

**THE IMPORTANCE OF CORPORATE MODELS:  
ECONOMIC AND JURISPRUDENTIAL VALUES AND THE FUTURE OF  
CORPORATE LAW**

By Prof. Benedict Sheehy (c) 2003

Title: The Importance of Corporate Models: Economic and Jurisprudential Values and the Future of Corporate Law

Author:

Benedict Sheehy  
Associate Professor  
Dept. of International Business  
Universidad de las Americas  
Puebla, Mexico

Biographical Sketch:

Professor Sheehy teaches international commercial law at the University of the Americas in Puebla, Mexico. He worked as a corporate lawyer for six years in Canada prior to becoming an academic lawyer. He publishes in the areas of corporate law, professional ethics, and insurance and law. He would like to thank Dr. Helmut Linder of the European School of Business, Reutlingen, and Dr. David Wetzell of the University of the Americas for their insightful comments, and Ms. Katharina Mirtsching for help with German law.

*Abstract: This article argues that the debate concerning the nature of the corporation is not finished and nor a mere intellectual exercise for interested legal academics. The current model of the corporation as an economic entity—the firm—has a number of imbedded value assumptions. Given the common territory between corporate law and economics, some scholars have come to identify the two as equal partners striving for the same ends. This is a serious error which has had and continues to have significant negative consequences for both the economic situation of the majority and justice in society. These value assumptions are being seriously brought into question in light of developing economic experience and analysis. In light of experience, the values are far from being universally accepted. Furthermore, they do not promote a just society. Models of the corporation are fundamental to the debate because models are both descriptive and prescriptive. For society to develop on just lines, the debate of the fundamental values needs to be brought into the open and brought under closer scrutiny.*

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JURISPRUDENTIAL VALUES AND THE FUTURE OF CORPORATE LAW

*Every school of thought is like a man who has talked to himself for a hundred years and is delighted with his own mind, however stupid it may be.*

J.W. Goethe, 1817, *Principles of Natural Science*

## 1 INTRODUCTION

Corporate law scholar, D. Millon, in his article “The Ambiguous Significance of Corporate Personhood”<sup>1</sup> argues that much of the current debate among scholars concerning the correct or most appropriate model of the corporation is misguided. He argues that the debate is misguided because it contributes little to the understanding of the actual use and operation of the corporation in today’s economy. Further, it does not jibe with current jurisprudence which seems to have settled on a particular efficiency based model.<sup>2</sup> Hence, to the extent that the purpose of having the correct model for the corporation is understanding actual use and operation of the corporation, he may be correct.

One approach to the corporate model debate includes a review of the history of the corporation, noting its privileged and public beginnings, the shift to the registration and

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<sup>1</sup> D. Millon, “*The Ambiguous Significance of Corporate Personhood*”, Washington and Lee Public Law and Legal Theory Research Paper Series, Working Paper No. 01-6, Jan., 2001.

<sup>2</sup> See comment of ,William T. Allen, *Contracts and Communities in Corporation Law*, 50 Wash. & Lee L. Rev. 1395, 1399 (1993).

limited liability corporations followed by the separation of management and shareholders.<sup>3</sup> Focusing on such things as legal fictions and nineteenth century legal developments, however, hardly informs or guides issues of the twenty first century. Another approach to the debate, largely informed by political views, is the debate between contractarian and progressive corporate law scholars.<sup>4</sup>

An effort to unravel the twisted jurisprudence is unlikely to be fruitful either, as the historical model debate demonstrates. The reality is that the corporation is a firm—a group of people organized to raise funds and operate a profitable business.<sup>5</sup>

These views, however, fail to go far enough into the issue. The issue is not “what is the corporation”? For to describe what is is not the same as to say what should be. This article commences with an examination of what is, and in particular, the model it is based on. It will then examine the values and assumptions underlying the model, and see how it has met its values or objectives. It will then examine its short-comings. Next it will turn to the future and see where corporations are going, asking if our model will be adequate to deal with those additional challenges. Finally we will propose a few modifications that a new model should perhaps include.

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<sup>3</sup> This approach seems to be more common among British and Australian corporate law scholars. See for examples, J. Dine, *The Governance of Corporate Groups*, (2000), S. Bottomley, “From Contractualism to Constitutionalism: A Framework for Corporate Governance” (1997) *Sydney LR* at p. 277, J. Farrar, “Frankenstein Incorporated or Fool’s Parliament? Revisiting the Concept of the Corporation in Corporate Governance” (1998) *10 Bond LR* at p. 161

<sup>4</sup> See P. Cox “The Public, The Private and The Corporation,” (1997) *80 Marq. L. Rev.* 391 and S. Bainbridge, “Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship.” *82 Cornell L. Rev.* 856

## 2 ECONOMICS: THE DISCIPLINE

Over the course of its brief history, economics has developed into a social science dealing with decision making and in particular, with predicting behaviour. It is essentially the science developed to analyze the utility of resources is economics, or perhaps more properly, the science of allocation under conditions of scarcity.<sup>6</sup> Although American economics has by and large failed to address the epistemological problems inherent to all science,<sup>7</sup> it has provided valuable insight into and support for decisions concerning creating a better society.

Economists generally assume a utilitarian approach,<sup>8</sup> using theoretical beings in developing models about the way the world works.<sup>9</sup> It is a long-standing and famous criticism of economics that its modeling and theory are quite removed from experience.<sup>10</sup>

As Nobel Laureate in economics, Ronald Coase, observed:

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<sup>5</sup> R. Coase, "The Nature of the Firm" 4 *Economia* (1937) (NS) 386.

<sup>6</sup> Lionel Robbins, *An Essay on the Nature and Significance of Economic Science*, (1932).

<sup>7</sup> The dearth of postmodern criticism of economics and general lack of requisite reflection on the foundations of the discipline are nearly incredible to humanists. For an encouraging and interesting tentative step in this direction, see Oxford economist, John Kay's musings "Postmodernism, Rationality Management" 7 March, 2001 *Financial Times*. Europeans have addressed these issues in more depth, particularly in the philosophy of science debate running from Karl Popper, to Thomas Kuhn, and on to Lakatos.

<sup>8</sup> Lon Fuller, *The Morality of Law*, 1962, Yale, p. 16, and see Posner's discussion comparing economics and utilitarianism in R. Posner, *The Economics of Justice*, 2<sup>nd</sup> ed. (1983), pp. 48-60.

<sup>9</sup> The rather extensive and at times overzealous use of assumptions in economics is a source of criticism both within and outside of the profession. As Cooter and Ulen light-heartedly repeat the comment, "the economist's predict was correct but the economy went wrong." In Robert Cooter and Thomas Ulen, *Law and economics*. 2nd ed., (1997), p. ix.

<sup>10</sup> See the interesting analysis of economists' mudslinging about theory in U. Maki, "Against Posner against Coase against theory." (1998) 22 *Cambridge Journal of Economics* 587.

Economics, over the years, has become more and more abstract and divorced from events in the real world. Economists, by and large, do not study the workings of the actual economics system. They theorize about it. As Ely Devons, an English economist, once said at a meeting ‘If economists wished to study the horse, they wouldn’t go and look at horses. They’d sit in their studies and say to themselves, “What would I do if I were a horse?”’<sup>11</sup>

Methodologically, economics works by establishing a point of reference and then adopting a value which it uses as a criterion for advocating or opposing a particular allocation, or predicting a particular behaviour.<sup>12</sup> Economics can be either normative or positive.<sup>13</sup> Normative economics includes a broad array of values, perspectives and approaches to the evaluation and allocation of society’s resources. It includes the ecological<sup>14</sup> and social values which are less often considered as part of traditional economic analysis, and is advocated and practiced by such noteworthy economists as Amarta Sen,<sup>15</sup> and Karl Polyani.<sup>16</sup> Normative economics, as represented by Ronald Coase<sup>17</sup> as an example, evidences some humility, recognizing that economics is but one of many approaches to addressing the problems of society, and in particular, the economic problems of society.<sup>18</sup> Coase, discussing economics’ movement into other

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<sup>11</sup> R. Coase, *The Task of Society*, quoted in H. de Soto, *The Mystery of Capital*, (2000) p. 15.

<sup>12</sup> See B. Hsiung’s excellent analysis of economic method in “The Success of Law and Economics: A Methodological Interpretation” (hereinafter, *Success*) pp. 7-10.

<sup>13</sup> For a simplified version, see Sir Richard Ivor’s discussion on the difference between descriptive and normative economics in law in his “Address to Inaugural Law and Economics Course” in the newsletter of Law & Economics Association of New Zealand, Sept. 1997, p. 3. Economics is simply put, not well suited to making these types of society shaping judgments. B. Hsiung’s “A Methodological Comparison of Ronald Coase and Gary Becker” (2001) *American Law and Econ Rev.* 186 (hereinafter *Methodological*) at

<sup>14</sup> See for example, R. Costanza, What is ecological economics? (1989) *Ecological Economics* 1(1): 1-7 and M. Sagoff, *The Economy of the Earth: Philosophy, Law, and the Environment.* (1988).

<sup>15</sup> A. Sen, *On Ethics and Economics* (1987)

<sup>16</sup> K. Polyani, *The Great Transformation*, (1944).

<sup>17</sup> R. Coase, “Economics and Contiguous Disciplines” (1978) 7 *J. of Legal St.*, 201-211 at 206-207.

<sup>18</sup> *Ibid* and discussed and explained in Hsiung, *Methodological*, op cit, n.13, p. 188-189

disciplines, offered: “it would perhaps be more plausible to argue that economists are looking for fields in which they can have some success.”<sup>19</sup>

Positive economics was a reaction against some of the more philosophically minded economists of the last century. Rather than focusing on theory, the positivists were concerned about what they could find in reality. One branch of this school developed the popular neo-classical approach to economics. Neo-classical economists claimed to be doing value free scientific inquiry and hence were not to be bound or judged by the philosophical mores or concerns of other economists. We will turn to examine the value free science claim later in this paper. For now, we will concentrate on neo-classical economics.

Neo-classical economics, contrary to their initial position, has moved a step beyond than positive economics by developing normative recommendations about how society should be organized and how resources should be allocated to meet those objectives.<sup>20</sup> It starts with the assumptions that all human behaviour as exclusively self-interested—i.e. humans as no more than “rational utility maximizers”<sup>21</sup>—and that all interaction as efficiency driven—i.e. market driven to find the lowest monetary cost for all goods and services. Indeed, Chicago economist Gary Becker states, “I am saying that the economic approach provides a valuable unified framework for understanding *all* human

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<sup>19</sup> R. Coase, “Economics and Contiguous Disciplines,” (1978) 7 J. Legal Studies 201 cited in B. Hsiung, *Methodological*, op cit, n. 13, p. 187, n. 2.

<sup>20</sup> For discussion of positive economics, see M. Friedman, “Positive Economics”, in *The Philosophy of Economics*, D. Hausman, ed (1990). pp 210-244.

<sup>21</sup> The famous *homo economicus* is what I am referring to. For an economist’s criticism of this model of human behaviour see Thaler, R. “Homo Economicus,” (2000) *Journal of Economic Perspectives* , Volume 14, Number 1, 133-141.

behaviour.”<sup>22</sup> Neo-classical economics, perhaps most commonly associated with the New Chicago School after the 1960’s<sup>23</sup> looks at the increase in wealth as the ultimate objective of social organization.<sup>24</sup> Where an action results in increased total wealth, the transaction should be transacted, regardless of the desires of the parties.<sup>25</sup>

The New Chicago School commonly uses Kaldor-Hicksian efficiency as the normative-standard to evaluate economic “institutions”. This is a normative form of economics whereby a dollars worth of value is the same across all persons. At this point, of course, economists are no longer engaged in positive economics; rather, they are implicitly validating the existing distribution of wealth and obviously, where this is the agenda, they will oppose any attempt at reallocation or “rent-seeking and rent-keeping.” What makes this argument a difficult one to engage is that in practice normative and positive economics get conflated, and particularly so by neo-classical economists who claim to be doing value-free science.<sup>26</sup> In the name of efficiency, following Kaldor-Hicks, they advocate that where an action results in increased total wealth, the transaction should be transacted, regardless of the desires of the parties.<sup>27</sup> This takes the form of a rule for the

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<sup>22</sup> G. Becker, *The Economic Approach to Human Behaviour*, (1976), p. 14. Although not all Economists agree with Becker in this respect, most would agree that one can explain much “social” and “political” behavior by reference to the pursuit of one’s self-interest.

<sup>23</sup> For a review of economic intellectual history, see Robert Heilbroner’s *The Worldly Philosophers*. For a brief summary of the Chicago School, see New School of Social Research’s history of economics website: <http://cepa.newschool.edu/het/schools/chicago.htm>

<sup>24</sup> See for example, Pareto efficiency or Kaldor-Hicks theorems. See also Posner’s discussion *Econ of Just*, op cit, n., 8 pp. 88-119.

<sup>25</sup> Kaldor-Hicks as applied in Calabresi and Malamed’s view of property law in , *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, (1972) 85 *Harvard L. Rev.*, 1089.

<sup>26</sup> See for example, Pareto efficiency or Kaldor-Hicks theorems. See also Posner’s discussion *Econ of Just*, op cit, n. 8, pp. 88-119. Concerning the conflation of positive and normative economics, see D. Hausen and M. McPherson, “Taking Ethics Seriously: Economics and Contemporary Moral Philosophy,” (1993) 31 *J. of Economic Literature*, 671-731, 673.

<sup>27</sup> Kaldor-Hicks as applied in Calabresi and Malamed’s op cit, n. 25.

allocation of property-rights discussed elsewhere in the law and economics literature.<sup>28</sup>

With the existence of transaction costs for their redistribution, the right should be assigned to the party that values it most initially.

If we return to Hsiung's methodological discussion, we recognize a dramatic difference between the two approaches. Hsiung pointed out the central role of value selection—referred to by Posner as “frame of reference”<sup>29</sup>—in determining the nature of the economic project. Whereas most normative and positivist economists are open to alternative values, neo-classicists have selected their one value and closed the door to other values. Selecting a value and developing knowledge has moved from being mere descriptive, normative economics, to positivist economics. This selection and total rejection of alternative values by the neo-classical economists is highly inappropriate and amounts to dishonesty in the academy. As noted economist Robert Heilbroner observes: “what is essential, then, is to become aware of one's socio-political values, not to pretend they do not exist.”<sup>30</sup> He goes on to note: “economics, in its ‘purest’ form is intrinsically and inescapably ideological.”<sup>31</sup>

The discipline most suited to developing value judgments can hardly be mathematically focused economics. Rather, those types of judgments are properly the province of philosophers. Although earlier in its history economics was affiliated with philosophy

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<sup>28</sup> Ibid.

<sup>29</sup> Noted and discussed in Hsiung, *Success*, op cit, n. 12 p. 10, n. 33.

<sup>30</sup> R. Heilbroner, “Vision and Analysis in the History of Economic Thought” in Pier Porta et al, eds. (2001) *Knowledge, Social Institutions and Division of Labour*. Pp. 54-63, at p. 61.

<sup>31</sup> Ibid, at p. 63.

and the humanities, it abandoned that approach in favour of a scientific methodology.<sup>32</sup> If economists wish to continue to make value decisions within the academy, they must abandon their claim to be conducting scientific study and producing scientific knowledge. Undoubtedly, the philosophers would be delighted to further participants in their engaging debates.

Nevertheless, if we examine neo-classical economics from a methodological perspective, we find that the neo-classicist economists have selected efficiency as the primary value of society.<sup>33</sup> All other values, including justice, mercy, and happiness come second, if at all.<sup>34</sup> Once having made this value judgment, further discussions of right and wrong, moral or immoral are ignored or dismissed as meaningless.<sup>35</sup> While appropriate for a science to dismiss such discussion, at least in some views<sup>36</sup> it is questionable methodologically to deny or stifle the a priori value debate in science, particularly where the selection of values is at the foundation of the method and therefore determinative of outcomes.<sup>37</sup> It is generally recognized, however, that efficiency is not an ultimate end. It is an immediate end. So, for example, the value of efficiency in killing a group of people targeted for execution depends on the perspective. From the perspective of the killers,

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<sup>32</sup> Heilbroner, *op cit*, n. 23.

<sup>33</sup> Hsiung, *Success*, *op cit*, n. 12, p. 14, notes “For economists, using efficiency as the criterion of judgment is almost beyond dispute.”

<sup>34</sup> While scientists can hardly be faulted for not addressing such values, the issue of economic science, which deals with such issues, is called into question as we shall see later. Posner has dealt with happiness in his readable and thoughtful criticism of utilitarianism; however, his wealth maximization principle does not address this issue any better—perhaps a criticism he himself recognized. See *The Econ of Justice*, p. 52.

<sup>35</sup> See for example, R. Posner, “1997 Oliver Wendell Holmes Lectures: The Problematics of Moral and Legal Theory,” (1998) 111 *Harv. L. Rev.* 1637.

<sup>36</sup> The problem here is whether or not one accepts science as value-free.

<sup>37</sup> This stronger view of the role of the researcher’s bias interestingly finds its roots in the natural sciences, and particularly with the phenomenon of researcher observation creating the phenomena in subatomic particle physics.

efficiency is an important value. From the perspective of the victims, inefficiency is the highest value. The value of efficiency, therefore, depends on the ends which it seeks to achieve.

For neo-classical economists, such as Chicago's Friedman quoted above, the ultimate end—the increased monetary wealth in society<sup>38</sup>—is the sole, exclusive and ultimate Good.<sup>39</sup> Accordingly, all their prescriptions for social organization and order revolves exclusively around increasing wealth (or at least utility) by increasing efficiency.<sup>40</sup> Any brake on efficiency is seen as wrong, erroneous, unscientific, and directing society down the wrong path. It is “irrational.”<sup>41</sup> If scientists were to use the language of ethics—which they sometimes slip into—they would argue that inefficiency is an immoral, evil waste of money. As such, economics tends to be limited to discussion of things that can be monetized.<sup>42</sup> While this limitation is insignificant in the discussion of economy, there can hardly be anything more significant to a discussion of human life. Health, happiness, family, friends and a sense of fulfillment—the most important things in life—simply are

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<sup>38</sup> Views clarified and argued by R. Posner, *Econ of Just*, op cit, n. 8.

<sup>39</sup> See Posner's chapter 3 of *Econ of Just*, op cit, n. 8, in which he sets out his theory of “wealth maximization” and specifically deals with it in chapter 4 “The Ethical and Political Basis of Wealth Maximization” as an ethical theory, in Posner, *Econ of Just*, op cit, n. 8, pp. 48-115 and in Malloy and Posner in “Debate: Is Law and Economics Moral?” 24 Val. U. L Rev. 147. Interestingly, in his 1997 Oliver Wendell Holmes lectures he denies completely having ethical concerns. His most distinguished opponent, R. Dworkin, challenges the views expressed in the Holmes Lectures in R. Dworkin, “Darwin's New Bulldog,” (1998) 111 Harv. L. Rev. 1718.

<sup>40</sup> To argue the opposite—that a society should be organized around creating inefficiency—fails to grasp the point of the discussion. The issue is not whether efficiency is an important value. Rather, the concern is whether it should be the sole or ultimate value or organizing principle of a society.

<sup>41</sup> Before concluding that it is “irrational”, however, one must consider the nature of rationality in economics, and in particular bounded rationality. Given the limited and imperfect character of the information we possess and the developing understanding of fuzzy concepts and chaos theory, conclusions about “irrationality” should carry a significant caveat—namely, that a choice or decision may be “irrational” but only so in the model being used.

<sup>42</sup> See discussion of money and monetary system in H. de Soto, *The Mystery of Capital*, (2000) NY, Basic Books, pp. 43-44, 63.

not subject to monetization.<sup>43</sup> Neo-classical positive economics tends to lack the humility of normative economics and is subject to the criticism of “economic imperialism.”<sup>44</sup>

Thus, while efficiency is clearly an important value,<sup>45</sup> it can hardly be the fundamental or organizing value or principle of a society.<sup>46</sup> In Sir Richard Ivor’s understatement: “A society where everyone is intent on maximizing their own wealth has its limitations.”<sup>47</sup> Efficiency may require killing off the excess humans or enslaving some other humans.<sup>48</sup>

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<sup>43</sup> Both Posner and Becker recognize the difficulty and overriding importance of non-monetized events and values. They have taken different approaches in dealing with them. Posner has acknowledge them, but largely been silent (see *Econ of Justice*, p. 64). Becker, by way of contrast, has applied his method even to such thorny issues as marriage, family and free time. *The Economic Approach to Human Behavior*, (1976).

<sup>44</sup> R. Swedberg, *Economics and Sociology*. In addition, for a criticism of the economic analysis of law, see, for instance, R. Dworkin, *Is Wealth a Value?* 9 *J. Legal Stud.* 191 (1980); R. Malloy, *Law and Economics: A Comparative Approach to Theory and Practice* (1990); R. Epstein, *Law and Economics: Its Glorious Past and Cloudy Future*, 64 *U. Chi. L. Rev.* 1167 (1997); and N. Nussbaum, *Flawed Foundations: The Philosophical Critique of (a Particular Type of) Economics*, 64 *U. Chi. L. Rev.* 1197 (1997). As observed by economist, Abba Lerner, “Economics has gained the title of queen of the social science by choosing *solved political problems* as its domain.” “The Economics and Politics of Consumer Sovereignty,” 62(2) *American Economics Review*, (1972), 258-266, cited in S. Bowles and H. Gintis, “Revenge of Homo Economicus: Contested Exchange and the Revival of Political Economy.” 7(1) *J. of Econ. Perspectives*, 83-102, (1993) p. 86.

<sup>45</sup> Hsiung observes that “For economists, using efficiency as the criterion of judgment is almost beyond dispute, but for some legal scholars at least, they find it difficult to accept the idea of efficiency as applied to studying legal studies.” *Success*, op cit, n. 12, p. 14.

<sup>46</sup> Societies have been organized around religion, social class, social relationships, artistic ability, warriors’ power etc. It is important to recognize that each of these societies considered itself to be “the best, most advanced etc.”. This recognition must bring a bit of humility to our evaluation of our economically driven society. See F. Fukuyama’s *The End of History and The Last Man*, and particularly his concluding chapter.

<sup>47</sup> “Address to Inaugural” op cit, n. 13, p. 3. Posner would argue not only that it is possible, but that society in fact does organize itself and its laws on the basis of efficiency. See his chapters “A Theory of Primitive Society” and “The Economic Theory of Primitive Law” in *Economics of Justice*, pp. 146-173 and 174-206 respectively.

<sup>48</sup> Posner recognizes this as a valid criticism of traditional utilitarian based economics in *Econ of Just*, n. 8, p. 54. While his theory successfully dodges this problem with utilitarianism, its error is equally egregious if not more pernicious in restricting all discussion and allocation of the world’s resources to those with the sufficient economic resources to acquire them. Posner argues that he and his fellow court of appeal judges are just average, ordinary citizens. It is hard to imagine how a person who could afford a minimum of seven years education, practice law for the requisite period earning an average lawyer’s salary, and have the political connections and prestige to be appointed appeal court judges are to be considered simply the average person. For further discussion and a more fundamental criticism of Posner’s view see those raised

Even neo-classicist Friedman acknowledges efficiency cannot be the driving force of society. He wrote, “I would favor a free society even if it were less productive than some alternative—say a slave society... because my basic value is freedom itself.”<sup>49</sup>

Nevertheless, neo-classical economists ignore other just such values, the values usually considered in economics, namely, freedom, security, justice and welfare.<sup>50</sup>

### 3 LAW AND ECONOMICS

The role of economics in legal analysis has blossomed since Coase’s critical 1960 contribution “The Problem of Social Cost,”<sup>51</sup> for understandable reasons and with good results.<sup>52</sup> In fact, it has developed to the point that, as one scholar puts it: “economic analysis in legal scholarship has become so *de rigueur* that even those who refuse to view economics as the Holy Grail of knowledge are compelled to use economics in their scholarship.”<sup>53</sup> Economics, adopted by law and economics scholars, tends to be neo-classical economics with its driving value, efficiency.<sup>54</sup> These neo-classical positive

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by N. Siegel, “Sen and the Hart of Jurisprudence: A Critique of the Economic Analysis of Judicial Behavior,” (2000) 87 Calif. L. Rev. 1581.

<sup>49</sup> M. Friedman, “Free Markets and Free Speech,” 10 Harvard J. Law & Pub. Pol’y 1 (1987). But to be consistent, should not Friedman then be developing an economics based on freedom as the ultimate value instead of efficiency?

<sup>50</sup> Interestingly, one of the supposed champions of neo-classical economists, von Mises considered these values as important and important in economic analysis. His concerns for these values tend to be completely missed by his later admirers who take him to be a neo-liberal, neo-conservative economist without social concern. The issues related to social costs were first brought up by Arthur Cecil Pigou which he addressed as externalities.

<sup>51</sup> R. Coase, “The Problem of Social Cost,” (1960) 111 Journal of Law of Economics, 1.

<sup>52</sup> For an enlightening discussion of this phenomenon, see B. Hsiung, *Success*, op cit, n. 12.

<sup>53</sup> A. Seita, “Common Myths in the Economic Analysis of Law,” (1989) B.Y.U. L. Rev. 993, 995-997.

<sup>54</sup> See for a general discussion of the development of economics in expending beyond the Economics Department, and particularly, into law, B. Hsiung, *Success*, op cit n. 12. A review of the general law and economics literature leads one to the conclusion of the efficiency value. See, for example, some of the criticisms of law and economics raised by Robin Paul Malloy, *Law and Market Economy: Reinterpreting the Values of Law and Economy*, (2001) Cambridge University Press. For a remarkably insightful and thorough article concerning the a priori philosophical and political values and commitments of scholars and relating them to corporate law, see Cox, op cit n. 4.

economists of law and economics scholarship posit one form of efficiency, wealth maximization, as the fundamental principle of social organization.<sup>55</sup>

Nevertheless this meeting of law and very limited, outdated<sup>56</sup> neo-classical positive economics<sup>57</sup> is seen by some law and economics scholars, including no less a noteworthy than Judge Posner,<sup>58</sup> to be the ideal. In the view of those law and economics scholars, law is the practical application or implementation of economic science and positive

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<sup>55</sup> The obsession with size in America, and particularly the idea that larger is better, is subject to many criticisms. In this particular case, one cannot but help make the analogy of craniometry—the “science” of brain size, founded by Paul Broca and Samuel Morton, and the “science” of wealth maximization where in both instances bigger is “better” without a deep understanding what “better” really is. Craniometry disappeared from the academy when it was realized and admitted that the evidence did not bear out the hypothesis. One can only hope that the neo-classicists will have the integrity and graciousness to take note of the evidence and follow that example.

<sup>56</sup> See criticisms below concerning postmodernism and economics. Also, see Amartya Sen’s criticism of the mechanistic method to economic analysis applied by contemporary economic theory which method he sees as its “major deficiency.” In *Ethics and Economics*, (1987) p. 28.

<sup>57</sup> The dearth of postmodern criticism of economics and general lack of requisite reflection on the foundations of the discipline are nearly incredible to humanists. For an encouraging and interesting tentative step in this direction, see Oxford economist, John Kay’s musings “Postmodernism, Rationality Management” 7 March, 2001 *Financial Times*. See also R. Rossini Favretti “Interpretation and Representation in the Discourse of Economics”, in P. Porta et al *Knowledge, Social Institutions and the Division of Labour* (2001) Northampton, USA.

<sup>58</sup> In much of the discussion that follows, I have taken Posner as the leading exemplar of law and economics positivists. As will be evident, my disagreement with Posner about the correct location of efficiency in the schemata of social values, leads to a number of criticisms of his positions. I have made an effort not to fall into the error some scholars engaged in the debate who tend to argue with caricatures of other positions rather than the real positions—an error identified by Cox Cox, n. 4, p. 401 Instead, I have developed my criticisms from reading of Posner. In my reading of Posner’s work his views appear to have become reified, more extreme and hence less nuanced over time. This trend makes it more difficult to access and assess his later work and accordingly, most of the discussion below deals with his earlier work, *The Economics of Justice*. My disagreement with Posner’s thinking and views should not be read as a denigration of his clever and thoughtful consideration of the issues he touches. It is an intellectual disagreement, with openness to competing values, much as he demonstrated in his earlier writings. At this time in his career, although not value-free as none of us are, at least he appeared open to considering alternative values, and it is in this spirit that I intend to offer this work and criticism. As Cunningham in his thorough and critical analysis of Posner’s claims notes: “no single view or approach endorsed by all proponents of economic analysis of the legal system, one viewpoint has remained the most prominent—that of Judge Richard Posner.” W. Cunningham, “Testing Posner’s Strong Theory of Wealth Maximization.” (1992) 81 *Geo. L.J.* 141. A legitimate argument could be made that Richard Epstein also of Chicago and the most cited law and economics legal scholar should serve as exemplar.

[http://www.utexas.edu/law/faculty/bleiter/rankings02/most\\_cited.html](http://www.utexas.edu/law/faculty/bleiter/rankings02/most_cited.html) My reason for focusing on Posner is his long career, his efforts to balance and consider his thinking in light of his judicial practice, his prominence in the Law and economics approach as just noted, and his efforts to communicate his views to

economic policy. Law is but the tool for balancing the utility of various competing claims and is best suited among society's tools for making decisions about those divisions, giving rise to and increasing society's overall wealth. The general idea is to bring scientific certainty, objectivity and impartiality to legal decisions.<sup>59</sup> Law allocates costs to where it is most efficient to do so<sup>60</sup> regardless of where they can be most easily absorbed. Corporate law, according to this view, as one spoke in the wheel of overall society, is to be developed, interpreted and applied extrapolating along this line for the exclusive purpose of increasing the economic output and wealth of society.

The economic role of the corporation tends to be the focus of analysis when one has come to the conclusion that the corporation is an economic arrangement or organization, and that corporate law is about increasing efficiency whether in the market, through such things as disclosure legislation and securities, or in terms of the overall welfare of society fulfilling the obligations of business.<sup>61</sup> As argued famously Nobel Laureate in Economics, Milton Friedman, the social good achieved by a corporation is producing a profit. As he wrote in his controversial 1970 article:

the one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits.... Few trends could so thoroughly undermine the very foundations of our free society as the acceptance

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the non-academic universe make him an important voice for the positivist economics perspective among the populous.

<sup>59</sup> Robin Paul Malloy, *Law and Market Economy: Reinterpreting the Values of Law and Economy*, (2001) Cambridge University Press, p. 5. Again, the idea of any science, let alone a social science, being certain, objective or value-free, no longer has credibility. The foundational work criticizing economic's pretensions to being value-free science was done by R. Heilbroner. "Economics as 'Value Free' Science" 40 Soc. Res. 129 (1973). See discussion of postmodernism above Rossini Favretti, op cit n. 57. See also the discussion of Critical Theory in D. Braybrooke, *The Philosophy of Social Science* (1987) and various Critical Legal Studies theorists such as Kennedy.

<sup>60</sup> Calabresi op cit, n. 25. This is the fundamental contribution of Coase in "The Problem of Social Costs" op cit n. 51.

<sup>61</sup> See for example M. Jensen, "Maximization, Stakeholder Theory and the Corporate Objective Function." (Fall, 2001) 14 (3) *Journal of Applied Corporate Finance* .

by corporate officials of a social responsibility other than to make as much money for their stockholders as possible.<sup>62</sup>

He argues that the fundamental freedom of society is properly equated with the unadulterated, unmitigated pursuit of shareholder wealth.<sup>63</sup>

Unfortunately, the positive economics and law approach fails to notice a critical and very fundamental difference between law and economics. As Joseph Singer puts it, drawing from T.H. White's character Balin "There is something important in humanity... I cannot at present describe it."<sup>64</sup> Singer identifies the issue of fairness as one of law's particular contributions to society and suggests, among other things, that the answers proposed by economists<sup>65</sup> fail to meet some fundamental needs and desires of human nature.

#### 4 LAW AND SOCIAL VALUES

Is arbitration of disputes with an eye to increasing of societal wealth the total or whole and complete role of law? Such a view would hardly appeal to the average citizen.<sup>66</sup>

Indeed, from the perspective of the average citizen law that only adds and subtracts wealth would be exceedingly strange. The courthouses are not called the House of

Economics and nor do the scales in the hands of the blindfolded Goddess of Justice,

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<sup>62</sup> "The Social Responsibility of Business is to Increase Its Profits," NY Times Magazine, Sept. 13, 1970, at 32-33, 122, 124, 126.

<sup>63</sup> A similar view is taken up by business scholars Michael Jensen and William Meckling in an alarmist, radical, and in hindsight clearly incorrect, article "Between Freedom and Democracy" (Oct. 1977) The Banker available at SSRN Electronic Library.

<sup>64</sup> T. White, *The Book of Merlyn*, quoted in J. Singer, "Something Important in Humanity" (2002) 37 Harv. C.R. C.L. L. Rev. 103.

<sup>65</sup> Singer's concern is with welfare economics, and in particular the work of L. Kaplow and S. Shavell *Fairness Versus Welfare*, 114 HARV. L. REV. 961 (2001). See Singer *ibid*.

Themis, contain gold coins or stacked dollar bills.<sup>67</sup> Rather, the scales hold a human heart. These figures are symbols of something different from economics and efficiency. It is something we call justice. The difficulty of defining the term, although notorious, need not force us to declare it meaningless and throw up our hands in defeat. Rather, it is a vague term—a term that by definition is not wholly or readily definable.<sup>68</sup>

Law is concerned not only with economic efficiency, but with things we call retribution, personal responsibility,<sup>69</sup> fairness,<sup>70</sup> and a just society.<sup>71</sup> It is a discipline extending well beyond economic concerns<sup>72</sup> looking to aspirations for individual human beings as well as for society as a whole. Its framework is not and cannot be limited to maximizing wealth transactions. As Sir Richard Ivor notes: “there are always policy trade-offs between efficiency, fairness and other individual and community values” with which law must concern itself.<sup>73</sup> In particular, law cannot be limited to a discussion of how to organize and protect those with wealth.<sup>74</sup>

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<sup>66</sup> Both law and economics escape the grasp of the average citizen. Law’s highly technical reasoning is simply beyond most people’s interest or ability, as Posner has noted, and economic analysis is either objectionable or in some models too technical, as Hsiung has noted, *Success*, op cit, n. 12.

<sup>67</sup> Traditional representations of *Themis* have a human heart in the balance.

<sup>68</sup> On the growing recognition of importance of vagueness in science and mathematics, see the R. Sorenson, “Vagueness” Stanford Encyclopedia of Philosophy (Fall Edition 2001) Edward N. Zalta (ed) <http://plato.stanford.edu/archives/fall1999/entries/russell/>

<sup>69</sup> The role of personal responsibility in the development of the human personality is central to much philosophy, from the idea of individual responsibility in Aristotle’s virtue ethics to the Existentialists’ angst and personal quest for meaning, as well as psychology including such thinkers as Karl Rogers and Abraham Maslow.

<sup>70</sup> Which includes of course, issues of distribution of resources, an activity greatly assisted by economic analysis.

<sup>71</sup> As Rawls observes, “A theory however elegant and economical must be rejected or revised if it is untrue; likewise laws and institutions no matter how efficient and well-arranged must be reformed or abolished if they are unjust.” *Theory of Justice*, p. 1.

<sup>72</sup> See T. Ulen, “Firmly Grounded: Economics in the Future of the Law” (1997) 3 *Wis. L. Rev.* 433 at p. 436.

<sup>73</sup> “Address to Inaugural” op cit n 47, p. 1.

Some readers may object that this article is not dealing with real law and economics scholars but a mere caricature.<sup>75</sup> Consider, however, Posner's explanation of value: "The most important thing to bear in mind about the concept of value is that it is based on what people are willing to pay for something rather than on the happiness they would derive from having it."<sup>76</sup> He goes on to explain: "The wealth of society is the aggregate satisfaction of those preferences (the only ones that have ethical weight in a system of wealth maximization) that are backed up by money."<sup>77</sup> Posner's dismissal of those people without resources as not valuing goods is difficult to understand and morally unacceptable even by the society he purports to represent. Recent pharmaceutical companies' decision to supply HIV drugs at low cost because of public pressure suggests that maximizing social wealth is not a sufficient or acceptable organizing principal or value to many Americans.<sup>78</sup>

Does Posner truly expect people to believe that a starving person with no money places less value (in any recognizable sense of the word) on a loaf of bread than a wealthy person who happens to buy a loaf to feed the ducks?<sup>79</sup> With a swipe of the pen Posner and some law and economics scholars have wiped off the concerns of 5.9 billion people

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<sup>74</sup> See Critical Legal Studies analysis of law as found, for example,

<sup>75</sup> See criticism noted by Cox, *op cit*, n 4, (n. 47 mentions caricature)

<sup>76</sup> Posner, *The Econ of Justice*, p. 60. Curiously, this explanation of wealth ignores the economic principle established by Daniel Bernoulli concerning the marginal utility of money. That principle is that the value of each additional dollar is less than the one prior.

<sup>77</sup> Posner, *the Econ of Justice*, p. 61

<sup>78</sup> The drug industry escaped this fate when in 1995 it stopped producing eflornithine, the cure for sleeping sickness, because of the lack of public awareness of sleeping sickness and because it does not strike people in Northern climates. It is estimated that the drug would save the 66,000 people who die of it annually. Production of the drug was restarted when pharmaceutical companies were able to commercialize its harmful side-effects.

<sup>79</sup> Dworkin's criticism of Posner, noted in *Econ of Just.*

because they lack the dollars necessary to purchase resources.<sup>80</sup> Oddly, if one were to consider the issue from a broader perspective, these people have all the same rights, including property rights in the environment to such things as clean air and water that provide an economic contribution of more than \$35 trillion<sup>81</sup> to the world's productive output of which America is a notoriously disproportionate non-paying (non-valuing, or perhaps, thief) over-consumer but nonetheless law and economics scholars dismiss.

Law recognizes that human nature is not only self-interested nor wealth driven in a way that positive economics does not.<sup>82</sup> For example, one need look no further than the Steve Martin character in the movie *The Jerk*. In that movie, Martin plays a character who became fabulously wealthy as a result of a quirky invention. In the course of the movie, the wealthy Martin marries, and later, as he loses his fortune, finds himself in a divorce. As he stumbles out of the mansion weeping, he grabs a few items that have meaning or "wealth" for him. He bawls; "All I want is this ashtray, my blanket and a pair of pants." The money involved simply does not interest him.

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<sup>80</sup> Estimates of the world's population are 6.5 billion, of whom 10% live a "developed" lifestyle—i.e. have the income necessary to support excess consumption.

<sup>81</sup> Figure from world renowned scientist and ecologist, David Suzuki, in "Suzuki offers 10 steps to save the planet" R. Cairney (January 10, 2003 ) Express News, University of Alberta. [http://www.expressnews.ualberta.ca/expressnews/articles/news.cfm?p\\_ID=3646&s=a](http://www.expressnews.ualberta.ca/expressnews/articles/news.cfm?p_ID=3646&s=a) R. Constanza offers a range of \$16 trillion to \$54 trillion. et al., The Value of the World's Ecosystem Services and Natural Capital, 387 NATURE 253 (1997) at 259 cited in D. Kysar, Sustainability, Distribution, and the Macroeconomic Analysis of Law (2001) 43 B.C. L. Rev 1, at 40.

<sup>82</sup> Economics is not the "Imperial Science." Although it examines various aspects of human behaviour, it is not all determinative nor can it be. Law and economics tends to use only one economic model of humans. These humans are singly motivated: they act only as "rational self-interested maximisers." Obviously, this model tends to be excessively reductionist. Exacerbating the issue is its dogmatic application over what is likely too wide a scope. See B. Hsuing "The Success of Law and Economics: A Methodological Interpretation", available at Law & Economics Association of New Zealand website, [http://www.leanz.org.nz/SITE\\_Default/SITE\\_papers/default.asp](http://www.leanz.org.nz/SITE_Default/SITE_papers/default.asp) Other models which include a much broader approach to human behaviour and society, such as that of Amarta Sen, are simply not addressed.

The positive economist has difficulty explaining this action. The lawyer acting for Martin, in order to avoid a negligence claim later would have to advise him to consider more carefully his economic rights. Nevertheless, should Martin the client persist in this view, the lawyer should not substitute her view of justice, fairness or value for that of the client. And the law must and does take account of these various value systems.

Economics, at least as utilized by law and economics, cannot.<sup>83</sup> As Hart has famously said, “law, however, is too important a thing to be left to lawyers,”<sup>84</sup> and Rorty the same concerning philosophers,<sup>85</sup> it is undoubtedly true the underlying value judgments required in economics are too important to be left to the economists.

## 5 JURISPRUDENCE AND CORPORATE LAW

Bringing our discussion back to the corporation then, we can see that the economic analysis of the corporation does not take into account all of law’s separate objectives such as fairness and justice. Further it fails to include plurality of values. Even a modest review of current corporate law objectives in the United States suggests that a plurality of values forms the basis. Furthermore, these values are not at all in coincidence with one another: They conflict as they represent different values in the corporation, society and competing policies. Millon, for example, argues that corporate law has at least four norms. He suggests that it should: (1) promote stable relations between certain non-shareholder constituencies and the corporation, (2) adjust the gains between shareholders

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<sup>83</sup> For a discussion of Rational Choice Theory in Law and Economics, see T. Ulen, Rational Choice and the Economic Analysis of Law, (1994) 19 L. & Soc. Inquiry 487.

<sup>84</sup> H.L.A. Hart, “Bentham on Legal Rights,” in Oxford Essays in Jurisprudence (2<sup>nd</sup> Series) A. B. Simpson ed. (1973) reprinted in D. Lyons ed., Rights, (1979), p. 146.

and non-shareholders, (3) address the fairness in allocation of transaction costs, and (4) look for ways to include in decision making those most directly effected by such decisions.<sup>86</sup>

Corporate law scholar Eric Orts observes the conflicting values in corporate law itself. He notes, for example, the divided economic object: profit vs. wealth, short vs. long term, central management vs. dispersed capital providers, capital accumulation, protection of investors, and the protection of other interests.<sup>87</sup> He offers following the law as an objective in itself described as “modest idealism.”<sup>88</sup> Orts even identifies the ethical dimension of corporate law that allows for the non-economic considerations of ethics and justice seen in such instruments as anti-takeover legislation.<sup>89</sup> Following a remarkable and interesting analysis of corporate legal theory Orts observes:

policies underlying corporate law cannot be reduced to a uni-dimensional value, such as the economic objective of ‘maximizing shareholders' wealth’ or even, more generally, ‘economic efficiency.’<sup>90</sup>

To narrowly limit discussion and consideration of corporate law to matters of economy and more specifically therefore is either an error or a blatant political choice.<sup>91</sup> If it is a political choice, that choice must be put on the table and debated as such, instead of attempting to hide it under the cloak of objective science often translated into orthodox

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<sup>85</sup> R. Rorty, *Philosophy and Social Hope* (1999).

<sup>86</sup> D. Millon, “New Directions In Corporate Law Communitarians, Contractarians, And The Crisis In Corporate Law,” 50 Wash & Lee L.R. Rev. 1373, at p. 1388.

<sup>87</sup> Eric W. Orts, “The Complexity And Legitimacy Of Corporate Law” (Fall, 1993) Washington & Lee Law Review 50 Wash & Lee L. Rev. 1565 (hereinafter *Complexity* ).

<sup>88</sup> R. Clark, “Agency Costs versus Fiduciary Duties,” in *Principals and Agents: The Structure of Business*, 55-79 (J. Pratt and R. Zeckhauser eds., 1984) cited in Orts, *Complexity*, op cit n, 87 p. 1602.

<sup>89</sup> Orts op cit, n. 87. This is a summary of Orts extensive arguments on pp. 1587-1612.

<sup>90</sup> *Ibid*, p. 1612

business management studies.<sup>92</sup> It is most certainly a right of all members of a society to participate in such a debate regardless of their material resources. First they have this right at least to the extent that they live in a democracy. Democracy is based in part on the view of individual worth and self-expression. Second, humans rarely occupy material resources for more than eighty years. After that time material resources are passed on, dispersed, lost, disposed of or simply disintegrate. By way of contrast, the social decision we make as a society has wide ranging, long-lasting and significant consequences, not only in our lifetimes but may affect the very future of life on the planet. Finally, the nature of the discussion must address the public property versus private property debate. At what point, if any, should control of vast amounts of resources and vast groups of people be regulated by the public?<sup>93</sup> Where such political decisions are being made, those decisions should be put on the table and openly discussed from these political decisions, appropriate models are developed, and indeed models are generally expressions of political decisions.<sup>94</sup>

## 6 MODELS<sup>95</sup>

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<sup>91</sup> S. Bainbridge explicitly acknowledges his debate with communitarian corporate legal scholars is political. *Op cit n 4*, p. 857.

<sup>92</sup> See for example, business scholar, Michael Jensen. Although Jensen has been vocal in his political leanings in earlier works such as “Between Freedom and Democracy,” (1977) *The Banker* 39, where he uncritically advocates certain views as apolitical truth, he seems to have dropped any mention of his views and presents his later work, although still informed by the same political views as objective management science. “Value Maximization, Stakeholder Theory, and the Corporate Objective Function.” (2001) *Journal of Applied Corporate Finance*.

<sup>93</sup> The issue of public and private is addressed considerably in the literature under the rubric of stakeholder modeling. See also Cox *op cit n. 4*, G. Mark, “The Personification of the Business Corporation in American Law.” (1987) 54 *U. Chi. L. Rev.* 1441 and J. Gordley, “The Moral Foundations of Private Law” (2002) 47 *Am. J. Juris.* 1

<sup>94</sup> This is certainly the case in politics even more than in science. See P. Feyerabend’s work on modelling and theory in his work on the philosophy of science.

<sup>95</sup> I have chosen to analyze this debate from the perspective of the Philosophy of Science. It has been considered in an insightful article by Thomas Joo from the perspective of Cognitive Science and Literary

Models have an important part to play in understanding,<sup>96</sup> whether attempting to understand oneself,<sup>97</sup> one's community,<sup>98</sup> or the universe itself.<sup>99</sup> Generally, models are miniature or simplified representations of structures, systems or processes.<sup>100</sup> They provide insight about how things may work, and provide a platform from which it is possible to gain deeper insights and make better predictions, projections and suggestions about how things may work in the future, including very importantly, how modifications to structures, systems or processes may effect their future working.<sup>101</sup> The first, informative function of models is sometimes described as “descriptive modelling.”<sup>102</sup> It is particularly useful in natural sciences where such models help explain natural phenomena and permit us to understand causal connections between such phenomena. In the social sciences, this is the more conservative approach to the scientific endeavour.<sup>103</sup>

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Heuristics in “Corporations Theory and Corporate Governance Law: Contract, Property, and the Role of Metaphor in Corporations Law” (2002) 35 UC Davis L. Rev. 779. Joo suggests that the corporation as a nexus of contracts—i.e. the Firm metaphor—is of limited applicability and therefore limited validity in explicating the nature of the corporation. His recommendation of improving the metaphor by considering the property aspects of the corporation deserves serious discussion. An alternative view is taken by Paul Cox who writes “clashing political moralities are imperfectly modeled as a confrontation between ‘communitarianism’ and the neoclassical economic analysis of the firm” in “The Public, The Private and The Corporation” (1997) 80 Marq. L. Rev. 391, at p. 396.

<sup>96</sup> As a curious note, models are not likely exclusive to humans. Psychologist Edward Chace Tolman studying rat abilities in navigating labyrinths, suggested that they create a “cognitive map” or model in order to navigate successfully. “Cognitive Maps in Rats and Men” (1948) 55 Psych. Rev. 189-208

<sup>97</sup> Models in psychology

<sup>98</sup> Models in social sciences

<sup>99</sup> Models in physical sciences

<sup>100</sup> See section “Model history is culture history” in Dr. Mueller “The Concept of Model and the Quadruple History of ‘Modulu’”, opening lecture of the 13<sup>th</sup> International Conference on History and the Philosophy of Science, Univ. of Zurich, 19-22 Oct., 2000 on Scientific Models: Their Historical and Philosophical Relevance.

<sup>101</sup> See for an extended discussion, M. Morgan and M. Morrison eds. *Models as Mediators: Perspectives on Natural and Social Science* (1999).

<sup>102</sup> See Braybrooke, chapter “Causal Regularities on the Naturalistic Side” in *Philosophy of Social Science*, (1986), pp. 20-46.

<sup>103</sup> See D. Braybrooke’s chapters “Three Sides of Social Science” “Settled Social Rules on the Interpretive Side” in, pp. 1-19 and 47-67 respectively.

The second predictive function is denominated “prescriptive” modelling.<sup>104</sup> This type of modelling does not provide the strong causal connection found in the physical sciences. Rather, it provides mere probability in terms of correlational relevance.<sup>105</sup> Nevertheless, it can provide valuable insight and guidance in terms of forward research and broader guidance.

Modelling, however useful as a heuristic device, like all human endeavour is value laden, or as discussed by such philosophers of science, as Lacan, “theory-laden.” This phenomenon—sometimes referred to as the hermeneutical circle<sup>106</sup>—refers to the phenomena that one’s understanding is built upon previous understandings, each one supposedly advancing upon the previous understanding, but obviously, to some extent at least guided by the presuppositions, and limitations of the underlying theory.<sup>107</sup>

Model theory is important because of the restrictions and perspectives that models impose.<sup>108</sup> Consider the restrictions models have imposed historically. When one uses a spiritual model of human beings, illness is the result of demon possession or punishment for moral or spiritual failing. When one uses a biological models that same illness becomes a matter of bacterial infection, or chemical imbalance or other disease. A less

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<sup>104</sup> See Braybrooke on Social Science Interpretive methods.

<sup>105</sup> Advances in correlational sciences have been greatly advanced by progress in statistical theory and calculation. See for example, W. Salmon, *Statistical Explanation and Statistical Relevance*, (1970).

<sup>106</sup> See for example, the post-Heideggerian hermeneutics tradition as carried on by H. Gadamer, J. Weinsheimer, and D. Marshall *Truth and Method*, or furthered in post-Marxian critical thought as represented in Jurgen Habermas’ work such as *Theory of Communicative Action*

<sup>107</sup> Essentially, Feyerabend’s critique of scientific method. See *Against Method* (1976).

<sup>108</sup> Although model theory was central to the debates of the philosophy of science from L. Wittgenstein *Tractatus logico-philosophicus* (1921), R. Carnap, *Philosophy and Logical Syntax* (1935) the term was coined by A. Tarski, *Logic, Semantics, Meta-mathematics*, (1954/55) and has subsequently formed the

dramatic change of models within a single discipline can have a dramatic outcome. For example, modelling had a dramatic impact on a formerly fatal illness known as “childbed fever.”

Women in the nineteenth century who gave birth often died from the associated illness, “childbed fever.” The Hungarian obstetrician and researcher, Ignaz Semmelweis, observed that women in the Maternity Hospital in Vienna where he worked had a higher mortality rate from “childbed fever”<sup>109</sup> than other women in neighbouring clinics, or at home. The model in vogue at the hospital and in the medical community at large suggested that the fever was the result of stale air. As a result of this model, a concerted effort was made by the players to avoid exposing new mothers to stale air and air from the outdoors opened to the women.

Semmelweis began to look at other explanations, however, particularly after a colleague pathologist Kolletschka, cut himself in the process of an autopsy of a woman who had died of the illness. The colleague soon succumbed to the same symptoms and was diagnosed as having died from childbed fever. Semmelweis, the alert researcher, discarded the stale air model, made the connection between the cut and the illness, which in addition to radically decreasing the deaths from childbed fever, led to the discovery of germs. Had Semmelweis been so committed to his model that contradictory information

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basis for much subsequent advance in the study and understanding of scientific method. Cited in Mueller op cit n. 100.

<sup>109</sup> See the first hand account in I. Semmelweis, *The Etiology, Concept and Prophylaxis of Childbed Fever*, trans. K. Codell Carter in *Medicine: A Treasury of Art and Literature* 136, A. Carmichael and R. Ratzan ed. (1991).

could not interfere, germs would not have been discovered possibly for several decades.<sup>110</sup>

As this example illustrates, the theory laden nature of model adopted can have significant impact on what is found. In particular, how scientists deal with phenomena inconsistent with the model can be determinative of not only current findings, but also future progress and the allocation of resources to research programs<sup>111</sup> or traditions.<sup>112</sup>

The problem resulting from model failure is dealt with in science in three manners or strategies. Where phenomena are observed that cannot be explained by the model, they can be ignored, used to modify the model, or where the phenomena is too far from the model's descriptive or predictive ability, the model can be discarded and a new model developed.<sup>113</sup> When a model is beginning to fail the entrenched defenders of the model, who continue to control the power and resources of the discipline defend their model at times viciously against the researchers finding contradicting phenomena which undermines the model and make efforts to stifle the dissenting researchers' voices.<sup>114</sup> An interesting example of this is in the case of economist, Tibor Scitovsky, who was interested in examining and weighing families of preferences. His efforts to do so were

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<sup>110</sup> Kuhn in his discussion of "normal science" contra Popper's suggestion that when falsified, a hypothesis can survive if the secondary premises of the hypothesis is discarded and the principle premise kept. See Kuhn and Popper in I. Lakatos and A. Musgrave, eds. *Criticism and Growth of Knowledge* (1970).

<sup>111</sup> Lakatos

<sup>112</sup> Laudan, *Progress and its Problems* (1977), and L. Laudan, "A Problem-Solving Approach to Scientific Progress", in I. Hacking (ed.), *Scientific Revolutions* (1987).

<sup>113</sup> T. Kuhn's seminal work challenging traditional notions of the rational progress of science by model advancement, sets out a theory based on an analysis of the actual development by a review of historical scientific discoveries. Kuhn suggests a five phase development of science: 1) immature science, 2) normal science, 3) crisis, 4) revolution and 5) resolution. In T. Kuhn, *Structure of Scientific Revolutions*. (1972)

<sup>114</sup> Kuhn, *ibid*.

challenged, research resources were denied and other efforts were made to thwart him.<sup>115</sup> Philosophers of science suggest that in fact this is the normal course of scientific research in which advocates of the current model control the resources, including research funding, faculty positions, and journals.<sup>116</sup> The critical problem arising from this effort to stifle opposing views, as identified by Feyerabend, is that we cannot know what the future will discover and count or value as knowledge, and accordingly, following a dominant model too strictly may retard the advancement of knowledge more than aid it.<sup>117</sup> All knowledge is founded upon cultural assumptions, and these assumptions are value laden.<sup>118</sup> Feyerabend confronted this in a first hand profound manner while teaching at UC Berkley. He wrote of his experience:

My function was to carry out the educational policies of the State of California which means I had to teach people what a small group of white intellectuals had decided was knowledge... In the years 1964ff. Mexicans, Blacks, Indians entered the university as a result of new educational policies. There they sat, partly curious, partly disdainful, partly simply confused hoping to get an 'education'. What an opportunity for a prophet in search of a following! What an opportunity, my rationalist friends told me, to contribute to the spreading of reason and the improvement of mankind! I felt very differently. For it dawned on me that the intricate arguments and the wonderful stories I had so far told to my more or less sophisticated audience might just be dreams, reflections of the conceit of a small group who had succeeded in enslaving everyone else with their ideas. Who was I to tell these people what and how to think.<sup>119</sup>

Feyerabend's insight is stunning, particularly in its blunt, critical and open presentation. It is a realization that in some ways became a clarion call for much of the academy

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<sup>115</sup> The Joyless Economy: An inquiry into human satisfaction and consumer dissatisfaction, (1976).

<sup>116</sup> See for example, L. Laudan op cit n. 112, I. Lakatos, "Falsification and the methodology of Scientific Research Programs" in I. Lakatos and A. Musgrave (eds.), Criticism and the Growth of Knowledge, (1970), pp. 91-196, discussed in the social science by Pierre Bourdieu, "The Specificity of the Scientific Field and the Social Conditions of the Progrs of Reason," (1975) Social Science Information 19-47, discussed in D. Braybrooke, Philosophy of Social Science, (1985) pp. 77-78.

<sup>117</sup> See for example, P. Feyerabend, Against Method, (1975).

<sup>118</sup> This is Lakatos idea in his discussion of Theory-laden models.

<sup>119</sup> *Science in a Free Society* (1978).

afterwards as in many disciplines it drifted from stark rationalism into the post-moderism Feyerabend confronted in this period.

Many economists, like many other scientists, understanding of the role of modelling in science is at best weak.<sup>120</sup> In economics, for example, the extreme views embraced by Positivists Friedman and Posner demonstrate an incorrect understanding of the nature of modelling despite its centrality to scientific enquiry.

The Positivist Posner, for example, states “A model can be a useful tool of discovery even if it is unrealistic... even though its basic premise was false... We should be pragmatic about theory.”<sup>121</sup> Another positivist Friedman writes: “Important and significant hypotheses will be found to have 'assumptions' that are wildly inaccurate descriptive representations of reality ....”<sup>122</sup> One cannot help but be find it a bit discomfiting to have major policy issues determined on bases we know to be “wildly inaccurate.”

The Normative Coase, on the other hand, states, “faced with a choice between a theory which predicts well but gives us little insight into how the system works and one which

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<sup>120</sup> See for example, Richard Rorty’s discussion of Nobel Laureate in Physics, Steven Weinberg, in his “Thomas Kuhn, Rocks and the Laws of Physics” (1997) 6 *Common Knowledge* 1, reprinted in R. Rorty, *Philosophy and Social Hope*, p. 175.

<sup>121</sup> R. Posner, “The New Institutional Economics meets law and economics,” (1993), 149 *Journal of Institutional and Theoretical Economics*, p. 77.

<sup>122</sup> M. Friedman, “The Methodology of Positive Economics,” in *Essays in Positive Economics* 23 (1985) p. 30.

gives us this insight but predicts badly, I would choose the latter.”<sup>123</sup> He continues, “. . . a theory is not like an airline or bus timetable. We are not interested in simply the accuracy of its predictions. A theory also serves as a base for thinking. It helps us to understand what is going on.”<sup>124</sup> Posner is fundamentally, methodologically wrong. Scientific theory is not about pragmatism.<sup>125</sup> It is about understanding reality,<sup>126</sup> about getting it right.<sup>127</sup>

While the internecine battling between academics may, with reason, seem trivial to those outside the academy, the implications of modelling do not stop on the steps of the academy. Where those competing models have an impact on policy and as a result, on society and on occasion, even on the planet as a whole, modelling and the scientific process takes on a gravity that extends well beyond the academy, even to the most remote corners of the globe.<sup>128</sup> Where, for example, a country adopts a particular economics model, which as noted previously carries its value assumption of “economy above all”, increased global warming inducing carbon-dioxide emissions which benefit the economy

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<sup>123</sup> R. Coase, “How Should Economists Choose?”, in *Ideas, Their Origins, and Their Consequences*, (1988) p. 64

<sup>124</sup> *Ibid.*

<sup>125</sup> Posner’s inability to put together a credible theory of pragmatism or ethics is skillfully demonstrated by R. Dworkin in the latter’s review of Posner’s works *The Problematics of Moral and Legal Theory* (2000) and *An Affair of State: The Investigation, Impeachment, and Trial of President Clinton* (2000). Dworkin’s critique can be found “Philosophy & Monica Lewinsky” 9 March, 2000 47 (4) *New York Review of Books*.

<sup>126</sup> This is not an adoption of essentialism. Rather, by reality I mean the generally accepted phenomena under study by a group of scientists.

<sup>127</sup> Interestingly, jurist F. Hallis adopted a similar view of models in “juridical science.” Hallis offered: “[I]f therefore juristic concepts are not true universals, they are not pure fictions which have not relation to the true account of the real facts. . . . [I]t is a sufficient answer to those who say that juristic science is not concerned with the real nature of social facts, but only with what the lawyer makes of them, to point out that the law has a practical and not a utopian aim.” Frederick Hallis, *Corporate Personality* xvi, xli (1930). xxxiii, cited in Mark, *op cit*, n. 93, p. 1470

<sup>128</sup> Global warming’s effects are being seen, for example, in the isolated communities of the Canadian Artic. Mush at the North Pole in the NY Times T. Friedman in Alaska.

are considered the better choice.<sup>129</sup> Such is the economic modelling debate,<sup>130</sup> of which corporate modelling is a very important expression.

Wisdom in handling models would like with Wittgenstein's observation: "Say what you choose, so long as it does not prevent you from seeing the facts (And when you have seen them, there is a good deal you will not say.)"

As we have seen, there are various value or "theory-laden" aspects to the model discussion and these apply no less in law. A fundamental analysis of scholar's prior philosophical and political commitments has been conducted by Professor Cox.<sup>131</sup> As Cox puts it:

Resolution of conflicting normative visions through law conceived as a political process or dialogue, or as the practical wisdom of legal authority is not a resolution compelled by the norms of our community. Rather, it is a choice of one tradition over another. That choice is not itself justified by reference to the tradition chosen; it is merely explained by reference to the chooser's prior commitment to that tradition.<sup>132</sup>

These prior commitments address the role of the state, the nature of the individual and the nature of society.<sup>133</sup> Briefly, the issues political and philosophical issues identified by Cox are threefold: (1) is the state an inefficient Leviathan of whom we should be skeptical,

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<sup>129</sup> G.W. Bush stated USA environmental policy in just these terms. In explaining why he rejected Kyoto he stated: "I will not accept anything that will harm our economy or hurt our American workers." "Bush says Kyoto could harm American economy" March 29, 2001 Canadian Broadcasting Corporation. While it may be argued that climate change may hurt the economy more than polluting will benefit it, because of the economic model used by the Bush Administration, the economic harm is apparently not factored in.

<sup>130</sup> In his famous lectures on the Industrial Revolution, renowned historian A. Toynbee discussed the economic modelling debate as "Economic Science, and its antithesis, Socialism", *Lectures on the Industrial Revolution in England*, (1884) reprinted as *The Industrial Revolution*, (1956) p. 58, cited in J. Cohen, *Revolution in Science*, (1985), p. 267.

<sup>131</sup> Cox, op cit, n 4.

<sup>132</sup> Cox, op cit, n. 4, p. 513.

or is its role to create and mold a better more humane, more just society? (2) Is the individual a rational self-interest maximizer, or a social being, such as a social constructionists suggest,<sup>134</sup> bound by the norms of society? And finally, (3) is society a cooperative measure for the good of all, or is it a mere means for individual to achieve individual ends and society having no independent existence in and of itself? The debate so framed becomes one in which the corporation and corporate law become one very important player in the larger enterprise of the understanding and shaping of human society and individuals. The debate requires fundamental value judgments concerning, among other things, the valuing of solidarity<sup>135</sup> over efficiency<sup>136</sup> or vice-versa, such things as whose planet the Earth is, and whose interests count, and whose interests will be ignored.

As previously noted, models are of two types: descriptive and prescriptive. The debate about models in corporate law has been restricted to the former: it has been a debate about what model best fits the corporation as we have it today in society. From this perspective, the contractarians would appear to be correct in their views.<sup>137</sup> As

Bainbridge opines:

“A theory is properly judged by its predictive power with respect to the phenomena it purports to explain, not by whether it is a valid description of an objective reality. As such, [quoting Friedman] 'the relevant question to ask about the 'assumptions' of a theory is not whether they are descriptively 'realistic,' for

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<sup>133</sup> The framing of the issues as set in this paragraph is based on Cox's article, op cit n 4, but in no way does justice to the careful and very sophisticated analysis offered by Professor Cox.

<sup>134</sup> See Cox n. 4

<sup>135</sup> Communitarian or Progressive Corporate law scholars.

<sup>136</sup> Contractarian Corporate law scholars.

<sup>137</sup> S. Bainbridge's article is perhaps the best analysis of this aspect of the contractarian-communitarian debate.

they never are, but whether they are sufficiently good approximations for the purpose in hand."<sup>138</sup>

Furthermore, as previously discussed, given the complexity of the issues, political inclinations and commitments, entrenched positions and interests, the debate on its own is unsatisfying and ultimately, an irresolvable debate. The other type of model, the prescriptive, has some interest and importance in the discussions about law, economics, society and social policy. Prescriptive models often do become descriptive models as society takes note of and adapts to or models itself after the prescriptive model.<sup>139</sup> In this context, the questions of “What is the corporation?” is transformed into, and “What should the corporation become?” come into renewed focus. And it is at this point that the discussion becomes very interesting and the difference between law and economics comes into even sharper contrast.

## 7 TRENDS AND CRITIQUES: STAKEHOLDERS, SHAREHOLDERS, AND VALUES

In North America up until the 1970's, the model for the corporation had some social responsibility aspects. As politics moved in a more conservative direction, however, the corporate legislation followed.<sup>140</sup> The prescriptive model for the corporation following

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<sup>138</sup> Bainbridge, p. 871.

<sup>139</sup> Heuristic and hermeneutical aspects of the model have been discussed above.

<sup>140</sup> L. McQuaig, *All You Can Eat*, Toronto: Penguin, 2001, pp. 33-39.

the neo-classical<sup>141</sup> economists' advice was adjusted to a more profit directed orientation. This prescription has been to increase corporate focus on wealth generation even to the exclusion of all other concerns. This view has been most directly advocated by one of the previously mentioned founders of the Chicago School, Milton Friedman. In his famous dictum quoted previously the role of corporate managers is "to make as much money for their stockholders as possible"<sup>142</sup> and that to propose social responsibility for corporation would "thoroughly undermine the very foundations of our free society."<sup>143</sup> Friedman and other profit maximization theorists,<sup>144</sup> however, recognize that wealth is not an end in itself. Rather, it is an intermediate end.<sup>145</sup> Accordingly, these economists make social welfare the ultimate justification for the exclusive focus of corporations on profit. In other words, the good end—social benefit—will be achieved by ignoring it and in fact focusing exclusively on another end—shareholder wealth maximization.<sup>146</sup>

In the law and economics field, Posner, Epstein and others have advocated wealth maximization as the organizing principal for law and have encouraged legislative and judicial reforms to implement this principal. Following Friedman, the shareholder primacy model as expressed by contractarians has become the dominant model of the

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<sup>141</sup> I use the term "neo-classical" to denote economic theory that favours rational choice theory, free markets, and monetary control of the economy. Economists who hold those values tend to be neo-liberal in political leanings, and so are at times referred to as neo-liberal economists.

<sup>142</sup> "The Social Responsibility of Business is to Increase Its Profits," Sept. 13, 1970, New York Times Magazine at 32-33, 122, 124, 126.,

<sup>143</sup> Ibid.

<sup>144</sup> See for example, Jensen, p. 302 "value maximization is an important one because it leads... to the maximisation of social welfare."

<sup>145</sup> Acknowledged even by Posner, *The Economics of Justice*, (1981) p. 108 and discussed in more detail in Cunningham, *op cit*, n. 58, p. 164.

<sup>146</sup> This position shows either a remarkable quasi-religious faith in free market economics or a Zen approach to social justice. For a discussion of foundations of the stakeholder-shareholder debate see my "Scrooge, the Reluctant Shareholder: Theoretical Problems in the Shareholder-Stakeholder Debate" (Forthcoming) 12 U. Miami Bus. L.R.

corporation in corporate law. If economics is indeed a science, as it claims to be, then it must be acknowledged that an unshakable faith in a model is a religious position rather than a scientific one.<sup>147</sup> Science and the scientist must deal with their models in light of the evidence rather than the reverse: dealing with the evidence in light of the model.<sup>148</sup> It should be asked, therefore, whether in fact the evidence demonstrates that following the neo-liberal, shareholder primacy model has increased social wealth.

The evidence is in and this model, particularly as applied in corporate law as the shareholder primacy/contractarian model, does not make for a better society.<sup>149</sup> It can hardly be argued that positive economics at least in its neo-liberal form have been successful in creating a wealthier or more just society.

The proposition that increasing shareholder wealth benefits all of society seems highly suspect in economic studies. For example, in the USA, as corporations have lost broader societal focus and increased shareholder primacy, one finds a growing disparity between rich and poor and decline in the wealth of the middle class.<sup>150</sup> The figures indicate a

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<sup>147</sup> John Kenneth Galbraith views the changes in his opinion in this light. Stephen P. Dunn, “The Origins of the Galbraithian System: J.K. Galbraith” interview with J.K. Galbraith, 2001.10 Division of Economics at Staffordshire University Business School. [www.staffs.ac.uk/schools/business/economics/papers/ec2001-10.pdf](http://www.staffs.ac.uk/schools/business/economics/papers/ec2001-10.pdf)

<sup>148</sup> This is indeed Coase’s point in the discussion above.

<sup>149</sup> See for example, the summary of statistics of poverty and homelessness in the United States in “Change The Channel” by Bob Herbert, December 19, 2003 NY Times.

<sup>150</sup> See for example, David Cay Johnston who reports “The 400 wealthiest taxpayers accounted for more than 1 percent of all the income in the United States in the year 2000, more than double their share just eight years earlier,” in “Very Richest’s Share of Income Grew Even Bigger, Data Show” New York Times article, June 26, 2003. Clearly, there are many reasons for such disparities such as government policies, performance of the economy and changes in the labour force resulting from globalization, but the disparity noted parallels the shift away from stakeholder thinking and seems to suggest that shareholder primacy cannot be supported along these lines. See Millon, *Frontiers*, p.229-230 on the triumph of shareholder primacy in this era. And L. McQuaig, *op cit* n. 140, pp. 96-107.

growing disparity between rich and poor and a monopolization of power associated with riches. Indeed, World Bank and IMF economists<sup>151</sup> whose structural adjustment programs, an integral part of which have been to open borders to transnational shareholder primacy corporations, have been a failure born on the backs of the poor.<sup>152</sup> The question, of course, is who is responsible for the distribution of goods in society in the first place. It cannot be assumed that a consensus exists concerning the equitable distribution of goods. Some will argue that the distribution of resources is irrelevant to the organization of society. Others will argue that a just society requires consideration and some adjustment of the distribution of society's benefits.<sup>153</sup> Yet others, following Coase's work, argue that absent transaction costs, the initial allocation of social benefits is immaterial. Parties will allocate goods to their most efficient use if permitted the opportunity to do so. If, however, we accept that society is for mutual benefit, and that neo-classical economics advocates the contractarian, shareholder primacy model for its stated purpose of improving social wealth, then we have the appropriate criteria to make a judgment. That judgment would appear to be, in summary, say that the overall benefits

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<sup>151</sup> W. Easterly, "The effect of IMF and World Bank programs on poverty" (2000) available on IMF website <http://www.imf.org/external/pubs/ft/staffp/2000/00-00/e.pdf> See also Noble Prize Laureate and former chief economist at the World Bank Joseph Stiglitz' book, *Globalization and Its Discontents*, (2001) and more recently, "The Broken Promise of NAFTA" January 6, 2004 NY Times. C. Welch, *Structural Adjustment Programs & Poverty Reduction Strategy*, (April 2000) Vol 5, Foreign Policy in Focus, Number 14. See also McQuaig's discussion op cit n. 140, pp. 82-92

<sup>152</sup> N. Lustig, economist and former Director of the World Bank's World Development Report and non-resident Senior Fellow at Brookings Institute observes that the poor and middle class absorb an inordinate share of the pain of structural adjustments. See her chapter "Social Costs" in N. Lustig, *Mexico: The Remaking of an Economy*, (1992) pp. 61-95. See Dine, *Governance*, Chap. 5 and extensive notes therein. For a recent analysis see Egor Kraev (2003 ). *Modeling Macroeconomic and Distributional Impacts of Stabilization and Adjustment Packages: Current Literature and Challenges..* CEPA Working Paper 2003-06 available at <http://www.newschool.edu/cepa/papers/abstract.htm#200306>

<sup>153</sup> Coase of course recognized that the real world operates with transaction costs and so that his theorem was merely an analytical tool for wealth maximization.

supposed to come from this neo-liberal economic model and its prescriptive corporate law model of shareholder primacy have simply not appeared.

Accordingly, for legal scholars to adhere to this model—the contractarian corporation—is an abdication of professional responsibility. Lawyers and legal scholars must be concerned with issues of ethics and justice. It is not sufficient to take Chancellor William Allen’s previously mentioned observation that the contractarian model of the corporation is “the dominant legal academic view” and end the discussion. Describing what is cannot be the same as saying what should be.

The argument for shareholder primacy is essentially an ethical argument from utilitarianism.<sup>154</sup> Quite simply, by focusing on the shareholder one produces the greatest efficiency one maximizes social wealth and hence overall social utility. Interestingly, Friedman himself recognizes that neither wealth nor efficiency are ultimate values for society. He wrote: “I would favor a free society even if it were less productive than some alternative—say a slave society... because my basic value is freedom itself.”<sup>155</sup>

Accordingly, it is appropriate even from an economist’s perspective to inquire about values and which values we wish to pursue in society. These economists are correct as far as they go—that society is for improved material benefit.<sup>156</sup> Social contractarians have made this argument in various forms for centuries.<sup>157</sup> Economists, however, fail to

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<sup>154</sup> See Posner’s acknowledgement of his “wealth maximization” theory as a refinement of ethical utilitarianism, *op cit* n 8.

<sup>155</sup> M. Friedman, n. 49.

<sup>156</sup> Rawls argues this as his first principle of social organization. Conflicting views are presented in Jared Diamond, *Germs, Guns and Steel: The Fate of Human Society* (1996) Norton.

<sup>157</sup> Philosophers with highly diverging views have made the Social Contract argument from John Locke and Jean Jacques Rousseau, to the present day John Rawls.

go far enough. As Rawls pointed out nearly thirty years ago, the second pillar of the social contract is justice in economy.<sup>158</sup> Economics is not a “value free” science.<sup>159</sup>

Economics, as some economists readily acknowledge,<sup>160</sup> does not hold all the answers and legal scholars should not be seduced into following that lead too quickly or unquestioningly.<sup>161</sup> As Orts in his compelling analysis of normative corporate law observes, “Corporate law, like most law, is primarily about the rule-oriented structuring of social power, and it is specifically about the rules that structure the organization of economic power.”<sup>162</sup> Following Rawls, therefore, a compelling argument can be made that corporate law should include access to power by non-shareholders.<sup>163</sup>

As a start, therefore, legal scholars should be developing a model that enhances access to economic power for more parties. Friedman’s and other neo-liberal economists’ dislike

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<sup>158</sup> Rawls, p. 4 and discussed in detail, 60-75, and 90-95.

<sup>159</sup> Indeed, there is no such thing as “value free” science, even in the hard sciences and we should not let ourselves be fooled into thinking economics is any such thing, especially as a social science. For the basic philosophical discussion undermining science as a rational progressive enterprise, see T. Kuhn, *The Structure of Scientific Revolutions* 2<sup>nd</sup> ed. (1970). As an attack on positivist epistemology, the work of C. Levi-Strauss probably serves as a good starting point. B. Hsiung points out that economic method is a two step method that requires value decisions, and offers a range of values which could be adopted by economists. In Hsiung, *Success*, op cit, n. 12, p. 7-10. Heilbroner attacks the scientific model as appropriate for the study of economics in “Visions and Analysis in the History of Economic Thought” in P. Porta et al *Knowledge, Social Institutions and the Division of Labour* (2001) Northampton, USA at pp. 59-63. As applied in corporate law, see T. Joo, “Corporations Theory and Corporate Governance Law: Contract, Property, and the Role of Metaphor in Corporate Law,” (2002) 35 U.C. Davis L. Rev 779 who observes, “rules of corporate law are often based on social welfare judgments of judges, lawmakers, and regulators rather than on parties’ bargains in the marketplace. It misleadingly suggests that the law imposes no value judgments but merely rubber stamps freely made individual decisions. Thus, the model lulls us into thinking we can avoid the hard questions of how the law makes its value judgments.” P. 778.

<sup>160</sup> Discussed in Hsiung, *Method*, p. 187, n. 2.

<sup>161</sup> Some economists plainly admit the fundamental role of values in their studies. See for example, Lipsey and Chrystal, *An Introduction to Positive Economics*, 8<sup>th</sup> ed., Oxford, p. 28, cited in J. Wolfenden, “*Homo economicus*: *Fantastics fact or factual fantasy?*” (1998) 1(2) *Ethos—A Journal of Global Ethics*.

<sup>162</sup> P. 1577.

of intrusions on freedom<sup>164</sup> cannot be restricted to preserving freedom for those wealthy and powerful enough to afford it. Hardly anyone would be willing to see a return to the pre-suffragette or pre-emancipation USA.<sup>165</sup> Yet the current model is just that—a regressive concentration of power and wealth in the hands of the few under guise of freedom. As we have seen, it sets the grounds for an increasing amount of wealth and power in fewer hands—it can hardly be any wonder that wealthy contractarians no longer engage in the debate about corporate models, justice and wealth distribution.<sup>166</sup> As scholar Stephen Bainbridge observes: “As a matter of intellectual interest, the debate over the contractual nature of the firm is over.... Those who adhere to the nexus of contracts model pass those who do not like so many ships in the night.”<sup>167</sup>

Just as the economists at the World Bank are asking themselves,<sup>168</sup> what then is the alternative model for development loans and government restructuring,<sup>169</sup> legal scholars need to be examining more carefully alternative models for corporations that both enhance social justice and economic growth.<sup>170</sup> Legal scholars should be asking important questions such as what objective should a new prescriptive model include?

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<sup>163</sup> See suggestion by W. Wilson Leung “The Inadequacy Of Shareholder Primacy: A Proposed Corporate Regime That Recognizes Non-Shareholder Interests” *Columbia J. Law and Social Problems* (Summer 1997) Vol. 30 (4), p. 587.

<sup>164</sup> See for example the alarmist, libertarian appeal made by Michael Jensen and William Meckling in “Between Freedom and Democracy”, (1977) *The Banker*, p. 39.

<sup>165</sup> M. Parenti “A Constitution for the Few” (1988). In particular, see excerpt in T. Simon, *Law & Philosophy*, (2003) 172-177. See also L. Cunningham’s discussion of the economics of slavery in Cunningham, *op cit* n. 58.

<sup>166</sup> Bainbridge, *op cit*, n. 4.

<sup>167</sup> Bainbridge *op cit* n. 33, p. 857.

<sup>168</sup> See Stiglitz, *op cit* n. 19.

<sup>169</sup> Possibly, new answers could arise if the science of economics is another point of revolution. Cohen, citing John Hicks notes various revolutions in the science of economics, including a current movement away from Keynesian economics. Cohen, *op cit.*, n. 131, p. 558-559. From J. Hicks, “‘Revolutions’ in economics” (1976) in Spiro Latsis, ed. *Method and Appraisal in Economics*, 207.

And then, of course, look at developing new models that would more effectively include those objectives.

Other models that have done somewhat better in terms of achieving better social ends<sup>171</sup> are those found in Europe and in particular Germany, and in Japan. The models followed in those countries have included other interests such as labour and collaborating companies. While the economists correctly argue that Japan's model has not made the most efficient use of economic resources,<sup>172</sup> as we have seen, efficiency is not the measure of all things. Indeed, Japan has been much more successful than America in keeping the ravages of a severe economic downturn from destroying people and communities. Unlike America which acquiesced to creating the hobos and communities hobbled by broken families caused by unemployment as America did in the Great Depression,<sup>173</sup> Japan, whose decade long downturn has been even more severe than the Great Depression in the USA, has neither of these phenomena in any significant number.

Indeed, in Japan nearly all the economic fluctuations have been borne by shareholders who have invested excess funds<sup>174</sup> as opposed to employees whose life's work and very

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<sup>170</sup> These are not necessarily conflicting norms. See for example, J. Hogendorn, *Economic Development*, 3<sup>rd</sup> ed. (1996).

<sup>171</sup> As distasteful as it may be to some market economists, it must be recognized that China's communist centrally controlled economy has been credited with saving millions from starvation which would otherwise have arisen under capitalist market conditions. See *The Economist*....

<sup>172</sup> The argument is made that the market for corporate control is stifled by the cooperation of companies with each other reducing efficiency by keeping afloat companies that should be in bankruptcy. See for example, *Economist* March 2002 in which the banking argument is made.

<sup>173</sup> The American experience of the time was immortalized by John Steinbeck in *The Grapes of Wrath*—an excellent reminder of the situation for the average family in that time. It is hard to imagine anyone reading that work and puzzling whether families in poverty are more concerned about efficiency in the market for corporate control and greater overall wealth, and the need for a basic income.

<sup>174</sup> Or savings. I use the term "excess funds" to emphasize that these funds are not needed for day to day living, and hence, "excess."

livelihood are dependent on employment.<sup>175</sup> Japan's legendary low unemployment figures are a reflection in part of this model.<sup>176</sup>

## 8 CORPORATE MODELS FOR THE FUTURE

Regardless of one's political and philosophical commitments it is evident that corporations with the concentrations of wealth and resources and as the major source of employment are the major drivers of the economy, culture and environment. Accordingly, the importance of decisions about corporate models can hardly be overstated. Not only will they have considerable bearing on the overall economy but also on development of societies throughout the world and such incredibly important things such as global warming. Before considering what models should be considered for the future, a very modest review of contemporary models and their respective strengths and weakness may serve as a springboard for our thinking forward, which will be followed by a brief review of two management scholars' views of future corporations and the significance of those ideas for future corporate law development.

### a) ANGLO-AMERICAN MODEL

The distinctive aspect of Anglo-American model is its "shareholder primacy."

Shareholder primacy places the interests of the shareholder above all others, and as we

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<sup>175</sup> Columbia University economist Frank Lichtenberg "In a Downturn, Cut Profits Before Jobs" *New York Times* (Sunday Business Section), Feb. 16, 1992, Section 3, p. 13, cited in Murray Dobbin, *The Myth of the Good Corporate Citizen*, (1998), p. 74, n. 29.

<sup>176</sup> Recent unemployment figures for Japan are 5.2% "Japan PM: Economy emerging from slowdown," Monday, January 5, 2004 · Associated Press, compared to United States' current accurate figure of nearly 9.2% "The White-Collar Blues" By Bob Herbert, December 29, 2003, Monday NY Times.

have seen even to the exclusion of all other interests.<sup>177</sup> Other interests which are ignored include such things as the social costs,<sup>178</sup> environmental costs, and employee needs. Every cost the Anglo-American corporation can avoid, it does avoid in order to return more money to the shareholders. Every benefit it can appropriate it does without regard to ensuring “there is enough, and as good left in common for others.”<sup>179</sup>

#### i) Benefits of the Anglo-American Model

This model is very attractive to for a number of reasons. First, it is attractive because it is familiar. Second, it is attractive because it puts a considerable amount of money into the hands of shareholders in a short amount of time.<sup>180</sup> Thirdly, when the economy is growing well, the share values of these companies increase rapidly.<sup>181</sup> Finally, its advocates claim that it is the most efficient. As noted, however, each model has not only strengths but also particular weaknesses.

#### ii) Weaknesses of the Anglo-American Model

One problem of the Anglo-American model is that it causes a short-term focus. The corporation’s executive are more concerned about quarterly results and daily stock prices

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<sup>177</sup> M. Miller, “Is American Corporate Governance Fatally Flawed?” chapter in Donald Chew ed., *Studies in International Corporate Finance and Governance Systems: A Comparison of the US., Japan, and Europe*, (1997) Oxford p. 38.

<sup>178</sup> Social costs include things as harm to consumers, and “social capital” discussed for example, in Paldam, “Social capital: One or many? Definition and measurement,” (14:5) *Journal of Economic Surveys*, , 629-653 and in M. Fafchamps, B. Minten, “Returns to social network capital among traders” (2002) *Oxford Economic Papers*, 54, 173-206.

<sup>179</sup> John Locke, *Second Treatise on Government*, Ch. 5. para 26. Locke’s theories form the underpinning of the neo-classical economists view of private property.

<sup>180</sup> Steven Kaplan, “Corporate Governance and Corporate Performance: A Comparison of Germany, Japan and the U.S.”, chapter in Donald Chew ed., *Studies in International Corporate Finance and Governance Systems: A Comparison of the US., Japan, and Europe*, (1997) Oxford p. 253.

<sup>181</sup> Kaplan’s numerous studies are summarized in this chapter and he finds little difference except in terms of use of cash pp. 251-257.

than the long term viability of the corporation. Not only may this short term executive focus be tied to corporate scandals,<sup>182</sup> it also causes serious under-investment in capital expenditures that in turn undermine the long-term viability of the corporation.<sup>183</sup> Such companies are vulnerable to becoming outmoded and to collapse, which in turn causes serious economic and social consequences.<sup>184</sup> Most Anglo societies are able to deal with such collapses including corporate funded pension collapses, because their economies are sufficiently robust and they have adequate social security systems; however, given the demographic changes and changes in fiscal policy, the strength and durability of such programs is questionable.<sup>185</sup>

Another problem with the Anglo-American model becomes evident when there is an economic downturn. As the world's foremost management professor Peter Drucker observed: "It is a fair weather model that works well only in times of prosperity."<sup>186</sup> In an economic downturn, Anglo-American corporations lay-off promptly their employees and as a result, in a recession many people are out of work.<sup>187</sup> This approach to

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<sup>182</sup> Krugman has referred to this as the lesson of the recent scandals, that we cannot bribe corporate officials to do their jobs. Paul Krugman has observed that options have been an important motivator in stock price manipulation. "The Outrage Constraint," August 23, 2002, NY Times. Paul Krugman opines, "now it's clear that options were a big motivator for corporate fraud," in his Op-Ed piece, "Enron and the System" January 9, 2004 NY Times.

<sup>183</sup> Porter, M. E. "Capital Disadvantage: America's Falling Capital Investment System." *Harvard Business Review* (September-October 1992)..

<sup>184</sup> The Enron cost, for example, was in excess of \$35 billion. Brookings Institution.

<sup>185</sup> See changes to unemployment in Chicago's demographic Bob Herbert "Locked Out at a Young Age" October 20, 2003 NY Times. The extent to which this data can or should be extrapolated, is of course uncertain. Nevertheless, there needs to be some attention to the issues raised there.

<sup>186</sup> P. Drucker, "Will the corporation survive? Yes, but not as we know it." Sep 15, 2001. Vol. 360, Iss. 8239; p. 16.

<sup>187</sup> At the time of writing, the American unemployment figures suggest that 480,000 lost jobs in the last month in response to the protracted economic downturn, and discussion concerning a severely "jobless recover" suggest this may be more than a mere temporary problem.

economic downturns is not too damaging to the employees or to the economy, again because of the social security system.

Anglo-American governments have strong social security systems to help employees without jobs continue to pay mortgages other living expenses and other costs. This ability of laid-off employees to continue their basic consumption habits is critical to the Anglo-American economies because of their reliance on consumers. The USA economy, for example, relies on consumers for two-thirds of its size and a great part of its activity.

Another problem arises from the Anglo-American model's ignoring other interests, or externalizing. Interests such as environment, social problems and employees have a cost which cannot be avoided. Although not taken into consideration by the Anglo-American model these costs must be paid in one way or another.<sup>188</sup> The Anglo-American way of addressing these costs is through its very expensive. The GDP contribution of legal services to the USA economy is significant.<sup>189</sup>

The costs of dealing with these externalized costs through the legal system are astronomical. The American economy and American corporations struggle under the burden of legal costs<sup>190</sup> to the extent that nearly every legal reform program looks at ways

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<sup>188</sup> Coase's Social Costs op cit, n. 51, deals with those costs caught by law; where law has not yet recognized such harms, for all economic and legal purposes, they fail to exist.

<sup>189</sup> W. Stavropoulos, President of Dow Chemical Company, claimed that the costs of tort claim 2.2% of the GDP of the USA. This, of course, is not much of an argument if tort law works as it should: this is just the cost to the economy for corporate malfeasance through product liability.

<sup>190</sup> Search Google for article by jury consultants on Jury perspectives on corporate America. See for example, "Interview with Valerie P. Hans, author of Business on Trial: The Civil Jury and Corporate Responsibility" (March/April 2002) 13:2 Bimonthly Review Of Law Books <http://www.law.suffolk.edu/faculty/ebander/index10-12-00.html>

of making the system less costly.<sup>191</sup> Not only is it very expensive, but it is questionable how efficient the system is in either paying externalized costs or preventing them in the first place. Indeed, it could be argued that many Anglo-American corporations operate with a “deferred costs” approach where corporations and corporate executives create costs— social, environment and other costs—with the hope that they will not be discovered and enforced through the legal system until they have taken their profits and the shareholders have taken their profits. Such cases include the examples of the asbestos lawsuits that bankrupted the Johns Mansville Corporation<sup>192</sup> and the recently launched employee suits for exposure to toxic chemicals while working in IBM chip manufacturing facilities,<sup>193</sup> as well as the actions behind the collapses of Enron, Worldcom and Tyco among too many others.

In addition, it is important to note that the Anglo-American exclusion of other “stakeholder” interests has led to considerable anti-corporate backlash which in part is behind the WTO and other anti-globalization protests.<sup>194</sup> Anglo-American corporations

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<sup>191</sup> S. Datta and J. Nugent have shown that for every increase of 1% in the number of lawyers in a society, economic growth suffers between about 4% cited in R. Cooter and Thomas Ulen, *Law and Economics: An Economic Theory of Property* (1997), Addison-Wesley, p. 79.

<sup>192</sup> To cite but a few of the 600,000 see *Adams v. Johns-Manville Sales Corp.*, 783 F.2d 589 (5th Cir. 1986) *Jackson v. Johns-Manville Sales Corp.*, 781 F.2d 394, *Gideon v. Johns-Manville Sales Corp.*, 761 F.2d 1129 (5th Cir. 1985), *Thompson v. Johns-Manville Sales Corp.*, 714 F.2d 581 (5th Cir. 1983), *Prelick v. Johns-Manville Corp.*, 531 F. Supp. 96 (W.D. Pa. 1982), *Hardy v. Johns-Manville Sales Corp.*, 509 F. Supp. 1353 (E.D. Tex. 1981). On the mass number of the suits, see Richard L. Cupp, Jr “ASBESTOS LITIGATION & TORT LAW: TRENDS, ETHICS, & SOLUTIONS: Asbestos Litigation and Bankruptcy: A Case Study for Ad Hoc Public Policy Limitations on Joint and Several Liability” (2003) 31 *Pepp. L. Rev.* 203. Cupp observes that as many as 3,000,000 suits may be filed in the case, and according the right wing think tank, the RAND Corporation, supposedly the majority of people filing are not sick. This objection to such claims is odd for two reasons: first, how is one to know whether the litigants are or will be sick without the evidence, and second, tort claims may be for those who suffer loss of a family member as well as being made by injured parties themselves.

<sup>193</sup> Bob Herbert, See also “Clouds in Silicone Valley” *NY Times* 03/09/08.

<sup>194</sup> Published by the Hemispheric Social Alliance. FTAA Exposed: A Citizens’ Critique of the November 2002 Draft of the Free Trade Area of the Americas.  
<http://www.cpdngo.org/docs/Shantal%20documents/Partners%20Perspectives%20on%20FTAA.doc>

are being forced by the Corporate Social Responsibility movement to expand their horizons and to spend money to include other concerns. The societies living with this model see the corporation as a destructive force in society which must be subject to a high level of regulation and control.<sup>195</sup>

Unlike enterprises in most other parts of the world,<sup>196</sup> Anglo-American model of the corporation has traditionally been a collection of unrelated strangers who invest money together. It is run by a board of directors who represent only the interests of shareholders and management. One of the on-going problems for participants in this model is the constant effort to keep parties working together.<sup>197</sup> Each party focuses exclusively on and fights for self-interest above all else. It is an antagonistic, expensive model to manage. Indeed, much research has focused on minimizing the effects of the “agency problem”—the problem when investors and management are distant from each other and pursuing separate, different interests.<sup>198</sup> Further, this animus is in part what drives the very expensive and questionably beneficial market for corporate control.<sup>199</sup>

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<sup>195</sup> Regulation of Corporations is one important aspect of jury perspectives. See Donald E. Vinson And David Perlut, “The American Jury’s View of Corporate America: It’s Not A Pretty Picture,” (February 2003) Briefly... Perspectives on Legislation, Regulation, and Litigation 7( 2), published by National Legal Center for the Public Interest. From the opposite end of the political spectrum, see work by such authors as David Korten, *When Corporations Rule the World*. 2<sup>nd</sup> ed. (2000).

<sup>196</sup> “Who is in charge? The ins and outs of corporate governance,” Oct. 25, 2003, *The Economist*, pp. 15-16.

<sup>197</sup> This issue of agency costs which started with Berle and Means, has been carried forward in the work of Michael Jensen and William Meckling, and O. Williamson. W. C. Kester, “Governance, Contracting, and Investment Horizons: A Look At Japan and Germany,” chapter in Donald Chew ed., *Studies in International Corporate Finance and Governance Systems: A Comparison of the US., Japan, and Europe*, (1997) Oxford, 227

<sup>198</sup> Bainbridge notes that this issue is now passé for most law and economics scholars. See S. Bainbridge, *The Politics of Corporate Governance*, (1995) 18 *Harv. J.L. & Pub. Pol’y* 671, 671-78 (reviewing Mark J. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (1994)).

<sup>199</sup> C.K. Prahalad, “Corporate Governance or Corporate Value added? Rethinking the Primacy of Shareholder Value” chapter in Donald Chew ed., *Studies in International Corporate Finance and Governance Systems: A Comparison of the US., Japan, and Europe*, (1997) Oxford p. 47-50. See also M.

### iii) Implications of the Anglo-American model for Societies

There are a number of particular and significant implications that can be drawn from the Anglo-American model poses. This model may not be well suited to economies that are not robust. A large corporate collapse in a weaker economy can be expected to have significant percussion throughout the economy and have significant social costs. Furthermore, some societies, workers do not have the benefit of a social security system. As a result, when the average worker in such a society loses a job, it is a crisis. Furthermore, if there is an economic downturn and workers do not have income to continue to spend, such an economy will have greater difficulty reviving. It simply will lack the consumption necessary to keep the economy prosperous. Accordingly, the Anglo-American model which cuts jobs rapidly and drastically in an economic downturn is not well suited to many other economies, including possibly the United States of the future.<sup>200</sup>

In its essence, the shareholder primacy model reflects American values: neo-classical economics and neo-liberal values.<sup>201</sup> There are important consequences which flow from this American value, including increased wealth concentration, higher levels of unemployment, and some of the problems with corporate governance are exaggerated. Given some of the problems of the Anglo-American model discussed, it is clear that there may be benefits to considering what other models may be available.

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Mark Walker, "On the shareholder wealth maximization objective of corporate governance: The case of leveraged recapitalizations," (1996) 22(4) *Managerial Finance* 53.

<sup>200</sup> M. Walsh "Failed Pensions: A Painful Lesson in Assumptions" Nov 12, *NYTimes*

## b) GERMAN MODEL

One of the European models which may offer some interesting alternatives is the German model. The German corporation is structured with a two tiered or “dual model” Board of Directors.<sup>202</sup> The executive board or “Vorstand” are management. The supervisory board, “Aufsichtsrat” is a split board with one section of the board of directors made up of shareholder nominated directors, and the other section of the board, being made up of employee nominated directors.<sup>203</sup> It is interesting to note that in contrast to the Anglo-American model in which all directors are nominated by the shareholders and are professional managers, the directors nominated by German workers are there to represent them, and although usually professionally trained as economists or business scholars, they are not managers.<sup>204</sup> This peculiar board structure is limited in its application to corporations which have more than two thousand employees—the “Mitbestimmungsgesetz.” Perhaps most interesting is that the operative executive board “Vorstand” is answerable not to the shareholders, but to the “Aufsichtsrat” or participatory supervisory board.

German corporations often invest money in training the worker nominated directors to help them become more effective in their roles as directors. This management training helps worker nominated directors to understand the management problems faced by the

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<sup>201</sup> See Mark’s interesting intellectual history reaching from 13<sup>th</sup> century theology to the 20<sup>th</sup> century’s view of the business corporation in the USA. Mark, *op cit*, n. 93.

<sup>202</sup> G. Alexander, “Property as a Fundamental Constitutional Rights? The German Example,” (March 2003) 88 *Cornell L. Rev.* 733

<sup>203</sup> F. Schilling, “Corporate Governance in Germany: the move to shareholder value,” (29001) 9(3) *Corporate Governance*, 148.

<sup>204</sup> *Ibid.*

particular corporation. By investing in this training, the German corporations are able to get the maximum benefit from the worker nominated directors, and the workers are more effective in communicating management concerns to workers and worker concerns to management. These directors work to protect workers' rights and interests.

Finally, German corporations tend to be financed by banks—that is, banks tend to be the major shareholders and indeed have accounted for some 90% of all external corporate finance.<sup>205</sup> This shareholding pattern will be seen to have significant effects in the management of economic downturns.

#### i) Benefits of the German Model

Germany benefits from this model in two important strategic ways. First, there is less labour unrest. Unlike the Anglo-American model where parties are fighting against each other else in pursuit of their own self-interests, the German model functions better because it aligns management and worker interests in the larger, overall goal of advancing the corporation. Indeed, although German executive see problems with the boards, they would not wish to change it.<sup>206</sup>

The second advantage is that it puts the workers in direct touch with the management solving at least in part, two fundamental management problems—communication and trust.<sup>207</sup> Management can understand worker complaints, concerns and suggestions more directly and easily. Workers sometimes have significant contributions to make to

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<sup>205</sup> J. Scott, *Corporate Business and Capitalist Classes*, (1997), p. 145-146.

<sup>206</sup> Schilling, *op cit*, p. 149.

management of the corporation because of their very different perspective and hands-on experience with operations.

German corporations, given their ability to coordinate more interests have more parties interested in the corporation's survival. As a result, they tend to keep their investments in capital equipment up-to-date, and have more secure long term outlooks.<sup>208</sup> German companies tend to have longer strategic visions, less collapses, and are still very appealing to investors.<sup>209</sup>

Traditionally, German corporations are family businesses.<sup>210</sup> The structure discussed reflects these family values and it seems to work well for those families. By including many more concerns German corporations have been highly successful not only in producing top quality products, but they have been able to do so competitively.

#### ii) Drawbacks of the German

Effective use of this model requires an egalitarian view of humanity. Whether presidents of companies or workers on the factory floor, the view must be that humans are valuable, intelligent and willing contributors to overall group achievement. Furthermore, management needs to have a confidence that workers have the intelligence and goodwill to contribute. Finally, the model requires a level of sophistication among workers.

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<sup>207</sup> Insert HR or OB reference ???

<sup>208</sup> Schilling, op cit, p. 150.

<sup>209</sup> Scott, op cit n. 205, p. 147-149, and Schilling, ibid.

<sup>210</sup> See "Who is in charge" article in the Economist, op cit n 196, and Scott, op cit, n. 205, p. 146-147.

### c) JAPANESE MODEL

Another corporate model which should be of interest is the Japanese model. Japanese corporate law and practice is an interesting mix of German, traditional Japanese, and American law.<sup>211</sup> In some ways, Japanese corporate law has drawn the best of each of the systems. It is important to note that although Japanese corporate law was established in 1950 by the occupying USA forces in practice it has developed differently.<sup>212</sup> To create corporate law the USA basically translated and planted the Model Business Corporations Act into the Japanese legal system. Thus, although at a legal level Japan has essentially American corporate law, Japanese corporations have largely ignored the law and operated their corporations on the basis of extra-legal norms.<sup>213</sup> Since it is these norms have driven corporate development in Japan more than the law, the relevant discussion focuses on the model set out by the norm rather than the law.

The Japanese model has rejected Anglo-American model “shareholder primacy.” In fact, in the Japanese model, shareholders interests are among the least important of the interests to be considered.<sup>214</sup> Japanese priorities are: the corporation itself, customers, employees, creditors and finally, shareholders.<sup>215</sup>

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<sup>211</sup> M. West “The Puzzling Divergence Of Corporate Law: Evidence And Explanations From Japan And The United States” (2001) 150 U. Pa. L. Rev. 527 p. 538.

<sup>212</sup> See discussion in West, *ibid.*

<sup>213</sup> See discussion Curtis Milhaupt “Symposium Norms & Corporate Law: Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance,” (2001) 149 U. Ps. L. Rev. 2083.

<sup>214</sup> J. Farrar, *Corporate Governance in Australia and New Zealand*, (2001) Oxford, p. 34.

<sup>215</sup> See. Toshiba Chairman, Joichi Aoi, “To Whom Doe the company belong?: A new management mission for the information age,” chapter in Donald Chew ed., *Studies in International Corporate Finance and Governance Systems: A Comparison of the US., Japan, and Europe*, (1997) Oxford, 244 p. 247.

The Japanese model is based on the village system where everyone worked together for common survival and the common good.<sup>216</sup> Accordingly, as noted, Japanese executives have given a higher priority to employees' interests than to shareholder interests. One example of that priority is the Japanese corporate policy lifetime employment.<sup>217</sup> While it is changing, it is interesting to note how the Japanese corporation has survived in very difficult economic times. This priority has created significant benefits for Japanese society.

i) Benefits of the Japanese Model

What is particularly interesting about the Japanese modeled corporation is how it has buffered society from economic crisis, addresses the interests excluded by the Anglo-American model and still has had great success in attracting foreign investment. It is particularly interesting because Japan has experienced one of the most severe economic declines in the history of the world with its society relatively intact.

Japan's economy has been in recession, if not depression, for over ten years.<sup>218</sup> The Japanese economy has shrunk more in the last ten years than the American economy did in the Great Depression of the 1930's.<sup>219</sup> Despite this economic decline, the average Japanese worker has been able to go on without experiencing the frightening, devastating

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<sup>216</sup> K. Ohmae, *The Mind of the Strategist*, (1982) NY. McGraw-Hill, pp. 218-219. Milhaupt claims the model is not the village but the family. Op cit n. 5, p. 2090.

<sup>217</sup> Curtis Milhaupt "Symposium Norms & Corporate Law: Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance," (2001) 149 U. Ps. L. Rev. 2083

<sup>218</sup> "Finance And Economics: Checking the slumpometer; Economics focus," *The Economist*. London: Mar 2, 2002. Vol. 362; p. 91.

<sup>219</sup> "Finance And Economics: Checking the slumpometer; Economics focus," *The Economist*. London: Mar 2, 2002. Vol. 362; pg. 91 Contrary view is expressed by Paul Krugman who observes that Japan's

loss of employment. People still have jobs, there is no threat of rebellion, consumers can still buy and the economy continues to work because of its consumers even though it continues to suffer severe problems.<sup>220</sup>

By way of contrast, in the Great Depression of the 1930's, American society suffered greatly, its workers had no money to spend and vast multitudes were reduced to utter poverty. Unlike the Anglo-American model which passed the costs of the economic decline directly onto the employees, the Japanese corporate model passes the costs of the decline to the shareholders and institutional lenders.<sup>221</sup>

A further benefit may be its efficiency—opinion is quite varied on efficiency, depending on how one looks at it, as will be discussed below. The one area of efficiency is in the access that shareholders and institutional investors have to information about corporate performance. They have much better and more direct access, and interestingly, studies show that they act to remove inefficient managers at least as quickly as European and USA counterparts.<sup>222</sup> Another area of efficiency is in the very limited market for corporate control, which while supposed to improve market efficiency, is notoriously expensive, and of questionable long-term value.<sup>223</sup> In Japan, it is nearly non-existent.

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last decade has not been as severe, losing only in 2 of the last 10 years, and that the benefit received by the average workers is due to government's public works projects. *The Great Unraveling*, (2003), at 95.

<sup>220</sup> The rate of Japanese unemployment has reached a record high of 5.2%, something shareholder primacy model economies and governments normally only dream of. *Financial Times*, April 25, 2003, p. 1 As well, this is a source of inefficiency referred to as "excess manpower." Kester, *op cit* n 197, p. 260.

<sup>221</sup> See for example, R. Wade, "Joe Stiglitz's Bum Rap" (2003) 25:5 *Journal of Policy Modeling*

<sup>222</sup> Kester, *op cit*, n. 197, p. 239.

<sup>223</sup> Walker, *op cit*, n. 199; Kester, *op cit*, n. 197, p. 239. See for a very thorough specific industry example of financial institutions, which should be the best evidence of the claim made for the market for corporate control, Robert DeYoung. "Bank mergers, x-efficiency, and the market for corporate control," (1997) 23 (1) *Managerial Finance*. 32, and the general opinion that it does not work as a basis for precluding it from developing in Less Developed Countries, in Ajit Singh, Bruce A Weisse. "Emerging stock markets, portfolio capital flows and long-term economic growth: Micro and macroeconomic perspectives," (Apr. 1998) 26(4) *World Development*. Oxford 607.

## ii) Drawbacks of the Japanese Model

The main problem with the Japanese model is that the support provided by the collectivist approach makes it difficult to deal effectively with underperforming assets.<sup>224</sup> Japanese corporate restructurings do not cut costs, or change much in the corporation other than the management team.<sup>225</sup> Japanese corporations tend to hold onto their cash instead of reinvesting it into the economy.<sup>226</sup> Furthermore, although not a corporate law problem, the Japanese system tends to burden suppliers and entrepreneurs with the debts of failed businesses.<sup>227</sup> In summary, the argument is that Japanese corporations do not have the same level of efficiency in other areas.<sup>228</sup>

## iii) Implications of the Japanese Model for the Future

The Japanese model offers some very attractive alternatives for keeping an economy and society functioning during difficult economic times. Even more appealingly, the model does so without undue stress on the government treasury. Many governments are not wealthy and have difficulty meeting even their basic social security obligations.

# 9 VISIONS OF THE FUTURE

## a) Peter Drucker

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<sup>224</sup> Noted in Wade, *ibid*.

<sup>225</sup> *Ibid*.

<sup>226</sup> Kester, *op cit*, n. 197, p. 260.

<sup>227</sup> K. Aichi and K. Yakushiji, "Can Japan's Politics Save Japan's Economic Troubles?" Feb 27, 2002, Center For Strategic & International Studies, <http://www.csis.org/japan/020227aichi.pdf>

<sup>228</sup> Aoi, *op cit* n 216, p. 245.

Peter Drucker arguably the world's foremost management theorist, suggests in his provocative article, "Will the Corporation Survive? Yes, but not as we know it" that in the foreseeable future there will be some profound changes to the corporation. Drucker opines that the corporation will increasingly rely on a few professional managers whose power will increase exponentially. The majority of the work will be out-sourced to tightly controlled suppliers. This "dispersed model" of the corporation poses huge challenges for the legal and financial system, not to mention society as a whole. The "dispersed model" with its higher concentration of power and corollary lower level of participation exponentially increases the risks of managerial abuse of power, both in terms of financial malfeasance, and politically.

Drucker notes that this "dispersed model" is not completely new and has precedents elsewhere. What is new, however, is the context in which it occurs—a loose non-affiliated corporate culture. This dispersed model also has parallels in multinational corporations. The regulatory issues<sup>229</sup> raised by multi-nationals may ultimately prove to be insurmountable.<sup>230</sup> Nevertheless, the multi-national and the regulatory problems they pose appear to be here to stay, and if Drucker is correct, we may see more of the same type of problem in the domestic market. Future legal developments must take this into account and should be forward looking anticipating some of the issues this will raise. Of course, law is a backwards looking enterprise examining previous cases and old doctrines. This orientation makes the future doubly challenging.

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<sup>229</sup> J. Dine, *The Governance of Corporate Groups* (2000)

b) Michael Jensen

Another important business thinker, Michael Jensen, wrote an even more radical article entitled, “Eclipse of the Public Corporation”<sup>231</sup> about the future of corporations. While Jensen’s predictions have turned out to be nearly completely incorrect—his hypothesis of a dramatic increase of leverage buy-outs has not panned out—his article bears merit in that it points out the possibilities for a similar concentration of power, although Jensen observed that the bought-out corporations were usually returned to the public market within a few years. If such power is available for an extended time in the marketplace, what risks does it create for the economy in terms of creating monopolies of power, further corruption of government by special interest groups, and concentration of wealth and resources.<sup>232</sup> These are important issues given the social wealth justification for the shareholder primacy model corporation on the one hand and the increasing skewed distribution of society’s resources through concentrations on the other. In any event, law has considerable ground to cover both in theory and in its development even to reach today, and increasingly central to law’s mandate is the issue of corporate modeling and control.

## 10 CONCLUSION

Each of the models of the corporation is informed by and heavily dependent upon values. It is imperative that the values incorporated in each of the models be put forth and made

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<sup>230</sup> See, for example, Dine op cit and J. Dunning, ed. *Governments, Globalization, and International Business* (1999).

<sup>231</sup> M. Jensen, “Eclipse of the Public Corporation” (Sept. Oct 1989), *Harvard Business Review*, 61.

<sup>232</sup> Interestingly, this concentration has occurred in both Germany and Japan, but perhaps in part because of the models discussed, the impact has not been as negative.

the center of the debate.<sup>233</sup> To fail to do so is to permit the incomplete work of the positivist neo-classical economist to create a normative vision for society. It permits the considerations of wealth to determine the path of humankind. A wealth focus offers no justice, no hope and ultimately undermines our humanity. As long as humans hold anything other than wealth maximization dear, the need to permit law, indeed to incite law, to include other values and form society must exist and the value of economic analysis kept in its place.

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<sup>233</sup> As M. Bradley, et al, observe, “The deepest challenge then is to find a way to enact communitarian sentiments in a contractarian world.” in “The Purposes And Accountability Of The Corporation In Contemporary Society: Corporate Governance At A Crossroads” (1999) 62 Law And Contemporary Problems, No. 3, 9