Washington and Lee Law Review

Volume 50 | Issue 4 Article 3

Fall 9-1-1993

Contracts And Communities In Corporation Law

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CONTRACTS AND COMMUNITIES IN CORPORATION LAW*

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Every general field of law embraces materials from which analysis can unearth the deepest questions that our social life recurringly presents to us. In some fields of law such questions lie near the surface, barely disguised by legal terminology and procedure. Most clearly, this is the case with the field of constitutional law, in which contests between claims of individual autonomy and claims of community are commonplace.[1] But it is hardly less true of criminal law, with its basic questions of culpability and punishment, or of tort law[2] or contract.[3] Other fields of law—one thinks of the various fields of commercial law, of intellectual property, or of taxation—appear or are more technical, more narrowly "legal." In such fields, legal problems may seem less pregnant with potentialities and answers may seem, and thankfully sometimes are, less controversial. It is easy in such fields to lose sight of—indeed it may sometimes be difficult to ever catch a first glimpse of—the contestable philosophical or political presuppositions that lie at their foundations, buried beneath the legal superstructure. Corporation law is such a field.

In this short essay I offer, in brief summary, some thoughts about the controversial philosophical foundations of contemporary corporation law. I do so in the hope of setting forth a helpful context within which to consider the dual questions presented by the subject of this symposium: whether a fundamental change has or is likely to occur in either academic corporation

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* These speculations constitute a continuation of informal remarks I made to a small but distinguished group of Canadian judges, regulators, practitioners and academic lawyers as a warmly received guest of the University of Toronto Faculty of Law in October 1993. As then, my thoughts continue very much as work in progress.

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1. *See, e.g.*, Rust v. Sullivan, 111 S. Ct. 1759, 1773-75 (1991) (holding that regulation tying abortion clinic funding to ban on abortion-related speech does not violate First Amendment); Cruzan v. Director, Missouri Dep't of Health, 497 U.S. 261 (1990) (upholding state's ability to prevent parents from terminating life support of comatose daughter); Michael H. v. Gerald D., 491 U.S. 110 (1989) (upholding, in the face of challenge by putative natural father, constitutionality of irrebuttable statutory presumption of paternity in mother's husband); Bowers v. Hardwick, 478 U.S. 186 (1986) (holding that statute criminalizing sodomy does not violate Fourteenth Amendment); Peyote Way Church of God, Inc. v. Thornburgh, 922 F.2d 1210, 1217 (5th Cir. 1991) (statute prohibiting peyote possession which excepts Native Americans in order to preserve their culture does not violate Establishment Clause of First Amendment).

2. *E.g.*, tort rules, such as those defining tort liability among family members, which address the borders of protected relationships. *See* 2 FOWLER V. HARPER ET AL., THE LAW OF TORTS § 8.10-.11 (2d ed. 1986).

3. *See In re* Baby M., 537 A.2d 1227, 1246-50, 1253-54 (N.J. 1988) (holding that constitutional right of procreation does not extend to use of surrogate mother; holding surrogacy contract void as against public policy).

law or in the field in practice and, in either event, whether such change is desirable.

I tentatively and modestly offer these thoughts, recognizing that my own experience and expertise lie in a more prosaic direction. I am modest especially because in offering these thoughts I am mindful that I foreshadow ground more cogently surveyed in this volume by Professors Ronald M. Green and Alan Wolfe and Dean Karen L. Newman and by their legal academic commentators.

I.

I begin with the observation that a fundamental (if perhaps primitive) taxonomy of our intellectual life might perceive two contrasting models of human action, each bottomed on a different view of what it *means* to be a human being in society. Complex and contradictory real life, of course, cannot be fully captured by either model.

A. The Liberal-Utilitarian Model

The first of the two competing paradigms can be represented as the classical liberal paradigm. Finding its roots in the work of Hobbes, Locke, and Smith, and importantly shaped by the work of Bentham and Mill, this perspective reached full development in the thought of Herbert Spencer. The classical liberal paradigm describes the social world as populated by individuals rationally (if sometimes imperfectly so) pursuing their own vision of the good life. In this model—ideally—legal institutions keep the peace, define and protect property and contract and ameliorate problems that individuals cannot effectively resolve through bargaining.

For classical liberals, the law is positivistic and should be utilitarian. Thus, ideally, the law should be a clear set of *rules* that facilitate the private ordering of human affairs. If the law comprised such a set of clear rules, individuals would have maximum control over their condition, and presumably free bargaining would lead towards better states of the world. An incidental cost of a system of clear rules will be that attempted transactions will occasionally fail to comply with the rules and will, as a result, collapse, causing unexpected disappointment or even injury. That fact is regrettable, of course, but classical liberals also see it as a necessary cost of a beneficial system of clear rules. Distribution of gains and losses is a secondary concern in this model.

Under the liberal-utilitarian model, the law creating and protecting property rights and the law enforcing contracts is the law of greatest importance to our welfare. The legal value of the highest rank in this classical liberal view is, I suppose, human liberty, and the greatest evil is oppression by the leviathan state.[4]

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4. It would be an error to equate the liberal-utilitarian model with what today we popularly call "conservative" or "right" political positions. The liberal-utilitarian model *today* has a right-of-center (classical liberal) as well as a left-of-center (left-liberal) variant, just as the alternative social model, described later in the text, has both a left (communitarian) and right (moral majority) version.

B. The Social Model

The classical liberal mind-set found its widest and deepest acceptance in English and American thought of the nineteenth century. I think of the contrasting approach as being grounded in the dominant concepts of continental Europe and a yet earlier age. If, with respect to economic relations, Spencer is the most complete liberal-utilitarian, Emile Durkheim is the most important voice of the contrary view. This alternative paradigm describes the world as populated not by atomistic rational maximizers, but by persons of limited rationality who lead lives embedded in a social context, in a community. That context includes traditions from which persons draw valued ethnic or religious identification. It includes communities or groups with worked-out moral codes, claiming various degrees of solidarity with the individual, and it includes affective relationships with others such as families and neighbors. This alternative paradigm is the social model of human action.[5] For those holding this perspective, individual autonomy and rationality are a part of the truth of human life, but their significance can easily be exaggerated.

While proponents of the social model of human life would concede that property and contract law are useful in promoting productive social life, those holding this perspective see them as partial and assert that their utility rests in part on presupposition of shared norms including those of fairness and trust. Those holding this perspective are more willing to regulate and define the legal institutions of property and contract in service of social values. For them, for example, legal protections for fallible or disadvantaged persons, such as limitations upon the enforceability of bargains, are appropriate. While the liberal model seeks rules that are clear *ex ante* in order to facilitate future transactions, the social model of law can tolerate ambiguity in rules in order to promote outcomes that, when viewed *ex post*, are seen as fair.[6] Standards and principles are seen as more useful than rigid rules.[7] Instead of clarity, rules, under this model, may sensibly require

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5. *See* EMILE DURKHEIM, THE DIVISION OF LABOR IN SOCIETY (George Simpson trans., 1933). *See also* Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215 (1992) (book review).

6. In equating the social model with an *ex post* style of judicial review of bargains and in later extending that equation to equity courts, I do not mean to say that equity or those who tend towards a social model of interaction exclusively evaluate contracts or promises from an *ex post* perspective. In the case of equity such a view would be descriptively wrong as well as ethically difficult to defend. What I do mean to say is that the social model and the legal institution of equity are much more open than is the liberal model I describe to considering outcomes as a relevant factor when evaluating or judicially enforcing contracts. In this sense I associate them with an *ex post* evaluation style.

7. *See* GRANT GILMORE, THE DEATH OF CONTRACT (1974) (stating that 20th century contract law emphasizes reasonable reliance rather than formality as prerequisite for binding obligation). See also the marvelous inaugural lecture of Professor P. S. Atiyah, as Professor of English Law, St. John's College, Oxford: *From Principles to Pragmatism: Changes In the Function of the Judicial Process and the Law, reprinted in* 65 IOWA L. REV. 1249 (1980). *But see* P. S. ATIYAH, AN INTRODUCTION TO THE LAW OF CONTRACT 30-39 (4th ed. 1989) (speculating

individuals to act "reasonably" or may void "unconscionable" contracts; courts may apply "balancing tests." Indeed, the social model may sometimes regard rules as less important than relationships. The centuries-old law of fiduciary duty is the best example in our law of what I have called the social paradigm. In the law of fiduciary duties, the integrity of relationships of trust and the protection of dependents by a relatively open-ended, morality-based fiduciary duty of loyalty have great importance.

In the social model, courts are not solely concerned with building and maintaining a system of general rules that is justified by its *future utility* to private bargainers. Rather, doing justice among the parties to a lawsuit based upon the very particular facts of the case is seen as a purpose of adjudication. An adjudication is seen as an end in itself in a sense, not a heuristic or pedagogic device intended to guide future conduct of others. The social model therefore may tend towards pragmatism, in the sense that "just" results are seen as crafted things that result from the responsible use of all of the available and pertinent materials, but not in any predetermined way. Compared to a liberal positivist, a judge who modeled her professional actions on the social model would be less afraid to find her perceptions of the general moral sentiments of the community to be relevant to her judgment. For such a judge, the law would be a constant working out of the just solution in a highly particular, but principled way. Except where legislation excluded all ambiguity, legal rules would be treated as "general rules" subject to growth and development in future particularized contexts.

I suppose that the legal value of the highest rank in the social model is not liberty, but justice, and the *bête noire* is not suffocation or slavery, but alienation.

II.

Until rather recently the liberal-utilitarian explanation and prescription for the social order of our economy did not focus upon what happened (or what should happen) *within* corporations. The "market" focus of the perspective implied that the internal operation of corporate actors was no more interesting than the internal operation of human actors. In a long ignored but now famous 1937 article, Ronald Coase for the first time offered a theory that looked inside the firm. Coase asked why some transactions are accomplished within firms while others are accomplished in markets.[8] This question and Coase's efficiency-based answer to it were finally taken up by economists in the 1970s, most notably by Armen Alchian

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that since 1980 there has been marked re-emergence of classical (liberal-utilitarian in our terms) contract law).

8. R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937), *reprinted in* R. H. COASE, THE FIRM, THE MARKET AND THE LAW 33 (1988).

and Harold Demsetz,[9] Oliver Williamson,[10] Michael Jensen and William Meckling[11] and others.[12] This work re-energized the field of institutional economics. This scholarship employed two related perspectives—transaction cost economics and agency cost economics—to generate both a conceptual account of why firms exist and why they are structured as they are, and a prescriptive account of how they should function. When applied by legal scholars to the institutional detail of corporation law, the agency cost perspective supplied for the first time a unified theory of corporation law. This work was carried on by a number of brilliant legal scholars.[13] Perhaps most prominent in that effort have been Judge Frank Easterbrook and Professor Daniel Fischel, the authors of *The Economic Structure of Corporate Law*.[14]

The work of the law and economics scholars has come, I believe, to dominate the academic study of corporate law, even if some of the field's most respected minds remain among the unconverted.[15] This work has left academic corporate law far more coherent than it had been and constitutes a substantial intellectual accomplishment.

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9. Armen A. Alchian & Harold Demsetz, *The Property Rights Paradigm*, 33 J. ECON. HIST. 16 (1973).

10. OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (1985); OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES (1975); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233 (1979).

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

12. *E.g.*, Stephen A. Ross, *The Economic Theory of Agency: The Principal's Problem, in Papers and Proceedings of the Eighty-Fifth Annual Meeting of the American Economics Association*, 63 AM. ECON. REV. 134-39 (1973); Joseph E. Stiglitz, *Incentives and Risk Sharing in Sharecropping*, 41 REV. ECON. STUDIES 219 (1974).

13. *See, e.g.*, Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982); Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989); Symposium, *Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981); Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984); Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761 (1985); Reinier Kraakman, *Taking Discounts Seriously: The Implications of Discounted Share Prices as an Acquisiton Motive*, 88 COLUM. L. REV. 891 (1988); Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55 (1991). Easterbrook and Fischel's work is collected in FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991).

14. EASTERBROOK & FISCHEL, *supra* note 13.

15. I count among the most significant dissenters Professor Victor Brudney and Professor Melvin Eisenberg. *See* Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985); Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461 (1989). *See also* Robert W. Hamilton, *Reflections of a Reporter*, 63 TEX. L. REV. 1455, 1467 (1985) (law and economics paradigm not expressly considered by drafters of Revised Model Business Corporation Act).

A. Nexus of Contracts

The dominant legal academic view does not describe the corporation as a social institution. Rather, the corporation is seen as the market writ small, a web of ongoing contracts (explicit or implicit) between various real persons. The notion that corporations are "persons" is seen as a weak and unimportant fiction. The corporation is regarded as a minor utilitarian invention designed to reduce the costs necessary to plan, coordinate and accomplish the complex contracts that large-scale ongoing projects would require.[16]

Since the corporate contract governs an ongoing venture, there is much that cannot be specified before the relationship among the real persons involved commences. Thus, a corporation can be seen as a form of relational contract,[17] in which rather large contractual gaps will necessarily exist. The essence of the corporate form may therefore be seen, on this view, as *the identification of structures or processes* by which (1) persons will be designated to make certain sorts of discretionary judgments, and (2) those so designated will be monitored. Thus, in the dominant view, a corporation may be said most fundamentally to be a contractual governance structure.

Corporate law is seen as a way to provide a standard set of instructions for the operation of such a governance structure. In the corporate charter much of this standard set can be replaced by terms better suited to the perceived needs of the parties involved, if that is efficient and desired, but the cheaper, "off-the-rack" terms set forth in the corporate statute will often serve well enough. United States corporate law is thus chiefly enabling in character, not regulatory.[18]

The transaction costs that corporation law can reduce include costs of negotiation and documentation of the corporate form, but in the dominant academic vision, most importantly they include other so-called agency costs. Agency costs are all the costs incurred by a principal by reason of the utilization of an agent to manage the principal's property. In the nexus of contracts model, the principals are the residiual risk bearers—shareholders—and the agents are directors and management. Agency costs include market rate salaries and other irreducible costs, but more importantly they include various forms of sub-optimizing behavior by agents. Certain implicit costs, for example, will arise from a disjunction between the kinds and amounts of investments made by agents and their principals and the returns available to each. In addition, shirking, empire-building or venal diversion of corporate property or prospects all constitute agency costs of the corporate form.

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16. Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542 (1990).

17. Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978).

18. Despite the fact that corporation law statutes in the U.S. are chiefly enabling, these statutes inevitably do provide for a few nonwaivable terms in the corporate charter, such as annual meetings to elect directors, stockholder access to books and records in proper circumstances, and stockholders' rights to amend the corporation by-laws.

It is, of course, a simplification to speak of a single economics-inspired theory of corporations. There is diversity and richness among the economists, too, running from those most closely associated with a neo-classical position (such as Michael Jensen, Easterbrook and Fischel) to those whose micro-analytic techniques and assumptions move them some distance from the liberal-utilitarian core (such as Williamson). These models, however, all share a view of persons as "undersocialized,"[19] self-interested maximizers.

B. The Realist or Institutional Model

Such is the dominance of the nexus of contracts model of the corporation in the legal academy that this symposium on new directions in corporate law can be understood only in opposition to this paradigm. One of the marks of a truly dominant intellectual paradigm is the difficulty people have in even imagining any alternative view. This is often the case in the legal academy with respect to the nexus of contracts model of the corporation. For many corporation law scholars this view is indisputably correct; its statement is seen as one of fact. Corporations, we are told, do not really exist; when we refer to one—General Motors or RJR Nabisco, for example—we are just using a rhetorical shortcut to refer to the vast network of contracts or implicit contracts that is the "reality."

There is, of course, force in this position.[20] But, as my simplistic analysis suggests, another view of corporations is possible. In opposition to the philosophical nominalism of economics stands the philosophical realism of sociology. To the philosophical realist, to call a corporation a network of contracts is to overlook an essential part of the empirical reality of social interactions "within" corporations. It implies that the circumstances that any participant in the enterprise may confront at any moment are fully accounted for by reference to one or more earlier negotiated (or implicit) bargains he or she made. This, to realists, is a palpably impoverished way to interpret much of what goes on within corporations. Contract, for example, can provide only a thin and weak account of the experience of long-term stockholders of a large public corporation that has recently started paying grossly excessive compensation to its senior management; or whose management wants to deploy a newly created "poison pill" to foreclose a hostile tender offer. Or consider an instance in which employees work especially diligently in order that a team, department or division can reach a production goal. It very plausibly could be the case that contract would provide only a very partial and inadequate explanation of their behavior.[21]

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19. Dennis Wrong, *The Oversocialized Conception of Man in Modern Sociology*, 26 AM. SOC. REV. 183 (1961).

20. One is reminded that Jeremy Bentham similarly held that "the community is a fictitious *body*, composed of . . . individual persons." JEREMY BENTHAM, AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION 3 (Basil Blackwell ed., 1948), *quoted in* AMITAI ETZIONI, THE MORAL DIMENSION: TOWARD A NEW ECONOMICS 6 (1988).

21. *See* George A. Akerlof, *Labor Contracts as Partial Gift Exchange*, *in* EFFICIENCY WAGE MODELS OF THE LABOR MARKET 66 (George A. Akerlof & Janet L. Yellen eds., 1986).

On the realist view corporations can be, indeed inevitably are, more than contracts. Actual bargains, explicit or implicit, provide an incomplete account of the social order we find in organizations. That social order can exist only because contracts are embedded in a social context that permits trust and expectations of fair dealing.[22]

More than a network of contracts, corporations are seen by realists as collective entities that have identities apart from those of any of the individuals who temporarily fill roles within them. The history of such an institution, the "culture" and values it comes to embody and the institutional goals it formally and informally moves toward affect in every sense (legal, social or economic) the relationships among those who participate in the corporate enterprise. Such an institution to succeed over time must employ learning (about markets, about technology, about organization and about improving human skills). It must create and sustain an evolving capacity to learn to recall, to plan and to coordinate action. Achievement of corporate goals may depend importantly on the trust and loyalty of the human actors involved in circumstances in which monitoring and incentives are difficult and costly to establish and implement.[23]

The provision of pre-defined roles and rules in the ongoing organization and the social-psychological processes of identification that successful organizations promote are seen by some as vital components of economic organizations *that simply are not visible to the "network of contracts" vision of the firm.* When Judge Easterbrook and Professor Fischel, for example, state that "*[e]verything* to do with the relation between the firm and the suppliers of labor . . . is contractual," they underline the word "[e]verything."[24] Those who tend towards the social model of human behavior see this sort of description of corporations as brittle, partial and flawed.

Some of those who hold a social or realist perspective tend normatively to be concerned with a corrosive effect that interpreting social life as a continuous, self-interested negotiation may have. Thus they do not accept the assertion that corporate management owes a duty to exercise discretion so as to maximize financial returns to stockholders.[25] Rather, they look for ways in which workers can participate in firm governance and thus gain a greater sense of the meaning of community membership. Perhaps incidentally, it is sometimes urged that steps that will increase worker engagement and responsibility will also increase corporate productivity.

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22. *See* Mark Granovetter, *Economic Action and Social Structure: The Problem of Embeddedness*, 91 AM. J. SOC. 481, 490-93 (1985).

23. *See* Herbert A. Simon, *Organizations and Markets*, J. ECON. PERSP., Spring 1991, at 25, 34-38.

24. *See* EASTERBROOK & FISCHEL, *supra* note 13, at 16.

25. *See, e.g.*, 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, 1194 (1991).

Seeing the business corporation as a social institution can supply justification for a variety of organizational forms that differ from the share value maximization model promoted by the dominant academic conception of the corporation. The social model, in one of its weaker forms, is highly consistent with the managerialist concept of the corporation that has, in fact, dominated the real world of business and politics since the great depression.[26] That view sees senior management as empowered to give fair consideration to workers, communities, and suppliers as well as to suppliers of capital. The statutory law in more than half of the U.S. jurisdictions has arguably come to reflect the managerialist concept of the corporation.[27]

Equally evidently the social model of philosophical realists is consistent with various forms of worker involvement in management, such as may accompany an Employee Stock Ownership Plan (ESOP), and with worker representation, such as is present in the German co-determination structure. At its most extreme, this conception may yield more "radical" forms of corporate organizations, such as the kibbutz or other worker communes.

III.

Many corporation law issues do not, of course, penetrate the dense superstructure of the field to reach the level of philosophical disagreement. Think of the issues in an appraisal proceeding, for example. From the host of technical questions relating to whether a right to an appraisal has been duly exercised, to the financial issues of "fair price," one's view of the meaning of human social life simply doesn't enter into the matter. Or consider the corporation law issues involved in that most common of all legal opinions, that a corporation is validly organized and in good standing, or an opinion that an act has been duly authorized by effective board action. In resolving such questions, formality, not contestable assertions of social meaning, is critical. Similarly, the experienced legal practitioner expects questions concerning the validity of by-laws, the need for a class vote, the rights of preferred stock, the proper way to count the vote at an election, and a host of other technical corporation law questions to be decided as matters of form according to clear pre-existing rules.

It is when the directors' duty of loyalty is properly called into issue that the corporate law may tend to cast off its heavy reliance upon formality to look beneath the surface of things. It is the concept of loyalty, which necessarily is grounded in the moral order of some community, that most evidently introduces into corporation law the dichotomy that I have men-

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26. *See* Edward S. Mason, *Introduction* to THE CORPORATION IN MODERN SOCIETY 1 (1959); William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 270 (1992).

27. *See* Symposium, *Corporate Malaise—Stakeholder Statutes: Cause or Cure?*, 21 STETSON L. REV. 1 (1991); Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 16 (1992); *see also* Joseph A. Grundfest, *Subordination of American Capital*, 27 J. FIN. ECON. 89, 91 (1990).

tioned: between a positivistic, utilitarian, rules-bound worldview on one hand and a flexible, moralistic one on the other. Fiduciary duty claims are equitable in origin. They tend to be analyzed in a particularistic *ex post* style. Their evaluation entails a moral account or prescription for a dispute that is in its own terms independent of, and sometimes inconsistent with, the positivistic, *ex ante* style of the liberal-utilitarian approach.

Large parts of the fabric of our corporation law have been woven on the loom of equity. In his classic article, *Corporate Powers as Powers in Trust*,[28] Professor Berle, for example, demonstrated the early origin of the doctrine of stockholder preemptive rights in the equitable powers of chancery. In *Speiser v. Baker*[29] I had the occasion to trace back the equity cases from which evolved the statutory prohibition on a corporation voting its own stock.[30] In fact, in every corporation law case in which the gist of the complaint is a breach of loyalty—in every case involving self-dealing by a controlling shareholder[31] or involving any manipulation of the voting process,[32] for example—compliance with the more or less clear technical rules of corporation law is not the determinative issue. A contestable judgment about fairness—the historic mission of chancery—is.

Thus, fiduciary duties, pre-eminently the duty of loyalty, introduce tension and ambiguity into corporation law. It is when questions of loyalty are at issue that the philosophical differences that I have mentioned begin to appear near the surface, visible to even judges and lawyers in practice. Most especially is this true, as the experience of the 1980s demonstrated, when the question of fiduciary duty arises in connection with a proposed sale of a company. One of the things that was so remarkable about that period in corporation law was the way in which deep philosophical conflict concerning the purpose of corporations and political questions concerning our commitment to the values of the liberal economy were forced to the surface. In that setting, the philosophical divergence between the liberal model and the social model did not appear ethereal or academic but vital.

IV.

The law and economics paradigm offers a highly coherent conception of corporation law as a system of rules facilitating wealth maximization

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28. A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1055-57 (1931).

29. 525 A.2d 1001 (Del. Ch. 1987).

30. Speiser v. Baker, 525 A.2d 1001, 1007-11 (Del. Ch. 1987); *see Ex parte* Holmes, 5 Cow. 426 (N.Y. Sup. Ct. 1826).

31. *E.g.*, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983) (discussing elimination of minority shareholders via merger between corporation and its majority owner); Jones v. H. F. Ahmanson & Co., 460 P.2d 464, 469 (Cal. 1969).

32. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971) (considering petition of stockholders for injunction to prevent management from advancing date of annual shareholders' meeting); Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988) (examining validity of board's adding two new members to board to prevent holders of majority of stock from replacing majority of board via consent solicitation); Aprahamian v. HBO & Co., 531 A.2d 1204 (Del. Ch. 1987) (discussing attempt of parties seeking election to corporate board to enjoin postponement of annual meeting).

through contracts, explicit or implicit. This is, to a substantial extent, an idealized version of the corporation law in action. Like much of neoclassical economics, the law and economics account of corporation law is at bottom not empirical description, but normative prescription. It means to tell us how people *would* act with respect to formation of legal rules concerning corporations *if* people acted rationally (as they sometimes, if imperfectly, do). It thus means to create an ideal corporation law to guide those who fill in "contractual gaps" to act rationally when they do so. I suppose that even those who prefer to think about life as a world of complete markets drifting in and out of equilibrium do not believe that in fact people always do act rationally. But that recognition does not, of course, mean that the law should not take rationality as a standard. It is the further step taken by the law and economics theorists, their attempts to forge an equivalence between rationality and profit maximization, that does give rise to warm disagreement.

The idealized law and economics version of corporation law makes a tremendous contribution to our understanding of the nature of the firm, but it is not complete. My own understanding, which is, I confess, incomplete as well, acknowledges the power and utility of much of the law and economics story, but recognizes as well the pressures on rule-creating agencies to view corporate directors as men and women with obligations of loyalty which will be evaluated *ex post* on a fairness standard. Courts have felt and responded to these pressures for over two hundred years. To whom director duties of loyalty are owed can and has sustained earnest debate in legislative chambers, in the press, and in the academy. Thus, either a descriptive account or a normative account of corporation law that I might advance would include a powerful element of wealth maximization, but it would inescapably include as well a political-moral component. Corporation law is a system of rules, principles and roles and a process by which they are defined, redefined in legally significant interactions, and enforced. In that process the law, or legal agents, mediate, pursuant to the processes of law, between the wealth maximizing value and the *ex ante* analytical style of the liberal model and the fairness value and the *ex post* analytical style of equity.[33] I offer no theory to explain that mediation here.

Turning from the world of theory to the world of action and events, this symposium seeks to raise the question whether fundamental change in corporate law is at hand. While I of course acknowledge that the political processes have enacted stakeholder statutes across the country, nevertheless, I think I also see popular acceptance of the assertion that all systems of corporate governance that take the social nature of the firm seriously are subject to threats of inadequate accountability and inefficiency. It is also widely understood, I think, that there are in the world powerful economic and technological forces that are forcing corporations towards greater efficiency. These forces include the re-aggregation of shareholders in institutional investors and the emergence of the global economy.

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33. *See supra* note 6.

Both phenomena are highly significant for American corporations. Today throughout the world, business corporations must operate in increasingly competitive markets. To survive in such markets, it seems accepted that the performance of the organization needs to be intelligently monitored. But there does not appear to be an easy or clear way in principle to evaluate the performance of those in charge of the deployment of corporate assets, if their duty is to balance the claims made upon the corporation by a variety of contesting claimants. Equally problematic for many (including Professor Stephen M. Bainbridge in this volume) is the possibility that this lack of a standard of accountability may be conducive to self-interested manipulation of the corporation by those who are placed in control of it. Thus, from a practical point of view, the special problems which would face a business organization operating in a legal regime consistent with the social model—or at least a large-scale organization operating in such a regime—do not appear easy to solve.

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In the United States the liberal-utilitarian account of and prescription for corporate law is the dominant legal academic model and will remain so for some time. The coherence and power of the economic model, as it is applied to corporations, have for many an all but irresistible appeal. Moreover, in our pluralistic society, it may be especially difficult to formulate any alternative comprehensive theory of corporations that takes its animating power from a conception of human connectedness and responsibility. Finally, in an age of global competition and fading expectations, the plausible claims of greater efficiency (wealth maximization) that the nexus of contracts theory makes also render this way of thinking powerfully attractive. Indeed, so powerful and pervasive are our concerns about global competitiveness that a more realistic and complex conception of corporations and corporate law could successfully be advanced only if it were premised on a plausible claim that such a model could lead to more productive organizations in utilitarian terms.

Thus, while tensions arising from the fundamental divergence between self and community will continue in our corporation law, as elsewhere, my own supposition is that in the immediate future tentative resolution of this tension will not be worked out in a substantially different way than it has been in the past. But while I therefore doubt that we have yet come to a turn in the road of corporate law, it does not follow that it is not important for some academics to test and challenge the dominant paradigm and especially to try to broaden the base of social science data and theory that informs academic corporation law. The social sciences that attempt to grapple with the complexity, ambiguity and contradictions of rounded human actors in real life will probably be more difficult for legal academics constructively to employ than neo-classical economics has been, but some bridge-builders should be working on those spans now.[34] The papers reported

34. Professors James D. Cox and Harry L. Munsinger's outstanding 1985 piece, *Bias in*

here and the work to which they refer offer hope to those who would welcome the articulation of legal theories of the corporation, and rules and principles of its governance, that take into account the complexity and contradictions contained within these organizations.

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the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion, LAW & COMP. PROBS., Summer 1985, at 83, is an encouraging example of what can be done. *See also* HANDBOOK OF ECONOMIC SOCIOLOGY (Neil Smelser & Richard Swedberg eds., forthcoming).