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The Separation of Corporate Law and Social Welfare

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Abstract

A half century ago, corporate legal theory pursued an institutional vision in which corporations and the law that creates them protect people from the ravages of volatile free markets. That vision was challenged on the ground during the 1980s, when corporate legal institutions and market forces came to blows over questions concerning hostile takeovers. By 1990, it seemed like the institutions had won. But a different picture has emerged as the years have gone by. It is now clear that the market side really won the battle of the 1980s, succeeding in entering a wedge between corporate law and social welfare. The distance between the welfarist enterprise of a half century ago and the concerns that motivate today's corporate legal theory has been widening ever since. This Essay examines the widening gulf. It compares the vision of the corporation and of the role it plays in society that prevailed during the immediate post-war era, before the fulcrum years of the 1980s, with the very different vision we have today, and traces the path we took from there to here. It will close with a brief prediction regarding corporate law's future.

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I. Introduction

For three decades, Lyman Johnson and David Millon have stood for the proposition that corporate law should concern itself with social welfare.[1] They have done so with commitment, analytical skill, and rhetorical facility, seeking to preserve an institutional vision in which corporations and the law that creates them protect people from the ravages of volatile free markets. They first intervened during the late 1980s, a time when corporate legal institutions and market forces came to blows over questions concerning hostile takeovers.[2] At the time it seemed like the institutions had won, with Johnson and Millon striving to add protective depth to the outcome by advocating for inclusion of constituent interests as beneficiaries in the corporation's legal model.[3] But a different picture has emerged as the years have gone by. It is now clear that the market side really won the battle of the 1980s, succeeding in entering a wedge between corporate law and social welfare.[4] The distance between the Johnson and Millon's welfarist enterprise and its corporate law target has been widening ever since.

This Essay is a meditation on that widening gulf. It will compare the vision of the corporation and of the role it plays in society that prevailed during the immediate post-war era, before the fulcrum years of the 1980s, with the very different vision we

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1. *See* David Millon, *New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1374 (1993) (addressing balance between shareholder and non-shareholder constituencies); Lyman P. Q. Johnson, *New Approaches to Corporate Law*, 50 WASH. & LEE L. REV. 1713, 1713–14 (1993) (discussing limitations on shareholder primacy).

2. *See* David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223, 224 (1991) (discussing hostile takeover crisis).

3. *See* Millon, *supra* note 1, at 1374 (discussing shareholder primacy); Johnson, *supra* note 1, at 1714 (addressing shareholder constituencies); Millon, *supra* note 2, at 223–27 (discussing director's duties to shareholders); Lyman P.Q. Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 878–88 (1990) (discussing focus on shareholder accountability).

4. *See* William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 677 (2010) (discussing the 1980s fueling market oriented corporate governance).

have today, and trace the path we took from there to here. It will close with a brief prediction regarding corporate law's future.

II. The Post-War Corporation

The post-war writings of Adolf Berle provide a lens that brings into focus a lost vision of a welfarist corporation. Berle described an "American economic republic," a sort of latter-day constitutional settlement directed to production and employment.[5] Although Berle is remembered for having problematized corporate power in a famous book published in 1932, for most of his career he stood for the opposite proposition.[6] There was no inconsistency, for, in Berle's view, the New Deal had changed everything, bequeathing a political economy in which corporate power had been rendered benign:

> The 1929 crash, the slow recovery of 1930, and the ensuing spiral descent into an abyss of unemployment, bank failures, and commercial paralysis was not corrected by market processes. The contemporary business captains, working desperately (as they did) to meet the situation, failed completely. Following established precepts of the American political process, the public . . . increasingly asked that the political state propose a program and act. Necessarily, this meant considerable reorganization of private business . . . . Out of the crisis was born the American economic republic as we know it today.[7]

In Berle's new republic, the state and the economy were interdependent, with the state taking ultimate responsibility for economic results and exercising the higher level of power.[8] The old economic order, with its private property and profit maximization engine persisted,[9] and, incentivized by the profit motive, did the

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5. *See* ADOLF A. BERLE, THE AMERICAN ECONOMIC REPUBLIC 81–82 (1963) [hereinafter BERLE, REPUBLIC] (discussing the role of competitive markets in the American economy).

6. *See generally* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (Harcourt, Brace & World 1968) (1932).

7. BERLE, REPUBLIC, *supra* note 5, at 91.

8. *See id.* at 95, 99, 169 (addressing the formation of new government institutions to provide "economic 'guide lines'").

9. *See id.* at 99 ("It[, the modified order,] maintained the institution of

producing.[10] The state had intervened only to stabilize its organizational lines and performance.[11] More extensive government intervention had been avoided, but only because sophisticated private actors had learned to moderate their conduct.[12] They had seen that the state's regulatory power took precedence over their own economic power, and accordingly had restrained the exercise of their power for the sake of its own preservation.[13] This permitted the state to exercise its economic power only negatively, rarely resorting to direct insistence on positive action.[14]

Two factors were responsible for this healthy equilibrium: first, government management of the economy from an unchallenged position of higher authority and, second, a solid supporting political consensus supporting the status quo.[15] The public consensus in turn depended on corporate performance—price stability, jobs, and benefits.[16] The voters had learned during the Depression that they did not want a perpetual struggle in a free market context.[17] Instead they wanted economic growth, distribution of its benefits to substantially all, and full employment.[18] They also wanted predictability without halts and starts, both as to employment and the prices of goods and services.[19] The interest groups—big business, small business,

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private property and wealth.").

10. *See* ADOLF A. BERLE, JR., POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN AMERICAN POLITICAL ECONOMY 94 (1959) [hereinafter BERLE, POWER] (recognizing that government regulation of corporations assumes profit will incentivize production, supply, and distribution).

11. *See* BERLE, REPUBLIC, *supra* note 5, at 99 (suggesting a new system emerged from the "emergency base wrought in 1933").

12. *See id.* at 169 (noting the lack of instruments like courts and tribunals).

13. *See id.* ("Economic power is secondary to political power.").

14. *See* BERLE, POWER, *supra* note 10, at 94 ("Most, though by no means all, governmental power is negatively exercised: it takes the form of prohibiting certain uses of economic power by non-Statist organizations.").

15. *See id.* at 120–22 (discussing increased production demands and need for continuity).

16. *See id.* at 122 (discussing desire for stability in labor market).

17. *See id.* (addressing fear of economic downturns).

18. *See id.* (discussing desire for "full employment").

19. *See* ADOLF A. BERLE, JR., THE 20TH CENTURY CAPITALIST REVOLUTION 50–51 (1954) [hereinafter BERLE, 20TH CENTURY] (discussing price stabilization in commodity markets).

labor, and farmers—all were in accord, along with the majority of both political parties.[20] Nothing in the post war era had changed those preferences.[21] Nor was a future change foreseeable.[22]

Berle described a benign equipoise amongst strong organizations, an equipoise constrained by a wider public consensus that empowered the central government in the role of welfare maximizer—he saw a state that guided and pushed markets to the right result with the cooperative engagement of interested parties.[23] Managers were caught inside a web of countervailing powers and had no way to get out of control. The strands in the web were product market price competition, labor unions, trade associations, public opinion, management's own sense of responsibility, and most importantly, government regulation.[24]

Managers emerged as quasi-public servants.[25] Whether they liked it or not, they were caught between the regulatory state and the public consensus.[26] Failure to satisfy the public meant new regulation; avoidance of new regulation meant satisfying the public.[27] So public duties could not, as a practical matter, be avoided, and managers emerged playing a role as economic and social allocators, actively assuming public functions.[28]

Changes on the ground backed Berle's vision. During the 1950s in the United States, while other countries were instituting national health systems and generous state pension schemes for

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20. *See id*. at 50 ("Obstinately, however, big business and small business, farmers and laborers, corporations which like their profit margins and labor unions which like their jobs, controlling majorities in the Republican as well as the Democratic parties, decline to acknowledge the error of their ways.").

21. *See id*. (discussing maintenance of price stabilization under President Eisenhower).

22. *See* BERLE, REPUBLIC, *supra* note 5, at 99 ("There appears no present likelihood that a new basis will be sought in the foreseeable future.").

23. *See id*. at 88 (discussing the role of the democratic process in change).

24. *See* BERLE, 20TH CENTURY, *supra* note 19, at 53–59 (discussing obstacles of manager control).

25. *See* BERLE, POWER, *supra* note 10, at 8 ("Since they are not owners but only managers, they really are a variety of non-Statist civil servant.").

26. *See* BERLE, 20TH CENTURY, *supra* note 19, at 59, 172–73 (discussing demands from public and government)

27. *See id.* at 59, 172–73 (discussing limited choices of managers).

28. *See id.* at 59, 175 (examining the rationale for corporate donations to educational institutions).

senior citizens, the corporations took on the great part of the welfare burden.[29] This was in part an accident of history—pensions and medical benefits found their way into a high-profile settlement between General Motors and its unions in 1948, a settlement that was copied across the industrial landscape and modified over time to labor's advantage as industries went from settlement to settlement.[30]

Those years were—not coincidentally—the golden age of American management. Commentators described a new economy that had evolved past Adam Smith's atomistic free market strivers so that forward motion came from innovative technocrats in management suites.[31] Shareholders dropped out of this governance picture. Berle explained why; all they did was passively collect dividends and then consume or save.[32] As such they played no productive role in the economy. Stock market controls, seen today as the cutting edge of discipline and productive efficiency, were then thought to be largely irrelevant. Corporations in need of capital retained earnings or borrowed.[33] The function of the stock market was to hold out liquidity for the benefit of the rich grandchildren of the entrepreneurs who had founded the great companies. Monitoring had gravitated over to the hands of government authorities,[34] which mediated between producing companies and the markets. The shareholder franchise was

29. GERALD F. DAVIS, THE VANISHING AMERICAN CORPORATION: NAVIGATING THE HAZARDS OF A NEW ECONOMY 42 (2016).

30. *Id.*

31. *See* Edward S. Mason, *The Apologetics of "Managerialism*," 31 J. BUS. 1, 3, 10 (1958) (addressing the role of managers in the rise of large corporations).

32. *See* BERLE, 20TH CENTURY, *supra* note 19, at 31–32 (arguing that no enterprise with so many members work absent a centralized command).

33. *See id.* at 36–37 (noting that during the preceding six years 64% of invested capital had been financed by retained earnings and only 6new equity); *see also* BERLE, POWER, *supra* note 10, at 45 (noting that 10–15% percent of new capital came from pension funds and insurance companies and 20% from bank borrowing).

34. *See* Adolf Berle, *Property, Production and Revolution: A Preface to the Revised Edition*, in ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY xxvii, xxxiii (Harcourt, Brace & World 1968) (1932) [hereinafter BERLE, 1967 INTRODUCTION] (discussing the rise of government intervention).

likewise irrelevant, the annual vote for the board of directors having degenerated into a meaningless ritual.[35]

As rich consumers, shareholders did play a role in social welfare enhancement as providers. They supported their families, they supported social welfare programs as taxpayers, and they supported charities as donors.[36] As such they were entitled to society's thanks, but not its political solicitude. The shareholder interest would emerge as a legitimate force in society, said Berle, only when shareholder wealth was so widely distributed as to benefit every American family.[37] Only in such a distributive utopia could the shareholder interest serve as a proxy for social welfare and thus hold out political economic salience.

Interestingly, there was not much in the way of discussion of corporate social responsibility in post-war Berle. Regulation and ancillary government pressure took care of externalities (or so he thought). The economy was growing, the constituents were content, and managers were seen as under control.[38] Nor did Berle problematize compliance with law, for his managers proceeded decorously when dealing with the powerful post-New Deal state.

III. Conflict and Resolution, 1970–1990

Conflicts did simmer under the surface. They became manifest during the 1970s and played themselves out during the 1980s, posing a multi-sided and ultimately successful challenge to Berle's American economic republic. This was the era during which corporate social responsibility and constituent rights came to the forefront of corporate policy debates, social responsibility in the 1970s and constituencies in the 1980s, negating Berle's vision of a satisfied public. Simultaneously, shareholder value maximization rose to prominence to pose a countervailing vision of the

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35. *See* BERLE, POWER, *supra* note 10, at 104–05 (identifying Board of Directors elections as "not an impressive ritual").

36. *See* BERLE, REPUBLIC, *supra* note 5, at 51–52 (discussing welfare by the state and community).

37. *See* BERLE, 1967 INTRODUCTION, supra note 34, at xxxv (balancing shareholder interests and wealth inequality).

38. *See* BERLE, POWER, *supra* note 10, at 120–22 (discussing production demands and content constituencies).

corporation's place in society, a vision that focused on market as opposed to government controls, and negated Berle's vision of a benevolent state maximizer. A resolution followed: the shareholder vision won. Social responsibility would not be imposed on companies and constituents would get no rights, and, indeed, would see their positions deteriorate considerably even as the shareholder interest gained influence.

The economic background was unstable during the early part of this period—the economic bill for the Vietnam War came due in 1972 and 1973, when the stock market collapsed and the economy went into a severe recession aggravated by the mid-east oil crisis.[39] The stock market did not really recover until August of 1982—a whole decade in which there was no money to be made long in stocks even as inflation rose steeply. The malaise was called "stagflation" and undermined the economic assumptions of the managerial golden age.[40] The appearance of international competition in manufactured goods added to the stock of chronic problems.[41] We were no longer a closed continental economy in which domestic corporations competed only against one another. People started to ask questions about how well managers were doing their jobs,[42] questions that began with the sudden collapse of the once great Penn Central Railroad in 1970[43] and intensified as bad results accumulated.

At the same time, the old New Deal political coalition that created and maintained the strong regulatory state fell apart. Managers, formerly co-operative in the face of overwhelming state power, defected, and started to play a hostile game against regulatory initiatives. Simply, they were no longer afraid of non-compliance.[44] Deregulation also started in the 1970s, and picked

39. DAVIS, *supra* note 29, at 47.

40. *Id*. at 55.

41. *Id*. at 55–56.

42. *Id*. at 56.

43. *SEE* STAFF REPORT OF THE SEC. AND EXCH. COMM'N TO THE SPECIAL S. COMM. OF INVESTIGATIONS, THE FINANCIAL COLLAPSE OF THE PENN CENTRAL COMPANY (1972) (discussing the fall of the Penn Central Railroad).

44. *See* Elliott J. Weiss, *Social Regulation of Business Activity, Reforming the Corporate Governance System to Resolve an Institutional Impasse*, 28 UCLA L. REV. 343, 347–48 (1981) (describing corporate noncooperation, such as court challenges and minimum legal compliance).

up speed after 1980. Deregulation, however, meant removal of an existing regime only in a handful of industries.[45] For the most part, deregulation meant not repeal but inaction—we just left things the way they were, even as corporate risk taking and externalization pursued new paths.

The conceptual framework surrounding corporations changed substantially as a result. Unbridled management power, problematized by Berle back in 1932, came back to the forefront as the problem in need of solution.[46] Corporate governance was invented to take care of the job. The phrase "corporate governance" had its first published appearance only in 1972.[47] The first fully developed text on the subject, Melvin Eisenberg's book *The Structure of the Corporation*,[48] followed quickly in 1976. Eisenberg synthesized and materially advanced a generation of thinking about deficiencies of the received legal model of the corporation.[49] For a corrective mechanism, he turned to the moribund board of directors.[50] If we scaled down the demands we placed on it and successfully required it to monitor management performance (as opposed to taking a leadership role in hands on management), corporate performance would improve.[51] This monitoring function in turn required independent directors and a committee structure keyed to monitoring functions.[52] All of a sudden there was something that could be *done* about corporations and "corporate governance" held the key, with best practices as the focus of the

45. *See* Michael L. Wachter, *Labor Unions: A Corporatist Institution in a Competitive World*, 155 U. PA. L. REV. 581, 628–30 (2007) (noting the regulation of specific "individual industries" had already replaced the breadth of New Deal regulations).

46. *See id.* at 630 (discussing the impact of deregulation on manager power).

47. *See* Mariana Pargendler, *The Corporate Governance Obsession* 13 (John M. Olin Program in Law & Econ., Stanford, Working Paper No. 470, 2015), https://ssrn.com/abstract=2491088 ("[T]he New York Times featured the phrase as early as 1972.").

48. MELVIN ARON EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS (1976). Eisenberg's monitoring model of the board of directors has ever since been the main focus of legal corporate governance.

49. *See generally id.* (discussing additional rules and structure for corporate governance).

50. *See id.* at 139–85 (discussing additional structure for board of directors and management).

51. *See id.* at 156–57 (discussing the function of the board of directors).

52. *See id.* at 156–57 (emphasizing the monitoring function of the board).

new mode of discussion. Expectations ran high, higher than a bland list of best practices would seem to justify. "Corporate governance" held out something for everybody.

The political left, which did not disappear quietly, grabbed hold of it first. Progressives, who in the 1970s still considered themselves the country's natural ruling group, had become manifestly frustrated—they were dissatisfied with the level of new regulation and outraged by corporate non-co-operation even as they despaired of marshalling political backing for new initiatives.[53] The American corporate social responsibility movement arose as a result, and its policy entrepreneurs looked to governance institutions for reform platforms.[54] Director "independence," they thought, could import corporate social responsibility.[55] Maybe we could require corporations to nominate their directors from a centrally qualified list, with all persons admitted to the list being sound progressive types.[56] Maybe we could use the proxy system to tap into popular protest of irresponsible corporate policies.[57] Maybe corporate law could be federalized and charter competition choked off, with the right sort of people cranking out new duties and reporting obligations.[58]

None of this came to much. The political traction was not there, for even as anti-corporate sentiment was gaining more political salience the emerging political economic equilibrium was taking a regressive turn. A new outlet appeared to channel and partially appease this negative sentiment—not taxation, not

53. *See* Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 597 (1982) (describing dissatisfaction with the current corporate regulatory regime).

54. *See id.* at 597 (discussing calls for reform).

55. *See id.* at 603–04 (noting a renewed focus on Berle's concerns regarding outside directors).

56. *See* Weiss, *supra* note 44, at 426–32 (discussing the composition of board of directors).

57. In 1970 a group of public interest lawyers launched a proxy contest at GM in an attempt to elect three progressives to the board of directors. "Campaign GM" received three percent of the votes. *See* Donald E. Schwartz, *Proxy Power and Social Goals: How Campaign GM Succeeded*, 45 ST. JOHN'S L. REV. 764, 764–66 (2012) (discussing the GM proxy campaign).

58. *See* NADER ET AL., TAMING THE GIANT CORPORATION 16 (1976) (discussing the great size and power of large corporations on a national level); Donald E. Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L. REV. 545, 548–49 (1984) (discussing federal regulation of corporate governance).

redistribution, not a stable environment for working families, not progressive capture of corporate governance institutions, but compliance with law for its own sake. Thus did the foreign bribes scandal incident to the Watergate investigations result in the Foreign Corrupt Practices Act of 1977.[59] Much like New Deal initiatives, this intervention leaned on corporations to get them in line with the public program. But, as befits new regulation in a deregulatory era, it did not much implicate the economic substance of corporate management even as it constrained management power. Where in Berle's day the regulatory objective was cooperative corporate participation in a national effort to enhance social welfare, now we had a narrower, simpler objective: to the extent we do have regulation, comply with it. Significantly, corporate governance mechanisms were pressed into service of the new compliance goal, a practice that would proliferate in regulation generally as the command and control approach yielded to self-regulatory initiatives.

For a time, managers felt threatened. They turned to the same focal point as did everyone else—corporate governance—and tried to capture it for themselves. The Business Roundtable, seeking to stave off more intrusive initiatives, publicly embraced the independent director majority.[60] So long as incumbent CEOs could use their influence to secure appointment of cooperative types, any threat was minimal.[61] Cooperative engagement did not last long in any event. Once the political climate changed and the threat receded, management went back into opposition, fighting tooth and nail when the American Law Institute geared up to propose governance mandates in the 1980s.[62]

There would, however, be no letup in the governance-based assaults on management prerogatives. But the source of pressure

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59. *See* 15 U.S.C. §§ 78m(b)(2), 78dd-1-2, 78ff (2012) (demonstrating an increased effort to regulate corporate practices globally).

60. *See* Business Roundtable, *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation*, 33 BUS. LAW. 2083, 2085, 2089, 2093 (1978) (proposing reforms to encourage more independent directors).

61. *See* Brudney, supra note 53, at 610–12 (describing the pattern of cooperation and management control of appointments).

62. *See* Victor Brudney, *The Role of the Board of Directors: The ALI and Its Critics*, 37 U. MIAMI L. REV. 223, 228 (1983) (opposing increased government regulation of board structure).

changed when the shareholders themselves emerged in the 1980s to take their own place at the new corporate governance table and replace progressives as normative entrepreneurs.

As we turn our attention to the shareholders, reference must be made to another fundamental text dating from the 1970s, the famous paper of Michael Jensen and William Meckling, *Agency Costs and the Theory of the Firm*, published in 1976.[63] This coined another new term, "agency costs," which would come into usage in tandem with "corporate governance," with very different implications from those attached by 1970s progressives.[64] Jensen and Meckling for the first time brought microeconomic analysis to the study of interior corporate arrangements, confirming the suggestion that corporate governance mattered for productivity.[65] But there's a critical point of distinction between Jensen and Meckling's vision and the vision of reformers like Eisenberg. Jensen and Meckling are the theoretical start point for the assertions that the purpose of the corporation is shareholder value maximization and that market forces by themselves can discipline managers effectively—a different and radical reversal of the assumptions that underlay the Berle's American economic republic.[66] There was also a corollary proposition: if anything impeded the forces of market control, it followed that agency costs were excessive.[67]

The market control scenario unfolded for real during the takeover wars of the 1980s.[68] The markets, suppressed in the

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63. Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

64. *See id.* at 308 ("We define agency costs as the sum of: (1) the monitoring expenditures by the principal, (2) the bonding expenditures by the agent, (3) the residual loss.").

65. *See* Jensen & Meckling, *supra* note 63, at 309 ("We show below that an explanation of why and how the agency costs generated by the corporate form are born leads to a theory of the ownership (or capital) structure of the firm.").

66. *See id.* at 313 ("Prospective minority shareholders will realize that the owner-manager's interests will diverge somewhat from theirs, hence the price which they will pay for shares will reflect the monitoring costs and the effect of the divergence between the manager's interest and theirs.").

67. *See id.* at 352 ("If the costs of reducing the dispersion of ownership are lower than the benefits to be obtained from reducing the agency costs, it will pay some individual or group of individuals to buy shares in the market to reduce the dispersion of ownership.").

68. *See* Scheherazade S. Rehman, *Can Financial Institutional Investors*

course of the New Deal settlement, came back to retake the forward role in corporate governance, a position that has been steadily solidifying ever since.[69] Market control and shareholder value maximization operate in tandem. Indeed, they are two sides of the same coin.[70]

Numerous factors combined to effect the change. Reagan came in and the left was marginalized.[71] Antitrust policies that inhibited same industry mergers were abandoned.[72] Labor unions markedly declined in influence.[73] Competition from abroad intensified. As the junk bond became available, ideas about acceptable levels of leverage changed markedly so that high leverage became a means to facilitate corporate control transfers.[74] The prime targets were the most extreme product of post-war managerialism,

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Legally Safeguard American Stockholders?, 2 N.Y.U. J.L. & BUS. 683, 701 (2006) ("In the 1980s, takeovers (friendly and hostile) radically changed the landscape of the U.S. economy.").

69. *See* Bratton & Wachter, supra note 4, at 676 ("[M]anagers emerged from the 1980s sensitized to the benefits of shareholder-value maximization even as the board of directors emerged as a more robust monitoring institution. Hostile takeovers lost their place at the cutting edge of corporate governance as a result.").

70. *See id.* at 667

> [S]hareholder proponents contemplate a species of market control. They want the market price—which is, after all, set by shareholders investing at the margin—to be the ongoing and determining source of shareholder input. It bids those managers who are effective agents to manage to the stock market in formulating business policy, thereby accessing the high-quality instructions embedded in stock market prices. With the market price as the management yardstick, value-enhancing opportunities to merge, sell, or dissolve will no longer be frustrated by the managers' desire to hold on to control; resources will no longer be misdirected to suboptimal executive compensation plans; and governance arrangements will import appropriate constraints and incentives. Managing to the market price also isthought to import administrative coherence, because the yardstick provides a means with which to evaluate management performance.

71. *See* Terry Carter, *Should This Toy be Saved?*, A.B.A. J., May 2013, at 52 (2013) ("Then Ronald Reagan became president in 1981 with a mission to shrink government and lighten the regulatory load on business.").

72. DAVIS, *supra* note 29, at 53–54.

73. *Id.* at 65–66.

74. *See* Ronald J. Gilson & Jeffrey Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 870–71 (2013) ("By the mid-to late 1980s, more than half of all junk bond issuances were related to acquisitions.").

conglomerate structures, which had come to be seen as dysfunctional, for the stock market systematically undervalued their businesses.[75]

The struggle's end point is familiar enough. Leveraged restructuring roared through the economy before the takeovers finally stopped. The stoppage was the ostensible result of collaboration between managers and state lawmakers to deter takeovers with legal barriers.[76] Meanwhile, thinking about corporations once again shifted fundamentally. Maximization of shareholder value came in as the objective to be achieved.[77] Managers, once seen as effective technocrats, now become incentive incompatible actors whose greed and incompetence choked the economy with chronic, out-of-control agency costs. Management empowerment accordingly remained as the salient policy problem, not because it resulted in externalities but because it left shareholders with suboptimal yields.[78] Indeed, shareholders emerged as a permanent aggrieved class with an unmet regulatory entitlement.[79] The long-standing but vague association between corporate purpose and social welfare dropped out of the picture.

IV. The Post-Takeover Era

There was a lot of carnage in the transition from the social corporation of the American economic republic to today's shareholder corporation. In the leveraged restructurings of the

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75. DAVIS, *supra* note 29, at 54–59.

76. *See* Edward F. Greene, *Regulatory and Legislative Responses to Takeover Activity in the 1980s: The United States and Europe*, 69 TEX. L. REV. 1539, 1542 (1991) ("The desire by both management and state legislators to curb hostile takeovers placed the courts in a difficult dilemma.").

77. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 449 (2001) ("[I]f the control rights granted to the firm's equity-holders are exclusive and strong, they will have powerful incentives to maximize the value of the firm.").

78. *See* Bratton & Wachter, *supra* note 4, at 659 ("If managers misunderstood the quantum of risks they were taking, then shareholders with more limited access to the relevant information certainly were no better informed and accordingly had no role to play in preventing externalization.").

79. *See id.* at 665–73 ("Shareholder empowerment emerged from the takeover era as the leading issue in corporate law, with a consistent consensus in its favor.").

1980s, a couple of generations of corporate employees, who had justifiably expected that their companies held out careers, lost their jobs.[80] Billions of dollars of wealth shifted as their human capital investments were sacrificed in order to enhance shareholder value. As result, constituent concerns displaced more general concerns about social responsibility at the forefront of progressive critique of the operation of corporate law, with Lyman Johnson and David Millon at the discussion's forefront.[81] There was even a law reform movement—a succession of bills were introduced in Washington to ameliorate the dislocation experienced by the subject employees.[82] None were enacted and the initiative faded away during the 1990s.[83] Henceforth, the corporate

80. *See* Patrick J. Ryan, *Corporate Directors and the "Social Costs" of Takeovers—Reflections on the Tin Parachute*, 65 TUL. L. REV. 3, 5 (1989) ("During 1984 and the first half of 1985, an estimated 550,000 employees' jobs were affected by takeover-related restructuring decisions.").

81. *See supra* note 3 and accompanying text (explaining that Johnson and Millon advocated for inclusion of constituent interests as beneficiaries in the corporation's legal model).

82. *See* Alan E. Garfield, *Helping the Casualties of Creative Destruction: Corporate Takeovers and the Politics of Worker Dislocation*, 16 J. CORP. L. 249, 273 (1991) ("By comparison to the frenetic lawmaking by the states, the federal response to takeover dislocation has been all talk and no action. Numerous congressional committees have held hearings on the issue, but no significant legislation has been enacted to address the problem.").

83. Below is a tabulation of bills introduced in Congress relating to corporations from 1987 to 2004, the "plant closing" category shows no activity after 1998:

	1987 - 1988	1989 - 1990	1991 - 1992	1993 - 1994	1995 - 1996	1997 - 1998	1999 - 2000	2001 - 2002	2003 - 2004
Hostile Takeover	20	12	4	3	0	1	0	0	0
Other Merger	11	3	5	0	2	2	7	4	3
Foreign Acquisitio n	6	4	6	1	1	0	0	0	0
Industry Specific	13	16	2	3	8	7	12	10	0
Plant Closing	3	0	3	0	2	0	0	0	0

law case for the employees' interests would be tied to the case for management empowerment vis-à-vis shareholders, and subordinated thereto.[84]

The job losses did not stop with the restructurings of the 1980s. America's large corporations have been steadily lightening their payrolls ever since. Manufacturing is outsourced wherever possible, usually abroad.[85] The change is pervasive. The greatest corporate successes of the present age are in the computer and electronics and telecommunications industries. Even so, employment in these sectors has dropped dramatically since 2000.[86] Today's most successful companies are Apple, which employs 92,000 (half of them in the stores), and Google, which employs 54,000.[87] Facebook, which makes sense as number three, employs 12,500.[88] The employment numbers fall off drastically at other successful tech companies.[89] General Motors, the most successful of mid-twentieth century corporations, employed 850,000 at its peak in the 1980s.[90]

Simply, big corporations have lost their position as the focal point of the lives of most Americans. In the management golden age, corporations were the places where talented people made careers. Restructuring put an end to that. Now, instead of careers, we have jobs. And it is looking like jobs are disappearing as well—there is shift away from jobs and employers to tasks and piece work contracts.[91] In the golden age, big corporations handled the accumulation of retirement savings. They stopped doing that too, as employers shifted from defined benefit pension plans to defined

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84. This is the contribution of Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999).

85. DAVIS, *supra* note 29, at 69–79.

86. *Id*. at 15.

87. *Id*. at 147.

88. *See* STATISTA, https://www.statista.com/statistics/273563/number-of-facebook-employees/ (last visited Jan. 22, 2017) (noting that as of December 2015 Facebook had 12,691 people under full-time employment).

89. *See* DAVIS, *supra* note 29, at xv ("At this writing, the combined global workforces of Facebook, Yelp, Zynga, LinkedIn, Zillow, Tableau, Zulily, and Box are smaller than the number of people who lost their jobs when Circuit City was liquidated in 2009.").

90. *See id*. at 15 (providing a chart showing the number of people employed at General Motors from 1923 to 2009).

91. *Id.* at 144–49.

contribution plans.[92] In the golden age, big corporations took care of medical benefits for most Americans. But that burden eventually ripened into a competitive disadvantage as regards companies in countries that chose to put government welfare schemes in place instead.[93]

None of this registers in today's corporate law policy discussions. Downsizing and asset-lite business plans enhance return on equity for the shareholders' benefit—end of discussion. The trade-offs of the 1980s have been forgotten without there ever having been a discussion of the cost-benefit question they posed: whether the toll of human capital taken together with the ancillary costs of over-leverage and resulting bankruptcy might have outweighed the shareholder benefits. The best account of the era characterizes the overleverage as a cost-beneficial external shock that redirected the management's incentives in the right, shareholder-oriented direction.[94] The human capital sacrifice matters not at all—it is a mere incident of capitalism at its most dynamic.

American society has been adjusting ever since to increased instability, decreased opportunity, and widening inequality. Such is the prestige of markets that few perceive this to be a problem. Meanwhile, management, which tried and failed to capture the newly important corporate governance system, has itself been captured in turn. During the golden age managers took it out as salary under what today would look like egalitarian pay structures.[95] Now they take it out in equity compensation arrangements that tie their fortunes to the stock price.[96] For all their complaining, they got with the program, and did well.

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92. *Id.* at 120–21.

93. *Id.* at 119–21.

94. *See* Bengt Holmstrom & Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, J. ECON. PERSP., Spring 2001, at 122–23 ("Thanks to lucrative stock option plans, managers could share in the market returns from restructured companies. Shareholder value became an ally rather than an enemy.").

95. DAVIS, *supra* note 29, at 131–34.

96. *See* Matthew A. Mellone, *The Section 83(b) Election and the Fallacy of "Earned Income"*, 10 BERKELEY BUS. L.J. 53, 54 (2013) ("The putative benefits of equity compensation arrangements are imbedded in the stock price at the time of grant.").

Shareholder advocates have two modes of coping with this dark side.[97] First, they assume that shareholder wealth maximization and social welfare maximization are more or less the same thing.[98] Second, even if shareholder wealth maximization does not by itself enhance social welfare as a theoretical matter, it does so as a practical matter because most Americans now hold shares.[99] Let us take up these claims in turn.

The first claim posits that shareholder value maximization and social welfare maximization are the same thing, or, at least that shareholder value is a robust proxy for social welfare.[100] This is inexcusably bad economics.[101] To see why, one needs to go back to theoretical square one, the first fundamental theorem of welfare economics.[102] This begins with a general equilibrium view of the economy and assumes away externalities[103] to pose that a competitive economy maximizes wealth.[104] The normative kicker is that everything that can be done to make the economy more competitive should be done so that the economy reaches a Pareto optimal production possibility frontier, the point of economic

97. *See generally* William W. Bratton & Michael L. Wachter, *Shareholders and Social Welfare*, 36 SEATTLE U. L. REV. 489 (2013) (describing both modes of the theory that shareholder maximization and social welfare maximization are linked).

98. *See generally id.* ("Under this theory, shareholder wealth maximization, it seems, is a key that unlocks the door to making the world a better place.").

99. *See id.* at 489–90 ("[T]he quest for political solicitude has made the jump from theory to practice: a 'shareholder class' is said to have risen in our political economy as an offshoot of the growth of stock ownership among the middle class. Thus, real-world shareholders again are seen to bear on social welfare.").

100. *See id.* at 498 ("[A] related question can be asked: whether shareholder value maximization legitimately can be characterized as a 'proxy' for social welfare maximization.").

101. *See id.* at 497 ("From the point of view of economic theory, 'social welfare' does not necessarily enter into this discussion, which concerns only the creation of wealth.").

102. *See id.* at 498 ("The exercise directly extends the first fundamental theorem of welfare economics. Strictly speaking, it provides a basis for describing shareholder value maximization as wealth maximization, but not as social welfare maximization.").

103. All individuals and firms are price takers, each firm produces so as to maximize its profits subject to a production constraint, and each individual consumes so as to maximize individual utility. *See generally* Allan M. Feldman, *Welfare Economics in* 8 THE NEW PALGRAVE DICTIONARY OF ECONOMICS 722 (Steven N. Durlauf & Lawrence E. Blume eds., 2d ed. 2008).

104. *Id.* at 723.

efficiency.[105] Once we reach the frontier we encounter the second fundamental theorem, which introduces social welfare. This theorem holds that, given an efficient economy, preferences for redistribution can be dealt with through lump sum taxes and transfers, provided that the transfers do nothing to impair the incentives that got us to the efficient frontier in the first place.[106] Things get tricky at this point because it is very likely that taxes and transfers will impair productive incentives, which in turn implies a policy against redistribution. Happily, the theory of the second best comes to the rescue, posing that taxes and transfers can make us better off net of their costs by satisfying preferences for social welfare-enhancing outcomes, even though production lies short of the efficient frontier.[107]

Let us extend the first theorem to corporate production. The adaption is quite easy: a system of corporate governance is ex ante efficient if it generates the highest possible payoff for all the parties involved, shareholders, creditors, employees, clients, tax authorities, and other third parties that may be affected by the corporation's actions.[108] As a matter of economic theory, the extension is completely uncontroversial, even though it sweeps in constituent interests. To get to shareholder wealth maximization as the purpose of the corporation, one must take two further, assumption-laden steps.

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105. *See* William W. Bratton, *Framing a Purpose for Corporate Law*, 39 J. CORP. L. 713, 715 (2014) (describing the first and second fundamental theorems of welfare economics).

106. More particularly, given the outcome of the first theorem, almost any Pareto optimal equilibrium can be achieved given imposition of appropriate taxes and transfers. *See* Feldman, *supra* note 103, at 724 (examining the necessary wealth-redistributive effects for optimal social welfare).

107. *See* Richard G. Lipsey & Kelvin Lancaster, *The General Theory of the Second Best*, 24 REV. ECON. STUD. 11 (1956) ("The general theorem for the second best optimum states that if there is introduced into a general equilibrium system a constraint which prevents the attainment of one of the Paretian conditions, the other Paretian conditions, although still attainable, are, in general, no longer desirable.").

108. *See* Marco Becht et al., *Corporate Governance and Control* 8 (ECGI Finance, Working paper No. 02/2002, 2005), http://ssrn.com/abs=343461 ("[A] corporate charter is ex-ante efficient if it generates the highest possible joint payoff for all the parties involved, shareholders, creditors, employees, clients, tax authorities, and other third parties that may be affected by the corporation's actions.").

The first step comes from the *ur*-text, Jensen and Meckling, and requires us to unpack some assumptions. Jensen and Meckling posited that if the firm is modeled as a nexus of *complete* contracts among all parties involved except for the contract between a firm and its shareholders, which is modeled as *incomplete,* then maximization of shareholder value is tantamount to the economically efficient result.[109] This assertion is literally true—if everybody other than one incomplete contract holder has a complete maximizing contract, then everybody other than the one incomplete contract claimant is already maxed out, and maximizing for the remaining claimant is economically efficient by definition.

It is worth noting that economic theory here opens a door for proponents of constituency interests to advance efficiency claims. All they have to do is point out that other constituents have incomplete contracts too, an assertion that is manifestly correct. This creates a problem for shareholder proponents, for they have to show that other constituent incompleteness does not disable their case. This theoretical burden is addressed with a trio of assertions: first, relatively speaking shareholders are more vulnerable than are other stakeholders;[110] second, decision-making costs should be minimized and a multi-constituent model imports incoherence, adding to decision-making costs;[111] and third, the shareholder interest is the residual interest and thus provides a superior management reference point.[112]

109. *See id*. at 8–9 ("[O]nly shareholders have a claim on residual returns after all other contractual obligations have been met."). Agency costs are assumed away. *See id*. ("Under this scenario, corporate governance rules should be designed to protect and promote the interests of shareholders exclusively.").

110. *See* Oliver Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1210 (1984) ("Some managements, however, play 'end games' (undisclosed strategic decisions to cut and run before corrective measures can be taken) and individual managers commonly disclose information selectively or distort data. Additional checks against such concealment and distortion can be devised to give shareholders greater confidence.").

111. *See* Becht et al., *supra* note 108, at 9 ("In his view, determining which constituency should govern the firm comes down to identifying which has the lowest decision making costs and which has the greatest need of protection.").

112. *See* Hansmann & Kraakman, *supra* note 77, at 449 ("[I]n most circumstances, the interests of equity investors in the firm—the firm's residual claimants— cannot adequately be protected by contract. Rather, to protect their interests, they must be given the right to control the firm.").

If one accepts these arguments (an admittedly big if), then shareholder maximization is confirmed as the firm's theoretical objective function. But the framework of analysis is limited. All we are talking about is economic efficiency, that is, reaching the production possibility frontier. Social welfare is not implicated.

Can one still say that managing to maximize shareholder value *proxies* for social welfare? A lot of people do just that.[113] In fact, some avoid inserting the "proxy" qualification and casually assume identity between shareholder value maximization and social welfare maximization. But the proposition is theoretically perverse either way. One suspects that the proponents are jockeying into position for the follow up discussion about shareholder value maximization's political economic implications. A social welfare characterization imports political legitimacy to deregulatory claims and policies that enhance market controls. Indeed, to the extent that economic efficiency and social welfare maximization are deemed to be equivalent, redistributive discussion is pretermitted altogether. Such habits of mind are unsurprising in an age in which economic disparities are widening.

The socio-economic status of shareholders has no relevance in this efficiency discussion. Things change once the topic shifts to social welfare, which is about distribution rather than production. Berle's assertion that the shareholder interest can proxy for the public interest only when all Americans hold shares[114] returns to challenge shareholder proponents. They respond with their second claim.

The second claim posits that the shareholder population has been democratized as an incident of the proliferation of retirement savings. The focal point showing is a 2005 study from the Investment Company Institute and the Securities Industry Association.[115] The study showed that one-half of all U.S. households now directly or indirectly own equities, up from about

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113. No names will be mentioned.

114. *See supra* note 37 and accompanying text (considering a hypothetical distributive utopia).

115. INVESTMENT CO. INST. & SECURITY INDUS. ASS'N., EQUITY OWNERSHIP IN AMERICA, 2005 (2005). The report summarizes results of a survey conducted by the Boston Research Group in January 2005. *See id.* at 39 ("The survey collected detailed information on individual stock and stock mutual fund ownership inside and outside employer-sponsored retirement plans.").

one-fifth in 1983.[116] They further reported that 90% of equity-owning households invest in stock mutual funds and nearly half own individual stock directly.[117] They add that the householders are virtuous shareholders, buying and holding their stock for the long term.[118] The householders "typically" own stock and funds worth $65,000, representing "more than half" of their total "financial assets."[119] Their median age is relatively young, fifty-one years, and only 56% of the group graduated from college.[120] It is a pretty picture.

The statistics have been selected with care, however. The Federal Reserve Board's triennial Survey of Consumer Finances provides a more complete picture. The 2013 Survey shows that the top 10% of households by wealth class owned 81.4% of the stock, with the top one percent owning 37.8%.[121] If we look at the shareholdings of the top 10% wealth class across time, there is some evidence of flattening.[122] In 1983 the top 10% owned 89% of the stock, a proportion that dropped to 81% by 1989, the same 81% that obtained in 2013, and also, within a narrow band of fluctuation, in the intervening years.[123] Extrapolating, movement to defined contribution plans did democratize shareholding, but

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116. *See id.* at 1 ("The number of households owning equities has increased more than three-fold since the early 1980s.").

117. *See id*. (demonstrating this assertion via graph labeled Figure 1).

118. *See id.* at 4 ("As in past years, nearly all equity owners in 2005 follow a buy-and-hold investment philosophy and view their equity holdings as long-term investments.").

119. *Id*. More than 40% held stock or stock mutual funds through IRAs; and nearly 90% held some or all of their equities in tax-deferred accounts. *Id*. at 15.

120. *Id*. at 5. A subsequent study tracking equity and bond ownership appeared in 2008 from the same two organizations. This shows some deterioration in the numbers: equity-owning householders grew to 53% in the peak year of 2001 but then declined to 45% in 2008. INVESTMENT CO. INST. & SEC'S INDUS. & FIN. MKT. ASSOC., EQUITY AND BONDS OWNERSHIP, 2008, at 7 (2008). The explanation lay to some extent with participation in defined contribution pension plans. It seems that a period of employer-by-employer pension fund expansion ended after 2000. Once the saturation point was reached, a disinclination to participate on the part of younger employees began to effect overall ownership numbers. Reverses in the equity markets filled out the explanation. *Id*. at 11.

121. Edward N. Wolff, *Household Wealth Trends in the United States, 1962-2013: What Happened Over the Great Recession?*, 56 tbl.7 (Nat'l Bureau of Econ. Research, Working Paper No. 20733, 2014), http://www.nber.org/papers/w20733.

122. *Id.*

123. *Id.*

only slightly and with an effect that completely worked itself through the economy before 1990.

Summarizing, shareholder value does not proxy for social welfare and no progress in that direction has registered during the shareholder value era.

V. The Present Posture

The scope of corporate legal theory's mainstream discussion has narrowed steadily since Berle's day. He integrated in the corporation in an overall political economy in which corporations played role in both production and allocation. Today, we only worry about production. This is nobody's fault. Corporate law follows from and reflects the national social settlement.

Today's corporate legal theory centers on a small-scale policy discussion about the balance of power between shareholders and managers. Most participants obsess on excess, embedded agency costs and model shareholders as a permanently disadvantaged group with an outstanding, unmet regulatory entitlement. It is a picture that resonates less and less, for the central trend since 1990 has been progressive agency cost reduction at the instance of market forces—just what Jensen and Meckling predicted.[124] With the benefit of hindsight, it's now clear that the shareholders decisively won their battle with management between 1985 and 1990, and did so without a significant regulatory assist.

This is where corporate law is going to stay, absent a negative external shock that upends the social settlement. We did have a negative shock in 2008, but not enough of one to jolt the social settlement. It was, in retrospect, just a blip on the screen. There is a standing concern about unproductive short-termism, triggered by the activities of activist hedge funds. But there's no compelling evidence from practice to back up the claim of a systematic crimp on productivity. Shareholder power certainly can have negative effects on going concerns, but they show up company by company rather than systemically, just as do agency costs.

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124. *See* Bratton & Wachter, *supra* note 4, at 675–88 ("Our challenge follows from the lesson Jensen and Meckling taught in their classic work on agency costs: institutions change in response to market incentives.").

If anything, the scope of corporate legal theory will narrow even more. The days of a separation of ownership and control as an over-arching political economic problem that corporate law needs to solve are over. If shareholder empowerment is here to stay and will not turn out to have systematic perverse effects (more admittedly big ifs), shareholder-management relations will fall back from the policy margin to become a field in which decision-making is customarily left to the business judgments of parties with direct stakes. Corporate law will become a field in which the basic assumption is that private ordering confronts the problems and effects any needed changes. The public coloration will fade so much that corporate law will look more and more like the rest of private law, a platform on which parties capable of self-protection bargain over outcomes. We made up our collective mind to forget about the externalities the bargaining parties inflict along the way during the 1980s. Should a future shift in the national social settlement rouse us from this collective amnesia, the writings of Lyman Johnson and David Millon will be there to facilitate restoration.