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# MODERN CORPORATE THEORY: PUBLIC UTILITY OR PRIVATE PART? A COMMENT ON PROFESSOR WOLFE'S PAPER

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Well, we asked for it. We invited Alan Wolfe, a distinguished social theorist who has written extensively and powerfully about the epistemological and ethical deficiencies of current social thought,[1] and asked him to take a look at what passes for theory in the field of corporate law. Now Professor Wolfe is a generous man, and obviously does not mean to offend, but he is a connoisseur of theory. He enjoys a good hearty helping of Weber, a little sweet and sour Durkheim, maybe a light, airy bit of Derrida for dessert. He has sampled current corporate law theory and he is saying, as nicely as possible, that as best he can tell, it is mush. Cold mush. Cold thin mush. Mush—because it provides neither an adequate factual description of how corporate actors behave nor an attractive prescriptive theory of how they should behave.[2] Cold and thin—because it embodies a concept of the individual devoid of culture, emotions and relationships, whose sole motivation is wealth maximization.[3]

So far, Professor Wolfe probably would not get much of an argument, at least from many of the participants in this symposium. The criticisms he makes of the new economic theory of the firm, as he recognizes, echo and expand on comments previously made by its critics within the corporate law academy.[4] When he turns to consider alternatives to the dominant

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* Professor of Law, Benjamin N. Cardozo School of Law. I would like to thank my colleague Bill Bratton for reading and commenting on a prior version of this piece in an effort to keep me out of trouble. I would also like to thank all the participants in the Washington and Lee symposium for laughing at the right places. As for the mistakes in this piece, I accept all the responsibility and none of the blame.

1. *See, e.g.*, ALAN WOLFE, WHOSE KEEPER? SOCIAL SCIENCE AND MORAL OBLIGATION (1989).

2. Alan Wolfe, *The Modern Corporation: Private Agent or Public Actor*, 50 WASH. & LEE L. REV. 1673, 1683 (1993) (hereinafter *Modern Corporation*).

3. *Id.* at 1687-88.

4. *See, e.g.*, William W. Bratton, Jr., *The New Economic Theory of 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); Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985) ; Lynne L. Dallas, *Two Models of Corporate Governance: Beyond Berle and Means*, 22 U. MICH. J.L. REF. 19 (1988); Lyman Johnson, *Sovereignty Over Corporate Stock*, 16 DEL. J. CORP. L. 485 (1991); David Millon, *Frontiers of Legal Thought I: Theories of the Corporation*, 1990 DUKE L.J. 201; Lawrence E. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263 (1992); 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); Charles D. Watts, Jr., *Corporate Legal Theory Under the First Amendment:* Bellotti *and* Austin, 46 U. MIAMI L. REV. 317 (1991);

economic theory of the firm, however, he finds that there really are none. His paper points out how numerous advocates of a more "public" conception of the corporation nonetheless adopt, implicitly or explicitly, the fundamental assumptions about corporate relationships embodied in the dominant paradigm.[5] There is, in current corporate law discourse, no real alternative, either at a conceptual or programmatic level, to that theory.

Indeed, when viewed from the level of fundamental institutions, the distance separating those corporate law academics who argue for a somewhat greater degree of governmental regulation of managerial conduct, and those who seek a reduced governmental role, is not very great. Everyone writing about corporate law, with the possible exception of a few Marxists and Michael Jensen,[6] assumes that the public corporation, with its familiar separation of ownership and control, will remain the dominant mode for conducting economic activity in the United States, and that the fundamental relationship between managers, shareholders and employees will remain essentially unchanged. Corporate law academics are like a bunch of interior designers trying to hang a picture on the living room wall. A few of us say, "move it a little to the left," and a few more say, "no, a little to the right." But nobody wants to put a different picture up there.

Professor Wolfe notes all of this, and is not particularly disturbed by any of it. He recognizes the defects of the nexus of contracts theory of the firm, tells us that he prefers the "inconsistency" of its critics to the "unreality" of the model,[7] but does not expect corporate law theorists to develop an alternative model any time soon. Rather, he pats us on the head and tells us to keep "muddling through," that caution is the appropriate response in complex matters such as this, and that no theory will ever fully capture the oxymoronic nature of the public-private corporation.[8]

I agree with Professor Wolfe in almost all his specific comments about the state of contemporary corporate law theory. Unfortunately, teaching and writing about corporate law is what I do for a living. Now, I can live with the fact that the dominant paradigm in my field is mushy and fails to capture important aspects of corporate reality, that the critiques of the dominant paradigm are inconsistent and marginal, and that all I can hope to do is "muddle through." My real problem is with a conclusion that is implicit but unstated in Professor Wolfe's paper.

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Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215 (1992) (reviewing FRANK A. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991) and ROBERT N. BELLAH ET AL., THE GOOD SOCIETY (1991)); Lawrence E. Mitchell, *The Cult of Efficiency*, 71 TEX. L. REV. 217 (1992) (reviewing FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991)).

5. Wolfe, *supra* note 2, at 1688-92.

6. Michael C. Jensen, *The Eclipse of the Public Corporation*, 67 HARV. BUS. REV., Sept.-Oct. 1989, at 61.

7. Wolfe, *supra* note 2, at 1676.

8. *Id.* at 1692-95.

If corporate law theory is, as Professor Wolfe portrays it, viewed as nothing more than an exercise in endlessly rehashing and reemphasizing the public and/or private aspects of corporate relationships, then it is, and will remain, incredibly boring. I am willing to concede that corporate law can never be made theoretically coherent, or develop a normatively satisfying account of the distribution of powers among capital, management and labor. I am unwilling to concede, however, that it has to stay as boring as it currently is.[9]

So I decided to reread Professor Wolfe's paper from a different perspective—not as a critique of contemporary corporate law theory (which it is), but as a metacritique of contemporary discourse about corporate law theory (which it also is). From this latter perspective, the crucial question Professor Wolfe raises is whether boredom is an inevitable consequence of theoretical discourse in corporate law, or merely an epiphenomenon caused by an unfortunate concatenation of current methodology and personnel.

My conclusion is that there is hope. Implicit in Professor Wolfe's paper are a number of programmatic suggestions for reducing the turgidity factor in corporate law discourse. The remainder of this Comment will be devoted to elucidating those suggestions as explicitly as possible.

Professor Wolfe begins his paper with the familiar antinomies of corporate existence. Is the corporation an entity or an aggregate, artificial or natural, public or private? The debates on these definitional issues have always struck me as vaguely unreal, something like arguing about whether Greenland is a large island or a small continent, or whether a minivan is a large car or a small truck. Since no empirical evidence seems persuasive or even relevant to such debates, the interesting question is why such insubstantial issues continue to engage the attention of very substantial scholars. Professor Wolfe considers the possibility, put forth by David Millon, that our theory of corporate ontology influences our beliefs about the appropriate degree of governmental regulation of corporate actors.[10] Professor Wolfe expresses some skepticism about this idea, pointing out that corporate law theorists rarely apply their theoretical positions in a consistent manner when engaged in policy debates.

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9. The claim that corporate law is boring should not be confused with the more ambitious claim, put forward most forcefully by Bernard Black, that corporate law is trivial. *See* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw. U. L. REV. 542 (1990). A moment's reflection will reveal many things that are extremely significant, but boring (e.g., the federal budget) and others that are trivial but rather interesting (e.g., Joey Buttafuoco). It must be conceded, however, that many things that are trivial are also pretty boring (e.g., golf).

10. Wolfe, *supra* note 2, at 1673 (citing Millon, *supra* note 4, at 241). In his article, Professor Millon actually argues *both* that theories of the corporation influence beliefs about corporate policy *and* that policy positions influence theories of corporate ontology. In this he is undoubtedly correct. Where Professors Wolfe, Millon and I would probably disagree, however, is in our views of the relative strength of the influence of policy on theory and of theory on policy.

This same unease over the way corporate lawyers use theory is expressed by Professor Wolfe in his discussion of the new economic theory of the firm. Professor Wolfe is familiar with two broad categories of theories, descriptive theories that explain how institutions actually function and prescriptive theories that explain how they should function. The nexus of contracts theory appears to fall into neither category. Its account of the behavior of corporate actors is too simplistic to be descriptive, and its normative implications are too unattractive to be prescriptive.

I would suggest to Professor Wolfe that the theory is neither prescriptive nor descriptive, but a third category. We might call it a "theory of justification." Some of the nexus of contract types, in their more candid moments, refer to it as a "heuristic."[11] What it really is, however, is just an old-fashioned legal argument. Like most legal arguments, those made by proponents of the new economic theory of the firm seek to justify existing or proposed legal rules against a shifting background of descriptive and prescriptive accounts of the world in which those legal rules operate.[12] Thus, a skillful account of the contracts supposedly implicit in the corporate relationship can be used to justify prohibitions on takeover defenses,[13] massive stock payments to corporate officers,[14] legalization of insider trading[15] and the reduction of liability of corporate directors for breach of fiduciary duties.[16]

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11. *See* Robert E. Scott, *Through Bankruptcy with the Creditors' Bargain Heuristic*, 53 U. CHI. L. REV. 690 (1986) (reviewing DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY (1985)). *See also* Ronald J. Gilson & Robert N. Mnookin, *Coming of Age in a Corporate Law Firm: The Economics of Associate Career Patterns*, 41 STAN. L. REV. 567, 570 (1989) (seeking to apply nexus of contracts approach to actual institutional analysis to show that it is more than just "powerful heuristic").

12. The malleability of legal argument is a central feature in the ongoing legal debate about the "indeterminacy of the law." Some of my favorite articles on this topic are James Boyle, *The Politics of Reason: Critical Legal Theory and Local Social Thought*, 133 U. PA. L. REV. 685, 695 (1985); Robert W. Gordon, *Critical Legal Histories*, 36 STAN. L. REV. 57 (1984); Allan Hutchinson, *Democracy and Determinism: An Essay on Legal Interpretation*, 43 U. MIAMI L. REV. 541 (1989); Duncan Kennedy, *Freedom and Constraint in Adjudication: A Critical Phenomenology*, 36 J. LEGAL EDUC. 518 (1986); Gary Peller, *The Metaphysics of American Law*, 73 CAL. L. REV. 1151, 1155-56 (1985); Joseph W. Singer, *The Player and the Cards: Nihilism and Legal Theory*, 94 YALE L.J. 1 (1984); John Stick, *Can Nihilism Be Pragmatic?* 100 HARV. L. REV. 332 (1986); Charles M. Yablon, *The Indeterminacy of the Law: Critical Legal Studies and the Problem of Legal Explanation*, 6 CARDOZO L. REV. 917 (1985); J. M. Balkin, *Ideology as Constraint*, 43 STAN. L. REV. 1133 (1991) (reviewing ANDREW ALTMAN, CRITICAL LEGAL STUDIES: A LIBERAL CRITIQUE (1990)).

13. 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).

14. Michael C. Jensen & Kevin J. Murphy, *CEO Incentives—It's Not How Much You Pay, But How*, HARV. BUS. REV., May-June 1990, at 138 (arguing that senior executives will only have optimal performance incentives when they have meaningful share of total corporate equity).

15. HENRY MANNE, INSIDER TRADING AND THE STOCK MARKET (1966); Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984).

16. *Continuation of Discussion of Principles of Corporate Governance: Analysis and*

Are these strange policy positions the results of the application of a defective theory? I do not think so. Rather, I think the strange theory is a result of attempts to justify these defective policy positions. In fairness, I should add that like many legal arguments, the new theory of the firm can, and has, also been used to justify positions directly contrary to those just stated.[17] The point is that one's theory of corporate ontology does not have much causal impact on one's position with regard to particular regulatory issues. More often, a person's position on a particular regulatory issue results in the adoption, at least temporarily, of a certain account of corporate ontology.

Such considerations may seem illicit in the value-free world of social science. As a lawyer, however, I am perfectly comfortable with a system in which (a) someone pays me some money up front, (b) that person tells me what position to support and (c) I argue for that position as persuasively as I can.

Now don't get me wrong. I am not suggesting that academic lawyers operate from the same base pecuniary motives as our colleagues in practice. Quite the contrary, we operate from a very different set of base pecuniary motives. Suffice it to say that we all have an "investment" of some sort in the positions we espouse, and that we all do our best to formulate the strongest possible arguments in support of those positions. Does that mean that we really do not believe our own arguments? Nonsense. Every lawyer worth her fee knows that the first step in effective advocacy is to train oneself to believe one's own arguments.[18] My point is simply that the debate about corporate law theory is best (and most interestingly) understood, not as an attempt to uncover the true nature of the corporation, but as a set of competing policy arguments about the appropriate type and degree of corporate regulation.

From this perspective, we can see why Professor Wolfe is right to prefer the inconsistency of the critics of the economic theory of the firm to the unreality of the theory as put forth by its proponents. In the world of legal argument, inconsistency is a pardonable sin. Judges and lawyers know that most general principles of law, consistently applied, lead to absurd or at least rather uncomfortable results.

Unreality, however, or misrepresenting the facts of the case, is a much more egregious fault. A lawyer in a contract action involving the statute of frauds who gets up and says, "Your Honor, let's just assume there was a valid contract in this case" really has not grasped the point of the enterprise.

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*Recommendations*, Tent. Draft No. 5, 63 A.L.I. PROC. 395, 411-13 (1986) (comments of Judge Frank H. Easterbrook).

17. *See, e.g.*, Wolfe, *supra* note 2.

18. *See* JAMES C. FREUND, LAWYERING: A REALISTIC APPROACH TO LEGAL PRACTICE 214-15 (1979) ("[The] hallmark of the effective advocate is his belief in the rightness of his cause. . . . And before he can set out to persuade others to agree, the first person to convince is himself. However skeptically the litigator begins, by the time he's arguing the case in court, his belief is total and absolutely sincere.").

Similarly, just positing the existence, at some level of generality, of an implicit understanding by corporate actors of their respective roles does not tell us what legal standards should apply in specific areas of corporate law. The theory cannot and does not tell us what actual power relationships and expectations exist among corporate actors in real institutions. It does not tell us the levels of generality and certainty at which the corporate law rules do or should operate, and it does not consider whether there are equitable principles apart from the hypothetical expectations of the parties that would justify a particular result.

In short, I believe Professor Wolfe's first suggestion for making corporate law more interesting is that we think about these issues like lawyers, not theorists. As lawyers, we do not need a competing theory to "beat" the prevailing thin and mushy theory of the firm. We can adopt the assumptions of the theory to the extent they seem to make sense and comport with our best current understanding of corporate law realities. We can abandon the theory when its assumptions appear unrealistic or its prescriptions are unattractive or indeterminate. Most importantly, we can ask a whole series of lawyerly questions about corporate law that the theory does not and cannot answer. How are corporate law rules communicated to corporate actors? At what degree of generality and certainty are they understood? Who, in the corporate context, interprets the rules? How effectively and consistently are violations of the rules constrained? Who determines what actions violate those rules?

To help answer these questions, and to respond to Professor Wolfe's critique of the thinness of corporate law theory, we should also follow a second suggestion implicit in Professor Wolfe's paper. That is, we should assume, contrary to prevailing theory, that most corporate directors, officers and employees are human beings. They are motivated by love, hate, fear, envy, friendship, loyalty and revenge as well as greed. They are smart, dumb, clever, not quite as smart as they think they are, too clever by half, honest, dishonest, and, all too often, confused.

How do we provide corporate law theory with a fuller, more human account of corporate actors? One way is by paying attention to the works of various social scientists, like Robert Frank, who are trying to develop economic or social theories that rely on a fuller and more realistic account of human behavior.[19] Another is to pay some attention to that much scorned discipline, management studies. Many corporate law theorists pride themselves on their familiarity with and understanding of the latest financial work being done at the top business schools. Management studies from those same schools get far less attention. This is, of course, a reflection of the academy's preference for hard theory over soft case studies.[20] But

19. ROBERT H. FRANK, CHOOSING THE RIGHT POND: HUMAN BEHAVIOR AND THE QUEST FOR STATUS (1985); ROBERT H. FRANK, PASSIONS WITHIN REASON: THE STRATEGIC ROLE OF THE EMOTIONS (1988).

20. *See An Economist Takes Tea with a Management Guru*, ECONOMIST, Jan. 3, 1992, at 89.

doesn't hard theory also imply that the enormous popularity of books by management gurus like Peter Drucker indicates that such people might provide useful insights into the actual behavior of corporate managers?[21]

The third and final suggestion implicit in Professor Wolfe's paper is that corporate law academics should broaden their horizons. In its most banal period, corporate law scholarship involved explaining why the standard corporate law rule in a given area, whatever it happened to be, provided the best incentives for the efficient conduct of corporate activity.[22] In recent years, however, corporate lawyers have begun to notice that the rules in places like Japan and Germany are very different from ours, yet many of those companies seem to be functioning as efficiently as or even more efficiently than their American counterparts.[23] To some, this suggests that their legal rules, with regard to things like shareholdings by financial institutions, are better than ours. To others, it suggests that corporate law rules may not be very important variables in competitive success. At the very least, however, a recognition that there are many successful ways to regulate corporate activity should help protect corporate law scholarship from the worst forms of parochialism.

By the same token, a little bit of historical perspective could sometimes be useful. It might tell us, for example, whether the development of the market for corporate control in the 1980s really did enhance managerial efficiency relative to, say, the 1950s, when hostile takeovers were almost nonexistent.[24]

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21. *See, e.g., $6000 Lecture Series: The Masters of Managing Tell All*, L.A. TIMES, Jan. 8, 1986, Pt. 5, at 1; Christopher Lorenz, *Drucker and the Art of Studied Simplicity*, FIN. TIMES, Sept. 23, 1983, at 12 (discussing how Peter Drucker and other management gurus make big bucks).

22. *See* Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, *supra* note 4, at 2235-45 (criticizing assumption that corporate law rules are efficient).

23. Richard M. Buxbaum, *Institutional Owners and Corporate Managers: A Comparative Perspective*, 57 BROOK. L. REV. 1 (1991); J. Mark Ramseyer, *Columbian Cartel Launches Bid for Japanese Firms*, 102 YALE L.J. 2005 (1993); Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan and the United States*, 102 YALE L.J. 1927 (1993); Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 YALE L.J. 2021 (1993).

24. The work of Alfred D. Chandler, for example, would appear to raise serious challenges to those who champion the efficiency-enhancing power of the market for corporate control. In his most recent book, ALFRED D. CHANDLER, JR., SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM 627 (1990), he expresses concern that extensive merger activity inhibits the long-term development of capital intensive industries. In ALFRED D. CHANDLER, JR., THE VISIBLE HAND—THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977), Chandler describes the relatively mergerless 1950s as a time of major efficiency-enhancing innovations in American corporate management.

Similarly, with regard to the ongoing debate regarding executive compensation, there is historical evidence that executive compensation levels were extremely high in the late 1920s and early 1930s, fell dramatically to a low point in the 1950s, and are now beginning again to reach the highest levels of the early 1930s. *See* Charles M. Yablon, *Overcompensating: The Corporate Lawyer and Executive Pay*, 92 COLUM. L. REV. 1867, 1871 n.9 (1992) (reviewing GRAEF CRYSTAL, IN SEARCH OF EXCESS (1991)). Again, it is hard to see how the higher

Finally, it might also be interesting to broaden our understanding of the subject matter of corporate law. The fact is that some of the most important and most debated issues in this country are direct outgrowths of corporate decisionmaking. I have in mind such questions as unemployment and underemployment, the lack of job creation in the recent recovery, the fear of a loss of competitiveness by many sectors of American industry relative to foreign companies, the desirability and possibility of freer international trade, and great concern about the growing disparities of wealth and economic opportunity among the people of this country. None of these issues falls within the traditional boundaries of corporate law, at least as it is currently taught and discussed in law schools. Perhaps this is simply a result of the artificial way legal topics are distributed through the law school curriculum. The primary subject of corporate law, at least as it is taught in American law schools, is management-shareholder relations, while management-labor relations is a matter for labor law, competitiveness is an issue for the antitrust course, and who knows where they talk about wealth disparities.

I suspect, however, that corporate law academics rather approve of the limitations they have placed on their field of inquiry. If corporate law scholarship were not confined to marginal issues, corporate law academics might have to avoid irresponsible or poorly thought out opinions, an unconscionable restraint on free expression. It might be interesting to find out, however, if corporate law scholars, with our presumed expertise in the rules, incentives and constraints on corporate managerial activity, can shed any light on the growing concern that American corporations are failing in their basic public role as the engines of economic growth and opportunity. If our current theories and scholarship can provide no such insights, that may itself be a pretty damning indictment of our field.

In any event, I thank Professor Wolfe for his paper, and am sure that our hosts will serve him something better than corporate law theory for dinner tonight.

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compensation levels of the early 1930s or late 1980s (much of it based on "incentive" compensation plans) resulted in better executive management.