DEVELOPMENTS

Review Essay – Corporate Law Matters. On Kent Greenfield's *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities* (2006)

By Steve Wolpert[*]

[Kent Greenfield, *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities*, Chicago: U of Chicago Press, 2006. ISBN 0-226-30693-3, 288 pp., $52.68 CAD]

A. Introduction

Corporate law matters. A simple statement of this kind may, on first glance, appear to, contribute little to public discourse. In an era where corporations control most of the wealth and most of the work to be done, it has become abundantly clear that the corporation's impact is not limited to these areas. It affects the welfare of global citizens in countless other ways as well. As a result, corporations, their managers and their practices are facing greater scrutiny. Nevertheless, few traces of this breed of scrutiny appear in Kent Greenfield's recent book *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities*.

Instead, this statement points to the focus and scope of a text that contributes a great deal. Greenfield's book inspects the rules that institutionalize corporations and make today's management practices not only possible, but, in many cases, likely. Indeed, the claim that corporate law matters is quite different from the claim that corporations matter.

The focal point of this inspection is the current American corporate law regime. While the book discusses governance principles in broad enough strokes to warrant attention beyond U.S. borders, the book has a focus on domestic issues that will leave scholars looking elsewhere for answers about the unique challenges that multi-national corporations raise. And where scholars seeking to make sense of

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multi-nationals typically use a combination of law and norms, Greenfield focuses entirely on the role that hard law has to play.

With corporate law at its center, the book aims to synthesize three discourses that have remained somewhat distinct despite their relevance and interdependence: the extent of individual freedom to contract and its suggested application to the corporation through the 'corporate contract'; the type of model that is most appropriate for corporate law; and, perhaps most influential to Greenfield's approach, the broader question of the role that corporate law is to play in the development and regulation of society. The attempt to merge these three discourses led Greenfield not merely to connect the dots between the reigning theories in each area. Rather, serious doubts are cast about the accuracy of prevailing theories. Indeed, Part I of the book – entitled 'Fundamental Flaws' – is devoted to an exposition of the theoretical flaws. It is only during the book's latter part – 'Progressive Possibilities' – that Greenfield attempts to reconcile the ideas. While both parts are valuable, it is their juxtaposition that exhibits how certain assumptions have led to a corporate law regime that could be fundamentally different.

This review aims to both discuss the characteristics of corporate law that Greenfield finds most problematic and to appraise his suggestions for improving corporate legal doctrine. The flaws that Greenfield highlights are the corporate fixation on profit, the corporation's ability and propensity to externalize costs, the notion that corporate law is private law, the supremacy given to shareholders over workers, and the democratic legitimacy ascribed to corporate law despite the Delaware effect.[1] His suggested solution – which he admits to having flaws and limitations of its own – is the development of a corporate law regime that serves the interests of society as a whole while recognizing that what makes corporations special is their ability to contribute to society by creating financial prosperity. The book goes on to assert that in such a regime 'a corporation's wealth should be shared fairly among those who contribute to its creation' and that 'participatory, democratic corporate governance is the best way to ensure the sustainable creation and equitable distribution of corporate wealth.'[2]

Given the level of disagreement that has emerged regarding good corporate governance practices, those seeking to truly understand corporate law cannot afford to read a book that merely describes the features of the current law. For

[1] KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES*, (2006) at 8. [Greenfield]

[2] *Id.*, 142 and 146.

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those people, this book is a worthwhile second read. Though neither exhaustive nor universally applicable in its treatment of corporate law, it certainly addresses many of the largest challenges that corporate law scholars are wrestling with today. And while these topics alone are enough to make the book a worthwhile read, the author's clarity of thought and meticulous explanations are peppered with valuable insights, including the need for anti-fraud laws protecting workers from board dishonesty, the potential application of the *ultra vires* doctrine to curtail corporate crime, and a theory suggesting that the business judgment rule exists to prevent the rigid application of fiduciary duties. The questions and criticisms that follow should not be taken as a derogation of such an insightful text, but rather as an outline of ways in which to better focus subsequent discussion.

B. Background on Each Discourse

Greenfield's arguments rest on his challenges to current thinking about the nature of contract, the nature of corporate law, and the broader role of corporate law to the well being of society. The background for each of these subjects is discussed briefly before engaging Greenfield's arguments.

I. Limits on Contract Law

100 years before Greenfield published his text, Justice Holmes recognized that regulators were empowered to 'interfere with the liberty to contract.'[3] Justice Holmes' dissenting opinion led many to the realization that the state is implicated in the creation and protection of contractual rights.[4] Further, while the Lochner dissent focused on more general policy principles for intervention, others have found that discouraging the enforcement of inefficient exchanges provides an economic justification as well.[5] Indeed, some argue that the state cannot avoid being implicated in contracts because even decisions regarding which contractual rights to protect and which not to protect necessarily implies the state's choice to remain silent regarding those other potential rights.[6] Further, while contracts are commonly viewed as agreements reached by consenting parties, they are based on

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[3] *Lochner v. New York*, 198 U.S. 45 (1905).

[4] See e.g. Morris Cohen, *The Basis of Contract*, 46 HARVARD LAW REVIEW 553 (1933).

[5] MICHAEL J. TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT (1993) at 17.

[6] Roger Brownsword, *Review: The Limits of Freedom of Contract and the Limits of Contract Theory*, 22 JOURNAL OF LAW AND SOCIETY (1995) 259 at 268.

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the bargaining power of the parties where the freedom of the weaker party to decline the contract is occasionally circumscribed by their personal circumstances.[7]

This importance of contractual rights and state intervention in the marketplace rose in importance as law and economics scholars introduced questions of efficiency to various areas of law. Contract law began its foray into corporate governance once Coase recognized that the nature of the firm was to avoid the costs associated with market transactions and the price mechanism by internalizing them within a single entity – the corporation. The next landmark step came with Easterbrook and Fischel's publication of 'The Corporate Contract.' They asserted that the corporation is best seen as a nexus of explicit and implicit contracts among all stakeholders relating to the corporation. The nexus of contracts view was used as a model to explain the most prominent features of corporate law. Under this view, the role of corporate law was seen to be the reduction of agency costs so that incentives to choose good governance structures would not be undermined by agency conflict and so that market mechanisms could be used to discipline management.[8] This model insists that control be exercised exclusively by shareholders and that the typical brakes on contract freedom, such as the doctrine of mistake, do not apply in the corporate setting. The justification for intervention of the supposedly private sphere of contracts using corporate law was the claim that while many corporate matters *could* be dealt with through contracts, drafting each contract rather than deferring to a pre-defined law would dramatically and inefficiently increase transaction costs.[9] The 'Corporate Contract' model dismisses non-profit issues such as dignity and compassion as irrelevant to corporate law.[10]

II. Models for Corporate Law

Though neither corporate law[11] nor capitalism itself[12] could be reduced to one simple set of assumptions, empirical evidence suggested that corporate law regimes

[7] Robert L. Hale, *Bargaining, Duress and Economic Liberty*, 43 COLUMBIA LAW REVIEW (1943) 603 at 604.

[8] Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract* in THE ECONOMIC STRUCTURE OF CORPORATE LAW 1 (1991) at 37. [Easterbrook & Fischel]

[9] Oliver E. Williamson, *The Modern Corporation: Origins, Evolution, Attributes* , 19 JOURNAL OF ECONOMIC LITERATURE 1537 (1981) at 1537.

[10] EASTERBROOK & FISCHEL, *supra*, note 8, 32.

[11] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEORGETOWN LAW JOURNAL 439 (2001). [Hansmann & Kraakman]

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were converging towards the shareholder-oriented model. The ascension of this model – which grants ultimate control over the corporation to shareholders, requires managers to act in the best interests of the shareholders, and forces other stakeholders to protect their interests through contractual and regulatory means – supposedly marked the end of history for corporate law.[13] Although some saw this convergence as beneficial, flaws in this model had long since been well documented.[14] Further, convergence alone did not undermine the efforts of those supporting other models.

Amongst these alternate models were the 'fiduciary' and 'representative' stakeholder models. Both models seek to include the interests of non-shareholder stakeholders in corporate governance. They differ, however, to the extent that the former endows investors with the exclusive right to appoint fiduciaries who must each work to protect all stakeholders while the latter allows various stakeholders to appoint partisan board members who, by working together on the board, are believed to reach decisions that reflect all of the stakeholders' interests.[15] Hansmann and Kraakman criticized both of these models, suggesting that the evidence explained waning support for these views. The fiduciary model was said to lead to managerial interests receiving undue prominence above the interests of other stakeholders, while the representative model was seen as an impairment of decision-making processes.[16]

III. Corporate Law in Society

After 'the end of history,' capitalism had been crowned champion, if only having won by means of attrition. But well after capitalism was unleashed on the world, it was still clear that a capitalist system did not always mean that economic growth was to trump all public interests. And while the spread of corporate law followed the spread of capitalism, it remained necessary to determine the scope that corporate law would have in the regulation of society in order to select the most appropriate corporate law model. As Hansmann and Kraakman famously stated,

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12,VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE (Peter A. Hall & David Soskice eds,.2001).

13 HANSMANN & KRAAKMAN, *supra*, note 11.

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

15 See *supra,* note 11 at 447; also see Margaret M. Blair & Lynn A Stout, *A Team Production Theory of Corporate Law*, 85 VIRGINIA LAW REVIEW 247 (1999).

16 HANSMANN & KRAAKMAN, *supra*, note 11, 448.

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> All thoughtful people believe that corporate enterprise should be organized and operated to serve the interests of society as a whole, and that the interests of shareholders deserve no greater weight in this social calculus than do the interests of any other members of society.[17]

It was unclear what should be done with this realization. At a minimum, it became apparent that corporations, being fictional entities entirely created by the law, should be molded to serve society. While some, including Hansmann and Kraakman themselves, believed that the scope of corporate law should be restricted in how it seeks to serve the public interest, others believed that that corporate law doctrine should not remain separate and distinct from labor, employment, debtor-creditor and other types of law. To the latter group, for whom the public-private distinction had already been undermined or largely eviscerated, corporate law was not a field limited to the regulation of private relationships.

C. The Search for Principles

Though Greenfield's understanding of corporate law doctrine is strongly informed by the discourses outlined above, he is keenly aware that that summary is incomplete. Each of those ideas has been, and continues to be, hotly contested. Greenfield draws on some criticisms of others, combined with some of his own, in an effort to show how narrowly and inequitably corporate law has been delineated.

Greenfield's first major task is to expand the scope of inquiry. Knowing that Contractarians characterize corporate law as being restricted to a purportedly private realm of contracts between a limited group of parties, he applauds Hansmann and Kraakman's view that corporations are to be operated for the benefit of society as a whole. But where the duo assumes that shareholder primacy benefits society, Greenfield sees this assumption as unjustified and analytically deficient. In his view, their explanation does not show the connection between shareholder primacy and broad societal benefit.[18] Indeed, it may be that shareholder primacy is not even good for the economy, depending on which economic indicators are used to decide. While metrics of overall wealth might support their claim, poverty rates and income disparities would undermine it.[19] In

[17] *Id*. 441.

[18] GREENFIELD, *supra*, note 1, 22.

[19] *Id*., 38.

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this way, Greenfield is able to cast doubt on the fixation on shareholder profit as either the best or only way to assess corporate law and to open the door to consideration of issues like equality and dignity.

Building on the idea that corporate law is to benefit all of society, Greenfield suggests that when analysts move to a higher level of abstraction about their visions of society and the purposes of law, "it cannot seriously be claimed that social utility will be maximized if corporations are unrestrained by law."[20] This view is built on two presumptions. The first presumption is that laws are tools that cannot be effectively employed until political questions regarding what is good for society have already been answered. The second is that other laws have been created with this political question in mind and that corporate law should not be treated differently in this regard. Greenfield has thus questioned the assumption of academics like Daniel Fischel and Jonathan Macey who argue that political avenues offer an alternate form of redress to changing corporate governance rules directly. As Greenfield sees it "both scholars assume, then, that politics is separate from corporate governance. Ignored is the possibility that changes in corporate governance may be the very thing that politics could propose changing."[21] It is from this analysis that the book's first of five 'increasingly particular and controversial' principles is established:

> *'The ultimate purpose of corporations should be to serve the interests of society as a whole.'*[22]

As such, Greenfield argues that some corporations – even profitable ones – should fail if their costs, including the externalities they generate, outweigh their profit and other benefits.

Interestingly, he also notes that "if public policy required corporations to make a more extensive accounting of their activities, corporate decision makers would likely take a broader view of their responsibilities."[23] This statement hints at two concerns that corporate law scholars must bear in mind. First, it is clear that economics will never cease to have a fundamental impact on corporate law. In other words, while some may hope that accounting practices will include more than just economic analysis, economics will never be left out. Second, the quote

[20] *Id*.

[21] *Id*., 31.

[22] *Id*., 126.

[23] *Id*., 129.

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illustrates that even if it were agreed that the scope of corporate law should be expanded, the ever-present question of what most benefits society – and the related questions of what things to measure and how to trade them off against one another – remains unanswered.

While answers to those questions are uncertain and ideologically debated, they are beyond the scope of Greenfield's task. What is not uncertain, however, is that corporations are uniquely formidable in their ability to generate wealth, largely because they have been given the legal status of separate legal entities with limited liability and the transferability of shares. This leads to Greenfield's second principle:

> '*Corporations are distinctively able to contribute to the societal good by creating financial prosperity.*'[24]

This financial prosperity is not only for shareholders – it is for all stakeholders. This principle is subject to the first principle, such that there are now two requirements for corporations: that they serve society *and* that they create financial prosperity.[25] Greenfield adds further context to this principle, recognizing that "as social values go, the creation of wealth is not at the top of the hierarchy" because it is a means and not an end in itself.[26]

Having challenged the notion that corporate law is private, Greenfield does not over-extend his argument. Showing that intervention of corporate activities through corporate law should not be ruled out as a possibility, it still remains to be seen whether changes within corporate law doctrine will actually bring about a more beneficial society than changes to doctrines considered outside corporate law (within labor law, for example).[27]

D. The Role of Corporate Law

Having shown that shareholder primacy should be seen as a presumption of the corporate law system that requires justification, Greenfield then conducts that examination. He is guided through this analysis by his third principle:

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[24] *Id.*, 130.

[25] It is not clear what room Greenfield sees for charities, many of which are incorporated but do not create financial prosperity.

[26] GREENFIELD, *supra,* note 1,133.

[27] *Id.*, 38.

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Corporate law should further principles 1 and 2.[28]

The first of three steps in this examination is to actually demonstrate that advancing shareholder wealth (through the shareholder primacy model) does not do a sufficient job of advancing the interests of society.

Greenfield finds that arguments upholding shareholder primacy have shifted away from the property-based claim that shareholders are 'owners' of the corporation and that no other stakeholders have any property interests in the corporation. He notes that as the implausibility of property-based claims became apparent, contract-based claims attempted to fill that void. The focus thus shifts to Easterbrook and Fischel's defence of shareholder primacy and the corporate contract. Greenfield does not deny that the primary arguments in favor of shareholder primacy – the need to reduce shareholders' agency costs, the need to provide a means to protect residual claims of shareholders, and the need for shareholders to enter into relational contracts with the board of directors – all still apply in one form or another. Important, however, is his belief that none of these arguments apply *exclusively or most forcefully* to shareholders. His goal is to establish that workers are not able to protect themselves without engaging corporate law and that worker interests, rather than shareholder interests, more closely align with the long-term interests of the corporation.

The subsequent arguments attacking the shareholder primacy model stem, in part, from Greenfield's assumption in Chapter 1 that "if one really cares what is better for a specific firm, shareholders' desires should not dominate, at least if we define 'what is better for the firm' to include survival."[29] This is a surprising presumption, given Greenfield's attempt to expand discussion to the benefits of society at large. In the same way that Hansmann and Kraakman jumped to the conclusion that what is good for corporations is good for society, Greenfield is making the assumption that firm survival is good for society. And while it is difficult to assess whether a firm's survival would be good for society, Joseph Schumpeter has suggested that creative destruction, and the resulting failure of some firms, is at least good for sustained, long-term economic growth.[30] As such, Greenfield's underlying argument, that each firm is less likely to survive if managed under a shareholder-dominated model, is perhaps better understood as a risk-based concern that well-

[28] *Id.*, 134.

[29] *Id.*, 26.

[30] JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM, AND DEMOCRACY (1942).

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diversified shareholders are willing to take risks that unnecessarily put the corporation's survival in jeopardy. Indeed, innovation may be a destructive (albeit positive) force under any corporate law model.

I. Agency Costs

Greenfield first tackles the agency costs, stating that "this 'agency cost' argument that corporate law should protect shareholders is straightforward and persuasive, as far as it goes. But the same argument provides a basis for legal protections for workers as well."[31] This view recognizes that both workers and shareholders make firm-specific investments and that both need safeguards against opportunistic or abusive management. Greenfield ascribes little value to the workers' advantage of proximity to management on the basis that this proximity provides no guarantee that the workers know what management is doing, contrasting this with the access to the board that institutional investors often receive.[32] It is also worth noting that many employees in multi-jurisdictional companies don't have this physical proximity to management in the first place.

Greenfield then takes this argument one step further by asserting that workers are actually *more* susceptible to managerial abuse than investors because while investors can easily sell their shares, the workers' risks are more closely tied to the company. Not only is it more difficult for workers to diversify their effort than for investors to diversify their portfolios, but workers who change employers face higher switching costs than investors changing stocks do.

II. Residual Claims

Another of Greenfield's primary findings is that the shareholder's claim to residual value of the corporation is best seen as a means to protect the long-term interests of the firm. As he puts it, the "more nuanced argument for the dominance of the shareholders depends instead on the assertion that the residual nature of the shareholders' claim makes the shareholders the best protector of the firm's interest."[33] Greenfield's claim here could use further explanation, as it is not clear that the residual claim was created to protect the corporation as a whole. While it may be that the purpose of the residual claim is to protect the corporation's interests, it also seems plausible that the residual claim is a means to protect shareholders *from* the corporation and its potential to be plundered.

[31] GREENFIELD, *supra*, note 1, 50.

[32] *Id.*, 52.

[33] *Id.*, 54.

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(Indeed, while shareholders' interests are generally considered to be well protected, there are only a few inter-related legal elements that keep this protection in place. If one of them, such as the residual claim, were cast in doubt, then the related devices – voting rights and access to dividends – would lose their value as protective devices. Further, if Macey was right to suggest that the fiduciary duty itself is to be understood as a residual claim,[34] then Greenfield's argument would do more than undermine the idea of shareholder primacy; it would dismantle all of the protections currently granted to shareholders. Nevertheless, it is clearly not Greenfield's intention to take away all forms of protection from shareholders. Here, as elsewhere, he merely seeks to demonstrate that the current corporate governance system and its Contractarian justification are faulty).

Moreover, it may be that residual claims tie shareholders interests to those of the corporation in such a way that it serves to protect *both* the long-term interests of the firm and the interests of shareholders to prevent plundering. If that is the case, then Greenfield's next argument about residual claims can be considered. He states that where the goal is protection of the corporation's long term interests, it is more appropriate to ask whether a claim is fixed than whether it is residual. The idea is that unfixed claims – claims whose value fluctuate in correlation with the corporation's success – act as a better proxy for determining who will have an ongoing interest in the company's success than residual claims, which merely state who is entitled to leftovers in the low-probability event of a liquidation. With pension benefits, retirement benefits, job security and other unfixed claims of workers in mind, Greenfield states that "the significant correlation between the overall health of the firm and the gains and losses that accrue to workers weakens the claim that the best proxy for the health of the firm is the return to the shareholders."[35]

This argument, while sensible in principle, is unpersuasive in establishing that worker claims are actually a *good* proxy. There is no necessary connection between corporate profitability and worker benefits. This has been demonstrated by corporations who conduct layoffs even during profitable periods. And while this may be a result of the shareholder-dominated legal regime that Greenfield is trying to undermine, it is still unclear that the connection being suggested by Greenfield has been drawn.

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[34] Christopher C. Nicholls, *Governance, Mergers and Acquisitions, and Global Capital Markets,* in CORPORATE GOVERNANCE IN GLOBAL CAPITAL MARKETS, 85 , 90 (Janis P. Sarra, ed , 2004).

[35] GREENFIELD, *supra*, note 1, 56.

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III. Relational Contracts

Although the concept of relational contracts have been explicitly understood since the 1960's,[36] according to Greenfield its nature has not yet been properly integrated into corporate law doctrine. The relational contract, in its simplest form, represents the notion that the vast majority of agreements fail to cover all aspects of the transaction. This stems from the widely held belief that it is either impossible or undesirable to determine every detail of the contract.

An example of a relational contract is recognized by Easterbrook and Fischel in corporate law, namely the agreement reached between shareholders and the board of directors. They find a fiduciary duty is owed to the shareholders because the variety of activities that the board will have to do to improve the shareholders' residual claim cannot be predicted at the time that their agreement is reached. Greenfield does not dispute this claim,[37] but sees the relationship between workers and the board as being relational, too. Indeed, he finds numerous reasons to think that it is more important to provide fiduciary duties to workers than to shareholders. He states:

> Despite all these reasons to doubt the strength of workers' ability to protect themselves through contract, conventional corporate law forces them to rely on just that. By contrast, it is the shareholder who is the sole beneficiary of management's fiduciary duties, imposed by law. This is despite the fact that shareholders have a much less real, meaningful relationship with the firm and that they benefit from a range of market and institutional protections. If difficulties with contracting provide the genuine rationale for dominance within the corporate nexus of contracts, one would expect to see the same logic applied to workers as the beneficiaries of fiduciary duties rather than shareholders.[38]

In summary, Greenfield argues that both shareholders and workers would benefit from directorial fiduciary duties as they both face agency costs, unfixed claims, and difficulty formalizing their relationships through contract. As he sees it, these

[36] See e.g., Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AMERICAN SOCIOLOGICAL REVIEW 1 (1963).

[37] GREENFIELD, *supra*, note 1, 60. While he doesn't dispute the existence of a fiduciary duty, he does question why it is a characteristic that has been built into corporate law, rather than being explicitly contracted for by the parties.

[38] GREENFIELD, *supra*, note 1, 66.

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factors demonstrate that workers actually need the protection of fiduciary duties even more than shareholders do, and that it would benefit the corporation to grant it to them. In other words, Greenfield is challenging the shareholder primacy model (and the corporate contract that attempts to uphold it) without challenging the relevance of the issues that that model attempts to address. Rather than attempting to replace Easterbrook and Fischel's analysis, Greenfield is seeking to contextualize the issues. It is on the basis of these arguments that Greenfield asserts that "workers' interests may function as a better placeholder for the best interests of the firm."[39]

Having established to his satisfaction that shareholder wealth does not equate to societal benefit, Greenfield's second step is to reject another commonly held view, namely that 'broadening manager's responsibilities to include other stakeholders releases them from any real responsibility.'[40]

It is at this stage that Greenfield first introduces his preference for a stakeholder model over a shareholder model. As Greenfield espouses use of both the fiduciary and representative stakeholder models – a board whose members have a duty to represent all stakeholders despite being voted in by separate constituencies[41] – the challenge is to ensure that the board will not be overwhelmed by temptations to serve themselves and will be able to make decisions effectively.

To the first issue, Greenfield argues that "the only way that having more and broader responsibilities would make it easier for managers to avoid responsibility is that they could use one obligation as a defense to a claim that they failed at meeting another", and that the law does not allow for such defenses.[42] While Greenfield may be right, it seems imprudent to fall back on descriptive claims of how the law currently works when his main purpose is to question the wisdom of those laws. Nevertheless, tying the debate back to concerns of societal benefit, he is wise to point out the irony of the shareholder primacy claim that suggests that society will suffer by having its interests being considered (or, put another way, society benefits most when only the interests of a select few are considered).

Greenfield also does an excellent job of illustrating the contradictory nature of claims supporting the shareholder model: "The mainstream cannot have it both ways – claiming, on the one hand, that we do not need to take care of non-

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[39] *Id.*, 26.

[40] *Id.*,136.

[41] *Id.*, 150.

[42] *Id.*, 139.

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shareholding stakeholders because their interests coincide with shareholders and, on the other hand, that the sky will fall once their interests are taken into account."[43] While this does not directly allay concerns about self-serving board members, it suggests that board opportunism is not likely to change dramatically from current levels and is thus not a sufficient argument to undermine stakeholder models. This illustrates the force of Berle and Means' discoveries about agency costs, as apparently corporate law scholars of all stripes are resigned to accepting them.

Finally, Greenfield's third step in explaining how corporate law can reinforce principles 1 and 2 is to posit that society would benefit if corporate law reinforced traditionally non-corporate regulatory initiatives rather than remaining in isolation. The better part of chapter 7 addresses this issue in an effort to establish that if Greenfield's suggestions for the reformulation of corporate law were enacted, stagnant real income and income inequality could be dealt with more effectively. Greenfield offers up managerial expertise in procedural fairness and the efficiency gained from a fair initial distribution over tax *re*distribution as two reasonable arguments favoring corporate law involvement in regulatory issues.

What may frustrate readers, however, is the lack of explanation provided for in his other arguments on this topic. First, in a brief nod to the multi-jurisdictional issues that corporate law frequently raises, Greenfield states that "changes in corporate governance would affect the corporation wherever it does business, whereas regulatory reforms largely stop at the state or national border."[44] This quote is clearly meant to relate back to Chapter 5 and the author's desire to eliminate the undemocratic, externality-generating internal affairs doctrine. And yet he tells us little of how to ensure that corporations do not export their operations to jurisdictions with more favorable regulatory schemes. He seems to rely on the current market conditions continuing into the future: "Given the power and stability of US markets, there are very few places likely to offer a better risk/return ratio."[45] This reliance seems to ignore the potential consequences of major changes to the regulatory environment.

Second, and perhaps more importantly, Greenfield takes for granted that 'the persistence of [stagnant real income and income inequality] means that they are quite resistant to existing policy efforts.'[46] While Greenfield leaves little doubt that

[43] *Id*.

[44] *Id*.141.

[45] *Id*. 32.

[46] *Id*. 154.

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these problems exist, he does not establish that policy-makers have failed in spite of real efforts; indeed, it might be that these issues have simply not been treated as priorities in the first place. If the latter proposition is true, then regulation through corporate law will yield no greater success in counteracting these problems than non-corporate regulation has.

Thus, in order to reinforce principles 1 and 2, Greenfield is looking for a corporate law regime that recognizes the importance and vulnerability of workers, the ability of directors to represent multiple interests simultaneously, and that can contribute to societal good in areas where corporate law is more effective than other means.

E. Proposed Model

As mentioned above, a stakeholder model combining elements of the fiduciary and representative models is envisioned by the author as the best alternative. Indeed, Greenfield's fourth principle is:

> *A corporation's wealth should be shared fairly among those who contribute to its creation*.[47]

Not only would there be an equitable sharing of corporate surpluses, but an equitable sharing of losses as well. Greenfield defends this position on the grounds that it solves the team production problem of convincing stakeholders to make firm-specific investments and that it will make stakeholders willing to actually give more to the corporation.

Team production theory is a descriptive and normative theory that indicates that the corporation's constituent groups – collectively referred to as the 'team' – willingly delegate their authority over the direction of the corporation, their firm-specific investments, and the distribution of corporate surpluses and losses to the board of directors where they cannot otherwise protect themselves through contracts, trust or reputation.[48] Greenfield seems to imagine broad application of this theory across a wide variety of corporate settings. But like the multi-jurisdictional limitations mentioned above, this theory exposes yet another limitation. Team production theory applies to public companies. It thus applies exclusively to large companies. In such firms, professional management, product diversification and other factors often act to stabilize the firm. Thus, while there is

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[47] *Id.*,142.

[48] Margaret M. Blair & Lynn A Stout, *A Team Production Theory of Corporate Law,* 85 VIRGINIA LAW REVIEW 247 (1999).

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no doubt that large companies suffer losses and occasionally become insolvent, team production members face less instability in their wages and profits. This is far from true for small companies who falter much more frequently. The question becomes whether team members involved in small firms are willing or able to absorb losses when they occur. It is not at all clear that workers in small firms would accept that kind of risk rather than a more stable salary. Thus, despite the theory's ability to describe large firms, it cannot be applied throughout corporate law. And though beyond the scope of the book, it would also have been interesting to see how the surplus would be allocated in corporate groups where, for example, a worker works for a profitable subsidiary of an otherwise-fledgling parent corporation.

A similar concern arises when considering the assertion that participants will contribute more to the firm as an act of reciprocation for a share of the surpluses. There is no doubt that people feel the need to reciprocate. But a feeling of positive reciprocation only arises when participants get more than they could rely on. Conversely, it is reasonable to predict that some workers, facing their share of corporate losses, might give less as a reciprocal response. Despite these concerns, there does seem to be some room for the effective implementation of surplus-and-loss sharing in stable, public corporations.

The fifth and final principle offered in the text aims to address how the corporation can be run in order to achieve the other four principles. It states:

> *Participatory, democratic corporate governance is the best way to ensure the sustainable creation and equitable distribution of corporate wealth.*[49]

As mentioned, Greenfield proposes a board whose members have a duty to represent all stakeholders despite being voted in by separate constituencies. Power would be delegated to the board to allocate surpluses with a goal of convincing the team members to stay with the company:

> What I am imagining here is, in an ironic sense, a genuine realization of the 'nexus of contracts' view of the firm. If the firm is best seen as a microcosm of the market, then let us be honest about recognizing all contracts by putting the most important market participants in a position where they can be heard at the decision-making level of the firm.[50]

[49] GREENFIELD, *supra*, note 1, 146.

[50] *Id.*,150.

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While the issues of board opportunism and decision-making efficiency have already been mentioned above, this statement triggers other concerns. The first is that a genuine realization of the nexus of contracts view brings concerns about party bargaining power and the entrenchment of market power back to the fore, although giving each board member a fiduciary duty to all stakeholders will mitigate this extensively. The second is that this creates a good deal of responsibility for board members that may not always be up to the task. First, as Mace illustrated in 1971, directors are actually far less active in governing than what might be expected.[51] And while much legislation has been passed since then – the Sarbanes-Oxley Act, for example – it is doubtful that the problem has fully been resolved.[52]

F. Conclusion

While Greenfield considers the statement "that corporate law matters" to be audacious, Kent Greenfield has managed to make that claim seem anything but audacious. Describing numerous flaws in the current governance system – only some of which were recounted here – has made it clear that it is seriously flawed to rely on narrowly constructed, contract-based theories that allow shareholders to dominant the corporate environment. And while there are some concerns about the possibilities that Greenfield himself puts forth, there is enough of value to consider this book to be the next step in the evolution of multiple corporate law discourses. Corporate legal scholarship certainly offers a range of possibilities beyond the shareholder and stakeholder models discussed in *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities*. Thus, to paraphrase Greenfield himself, for most people honestly wrestling with issues of corporate governance, shareholder and stakeholder models should be seen as amongst many potential conclusions – not the foundational assumption.[53]

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[51] Myles L. Mace, *Directors: Myth and Reality – Ten Years Later*, 32 RUTGERS LAW REVIEW 293 (1979).

[52] MARY G. CONDON, ANITA I. ANAND & JANIS P. SARRA, SECURITIES LAW IN CANADA: CASES AND COMMENTARY (2005).

[53] See, *supra,* note 1 at 127.

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