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NEW DIRECTIONS IN CORPORATE LAW

COMMUNITARIANS, CONTRACTARIANS, AND THE CRISIS IN CORPORATE LAW

DAVID MILLON*

I. CRISIS

At a recent corporate law conference, I found myself seated beside a young professor from one of the leading east coast law schools.¹ Referring to the brochure advertising our symposium on "New Directions in Corporate Law," which he had received in the mail, he recalled his surprise—and incredulity—at the asserted existence of a "crisis in corporate law." He related that he had puzzled over this for a while and finally turned to a faculty colleague for enlightenment. That person could not identify any crisis either. So, one may ask, is there really a crisis in corporate law, or, instead, is the title of this essay just a misleading marketing ploy?

We *are* in the midst of a crisis. It is a crisis of uncertainty over corporate law's normative foundations. For much of this century, at least

* Associate Professor of Law, Washington and Lee University. A greatly abbreviated version of this essay was presented orally at the New Directions in Corporate Law symposium held at Washington and Lee University on November 5, 1993. For their comments and suggestions on an earlier draft of the full text of this essay, the author is grateful to Lyman Johnson, Bill Bratton, Denis Brion, Larry Mitchell, and Marleen O'Connor. There was some talk at the symposium of a "Washington and Lee school of corporate law." In light of those remarks, it is even more than usually incumbent on me to disclaim any intentions to speak in this essay on behalf of anyone except myself.

1. This conference, on the American Law Institute's *Principles of Corporate Governance*, was held at the Benjamin N. Cardozo School of Law on October 15, 1993. The conference centered on presentations of papers published in a symposium issue of the *George Washington Law Review* (see 61 GEO. WASH. L. REV. 871 (1993)), followed by brief remarks by commentators.

since the publication of Berle and Means' classic in 1932,² the orthodox assumption has been that corporate law's objective is to develop legal structures that will maximize shareholder wealth. This shareholder primacy vision of corporate law therefore disregards claims of various nonshareholder constituencies (including employees, creditors, customers, suppliers, and communities in which firms operate) whose interests may be adversely affected by managerial pursuit of shareholder welfare. Managerial accountability to shareholders is corporate law's central problem. Nonshareholder interests, if entitled to any legal protection at all, are for other, noncorporate law legal regimes.

To say that shareholder primacy has been corporate law's governing norm is not to say that corporate law has succeeded to everyone's satisfaction in achieving its shareholder welfare objective. To the contrary, the ongoing theme in corporate law discourse has been the need to increase the accountability of management to the corporation's shareholders. Berle and Means articulated this concern in their book, identifying the separation between ownership and control as the source of the accountability problem. A complete solution has proved elusive. For one thing, as economic theorists have pointed out, the costs of delegation of managerial authority—so-called agency costs—can never be eliminated entirely because at some point the marginal costs of remedial measures exceed the marginal benefits.³ More importantly, legal doctrine has displayed a certain degree of ambivalence on the accountability question. As with any difficult public policy problem, there are countervailing considerations. Deference to managerial discretion has been thought to have a value of its own, if for no other reason than the recognition that courts, staffed by lawyers rather than professional managers and sitting in an *ex post* posture, lack the expertise to make sound judgments about business policy.⁴ In addition, corporate law has always understood—though usually only dimly—that truly relentless pursuit of shareholder wealth maximization is inconsistent with actual business practice and socially unacceptable in any event.⁵ Even as these considerations have mitigated against a wholehog commitment to shareholder wealth maximization, it is still clear that shareholder primacy has served as corporate law's governing norm for much of this century. It is otherwise impossible to understand corporate law's basic doctrinal structures (for example, shareholder voting rights and directors' fiduciary duties to shareholders) as well as its academic discourse.⁶

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

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

4. This idea underlies the business judgment rule, which, of course, has the practical effect of diluting managerial accountability to shareholders.

5. For example, this ambivalence is reflected in corporate law's statutory endorsement of modest charitable giving. See, e.g., DEL. CODE ANN. tit. 8, § 122(9) (1974) (1991 rep. vol.).

6. For example, the antimanagerialist critiques of scholars like Professors Cary, Brudney,

The hostile takeover explosion of the 1980s initially held out the promise of a final resolution of the accountability problem. An active market for corporate control would create a mechanism for managerial discipline far more formidable than the lax constraints of the voting rights and fiduciary duty systems. The beauty of the hostile tender offer, of course, was that it allowed the bidder to do an end run around target company management, appealing directly to the shareholders with the enticement of a hefty premium over current stock market price. The specter of a hostile tender offer would prompt underperforming managers to do better; those who failed would be replaced. Either way, shareholders would benefit.

The case for an unrestricted market for corporate control rested on the traditional shareholder primacy principle.⁷ But now the claims of shareholders were being pressed in a new context, one that presented difficult, politically troubling implications not previously encountered. In particular, there arose a widespread perception that, however beneficial they might be for shareholders, hostile takeovers imposed extensive, uncompensated costs on various nonshareholder constituencies. Workers lost jobs and other business relationships were disrupted, and local communities suffered further ripple effects, sometimes severe, from plant closings. State courts therefore refused to go along with the shareholder primacy agenda in this setting and validated resistance by target company managers, at least under certain circumstances.⁸ And, as if that were not enough, state legislatures enacted statutes that effectively insulated corporations from control transactions not approved by target management.⁹

Hostile takeovers, which seemed to promise so much for shareholders, ended up raising serious doubts about the shareholder primacy norm that was their strongest justification. Recent developments underscore this phenomenon. At last count, thirty states have passed statutes that allow management to consider enumerated nonshareholder interests (in addition

and Eisenberg as well as the "corporate social responsibility" arguments of the 1970s rest on an underlying assumption that shareholder welfare is corporate law's primary value.

7. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981). The inspirational antecedent was Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

8. See, e.g., *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985); *TW Services, Inc. v. SWT Acquisition Corp.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334 (Del. Ch. Mar. 2, 1989). For a discussion of the Delaware judiciary's vacillating commitment to shareholder primacy, see Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865 (1990).

9. See generally Lyman Johnson & David Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846 (1989). At the same time, Congress refused to intervene on behalf of shareholders, despite repeated requests to do so.

to those of shareholders) in corporate decisionmaking.¹⁰ These new directors' duty statutes typically are not limited to the takeover context.¹¹ Equally noteworthy are the Chancery and Supreme Court opinions in the *Time* case.¹² Despite an offer from Paramount that was clearly attractive to Time's shareholders, the Delaware courts allowed Time's management to pursue an alternative designed to preserve the integrity of the corporate enterprise. Read generously, *Time* suggests that management may disregard shareholder preferences for the sake of competing nonshareholder considerations. Today, hostile takeovers, though not extinct (witness the recent battle for Paramount itself), are rare.¹³ Nevertheless, the underlying question of the appropriate balance among shareholder and nonshareholder interests—which had lain largely dormant within corporate law for so long—retains its urgency (especially as institutional investors increasingly press their claims for heightened managerial diligence),¹⁴ and can no longer be resolved by a facile bow in the direction of shareholder primacy. For significant numbers of businesspeople, lawmakers, and academics, that response is insufficient. In these quarters, management ought to be empowered—and perhaps required—to take the interests of nonshareholders into account.

The upshot of all this is that the longstanding shareholder primacy norm is on very shaky ground. Nevertheless, the advocates for shareholder interests have not abandoned the field. They have returned to the fray, reinvigorated by recent developments in the corporate world. In particular, institutional shareholders are flexing their considerable muscles, bringing to bear public and behind-the-scenes pressure on the companies whose stock they increasingly control.¹⁵ The Securities and Exchange Commission, pursuing its usual single constituency agenda, recently revised its proxy rules to encourage institutional shareholder activism,¹⁶ and academic partisans are

10. See generally David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223 (1991).

11. *Id.* at 246.

12. *Paramount Communications, Inc. v. Time Inc.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. 1989), *aff'd*, 571 A.2d 1140 (Del. 1990). For discussion, see Lyman Johnson & David Millon, *The Case Beyond Time*, 45 BUS. LAW. 2105 (1990); David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 251-61.

13. The recent Delaware decisions involving QVC's hostile bid for Paramount seem to be limited to the special case of a voluntary transfer of control to a merger partner controlled by a single person. Such transfers, the courts have held, generate a *Revlon* auction duty. See *Paramount Communications Inc. v. QVC Network Inc.*, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,000 (Del. 1993).

14. See *infra* text accompanying notes 15-17.

15. See ROBERT A.G. MONKS & NELL MINOW, *POWER AND ACCOUNTABILITY* 230-38 (1991); Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 570-75 (1990); John Pound, *Beyond Takeovers: Politics Comes to Corporate Control*, HARV. BUS. REV., Mar.-Apr. 1992, at 83; Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 478-90 (1991).

16. Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,051 (Oct. 16, 1992).

advocating further reform.¹⁷ All of this is aimed at making it easier for institutional investors to play an active role in corporate governance. In contrast to the small individual investor, for whom passivity is rational, these large, illiquid ownership stakes provide the incentives as well as the means to get involved. The possibility of effective shareholder control seems to promise a revolution in corporate governance no less startling than the emergence into plain view of nonshareholder considerations. By closing the separation between ownership and control, the accountability problem may be solved once and for all.

Here then is our crisis. An exuberant, apparently realizable pro-shareholder agenda seeks to breathe new life into the shareholder primacy ideal and generates ardent support. Elsewhere, advocates of nonshareholder interests press competing claims that are being taken seriously. In these circles, the shareholder primacy model has exhausted its usefulness. These two positions point in opposite directions.¹⁸ Each commands substantial respect, in law schools and in the "real world." These differences ultimately rest on strongly conflicting political visions of the appropriate foundations of corporate law. When these visions are exposed, the depth of the disagreement is readily understandable. The rift is deep and likely to persist.

II. CONTRACTARIANS AND COMMUNITARIANS

A. Legal Theory

Today's advocates of the shareholder primacy position—including the current focus on institutional investor activism—rely on a "contractarian," antiregulatory, individualistic stance.¹⁹ Proponents argue against corporate

17. See, e.g., Bernard S. Black, *Next Steps in Proxy Reform*, 18 J. CORP. L. 1 (1992). Professor Black also argues that further federal securities law reforms, beyond revision of the proxy rules, would further facilitate institutional investor activism. See Bernard S. Black, *Next Steps in Corporate Governance Reform: 13(d) Rules and Control Person Liability*, in MODERNIZING U.S. SECURITIES REGULATION: ECONOMIC AND LEGAL PERSPECTIVES 225 (Kenneth Lehn & Robert Kamphuis, Jr. eds., 1992). For a cautionary perspective on institutional investor power, see Allen D. Boyer, *Activist Shareholders, Corporate Directors, and Institutional Investment: Some Lessons from the Robber Barons*, 50 WASH. & LEE L. REV. 977 (1993) (noting potential for abuse when corporate ownership and control are joined).

18. Although they seem to oppose each other in the current American context, the conflict between activist, self-interested institutional share ownership and responsiveness to nonshareholder interests is not necessarily wholly irresolvable. In Germany, for example, large banks own substantial blocks in major corporations, but the legal and business cultures seem more accommodating toward worker interests. A similar point might be made about Japan. In other words, the politics of corporate governance questions are more or less context-specific. Marleen O'Connor reminded me of this point.

19. The leading academic proponents of the contractarian view have been Judge Frank Easterbrook and Professor Daniel Fischel. See generally FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991). For a concise overview, see Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON L. REV. 100 (1989). For critical appraisal, see William W. Bratton, Jr., *The New Economic Theory of*

law rules that mandate or inhibit particular governance relationships. They would instead leave it up to the various participants in corporate activity to specify their respective rights and obligations through contract. According to this view, state corporate law provides the terms of the contract by which shareholders purchase management's undivided loyalty to their welfare. The key term is management's fiduciary duty to direct the corporation so as to maximize shareholder wealth. This mandate must necessarily be general and open-ended, because detailed *ex ante* specification of how management should act in running the business is simply not realistically possible. In contrast, to the extent that management's pursuit of shareholder welfare threatens nonshareholder interests, workers, creditors, and other affected nonshareholders are free to bargain with shareholders (through their agents) for whatever protections they are willing to pay for. This view assumes that feasible (that is, not excessively costly) contracting strategies exist for correction of the harmful external effects of shareholder/management activity and, perhaps, that such effects are relatively uncommon. The contractarian view thus rests on a descriptive assessment of current possibilities, as well as a normative vision of the limited role that law should play in relation to individual economic activity.

In contrast to contractarians, "communitarians"²⁰ more readily look to legal rules to structure relations among the corporation's diverse constituent groups, believing that corporate law must confront the harmful effects on nonshareholder constituencies of managerial pursuit of shareholder wealth

the Firm: Critical Perspectives from History, 41 STAN. L. REV. 1471 (1989); William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989). Contractarians differ among themselves as to the appropriate level of legal regulation indicated by a contractarian premise. Some, like Easterbrook and Fischel, would tolerate a relatively substantial body of mandatory rules in order to counteract market failure. For discussion of this point, see William W. Bratton, Jr., *The Economic Structure of the Post-Contractual Corporation*, 87 NW. L. REV. 180, 191-97 (1992). Others, in contrast, appear to be opposed to any sort of regulation that interferes with private ordering through contract. See, e.g., Larry E. Ribstein, *The Mandatory Nature of the ALI Code*, 61 GEO. WASH. L. REV. 984 (1993).

It should be noted that contractarianism as a general approach to political theory may have quite different normative implications from those of its current corporate law variant. In the hands of Rawls, for example, contractarianism can yield arguments that resonate strongly with the rights-based views of corporate law communitarians. For an overview of contractarianism as an approach to political theory, see Kim L. Scheppelle & Jeremy Waldron, *Contractarian Methods in Political and Legal Evaluation*, 3 YALE J.L. & HUMANITIES 195 (1991).

20. This term has been used to characterize those of us who are critical of the contractarian position. See Michael E. DeBow & Dwight R. Lee, *Shareholders, Nonshareholders and Corporate Law: Communitarianism and Resource Allocation*, 18 DEL. J. CORP. L. 393 (1993). In accepting the characterization, I would emphasize that antiliberal connotations are not intended. In other words, for reasons that I hope emerge clearly below, it is possible to retain a commitment to the moral value of individual autonomy and choice while nevertheless rejecting the market as a sufficient solution to all social problems.

For a bibliography of recent corporate law scholarship in a communitarian vein, see *infra* bibliography accompanying note 47.

maximization. For example, a plant closing may serve the interests of shareholders while imposing substantial uncompensated costs on laid-off workers and on a local community that has made infrastructure investments in the expectation of a continued corporate presence. Or, bondholders may find themselves holding riskier investments due to corporate releveraging. Communitarians are skeptical about the practical efficacy of contract as a mechanism by which nonshareholders can protect themselves *ex ante* from these sorts of harmful effects. Particular kinds of harmful conduct may be difficult for nonshareholders to foresee and specify adequately, because of management's informational advantages and also because of the endless change and innovation in corporate activity that a market economy demands. Coordination of bargaining efforts among similarly situated nonshareholder constituencies may also present costly practical difficulties. Accordingly, one way in which communitarians differ from contractarians is in their greater willingness to use legal intervention to overcome the transaction costs and market failures that impede self-protection through contract.

Communitarians also differ from contractarians in emphasizing the broad social effects of corporate activity. Contractarians tend to focus on the corporation's internal relationships, applying a cost-benefit analysis to a relatively narrow range of more or less readily monetizable interests. Communitarians see corporations as more than just agglomerations of private contracts; they are powerful institutions whose conduct has substantial public implications. Thus, for example, assessing the cost of the reorganization of a corporation like Time is not just a matter of adding up possible costs in worker layoffs and potential gains to Time shareholders. It is also necessary to take into account the general public's possible interest in the various publications' continued editorial independence.²¹ Even within the corporation's boundaries, communitarians tend to understand social cost more capaciously. For example, the laid-off worker who is able to find a replacement job at the same wage may nevertheless suffer from a sense of insecurity that was not there previously. So too may the worker who escaped layoff. Contractarians tend to disregard less readily measurable morale costs like these in making their welfare calculations.²² Greater sensitivity to the social costs of shareholder wealth maximization further encourages com-

21. Of course, there is room for disagreement over the value of Time's products, but this was the point of the "Time Culture" argument made in the litigation over Paramount's unsuccessful takeover attempt. See Millon, *supra* note 12, at 256-57.

22. Similarly, the cost of a lost job in one place would not necessarily be offset by a new employment opportunity for someone else in another locality. Compare Professor Macey's argument that nonshareholder losses need not be factored in when assessing the welfare implications of a hostile takeover. Even in those cases (rare in his opinion) in which jobs are lost in one locality, workers elsewhere will find new employment, so "overall national employment is unaffected." See Jonathan R. Macey, *State Anti-Takeover Legislation and the National Economy*, 1988 Wis. L. Rev. 467, 478-79. Even if this assertion were true, it fails to take into account the possibility that the welfare loss might still be greater than the gain, depending on the relative values of the jobs in question. It also ignores the various negative effects on worker morale of heightened insecurity generated by an unstable economy.

munitarians to regard regulation in the public interest as appropriate. Problems appear much larger, and contract all the more ineffective as a practical solution. From this perspective, the contractarian view of the corporation has too narrow a focus, and its response to the problem of social cost is far too simplistic.

Despite the typical hostility of the contractarian stance toward claims of nonshareholders for legal protection, it should be noted that a contract-based approach to the definition of entitlements can be used to generate progressive (that is, nonshareholder protection) arguments. Legal scholars have recently drawn on research by labor economists that models expectations of deferred compensation and long-term employment as implicit understandings in actual labor contracts.²³ Although such understandings are unenforceable under current contract doctrine, they provide a theoretical foundation for otherwise vaguely grounded assertions of a right to job security. For progressive contractarians, these understandings could be enforced judicially or might be incorporated into a reconstituted conception of management's fiduciary obligations. However, the strength of this approach—its foundation in actual contracting practices and understandings—is also its weakness. Management can readily preclude claims of reliance on implicit understandings, by means of explicit disclaimer in an employee handbook, for example.²⁴ Further, the economists' elegant "life cycle earnings" model²⁵ translates imperfectly at best into a sufficiently determinate legal standard for particular cases. Judicial sympathy more than anything else may determine outcomes. In any event, the disparities in bargaining power that workers bring with them to the labor market shape the outcomes of the bargaining process. Contract-based approaches to nonshareholder protection therefore take for granted the existing distribution of wealth. As a vehicle for nonshareholder protection, the value of progressive contractarianism must ultimately turn on an assessment of the efficacy of bargaining as a means for self-protection. As discussed below, it is not at all clear why protection ought to depend entirely on bargaining power.²⁶ From a

23. See Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189 (1991); Katherine Van Wezel Stone, *Employees as Stakeholders Under State Nonshareholder Constituency Statutes*, 21 STETSON L. REV. 45 (1991). Professor Coffee previously used implicit contract analysis to make a case for legal protection of mid-level managerial employees. John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1 (1986).

24. The same strategy could also be used to defeat reliance-based arguments that do not depend on implicit labor contract analysis. For one such argument, see Joseph W. Singer, *The Reliance Interest in Property*, 40 STAN. L. REV. 614 (1988).

25. See Stone, *supra* note 23, at 50 (including graph showing relationship over time among actual wage, opportunity wage, and value of marginal product).

26. Professor Daniels' alternative progressive contractarian approach—that would ground protection on hypothetical rather than implicit contract—is superior to the latter in attempting to move beyond actual bargain to intervention based on fairness grounds. See Ronald Daniels, *Stakeholders and Takeovers: Can Contractarianism Be Compassionate?*, 43 U. TOR. L.J. 315

communitarian perspective, even these well-intentioned contractarian arguments are problematic.²⁷

Communitarian skepticism about the efficacy of contract is not all-encompassing, however. Just as a contractarian perspective can be turned to progressive ends, it should also be clear that a communitarian stance in corporate law does not result in a monolithic approach to concrete issues. Communitarians may disagree among themselves about the strength of claims of certain nonshareholder constituencies for legal intervention. For example, some might accept arguments to the effect that bondholders can effectively take care of themselves.²⁸ In other words, one can recognize that legal protections may be needed in some settings but not others. Having said that, however, what does set communitarians apart from contractarians is the communitarians' strong skepticism toward the baseline presumption that contract alone should specify the terms of corporate governance relationships.

B. Ideological Differences

So far, the dispute between contractarians and communitarians (and also the differences within each camp) may appear to be nothing more than

(1993). However, as with the implicit contract approach, such efforts can be defeated ex ante by management disclaimer, and the almost total lack of substantive content of this approach leaves nonshareholders even more at the mercy of judicial good will. As an effort to use the rhetoric of consent to avoid the messy political choices and value judgments that communitarianism acknowledges to be unavoidable, a hypothetical contract approach tries to have it both ways but seems doomed to failure.

27. Some might object that the dichotomy between communitarians and progressive contractarians is too starkly stated. It is not always easy to say whether particular scholars advocating various sorts of legal protections for nonshareholders come to their position from a communitarian angle or from what I have termed a progressive contractarian one. This is because even arguments for legal intervention couched in terms of "fairness" (rather than efficiency) often seem to rest on claims about actual expectations (even if only implicit) existing in bargained-for relationships. See, e.g., Singer, *supra* note 24. Likewise, arguments couched in terms of contract may actually be about fairness in a noncontractual sense. See Daniels, *supra* note 26. In other words, questions of entitlement often tend to get talked about in terms of bargain, rather than in terms of rights that exist prior to actual market relationships. Even so, I still think it is useful to focus attention on the extent to which contract and consent (even if only implicit or hypothetical) are deemed to be the sole determinant of rights and duties. Communitarians may occasionally seem to talk the language of contract for reasons of convenience or habit, or because current legal scholarship lacks a widely accepted vocabulary for discussion of non-contractarian sources of rights. Or, as discussed below, communitarians may deem contract sufficient in some settings, but refuse to accept it as a totalizing positive or normative model for all social relations. I discuss this deeper-level division at greater length below.

28. Professor Bratton concedes that bondholder rights should be a creature of contract but argues that courts should interpret contract terms generously. See William W. Bratton, Jr., *Corporate Debt Relationships: Legal Theory in a Time of Restructuring*, 1989 DUKE L.J. 92; William W. Bratton, Jr., *The Interpretation of Contracts Governing Corporate Debt Relationships*, 5 CARDOZO L. REV. 371 (1984); see also Morey W. McDaniel, *Bondholders and Stockholders*, 13 J. CORP. L. 205 (1988). For a forthrightly communitarian approach to bondholder protection, see Lawrence E. Mitchell, *The Fairness Rights of Corporate Bondholders*, 65 N.Y.U. L. REV. 1165 (1990).

a fairly technical dispute over the pervasiveness of externalities and the efficacy of the market as a means for achieving efficient outcomes despite transaction costs. One might interpret the communitarian critique as nothing more than a rejection of the contractarians' normative position (antiregulation) on the ground that their positive premise (that contract is generally a sufficient vehicle for nonshareholder protection) is invalid. However, I think the debate actually rests on a much more fundamental disagreement. What is at stake is a profound difference in normative world view. This ideological difference defines the basic divide between communitarians and contractarians. It explains why corporate law communitarians and contractarians typically seem unable to take each other seriously.

In roughly sketching these contrasting perspectives, I want to emphasize that I am trying to describe sharply differing ideological predispositions rather than a rigid set of beliefs subscribed to by every contractarian or communitarian. The risk is useless caricature. The hope is that the effort may help partisans of both camps to see more clearly the typically unarticulated normative assumptions that underlie the current corporate law crisis.

Contractarians start from the presumption that people ought to be free to make their own choices about how to live their lives (subject to an overriding duty not to harm others). Legal rules that redistribute wealth, mandate particular forms of behavior, or prevent people from making bargains they would otherwise choose to make are presumptively objectionable because they interfere with people's ability to live their own lives according to their own preferences, structuring their relationships with others and defining their duties toward them by means of consent.²⁹ This idea focuses on the individual as an autonomous being and is based on a particular vision of human liberty as freedom from external, unconsented-to restraint. Contractarians are willing to admit the legitimacy of certain mandatory rules, but such restraints on individual liberty must themselves be justified in terms of the liberty interests of those who may be harmed by the conduct restrained.

Communitarians approach these questions from a different perspective. Their view of society contrasts sharply with the contractarians' animating vision, emphasizing the social arena in which individual activity occurs. Simply by virtue of membership in a shared community, individuals owe obligations to each other that exist independently of contract. We are born into civil society and thereby inherit the benefits of life in a community. The value of those benefits depends in large part on the quality of the social environment. That in turn is determined by the behavior of one's fellow citizens, which is largely a matter of their values and goals. If we are to discharge our obligation to preserve and strengthen the social fabric that is our heritage, we cannot ignore those aspects of the material and cultural landscape that shape those values and goals. Acknowledging our interdependence, we must recognize our responsibility for the quality of the

29. See MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* (1962).

lives of all community members. The state acts appropriately when it enforces such duties.³⁰

State action of this sort necessarily involves restrictions on freedom. Nevertheless, the communitarian idea is also based on a vision of liberty, but it is one that includes a positive component.³¹ Liberty is empty without taking into account those primary needs upon which adequate conceptions of individual dignity and human flourishing depend. Basic physical comforts, facilities for intellectual and emotional growth, and enriching social environments are necessary if individuals are to have meaningful opportunities to define and pursue their own life-plans and to participate with civility in a community of interdependence. Many communitarians, including the corporate law communitarians referred to in this essay, share the contractarians' commitment to individual autonomy and choice as foundational moral values, but they insist that meaningful choice requires a social framework that cannot itself be constructed entirely out of private, bilateral transactions. The market alone cannot adequately fulfill basic human needs for everyone because many people lack the resources to participate effectively in the market.³² Insistence on the market's sufficiency for the sake of individual liberty therefore ignores those civic obligations that flow from the social aspect of human existence. To communitarians, life chances should not depend entirely on accidents of birth and bargaining power: people are entitled to more out of life than what they can pay for.

C. *Defining the Scope of Shareholder Property Rights*

In the corporate law context, contractarians characterize the debate as a disagreement over whether it is appropriate to use mandatory rules to impede shareholder wealth maximization in order to benefit other corporate constituent groups or other affected interests outside the corporate enterprise. For contractarians, such rules represent an unjust imposition on the liberty of shareholders to pursue their own interests. They have made this point by criticizing communitarian corporate law reform as the reallocation

30. One way to think about this contrast in perspective is the difference between some economists' tendency to dissolve all social institutions into nothing more than a tangle of selfishly motivated bilateral exchanges and sociologists' sensitivity to the complex, richly textured, cultural embeddedness of mutual responsibility. For a thoughtful discussion of this difference in worldview and its implications for corporate law, see Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215 (1992).

31. For a discussion of the distinction between negative and positive conceptions of liberty, see ISAIAH BERLIN, *Two Concepts of Liberty*, in *FOUR ESSAYS ON LIBERTY* 118 (1969). Compare Rawls' distinction between the value of equality of liberty for all and differences in the worth of liberty among various individuals depending upon their life circumstances. JOHN RAWLS, *A THEORY OF JUSTICE* 204-05 (1971).

32. Accordingly, an individual's failure to succeed in the market does not necessarily absolve the rest of society from regard for that person. In other words, communitarians reject the Social Darwinist notion that failure is a matter of desert, and societal disregard justified by larger social values.

or transfer of wealth from shareholders to nonshareholders.³³ The wealth reallocation assertion rests on the fact that, under current corporate law, shareholders are for the most part entitled to pursue their own financial advantages without regard for possible harms to nonshareholders, unless they have agreed to restrictions on that freedom. For example, unless workers have bargained and paid for relevant protections, they may be laid off should that serve the shareholders' interests. Bondholders are in a similar position with respect to corporate actions that increase the riskiness of their investments. Restrictions on shareholder freedom that have not been bargained for by their beneficiaries thus devalue shareholder property rights unjustly.

An alternative legal regime might assign entitlements to nonshareholders rather than shareholders, requiring that shareholders bargain and pay for the right to harm nonshareholders under defined circumstances. Contractarians write as if changing corporate law so as to recognize such entitlements would be obviously illegitimate. Yet surprisingly little effort is made to defend the current entitlement regime. The claim that shareholders should continue to enjoy a property right to harm nonshareholders incidentally to their pursuit of profit maximization seems at times to rest on nothing more than a reflexive commitment to the status quo.³⁴

More seriously, one might argue that shareholders should enjoy this right because they value it more highly than nonshareholders would value a property right not to be harmed.³⁵ One response is to question the validity of the factual assertion. Many nonshareholders lose far more from shareholder exploitation of nonshareholder vulnerability than would shareholders if such opportunities were impeded. If an entitlement were with nonshareholders, shareholders would presumably sustain a somewhat lower rate of return on their investments (unless job security and other protections actually resulted in heightened productivity). In contrast, as long as the entitlement is with the shareholders, workers, for example, are vulnerable to the loss of their jobs and attendant human capital investments, to the prospect of potentially lengthy unemployment or inferior reemployment, and to the morale costs generated by insecurity. It seems reasonable to assume that workers would value *ex ante* protection more highly than would shareholders value a right to harm.³⁶

33. See, e.g., William J. Carney, *Does Defining Constituencies Matter?*, 59 U. CIN. L. REV. 385 (1990); Jonathan R. Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173; James J. Hanks, Jr., *Playing with Fire: Nonshareholder Constituency Statutes in the 1990s*, 21 STETSON L. REV. 97 (1991); DeBow & Lee, *supra* note 20.

34. As a legal argument, the objection to tampering with the status quo is weak in the corporate law context. Taking the cue from Justice Story's opinion in *Trustees of Dartmouth College v. Woodward*, 4 Wheat. 518 (1819), state corporate statutes routinely include provisions reserving the power of amendment and announcing their applicability to corporations formed prior to amendment. See, e.g., DEL. CODE ANN. tit. 8, § 394 (1974) (1991 rep. vol.).

35. For discussion of this general approach to the assignment of entitlements, see RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 445-47 (3d ed. 1986).

36. One might question whether the entitlement assignment question has any practical

Even if the current entitlement assignment can be justified on efficiency grounds, communitarians find that justification insufficient. At best the market-based approach simply produces an outcome that registers existing inequalities of wealth and bargaining capability.³⁷ Nonshareholder protection from the costs associated with shareholder profit maximization is assumed to depend on relative willingness and ability to pay contractual guarantees. Should job security or compensation for abrupt layoff, for example, depend entirely on the ability to pay? The force of the market-based argument for the legal status quo rests ultimately on the legitimacy of the existing distributional context, an argument that contractarian corporate law scholars have not made.

Contractarians base their claim that communitarian corporate law threatens shareholders' property rights on the current but historically contingent property rights regime. To the extent contractarians justify this regime by reference to the market, communitarians respond by rejecting the view that the market should provide the answer to all questions about the assignment of legal entitlements. Again, under some circumstances, people are entitled to more than they can bargain for.³⁸

importance. If transaction costs were minimal, efficient outcomes would emerge either way. For example, if shareholders value a particular large-scale layoff more than the affected workers value retaining their jobs, the layoff would represent a more efficient allocation of resources than would continuation of the existing situation. Shareholders will either bring about the layoff, or, if the entitlement is with the workers, the shareholders will pay the workers an amount equal to or greater than the value of their jobs but less than the value to the shareholders of the layoff. See Ronald Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960). In real life of course, transaction costs often are significant; it is therefore possible that the workers in our example may value their jobs more than the shareholders value the layoff but, if the entitlement is with the shareholders, workers may nevertheless be vulnerable because of the practical difficulties involved in bargaining for protection. Further, regardless of efficiency considerations, assignment of the entitlement has important distributional implications. Assignment to shareholders puts the burden on nonshareholders to bargain and pay for any protections from shareholder harm. Security therefore depends on the ability to identify and specify in advance the kinds of protection that are needed and the circumstances under which they should apply—and on the ability to pay for them. Failure leaves nonshareholders vulnerable to shareholders to the full extent of the failure, because the default is allowance of shareholder wealth maximization regardless of harms to nonshareholders. In contrast, assignment to nonshareholders of a legal right to protection would require that shareholders bargain and pay for the opportunity to inflict losses on nonshareholders under the circumstances defined by the nonshareholders' property rights. Under one entitlement regime, nonshareholders must pay for whatever protections they are to enjoy, and bear the risk of incomplete specification; under the other, nonshareholders are entitled to compensation for harm regardless of bargain.

37. In fact, it seems possible that this approach actually exacerbates existing distributional inequalities. Transaction costs and other bargaining difficulties (such as the burden on nonshareholders to specify ex ante the parameters of protection) that impede nonshareholder self-protection facilitate corresponding gains for shareholders. Further, to the extent that nonshareholders can obtain protection, ignorance about the future may lead them to purchase protection that is broader than necessary. Overpayment increases existing wealth inequalities.

38. Ironically, assignment of the property right in question to shareholders on the ground that they would be willing to pay more for it than would nonshareholders gives shareholders the benefit of that imaginary bargain but relieves them of any duty actually to pay for it.

Communitarians await a persuasive argument for the proposition that the market alone should govern questions like the respective rights of shareholders and various nonshareholder constituencies in corporate governance matters. Contractarians often seem to assume that the burden is on the communitarians to justify an alternative approach to corporate law. Yet one could readily respond that it is the contractarians who ought to justify their insistence on a relentless commitment to market-defined outcomes. References to efficiency simply beg the underlying question of why efficiency should provide the sole normative criterion. As a society, we have not embraced the market as a totalizing model for the definition of rights and responsibilities. We have not even done that with respect to all of the questions that arise in the course of corporate pursuit of shareholder wealth. Those who see legal intervention in corporate governance relationships as unjust wealth reallocations should not assume that their notion of injustice is so obviously correct as to obviate any need for elaboration and justification.

The communitarian position with respect to nonshareholder entitlements thus does *not* rest on an essentially empirical disagreement over the extent of externalities and the technological feasibility of contractual protection. Communitarians reject the view that nonshareholder protections should be limited to those they can bargain for or would bargain for but for prohibitive transactions costs. (The refusal to accept actual bargaining capability as the relevant benchmark sets communitarians apart from progressive contractarians as well.) Communitarians are instead preoccupied with a different set of considerations. They seek to redefine the range of interests that corporate law should view as legitimately entitled to regard, and to develop legal mechanisms to protect those interests. For communitarians, justice does not require endorsement of the existing distribution of wealth and bargaining capability. They seek instead to reform corporate law so as to foster individual dignity and promote societal welfare.

III. COMMUNITARIAN APPROACHES TO CORPORATE LAW

No one is under any illusion that communitarian corporate law reform is an easy project. At the very least, communitarians will need to articulate why corporate law should not continue its focus on shareholder wealth maximization and leave protection of nonshareholder interests for other legal regimes (e.g., labor and employment law) with their own particular constituencies. However normatively deficient the contractarian defense of the traditional shareholder primacy model may be, at least that model has the virtue of a relatively narrow focus. One response would emphasize the corporation as the arena in which the various interests of shareholders and nonshareholders encounter each other. If one discards the view that bargaining is sufficient to mediate among those interests, reform of the rules structuring corporate governance presents an opportunity to develop rational, well-considered regulation of relations among shareholders and nonshareholders. Perhaps supplemented by public law interventions, this approach

seems preferable to a number of uncoordinated, ad hoc reform efforts, in various discrete areas of the law, that ignore the need for systematic balancing of shareholder and nonshareholder interests.

If corporate law is to move beyond exclusive concern for shareholders, some will seek to develop a new theoretical foundation upon which a new body of doctrine can be erected. Even those who are content to take a more local approach, focusing on particular, tangible problems rather than general abstractions of doubtful determinacy, must face difficult questions of fact and value. Questions like these are a far cry from the apparently elegant, assertedly scientific, and narrowly shareholder-centric assertions of the corporate law contractarians' economic approach. By moving corporate law away from its traditional focus on the shareholder/management accountability problem, the communitarian project openly addresses political questions and demands judgments that contractarians often seem to believe—incorrectly, of course—to be avoidable.³⁹ Contractarians too push a political vision. They simply do not bother to speak about it in those terms. If they do, they will encounter many of the same kinds of challenges now confronting the communitarians.

Those who say that communitarians have not yet articulated a fully developed alternative agenda are correct. Much of the effort over the past few years has been in the form of negative critique of shareholder primacy, particularly its radical manifestation during the hostile takeover controversy. Communitarians are now turning their attention toward a positive agenda, but so far their numbers are few and the project is still in its early days.⁴⁰ It is possible to discern some of the directions this project could continue to take in the years to come. One avenue that has already received attention is the use of corporate law to promote stable relations between certain nonshareholder constituencies and the corporation. Additionally, corporate law may have a role to play in the adjustment among shareholders and nonshareholders of gain-sharing. It might also attend to questions of fairness in the apportionment of transition costs as the economy moves through the

39. Thus, aside from their fundamental ideological differences, a further, perhaps equally fundamental, difference divides the two camps. Contractarians often seem psychologically predisposed against the kind of openly normative and political, and therefore unavoidably untidy and controversial, questions that communitarians insist must be addressed.

40. Even so, communitarians have generated concrete law reform proposals. For example, Professor O'Connor has argued for legal protections within the corporate law framework for employees. See Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899 (1993); O'Connor, *supra* note 23. Professor Mitchell has advocated protections for bondholders, and also more far-reaching governance reforms. See Lawrence E. Mitchell, *supra* note 23; Professor Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263 (1992). Professors Millon and Mitchell and Steve Wallman have suggested interpretive strategies for the new directors' duty statutes. See David Millon, *supra* note 10; Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1992); Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163 (1991).

jarring transformations ahead. As it does in Europe, corporate law might facilitate participation in decisionmaking by those most directly affected by particular kinds of decisions. Employee ownership structures are yet a further possibility.

To date, much communitarian law reform scholarship has focused on a "multifiduciary" model, according to which management's duty is redefined to embrace nonshareholder as well as shareholder interests. This work has sought to suggest ways in which the otherwise frustratingly vague directors' duty statutes might be interpreted so as to serve communitarian ends.⁴¹ However, no one has suggested that the multifiduciary model provides a complete reform package. While this model may seem to be gaining broad support among communitarians and others, it is important to appreciate that it is not the only—or necessarily the best⁴²—available alternative. Some wish to explore a different approach, one based on democracy and self-governance rather than paternalism and dependence implicit in a fiduciary model.

The ideological and psychological predispositions that turn many corporate law scholars away from these kinds of inquiries explain the inability of at least some contractarians to acknowledge the existence of a crisis in corporate law.⁴³ Like voting rights and derivative suit enforcement of fiduciary duties before them, takeovers failed to provide shareholders with salvation from managerial irresponsibility. Now attention turns hopefully to institutional investors, and doctrinal tinkering with the shareholder primacy model proceeds apace. From this perspective, corporate law is an

41. See Millon, *supra* note 10; Mitchell, *Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, *supra* note 40; O'Connor, *supra* note 23; Wallman, *supra* note 40.

42. Critics repeatedly point to the accountability (or agency cost) problems that this model replicates and perhaps exacerbates. There may be something to be said for these arguments, though one communitarian response might be that agency costs are part of the price to be paid for communitarian benefits.

43. For example, a recent collection of articles intended for use as a supplement to standard corporate law casebooks ambitiously claims to reveal "the foundations of corporate law" but contains nothing but articles by neoclassically-oriented economists and more-or-less doctrinaire contractarian law professors employed at elite law schools. The book ignores entirely the scholarship of the communitarians (or the progressive contractarians), as well as the larger political controversy over corporate law's appropriate objectives that is currently taking place. See *THE FOUNDATIONS OF CORPORATE LAW* (Roberta Romano ed., 1993). It is not hard to see why elite law school professors for the most part consciously ignore the evidence (in the form of judicial and legislative developments and academic scholarship that reject shareholder primacy) of a crisis in corporate law. Elite law school academicians look to each other for professional esteem, rather than to others outside their circle. These scholars all take shareholder primacy more or less for granted, and most of them appear to be more or less wedded to the political value judgments that underlie the neoclassical economic approach (i.e., contractarian) to corporate law. In this environment, one does not score points with the people who count by paying attention to scholarship produced by outsiders, let alone by using one's time to engage it. The opportunity cost of doing so would be neglect of the problems that have been identified as worthy of serious attention. Currently at the top of that list is institutional shareholder activism in its various dimensions.

ongoing quest for the holy grail of shareholder wealth maximization. Like Mr. Micawber, hope springs eternal that, if only we are patient and look hard enough, "something will turn up." The communitarians' belief that corporate law might be used to improve the quality of people's lives beyond what they can bargain for seems irrelevant to the contractarian task at hand. Efforts by legislatures and courts to move away from the old shareholder primacy orthodoxy are assumed to be the product of political expediency rather than a broadly based, self-conscious rejection of the legal economists' attempts to justify an extreme antiregulatory shareholder primacy regime. Recent challenges to shareholder primacy appear to be no different from the short-lived "corporate social responsibility" debate of the early 1970s, which left no lasting impact on corporate law. There is no crisis, just some minor perturbations that have, at best (or worst), only temporarily sidetracked corporate law from its shareholder-centered orbit. The endless quest—endless both because no legal solution is ever perfect and also because our society never has committed itself, and never will, to relentless shareholder wealth maximization and its attendant social costs—to solve the shareholder/management accountability problem continues as if nothing really new has happened.

One should not interpret the contractarians' parochial indifference toward recent communitarian developments as indicating their genuine triviality. The shareholder primacy model continues to command respect, especially among mainstream academicians and self-proclaimed "shareholders' rights" advocates, but the search for communitarian alternatives enjoys broad support in political as well as academic arenas. Neither position is on the verge of imminent triumph over the other. And, given the depth of disagreement, it should come as no surprise that no realistic possibility of compromise has yet emerged. For too many people, the traditional shareholder primacy model has outlived its utility and now threatens important values. The crisis is here, and we should expect it to continue.

In light of the magnitude of the task confronting the communitarians, attention to traditional legal sources, however necessary, is unlikely to provide sufficient creative inspiration. Just as the defenders of shareholder primacy have successfully turned to neoclassical economics and finance theory, so too communitarians may benefit from interdisciplinary inquiry. The threshold task of calling for that broader view is the occasion for this symposium. As legal academicians engaged in normative discourse, we will always have much to learn from our colleagues in the humanities and social sciences. This conference brings together a number of corporate law scholars—mostly, though by no means exclusively, of communitarian bent—to consider the thoughts of three nonlawyers on various aspects of corporate law and activity. We chose three people whose recent work led us to believe they might have something interesting to say to corporate law academicians: Alan Wolfe has investigated moral obligation from a sociological perspective, with brilliant results,⁴⁴ Karen Newman is engaged in exciting empirical

44. ALAN WOLFE, *WHOSE KEEPER? SOCIAL SCIENCE AND MORAL OBLIGATION* (1989).

research into justice in the workplace,⁴⁵ and Ronald Green turns his philosopher's eye to questions of business ethics in a new and innovative textbook.⁴⁶ Our hope is that these encounters will spark fruitful ideas about the future of corporate law. And perhaps the nonlawyers will return to their disciplines stimulated to pursue avenues of inquiry they otherwise might not have considered. Corporate law is currently in the midst of crisis, because of the exhaustion of the shareholder primacy model. How we articulate the nature of that crisis, and the breadth of vision with which we seek alternative approaches, will help to shape the resolution that will eventually emerge. The direction that resolution takes is terrifically important. This symposium seeks to make a contribution to that process.

45. Karen L. Newman [Gaertner], *The Effect of Ethical Climate on Managers' Decisions*, in *MORALITY, RATIONALITY, AND EFFICIENCY* (R.M. Coughlin ed., 1991).

46. RONALD M. GREEN, *THE ETHICAL MANAGER* (1994).

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