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Team Production Revisited

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ABSTRACT

This Article reconsiders Margaret Blair and Lynn Stout's team production model of corporate law, offering a favorable evaluation. The model explains both the legal corporate entity and corporate governance institutions in microeconomic terms as the means to the end of encouraging investment, situating corporations within markets and subject to market constraints but simultaneously insisting that productive success requires that corporations remain independent of markets. The model also integrates the inherited framework of corporate law into an economically derived model of production, constructing a microeconomic description of large enterprises firmly rooted in corporate doctrine but neither focused on nor limited by a description of principal-agent relationships among shareholders and managers. This Article shows that the model retains descriptive robustness, despite the substantial accretion of shareholder power during the two decades since its appearance. The Article also shows that the model taught three groundbreaking lessons to corporate legal theory. First, nothing binds microeconomic analysis together with a theory of the firm rooted in shareholder primacy. Second, microeconomics, with its emphases on efficiency and maximization, can be deployed in the service of an allocatively sensitive description of corporate governance, providing a more capacious methodological tent than anyone in corporate law understood prior to Blair and Stout's intervention. Third, it is not only possible but arguably necessary to take corporate law seriously when articulating a microeconomic theory of corporate production. To the extent an economic model's description of the appropriate legal framework differs materially from the inherited legal framework, there is a possible, even a probable, infirmity in the model.

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INTRODUCTION

Margaret Blair and Lynn Stout published *A Team Production Theory of Corporate Law* in the *Virginia Law Review* in 1999.[1] It is an article that does not announce its own importance. Nor does it identify a gap in the literature that it claims to fill. It stakes no explicit claim to an innovative, brilliant contribution. It does not have to. *A Team Production Theory* is the rare law review article that really does fill a gap. In fact, at the time of its appearance, it filled several gaps and in so doing made a brilliant and innovative theoretical contribution, pushing the envelope of corporate legal theory in new and salubrious directions. Were I asked to name the leading theoretical contributions to corporate law literature in the last century, I would include it on a shelf containing five books—Adolf Berle and Gardiner Means's *The*

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

Modern Corporation and Private Property,[2] Melvin Eisenberg's *The Structure of the Corporation*,[3] Frank Easterbrook and Daniel Fischel's *The Economic Structure of Corporate Law*,[4] Mark Roe's *Strong Managers, Weak Owners*,[5] and Henry Hansmann's *The Ownership of Enterprise*.[6]

Blair and Stout set forth a team production model ("TPM") of corporate organization. The TPM explains both the legal corporate entity and corporate governance institutions in microeconomic terms as the means to the end of encouraging investment. In so doing it situates corporations within markets and subject to market constraints. The model simultaneously insists that corporations remain independent of markets and that the element of independence contributes materially to their success as producers. The TPM also integrates the inherited framework of corporate law into an economically derived model of production. It offers a microeconomic description of the firm that is firmly rooted in corporate doctrine but is neither focused on nor limited by a description of principal-agent relationships among shareholders, board members, and managers. The TPM retains descriptive robustness, despite the substantial accretion of shareholder power during the two decades since its appearance.

In thus leaving agency behind as it fused microeconomics and legal doctrine into a theory of the firm, the TPM taught three groundbreaking lessons, two about methodology and one about substance. First, nothing binds microeconomic analysis together with a theory of the firm that is rooted in shareholder primacy, shareholder primacy being the normative view that the purpose of the corporation is to maximize value of the shareholders. Second, microeconomics, with its emphases on efficiency and maximization, can be deployed to serve an allocatively sensitive description of corporate governance, providing a more capacious methodological tent than anyone on corporate law theretofore had understood. Third, it is not only possible but arguably necessary to take corporate law seriously when articulating a microeconomic theory of corporate production. To the extent an economic model's description of the appropriate legal framework differs

2. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

3. MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS (1976).

4. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991).

5. MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994).

6. HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE (1996).

materially from the inherited legal framework, there is a possible, even a probable, infirmity in the model.

Despite all of this, the TPM did not achieve paradigmatic dominance, or even general acceptance as a useful alternative perspective. This is because corporate legal theory is not at bottom about descriptive accuracy or methodological correctness. It is above all responsive to normative concerns. The academic community's equivocal reception of the TPM demonstrates the depth of its commitment to the norm that corporate managers be held accountable for their exercises of the power to direct the business and its continued view that corporate law fails to adequately assure accountability. The TPM stands for a contrasting, contractarian proposition—that market and legal constraints adequately (if not perfectly) control managers and that the salient normative concern is the encouragement of firm-specific investment. The choice between the two perspectives is a judgment call, an exercise likely to be influenced heavily by ideological preferences. It thus is not Blair and Stout's fault that the wider community did not accept their model's normative invitation, however well made. Meanwhile, no one knows what the future may bring. As more and more power accretes to shareholders, a converse accountability problem becomes more and more salient. An adjustment of academic views remains a distinct possibility.

This Article expands on this evaluation of the TPM.

Part I is preparatory, describing the theoretical landscape onto which Blair and Stout intervened. The presentation covers a considerable stretch of historical territory, sketching the evolution of corporate legal theory from the post-war period through the end of the twentieth century. It is for the most part a story of shareholder primacy and agency relationships in theory and shareholder travails and excessive agency costs in practice, but not entirely. There is also recessive managerialist strain, a strain reinvigorated by the TPM.

Part II recounts in detail the TPM as described in Blair and Stout's 1999 article. The discussion begins with the model's economic assertions, then traces its antecedents in economic literature, and turns finally to the relation of mutual support between the economic TPM and the structural inheritance of corporate law.

Part III reconsiders the TPM as economics, as contractarianism, as legal doctrine, and as history.

I. CONTEXT

This Article claims that Blair and Stout made a great contribution by filling gaps in the dispensation of corporate law and economics. To sustain the claim, that preexisting dispensation needs to be described. This Part fills in this historical background.

The account starts by turning the clock back to the era before the arrival of law and economics, picking up with the period from 1945 to the early 1970s. This is the time when corporate management enjoyed a great deal of prestige and microeconomic theory had little to say about the internal operation of corporations. The timeline moves forward to the economic strains of the 1970s, when perspectives and evaluations changed markedly. There was an anti-managerial backlash accompanied by the beginning of corporate governance as we now know it and the appearance of agency theory in microeconomics. Agency theory introduces shareholder primacy as a function of economic analysis. During the 1980s and 1990s, it spawned two contrasting lines of legal theory. One line depicts corporations as entirely ancillary and subject to market forces, subsuming both the organizations and the corporate law framework into a picture of market discipline. A contrasting and more widely accepted approach bemoans the absence of market control of management power and goes on to problematize the legal framework, recommending law reform toward the end realizing shareholder primacy in practice as well as in theory.

A. Managerialism and Anti-Managerialism

1. The Managerialist Era.

The first exhaustive diagnosis of the management accountability problem appeared during the depths of the Depression with the publication of Adolf Berle and Gardiner Means's *The Modern Corporation and Private Property*.[7] Berle and Means described a separation of ownership and control—the shareholders owned but could not control, due to dispersed holdings and resulting collective action problems. Managers accordingly wielded considerable power in the economy and the polity without the wholesome accountability that befalls a property owner.[8]

Management unaccountability would remain a central and constant question in academic corporate law. But, at least during the quarter century that followed World War II, the edge of policy concern was much softened. Corporate managers enjoyed great prestige as the

7. BERLE & MEANS, *supra* note 2, at 1 (noting that economic power had concentrated in the hands of corporate managers and that the corporate system amounted to a major social institution).

8. *Id.* at 1–2, 4–5, 7–9, 13–35.

successful planners of an expanding economy.[9] Most observers agreed that management power ineluctably flowed from organizational expertise and that structural impediments foreclosed the possibility of putting hierarchical firms under market control.[10] Few bemoaned the apparent absence of market constraints—based on the experience of the Great Depression, most people thought of markets as prone to fail in any event.

The microeconomics of the day supported the point. Microeconomic theory focuses on markets, and, prior to the mid-1970s, economists tended to situate the large corporations outside of markets and to theorize about the line of division between the two. The earliest exercise in drawing a line between market coordination and production in firms came from Ronald Coase in a famous essay published in 1937.[11] Coase posited that if markets held out a framework conducive to complex production, then actors could be expected to produce based on individual transactions in markets and firms would not exist. But firms did exist and production occurred in firms. For an explanation, Coase looked to transaction costs. Production through individual market contracts would be too expensive, for organizing production through the price mechanism meant incurring the cost of ascertaining the prices;[12] furthermore, long-term relationships would be difficult to sustain.[13] Hierarchical structure reduces these costs, facilitating complex economic endeavor by turning coordination over to an entrepreneur.[14] Management empowerment, while problematic, was unavoidable because the markets were intrinsically incapable of providing an environment conducive to complex production.

The accountability problem identified by Berle and Means still followed. But during the post-war era Berle himself pronounced the problem to have been solved. In Berle's view, the post–New Deal regulatory state adequately controlled the managers' behavior and kept them responsive to constituent demands.[15] He simultaneously

9. ADOLPH A. BERLE, THE AMERICAN ECONOMIC REPUBLIC 83, 89–91 (1963) (describing an "American economic republic" in which the state and the economy were interdependent, with the state taking ultimate responsibility for economic results and exercising the higher level of power).

10. *See* William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 413 (1989) (describing management's power over the processes of production and distribution, its control over hierarchical bureaucracies, and its imposition of externalities on those outside the entities).

11. R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

12. *Id.* at 390.

13. *Id.* at 391–92.

14. *Id.* at 392.

15. BERLE, *supra* note 9, at 99, 169 (noting that the state intervened only to stabilize the organizational lines and performance of private producers and that managers, in order to keep the state at bay, were forced to keep the public satisfied with jobs and growth). Thus constrained,

dismissed dispersed shareholders as having no positive governance contribution to make.[16] They played their only economic role as wealthy consumers. They supported their families, they supported social welfare programs as taxpayers, and they supported charities as donors.[17] As such they were entitled to society's thanks, but not its political solicitude.

It was an environment in which corporate law fell back from the policy margin. Indeed, it came to be viewed as a backwater. In 1962, Bayless Manning, one of the era's prominent corporate law academics, pronounced corporate law dead as a field of intellectual effort, a dry as dust doctrinal inheritance lacking in policy salience.[18] No reinvigorating reference over to microeconomics would be made until the late 1970s.

2. Reversal of Fortune

The managerialist era ended abruptly when the economic bill for the Vietnam War came due in 1972 and 1973. The stock market collapsed and the economy went into a severe recession aggravated by the mid-east oil crisis.[19] The appearance of international competition in manufactured goods added to a growing list of chronic problems.[20] The stock market did not really recover until August of 1982—a whole decade in which there was no money to be made investing long-term in equities even as inflation rose steeply. The malaise, called "stagflation," undermined the economic assumptions of the managerialist era.[21] People started to ask questions about how well managers were doing their jobs,[22] questions that began with the sudden collapse of the once-

managers amounted to quasi-civil servants. *Id.* at 89–90. Berle's description had a theoretical counterpart in JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE (1967), which leaves the competing groups free to make their own rules, subject to government intervention to assure that excessive power does not accrue to one group.

16. Adolf Berle, *Property, Production and Revolution: A Preface to the Revised Edition* of ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY, at xxiii (rev. ed. 1967).

17. *See* BERLE, *supra* note 9, at 51–53 (discussing welfare by the state and community).

18. Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962) ("[C]orporation law, as a field of intellectual effort, is dead in the United States.").

19. GERALD F. DAVIS, THE VANISHING AMERICAN CORPORATION: NAVIGATING THE HAZARDS OF A NEW ECONOMY 47 (2016).

20. *Id.* at 55–56.

21. *Id.* at 55.

22. *Id.* at 56.

great Penn Central Railroad in 1970[23] and intensified as bad results accumulated.

The conceptual framework surrounding corporations changed substantially as a result. The happy story of managers as capable technocrats who enhance social welfare under the watchful eye of the big stick state no longer resonated. Unbridled management power came back to the forefront as a problem in need of solution and "corporate governance" was invented to tackle the job.[24] The first fully developed text on the subject, Melvin Eisenberg's *The Structure of the Corporation*,[25] appeared in 1976. Eisenberg synthesized and materially advanced a generation of thinking about the deficiencies of the corporation's received legal model.[26] For a corrective mechanism, he turned to the board of directors, theretofore thought to be a moribund institution.[27] 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.[28] The monitoring function in turn required independent directors and a committee structure keyed to monitoring functions.[29] The approach caught on quickly. The independent board became so salient as to become a target of management capture: The Business Roundtable, seeking to stave off more intrusive initiatives then in circulation, publicly embraced the independent director majority in 1978.[30]

Corporate law was back at the policy margin.

23. *See* STAFF REP. OF THE SEC. AND EXCH. COMM'N TO THE H.R. SPECIAL SUBCOMM. ON INVESTIGATIONS, 92D CONG., THE FINANCIAL COLLAPSE OF THE PENN CENTRAL COMPANY 170–72 (Subcomm. Print 1972) (discussing the fall of the Penn Central Railroad).

24. The phrase "corporate governance" had its first published appearance only in 1972. *See* Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. CORP. L. 359, 373–375 (2016) ("[T]he New York Times featured the phrase as early as 1972.").

25. *See* EISENBERG, *supra* note 3, at 162–70. Eisenberg's monitoring model of the board of directors has ever since been the main focus of legal corporate governance.

26. *See id.* at 139–85 (discussing additional rules and structure for corporate governance).

27. *See id.* (discussing additional structure for board of directors and management).

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

29. *See id.* at 162–68 (emphasizing the monitoring function of the board).

30. *See* Bus. Roundtable, Statement, *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation*, 33 BUS. LAW. 2083, 2092–93 (1978) (proposing reforms to encourage more independent directors). Skeptics took the view that management capture was the end in view: so long as incumbent CEOs could use their influence to secure appointment of cooperative types, any threat was minimal. *See* Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 610–12 (1982) (describing the pattern of cooperation and management control of appointments).

B. Agency Theory and Contractarianism

The 1970s stagflation also undermined confidence in the regulatory state. People were ready to return their trust to markets. A second text published in 1976, Michael Jensen and William Meckling's *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, was there to greet them.[31]

Jensen and Meckling's principal-agent model tells a corporate creation story in which the only problem confronting the firm is management moral hazard, which causes agency costs. It is a partial equilibrium set up: but for management moral hazard and shareholders' and managers' arrangements in respect thereof, all other things are equal and efficient. Hence, the entire focus is on the shareholder-manager relationship.

In the model, agency costs are reduced to the extent that managers find it cost effective to incur bonding costs and investors find it cost effective to incur monitoring costs.[32] A possibility is held open that contracting between managers and investors will yield further cost reductive results, contracting that occurs at the moment a founder-manager conducts an initial public offering ("IPO") and creates a public corporation.[33] The model does not predict that bonding, monitoring, and contracting will reduce agency costs to zero—residual agency costs that cannot be cost-effectively eliminated will persist as an intrinsic cost of production.[34] The persistent residuum is unproblematic because, in the model, the equity trading market allocates these costs to the founder-manager at the moment of creation.[35] All of this had a surprising implication: between markets and contracts, the main problems addressed in corporate law were being solved.

The principal-agent model minimizes the importance of authority and hierarchy in the description of corporate production, redirecting our attention to contracts between the managers and outside providers of equity capital. The shift of perspective deflects the Coasian theory of the firm, making it possible to show that private ordering in capital markets works effectively to discipline corporate governance. More particularly, market trading prices management moral hazard and allocates its cost. And, in cases where markets do not

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

32. *Id.* at 323–26.

33. *Id.* at 319–23.

34. *Id.* at 327.

35. *Id.* at 313, 318–19.

work, private contracting comes to the fore to solve any problems.[36] The Coasian production hierarchy has not exactly disappeared. It just no longer matters.

The model incorporates shareholder primacy, but as an assumption rather than as a result. It assumes that all parties connected to the firm other than the shareholders and managers already possess complete, maximizing contracts and that as between managers and shareholders, management moral hazard is the sole source of contractual incompleteness.[37] From this, it automatically follows that whatever minimizes the effects of moral hazard automatically maximizes both shareholder return and overall welfare. Meanwhile, the model assumes away everything in corporate governance other than the management-shareholder conflict of interest, manager-shareholder contracting with respect thereto, and the stock market's ability to price out the conflict.

This spare microeconomic model held out a blank canvas on which legal theorists could paint in descriptions suited to their normative priors. Frank Easterbrook and Daniel Fischel did just that, turning what is implicit in the model into a sequence of normative assertions for legal contexts.[38] This "contractarian" restatement mightily expanded the model's field of application.

The Easterbrook and Fischel model quietly relaxes the model's limiting assumptions to accommodate the real-world corporate governance framework. The "contract" grows. It is now not just the result of face-to-face bargaining at the moment the public firm is created through an IPO, but also corporate law itself and internal corporate legislation enacted over time.[39] The model also expands the set of market controls of agency costs. In addition to stock market

36. Note that the authority structures in firms do not disappear. There is instead a change in the characterization of what it means to be a hierarchical inferior. For Coase, this implied a sacrifice of liberty that required explanation. For Jensen and Meckling, the hierarchical inferior is a contract counterparty who can always walk away. *Id.* at 310–11. Jensen and Meckling here repeat a point made earlier by Alchian and Demsetz. Firms, said the latter pair, have "no power of fiat, no authority, no disciplinary action[.] [They do not differ] in the slightest degree from ordinary market contracting between any two people." Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 777 (1972).

37. Jensen & Meckling, *supra* note 31, at 312–18, 326.

38. The arbitrage was effected in a series of articles. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271 (1986); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989) [hereinafter Easterbook & Fischel, *Contract*]; Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89 (1985); Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 611 (1985). The initial cross-reference occurred in Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1, 8–9 (1978).

39. Easterbrook & Fischel, *Contract*, *supra* note 38, at 1429–31.

pricing, it relies on the market for corporate control (also known as hostile takeovers), the product markets, and executive labor markets. The four markets operate together to assure agency cost minimization on a multi-period basis.[40]

Two broad claims about corporate law follow. First, there should be a presumption against having any more corporate law than already exists. Because rational actors arrange governance in contracts and markets price the contract terms, legal mandates are justifiable only in the unlikely event that "the terms chosen by firms are *both* unpriced and systematically perverse from investors' standpoints."[41] Second, the inherited corporate law regime is economically rational,[42] justifying a strong normative presumption in its favor. The two claims, taken together, ratified corporate law's status quo, a natural result in a framework asserting the evolutionary dominance of maximizing arrangements.

Easterbrook and Fischel's arbitrage of economic agency to legal policy was controversial, and never gained ascendance in all particulars. The sticking point was the capacious notion of contract, which encompasses all interaction between managers, investors, consumers, and the government in a multi-period, dynamic setting that features few actual negotiations.[43] Microeconomics does not go nearly this far in describing contracts. Its only addition to out-of-market exchange by direct negotiation is a category of "relational" contracts,[44] a category not nearly big enough to fill the category devised under contractarianism.

The question was whether the territory of "contract," with its arm's-length bargains and equally situated parties, plausibly covered the entire ground swept in by the Easterbrook and Fischel's contractarian firm, much of which was manifestly hierarchical in character and displayed persistent accountability problems at the top. The consensus answer was that contractual characterization was insufficiently robust to justify turning corporate law into a thoroughgoing default regime—fiduciary duties would have to remain

40. EASTERBROOK & FISCHEL, *supra* note 4, at 4, 18–21, 91, 93, 96–97. Reliance on a market triad (control, product, and employment) to control management antedates Easterbrook and Fischel's arbitrage of Jensen and Meckling. *See* Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporatio*n, 6 J. LEGAL STUD. 251, 262–70 (1977).

41. EASTERBROOK & FISCHEL, *supra* note 4, at 21. Easterbrook and Fischel make a strong claim for institutional primacy for the market price without also making a claim for strong market price efficiency. *Id.* at 18–19.

42. *Id.* at 315.

43. *See* Easterbrook & Fischel, *Contract*, *supra* note 38, at 1428–34.

44. *See* Jonathan Levin, *Relational Incentive Contracts*, 93 AM. ECON. REV. 835, 835–36 (2003).

mandatory because proxy voting was not a process context suited to effective noncompetitive transacting.[45]

Still, even with only partial acceptance, the contractarian paradigm precipitated fundamental changes in the way people view corporate law. Henceforth, policy discussions would proceed in a microeconomic framework dominated by two normative presumptions—a presumption disfavoring new regulatory initiatives to control management and entity behavior and a presumption favoring private contracting and market control.

C. The Shareholder Paradigm

Easterbrook and Fischel's work appeared even as the hostile takeovers of the 1980s assailed managers and transformed corporate law. The takeovers imported credibility to their novel perspective. Easterbrook and Fischel, by folding the market for corporate control into Jensen and Meckling's moral hazard account, produced a neat explanation of what was going on in the real world: moral hazard had caused agency costs to run to excess and discounted stock prices reflected the value impairment. The discounts in turn attracted control bidders by assuring an arbitrage profit, with the market-based control transfer performing a critical agency cost reductive role.[46] An account based on market control suddenly seemed plausible. The takeover boom denuded management of insulation from market pressure, demonstrating the power and transformative potential of capital market inputs for the first time since the early twentieth century. The takeovers also brought forward the shareholders as the primary

45. *See, e.g.*, John C. Coffee, Jr., *No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919, 924 (1988) (arguing that corporate adoption of contract law makes opting out of default rules difficult); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1574–80 (1989) (discussing the drawbacks to shareholder voting rights); John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1619–20 (1989) (arguing for judicial involvement in contracting); Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1462–63, 1486–89 (1989).

46. Viewed retrospectively, Jensen and Meckling's theory is unlikely to be satisfactory as a standalone explanation for 1980s takeovers—the empirical profile holds out a much richer collection of causative factors. *See, e.g.*, Robert Comment & G. William Schwert, *Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures*, 39 J. FIN. ECON. 3, 29 (1995) (looking at a range of factors—including ownership, abnormal return, sales growth, leverage, Tobin's q ratio, market to book value ratio, and size—to predict the likelihood that a firm will become a hostile target and finding that size is the only consistently successful predictor); Mark L. Mitchell & J. Harold Mulherin, *The Impact of Industry Shocks on Takeover and Restructuring Activity*, 41 J. FIN. ECON. 193, 195–96 (1996) (observing that mergers come in waves and focus on specific industries).

corporate constituents, ushering in a new era of solicitude of their interests. Easterbrook and Fischel put agency theory at their service.

The takeovers ceased in the wake of the economic collapse of 1989 and then failed to restart in tandem with economic recovery a couple of years later. A public choice story circulated to explain this,[47] ascribing the takeover's diminished salience to higher regulatory barriers. It followed that a takeover-centric view of corporate governance remained appropriate: takeovers were deemed an essential means to the end of agency cost reduction long after they disappeared in the real world.[48] It also followed that in the post-takeover era agency costs were chronically and suboptimally high.

A reformulation of the contractarian paradigm naturally followed. Contractarianism had borrowed the microeconomics of the principal-agent model to describe highly successful private ordering, a story that lost plausibility once nefarious managers and corrupt politicians choked off the leading market control. It followed that private ordering could not by itself assure an efficient governance system. The adjusted account retained the principal-agent model's exclusive focus on management moral hazard along with an information-efficient account of stock market pricing. But now, instead of a contracting field conducive to efficient self-correction, we had a field riven with collective action problems, path dependencies, and other failures.[49] There is no generally-accepted label for this perspective. For convenience, it will be referred to here as the "shareholder paradigm."

Regulation came back into the picture as a result, but for the limited purpose of adjusting the corporate process framework so that market control could work in fact and finally get us to the partial equilibrium result posited at the start by Jensen and Meckling. Shareholders should exercise "ultimate control" of the firm,[50] but were

47. Roberta Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 U. CIN. L. REV. 457, 457 (1988) (managers seeking renewed insulation from the markets went to state legislatures and appealed to state judiciaries to promote antitakeover statutes and otherwise validate takeover defensive measures).

48. *See* Guhan Subramanian, *A New Takeover Defense Mechanism: Using an Equal Treatment Agreement as an Alternative to the Poison Pill*, 23 DEL. J. CORP. L. 375, 383, 397 (1998); Comment & Schwert, *supra* note 46, at 5, 28, 33 (large-sample evidence "provides little support for the proposition that modern antitakeover measures have been used to deter takeovers systematically").

49. *See, e.g.*, Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641, 644–45 (1996) (outlining how path-dependent histories lead to missed modern adaptations); *see also* Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 161–62 (1999) (arguing that contracting around mandatory rules is unrealistically costly—or even impossible).

50. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440–41 (2001).

not doing so. Corporate governance needed positive law reforms to bring this about.[51] Removal of antitakeover barriers not being politically feasible, the policy agenda looked toward "shareholder empowerment" more generally. Management needed to be forced to yield to shareholder inputs on governance and business planning on a going concern basis. That information asymmetries might impair the quality of any shareholder inputs was not deemed to be a salient problem, for a market-based performance metric was available—the stock price.[52] Everything in corporate governance thereby came down to a single real-world instruction—manage to maximize the market price of the stock.

D. Shareholder Primacy

Shareholder primacy is a tie that binds together Jensen and Meckling's model, Easterbrook and Fischel's contractarianism, and the shareholder paradigm. Recall that in Jensen and Meckling it operates at the level of an assumption: if we model the firm as a nexus of complete contracts among all parties involved while modeling the contract between a firm and its shareholders as incomplete (in that the shareholders claim the residual return after all other contractual claims have been met), maximization of shareholder value automatically follows as the economically efficient result.[53] The assumption's plausibility depends entirely on the model of constituent contracts: if all contracts other than the shareholders' are complete and embody a maximizing trade for each party, then maximizing the shareholders' residual return does maximize value for all concerned. The problem is that no one thinks that in the real world other stakeholders enter into complete contracts.

To surmount this problem, shareholder primacy's proponents make a two-part robustness case. The first part is a fallback claim for shareholder entitlement in a world in which incomplete contracts are ubiquitous: relatively speaking, the shareholder's contract holds out less in the way of protection than do the other constituents' contracts. Employees can look to alternative employment at their opportunity wage in competitive labor markets and creditors can take security or

51. *See, e.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 865–70 (2005) (recommending expansion of the zone shareholder legislative access to the corporate charter and the state of incorporation decision); Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. Rev. 675, 700–01 (2007) (recommending a right to replace all incumbents every two or three years).

52. Hansmann & Kraakman, *supra* note 50, at 440–41.

53. Marco Becht, Patrick Bolton & Ailsa Röell, *Corporate Governance and Control* 8–9 (Eur. Corp. Governance Inst., Working Paper No. 02/2002, 2005), http://ssrn.com/abs=343461 [https://perma.cc/QMU5-PMMS].

shorten their maturities, while shareholders' capital is locked in for an indefinite duration with their only further protection stemming from governance arrangements. A claim to pride of place in the legal model follows from the diagnosis of relative vulnerability.[54]

The second part of the case references alternatives to a shareholder maxim and finds them wanting. The argument proceeds in two phases. It is first asserted that decisionmaking costs should be minimized. This in turn implies a limitation on the number of constituents referenced in the firm's objective function.[55] Multi-constituent models invite incoherence due to conflict amongst the interests referenced. Incoherence in turn expands the scope of management discretion, potentially increasing management agency costs.[56] Second, the shareholders are the best reference point among the available constituents. As they hold the residual claim, managing in their interest maximizes returns for the corporation as a whole.[57] Moreover, their capital investment in the residual lends them an undiluted, pure financial incentive to maximize the firm's value.[58] From an incentive point of view, they contrast favorably against managers and independent directors, whose incentives are comprised by interests in compensation and job retention, and against other constituents, whose contractual interests exclude the residual upside.[59]

II. THE MODEL

Blair and Stout intervened just as the shareholder paradigm emerged as corporate law's consensus view. Their TPM challenged the consensus by widening the descriptive lens. Where the agency models look only at the shareholder-management contract, the TPM looks at the contracts between the corporation and all capital providers, both financial and human. Where agency models look for value enhancement only through agency cost reduction, the TPM looks to the production

54. *See* Oliver Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1210–11, 1227–29 (1984) (describing the shareholders as having a unique position as regards the firm).

55. Becht et al., *supra* note 53, at 9.

56. *See* Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APPLIED CORP. FIN. 8, 9, 13 (2001) ("Stakeholder theory directs corporate managers to serve 'many masters.' And, to paraphrase the old adage, when there are many masters, all end up being shortchanged.").

57. *See, e.g.*, Hansmann & Kraakman*, supra* note 50, at 449.

58. *Id*.

59. For a caveat, see Bengt Holmstrom & Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, 15 J. ECON. PERSPS. 121, 138 (2001) (suggesting that market shareholders have an advantage in moving capital from declining to rising industries but that managers and employees have decisive expertise as regards technologies, products, and processes).

side to encourage firm-specific investment. The TPM also deemphasizes market control, reviving the Coasian stress on hierarchical relationships independent of markets.

This Part describes the model. It outlines the economic assertions in Section II.A, including a look at the economic literature from which the model draws. Section II.B reviews the model's innovative treatment of the corporate law inheritance.

A. Economics

1. Outline

The TPM explains the corporation's legal framework by reference to the production function, which is said to require the investment and coordinated effort of the multiple individuals and groups that make up a team. The investments are firm specific—they cannot be pulled back out and are non-separable, which means that valuable project attributes cannot be traced back to individual inputs.[60] A contractibility problem results. If, once a project gets underway, there is no way to connect the inputs of team members to particular project returns, there is no way to draft an ex ante contract that specifies an ex post division of the economic surpluses generated by the project (termed "rents"). The contract is going to have to specify an allocation ex ante or establish a process that effectuates an allocation ex post.

Suppose the participants draft ex ante a formula that fixes returns ex post. This solution invites slacking off—a team member with a pre-set return has an incentive to take a free ride, reducing its capital contribution given imperfect monitoring and information asymmetries. Now assume instead that the team proceeds without a pre-set allocative scheme or governance regime, deferring the matter for ex post negotiation. This invites opportunistic rent-seeking, a debilitating scenario that dissipates the project's positive returns.[61] It follows, say Blair and Stout, that the allocative problem is noncontractible. To make team production work, the team members must consent in advance to a governance structure—an organizational design that provides a confidence-inspiring means of effecting ex post allocations of rents.[62]

At this point Blair and Stout give us their creation story. The team members, who include providers of financial capital as well as providers of human capital, give up their property rights in their capital

60. Blair & Stout, *supra* note 1, at 249.
61. *Id.* at 249.
62. *Id.* at 250.

inputs and their rights to returns from the firm's output to a corporate entity. The corporation is in turn governed by a mediating hierarchy, which coordinates inputs, allocates proceeds, and mediates disputes. The corporation's board of directors sits at the hierarchy's peak. Its members are neither owners nor agents. Instead, they are trustees for the benefit of the corporate entity,[63] representing the interests of all team members and not just of the shareholders.[64]

The board wields absolute power over the entity's assets, and, importantly, must be independent of the individuals and groups in the team.[65] Thus described, the board's function is not to reduce agency costs of management but to encourage firm-specific investment. The board's job is to protect team members' investments, whether of financial or human capital, rather than to maximize shareholder value.[66] It follows that the board cannot be under the control of either the shareholders or the other stakeholders[67] and that shareholder value enhancement should not be held out as the purpose of the public corporation.[68]

Two additional specifications should be mentioned, one going to agency costs and the other to allocative outcomes. There is no prediction that agency costs will be reduced to zero. Although the board is independent, perfect incentive incompatibility should not be expected, given small capital stakes and rational self-interest. At the same time, team membership does not imply a right to a particular share of proceeds. The members are incented to stay on the team so long as individual gains from the overall arrangement exceed the foregone costs of slacking off and rent seeking.[69] Disparate allocations can occur given large returns, allocations subject to the politics of the moment.[70]

Blair and Stout, summing up, describe the TPM as a second-best solution to a problem that resists an optimal solution.[71]

63. *Id.* at 280–81.

64. *Id.* at 286.

65. *Id.* at 251. The TPM's description does not imply hands on management by the board. Most production decisions are made down the hierarchical line through the collegial interaction of team members, who have every incentive to solve their own problems (including allocational problems) and keep the board at a distance. The board is more of a final authority, held in reserve for resolution of intractable problems. *Id.* at 282.

66. *Id.* at 253.

67. *Id.* at 254.

68. *Id.* at 253.

69. *Id.* at 283.

70. *Id.*

71. *Id.* at 284.

2. Derivation

The TPM is original. As such, it differs from most law and economics, which gets its theory by means of cross-disciplinary arbitrage based on a completed analysis. But the TPM also has deep roots the microeconomic literature.

Blair and Stout explain why the usual arbitrage is not an option. They divide the field of economic theory of the firm into two schools, agency and property rights, neither of which, they tell us, gets it right. Agency theory, with its focus on delegations from principals to agents and exclusive stress on agency cost reduction,[72] fails to see the principal-agent contract as a two-way street. The problems do not lie exclusively with slacking and self-dealing by the agent at the principal's expense. The agent might in turn have problems getting the principal to perform her end of the deal.[73] Property rights theory, in contrast, problematizes incomplete contracting amongst firm participants and fills the void by assigning property rights, also known as control, to a participant, usually the equity holder.[74] Here the problem lies in the transition to the context of corporate law, which does not vest shareholders with a property right to control.[75]

Blair and Stout then accurately describe the result of the arbitrage of these economic observations to corporate legal theory. The microeconomics of agency and property rights are fused into a single convergent description of the corporation. This depicts a top-down firm hierarchy with the shareholders at the top, delegating authority to the board, which delegates on to the top officers and so on down the line.[76] Thus modeled, the firm's only problem lies in assuring optimal performance by the delegee-agents.

A more cogent model, say Blair and Stout, eliminates the shareholder principal and shifts attention from vertical relationships in the hierarchy to the horizontal relationships of team members. They build on the assertion by drawing three notions from the existing literature: (1) that production calls for teamwork, (2) that allocational problems among providers of capital are debilitating, and (3)

72. *Id.* at 258–59.

73. *Id.* at 259.

74. *Id.* at 259–60 (citing, inter alia, Oliver D. Hart, *Incomplete Contracts and the Theory of the Firm*, 4 J.L. ECON. & ORG. 119 (1988); Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691, 693 (1986); Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119, 1120 (1990)).

75. Blair & Stout, *supra* note 1, at 260.

76. *Id.* at 262–63 (terming this the "grand-design principal-agent model").

monitoring and allocational functions are best vested in a neutral rather than in a capital provider.[77]

Blair and Stout extract a definition of team production from Alchian and Demsetz's 1972 model.[78] But they otherwise keep their distance, and for good reason. Alchian and Demsetz solve the team production problem with a monitor who employs all other team members under complete market contracts, dispensing with hierarchical power relationships.[79] The model is the earliest exemplar of a model of the firm operated through market contracting. In the history of theory of the firm, it holds a place as a precursor[80] to Jensen and Meckling.

Blair and Stout then turn to property rights models, drilling down on Bengt Holmstrom's 1982 model of contractual incompleteness in a production context.[81] Holmstrom attempted to model a monitoring arrangement that simultaneously controlled shirking under asymmetric information and allocated proceeds. He did not succeed, with the model's interest lying in its explanation of the reasons for its own failure. The lesson was that an ex ante allocation triggered shirking, which could be punished only by an across-the-board withholding of proceeds, which in turn led to opportunism on the monitor's part. The solution to the problem lay in a mechanism for an incentive compatible outside monitor,[82] with Holmstrom suggesting that outside shareholders in public companies might be viable candidates for the job.[83]

Holmstrom set the stage for Blair and Stout's final move, for he conjoined hierarchical monitoring and allocational problems and rent seeking at the production level to present an unsolved, incomplete contracting problem. Blair and Stout fold in the team notion to suggest that the team members have a mutual interest in minimizing shirking and rent seeking and can solve their problem by transferring control to a neutral third party, the mediating hierarch.[84] Here they draw support

77. *Id.* at 264–69.

78. *Id.* at 265–66 (quoting Alchian & Demsetz, *supra* note 36, at 779) ("In [their] paper, [Alchian & Demsetz] defined team production as 'production in which 1) several types of resources are used . . . 2) the product is not a sum of separable outputs of each cooperating resource . . . [and] 3) not all resources used in team production belong to one person.' ").

79. Alchian & Demsetz, *supra* note 36, at 778, 781–82.

80. Bratton, *supra* note 10, at 415.

81. Bengt Holmstrom, *Moral Hazard in Teams*, 13 BELL J. ECON. 324, 324–25 (1982).

82. Blair & Stout, *supra* note 1, at 268–69.

83. Holmstrom, *supra* note 81, at 338–39.

84. Blair & Stout, *supra* note 1, at 271.

from a Rajan and Zingales[85] model of two parties making a firm-specific investment. The model shows that vesting control rights in either party chills investment on both sides. It thus does not make sense to vest control in the party with the most capital at stake. Better to find a third party who makes no firm-specific investment, securing decision services with a nominal slice of the project's returns.[86]

We reach Blair and Stout's bottom line at this point: rational team members submit to hierarchical control not for the hierarch's benefit, but for their own.[87] Providers of human and financial capital need a hierarch to perform the function of gathering information and to monitor against shirking.[88] But they cannot assume the role of hierarchical principals themselves. They accordingly give up their property rights in their capital to an economically neutral decisionmaking process,[89] a process that encourages cooperation and firm-specific investment.[90]

B. Law

The TPM is unique in drawing on the legal inheritance as an affirmative input in an economic model of the firm. Elsewhere in the law and economics literature, the economic model comes first, with the theorist then laying it on top of the legal model, claiming consonance where plausible but, given dissonance, asserting that economic analysis highlights a legal infirmity. The TPM, in contrast, looks to the legal model for inspiration, in particular its provision of a board of directors without a principal. Blair and Stout simultaneously draw on the law to support the model's economic description and draw on the model's economics to explicate the law.

The legal inheritance does, in fact, yield deep support for the TPM. Corporate boards exercise "original and undelegated" powers.[91] To file a charter and incorporate is to untap a direct delegation of authority from the state to the corporate board to do business, authority

85. Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q.J. ECON. 387, 392 (1998).

86. *Id.* at 422.

87. Blair & Stout, *supra* note 1, at 274.

88. *Id.* at 278.

89. *Id.* at 285.

90. *Id.* at 277.

91. *See, e.g.*, People *ex rel.* Manice v. Powell, 94 N.E. 634, 637 (N.Y. 1911) (quoting Hoyt v. Thompson's Ex'r, 19 N.Y. 207, 216 (1859)).

that vests before the issuance of any shares.[92] Voting power to select board members is indeed vested in the shareholders.[93] But this grant does not give the shareholders the power to issue management instructions to the board.[94] Absent such a power, there is no agency relationship—period. An analogy to the legal relations of trustees and beneficiaries works much better. But, even given a shift over to a trust model, corporate law imposes no duty on its director-trustees to maximize for the shareholders. Instead, directors owe their fiduciary duties to the corporate entity. In Blair and Stout's description, they are independent hierarchs who pursue the "interests of the corporation," which they further describe as "a joint welfare function of *all* the individuals who make firm-specific investments and agree to participate in the extracontractual, internal mediation process within the firm."[95]

Blair and Stout take this legal structure and run with it. They show us that it is not some hoary conceptual inheritance that can be dispensed with as we modernize to a principal-agent framework. In their picture, corporate fiduciary law assimilates the structure and carries it to a logical conclusion, according the board a protected zone within which to make allocative decisions.[96] The zone of discretion partly results from the operation of the business judgment rule, which prevents litigating shareholders from second-guessing management decisions gone wrong, and partly results from the operation of the duty of loyalty, which is sparing in its articulation of prohibited, self-interested conduct on the directors' parts.

The duty of loyalty discussion is noteworthy. Blair and Stout point out that even as self-dealing contracts can trigger a breach of the duty, many actions that are manifestly self-interested escape scrutiny.[97] Defensive measures against a hostile tender offer are a leading example.[98] Investments and acquisitions that make the firm bigger and safer for the benefit of internal constituents but at a sacrifice of shareholder value are another.[99] Neither traverse the duty to the corporation even as they manifestly injure the shareholders' economic

92. DEL. CODE ANN. tit. 8 §§ 102(a)(6), 108, 152 (2021) (the first things that happen upon incorporation are the appointment of the board of directors and approval of the bylaws; the board then approves the terms of the issue of stock).

93. Blair & Stout, *supra* note 1, at 291.

94. DEL. CODE ANN. tit. 8 § 141(a) (the board manages the business unless the charter provides otherwise).

95. Blair & Stout, *supra* note 1, at 288.

96. *Id.* at 298–309.

97. *Id.* at 305–09.

98. *Id.* at 307–08.

99. *Id.* at 306–07.

interests. The fact that generations of academic colleagues have excoriated these features of the fiduciary landscape does not bother Blair and Stout. Far from it—one senses that they relish the exercise of bringing disfavored cases and statutes into the center of an economic theory of the corporation.

There are sticking points, of course. The shareholder derivative action is one: shareholders are the only constituents with standing to enforce fiduciary law against directors, a privilege implying fiduciary beneficiary status. Blair and Stout push back against the implication with expedient points, but the points are fair and add up. The shareholders, they say, have standing not because they enjoy the juridical status of beneficiaries, but because, as the holders of residual economic interest in the corporation's returns, they are the constituents best suited to take the enforcement role.[100] Their standing, moreover, is contingent. Given insolvency, the creditors step into the economic shoes of the residual interest holder and litigation standing comes with it.[101] Meanwhile, procedural stumbling blocks work to assure that any interventions by particular shareholders operate for the benefit of the corporation as a whole,[102] as does the rule on damages, which channels the proceeds of a judgment to the corporation's bank account.[103]

The other, even bigger sticking point is shareholder voting, which also implies beneficiary status. Blair and Stout deploy a similar strategy against this implication. First comes a negative. Shareholder voting rights are in practice so weak as not to implicate control; the board, which controls the proxy solicitation process, in effect elects itself.[104] Two positives follow. The vote needs to be vested somewhere, lest the board become a self-perpetuating oligarch. Shareholders, with their interest in maximizing their shares' value, are less likely to be motivated by rent-seeking than are the competing stakeholder groups.[105] Blair and Stout follow up by drawing on a prominent point in the shareholder primacy case: compared to other stakeholders, shareholders have a weak position when it comes to contracting into slices of corporate pie. Managers and employees do their rent-seeking on the inside. Public shareholders, in contrast are outside and thus positioned suffer from informational asymmetries and labor under an intrinsic collective action problem. With voting rights, the legal model,

100. *Id.* at 289.
101. *Id.* at 295–97.
102. *Id.* at 293–94.
103. *Id.* at 294–95.
104. *Id.* at 310–12.
105. *Id.* at 313 & n.175 (citing HANSMANN, *supra* note 6, at 97–98).

in effect, makes a give back that evens their position vis-à-vis interior stakeholders.[106]

These treatments will not satisfy shareholder advocates, who will insist that the points favoring shareholders be carried to a logical conclusion. They look at the legal model and ask: "Who should be in and who should be out?" The ins are the common shareholders, the preferred shareholders (on limited fact patterns), and the creditors in the wake of insolvency, and for the same reasons given by Blair and Stout in their explanation of derivative standing and voting rights. All other stakeholders are out and are not corporate law beneficiaries. Blair and Stout, in contrast, get past this mode of thinking by reminding us that the corporate entity is "in" first and foremost. This move expands the beneficiary envelope and integrates the TPM and the inherited legal model.

A follow up question arises: "Who is on the team and who is not?" Blair and Stout leave the question unanswered—management, employees, and common equity clearly are members; other stakeholders like creditors and the local community may be members.[107] The hesitancy is understandable. A long-term lender parts with capital that is sunk into a firm-specific project, just as does a purchaser of a share in an IPO. Yet while the shareholders get protective participatory rights, the lenders have a near-complete contract negotiated at arm's length, inclusive of a power to extract the monetary value of the sunk capital by force (and necessitating a costly defensive bankruptcy regime in response). A capital contributor thus situated does not bear the earmarks of a team member, as defined. A supplier of firm-specific goods or a long-term, dependent customer whose account requires extensive servicing might make a more viable candidate, but, depending on the situation, need not. Outside of the core group, then, team membership is fact dependent, and left to the management of the mediating hierarch. Blair and Stout are right to leave the point open.

C. Claims

Blair and Stout make several claims for the model. First, it affords a "more appropriate basis" for understanding the functions served by the public corporation than does the prevailing principal-agent model of the firm.[108] Second, the model is "consistent with the

106. *Id.* at 314.
107. *Id.* at 253, 278.
108. *Id.* at 250.

'nexus of contracts' approach to understanding corporate law."[109] Third, the model subsumes corporate law without dissonance, which similarly should be seen as holding out a second-best solution to team production problems.[110] The Part that follows takes up these claims, passing on the first while confirming the second and third.

III. EVALUATION

Blair and Stout set themselves the task of articulating a model of the public corporation that does three things simultaneously. First, the model must be grounded in a microeconomic theory of the firm. Second, the model must be consonant with the provisions and structure of corporate law. Third, the model must situate the accomplishment of productivity outside of the tent of shareholder primacy and market control. Blair and Stout succeed at the task described, achieving closure for their theory. Indeed, they did something that no one thought could be done.

The discussion that follows expands on these observations. In so doing, it does not address Blair and Stout's first claim—the question whether the TPM is correct (or more appropriate) in some sense that renders agency theory incorrect (or less appropriate).[111] So to do is to join a search for the firm's essential nature, and to draw exclusionary lines around the descriptive essence, once established.[112] Such exercises can be insightful and have been executed with great analytical facility.[113] Essentialist claiming and counterclaiming is an academic pastime drawing many enthusiastic participants. It has a downside, however. Essentialism means exclusion that, however convenient as a prop to theoretical simplicity,[114] leads to inaccuracy. In legal contexts, bad policy follows.

109. *Id.* at 254.

110. *Id.* at 250 & n.6 (citing Kelvin Lancaster & Richard G. Lipsey, *The General Theory of the Second Best*, *in* TRADE, MARKETS AND WELFARE 193, 193–220 (Kelvin Lancaster ed., 1996)).

111. Or, alternatively, the question whether agency theory is correct (or more appropriate) in some sense that renders the TPM incorrect (or less appropriate).

112. Blair and Stout do not make an explicit essentialist claim. But they at times gesture in the direction, for example, when they claim that the board's function is not to reduce agency costs of management but to encourage firm-specific investment. *See supra* text accompanying note 66. Nothing in the TPM requires the board to ignore agency costs, even as the model does state that agency cost reduction cannot be the board's exclusive concern.

113. *See, e.g.*, Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 390 (2000) (implicitly countering the TPM by centering the capital protection function on asset partitioning).

114. Occam's Razor, etc. *Cf.* BERTRAND RUSSELL, HISTORY OF WESTERN PHILOSOPHY 462–63 (2000). The idea is that a simple explanation is superior to a complicated explanation. Many subscribe to it.

The discussion that follows is accordingly directed to a different question. Agency has been and continues to be the dominant paradigm, with most observers in the field employing it exclusively. Descriptive exclusions do follow. So the question to be addressed is whether the TPM is a necessary concomitant.[115] Here the answer is a strong affirmative. Both approaches focus on critical points of incompleteness in corporate contracts, points from which incentive problems and other costly frictions tend to emanate. Focusing only on agency (or focusing only on team production) leads to descriptive distortion.

This Part's discussion also highlights the TPM's limitations. The authors, as they went about dotting all the i's and crossing all the t's on their way to closure, carefully delimited their model's field of application. Strictly speaking, the TPM is not a theory of the firm but a theory of a subset of firms—publicly traded corporations with separated ownership and control[116] as they appeared at the time Blair and Stout wrote in the late 1990s. The limitation bespeaks expedience, but, as we will see, also turns out also to enhance the model's robustness reserves.

Section III.A evaluates the TPM as economics. Section III.B takes up Blair and Stout's claim that the TPM is contractarian, finding the claim to be justified and the TPM to be a more robust contractarian exercise than its Chicago forebear. Section III.C enters a *caveat* to Blair and Stout's doctrinal account. Section III.D situates the TPM in the corporate governance environment that prevailed at the time of its appearance in the late 1990s. Section III.E considers the implications for the TPM of governance developments since the turn of this century.

A. The TPM as Economics

Blair and Stout's model is a milestone in the history of corporate law and economics because it is simultaneously methodologically correct and normatively contrarian. It deploys rational actors to make their own arrangements in a contractarian framework. Yet it accommodates group as well as individual interests and privileges a zone of discretion for allocational decisionmaking in its description of productive arrangements. Before the TPM's arrival, it looked as if

115. The question could be phrased more broadly as whether an approach sensitive to internal stability and conditions conducive to investment is a necessary concomitant. The TPM is not the only such approach. *See, e.g.*, William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 659–60 (2010) (stressing information asymmetry); Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 770 (2017) (stressing moral hazard on the part of the principal). But the TPM is the leading such approach.

116. Blair & Stout, *supra* note 1, at 249 (suggesting that agency theory provides no insight into the operation of public corporations even as it is important in understanding other firms).

microeconomic methodology, market discipline, and an agency description inclusive of shareholder primacy were inextricably bound together. Blair and Stout showed that, as a matter of economics, shareholder primacy could be cordoned off as a normative assertion based on a contestable analysis. They also showed that stock market discipline is not the only market discipline pertinent to corporate governance. In the TPM's vision of things, the salient market is the product market: you need a well-functioning team to make a competitive product, and absent a competitive product you never get to the stock market in the first place. By thus separating economic methodology from the normative result of shareholder primacy, Blair and Stout demonstrated the methodology's potential to observers with a range of normative perspectives. Corporate legal theory emerged with a more robust framework of enquiry.

The TPM does more than separate the methodology from the normative result. It also smacks down shareholder primacy as a descriptive result. This happens implicitly. The TPM is stated affirmatively, as a model should be. The authors do not pause to lay out the components of shareholder primacy and rebut them one by one in the argumentative style of legal writing. But the affirmative statement of the model does indeed rebut.

Recall that in Jensen and Meckling, shareholder primacy operates at the level of assumption—all constituents other than the shareholders are assumed to have complete maximizing contracts.[117] For purposes of establishing the point as bedrock theory an affirmative case must be made, and not just in legal contexts. There is no presumption favoring shareholder primacy in economic theory. In fact, the theory is to the contrary. The first fundamental theorem of welfare economics looks to economic efficiency conceived as maximum aggregate wealth.[118] Marco Becht, Patrick Bolton, and Ailsa Röell restate the theorem for a given system of corporate governance as follows: a system 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."[119] This extension is uncontroversial, and, unsurprisingly, shows up as the operative objective in the TPM.[120] As

117. *See supra* text accompanying note 37.

118. *See* William W. Bratton & Simone M. Sepe, *Corporate Law and the Myth of Efficient Market Control*, 105 CORNELL L. REV. 675, 695–96 (2020).

119. Becht et al., *supra* note 53, at 8.

120. *See supra* text accompanying note 95 (noting Blair and Stout's definition of "interests of the corporation" as a joint welfare function).

we have seen,[121] shareholder value maximization displaces general maximization based on a further, two-part analysis grounded on the one hand in shareholder vulnerability and on the other hand in the incoherence of stakeholder governance.

The TPM quietly confronts both legs of this primacy case. It begins by undermining the robustness of Jensen and Meckling's assumptions regarding completeness by showing that all team members (and not just the shareholders) suffer from an incompleteness problem. The model then deals with the shareholder vulnerability point by accepting and assimilating it. There is no attempt at denial. Instead, vulnerability becomes a justification for shareholder voting rights but not a justification for an agency structure incorporating primacy. And why not? Implicitly, the model predicts that the costs attending erosion of the team's integrity would be greater than the gains stemming from further agency cost reduction.[122] Finally, there is the stakeholder governance problem. The TPM averts it by refraining from advocating stakeholder governance in the first place (even as it does advocate consideration of stakeholder interests). Interestingly, the TPM at this stage flows in the same stream as shareholder primacy—both hold that the company needs a directive and authoritative hierarch in the form of a board of directors. The difference is that the TPM board makes its own policy where the primacy board is directed to perpend to shareholder instructions magically communicated by the stock price.

A shareholder primacy advocate might take the TPM to task at this point in the back-and-forth: even if the foregoing is persuasive, the TPM fails because it builds in no metric for evaluating the performance of the board and the managers.[123] Shareholder primacy, it argues, builds in the benefit of the stock price as a one-size-fits-all report card. Absent this yardstick, managers cannot be held accountable for suboptimal performance.

A response to this objection is implicit in the TPM. The TPM is a model of publicly traded companies—it accordingly does not make the stock price somehow disappear. The price stays in the picture as an imperfect report card. What it cannot do in the TPM is serve as a one-size-fits-all maximization metric because it only measures the value of the residual equity interest and cannot by itself tell us whether the

121. *See supra* text accompanying notes 54–58.

122. This implicit cost-benefit result also deflects shareholder primacy's emphasis on the shareholders' pure financial incentives. *See supra* text accompanying note 57.

123. *See, e.g.*, Hansmann & Kraakman, *supra* note 50, at 440–41 (noting that the market price of the stock should provide "the principal measure" of the shareholder interest); Jensen, *supra* note 56, at 9, 13 (noting that a multi-constituent model invites an increase in management agency costs).

managers are maximizing welfare. This approach, which does not by any stretch assert that the stock price lacks heuristic value, has the great benefit of taking the stock price in a broader context. Given inevitable information asymmetries between the firm and the market, contextualization is necessary in any event.[124] This is a cogent response to the shareholder proponents' objection, if not a response so compelling as to persuade them to renounce the faith.

One final point should be made on the TPM as economics. It is not a formal model, even as it is derived from a sequence of formal models. It accordingly is not quite economics. It is instead law and economics, which is not a problem so far as concerns its place in legal policy discussions. After all, Easterbrook and Fischel occupied the same methodological space.

This hybrid status does leave the TPM unattached on the wider academic landscape. Shareholder advocates see themselves as Jensen and Meckling's successors and enjoy the convenience of reference to the copious theoretical and empirical literature on agency costs produced by financial economists. The TPM, while derived from high theory, does not enjoy such a cross-disciplinary source of support. Over in financial economics, inquiry into incompleteness problems tends toward either moral hazard or information-based explanations; there is no comparable interest in teams. Not that support is utterly lacking. The TPM enjoys an indirect line of confirmation from an information-based model of management myopia (and an accompanying empirical literature) that descends from theoretical work by Jeremy Stein.[125] There is a notable confluence at both bottom lines: shareholder pressure chokes firm-specific investment under both the TPM and the myopia model.

B. The TPM as Contractarianism

Blair and Stout assert that the TPM is contractarian, but do not elaborate. The assertion jars on the first encounter. Contractarianism comes from Easterbrook and Fischel, a team famous not only for

124. *See* Bratton & Wachter, *supra* note 115, at 691–96; *see also* Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 248–50 (2017) (contending that, given externalities, firms should maximize shareholder welfare net of externalities rather than market value).

125. *See* Jeremy C. Stein, *Takeover Threats and Managerial Myopi*a, 96 J. POL. ECON. 61, 63–67 (1988) (showing formally that, even absent agency costs, managers of the firm threatened by a takeover will sell an underpriced asset); Jeremy C. Stein, *Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior*, 104 Q.J. ECON. 655, 667 (1989) (modeling suboptimal investment where managers maximize a weighted average of near-term stock prices and long-run value).

introducing agency theory to corporate law[126] but for privileging efficiency over fairness, asserting that parties to corporate contracts want whatever maximizes value regardless of any allocative inequalities.[127] Blair and Stout reject the agency picture and make the internal solution of allocative problems the touchstone of their descriptive model. The contrast is stark.

But the TPM is indeed contractarian, much more so than is the shareholder paradigm. Easterbrook and Fischel seek to merge corporate law into a microeconomic agency account as fully as possible. In so doing, their model validates the corporate law inheritance,[128] accepting self-interested behavior on management's part (and resultant agency costs) as an inevitable concomitant of the system.[129] Blair and Stout pursue the same program. The shareholder paradigm, in contrast, seeks affirmatively to reduce agency costs to zero in the teeth of Jensen and Meckling.[130]

The TPM, like Easterbrook and Fischel's model, presupposes evolution over time in a productive direction both for actual contracts and for competitively derived provisions of corporate law. Blair and Stout reject the account of charter competition as corruption,[131] an account favored by some shareholder paradigm proponents.[132]

Blair and Stout also abjure any concern with fairness. Even as they worry about allocational disputes, they insist only that each team member get a return in excess of their reservation price. Any further distributive considerations are remitted to board of directors to be dealt with in the context of the firm's ongoing internal politics. The TPM's zone of discretion at this point accomplishes something that proves difficult to do from an agency perspective—it leaves open an opportunity for the mediating hierarch to take ethical concerns into account on behalf of team members who contribute human capital. Given an agency perspective, any financial sacrifices resulting from

126. *See supra* text accompanying notes 39–42.

127. The most famous exemplar of this thinking is their paper on corporate control. Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982).

128. *See supra* text accompanying note 41.

129. *See* Easterbrook & Fischel, *Contract*, *supra* note 38, at 1417–18 ("Although managers are self-interested, this interest can be aligned with that of investors through automatic devices, devices that are useless when those in control are 'disinterested' . . . .").

130. *See* Bratton & Wachter, *supra* note 115, at 688.

131. Blair & Stout, *supra* note 1, at 252–53.

132. *See, e.g.*, Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1444 (1992).

ethical restraint give rise to a debilitating "other peoples' money" problem.[133]

There are even strong parallels between Easterbrook and Fischel and Blair and Stout regarding the statement of corporate purpose. A good contractarian leaves the purpose of the firm over to the contracting participants, keeping contractarian theory free of any mandatory taint. Easterbrook and Fischel certainly play it this way, going so far as to say "who cares?" about purpose.[134] But in the end they stumble onto the shareholder primacy party line. When the parties say nothing about purpose a term must be implied to serve as a background default:

> For most firms the expectation is that the residual riskbearers have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock. Other participants contract for fixed payouts—monthly interest, salaries, pensions, severance payments, and the like. This allocation of rights among the holders of fixed and variable claims serves an economic function. Riskbearers get a residual claim to profit; those who do not bear risk on the margin get fixed terms of trade.[135]

This "promise to maximize long-run profits" is an odd promise for a director or manager to make, and not because it puts the shareholders first. The dissonance follows from the term "maximize." Who would ever promise to do that? How, in a complicated world, could performance or breach be verified? An economist working in shareholder primacy mode can construct a partial equilibrium model of a problem that gets us from a stated here to an efficient, maximizing there. That is the economist's job, but it can be performed successfully only under highly controlled conditions.[136] No such maximization templates obtain in the real world of going concerns, where no one really knows when wealth is being maximized. Moreover, even if someone derived a plausible maximizing template for a given producing context, corporate law would make no attempt to impose it, so powerful (and practical) is the business judgment inheritance. To interpolate a promise to maximize in the real world is to allow the economics to dominate the law in the fused description in a way that makes no sense. The best that corporate law can do is to facilitate the corporation's *attempt* to maximize the value it produces. The contractual equivalent is the standard "best efforts" formulation.

133. Milton Friedman, *A Friedman Doctrine—the Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html [https://perma.cc/8SMM-56JL].

134. Easterbrook & Fischel, *Contract*, *supra* note 38, at 1446.

135. *Id.* at 1446–47.

136. Bratton & Sepe, *supra* note 118, at 696–98.

Blair and Stout, as proper contractarians, are sparing in their use of maximization terms. "Maximize" and "maximization" show up only twenty-one times in *A Team Production Theory of Corporate Law* (usually in connection with the citation or description of the work of others); "efficient" and "efficiency" similarly appear only twenty-one times; and "optimal" is used a bare eleven times. This reticence works in tandem with the model's second-best aspirations—efficient results are not to be expected. Furthermore, the mediating hierarchs themselves, the members of the board, do not even occupy the second-best space. They are trustees looking for modest returns in their personal accounts, acquitting themselves of a duty. Given that, a promise to maximize is doubly improbable. Meanwhile, the directors' duty makes its first appearance in the TPM phrased defensively—the board's job is to protect the team members' firm-specific investments.[137] This is a sensible formulation. Unfortunately, Blair and Stout keep going only to stumble upon a maximization directive in the end: the mediating hierarch's "primary function is to exercise [its] control in a fashion that maximizes the *joint welfare of the team as a whole*."[138] As we have seen, they are in distinguished company as they stumble. Like Easterbrook and Fischel, they interpolate a maximand as an implied, default term, drawing on their economic model for inspiration. It is a momentary and forgivable lapse in both cases.

It also bears noting that Blair and Stout's fusion of the legal model and the economic description carries the contractarian project a step farther along, for they accept the legal inheritance in all particulars. Easterbrook and Fischel, in contrast, found that the contractarian presumption favoring the inherited legal dispensation could be overcome as regards hostile takeovers, as to which they made a prominent law reform suggestion—a ban on defensive responses.[139] The suggestion is in turn unsurprising—the hostile takeover is the linchpin of Easterbrook and Fischel's system of market controls.[140] Blair and Stout, as we have seen, boldly accept corporate law's permissive envelopes for takeover defense and reinvestment of free cash

137. Blair & Stout, *supra* note 1, at 253.

138. *Id.* at 271 (emphasis added).

139. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offe*r, 94 HARV. L. REV. 1161, 1164 (1981) ("[S]hareholders' welfare is maximized by an externally imposed legal rule severely limiting the ability of managers to resist a tender offer even if the purpose of resistance is to trigger a bidding contest.").

140. At this critical point Easterbrook and Fischel's contractarianism overlaps the shareholder paradigm—their reform suggestion presages the shareholder paradigm's later agency cost reductive law reform program.

flow.[141] The comparison is telling—where Easterbrook and Fischel are forced to gloss over a big sticking point, the TPM's fusion works neatly.

C. The TPM as Corporate Law

As we have seen, the TPM has doctrinal sticking points of its own, however impressive the overall neatness of fit. And they cannot be analyzed and distinguished away. The problem lies in the doctrine's equivocation regarding the legal statement of corporate purpose and the shareholders' place in it. Delaware, going back at least to the watershed 1984 case of *Aronson v. Lewis*, holds that the board owes its fiduciary obligations "to the corporation and its shareholders."[142] The formulation leaves in place the doctrinal superstructure described by Blair and Stout; it does not declare an agency. But it also appears to bring in the shareholders as contingent fiduciary beneficiaries, opening a door to a fiduciary breach triggered by a defensive or other allocative action injurious to the shareholder interest.

Blair and Stout address and dismiss this quirk in the doctrine in their treatment of the famous 1919 case, *Dodge v. Ford Motor Co.*[143] Henry Ford, the closely held motor company's controlling shareholder, was withholding dividend payments. An enormous cash hoard had accumulated. The Dodge brothers, minority shareholders and competitors, claimed a breach of fiduciary duty. Ford posed an innovative managerialist defense—the business plan should pass

141. *See supra* text accompanying notes 97–99.

142. Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984). Significantly, the statement in the opinion footnotes to a string cite of law review articles that includes a range of positions. The court's comment is open-ended: "The broad question of structuring the modern corporation in order to satisfy the twin objectives of managerial freedom of action and responsibility to shareholders has been extensively debated by commentators." *Id.* at 811 n.4; *accord* N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007) ("It is well established that the directors owe their fiduciary obligations to the corporation and its shareholders."); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989) ("In discharging [the board's function to manage the corporation], the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders."); Polk v. Good, 507 A.2d 531, 536 (Del. 1986) ("In performing their duties the directors owe fundamental fiduciary duties of loyalty and care to the corporation and its shareholders."); *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 36–37 (Del. Ch. 2013) ("This formulation captures the foundational relationship in which directors owe duties to the corporation for the ultimate benefit of the entity's residual claimants. Nevertheless, 'stockholders' best interest must always, within legal limits, be the end. Other constituencies may be considered only instrumentally to advance that end.' ").

There is a similar equivocation in the best-known legal statement of the purpose of the corporation (as opposed to the purpose of corporate law), the statement contained in section 2.01(a) of the American Law Institute's Principles of Corporate Governance: "a corporation [ ] should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain." 1 AM. L. INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1994).

143. 170 N.W. 668 (Mich. 1919).

inspection because it benefitted employees and consumers. He lost: "[a] business corporation is organized and carried on primarily for the profit of the stockholders," said the Michigan Supreme Court.[144] Blair and Stout are unconcerned, telling us that *Dodge v. Ford* is a close corporation case and viewed as such should not be read as a bold traversal of the public corporation's business judgment envelope; it should instead be seen as an uncontroversial intervention against a majority shareholder effecting an unequal allocation.[145] Close corporations, in any event, lie outside of the TPM's clearly stated bounds.

Delaware recently replayed *Dodge* in *eBay Domestic Holdings, Inc. v. Newmark*.[146] There, the majority interest in a close corporation, Craigslist, Inc., invoked community welfare to justify defensive measures against a minority shareholder interested in monetization. They were slapped down in Chancery: "Having chosen a for-profit corporate form, the [C]raigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders."[147] Significantly, Blair and Stout would pose exactly the same distinction—Craigslist being a close corporation—with explicit support from language in the *eBay* opinion.[148] Delaware courts otherwise wax eloquent about maximizing for the common stock only in cases involving common-preferred stock conflicts.[149] Just as Blair and Stout predict, they avoid committing themselves to shareholder primacy in respect of public corporations[150] lacking a controlling shareholder.[151]

144. *Id.* at 684.

145. Blair & Stout, *supra* note 1, at 301–02.

146. 16 A.3d 1 (Del. Ch. 2010).

147. *Id.* at 34.

148. *Id.* at 28–31 (stressing that the case law on poison pills concerns publicly traded companies, not close corporations).

149. *See, e.g.*, *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 40–41 (Del. Ch. 2013) ("[T]he standard of conduct for directors requires that they strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm's value, not for the benefit of its contractual claimants.").

150. Even the *Revlon* rule, originally framed in terms of maximization, came in for relaxation. *See, e.g.*, Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) ("[T]he basic teaching of [*Revlon* and its related] precedents is simply that the directors must act in accordance with their fundamental duties of care and loyalty.").

151. Given a controlling shareholder, the Delaware courts do exalt the status of the shareholders—minority shareholders—particularly in merger cases. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983) and its many progeny. These situations are not within the zone covered by the TPM. A question arises as to whether the line-drawing that leads to the exclusion is unduly expedient. These can be large enterprises reliant on their teams, suggesting that the exclusion is ill-constructed. At the same time, the disputes covered lie within the shareholder

A question nonetheless arises about the state of the law: Could *Dodge v. Ford* happen today in respect of a publicly traded company under separated ownership and control? I answer yes: if the case came up again in Delaware with the same arguments on the table it would come out the same way. A business run for the benefit of employees would be held to traverse the rights of the shareholders in the "corporation and its shareholders." The answer does not much destabilize the TPM, however, for *Dodge* would never come up with the same arguments on the table. The defending board would obscure its managerialist objectives in the language of long-term corporate profit and shareholder value enhancement. So long as the defending managers grounded their case in a justificatory record (a task easily accomplished) and were not otherwise self-dealing, their allocational acts would be covered by the cloak of business judgment. The TPM's envelope of discretion would persist.

A caveat must be entered nonetheless. Management is privileged to wear the business judgment cloak only if it remains ready to pay lip service to the shareholder interest. Commitment to the shareholder interest must never be explicitly denied, whatever the occulted truth. Management must genuflect when challenged. And it routinely does so, knowing that the ritual has performative value. It is in management's interest to hew to the norm, for it emerges from the act of worship at the shareholder altar with its own power and position legitimated. Thus did the Business Roundtable bow to the shareholders in its first *Statement on Corporate Governance*, issued in 1997.[152]

Meanwhile, legal ambiguity prevails—a constructive ambiguity. In the century since *Dodge*, the issue has never been joined in respect of investment and earnings retention policy at a public company. No manager wants a challenge and, remarkably, no shareholder plaintiff has ever pushed a manager into a corner on an allocative action, at least outside of the context of a sale of the company. Such is the genius of corporate law, a genius captured by the TPM.

Let us nonetheless join the issue. Here is the hypothetical. A manufacturing firm employs skilled laborers, who contribute high value added as they produce a premium product. The company has a secure market share. Miraculously, a technician at the company invents a new mechanized process that can do most of the work done by the skilled

precinct and do not directly concern providers of human capital. Moreover, given a controlled board, a mediating hierarch is absent as regards the complainants. It follows that Blair and Stout had no choice but to draw the line.

152. BUS. ROUNDTABLE, STATEMENT ON CORPORATE GOVERNANCE, 1–4 (Sept. 1997) ("The Business Roundtable wishes to emphasize that the principal objective of a business enterprise is to generate economic returns to its owners.").

laborers for a fraction of the cost. If the new process is deployed, the company will fire half of its workers, substantially lower its costs, and double its stock price even as revenues stay the same. Alternatively, the company can hold onto its market share and its revenue stream but retain the workers and suppress the new technology. Management, which believes that the existence of the technology can be kept secret, opts for suppression out of loyalty to its employees.

The question is whether the suppressing board will be held to have breached its fiduciary duty when a disgruntled whistleblower discloses all to a plaintiff's lawyer. I predict that it would be held so to do. The decision to suppress the technology would at a minimum be deemed antithetical to the company's best interest and so in bad faith.

The prediction cuts against Blair and Stout's description of corporate law, but only a little. Note how careful one must be in crafting a hypothetical. If we resituate the case in a larger enterprise in which the particular product amounts to only ten percent of the business, I would have no trouble getting the decision back inside the business judgment tent—management could obscure the allocation as necessary for employee relations in the context of the company as a whole.

Summing up, although corporate law does elevate the shareholders to *primus inter pares* status, it so equivocates as it does so that it leaves the TPM standing.

D. The TPM as History

We now ask how well the TPM synchronizes with corporate governance practice. It turns out that the tightness of fit varies depending on the moment in history.

Blair and Stout state their contractarian fusion of law and economics ahistorically, as one would expect. But the model is nonetheless sensitive to historical contingency and has close ties to the posture of corporate governance at the time of its appearance. Indeed, the TPM could not credibly have appeared earlier than the late 1990s, even though its managerialist aspect recalls the post-war period. The managers of the 1950s and 1960s arguably were the greatest in history when it came to the advancement of non-shareholder team members' welfare—those were the folks who invented employer-subsidized healthcare.[153] But any attempt to situate the TPM in management's golden age stalls quickly. The TPM depends absolutely on an

153. William W. Bratton & Michael L. Wachter, *Tracking Berle's Footsteps: The Trail of The Modern Corporation's Last Chapter*, 33 SEATTLE U. L. REV. 849, 867–70 (2010).

independent, substantially disinterested monitoring board[154] that stands in as a credible trustee to which team members can surrender their property rights with confidence. Such boards first appeared during the 1970s, and then only in theory.[155] They gradually came to dominate in practice in the two succeeding decades. When the TPM appeared at the end of the 1990s, it had only recently become safe to assume that publicly traded companies had majority independent boards.[156] Decades earlier, during management's palmy days, the board was moribund and a model insisting on a central place for board independence would not have enjoyed descriptive credibility.

The late 1990s suit the TPM in another respect. It was, relatively speaking, a quiet time. The takeover wars of the 1980s were over and the next century's scandals and activist interventions were yet to come. Still, Blair and Stout had to look to backward and bring the takeover wars into the team picture. In TPM terms, the hostile takeovers of the 1980s amounted to a shareholder attack aimed at adjusting a prevailing team coalition settlement. Corporations emerged in the 1990s under a new, more shareholder-oriented settlement built on equity compensation plans that reoriented manager incentives toward stock price enhancement.[157] Blair and Stout accept this and describe a mediating hierarch making a political adjustment to the waxing of institutional investor influence and the waning of trade union

154. *See supra* text accompanying note 65.

155. For a picture of governance during the managerialist era, see Edward S. Mason, *The Apologetics of "Managerialism*," 31 J. BUS. 1, 1–5 (1958). During that period, monitoring gravitated over to the hands of government authorities, which mediated between producing companies and the markets. *See* Berle, *supra* note 16, at xxv. The shareholder franchise was likewise irrelevant, the annual vote for the board of directors having degenerated into a meaningless ritual. S*ee* ADOLF A. BERLE, JR., POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN AMERICAN POLITICAL ECONOMY 104–05 (1959) (describing a stockholders' vote as "apt to be a pale affair").

156. Today it is safe to assume that they have super-majority independent boards. *See* William W. Bratton, *Reconsidering the Evolutionary Erosion Account of Corporate Fiduciary Law* 51 (Univ. of Pa. Carey L. Sch. Inst. For L. & Econ., Rsch. Paper No. 21-04, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3753589 [https://perma.cc/UW8W-43YR] ("All of the Dow companies, all but one of the midcap companies, and all but four of the small cap companies reported super-majority independent boards.").

157. The best description of this shift is Holmstrom & Kaplan, *supra* note 59, at 121–23. Holmstrom and Kaplan survey the evolution of shareholder-manager relations, noting that a regime of market-oriented corporate governance emerged in the wake of the 1980s. They depict the takeover wars as a reaction to an external shock caused by economic factors such as deregulation, globalization, and new information and communications technologies. The financial markets, they observed, showed a comparative advantage over management in undertaking the structural adjustments made necessary by the changes. The shift to market control, viewed from this perspective, followed neither from its intrinsic superiority respecting capital allocation nor from a structurally embedded level of excess agency costs, but from transitory economic factors. For Holmstrom and Kaplan, takeovers were a one-time-only external shock that did not imply a permanent shift of the locus of production decisionmaking from within the firm to outside markets. *Id.* at 137.

influence.[158] Alternatively, they ascribe the change to international economic competition—the shareholders' reservation price went up even as the labor market saw downward pressure on employee returns.[159] Either way or both ways, power had shifted to the shareholders with the TPM description otherwise remaining intact.

Now let us turn our attention to another 1980s phenomenon, the management buyout, which interplays interestingly with the TPM's definitional limitation to publicly traded companies under separated ownership and control. To go private is to exit the TPM: because the buyout implicates control transfer to a blockholder and delisting, the buyout target no longer has separated ownership and control. Management buyouts resembled hostile takeovers in reflecting the shift in public shareholders' favor, for they too cashed public shareholders out at a premium. The difference was that the incumbent management group worked cooperatively with a financial intermediary in a friendly transaction (even as it laid itself open to the disciplinary ministrations of a control party post-closing). The objective was leveraged restructuring and an enhanced return on equity, and, as was the case with many hostile offers, the transaction led to brutal cost-cutting and reductions in workforce. Buyout deals turned on defection against inside team members by management incumbents looking for jackpot personal payoffs. This is not the way of the TPM. Blair and Stout's definitional line drawing finesses the problem. To go private, they explain, is to determine that agency problems so dominate as to justify a shift away from the team coalition to a shareholder-controlled board.[160] The point is fair one and the line of demarcation holds.

But there is a residual element of disquiet. Management buyouts are about leveraged speculation and defection against the team as well as agency cost reduction.[161] The target eviscerates its team even as it stays in the product market with its profile unchanged, suggesting that team cohesion may not be as essential as the TPM asserts. As the flow of companies from public to private by buyout increases, the real-world productivity advantages of team governance diminish. Happily, by the time the TPM appeared in the late 1990s, the leveraged restructuring moment seemed to have passed. Neither leveraged hostile takeovers nor leveraged management buyouts were occurring in significant numbers.[162]

158. Blair & Stout, *supra* note 1, at 325–26.

159. *Id.* at 326.

160. *Id.* at 322.

161. WILLIAM W. BRATTON, CORPORATE FINANCE: CASES AND MATERIALS 517–18 (8th ed. 2016).

162. *Id.* at 513, 1116–17.

There was also notable movement from private to public on the startup front during the late 1990s, a movement tending to confirm the TPM's robustness.[163] Venture capital ("VC") startups manage to achieve teamwork in the absence of the TPM's independent, mediating board. VC deal structures tend to split the board between a founder and the founder's designees and designees of the venture capitalist who holds convertible preferred stock.[164] To be sure, many structures include a link to the logic of the TPM: where the VC and the founder are allocated equal numbers of board seats, there is also a nominally independent tie-breaker director.[165] Overall, however, VC startup governance is characterized by a principal-agent structure channeled through elaborate negotiated mechanisms that allocate not only control but return on investment. Such a setup lies outside the TPM's well-defined limits. But, at the time the TPM appeared in the late 1990s, there were no negative implications. Startup success meant an IPO and eventual transition to separated ownership and control.[166] For all that appeared, a shift to team governance was an inevitable concomitant of organizational maturity.

Thus was 1999 the perfect moment for the TPM. Independence finally prevailed in boardrooms. There was little hostility (and hostile takeovers never did come back). There was little movement from public to private. An unprecedented spate of VC IPOs magnified the team model's salience. Even as incentive structures had evolved to adjust the scales in the shareholders' favor at public companies, separated ownership and control and team production, thus adjusted, still prevailed as the governance mode for large enterprise.

E. The TPM in History

Developments in corporate governance since the turn of this century have not gone the TPM's way, at least at first glance. The power shift in the shareholders' direction has intensified markedly, so much so that the problem of separated ownership and control has been

163. For further discussion of the TPM's interplay with venture capital governance, see Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 177–78 (2019).

164. Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281, 287–90 (2003).

165. Brian J. Broughman, *The Role of Independent Directors in Startup Firms*, 2010 UTAH L. REV. 461, 468–71 (2010).

166. *See* Steve Blank, W*hen Founders Go Too Far*, HARV. BUS. REV., https://hbr.org/2017/11/when-founders-go-too-far (last visited Sept. 25, 2021) [https://perma.cc/MEX9-DKJ2].

pronounced solved.[167] At the same time (and perhaps ironically), fewer companies operate under separated ownership and control,[168] partly due to a renewed trend toward privatization and partly due to continuing concentration through mergers. It seems that team integrity matters less and less, detracting from the TPM's economic and policy salience. But let us take a closer look.

The continued shift of power to shareholders by no means negates the TPM. The shift follows in the first instance from activist hedge fund interventions in business planning. These engagements *do* cut against the case made in *A Team Production Theory of Corporate Law*—the activists so invigorate the shareholder franchise as to superannuate the TPMs characterization of shareholder voting.[169] But they do not somehow turn the hedge funds into juridical principals. The successful activist usually leaves the independent mediating board in place, working with the existing team and the received legal model.[170] The activists use the franchise to lever their way to a place at the business planning table[171] and then use board representatives for ongoing monitoring. The difference is that the mediators are now much more likely to favor items on shareholder agendas. The items—asset sales, cost cutting, share buybacks, and sell-side mergers—look to monetize investments in the firm and channel the proceeds into shareholder pockets, thereby making the environment less protective of firm-specific investment. The follow-on question, in the view of many, is whether the pendulum has shifted so far in the direction of short-term monetization and away from productive long-term investment.[172] Thus in 2019 did the Business Roundtable, taking advantage growing skepticism regarding shareholder primacy, withdraw its 1997

167. Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 865, 867, 874 (2013).

168. *See* Margaret M. Blair, *Are Publicly Traded Corporations Disappearing?*, 105 CORNELL L. REV. 641, 653–73 (2020) (highlighting the "decline in the number of IPOs and in the number of publicly traded corporations since 2000").

169. *See supra* text accompanying note 105–106.

170. William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1405–09 (2007).

171. Bratton & Sepe, *supra* note 118, at 692–94.

172. *See, e.g.*, ERNST & YOUNG, STUDY ON DIRECTORS' DUTIES AND SUSTAINABLE CORPORATE GOVERNANCE: FINAL REPORT 37 (2020) (prepared for the Eur. Comm'n):

> [T]he prominence of shareholder primacy in corporate governance and the pressure it generates to pursue short-term profit maximisation leads *board members not to take sufficient account of the long-term interests of stakeholders other than shareholders* (such as employees, creditors, suppliers, customers and the society at large as well as the environment);

COLIN MAYER, FIRM COMMITMENT: WHY THE CORPORATION IS FAILING US AND HOW TO RESTORE TRUST IN IT (2013) (arguing for binding statements of commitment to broad welfare enhancement).

endorsement.[173] As the question about perverse effects looms larger, the TPM's policy salience undergoes restoration.

The trend toward privatization does not negate the TPM either, even as it certainly does entail movement away from independent boards and their teams in favor of institutional shareholder control. Management buyouts for all intents and purposes had disappeared when the TPM appeared in the late 1990s. Thereafter, in the wake of the market correction of 2000–2002, they returned to the frontline of the mergers and acquisitions market (rebranded as private equity) and have held their place ever since.[174] Very few private equity targets return to public trading as stand-alone companies, although many do return to separated ownership and control after being sold to public corporations in strategic mergers.[175] At the same time, many targets stay private indefinitely.[176]

Prior to 2020, we also experienced a periodic decline in the number of IPOs of venture capital-backed startups. This resulted from an expanded base of private capital, a willingness to delay the incurrence of regulatory costs,[177] increased numbers of private sales,[178] and perhaps the economics of options (delay preserves option value). But the question went less to the ultimate advantages of a public listing than to the costs and benefits determining the length of delay. Here too, then, the TPM still stands, albeit with a reduced zone of operation.

The TPM, in sum, still fits corporate governance practice, although not nearly as neatly as it did twenty years ago. How then does the TPM look today when compared to its rivals in corporate legal theory—Easterbrook and Fischel's contractarianism and the shareholder paradigm? Proponents of both theories doubtless will have found much to celebrate as the shareholders have racked up real-world victories. But as between the two rival theories, only the contractarian model comes away looking more robust in light of recent events. Indeed,

173. *Statement on the Purpose of a Corporation*, BUS. ROUNDTABLE, https://opportunity.businessroundtable.org/ourcommitment/ (last visited Aug. 21, 2021) [https://perma.cc/GM9N-G5F8] ("While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders."); *see also* Letter from Larry Fink, CEO, BlackRock, Inc., to client CEOs (Jan. 2018), https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter [https://perma.cc/GJV2-4UEY] ("Society is demanding that companies, both public and private, serve a social purpose.").

174. WILLIAM W. BRATTON, CORPORATE FINANCE: CASES AND MATERIALS, 542–551 (9th ed. 2021).

175. BRATTON, *supra* note 161, at 520–21.

176. The private equity firms sell them to one another in so-called secondary buyouts. *Id.*

177. Renee M. Jones, *The Unicorn Governance Trap*, 166 U. PA. L. REV. ONLINE 165, 171–74 (2017).

178. Blank, *supra* note 166, at 99.

corporate governance now finally begins to look the way Easterbook and Fischel said it looked three decades ago. Shareholder empowerment for the most part follows from ground level changes in markets and financial institutions—changes that reduce agency costs—much as the contractarian model predicts.[179] Its accomplishment validates ex post a description that fell short of accuracy at the time it appeared. The shareholder paradigm, in contrast, is falsified by recent developments in practice. It counsels that embedded institutional arrangements prevent shareholder empowerment and foster permanently excessive agency costs, necessitating law reform. As it has turned out, there was nothing embedded about shareholder disempowerment. No reform has been necessary.

Corporate legal theory now enters a phase well-suited to a contractarian perspective. It has two contractarian models on which to draw, one based on agency and the other the TPM. They are best viewed as complementary to one another.

CONCLUSION

Blair and Stout intervened in the midst of corporate legal theory's long, agency-centric run to show that the set of available microeconomic referents was larger and more descriptively rich than could be yielded by a framework strictly focused on agency cost reduction. They put forward a cogent counter-story that focused on management's role in marshalling factors of production rather than management's relationship with public equity holders. They parried every thrust made in the patchwork of theories surrounding shareholder primacy and successfully contended that their description better accounted for the terms of corporate law. They also redirected corporate law and economics from a collection of extensions of the Jensen and Meckling model to the basic teaching of the first theorem of welfare economics.

And they were right about a lot of things. But even as they earned a place at the table, they did not upset the agency-centric apple cart because they sought to legitimize management power where most others saw an embedded accountability problem. This disposition bespeaks the view that agency costs outweigh in magnitude the costs of team disruption, a view less driven by conclusive empirical findings than by normative priors. Corporate law scholarship, like all legal scholarship, is at bottom normative. Within its normative frame of

179. Legal reform has played a strictly secondary role. Bratton & Sepe, *supra* note 118, at 724, n.177.

reference, nothing more consistently excites academic engagement than the sight of power without accountability. The turn to empirical inquiry and interdisciplinary reference to theories from social science does not change this normative orientation, even as it certainly does mean an increase in the volume of descriptive scholarship.

At the same time, new directions in corporate law scholarship are driven by developments in practice and the arrival of the hedge fund activists has been a paradigm-shifting practical development. The separation of ownership and control is no longer corporate law's great unsolved problem. The new question is whether we have entered a new era of power without accountability, this time on the shareholder side. Given an affirmative answer, the TPM matters more than ever.

Where, then, are we going? The management moral hazard problem has not gone away, even as the growing influence of shareholders fosters just the sorts of perverse effects highlighted by the TPM. The theoretical question posed is not an either/or—do we stick with an exclusive focus on management moral hazard or go with team production (or management myopia or whatever you prefer to call it)? We inevitably will be doing both—it will be markets and hierarchies[180]—and we do not have a theory that tells us in a nice, neat box how to do both at once. We accordingly find ourselves weighing a growing list of costs and benefits. This is an uncomfortable place to be for a field that is only really comfortable following a clear-cut normative vector. Round and round we'll go between shareholder value and stable production environments and concern about externalities and where we stop is anybody's guess. One thing can be predicted safely: developments in practice will determine the stop point, as they always have in the past.

I will add a tentative, contractarian projection. Suppose that private ordering continues to work well and advances to a higher level: We evolve past today's one-size-fits-all governance model to a new level at which (1) all parties in interest take a company-specific view of items on activist agendas, scrupulously weighing short-term results against long-term opportunities, and, (2) boards of directors, activists, and other institutional shareholders learn how to contract with each other to

180. *Cf.* OLIVER WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING 294–97 (1985) (recognizing the firm entity as a hierarchical governance structure significantly distinguishable from market contracting and focusing on bounded rationality and opportunistic conduct as limitations on market contracting). Oliver Williamson later posited an intermediate category. *See* Oliver E. Williamson, *The Theory of the Firm as Governance Structure: From Choice to Contract*, 16 J. ECON. PERSPS. 171, 180–81 (2002). Williamson's category does not, however, describe today's shareholder-directed public corporations.eci

determine suitable, company-specific power allocations.[181] It could follow that the power without accountability problem would again fade to the rear and that corporate governance would drop back from the policy margin to become a quieter, more technical precinct. The projected environment would occupy a place much like that presently occupied by corporate decisionmaking concerning capital structure—a place where business judgment and arm's length contracting operate largely unregulated in the absence of handwringing about accountability.

181. *Cf.* ALEX EDMANS, GROW THE PIE: HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT 38–57 (2020) (arguing that while growing the pie and attending constituent concerns is inconsistent with shareholder primacy it does often maximize profits in the long run).