decide to incorporate in Delaware despite significant unhappiness with its substantive law. Predictable and understandable law is clearly a benefit, but if the predictable and understandable law were unattractive law, surely many would decide they'd prefer to take their chances elsewhere. So, it seems safe to assume that the overwhelming choice of national corporations to incorporate in Delaware reflects corporate decision-makers' genuine choice and consent.

law at all. Public firms can go private or vice versa; for-profits can reorganize in mutual and cooperative forms, the various forms of trust, partnerships, limited liability companies, even wholly-owned sole proprietorships (incorporated or not).

Entity liability can be effectively replaced outside the corporate form using secured interests, as Lynn LoPucki has pointed out[33] or using trusts, as John Langbein has suggested.[34]

Funding need not be raised in the stock market; junk bonds can provide a functionally similar–though legally quite different–alternative. Indeed, at one point, leading corporate theorists pronounced the public corporate form dead, predicting that closely-held, highly leveraged firms with purportedly superior managerial incentives would compete public corporations out of existence.[35]

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[33]See, e.g., Lynn LoPucki, *The Irrefutable Logic of Judgment Proofing*, 52 STANF. L. REV. 55, 62 (1999) (demonstrating that judgment proofing enables corporations to avoid tort liability and skews investment decisions); Lynn LoPucki, *The Death of Contract*, 106 YALE L.J. 1 (1996) (describing mechanisms for creating effective judgment proofing). LoPucki argues that the alternative forms are sufficiently fungible that it would be virtually impossible for any state today to significantly restrict limited liability. Limited liability remains the major attraction of the corporate form for small firms; although access to the capital markets may be more important for large ones. LoPucki's work thus suggests that even a concerted effort of the states to impose regulatory content on corporate law would probably fail relatively quickly with respect to small firms, since such firms would abandon the corporate form for other forms of organization with different ways of limiting their liability. A debt-financed firm with an insolvent equity owner effectively has limited liability even if the equity owner is liable for the firm's obligations. The planning task, therefore, is to create debt-financing with both priority over later contract and tort creditors and sufficient flexibility to avoid crippling the firm prematurely in the event of a temporary or cyclical business setback, while offering financiers sufficient potential return to compensate for the remaining risk borne. Capital suppliers who fund the firm through something like a renegotiable senior bond at an unrealistically high interest rate can extract most of the returns to capital without much risk of liability for firm delicts. See LoPucki, supra.

Some commentators have suggested, for this reason, that it would be impossible to eliminate limited liability for torts. See, Joseph Grundfest, *The Limited Future of Unlimited Liability: A Capital Markets Perspective*, 102 YALE L.J. 387, 421 (1992), but see, Henry Hansmann & Reinier Kraakman, *Do the Capital Markets Compel Limited Liability? A Response to Professor Grundfest*, 102 YALE L.J. 427, 430 (1992) (defending proposal that corporate shareholders have pro rata liability for torts). This article's thesis suggests that Hansmann & Kraakman's proposals will be stillborn so long as corporate law remains immune from ordinary political discourse.

On the other hand, it seems likely that a determined and centralized regulator could impose a mandatory form of organization on firms that seek access to the public capital markets, on larger capitalization firms or those employing significant numbers, especially if we were able to overcome the fetishism of form. Thus, we have succeeded in imposing entity level taxation and securities regulation on publicly traded firms, and substantial employee regulation on even relatively small firms in the Civil Rights area, while the Germans have successfully mandated particular forms of organization, including employee rights, on large capitalization firms.

[34]See, e.g., John Langbein, *The Secret Life of the Trust*, 107 YALE L.J. 165, 167-78 (1997). Trusts, of course, were widely used to evade bars on merger contained in corporate law prior to the great reform begun by New Jersey; hence the oddity that our anti-monopoly law is known as the Anti-Trust Act. Today, most REITs and about half the mutual funds use the trust rather than the corporate form, apparently in order to avoid some of the few remaining regulatory requirements of corporate form: the annual meeting, a specified number of shares and the corporate franchise tax. Langbein, id, at 171, 184, 187 & n.133. Langbein suggests that the business trust offers virtually the same limited liability protection as the corporation, without entity taxation, and thus leaves an interesting puzzle, namely why there are any corporations at all. The obvious answer–that people prefer paying taxes to filling out tax forms–suggests that tax reform efforts ought to focus on replacing the income tax, at least for the middle class, with a VAT requiring no forms at all, while reserving the more complicated income tax only for those with enough income to have significant savings (perhaps the most affluent 5%).

[35]See, e.g., Michael Jensen, *The Eclipse of the Public Corporation*, HARV. BUS. REV., Sept.-Oct. 1989.

While that particular prediction seems overblown in retrospect, corporate lawyers remain heavily employed in shifting firms, or parts of firms, among various types of legal entities. The regular oscillation between conglomeration or consolidation and deconglomeration or downsizing fads in various industries regularly take publicly traded companies private (as divisions of public companies), later spin them off as free standing public companies, before taking them private in management led buyouts, only, in the next stock market boom, to go public once again. More radically, Mesa Petroleum reorganized as a publicly traded limited partnership and then, after tax reform reduced the attractiveness of the LP form, it reverted to corporate form.

For many years, business planners assumed that there were four or five principal characteristics of corporate form which to a large extent could be achieved only in a package by incorporation: centralized management, eternal life, limited liability, free transferability of economic interests and entity taxation. Much business planning was devoted to the difficult task of obtaining at least some of the former four characteristics without the fifth. But these legal characteristics of the corporation have been entirely deconstructed: any combination of the corporate characteristics is available outside the corporate form. With the advent of the limited liability company, even the IRS has given up and now accepts that entity taxation is entirely voluntary for all firms unless they choose to have their securities publicly listed. With the increasing sophistication of the private placement market, it is no longer–if it ever was–impractical for even quite large firms to remain private.

Similarly, the firm's underlying investors can readily switch their investments to different corporations or, in most cases, to different organizational forms. Few investors are required to remain in any given firm or even in the market for corporate securities itself (and the few that might be, such as mutual funds, have asset bases that could themselves disappear if the underlying human investors became unhappy with corporate investment). As technological cycles accelerate and physical capital has an ever shorter life span, it is increasingly easy to redeploy capital by the simple (and virtually unregulable) expedient of reinvesting profits elsewhere. Thus, both corporate managers and investors appear to face a wide range of choices that, within the constraints of the Internal Affairs Doctrine, is difficult for a state legal regime to restrict.

Finally, if a corporation changes its mind–determines that the law it previously organized under is no longer in its interests–it is free to reorganize elsewhere, again with little or no collateral costs. Reincorporation in a different state usually requires little more than filing a piece of paper and paying a relatively small fee.[36]

Under these circumstances, Locke's tacit consent looks far closer to real consent. Since corporations have readily available and relatively inexpensive alternatives to

[36]First, of course, the corporation must decide to reorganize, which under standard American corporate law will require a vote of its board of directors followed by a vote of its shareholders. These costs are trivial by comparison with the costs of genuine emigration.

compliance with the law of the local authorities, acceptance of that law is reasonably understood as not merely tacit consent but something much stronger. The same can never be true for human citizens, who always have non-legal constraints tying them to a particular citizenship.

In short, it appears possible for nearly any firm to pick and choose not only among different corporation statutes but among a far wider full range of business forms: corporate law has no unique benefits to offer and therefore, virtually no coercive power at all. Since firms have so many alternatives within corporate law and need not subject themselves to corporate law at all, business organizations law meets the liberal demand of non-coercion. On this view, then, corporate law appears close to the liberal ideal of an entirely voluntary, non-coercive state.

Superficially attractive as it is, this theory is nonsense. Corporations have no claim to human rights; firms are not repositories of intrinsic human value. There is no reason why firms should be free of human or political coercion–on the contrary, they are merely tools for the pursuit of human happiness, entitled on liberal grounds to no more or less a priori respect than that other tool of human happiness, the state.

The image of the corporation as a citizen replaces argument with metaphor in order to reverse the burden of proof. By pretending that corporations are citizens, it suggests that they should be free. But we should not be fooled. An argument is necessary to explain why firms should be regulated, freed from regulation, or even allowed to exist. The value of free choice of law by corporations, if any, is purely derivative of some consequences to humans, and any theoretical defense of granting liberal citizenship to corporations must make that connection.

In the final analysis, then, entity theory is rhetorically powerful because it invites us to imagine corporations as citizens. Were corporations citizens, granting corporations rights, such as the right to choose their own law, would be the same thing as granting citizens rights. As a trick, this is a quite elegant use of framing, in the sense explained by the cognitive bias theories. But as an argument, it fails. By anthropomorphizing the firm, this firm-as-citizen or corporatist theory ducks the difficult question, which is to determine how best to use corporations to promote human interests.

B. Corporate Law as Ideal Liberal Freedom: consumer sovereignty and the corporation as aggregate

To avoid the problem of the anthropomorphized corporation, the obvious solution is to break down the firm into its component parts. Standard corporate theory does this by the aggregate theory. This approach relies on a metaphor of a firm as a coalition of shareholders who have hired a manager/CEO (or, occasionally, the reverse: a CEO who has hired himself or sold his company to shareholders). The rights of the corporation, then, are understood as rights of shareholders and/or managers. This second defense of corporate citizenship, then, is the opposite of the one discussed in the previous section: rather than taking the corporation as a citizen in its own right, it takes the corporation to be a proxy for the citizens who "compose" it. Sometimes–more often in the political sphere than in corporate law–the metaphor of corporation as coalition is extended even to the people who act for the corporation, its employees.

The key to the metaphor's political power is that it makes the firm disappear. "Really," this metaphor claims, General Motors doesn't exist; it is just an illusion or a fiction. Much as if someone were to claim that the United States doesn't exist because it is "really" just its citizens or that an individual human is "really" the food she eats, the chemicals that make him up, or the brain cells that mediate her decisions, the corporation as aggregate metaphor urges us to ignore the sociological entity, the collective existence, the institutional and bureaucratic decision-making processes, the economic power and corporate assets (which do not belong to any individual or collection of individuals under current law), the material forces controlled by the firm, and the legal rights associated with the entity. Instead, we should pretend that General Motors is no more than the financial interests of its shares. The firm dissolves into its component parts (or some of them).

1. Role morality: why corporations won't act the way the citizens who own shares in them or manage them would

I have discussed elsewhere the fallacy of assuming that the rights of the human beings behind the firm's shares are protected by granting the firm rights; there is no necessary connection.[37] In the current context, this version of the deconstruction of the firmless firm may be seen as follows:

Two actors, investors and managers, bargain with each other in the shadow of corporate law. But the shadow of corporate law, as opposed for example to ordinary contract or labor law, is extremely dim. As discussed above, managers and investors bargaining together may choose virtually any relationship, and associated law, they like. Managers and investors, then, are in something like the state of nature: They are unconstrained by anything other than their own powers and sense of right and wrong. Any agreement they come to and any law they agree to accept will necessarily be free of governmental coercion.

Not accidentally, this is a picture of a classic free market, and the actors presumably are free in the same sense that market actors in the classical model are free. They may use whatever resources they have in the way that seems best to them under the circumstances. Given the extraordinary range of options the law presents to negotiating investors and managers, it is not an effective restraint.

Unlike the anthropomorphized corporation, this picture of corporate freedom cannot be simply dismissed. Reified corporations are not citizens. But investors and managers are (or may be) humans and citizens in their own rights and the results of their free bargaining are entitled to prima facie deference, at least under fair background conditions.

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[37] *Fictional Shareholders*, supra n. .

However, there is no reason to think that firms will function the same way as their separated component parts would; the aggregation theory fails to reflect sociological reality. As I have argued elsewhere,[38] investors and managers do not act like citizens. Investors, of course, may not be humans at all, and even if they are, in our increasingly global financial markets, they may not be citizens.

Even if we restrict our gaze to actual human Americans entitled to political consideration, the corporate system's role contexts mean that Americans acting on behalf of corporations will not act like citizens when in their managerial or investor roles. Thus, managers of both corporations and institutional investors are tightly constrained by their roles to act in ways that they would not were they thinking as citizens. In particular, managers, whether of corporations or their investors, are professionals. As such, they are expected to set aside their own goals, views and interests in order to pursue those of their client–the corporation itself. Ordinarily they should feel compelled to set aside all values that compete with profit maximization, even in circumstances where, as citizens, they would not do so. For a manager who (as a citizen) believes that shareholder value maximization should sometimes give way to other duties–for example, environmental respect, working conditions suitable for parents, or commitments to or relationships with particular localities, employees or products–increased corporate freedom may paradoxically reduce managerial and investor freedom.

Similarly, shareholders, whether because of institutional constraints or limited rationality, are likely to act as if they (or the humans they represent) had no interests other than maximizing the value of these particular shares at any cost. That is the perspective of a colonialist exploiter, not a citizen.

Consider, for example, tobacco companies. Cigarettes are legal but many people believe they are dangerous and addictive. Managers of an institutional investor, however, should feel obligated as professionals to set aside their personal views on this issue–the ones they would express as citizens in a political forum. Instead, a good professional money manager will focus on whether tobacco companies are good investments.

If other investors avoid tobacco stocks because of their political beliefs, the effect will be to drive down the price of tobacco stocks and, accordingly, increase the expected return. A conscientious institutional investor, then, seeking to maximize return for his or her clients, will therefore see this as a strikingly good investment opportunity–even leaving aside the underlying business, which, since it involves the sale of addictive drugs, is likely to be quite profitable. (Of course, any investment manager who cannot accept this internal separation between professional and citizen, and follows his views as a citizen or opts out of the profession entirely, simply increases the rewards for those who respond to the demands of role morality). In a reasonably competitive market, these professional investors should overweight tobacco stocks until they drive the price back to

[38] *Essential Speech*, supra n. .

the point where it is in line with other market opportunities to purchase similar expected future returns.[39]

The net result should be that only those shareholders who concentrate strictly on profit will have any influence on the firm. Profit maximizers set the price of the stock, since profit-seeking professionals see an arbitrage opportunity anytime price departs from expected return. That means, of course, that any boycott by politically conscientious investors has no effect on stock prices or the stock market's message to managers (except to reduce the boycotters' expected returns[40] and create some disequilibrium profits for first-mover arbitragers).[41] Second, at any given time, the actual shareholding body should be composed of those who are comfortable with the role obligation to ignore issues other than profits: The others rationally will sell their stock.

Similarly, managers at the tobacco producing firm itself are likely to view the firm as having an obligation to its shareholders to continue in cigarette production so long as it is legal–regardless of any personal views they may hold. As good professionals, it is their job to set aside their own views as citizens and instead work for the interests for which they are fiduciaries–that is, to profit maximize on behalf of shares. Again, those who disagree are most likely to quit, leaving the field to those with fewer scruples but not affecting the institutional behavior at all.

In short, the human shareholders and managers will either put aside their personal views and work for profit maximization, adjust their views to fit their job or find another line of work with less personal conflict. Personal character and political, moral, ethical and aesthetic beliefs largely drop out.[42] The conflict between role and citizen moralities is utterly impotent. Profit, not citizens, controls the decision.

Curiously, even if all the humans involved believed that cigarette manufacture is immoral, so long as enough of them were willing to set aside their personal beliefs and

[39]The degree to which stock market pricing actually matches this model of rational pricing is highly controversial. However, if explicit, public, political attempts to move individual stock prices away from the relative valuation in the market of similar risk adjusted expected future returns cannot be corrected by normal stock market processes, then stock prices are far less accurate than anyone has suggested.. Even efficient market pricing hypothesis sceptics should agree that given the general level of noise in stock market pricing, arbitrage should ensure that disapproving citizens "voting with their investing pocketbooks" will rarely have a perceptible impact on any company's stock price.

[40]Boycotters will be investing at something less than the efficient frontier, accepting lower returns than is necessary given their preferred level of risk.

[41]Stock boycotts may well be politically effective via secondary effects on the firm. First, the firm may be concerned that the bad publicity will have an actual adverse effect on the market for its products (rather than for its stock). Consumers, unlike institutional investors, buy for many reasons other than to achieve the highest possible risk-adjusted stream of future earnings. Many companies invest heavily in creating a "feel-good" appeal connected to their brandname, and negative publicity of any variety threatens that real market value. Second, company managers may have self-image invested in considering themselves and the company they work for as good citizens advancing the quality of human life. If boycotters threaten that image, managers may seek to rebuild it in a variety of ways, which could include changing the corporate behavior that boycotters find offensive, particularly if the company's consumer markets are sufficiently far from full competitiveness to give managers some room to depart from profit maximizing norms.

[42]That roles can dominate personal beliefs has been a commonplace of the social sciences at least since Durkheim. In the law reviews, the notion has recently been masterfully restated by Hanson & Yosifon. See generally, Jon Hanson & David Yosifon, *The Situation: An Introduction to Deep Capture*, 152 U. PENN. L. REV. 129 (2003).

act as professionals, the corporation would continue to produce cigarettes to the maximum extent profitable under existing market and regulatory law circumstances. The views of citizens, as citizens participating in the firm under the current corporate law regime, have no effect at all on how the firm is run.

This picture can be generalized to all controversial activities that a firm may engage in. Thus, for example, if discrimination is legal, managers of institutional investors may feel compelled to invest in discriminatory firms, especially if discrimination is profitable (as it may be where, for example, some customers prefer to deal with discriminatory firms[43] or where discrimination is a cheap (to the firm) even if highly inaccurate and unfair alternative to fairer sorting mechanisms). The more that other investors–acting as citizens–avoid discriminatory firms, the higher the profit potential of investing in discriminatory ones and the greater the pressure professional investors will feel to set aside their personal views and do what is best for their investment returns. If pollution, or downsizing, or union-busting (or union-supporting in order to regularize employee relations and end wildcat actions), or creating unattractive, unnecessary, unsafe, addictive or immoral products, or gambling (with safety or literally), or weakening traditional families by odd working hours or frequent changes of the workforce, or purchasing the products of slave labor, or any other potentially controversial activity, is both legal and profitable, firms will do it regardless of the personal and political views of the investor and managerial classes.

Conversely, firms will not engage in arguably socially attractive activities, regardless of the political views of those who run them, unless they are also perceived as profitable. Businesses that close on holy days, offer pay or working conditions better than the market demands, avoid free-riding or externalization of costs, and so on, will be punished by the market; professional managers will avoid taking such actions when they cannot be justified as profit maximizing.

Often, of course, such actions are (or can be imagined to be) profit-maximizing. Sometimes markets do reward seemingly other-directed actions. Employees and customers are people after all and most people respect and reciprocate a certain degree of fair dealing, patriotism, charity, decency and neighborliness. Charity that the firm (rightly or wrongly) believes is really advertising or above clearance wages that generate loyalty that the firm believes it needs, are profit maximizing and do not create the problem described above. Even where exploitative behavior clearly would be more profitable, markets are imprecise and may not punish firms that do not profit maximize strictly. Managers, being human, may convince themselves that doing right is the best way to do good even when it is not true, despite the best efforts of the free-market theologians

[43]Bell v. Maryland, 378 U.S. 226 (1964) ("I have nothing against blacks, but I'll lose all my customers if I serve them"). Cf. *Color Code: Black Entrepreneurs Face a Perplexing Issue: How to Pitch to Whites*, WALL ST. J., 1/26/99 at 1 (describing how black entrepreneurs avoid using black employees in visible positions because of fear of racist customers).

(including cases such as Dodge v. Ford) to teach them that doing right is actually wrong.[44]

Nonetheless, the net effect is that corporate freedom does not increase personal freedom for managers or investors. They are constrained by the market to profit maximize. What is profitable and legal will be done, regardless of how many citizens, even citizens acting as managers or investors, might prefer that the another value prevail and that controversy be decided against profit maximization. A fortiori, the firm is not increasing the freedom of other participants who are neither proximate decision-makers nor beneficiaries of fiduciary duties.

Moreover, political interventions to affect regulatory law are no different from any other decision the corporation must make. Corporations run by professionals who remain within role obligations will typically lobby for regulatory law that enables them to profit maximize. Self interest (except in race-to-the-bottom end games) typically will drive them in the same direction. The occasional citizen who sees a conflict with role obligation and chooses to stick with her sense of the right thing for a citizen to do, is likely to be eliminated from the system quickly, out-competed by those with fewer qualms about doing their (narrowly constructed) job. Publicly traded firms thus become a permanent lobbying force for changing law to promote their own profit, regardless of the cost to competing values.

Finally, when it comes to choosing corporate law, this picture applies again. The race, whether to the top or the bottom, involves only the value of profit versus the private, personal, non-professional interests of managers. Corporate managers will choose corporate law that enables them to strike the best deal with shareholders or other powerful corporate constituents, typically the one that allows them to work for shareholders with the least distraction from societal values beyond profit or competing interests (except of course their own, whether best served by self-restraint and faithful service or by exploitation of other corporate participants).

The most important difference between corporate law and regulatory law is that managers need not lobby for corporate law. Under the current legal regime, they have the right and obligation to elect the law that best enables them to shift corporate surplus to shareholders, taking a portion along the way, without regard to any other values, even if as citizens they might act otherwise. The powerful forces of the market, professional norms and law alike are arrayed against considering any alternative views.

2. Consumer sovereignty: the corporation as market, or are professional managers enabling someone else's freedom?

It is sometimes argued that this professional constraint on managers and investors is precisely the reason why corporate freedom is human freedom. Corporate investors

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[44] Dodge v. Ford Motor Co, 204 Mich. 459 (1919) (holding that firm may not be run as a semi-eleemosynary institution but must ignore will of its majority shareholder, public interest and interest of its employees even in face of arguable evidence that lowering prices and increasing wages would be profit maximizing).

and managers have no ability to control what the market-place creates: if one individual or institution declines to act as the market demands, another firm will enter the deserted niche, with no effect on the market as a whole. Thus, despite their apparent control, neither investors nor managers actually have any power at all.[45] In this view the corporation itself is just a market, reflecting and aggregating the views of market participants without adding anything of its own. Like the metaphor of the firmless aggregated firm described in the last section, this image also disaggregates the corporation. This metaphor, however, does not present the corporation as "really" its shareholders or an independent citizen in its own right. Instead, it claims it is "really" a powerless slave to consumers.

Applied to corporate law, the argument is that, as the race-to-the-top argument contends, when investors and managers bargain and agree upon the legal form that is most advantageous to them, the markets for finance capital will assure that managers work for shareholders and that shareholders–by their ever-restless search for investments at or above the capital investment frontier–will place their capital where it is most productive and thus work for all of us. In turn, the product market, by determining the ultimate profitability of the capital investment, assures that all of us, in our role as consumers, remain in ultimate control (at least to the extent that we are consumers).

In this anti-political critique, politics are unnecessary because consumers are sovereign, the only independent actors in the economic system. Accordingly, the only meaningful problems for corporate politics are the market failures–monopoly, free riding and information problems–and egalitarianism.

a. Market failures

As to market failure, opinions vary, with some seeing market failure as unusual anomalies probably best ignored and others seeing the market model itself as no more than an heuristic to more easily identify the various pervasive failures. For current purposes, it is perhaps enough to say that in the post-Lochner era, our democracy has agreed that markets must be structured and regulated by a political process under the ultimate control of elected officials and the electorates to which they are answerable. Markets generate determinate answers only within a determinate legal and regulatory system; to allow the market to choose its own regulatory system, as the race-to-the-bottom/top does, is circular and unlikely to solve whatever market failures exist. Rather, to whatever extent there are market problems, the race should simply accentuate them.

b. The egalitarian problem

The egalitarian problem is not a market failure but rather intrinsic to the market theory: the more perfect the market, the greater the egalitarian problem. Although it is

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[45]In this strong form, the argument counterfactually assumes something like perfect competition. More realistically, managerial power is limited to the interstices created by market imperfections such as transaction costs and failures of imagination.

sometimes understood in purely economic terms, the egalitarian problem is fundamentally a political one: Markets treat dollars, not citizens, as equal.

i. Market equality vs. democratic equality

In a functioning capitalist marketplace, dollars are equal; in sharp contrast to feudal systems (or Soviet communism[46]), the identity and status of buyers and sellers is irrelevant. "My dollars are as good as yours" is, I believe, the leading force behind most economic anti-discrimination law. The market's version of the anti-discrimination idea is that the highest bidder ought to win in the market; personal likes and dislikes should not affect the transaction. Markets, thus, normally look to the product for sale, not personal characteristics of the buyer or seller: the bazaar is the great locus of freedom for despised castes. Similarly, markets normally ignore history: the grocer has no obligation (or even right) to ask how I earned the cash I use to buy his products. In a market context, there is always something presumptively wrong when auctions do not go to the highest bidder.

Accordingly, markets ideally function anonymously, like the Stock Exchange or any well-organized commodity market, with only dollars representing the individuals behind them. This anonymity ensures equality of dollars without regard to irrelevant personal factors, including (but not limited to) feudal status or caste, race, religion, party, and even personal dislikes. In this market world, the "race-blind" version of anti-discrimination law is quite natural: it is nothing more than the usual norm of anonymity.

Property notions contrast strongly to these market ideals. On a property view, there is nothing odd about a property owner declining to go to the market or even entering into a non-market transaction with a favored person. The anonymity of the Stock Exchange or other markets is not an exception to the property principle of personal control but rather a contrasting and opposed ideal. Both privacy and property ideals suggest that the "owner" should have extensive control rights, including the right to decide to whom to transfer property, with whom to do business, and whom to permit to use the property.

Property, thus, is based in personal relationships; in personal relationships, personality matters, so that discrimination is the norm, not an anomaly. Where unbounded, irrational discretion is the norm, anti-discrimination principles are difficult and controversial. If one may invite or not invite a person to enter into a relationship for any reason or no reason at all (as the employment-at-will doctrine provides), why is one particular reason forbidden, and how can a legal system distinguish between permissible and impermissible reasons, especially when they overlap, as must usually be the case?

[46]In the heyday of the Soviet system, party elites had access to special stores and even special lanes on busy highways startlingly reminiscent of the *ancien regime*. Compare, VICTOR HUGO, LES MISERABLES; DICKENS, TALE OF TWO CITIES (describing differential rights of aristocracy). In twenty-first century America, we again have special transit systems (private jets, if not yet private highway lanes) for the super-rich and are rapidly returning to the principle that "only the little people pay taxes" (as Leona Helmsley presciently but prematurely put it), but we retain the equality of dollars. Anyone with $40 million can join the privileged classes.

Property and privacy are, in this sense, feudal ideals, enforcing actors' abilities to enforce class and caste differences by treating different people differently; the market demand for equality of dollars conflicts with and erodes them. Property rights find their highest development in the law of entail, allowing the owner to control the property even from beyond the grave. Markets demand, in contrast, free alienability in order to elevate the equality of cash over the privileges of birth.[47]

Democracy shares with markets the rejection of the aristocratic ideal of personal relationships and caste privilege, and similarly rejects unlimited property rights to bar transactions. In contrast to markets, however, political democracies hold *members*, not dollars, to be equal. The property rights/aristocratic view allows owners to freely treat different people differently. Markets insist that those with equal funds be treated equally, so that assets end up in the hands of those willing to pay the most, rather than staying within aristocratic castes. Democracy demands that as equal members we, not our money, should have equal votes (and that other privileges of membership similarly be distributed based on equal membership).[48]

Because politically based understandings of equality extend to people and not just to dollars, they cannot fully accept the market understanding of the anti-discrimination principle as simply anonymity. To be sure, anonymity is an improvement over active discrimination. For European Jews and American Blacks the right to buy real estate (referred to as "emancipation" in both contexts) on the same terms as others was a tremendous step forward from the old regime. In feudal or caste-based societies, even willing and able sellers and willing buyers will be barred from transactions. But just opening the ghetto gates or dismantling Jim Crow is not enough.

Politics is never anonymous or without history; if the goal is to treat each other as equals in a common enterprise, we cannot be blind to the past. To acknowledge our fellow citizens as members of a common enterprise, we must know who they are. Anonymity is a useful device for breaking down status distinctions. However, because the central figure of the democracy is the citizen, individuality can never be irrelevant and anonymity never fully possible.

History is unimportant in a market in which equality is of dollars: Dollars have no memory. But in the political arena, when we seek to treat our fellow citizens as fellow members of "us," we can never ignore the past. Even children know that a successful cooperative relationship requires taking turns: those who've gotten what they want in the past must allow the others to get what they want this time. Democracies, then, should never fully accept the market-based "race blindness" principle that the goods go to the

[47]But see, RICHARD A. EPSTEIN, FORBIDDEN GROUNDS 3 (1992) (arguing that anti-discrimination laws are both unnecessary and improper in a capitalist market). Although Epstein claims to be a theorist of the market, his attack on the anti-discrimination laws is based on the property metaphor: He sees as fundamental to "freedom of contract" not the anonymity of the capitalist market but the unfettered discretion of the feudal property owner to refuse to deal. In the name of capitalism, he is defending feudalism.

[48]For further discussion of these points, see *Counter-Majoritarian Difficulty*, supra n. .

highest bidder regardless of how the bidder came to have its money or power. Thus, more sophisticated anti-discrimination ideals go beyond the market's anonymity to a political conception of membership in a common enterprise.

ii. Egalitarianism: the equality of membership

Since Aristotle, equality has been seen as both fundamental and problematic. Aristotle proclaimed that justice is treating equals equally.[49] This Aristotelian Principle seems fundamental to any notion of justice or fairness, but as Aristotle recognized, it is almost purely formal: "equals and unequals, yes; but equals and unequals in what?"[50] The Aristotelian Principle seems to require that some justification be offered for treating different people differently (or for treating different people the same.) But it offers no theory of what constitutes equal situations or which differences may be cited to justify unequal treatment. The great puzzle has been in determining which samenesses (or differences) of people are relevant. Some theorists have claimed that equal humanity is enough. Isaiah Berlin thus claims that pursuant to Aristotle, no special justification is needed for pure equal division of, for example, a cake.[51] But he is wrong–different individuals are likely to be quite differently situated with respect to, for example, how much they contributed to making the cake, how much they want or need the cake, whether they are overweight or diabetic, and whether the cake distributor is in love with them. Procrustean equality requires just as much justification as any other division, because ordinarily we are different.[52] If justice requires treating equals equally, it also requires treating unequals inequally.

In contrast, when membership in a democratic political community is the good being distributed, equality indeed is the only distribution that requires no justification. Equal members are equal in their membership and entitled to equal benefits of membership (whatever those may be). Anything else means that some members are "more equal than others" or that some are only second-class members.[53] (Of course, plenty of room is left to debate what the privileges of membership might be.[54])

To be a member of the group is to have the group consider you part of the "we" for whom the group acts. If different members disagree on what the group goal should be, only some form of equality of decision making can fully acknowledge that all the members are indeed members, subjects rather than objects of the group. Thus, most arguments regarding the proper scope of egalitarianism can be understood as disputes over whether a particular good is an attribute of membership. If it is, like voting, it ought to be distributed equally, not based on need, contribution, love, desert, qualifications,

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[49] POLITICS, Book III, Ch. XII, § 1. ("persons who are equal should have assigned to them equal things.").
[50] Id. at III. xii. 2.
[51] Isaiah Berlin, *Equality*, 56 PROCEEDINGS OF THE ARISTOTELIAN SOCIETY 301 (1956).
[52] Compare, BABYLONIAN TALMUD, SANHEDRIN 109b (listing among the injustices of Sodom a Procrustian bed into which they forced all strangers to fit, stretching the short and chopping the long). This kind of equality is the opposite of justice.
[53] GEORGE ORWELL, ANIMAL FARM.(1945).
[54] See, The Slaughter-House Cases, 83 U.S. (16 Wall.) 36 (1873) (defining privileges and immunities of United States' citizenship very narrowly).

ability to use it, status, wealth or some other basis.[55] If it isn't, other considerations likely apply.[56]

While democracies reject status distinctions as vehemently as do markets, the democratic principle, when it applies, will also reject wealth distinctions: members, not their bank accounts, are citizens of a democracy. Because consumer sovereignty counts dollars rather than citizens as voters, democratic political justice will always seek to restrain it. Consumer sovereignty gives the rich more votes than the poor. Thus, it is based on an understanding of equality–the market's equality of dollars–that is foreign to politics. For this reason as well as the familiar problems of market failure, consumer sovereignty cannot be a solution to the aggregation problem. It cannot transform the powerlessness of corporate managers and shareholders into political freedom because it ties them to the market, not the democratic regime.

c. Limits to consumer sovereignty in a profit-driven world

But for present purposes, there is a more fundamental problem with the anti-political claims of consumer sovereignty. Consumer sovereignty, even setting aside the internal problems of market failure and the external problem of egalitarianism, can claim to control only a limited sphere of corporate behavior. Consumers collectively direct the profit motive but cannot restrain it. Even consumers who would prefer that firms limit their pursuit of profit in order to promote some other value have little choice but to buy the products of a profit maximizing firm.

Indeed, given the realities of consumption in a world of information overload and limited time to allocate to shopping, consumers are likely to continue to patronize profit maximizing firms even in the unlikely circumstance that other choices do exist. Regardless of the strengths of ones political opinions or views about when the profit motive should defer to other important values, one is likely to compartmentalize: politics is for debating around the dinner table, not for shopping in the supermarket. Of course, there are occasional exceptions: boycotts of grapes in support of the UFW, or of Proctor & Gamble for its supposedly satanic trademark. But the limited number of such actions make them just arbitrary bolts of lightening with little impact on politics of the economy as a whole. Most of the time, even consumers who strongly believe that corporate norms have drifted far from their values will buy products based on quality and price rather than the characteristics of the producer–if indeed they even know anything about the characteristics of the producer. In the anonymous market, it is the product that is important, not the process by which it was produced or the other actions of the producer.

Thus, for example, the New Yorker reports that all the major orange juice producers purchase oranges from a market that employs slave labor.[57] Similar allegations

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[55]See, e.g., the default voting rule of the Uniform Partnership Act § 18 (e) (providing that "all partners have equal rights in the management and conduct of the partnership business").

[56]Partnerships not always being membership groups in the political sense, default rules are only default rules. Compare, MICHAEL WALZER, SPHERES OF JUSTICE (discussing spheres in which (different senses of) equality is appropriate, principally attributes of membership); *Counter-Majoritarian Difficulty*, supra n. .

have been made about sneakers.[58] The principle of market anonymity–consumers buy products, not producers–allows otherwise decent people at Tropicana and Nike largely to ignore the conditions of workers who, after all, are not their employees and for whom they are not responsible. Most American consumers, I assume, would prefer to pay slightly more for orange juice or sneakers rather than support slavery. Consumer sovereignty, however, does not offer this option. One can buy high quality orange juice or low quality orange juice, but there is no way to buy slavery-free orange juice.

Similarly, the market anonymity notion that only product, not process, is important was the underpinning to Alan Greenspan's opposition to President Clinton's proposal that Social Security invest in the stock market.[59] Under the Clinton proposal in its original form, Social Security would have held up to 4% of the publicly traded stock.[60] Greenspan expressed concern that the government might seek to use these holdings politically, for example, in opposition to cigarette smoking. At first glance, Greenspan's criticism is almost incomprehensible. If tobacco production is bad for America, why wouldn't we want the government to use whatever tools are available to limit it, and why would we want Social Security to provide the tobacco industry with investment capital? Within the logic of the anonymous market, however, Greenspan's concern is straightforward. The capital market produces returns on capital, and purchases in that market "should" reflect only returns on capital, not "extraneous" issues like where those returns came from. Greenspan is, in effect, making an anti-discrimination argument: Investors should not discriminate against producers whose products or production methods are perceived to be immoral. It is, therefore, a powerful political claim that in the marketplace profit maximization ought always to trump other competing values. In accord with this view, Greenspan's preferred proposal, individual accounts, does not privatize the values decision but rather assures that profit-maximization will be the only value expressed. There is no practical way for individual investors investing small amounts of money via mutual funds to express any other value.[61]

There is no effective way for consumers to signal when they believe the profit motive has gone far enough. As a result, corporate "freedom" in the consumer sovereignty model is simply the freedom to profit maximize, regardless of what competing values may be about. Real citizens always have other values than profit maximization and real politics usually is about the trade-offs and conflicts between them. The consumer market, however, denies voice to this debate and coerces one solution to all value conflicts: profit *uber alles*. Not only investors and managers, then, but consumers as well, may find that granting rights or freedom of action to *corporations* does not increase their freedom as *citizens* at all.

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[57]John Bowe, *Nobodies: Slave Labor in South Florida*, NEW YORKER (April 21, 2003) at 106, 128.
[58]See, Nike, Inc. v. Kasky, 539 U.S. 654 (2003) (recounting allegations and Nike's denials).
[59]NY TIMES January 23, 1999.
[60]WALL ST J. Jan 25, 1999.
[61]See, *Fictional Shareholders*, supra n. .

We see, then, that the corporation can not be reduced to its components–whether shareholders or customers. It will predictably act differently from and often in opposition to the human beings who make it up, as managers–even if they act entirely in good faith and even leaving aside the obvious problems of corruption and self-interest–find that their role constrains them to ignore the interests, values and desires of the human beings they are meant to serve. Corporate freedom can not be justified as simply freedom for the corporation's human members (however defined) any more than freeing the state would necessarily increase the freedom of its citizens.

C. Corporations as Property

A third justification of treating corporate freedom as human freedom stems from a misuse of fundamental liberal notions of property. Protecting property is an important part of protecting freedom. Corporations are sometimes viewed as a form of property. Ergo, it seems axiomatic that protecting corporations must be protecting freedom.

To fully engage the argument about property and freedom would require a discussion of property that is beyond the scope of this Article: the relationship between property rights and freedom is a good deal more complex than the simple assertion acknowledges. For a start, property rights are the right to demand that the state protect certain power relationships between people and objects or among contesting human claims to objects. The objects of the claims, of course, need not be something physical: one can have property in purely legal inventions, such as cash flows, stock or copyrights. Since all property involves contested power relationships, invoking property rights can only begin, never finish, a discussion about freedom. Property rights are the ability to say that some things are mine for some purpose, but the more that is mine, the less that is yours, and so my property (and my freedom, in this sense) necessarily conflicts with yours. A persuasive theory of property (and a persuasive theory of liberal freedom) must explain where my property (and freedom) ends and yours begins, not simply assert that property (or freedom) is a good thing.

With respect to corporations, the simple equation of property and freedom suffers from an even simpler flaw. In our legal system, no human holds the basic fee simple property rights in a public corporation. It is fundamental to Delaware corporate law that public shareholders own their shares but not the corporation: they have no right to control the corporation. At the most basic level, so long as the corporation remains public, no participant in it has the right to destroy it. More importantly, as we saw in the previous section, no one has the right to change its basic purpose or adopt a different set of values for it than the one–profit maximization–that the market as currently regulated mandates.

For example, were a majority of the shareholders (or even the holders of a majority of its shares) of a public corporation to believe that the public good would be better served if the corporation were to sacrifice some profits for a public purpose–supporting a war effort, protecting the environment, educating the younger generation, building bigger highways, offering above-market employment terms to farmers, descendants of former presidents or other meritorious citizens–they would have no mechanism in current corporate law to cause the corporation to take on this task. First, shareholders have no right to manage the corporation. As a rule, shareholder resolutions on issues of corporate management must be merely precatory and do not bind directors. Indeed, the fact that a majority of the shares voted had been cast in favor of the project would be largely irrelevant. Directors are bound by fiduciary duty to act as Burkean statesmen, doing what they in their best professional business judgment view as in the interests of the corporation, not to be mere representatives of share-voter will.

Second, were shareholders to use their right to elect a board of directors of similar views, the directors would have a fiduciary duty to represent all shareholders and not just those who voted for them, and to take into account the interests–not the views–of all shareholders (understood as undiversified investors with no interests other than the share value). Were the directors to conclude that they should pursue the platform on which they were elected, they would be subject to personal liability on a breach of duty lawsuit for corporate waste, brought by even a single holder of a single share: and, if the directors were open about their decision to sacrifice share profit for another goal, they would stand a good chance of losing.[62] The directors have a fiduciary duty to act in the interests of the shares that is independent of the shareholders' own views as to those interests.[63]

Corporations are not representative democracies. Indeed, when a corporation's board seeks to take some action that is not within the norms of ordinary share value maximization, courts generally view the existence of a voting majority supporting the directors as an aggravating, not a mitigating, factor. The majority vote demonstrates not electoral legitimacy but majority oppression.

Third, the market will punish such deviance from share value maximization even more harshly than the fiduciary law. Most investors in the public market in fact behave as if they wish to maximize the value of their shares regardless of other values they may hold. Some may not have any conflicting values or may resolve the conflict in favor of share profit. Others will act as if they had no conflicting values even though they do, due

[62]Ordinarily, directors pursuing goals other than immediate share value justify their actions by invoking long term share value. Courts are generally quite deferential to such claims, upholding the directors' actions under the Business Judgment Rule unless there is evidence of self-dealing or the court concludes that the directors' justification is incredible. See, e.g., A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145 (1953) (upholding charitable contribution based on implausible testimony that gift was profit-maximizing).

[63]Thus, in the few cases where directors have openly stated that they were not running the corporation in the interests of fictional shareholders, courts have been far less deferential to managerial judgments. See e.g., Dodge v. Ford Motor Co, 204 Mich. 459 (1919) (holding improper corporation's decision to act according to political views of the holder of a majority of its shares, despite evidence that course was in fact profit maximizing); Smith v. Van Gorkum, 488 A.2d 858 (Del. 1985) (holding that directors may not abdicate their fiduciary duties in favor of a shareholder vote); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del 1985) (barring directors from considering actual interests of owners of shares–who were also owners of bonds–and requiring that they instead pretend that share owners have no interests other than share value maximization).

to the simplifications of ordinary cognitive overload, which are likely to leave them citizens in the voting booth but share-value-maximizers in the stock market.

Moreover, roughly half of the publicly traded shares are held by institutions that are legally required to pursue share value maximization regardless of the views of the humans who manage them or are their ultimate beneficiaries. Standard financial theory suggests that these professional investors, committed only to share-value maximization, ordinarily will set the market price.[64]

Each of these investors will sell or avoid the shares of any company that openly deviates from a share value maximization strategy, driving the company's share price down to reflect its reduced financial prospects for profit-maximizing shareholders. That reduced share price, in turn, opens an enormous profit opportunity: an arbitrageur who can acquire control at a price reflecting the corporation's public good orientation can make a huge and easy profit by directing the firm to revert to the market's normative amoralism. The powerful incentives of the capitalist marketplace should assure that intentional, explicit deviations from the profit maximization norm will be rare indeed.

In the ordinary course, this market incentive should be enough to force a corporation interested in pursuing any goal other than share value maximization into a limited set of options. It can, of course, go private: A single shareholder has a set of rights much closer to fee simple absolute than do public shareholders, even in the aggregate. With only one shareholder, legal doctrines of fiduciary duty are irrelevant and market pressures are mere opportunity costs (the firm would be worth more in another, more conventional, shareholder's hands, but so long as the private owner is willing to sacrifice the money that could be made by selling out, the market has no power to force change).

Short of ceasing to be a public corporation, however, the corporation that seeks to place a goal above shareholder profit has only two plausible courses. It can seek to persuade (or fool) the investing public that there is no conflict between its goals, that it can do well by doing good. This was the tactic taken by the numerous corporations that vastly increased managerial pay in the last several decades. They claimed they were doing this not because it was good for managers but because it was good for shareholders, and to a large extent they successfully persuaded the market that indeed there is no conflict between giving managers huge stock option grants and making shareholders (now including managers) rich.[65] If persuasion fails and going private is not an option, it will have little choice but to abandon the other values under pressure of the stick of threatened takeover or the carrot of rich increases in share value for returning to the fictional shareholder's service.

The property metaphor, thus, fails to support corporate freedom because publicly held corporations are not property: No human has the legal right to use them for any

[64]See supra, p. .
[65]This is the typical tactic in litigation as well. See, e.g., A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145 (1953) (charitable contribution defended as not really charity but rather advertising); Brehm v. Eisner, 825 A.2d 275, 286 (Del. 2003) (managerial payoff defended as shareholder-value maximizing).

human purpose other than the one specified by race to the bottom/top law, namely share profit.

In short, none of the metaphors of corporation as citizen, contract or property provides a sufficient justification for freeing corporations from the law. Corporate freedom is not human freedom; we must instead consider when and where corporate law will promote our interests and desires and when it will not.

D. Corporate Law and Value Choices: corporations as voluntary associations or local governments

The reason that corporations must be taken to be tools of citizens rather than the citizens themselves is central to corporate law's legitimacy and success. Real citizens have multiple and diverse views, reflected in and reflecting their various and conflicting value judgments about many issues important to public life. In a democracy, value issues must be debated and decided in a political process: it is fundamental to the notion of equal citizenship that no democratic citizen has the right to determine value issues by fiat.

1. Elections without democracy

Corporate managers are not elected by anything resembling a legitimate democratic political process. Corporate law, and in particular corporate governance advocates, often use the rhetoric of political democracy to explain why shares should be given authority within the corporation's internal decision-making processes. But the rhetoric only works because we don't take it seriously.

Were corporations understood to be political organizations run by a democratic process, we would have to reform corporate law in a radical and fundamental fashion: Democracies operate on a principal of one person one vote and corporations do not. The fundamental voting rule of corporate law is that only shareholders vote and they do so on the basis of one share one vote (subject to some flexibility when the corporation elects different voting rules and with the potential disenfranchisement or vote dilution of poison pills and their statutory equivalents). Voting, thus, is proportional to wealth, not membership. In a democracy, the principle of one-dollar-one-vote would be completely unacceptable.[66]

Corporate "democracy," then, fails the most basic test of democracy. It does not provide for equal citizenship. (Alternatively, one could say that it does provide for equal citizenship, but the citizens are dollar investments, not human beings). Moreover, it does not provide citizenship for the right people. While shareholders have limited say in running the corporation, proportional to their shareholdings, many other constituents

[66] Kramer v. Union Free School District, 395 U.S. 621 (1969) (invalidating New York law granting school district vote only to owners of taxable real property and parents of enrolled children on ground that it denies excluded citizens the equal protection of the laws); but see, Ball v. James, 451 U.S. 355 (1981) (upholding "one acre-one vote" scheme for water reclamation district election on ground that, although governmental in form, the relationship was closer to that of business and customer).

and affected parties, some of them (unlike most shareholders) even human, lack even a limited right to vote.

Corporate law, however, has not gone the way of other pre-democratic regimes. In part, this is a failure of the democratic project, a remnant of the bad old days still alive in our midst, a reminder that not all democratic failure is abroad.

2. Excluding politics from corporate elections: policing professionals not choosing values

But in part the survival of corporate law's limited and unequal voting is because the basic self-understanding of corporate law is not political at all. Corporate law does not imagine directors to play the role of elected representatives of the "people" or even of the dollar investments of fictional shareholders, for the simple reason that corporate law does not imagine directors to be making the value choices that are the appropriate realm of elective politics.

Instead, corporate law itself makes the value choice. According to the law corporations have chosen for themselves, corporations are an organization created for and dedicated to a limited and specified purpose. As a matter of corporate law, corporations exist to make money for shareholders proportional to their shareholdings. Directors and their managerial delegates are understood to be professionals who, like other professionals, will work out the implications of this goal. Like other professionals, they have a good deal of discretion in interpreting, giving meaning to and pursuing the goal. The business judgment rule is largely a recognition of the need for this large degree of professional autonomy. But like other professionals, they violate their role if they substitute their own values for the goal that is set for them by their client.[67] In this case, the client is corporate law itself, and the goal is profit maximization from a fictional shareholder perspective.

On this view, the purpose of shareholder "democracy" is simply to police the professionals. Shareholders do not vote to make value choices, to reaffirm common membership in a joint enterprise, or to give meaning to collective commitments. Rather, they vote in order to keep directors within their role requirements, to ensure that they aren't stealing from the corporation or distorting it to some other purpose.

Unlike citizens, shareholders do not vote to determine the fundamental value conflicts that are outside a professional's role. Public shareholders are not the client. Rather, the principal of these professional agents is merely a legal principle.[68] Unlike a doctor's client, they have no right to pull the plug. Unlike a lawyer's client, they have no right to instruct the professionals to take an action just because the client thinks it is right. Those client decisions are made by corporate law. Rather, the shareholder role is to eliminate corruption, self-service and incompetence.

[67]See *Counter-Majoritarian Difficulty*, supra n. , for a fuller discussion.
[68]See, *Fictional Shareholders*, supra n. .

The limited shareholder role is the reason why shareholder votes so often look more like the plebiscites of dictatorial regimes than the tense contests of democratic ones. Where conflicts are over views of the world or balances between powerful but conflicting moral claims, voters normally will disagree, often sharply. It would be quite surprising if a democratic vote produced a 95% majority on abortion rights, for example, or indeed on any issue of importance and interest. In contrast, if the issue is corruption or even competence in pursuing an agreed-upon goal, one would expect a high degree of uniformity: these are largely factual issues more amenable to consensus.

3. The benefits of monomania

The public corporation's single and limited goal is the source of much of the success of our corporate sphere. Corporate managers, unlike political leaders, need not concern themselves with the views of their electorates. On the contrary, in the ordinary course they don't even need to know who the electorate is. Instead, they can view themselves as working for a purely imaginary and purely homogeneous fictional shareholder. As Henry Hansmann and Kelman explained in their different ways, this unanimity of purpose (even if it is only a legal imposition) drastically simplifies the directors' task. Basic value conflicts are excluded from their job. It is someone else's responsibility, not the board of directors' or the managers', to decide when profit should give way to other important values. Of course, the problem is that the "someone else" often does not exist. Corporate monomania is not balanced by any similarly strong countervailing power.

The issues that are left are by no means simple: managers and directors are charged with finding the cheapest and most efficient ways to turn raw materials, ideas and human labor into saleable products. But those are professional issues, requiring expertise and rationality, not representativeness or value choices; they are issues of applying hypothetical not categorical imperatives. Managers can specialize in that limited set of issues without worrying about the rest of the harder problems of our collective and political life. Presumably, we all win, or at least have a more successful economy, because of this division of labor. (This, no doubt, is also a key reason why private industry sometimes is able to provide services more cheaply than government. Government officials are almost never *permitted* to put aside the other considerations that public corporate managers are *required* to set aside).[69]

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[69]Hansmann contends that the simplicity of goals of shareholders reduces their governance costs and that this efficiency is, in turn, the key reason why shareholders run corporations. See, e.g., Henry Hansmann, *The End of History for Corporate Law*, 89 GEO. L. J. 439, 445-6 (2001) (contending that heterogenity of interests precludes efficient decision-making). But the "uniformity of interests" of shareholders is entirely a result of legally structured markets that render invisible all the multifarious interests, values and goals of the human beings behind the shareholders, leaving only share-value maximization. It is hard to see why efficiently promoting only one value at the expense of all others is an effective way of achieving the values ignored. Kelman makes a somewhat similar point: because governmental institutions are usually expected to balance various competing goals (because the world is full of competing values), their processes are almost necessarily more "expensive" if measured along the single value of private cost minimization with no balancing.

But if the limited role of corporate decision-makers is the source of their success, it is also the reason why corporations are not legitimate participants in the political process of creating corporate law and deciding the limits of the corporate sphere. A public corporation is a legally created entity designed to accomplish a specific purpose. The purpose is useful, even noble. But it is only one purpose among many human purposes and it often conflicts with others. A single purpose entity devoted to one value alone is in no position, almost by definition, to know when to stop, when that value must be balanced with others. Because corporate values are the product of corporate law, not of the citizens that work for or invest in or purchase from the corporation, corporations must not be allowed to decide the limits of their own values.

4. The proper limits of the corporate sphere

When corporations choose corporate law, the result is not freedom *of* citizens, but freedom *from* citizens. An important aspect of our collective governance structure, created to promote one of our values, is out of our control and out of its proper sphere. Corporations cannot properly balance the claims of employees, bondholders, tort victims, pensioners or environmental claimants against those of shareholders: they have been designed to view the former as strangers to be exploited to the maximum extent practical for the benefit of the latter. Corporations can not balance the claims of conservatism–children who need continuity in school, communities that thrive on commitment and stability, employees whose skills are not readily redeployed–against those of growth and dynamism. They have been designed to exclude the former claims from consideration except to the extent they serve the latter.

Corporate law sets the limits to corporate one-sidedness. It is corporate law that tells corporate managers whom they must consider a cost and whose gain is the corporation's gain, that increased dividends are good in themselves, but increased salaries are bad (unless they are a means to the proper end–increased dividends). Having constructed contract and tort claimants as outsiders and costs, corporate law then sets the limits to which they may be exploited, by determining, for example, the degree to which corporate managers can move assets out of the reach of those claimants for the benefit of the shareholders for whom directors are meant to work.

The race to the bottom/top or free corporate choice of law distorts the process of countervailing powers that ought to be at work here. Professional managers working within a given framework to maximize a single value must have someone else–the client, the citizenry–to do the job they have given up, namely deciding when it is no longer appropriate to pursue that value. In our corporate law system, no corporate player can do that balancing. But the race to the bottom/top means that corporate players, not the citizenry or their elected representatives, are determining the law that determines where

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Governments are not supposed or permitted to act like profit-maximizing businesses that ignore all other values, and there is something odd about then condemning them for that. It is, rather, their strength.

share value maximization will end. That cannot be right. If we allow the one-sided maximizer to set its own limits, there will be no limits set.

III. Taking Corporate Law Public

Corporations are power centers in our society, not citizens that need to be protected from the powerful. Once we de-anthropomorphize them, stepping away from the metaphor of a corporation as a person with an intrinsic value of its own, this seems almost painfully obvious. Corporations are tools that we create for our own purposes, much like governments, and much like governments they can function to make our lives better–or the reverse. "'The question is,' said Humpty Dumpty, 'which is to be master–that's all.'"[70]

The internal affairs doctrine and the race to the bottom/top make corporations subject only to their own ineluctable internal logic. They choose their own law according to the role restraints and incentives of their own decision-makers, defined in large part by the very law they've chosen. Shareholder votes and market constraints, to be sure, limit the freedom of action of corporate decision-makers to a significant degree. But neither offers a mechanism for importing the full range of important political issues into corporate governance. The mechanisms for shareholder influence have the effect of stripping away shareholder humanity, leaving only a legal fiction dedicated to its own self-interested profit maximization. Such a "voter" is an extremely poor proxy for the genuine interests and wishes of real human beings (even leaving aside the fundamental problem that in politics, unlike investment, one dollar one vote is clearly illegitimate).

Even setting aside these role problems of the constrained manager, the fictional shareholder and the limited sovereignty of consumers, there is another problem with the standard picture. Market choice analysis assumes that corporate law is basically private law. Managers and investors, in a situation of relatively equal bargaining power, negotiate a mutually beneficial contract; outsiders have only a relatively minimal interest, primarily in preventing fraud and informational failings or possibly in protecting the weaker party from overreaching.[71] This picture is manifestly false.

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[70] LEWIS CARROLL, THROUGH THE LOOKING GLASS (ch. VI).

[71] The conditions under which apparently voluntary transactions should be viewed as in fact voluntary are controversial. Compare, e.g., ROBERT NOZICK, ANARCHY STATE AND UTOPIA (1974) (listing conditions under which voluntary agreements should be seen as voluntary); Nozick Normative Theory of Individual Choice. Nozick, who views agreements made at the point of a gun as voluntary, takes a rather extreme expansive view of voluntarism. For a contrasting view, see, e.g., GRANT GILMORE, THE DEATH OF CONTRACT (arguing that contract law is largely indistinguishable from tort, because legal and moral analysis is always necessary to determine whether an agreement should be enforced). In Gilmore's analysis, voluntariness is always a matter of degree, and coercion is almost always present to some extent. Cf. Kennedy, Distributive and Paternalist Motives in Contract and Tort Law with Special Reference to Compulsory Terms and Unequal Bargaining Power, 41 Md. L. Rev. 563 (1982).

[Delete this para. Contract law theorists debate whether contracts are binding because they are promises (and promises have intrinsic moral force), see e.g., CHARLES FRIED, CONTRACT AS PROMISE (1981), or rather in order to encourage mutual reliance, see, e.g., Anthony Kronman, *Contract as Promise*, 91 YALE L.J. 404, 411 (1981). Under the former view, the intrinsic moral force surely diminishes as the promise appears more coerced; under the latter view, the social interest in

Corporate law is public law: the private arrangements of investors and managers in the dim shadow of a nearly voluntary law affect all of us. The law of business organizations determines the effectiveness of other regulatory schemes and sets the framework within which markets function. Thus, as a simple example, it is the law of business organizations that determines who is responsible (and to what degree) for business violations of tort, regulatory or criminal norms. If regulatory schemes seek to make firms internalize costs they would otherwise externalize, but business law allows them to decline the resulting liability, the regulatory scheme fails.

Similarly, it is business law that determines on whose behalf managers work: the market tells firms to profit maximize, but to a large extent it is law that determines where the firm ends and the outside begins. Law, by setting the boundaries of the firm, can help to decide who is an input to be exploited to the maximum degree the market permits and who is the firm, to receive profits to that same degree. Law determines the relative power of the various parties to the market negotiation, for example by solving (or creating) collective action problems. And business law affects the time frame chosen by managers, their responses to taxation, and a myriad of other issues.

A. The Effects of Free Bargaining for Corporate Law

In the remainder of this section, I summarize some of the areas in which business law affects the citizenry as a whole, creating significant political issues that cannot be debated or decided within a market based framework of consumer sovereignty or free choice of law for business entities.

Market negotiations take place within a given allocation of powers and resources; our business organization law regime empowers certain parties at the expense of others.

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encouraging reliance diminishes as the promise becomes less voluntary. Neither view, however, determines the issue of how to determine when an agreement should be seen as voluntary. See, e.g., Kronman at 414 (Fried rejects consideration doctrine, maintaining that "what ought to matter... is the *freedom* with which a promise is made"); 417-20 (discussing line between permissible and impermissible advantage taking under his and Fried's approaches).]

Since bargaining tends to reproduce or accentuate existing power imbalances–the party that can walk, as every business advice book teaches, wins the deal–the law (and moral theory) tends to devalue agreements when the background conditions are too imbalanced. Thus, if one party holds a gun, the agreement will be viewed as coercive. If one party conceals (too much) relevant information, the agreement may be labeled fraudulent, mistaken, or unconscionable. If one party seems to have too much bargaining power, the law may disregard the agreement under the doctrines of overreaching or duress. See, e.g. Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (DC Cir. 1965) (holding overreaching contract unenforceable for unconscionability); Alaska Packers Association v. Domenico, 117 F. 99 (9th Cir. 1902) (holding that immigrant fishermen were not entitled to $50 for the season pursuant to contract with the Fish Trust renegotiated in mid-fishing season in Alaska after discovering they had been misled, because of lack of consideration–the Trust was "coerce[d]"into agreeing), discussed in Debora Threedy, *Fish Story*, 2000 UTAH L. REV 185 (stating that case has become a classic example of duress or extortion, despite fact that fishermen faced a monopoly employer with potentially excess supply and evidence that employer was exploiting its monopoly power.

Nonetheless, bargaining between upper level managers and investors appears to be quite close to the paradigmatic model of free contract. Investors are both fully fungible and faced with a wide array of (according to modern portfolio theory if not always legal doctrine, see (injunctions)) largely fungible investment options. Managers are not nearly so fungible nor do they face as competitive a market for their services, but at least in the upper levels they seem relatively mobile and quite amply compensated. But see, John C. Coffee, *Shareholders v. Managers: The Strain in the Corporate Web,* 85 MICH L. REV.1 (1984) (describing shareholder defection from legally unenforceable commitments to middle level managers).

State corporations law, in its current incarnation, solves many of the negotiation problems fictional shareholders (and the shareholder/managerial alliance) might have, while leaving other participants in the firm with serious collective action problems. This result is precisely what one might predict from the race to the bottom/top: neither the financial markets nor the proximate decision-makers have any interest in choosing law that would increase the effective market power of other (non-shareholder or manager) participants in the corporation.

Corporate law overweights the responsiveness of firms to the needs of capital and underweights the response to other claimants. In turn, this empowerment of capital has dramatic effects on our collective life and culture, effects that ought to be highly controversial. Capital, after all, is immortal, uncommitted, fully fungible, and mobile, while citizens usually are none of those. Corporate law makes corporations and the law they influence subservient to markets, and markets–for all their efficiency in producing consumer goods–left to their own also efficiently produce increased inequality of income and wealth,[72] environmental destruction and other unpleasant side effects.

The controversy, however, is suppressed by a legal system that allows voice only to one side. So long as corporate law is chosen by corporate managers accountable only to corporate shareholders, other claimants and potential beneficiaries or victims will not be heard. As a result, we make a critically important political decision about our collective life without either a democratic collective (political) decision or a meaningful aggregation of individual (economic) decisions: not the views of individual citizens but the legal structure of voluntary law determines the collective decision.

The key aspects of the bargaining struggle that are determined by law are relative mobility, collective action and free-rider issues, governance problems relating to conflicting goals, and ease of externalization.

1. Relative power: mobility, time indifference and unity of capital

Corporate law constructs shareholders as identical and fungible. As a matter of corporate law, the shareholders of a given corporation are assumed to be primarily interested in that corporation maximizing its profits (calculated from a shareholder perspective) and, ultimately, its payout to shareholders. Since the law requires that corporate payouts to shareholders be made pro rata, shareholders ordinarily are imagined to be identically situated with respect to this goal.

This construct is a fiction. In fact, all human shareholders (and all human beneficiaries of corporate shareholders) have other relationships with the firm in other

[72]Employment and wealth markets will tend to make the richer faster than the poor, thus increasing inequality, whenever they are left relatively unrestrained. This follows almost axiomatically from two foundational principles of free trade: the diminishing marginal utility of money and voluntary trade. The latter means that market transactions don't take place unless both sides view the transaction as profitable. The former means that it takes more to make a transaction attractive to the rich than to the poor. The combination simply reaffirms the popular understanding that in bargaining, he who can walk, wins. At the extremes, if you need to eat, you will give up whatever is necessary; if you already have more than you know what to do with, you must be paid exorbitant sums to induce further participation. Thus, the wealthy will need to be paid quite a bit to convince them to work, invest, or even consume at levels commensurate with their wealth.

roles. The law treats shareholders as if they were aliens or imperialist occupiers, with no interest in our society other than extracting maximum profit from it. In fact, however, we are also consumers, employees, neighbors and citizens and must care about other issues as well. Even those shareholders who really are aliens encounter firms in other roles: if nothing else, at least as inhabitants of a limited ecosphere.

The fiction, however, assures that the interests of shareholders in share value maximization will be efficiently pursued even in circumstances where the actual humans, on reflection or in a system that allowed more room for expression of conflicting interests, might prefer that other interests be pursued as well or instead. Citizens who disapprove of liquor, cigarettes, daytime television, pollution or whatever will nonetheless find their pension savings efficiently used to promote the production of those "goods" so long as it remains profitable.[73]

Because the law makes shareholders identical, the financial markets can effectively and rapidly move capital to corporations that it believes are profit maximizing. This mobility, in turn, ensures that fictional shareholders (in other words, the interest that real shareholders have, among other interests, in maximizing the value of their shares) will have an enormous bargaining advantage as against employees and other firm participants, who are almost necessarily less mobile. If Wall Street doesn't receive its due, it will simply take its capital elsewhere.

As between fictional shares and managers, top managers have place and information advantages relative to shares that may be even more important than the fickle mobility of the financial markets. That is the conflict between race to the bottom and race to the top theorists. As between top managers and shares, the division of the spoil will depend on whether mobility and fungibility or place and information win out. The results will shift from time to time, depending on the degree to which the financial market anticipates managerial defections ex ante, whether those managers who would prefer to bind themselves not to defect are able to overcome the resistence of those already playing an end game of "apres moi (and my millions) le deluge," and whether the legal system generates solutions to what otherwise may become a market for lemons in which investors, unable to assure themselves that managers will not defect, simply opt out.

However, other corporate participants generally can expect to find a united front of mobile shares and informed managers set against them. In the market competition for division of the corporate pie, capital has a basic advantage: it can walk more easily than can labor. Other corporate participants may be entirely locked in, with commensurately little bargaining power: for example, pensioners; employees with non-transferable seniority, firm specific skills or medical plans; the city in which a plant is located and other economic neighbors; suppliers and consumers of less than completely fungible

[73]See supra p. ff.

products; and so on.[74] As against all these, the ease with which the financial markets can cripple the firm should allow shares to extract a large part of the corporate surplus.

Moreover, these other corporate participants can expect no assistance or recognition from corporate law. Whatever their differences between themselves, shares and managers alike gain by limiting the responsibilities of the corporation to its other participants. The race to the bottom/top means that corporate law will be chosen by corporate managers answerable primarily to the finance markets. They will not choose law that helps others.

2. Agency and single-mindedness

As Henry Hansmann has emphasized, governance is extraordinarily expensive. One aspect of the governance problem is that we do not have a successful, mutually acceptable way of resolving differences. When there is no consensus and discussion does not create one, all the available solutions are problematic.[75]

We can take a vote, but while majority support offers a basis for making any given decision, it does not create legitimacy where there was none before. No one believes that majority vote can make a wrong into a right: American apartheid was not more justifiable in those states where whites were a majority than in those where they were a minority, nor would Nazi Germany be more attractive if, as Goldhagen claims, murderous anti-Semitism was widely popular rather than just the view of a tiny elite gone mad.[76] Most dramatically in our own history, no side to the slavery struggle considered that a majority vote was a proper basis on which to decide the question, unless the forum that was to vote was so constituted as to predetermine the result.

Even where fundamental moral issues are not at stake, on significant issues, the losing side is unlikely to give up, and when the same group perceives itself as losing consistently, it is likely to reject the entire process. While language groups and cultures have decided to assimilate (collectively or individually) for a variety of reasons, I know of no instance in which a minority language or culture has viewed a vote of the larger group as a legitimate basis for the end of collective existence.[77]

Similarly, more individualistic decision making methods–the classic liberal device embodied in our First Amendment of collectively deciding only not to decide–will fail to convince those who believe that the very issue is whether such individual decision-

[74]See, OSCAR WILLIAMSON, ECONOMIC INSTITUTIONS OF CAPITALISM (arguing that lock-in is most important reason for governance protection in the corporation).

[75]For a fuller discussions of these problems in democratic theory, see, *Akhnai*, supra n. ; *Counter-Majoritarian Difficulty*, supra n. .

[76]DANIEL J. GOLDHAGEN, HITLER'S WILLING EXECUTIONERS: ORDINARY GERMANS AND THE HOLOCAUST (1996).

[77]For examples of voluntary abandonment of cultural or linguistic identity, consider the history of almost any American ethnic group; for rejection of majoritarianism as a basis for determining that identity, consider the history of every separationist nationalist movement. See, generally, WILL KYMLICKA, MULTICULTURAL CITIZENSHIP: A LIBERAL THEORY OF MINORITY RIGHTS (1995) (discussing national rights of ethnic minorities).

making is acceptable.[78] For those who believe that abortion is murder, or that teaching evolution or blasphemy are offenses against God and state, or that a republic can not long stand if its children are deliberately kept innocent of basic scientific knowledge or its adults permitted to accumulate and bequest wealth great enough to buy loyal dependants, or that a society should devote a significant part of its collective resources to activities that markets cannot provide (whether they be armies or the arts), a decision to exclude the matter from the political process is a defeat, pure and simple. If abortion is an individual decision, it is not banned; murder is not something we leave to individual conscience, so Roe (or even legal abortion after rape) is a political decision that abortion is not murder.[79] If we were to decide that armies (or museums, cathedrals, parks, schools, social security, health insurance, Western water systems, ranching rights on public lands, or baseball stadiums) should be provided by profit-seeking entrepreneurs or private charity, collectively we would have decided that they are not terribly important, at least relative to things that markets provide effectively, like corn flakes, cars and commercial television, or things we continue not to trust to markets, like highways or the price of oil.

In the firm, capital's governance issues are resolved by law, because the law creates a uniformity of interest for all investors.

First, taking investors as investors alone (that is, neglecting their other roles and values), our financial markets allow all investors to be treated as if they were identical clones. Even pure investors, of course, have different risk tolerances, different time frames and different views on the likelihood of success of particular plans. But portfolio theory has taught us that managers should (and do) manage without regard for their investors' risk or time preferences. In a functioning public capital market, all investors– regardless of their personal risk preferences or time frames–should be looking for the same thing: the portfolio with the best available risk/reward ratio, discounting future rewards to present value but otherwise neglecting timing.

Moreover, for investors without particular non-publicinformation in reasonably competitive financial markets, this generally will be the most widely diversified market portfolio (known as "M", for market). Those who prefer less risk will hold less of this risky portfolio and more of the best available low risk investment, while those who prefer more risk will reverse the ratios. But each will look for the same thing in risky investments: the best available risk/reward ratio, neglecting both the absolute amount of risk and any diversifiable risk.

Just as both risk seeking and risk averse investors look for the same behavior in corporate managers, similarly investors with long and short term horizons also should choose the same equity investments. It is simply cheaper and more effective to adjust for

[78]For further discussion, see, Daniel JH Greenwood, *First Amendment Imperialism (a response to Michael Walzer's Leary Lecture)*, 1999 UTAH L. REV. 659 (1999) <http://www.law.utah.edu/greenwood/html/Leary.htm>.

[79]For further discussion, see, Daniel JH Greenwood, *Beyond Dworkin's Dominions: Investments, Memberships, The Tree of Life and the Abortion Question*, 72 TEXAS L. REV. 559 (1994) <http://www.law.utah.edu/greenwood/html/Dworkin.htm>.

time preferences elsewhere. This is why our longest term investors–insurance companies, pension funds and endowments that are effectively eternal–can also be the shortest-term traders.[80] The result is that both portfolios and firms (which are themselves portfolios for these purposes) should invest as if their investors were risk and time indifferent. While people are never risk or time indifferent, the market allows them to invest as if they were.

Thus, these differences between investors drop out, allowing managers to treat them as if they were all the same and eliminating most governance conflicts that might divide pure investors. Critically, managers need not concern themselves with whether their shareholders are widows and orphans, savvy insurance companies, or day traders and arbitrageurs: Portfolio theory ensures that the same corporate decisions are appropriate for all investors and all these groups will seek the same profit-maximizing actions from management.

Similarly, since portfolio investors treat firms as cash flows with associated risks, managers also should act as if investors were utterly uncommitted to any given investment, location, or set of human relationships. The human investors aren't, of course: most obviously, a large percentage of publicly traded stock is held by pension funds, the beneficiaries of whom (most of whom are still working) are likely to be anything but indifferent between investments in the firm (or location or industry) where they work and alternatives. But most institutional investors (and corporate managers) are barred by law from considering these differences between investors, and even when the law doesn't bar such considerations, the dynamics of markets operating on limited information will. Firms, then, will again act as if investors were all the same.

These solutions to the governance problems of capital create a seemingly homogeneous capital pool. Firms, then, can be managed by agents on behalf of capital without the agent having to consult the actual investors at all: any competent professional can imagine the goals of a rational investor who is assumed to have no interest other than profit maximization. The result, as Hansmann points out, is that it is easier and cheaper to manage firms on behalf of capital, since there are no disagreements to worry about.

But it is also important to emphasize, as Hansmann does not, that the unity of capital is artifactual. Firms managed on behalf of these fictional shareholders are time indifferent, risk indifferent, free of any commitment to particular products, technologies, employees or location. But that can't be true of the human investors taken individually or collectively. To the extent that the human investors–who are, more or less, the citizenry–have any commitments, the corporate law system assures that firms will undervalue them. We have created a law under which we–even as investors–have no mechanism to say that sometimes profit maximization should give way to other values.

The artificial unity of investors also assures that capital, or fictional shareholders, will have a comparative advantage in negotiations with other corporate participants.

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[80]For a fuller discussion, see *Fictional Shareholders*, supra n. .

Employees have no mechanism to disguise their different risk preferences, time preferences, location preferences and personal commitments. While pension funds are managed on behalf of an ageless beneficiary, always about to retire but never doing so, actual employees must forge difficult to create and maintain coalitions between those who are primarily concerned with the short term–resume building youngsters or about to cash out veterans–and those who are in it for the long term; between the footloose and the rooted; the risk loving (or option holding) and the conservatives (or undiversified); those who are committed to a particular job and those who are not. This fractious coalition will have little chance in a negotiation with a single-minded agent for a fictional unified capital. As a result, the very real interest of capital in profit-maximization will be unduly likely to prevail against any set of competing interests.

Similar results will obtain even in the simplest negotiation of all, the negotiation over the spoils of the corporate system. The corporate law system assures that investors are represented by a single agent with a single voice, while employees (at least in the absence of a strong industry-wide union, an absence guaranteed by US law) will always be divided. In a perfectly competitive market, this difference might not matter. But employees (at least outside of Silicon Valley during the dot.com boom)[81] always face a partial monopoly in their employer and high transaction costs in re-entering the job market. The constructed unity of the corporation means that many employees face one employer: the employer can generate competition among employees more easily than the reverse. In effect, race to the bottom/top corporate law creates a union–and a closed shop–for capital, while leaving the rest of the corporation unorganized. This, like the mobility of capital, should lead to fictional shareholders obtaining a larger share of the corporate surplus than they would in a more even handed bargain.

Law determines the background rules within which shareholders bargain with other corporate participants; the race to the bottom/top excludes those other participants from the law making process. The predictable result ought to be higher returns to capital and upper management than in the absence of the race.

[81]In Silicon Valley during the boom, it appears, a largely youthful workforce was strikingly mobile. Because of a high concentration of similar firms in a small geographic area, an extensive professional network that is not firm based, and a lack of firm-specific incentives (such as immobile health insurance or pensions), workers could move from firm to firm with a minimum of disruption to their personal lives. In Silicon Valley, job switching didn't involve pulling the kids out of school, making new friends or gaps in health coverage. This unusual employee mobility should have put employees into a better negotiating position relative to capital and assure that mobile employees receive a larger share of the corporate surplus than is seen in less mobile industries. He who can walk, wins.
In the post-boom era, a tighter job market has enabled many employers–who presumably correctly concluded that mobile employees are better able to demand a larger share of the corporate pie–to return to a more standard model. By refusing to hire the formerly footloose (even where this imposes short-term costs on the firm), managers (over the longer term) can reduce employee bargaining power. In the next boom, employees will think twice before using the power that mobility seemingly gives them, for fear of entering this blacklist. For an anecdotal account, see Scott Thurm, *System Failure: In Silicon Valley, a techie-for-hire struggles to get by*, 4/23/02 WALL ST. J. at A1 (describing reluctance of employers to hire highly qualified formerly mobile individual).

3. Boundary issues: limited liability, externalities, entity taxation and related issues

Corporate law determines the firmness of firms: whether, when trouble happens, there will be a there there. It is fundamental to Delaware law that the corporation, not those who profit from it, is liable for the corporation's debts, meaning that only corporate assets are available to unsecured corporate creditors. (Secured creditors, of course, may obtain rights to other assets by agreement, and in public corporations it is not uncommon for secured creditors to have claims against various members of a corporate group while unsecured creditors are left to slimmer pickings.)

It is similarly fundamental that the corporation's directors and shareholders have nearly unfettered discretion in determining the scope, financial structure and activities of the corporation.[82] Thus, the directors may choose to put new projects inside or outside the existing corporation. They may choose to pursue risky projects or to stultify the firm in a stagnant status quo. For any given set of projects, they may finance them jointly or separately; by debt, new equity issuance, or retained earnings. They may staff them with new or existing employees, located in new or existing locations, using new or existing physical capital. They can combine the corporation with others or divide into pieces.

Similarly, as a formal legal matter, the directors have virtually complete control over the degree to which the corporation will have assets available for unsecured creditors including employees, long term unsecured creditors, pensioners, tort claimants or regulators. By encumbering corporate assets with prior liens, or distributing them to shareholders as dividends, the share/manager alliance can shift risk to current or future creditors or decide to protect those corporate participants.

Creditors with bargaining power will protect themselves in a race to the top type manner by obtaining security interests in corporate, and if necessary, even extra-corporate assets. But the race to the top is of no avail for corporate claimants who do not engage in ex ante negotiations and thus cannot force the firm to internalize its future defections: for example, tort victims, the environment and governmental regulators. Less obviously, other claimants who may have ex ante negotiations, such as employees or pensioners, may not be able to predict defections with sufficient clarity. Standard cognitive bias theory suggests that employees should be likely to underestimate the probability of corporate failure and will not adequately charge for it, just as factory workers do not adequately charge for predictable accidents.

The race to the bottom/top assures that state corporate law will never protect these unsecured "outsiders" no matter how deserving they may be or how efficient correcting the pricing mechanism (which under current law undervalues their claims) might be. If corporate managers can find a way to extract extra value from pensioners,

[82] Some structural changes may require shareholder consent, but even when share consent is required, as in formal mergers, generally there are relatively similar alternatives that do not require share votes. Creeping acquisitions or decisions regarding reinvested earnings can transform a company as radically as a merger without ever entitling the shareholders to a vote. Rarely indeed will other corporate participants have blocking power.

corporate law encourages them to do so. Similarly, the free corporate choice of law assures that corporate law will be fundamentally antagonistic to tax collection, accident prevention and tort regulation, unionization and employee benefits and so on. The larger the share of the corporate pie these claimants receive, the less there is for the managerial/share alliance that chooses corporate law.

Tort law is a particularly egregious example. State tort law attempts to make businesses internalize the cost of the accidents they predictably create, thus ameliorating a critical market failure that otherwise threatens to destroy the accuracy of the pricing mechanism on which our capitalist system depends. Corporate law works in precisely the opposite direction: it invites businesses, by incorporating and limiting the assets they keep available for unsecured creditors, to take risks at the expense of third parties.

Whether tort law is properly calibrated is–rightly–a highly controversial topic. There should be nothing controversial, however, about the democratic implications of our current system. So long as the race to the bottom/top exists, the most important part of Texas tort law is that corporate law directs managers to evade tort law as much as possible; corporate law gives manager the tools to do by encouraging managers to see social responsibility as outside their purview but limiting the assets available for tort creditors as a key part of their role; and the content of corporate law is determined by those very managers it creates and directs to ignore the social good. This self-reinforcing cycle of substantive law-avoidance, as much as the Texas legislature, determines the degree to which Texas tort law has any bite.

The same is true of much other law. Remedies against a corporation are meaningful only to the extent that the corporation has a continuing existence: individuals to be enjoined and assets to be seized. The race to the top/bottom assures that corporate managers will be relatively unencumbered in planning corporate structures that allow them (and shares) to profit during the good times and dump costs on outsiders during the bad ones. Long term contractors, including employees who hope to have long term employment or pensions, must either irrationally assume that corporations will resist the directions corporate law gives them, or recognize that they inhabit a market for lemons and plan accordingly–inefficiently settling for second-best solutions. Good professionals will understand their roles to require that they use this freedom in precisely this sleazy and anti-growth way.

4. Who is the firm: portfolio theory and the goals of the public corporation

When firms are run in the interests of their shareholders as constructed by current law, they are not actually run by the human beings who are the ultimate beneficiary of our institutional shareholders nor even in their interests. Rather, they are run in the interest of share-value maximization–which may be quite contrary to the interests of the real people who own the shares. Line employees, through their pension plans, now own a significant portion of the American publicly traded stock. But that stock is voted, and managers who act in its interest act, without regard for any interests those employees have as citizens or even as employees. Even employees, pensioners and universities, when they own shares, are imagined to be interested only in share value maximization.

Free corporate choice of law results in managers largely abandoning any attempt to run the firm in the interests of anyone other than themselves and these fictional one-sided shareholders. Accordingly, it gives the capital market an extraordinary influence over our public corporations.

Following the dictates of corporate finance, share prices will rise when firms take on extra risk. The market pressures firms to act more like itself: since diversified portfolio shareholders can eliminate all firm specific risk, they do not value stability, rootedness, or commitments. Rather, they value firms that, like portfolio investors, see each moment as an opportunity to reevaluate all existing projects. This tends to be bad for the human beings associated with the firm, since human beings, unlike shares, are always committed, relatively rooted, and never time indifferent.

Not the shareholders but the market calls the shots–and the market, following the dictates of portfolio theory, has a very clear and particular program: Firms should pursue the best available investment opportunities, understood as those with the best risk-reward ratio, without regard to overall levels of risk, specifics of cash flow, or any other commitments. Like the market itself, firms should be fully mobile and utterly uncommitted.

This slightly surprising result follows from the nature of the finance markets as currently structured and understood, and stands independent of any political beliefs the ultimate human holders of securities may have. Like so many of the political decisions we have tied to corporate law, it is a consequence of portfolio theory and rational behavior under the restricted rules of the market, not of conspiracy. The actual views of the actual citizens involved are functionally irrelevant. Union-owned pension plans will not act any differently in any significant way (for present purposes) than the most class conscious member of the capitalist bourgeoisie.

The key to the portfolio theory dominated market agenda is this: Diversified portfolio investors can eliminate virtually all firm-specific risk themselves. They view firms as largely interchangeable–each one is a predicted cash flow with a degree of probability, and little else. Portfolio theory teaches that the cash flow and risk characteristics of a portfolio are largely independent of the cash flow and risk characteristics of the individual components of the portfolio: thus, in the most famous example, an extremely cautious investor can do better (achieve a higher expected return at any given risk level) by purchasing risky assets than by buying (only) safe ones. Indeed, in the pure theory, given equal information all investors, regardless of risk preference, should buy the same portfolio–a market index of the risky assets and some quantity of T-bills. The only difference between risk loving and risk averse investors would be in the quantity of T-bills they hold: risk averse investors do not hold lower risk stocks than risk loving investors.

Another way to look at the same portfolio theory point is that risk averse portfolio investors will find that they can eliminate firm-specific risk from their portfolios and achieve their preferred level of overall risk almost without cost (by diversification and holding more or less T-bills). Firms, in contrast, can reduce such risk only imperfectly and usually at great cost--most obviously, diversification at the firm level is the same thing as giving up the benefits of specialization. Even risk-averse shareholders, in their investor role, thus, should oppose measures to reduce diversifiable risk at the firm level; they can eliminate it more cheaply “at home” by holding a diversified portfolio of undiversified firms.

In contrast, investors seeking risk in some part of their investment portfolio will not necessarily be indifferent to risk at the firm level. They may prefer more risk than they can create outside of the firm. Once a portfolio reaches zero T-bills, portfolio theory counsels that the best way to increase risk further is to borrow money, which may not be possible, or not possible at a rate as low as the firm could achieve. Accordingly, while risk-averse portfolio investors are indifferent as to diversifiable firm-level risk, seeking only the most favorable risk/reward ratio, risk loving portfolio investors may prefer significantly worse risk/reward ratios at the firm level in order to achieve high overall levels of risk. Shareholders as a group, as a result, will not be risk neutral, but rather risk seeking, even at some cost.

Similarly, portfolio theory teaches that given similar expectations about business prospects, individual investors should all hold the same stock portfolio regardless of their time preferences. Those who need current income and those who do not will choose the same stock, based solely on its risk/return ratio and not on its dividend policy or the timing of the firms cash flows. Indeed, Wall Street can be thought of as specializing in adjusting firm cash flows to fit the needs of each individual investor, outside of the firm.

Similarly again, the central lesson of portfolio theory is that investors should not be unduly concerned with the particulars of any given company’s investments: indeed, the counsel to diversify is precisely the opposite. Rather than being deeply committed to a particular business, product, place, set of people or relationships, portfolio investors diversify to eliminate the effects of those details on their investment returns.

The net result is that portfolio investors act (in their investing) as if they were risk indifferent, time indifferent, place indifferent and free of all commitment to any particularity. This is the source of the well-known paradox that mutual funds and pension funds, which are immortal permanent investors–with the longest possible time-frame of investors in a human community–are notoriously our shortest term traders (with the possible exception of the unlamented Internet day traders). All firms, even or especially for the long term investor, appear as nothing more than a predicted cash flow at a predicted risk. If a better predicted risk/return package is available elsewhere, the investor simply switches.

A shareholder-run firm, then, is likely to be a highly risky firm. Moreover, like an aging roue, it is likely to have a serious commitment problem: financial markets do not marry investments. Employees, in contrast, are likely to prefer less firm-specific risk, if only because they are less able to diversify to avoid it and because steady firm growth usually provides maximum job security and the least disruptive path to career advancement, let alone life outside the firm. Similarly, other long-term creditors (formal ones such as bond holders or pensioners, and informal ones such as non-commodity suppliers or neighbors) are likely to benefit from steady growth patterns, which in effect increase the security of their loan (or similar claim) without lowering the compensation they receive.[83]

Furthermore, the finance market being without any long term commitments to businesses, localities, relationships, products or people, shareholder controlled firms are likely to be remade in the market's image. While employee controlled firms (or even ones with powerful unions) are notoriously committed to job stability and to the current employee body, share controlled firms are far more likely to shed and regain employees, products and businesses in the manner of a dieting baby boomer. As different business opportunities appear, each can be judged by the risk adjusted present value of the expected returns; professionals acting on behalf of shares are less likely to be moved by intangible factors such as morale, firm-specific investments by employees, long standing relationships with particular places, people or products, patriotism or even a quality product. While such traditions or stability may have value to the people involved, the value is unlikely to be reflected in the risk/return calculations of portfolio managers.

B. Conclusion: excess mobility

This brief tour through portfolio theory suggests the principal effects of legislation by market:

1. The stock market has an agenda of its own, one that emphasizes its own characteristics of time-indifference, space-indifference, mobility, and lack of commitment. The stock market seeks to increase the mobility of capital, across borders and businesses alike, to enable it to pursue the highest possible returns. But people are never so mobile, and high returns to capital, important as they are, are never our only political agenda. People are not time indifferent or place indifferent: while for a shareholder, profit here and now is always fungible with profit somewhere else and sometime later (properly adjusted for the costs of repatriation and the time value of money), for people a job here and now is never the same as one somewhere else or some other time. Capital can shift instantly from Flint to the Philippines and then on to Fresno, or from steel to software; people can't.

2. When we turn over lawmaking to the market, we lose the ability to trade off market values against non-market values. Corporations, run on behalf of their shareholders, will never choose law that sacrifices shareholder value for human values, even if the shareholders might. Shareholders, after all, are us, and we have many

[83]To the extent that bondholders are the same diversified portfolio investors as the shareholders, this effect is lessened: part of the benefits the investor wins as a bondholder will be lost as a shareholder.

commitments that conflict, at least some of the time, with the needs of the capital market. But those commitments will not be reflected in the process we have created.

3. In the competition for state law, corporations will choose the law that best suits the needs of the capital market. They will seek maximum flexibility and minimum commitment. They will, for example, oppose any efforts to introduce into corporate law notions of continuing obligations to corporate employees, firm products, firm suppliers or customers, or the localities (or even countries) in which the firm operates. Such rules (which are not uncommon in other advanced democracies that do not have our market driven system of creating corporate law) tend to reduce the share of corporate product that goes to shares, and will be rejected by firms seeking to maximize share return.

There is one significant exception to this rule. When share interests conflict with those of upper management, firms may choose law that limits share rights. This is, of course, the race to the bottom thesis; I mean not to rehash it here or even to take sides but only to point out that the race to the top thesis relies on an assumption that equity markets can force managers to internalize the costs of such actions, and that assumption may not always be correct.

Nor is it generally the case that managers and shares are in conflict primarily with each other. The current state of hostile takeover law is a good example: the combination of the poison pill and the "stakeholder" constituency statutes have essentially eliminated the hostile takeover. But while at first glance this might appear to be a pure vindication of the race to the bottom thesis, the reality is more complex. In fact, the new law has fortified the current alliance of fictional shareholders and top managers against the rest of the corporate participants and furthered, rather than limited, the mobility of capital. Managers no longer oppose the radical restructurings that originally motivated the hostile takeover movement. Instead, they give finance markets more or less what they want and take 10% as a commission.

Market driven law, in short, will be law in the interests and the image of the capital market–a law of maximum flexibility and minimum tradition, maximum mobility and minimum stability, maximum return to capital and top management and a minimum return to labor. Most importantly, it is simply incapable of sustaining any debate on when, if ever, markets should be restrained. Market mobility conflicts with our needs as citizens for a certain level of stability in which to raise our families, produce our culture and live our lives. Excess mobility of capital may, as George Soros has claimed, threaten the capital market itself.[84] But that issue cannot be a factor in the creation of our corporate law so long as it is dominated by the Internal Affairs Doctrine, free corporate choice of law and the competition between the states.

We Americans are mostly descended from those who fled the stagnation of stability in small towns here and abroad. We are unlikely to rush to restrain the markets'

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[84]George Soros, On Globalization (2002)

mobility in a major way. But the voluntary law of corporations removes the issue from democratic debate altogether.

IV. Conclusion: Who Is A Means And Who An End?

The most important differences between a democracy and the other forms of government are two. First, democracies take their citizens to be the ends of the law: the good of the citizen is the good of the state. In a democracy, the citizens are never only tools to some goal greater than themselves, means simply to be exploited, or strangers to be treated entirely at arms length.

Second, democracies allow the citizens to debate and decide their own good; it is not imposed on them by government or some supra-governmental movement. Democracies do not have established churches, in the broadest sense.[85]

Corporate law is central to a democracy because it determines, for the corporation, who is a citizen and who is a foreigner.

“Foreigners” are outsiders, external to the firm, to be dealt with at arms length. The morality of the marketplace bars the firm from lying to them or stealing from them, but certainly doesn’t require empathy with them. If we can get more work out of an outsider for less money, if the outsider doesn’t quite understand the full implications of the deal, if a legal loophole allows us to exploit the outsider in some fashion, corporate managers are entitled to do so. Indeed, the profit maximization norm states that they are required to do so. A manager would be in breach of duty if she intentionally offered to pay employees more than is necessary to maximize their productivity, or to lower prices below the profit maximization point, or to pay taxes that are not legally mandatory, or to voluntarily assume a significant social burden without any public relations value. When a manager decides to end legal (and profitable) discrimination, or to give charity, or to change production methods so as to reduce pollution well below legal requirements, or to increase employee safety beyond profit maximizing levels, his decision is automatically suspect. To be sure, the business judgment rule, the possibility that apparently expensive ways of doing business may turn out to be profit maximizing, and the difficulties of proving motive offer a great deal of protection for socially minded managers, especially if they are not entirely faithful to their role obligations or if creative brilliance or cognitive dissonance enables them to see a potential for profit in self-less activity. Highly paid workers are less likely to quit and more likely to work hard; charity and environmental protection may have public relations value that translates into dollars and cents; low prices may bring higher and more profitable market share. But, the principled issue remains: managers have no right to use corporate funds for non-corporate benefits. It is all very well to give charity, but it is not all very well to give charity with someone

[85] I’ve addressed these ideas at greater length in earlier work. See, *Counter-Majoritarian Difficulty*, supra n. ; *First Amendment Imperialism*, supra n. ; *Akhnai*, supra n. .

else's money. Giving outsiders corporate funds is charity, and for this purpose every corporate participant other than the shares is an outsider.

In short, when a corporation works for outsiders, it is doing something presumptively wrong under current norms and law. We expect an explanation along the lines of instrumental profit maximization. And we get them. It may look like we are giving corporate money to the CEO, say directors, but that is just an illusion: really, we are buying greater motivation from him. And so on down the line. Apparent charity, gifts and social responsibility are mere illusions: in reality, corporate managers are forced to claim, these apparent acts of good will are selfish–just brutal manipulations designed to enrich the corporation.

In contrast, when a corporation treats outsiders as mere tools to its ends, no explanation is needed. A corporation has done nothing that needs justification when it pays its employees the legal minimum wage and not a penny more; employs hordes of lawyers to find the minimum taxes it can legally pay; lobbies to modify environmental regulation to allow it to poor more junk into the air; or charges the highest price the market will bear. So long as the corporation remains within the law, the managers are entitled–indeed expected–to act as if the rest of society were of no interest to them. A corporation treats outsiders as a democracy treats foreigners: with respect, one hopes, but without solidarity.

Under current law, shareholders are different. A corporation that gives its shareholders more than the market demands is praiseworthy, with no overtones of breach of duty. Unlike high wages, low prices or charity, high dividends are not a suspicious act that needs to be defended in terms of the long run interests of the firm. Sometimes firms do offer instrumental explanations of high dividend policies: corporations have been heard to say that a high and steadily increasing dividend makes the financial markets more likely to support the firm, just as a high and steadily increasing wage makes employees more loyal. But corporate law does not require or encourage such excuses. No derivative action lies to test whether this explanation is a mere excuse for a give-away of corporate assets, because in the law's view, giving money to shareholders is not a give-away at all[86]. Giving corporate assets to shareholders is not even potentially waste or breach of duty.

The difference is simple: shareholders are "citizens," not "foreigners." Just as a democracy is supposed to work for its citizens, just as benefitting the partners is the same as benefitting a partnership, so too in the ordinary course our corporate law views benefitting the shareholders as the same thing as benefitting the corporation. A benefit to citizens is not a cost but rather a profit: it is a benefit to the institution. The difference between corporate citizens and corporate foreigners, then, is that benefits to the former are viewed as benefits to the corporation while benefits to the latter are costs to it.

[86]Except at or near bankruptcy, at which time some courts see a fiduciary duty to protect corporate creditors.

As a rule, modern corporate accounting and modern Delaware-model corporate law view shareholders as "citizens" and all other corporate participants as "costs". Payments to all corporate factors of production reduce profits, with the sole exception of those made to shares, which are thought of as made out of profits (defined as whatever is left after the other payments are made). There is nothing inevitable about this division, deeply ingrained as it is in our legal culture. Non-profit corporations (especially non-membership firms) have a radically different sense of who their "citizens" are; so do partnerships (which include some employees as "citizens"), cooperatives and other established business forms. Corporate constituency acts in most states recognize the possibility (even if they do not create the actuality) of a broader view of the corporate citizenry. At the edge of insolvency, we admit creditors into the "citizen" group. Some of our most successful institutions have multiple and conflicting "citizen" conceptions: Harvard University's Corporation appears to view its faculty, students, urban neighbors, educational and research missions, buildings and investments as both "citizens" and costs at different times and in different circumstances.

Corporate law decides who is a citizen and who is a cost. If corporate law made the environment an object of the fiduciary duty of corporations, profit-maximizing corporate managers would lobby for stronger–not weaker–environmental regulation. Only if they were freed to spend more money on reducing pollution, for example by penalizing free-loading competitors, would they be able to fulfill their mission. When environmental expenditures (like dividends) count as profit, responsible managerial maximizers will maximize it. If corporate law made employees citizens, managers might fight to pay shareholders the minimum they could get away, with Wall Street busting replacing union busting as a major and lucrative consulting specialty. The creative energies that now go into finding new ways to defect on bond contracts (so as to allow shifting corporate assets to shares) might instead be directed to finding ways to fool the equity markets (so as to allow shifting corporate assets to pay increases).

In a perfectly efficient and perfectly competitive friction-free market none of this would matter. All factors of production–shares no more or less than others–would be paid no more or less than their own cost of production. In the real world, friction usually is determinative. Managers directed to work for fictional shareholders will seek to evade laws that direct them to treat any other value or person as important. Managers given a different task would often act differently.

Corporate law, then, is anything but empty. It matters enormously. Our decision to leave corporate law to the corporations is a decision to create self-guided autonomous power centers under the control of no one. A market for law responsive to a financial market structured by law that it itself structures, with little input from citizens except within very narrow role constraints: this is the system we have created. It is one that is unlikely to reflect most human values except by accident.

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