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REDEFINING THE FIDUCIARY DUTIES OF CORPORATE DIRECTORS IN ACCORDANCE WITH THE TEAM PRODUCTION MODEL OF CORPORATE GOVERNANCE

GREGORY SCOTT CRESPI†

I. INTRODUCTION

In several recent and important co-authored articles, Margaret Blair and Lynn Stout have set forth and elaborated upon an intriguing "team production model" (henceforth "TPM") of corporate governance.[1] These articles advance two bold claims. First, the authors make the descriptive claim that the courts now embrace the TPM as the paradigmatic governance framework for public corporations more than they do the competing agency model and its associated norm of shareholder primacy.[2] Second, the authors applaud this development, contending that the TPM better reflects the reality of modern public corporate governance arrangements than does the conventional agency model, and thus provides a superior normative paradigm for guiding corporate law.[3]

Their original 1999 TPM article has subsequently received considerable scholarly attention,[4] some of it laudatory,[5] some of a more

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1. *See, eg.,* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) (reprinted in 24 J. CORP. L. 751 (1999)) [hereinafter "Blair and Stout I"]; Margaret M. Blair and Lynn Stout, *Corporate Accountability: Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403 (2001) [hereinafter "Blair and Stout II"]; Margaret M. Blair and Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Norms of Corporate Law*, 149 U. PA. L. REV. 1735 (2001) [hereinafter "Blair and Stout III"]. *See also* Margaret M. Blair and Lynn A. Stout, *Team Production in Business Organizations: An Introduction*, 24 J. CORP. L. 743 (1999). The authors explicitly recognize that their TPM approach is grounded in a substantial body of prior economic literature, in particular, Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. L. REV. 777 (1972); Bengt Holmstrom, *Moral Hazard in Teams*, 13 BELL J. ECON. & MGMT. SCI. 324 (1982); and Raghuram G. Rajan & Luigi Zingales, *Power in the Theory of the Firm*, 113 Q. J. ECON. 387 (1998). *See* Blair and Stout II, 79 WASH. U. L.Q. at 419 n.34.

2. *See* Blair and Stout I, 85 VA. L. REV. at 287-89.

3. *Id.* at 289.

4. *See, e.g.*, John C. Coates IV, *Team Production in Business Organizations: Measuring the Domain of Mediating Hierarchy: How Contestable are U.S. Public Corporations?*, 24 J. CORP. L. 837 (1999); David Millon, *New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001 (2000);

mixed character,[6] and some critical of both its descriptive and normative claims.[7] I am not aware of any judicial opinions that have yet

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Henry Hansmann and Reiner Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001); Peter Kostant, *Team Production and the Progressive Corporate Law Agenda*, 35 U.C. DAVIS L. REV. 667 (2002); Alan J. Meese, *The Team Production Theory of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629 (2002).

5. *See, e.g.*, Kostant, 35 U.C. DAVIS L. REV. at 672-74, which states:

> The TPM . . . provides a useful theoretical framework for understanding corporate governance . . . [and] provides a new and more inclusive paradigm of corporate governance in which stakeholder voice and loyalty are crucial. Applying TPM can help to introduce more meaningful "governance" into corporate governance and to provide some of the benefits commonly resulting from a political system.

Kostant, 35 U.C. DAVIS L. REV. at 672-74.

6. *See*, e.g., Coates, 24 J. CORP. L. at 838 who states:

> The [Blair and Stout TPM] model returns to an important topic—the potential importance of firm-specific capital in explaining organizational structure . . . . For those who view income and wealth disparities in the U.S. with dismay, the TPM/MH is also appealing from a distributional perspective, suggesting that boards distribute more to employees and less to the relatively wealthy segment of Americans that own stock.

Id. However, Coates later expresses strong reservations about the scope of applicability of the TPM as a normative framework. "[I]n the vast majority of close corporations and a significant minority of public corporations . . . [the TPM] does not have facial plausibility . . . the ability of the TPM/MH to rationalize corporate law may be considerably more limited than might first appear." *Id.* at 864-65. *See also* Viet D. Dinh, *Codetermination and Corporate Governance in a Multinational Business Enterprise*, 24 J. CORP. L. 975, 990-91 (1999) which states: "[While the TPM] seems to offer more fresh insights and a better understanding of economic functions . . . the theory places too much emphasis on judicial competence to enforce those duties . . . a structural shortcoming in their theory."

7. *See, e.g.*, Millon, 86 VA. L. REV. at 1001. Millon makes clear that he regards the shareholder primacy norm as having much greater sway in corporate law than Blair and Stout recognize in their original TPM article, and that their claim that the TPM model accurately describes current governance arrangements in public corporations is at least overstated if not flatly incorrect. *See id.* at 1009-24 (close look at their analysis suggests that, at best, TPM's claim of descriptive validity is overstated). In addition, he criticizes the TPM as a normative paradigm on several bases. First, he argues that rather than solving in an efficient fashion the rent-seeking problem that participants in a corporate enterprise must address in dividing the economic rents of the enterprise *ex post* when they have not agreed *ex ante* to a division, it likely just channels those unproductive efforts into attempts by each class of claimants to influence the board of directors to favor them in the allocation. *See id.* at 1031. He notes that this may actually lead to more inefficient rent-seeking than would occur when the board of directors embraces a shareholder primacy norm and therefore other classes of claimants concede defeat and spare their efforts. *Id.*

Second, Millon argues that the appeal of the TPM for communitarian corporate scholars who generally favor policies which would alter the current distribution of gains from corporate enterprises away from shareholders and in favor of other claimants such as workers is greatly reduced by the fact that under that approach, the allocation of economic rents would likely depend solely upon the the relative balance of "political" power among the different groups of claimants. *See id.* at 1037-38. Since the TPM does nothing to alter the current relative bargaining power of shareholders vis-a-vis workers, local communities, etc., he concludes that it will not alter the relative distribution of rewards among these groups, and is therefore from the communitarian perspective merely a sophisticated justification for the staus quo. *See id.* at 1038. Mullin concludes by stating: that "[d]espite the apparent appeal of its rejection of shareholder primacy,

drawn upon this growing TPM literature to change or clarify the legal standards applicable to corporate governance disputes. However, the TPM concept is unusual in that it to some extent bridges the wide chasm between the mainstream "contractarian" and the competing "communitarian"[8] views of corporation law[9] that has now persisted for decades.[10] Adherents of these two competing analytical frameworks usually start from radically different normative premises[11] and advance sharply conflicting policy recommendations, particularly with regard to the roles that non-shareholder corporate stakeholders such

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TPM therefore does little to advance a progressive agenda for corporate law." *Id.* at 1044.

Blair and Stout II was written after Millon's comprehensive and perceptive critique was published, and the article is somewhat disappointing in that it does not attempt to squarely address his criticisms, either through direct rebuttal or through making suitable concessions or qualifications, but merely notes his article in a couple of brief footnote references without joining the issues he raises. *See* Blair and Stout II, 79 WASH. U. L.Q. at 428-29 n.71, 435 n.94. *See also* Meese, 43 WM. & MARY L. REV. at 1646, 1664, 1671 (describing Blair and Stout's TPM as "a quintessential application . . . of the Nirvana Fallacy") (Meese argues that under the TPM model directors lack the incentive to maximize the welfare of the other team participants and restrain opportunism, and the framework thereby creates additional "ownership costs" of a monitoring nature which would offset any efficiency advantages that might result); *see also* Hansmann & Kraakman, 89 GEO. L.J. at 447 (referring to Blair and Stout as "sophisticated American advocates of the fiduciary model"). Despite this reference, Hansmann and Kraakman offer the following critical assessment of the TPM approach:

> There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value . . . [The Blair and Stout TPM does not] consitute at bottom a new approach to the corporation . . . Stakeholder models of the [Blair and Stout TPM] fiduciary type are in effect just reformulations of the [now rejected older] manager-oriented model, and they suffer the same weaknesses. While untethered managers may better serve the interests of some classes of stakeholders, such as a firm's existing employees and creditors, the managers' own interests will often come to have disproportionate prominence in their decisionmaking, with costs to some interest groups—such as shareholders, customers, and potential *new* employees and creditors—that outweigh any gains to the stakeholders who benefit. Moreover,the courts are evidently incapable of formulating and enforcing fiduciary duties of sufficient refinement to ensure that manager behave more efficiently and fairly.

Id. at 439, 448. (emphasis in original).

8. The "communitarian" view is sometimes labled the "progressive" view of corporate law.

9. Blair and Stout emphasize this point in their original article. Blair and Stout I, 85 VA. L. REV. at 253-54. For a good general discussion contrasting the contractarian and communitarian perspectives on corporate law, see David Millon, *New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373 (1993).

10. "The war between the contractarians and the anticontractarians has raged for two decades and produced a voluminous literature." Blair and Stout III, 149 U. PA. L. REV. at 1782.

11. *See* Millon, 86 VA. L. REV. at 1040-42.

as employees and members of the "local communities"[12] in which the corporations are situated should play in corporate governance. The possibility that those two groups of corporate law scholars who rarely agree with one another may each find some merit in the TPM concept, both as a descriptive schema and as a normative standard, suggests that Blair and Stout may have developed a flexible yet useful new framework that will eventually influence thinking beyond the academy and impact judicial decisions in a positive way.[13]

While the TPM concept has some shortcomings and is not yet fully articulated, in my opinion it nevertheless has substantial merit as an alternative description of public corporation governance and as a yardstick for the assessment of corporation law as applied to those entities. It definitely provides an interesting contrast to the more conventional agency model of corporate governance and its associated shareholder primacy norm, as well as to the communitarian perspective on corporate governance. It therefore would be a worthwhile exercise on the part of corporate law scholars to add to the recent work done by John Coates,[14] Viet Dinh,[15] Henry Hansmann,[16] Reiner Kraakman,[17] Peter Kostant,[18] Alan Meese,[19] David Millon[20] and others, and more fully elaborate the theoretical and practical implications of the TPM and subject them to discussion and criticism. In this article, I will attempt to make a modest contribution to that effort by examining the implications of the TPM for the locus and definition of the fiduciary duties that should be imposed upon the boards of directors of public corporations and by considering how effective a fiduciary duty regime that is tailored to fit TPM-style governance of public corporations is likely to be in achieving desirable social objectives.

As noted above, the TPM contrasts sharply with the conventional agency model of corporate governance and with the corollary principle that the fiduciary duties of corporate directors and officers should run solely to the corporation's residual claimant common shareholders.[21] The growing body of TPM literature, however, has so far failed to

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12. By this term I intend to refer broadly to the corporation's customers and suppliers as well as those persons who reside in proximity to the corporation's facilities or are otherwise indirectly affected by its operations.

13. *See* Millon, 86 Va. L. Rev. at 1001 (questioning whether the TPM will ultimately hold any appeal for communitarian scholars).

14. Coates, 24 J. CORP. L. at 837.

15. Dinh, 24 J. CORP. L. at 975.

16. Hansmann & Kraakman, 89 GEO. L.J. at 439.

17. *Id.*

18. Kostant, 35 U.C. DAVIS L. REV. at 667.

19. Meese, 43 WM. & MARY L. REV. at 1629.

20. Millon, 86 VA. L. REV. at 1001.

21. *See* Blair and Stout I, 85 VA. L. REV. at 253-55; *But see* Gregory Scott Crespi, *Rethinking Corporate Fiduciary Duties: The Inefficiency of the Shareholder Primacy*

make entirely clear whether under the TPM framework these traditional agency model-based fiduciary duties in favor of shareholders should be 1) preserved as a means of limiting director discretion, but augmented by the imposition of additional fiduciary duties to other stakeholders; 2) retained as the sole fiduciary duties, but respecified to run in favor of a larger class of stakeholders; or 3) discarded altogether, with other legal and/or non–legal means instead relied upon to constrain director discretion.

To briefly summarize my conclusions, if fiduciary duty law as applied to the directors of public corporations is to be redesigned to better facilitate TPM–style corporate governance arrangements, as I discuss below I would favor the respecification of those duties along the lines of the second alternative above. The proliferation of potentially conflicting fiduciary duties called for by the first alternative above would create a severe "too many masters" problem[22] that would not arise under the second or third alternatives. However, the second alternative above—preserving the concept of exclusive fiduciary duties and simply respecifying their locus as being the corporate entity as a whole, very broadly defined to include all de jure and de facto stakeholders—is more in accord with the basic TPM concept than is the more radical third alternative.[23] In addition, as a practical matter the courts tend to favor incremental over more radical changes and are far more likely to seriously consider embracing the new TPM paradigm if it is presented to them as a rationale for reorienting the application of traditional fiduciary duty principles than if it requires them to completely discard those principles.

In this article, I will in Part II present a very brief overview of the major TPM concepts.[24] In Part III, I will initially discuss how the locus of fiduciary duties should be respecified to be consistent with the

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Norm, 55 SMU L. REV. 141 (2002) (arguing that even under the agency model a contractarian analysis does not support the shareholder primacy norm).

22. *See* Millon, 86 VA. L. REV. at 1001.

23. While Blair and Stout in their original article do not make entirely clear what role fiduciary duties would play under the TPM, they do suggest that those duties should remain in place and run to the corporate entity as a whole. *See* Blair and Stout I, 85 VA. L. REV. at 271. ("[The mediating hierarch's] primary function is to exercise that control in a fashion that maximizes the" joint welfare of the team as a whole.). In their second article, however, they appear to more explicitly endorse the concept of a unitary fiduciary duty running to the corporate enterprise as a whole. *See* Blair and Stout II, 79 WASH. U. L.Q. at 421-25. ("[The mediating hierarch's allocation decisions should be made] with an eye to maximizing the total surplus . . . . The board of directors [under the TPM] acts as a fiduciary of the firm, meaning that it seeks to maximize the total value of these combined interests" of the shareholder, bondholder, manager and employees.).

24. A reader interested in a more complete explanation of the TPM should read the series of Blair and Stout articles on the subject, *supra* note 1, as well as David Millon's and Alan Meese's comprehensive critiques of the TPM approach, *supra* note 4.

TPM framework of corporate governance, should that paradigm be determined to be a descriptively more accurate model of public corporations than is the conventional agency model. I will then review the relatively complex calculations that would have to be carried out to determine how the performance of a TPM-style corporate board of directors measures up against these respecified fiduciary duties. Finally, I will discuss what practical significance of embracing the TPM by the courts as well as their subsequent respecification of the fiduciary duty standards to be consistent with this model, would have for corporate governance. Part IV will present a brief conclusion.

This article will address only the fiduciary duty law implications that should follow from judicial acceptance of the TPM as the dominant governance paradigm for public corporations. There are of course several other substantial and interesting questions presented by the TPM that also merit extended consideration. For example, Blair and Stout's strong descriptive claim that corporate governance law already is more in accord with the TPM than with the agency model of corporate governance is open to serious question.[25]

As another example, their claim that the TPM governance structure generally solves the public corporation stakeholder contracting problems that they identify more efficiently than would a governance structure that charged the board of directors to act as agents of the common shareholder principals leaves considerable room for debate, as does the claim that a contractarian hypothetical bargain analysis therefore calls for the TPM to be utilized as the normative baseline for assessing the facilitative properties of corporate governance law.[26] Finally, it is unclear whether legal rules designed to facilitate TPM-style corporate governance arrangements will actually work to further traditional communitarian objectives such as enhanced rights for workers and local communities more than does the the agency model-based shareholder primacy norm.[27] These interesting questions, however, are beyond the scope of this article.

II. THE TEAM PRODUCTION MODEL OF CORPORATE GOVERNANCE

Blair and Stout base the TPM on a rejection of the conventional contractarian agency model of corporate governance under which corporate directors and officers are regarded as agents of their share-

25. *See, e.g.*, Millon, 86 VA. L. REV. at 1020-21; Meese, 43 WM. & MARY L. REV. at 1672-1700.
26. *Id.* at 1030-32, 1701-02.
27. *See, e.g.*, Millon, 86 VA. L. REV. at 1038-39.

holder principals.[28] They contend that the agency model does not fit most public corporations very well because their shareholders retain too little effective control over corporate officials to be meaningfully regarded as their principals.[29] They argue that the true objective of corporate governance arrangements is not the minimization of agency costs, as is widely thought, but is instead an efficient solution of the team production problem.[30]

This problem arises because the different stakeholders in a public corporation each must invest "firm-specific"[31] resources in the enterprise as part of the effort to jointly produce firm output, and are consequently vulnerable after making these relatively illiquid investments to opportunistic behavior on the part of the other stakeholders. The central contracting problem they face is how to efficiently allocate the gains from the production and sale of that output among themselves when the output is by its nature joint production drawing upon all of their contributions, and where there is an "economic rent" surplus remaining for distribution in some fashion after each class of stakeholders has been compensated for their investment of capital or labor in accordance with their opportunity costs.[32] Blair and Stout contend that the stakeholders of large public corporations are generally unable to contract *ex ante* at a reasonable transaction cost for a division of that economic rent in a manner that effectively precludes all forms of shirking.[33] Moreover, if they attempt to address the shirking problem in isolation by according one class of stakeholders, such as, for example, the common shareholders, the right to retain all of the economic rent after the other stakeholders have been compensated in accordance with their opportunity costs, then that class as the sole residual claimants will have the proper incentive to act as *ex post* monitors to prevent shirking by the other stakeholders. However, the other stakeholders will then have inadequate incentives to make efficient levels of firm-specific investments since their opportunity cost-based compensation will not reflect the full value of their firm-specific investments to the corporate entity. The overall wealth of the corporate

28. Blair and Stout I, 85 VA. L. REV. at 253-55.

29. *Id.* at 258-59.

30. *Id.* at 249-51.

31. Blair and Stout define "firm-specific" investments as investments that are difficult or impossible for the contributors "to recover once committed to the [corporate enterprise]." *Id.* at 249.

32. These opportunity costs would be determined by what the contributors could earn by withdrawing their resources from the corporate enterprise, being able to recapture only at most a portion of their firm-specific investments, and then devoting those resources to their best alternative use.

33. Blair and Stout I, 85 VA. L. REV. at 265-66.

entity as a whole will therefore be reduced by this underinvestment, perhaps substantially so.[34]

Barnes and Stout argue that the most cost-effective strategy for the participants in the corporate enterprise to deal simultaneously with these two sources of inefficiency is to relinquish control of the enterprise to an independent third party—the board of directors. It is then the board's duty to further the interests of the entire enterprise and allocate the rewards of production among the investing stakeholders in a manner that 1) assures the continuing participation of each group by compensating them for at least the opportunity costs of their investment; 2) effectively controls shirking with *ex post* monitoring; and 3) allocates the economic rent in a manner which reflects the political balance of power among these groups within the overall enterprise and which preserves the proper incentives to encourage efficient levels of firm-specific investment.[35]

The board of directors under the TPM is thus best characterized as a "mediating hierarch"[36] rather than as an agent of the shareholders. The board is conceded authority by the various stakeholders because by doing so they can avoid both the transaction costs they would otherwise incur in negotiating *ex ante* the much more fully specified contracts that would otherwise be necessary to protect themselves from shirking by others, and the losses that would result from the reduced incentives to commit firm–specific resources that would result from assigning one class of claimants the exclusive rights to the surplus and limiting all other stakeholders' compensations to their opportunity costs. Under the TPM, the power that the stakeholders confer upon the board of directors to favor one group of corporate claimants over others is virtually absolute as long as their decisions are in the long–term interest of the overall enterprise, and as long as the board of directors evidence loyalty to the overall enterprise and refrain from self-dealing at its expense.[37]

The TPM is a particularly interesting framework to use as a normative paradigm for the assessment of corporate governance law. Its main features are grounded in a conventional contractarian assessment of the hypothetical bargain that public corporation stakeholders would reach in costless *ex ante* negotiations in an attempt to simultaneously minimize the costs of limiting shirking, the costs of reduced output resulting from the provision of inadequate incentives to bring

34. *Id.* at 272-73.
35. *Id.* at 282-83.
36. *Id.* at 250.
37. Good summaries of the Blair and Stout TPM framework are provided by Kostant, 35 U.C. DAVIS L. REV. at 672-74; Meese, 43 WM. & MARY L. REV. at 1629-45; and Millon, 86 VA. L. REV. at 1005-09.

forth efficient levels of firm–specific investment, and the costs of dividing up the economic rents. Blair and Stout conclude, however, that such bargaining would *not* lead to acceptance of the conventional contractarian shareholder primacy legal norm and the corollary principle that fiduciary duties should run exclusively to the common shareholders, but would instead result in the board being given the authority to favor other stakeholders over the common shareholders if the long–term interests of the entire enterprise were thereby advanced. In other words, the TPM framework interestingly provides a contractarian, efficiency–oriented justification for legal rules that allow corporate boards to at times implement policies of the sort more widely favored by communitarians than by contractarians in favor of workers or other non–shareholder stakeholders that may reduce shareholder wealth, even over the longer term.

What would be the nature of the fiduciary duties that should be imposed upon corporate boards under the TPM framework, if any? To whom should those duties run, and how should director compliance with those duties be assessed? To these questions I will now turn.

III. FIDUCIARY DUTIES UNDER THE TEAM PRODUCTION MODEL

A. THE NEW LOCUS OF FIDUCIARY DUTIES

Under the TPM, the board of a directors plays a mediating role among the various corporate stakeholders, subject only to very broad constraints. One might still technically characterize such a board as an "agent," although it would be more of an independent contractor-type agent with very substantial discretion as to how to discharge its duties than a traditional master-servant corporate agent. Even if a TPM–style board is regarded as being a species of agent, each of the stakeholder groups would be entitled to be treated by the board as "joint principals." For such a multi-principal agency relationship, imposing fiduciary duties of care and loyalty that run exclusively to common shareholders would make no sense at all. If the legal system is to facilitate TPM–style corporate governance it will therefore be necessary for the courts to either impose upon the board additional and co–equal fiduciary duties in favor of each of the other stakeholder groups, redefine the locus of exclusive fiduciary duties as now being the corporate entity as a whole, or else discard the concept of fiduciary duties altogether and implement another means of limiting director discretion. These seem to be the only reasonable choices available.

Corporate law scholars have long debated the merits of supplementing the fiduciary duties running to common shareholders with additional, co–equal fiduciary duties running to other stakeholders,

such as workers or local communities.[38] This debate was energized in the late 1980s by the passage of a large number of "constituency statutes" in response to the various concerns raised by the increase in the number of large hostile corporate takeovers.[39] While some participants in that debate argued in favor of imposing such additional fiduciary duties,[40] others expressed concerns that corporate directors and officers would have undue difficulty balancing the conflicting duties, and that the probable reluctance of courts to second-guess such difficult decisions might lead to the effective reduction of fiduciary duty constraints, perhaps to the point of near-elimination, except in cases of self-dealing.[41]

The imposition of additional and competing fiduciary duties would clearly present major difficulties in assessing compliance, but such legal changes are fortunately not necessary to facilitate TPM-style corporate governance. There is no question but that a TPM-style board of directors that is not guided by the shareholder primacy norm is going to have to balance in some fashion the interests of different stakeholder groups where they conflict. However, in many instances those interests do not conflict, and an exclusive fiduciary duty in favor of the interests of the entire corporate enterprise is under those circumstances an appropriate legal directive, regardless of whether one regards the matter from a contractarian or instead a communitarian perspective, since it would both reflect the hypothetical *ex ante* bargain among the interested parties and not privilege shareholders at the expense of other stakeholders. Barnes and Stout in their second TPM article evidence an increasingly clear recognition of this point.[42]

When, however, corporate decisions must be made on matters where the interests of different stakeholder groups do diverge, and where neither the overall welfare of the enterprise nor benefits to the board itself are at issue, some legal principles beyond the fiduciary duty to the overall enterprise may be desirable to guide director deci-

38. *See, e.g.*, Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23 (1991); Katherine Van Wezel Stone, *Employees as Stakeholders Under State Nonshareholder Consistency Statutes*, 21 STETSON L. REV. 45 (1991); Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899 (1993).

39. By 1993, approximately 30 states had passed statutes permitting but not requiring corporate officials to consider enumerated nonshareholder interests going beyond contractual obligations in corporate decisionmaking. Millon, VA. L. REV. at 1375-76.

40. Van Wezel Stone, 21 STETSON L. REV. at 45; O'Connor, 78 CORNELL L. REV. at 899.

41. Macey, 21 STETSON L. REV. at 23.

42. *See* Blair and Stout II, 79 WASH. U. L.Q. at 434-38.

sions. One may favor a legal regime permitting unencumbered "political" balancing of interests under such circumstances, as is called for by Barnes and Stout,[43] relying upon the "intrinsic trustworthiness" of TPM–style boards to impose socially acceptable allocations of the economic rents.[44] Alternatively, one may conclude, as does David Millon, that legal deference to such political allocation decisions will simply validate the much greater extralegal social influence over TPM–style boards exercised by shareholders compared to other stakeholder constituencies, particularly workers and members of local communities, thus for better or worse replicating the substantive results of the shareholder primacy norm.[45] However, in any event, a framework of conflicting fiduciary duties is neither an appropriate nor a workable way for the legal system to attempt to influence such decisions.

I therefore conclude that the fiduciary duty regime that is best suited for facilitating TPM–style corporate governance is to retain the concept of exclusive fiduciary duties of loyalty and care owed by the board of directors, but to respecify their locus as the corporate enterprise as a whole rather than the common shareholders. In Part II B of this article below, I will discuss how such a respecified exclusive fiduciary duty regime can be given operational content. Such a legal regime concededly will not provide legal guidance to directors when making those allocative decisions among stakeholder groups that do not affect overall corporate welfare or raise director self–dealing concerns. I recognize that some form of legal constraints on such board decisions may well be preferable to the naked political resolution of such questions that Barnes and Stout advocate. However, given the "trump card" nature of fiduciary duties, it simply will not help the courts to resolve challenges of such decisions in a consistent and principled fashion if they deal out conflicting fiduciary duty trump cards to all of the players. Some other approach will have to develop to limit the political character of such decisions if such limitations are deemed desirable.[46]

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43. *See* Blair & Stout I, 85 VA. L. REV. at 250.

44. *See* Blair and Stout II, 79 WASH. U. L.Q. at 438-43. *See also* Blair and Stout III, 149 U. PA. L. REV. at 1735 for an extended discussion of the role played by trust and confidence in corporate relationships.

45. Millon, 86 VA. L. REV. at 1037-40.

46. As noted above in the text, the question of the appropriate non-fiduciary duty limitations on the discretion of a TPM-style board of directors is beyond the scope of this Article.

B. Assessing the Impacts of Decisions for Fiduciary Duty Purposes

As a threshold matter, if the fiduciary duties to be applied to TPM-style board decisions are to be duties of loyalty and care with regard to the interests of the entire corporate enterprise, it seems clear that the laws would have to be changed to allow each class of stakeholders standing to press a derivative suit on behalf of the corporation to enforce this duty. Otherwise, if standing were more limited, no one could effectively challenge a board decision that injured the overall enterprise but furthered the interests of the subset of stakeholders who had standing to press a derivative claim.

Assuming that all classes of stakeholders are accorded standing to enforce the fiduciary duties to the overall corporate enterprise, how would the board's compliance with those duties be assessed if challeged? If the challenge was based upon some form of self-dealing by the board as a whole, or by some directors acting individually, the appropriate standard would differ little if any from the duty of loyalty standard currently applied to claims of director self-dealing under the shareholder primacy norm. If, however, the challenge was based upon an allegation of injury to the enterprise as a whole that did not involve director self-dealing, then new criteria by which the impact of a decision on the overall welfare of the corporate enterprise could be assessed for its consistency with fiduciary duty of care obligations would have to be applied.

As a conceptual matter, the appropriate criterion here seems to me readily apparent. The fiduciary duty of care to which TPM-style boards of public corporations should be subject should be to maximize the overall value of the corporate entity to all stakeholders, broadly defined to also include the value of the entity to its (contractual) customers and suppliers as well as to those de facto stakeholders (such as members of local communities) who may not have formal contractual relationships with the corporation. Such an inclusive specification of the locus of fiduciary duties of course raises the question whether it is reasonably amenable to quantification to the extent necessary for it to be meaningfully applied. Let me attempt to first justify the use of this very broad criterion as a matter of principle, and then I will discuss some of the details of its application in order to shed light upon the feasibility and consequences of its use.

I have argued in some of my earlier work that even under the conventional agency model of corporate governance, the purely financial stakeholders in a corporate entity, i.e., the various classes of common or preferred shareholders and bondholders, not including employees or members of local communities, would, if rational, not

agree *ex ante* among themselves to impose by contract an exclusive fiduciary duty running solely to the common shareholders.[47] Modern financial theory is premised upon the insight that such rational investors would, if transaction costs permit, each be fully diversified in their holdings of all financial assets—including among their assets holdings of each of the various classes of financial claims against the subject corporate entity—in proportion to the relative aggregate market value of each class of claims, so as to eliminate the unsystematic component of their portfolio risk.[48] Their individual sub–portfolios of holdings of claims against the subject corporate entity would therefore not differ among these investors in terms of their relative composition, but would differ only in their size because of individual wealth differences and in the extent to which they were leveraged by borrowed funds because of different investor attitudes towards systematic market risk. These investors would therefore not choose to impose by contract a blanket fiduciary duty rule that the board of directors was to favor the residual shareholder claimants regardless of whether the consequence was a greater adverse impact on other classes of financial claimants. Such a rule could work to injure *all* of those investors.[49] Each hypothetical investor being fully diversified across all of those claims, they would all very quickly agree that the board should be contractually placed under a fiduciary duty to instead maximize the overall value of all financial claims combined, rather than the value of only the most residual claims.

This simple hypothetical bargain analysis of the locus and nature of efficient fiduciary duties among purely financial claimants cannot be generalized without qualification to the TPM situation here considered, where all classes of de jure and de facto stakeholders, employees and members of local communities as well as purely financial claimants, would be involved in the hypothetical *ex ante* negotiations. This is because employees and members of local communities, even if "rational," in general simply do not have the wealth available to enable them to fully diversify away the high degree of unsystematic risk brought to their "portfolios" by their employment or otherwise-based stake in the welfare of the corporate entity. These claims will quite often be their dominant "asset" despite their attempts to diversify, and their interests in these hypothetical negotiations would therefore often diverge to some extent from those of the more fully diversified purely financial claimants.

47. *See* Crespi, 55 SMU L. REV. at 141. *See also* Thomas A. Smith, *The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty*, 98 MICH. L. REV. 214 (1999).
48. *See* Crespi, 55 SMU L. REV. at 149-52.
49. *Id.* at 151.

While the financial and non-financial stakeholders would approach these *ex ante* negotiations with differing interests, they would nevertheless all agree that imposing a fiduciary duty upon the board of directors to maximize the overall combined value of all stakeholder claims against the corporate entity would be in their collective interest. Put simply, despite their differences as to how the corporation's economic rent "pie" should be divided, they would all agree that the board of directors should be subjected first and foremost to an overriding fiduciary duty obligation to make the pie as large as possible, consistent with the honoring of all corporate contractual commitments.

There are of course some formidable measurement problems inherent in determining whether a board decision has truly maximized the aggregate value of the corporate entity to all stakeholders, as compared to the consequences of the other available course of action (including the "no action" null option). Conceptually, one would ideally like to be able to do a "before" and "after" comparison of the total aggregate value of the corporate entity to all stakeholders to determine the net impact of the decision at issue and then assess whether that net impact was the most favorable to the entity of the set of potential before/after net impacts that would have resulted from each of the competing options (including the "no action" option) from which the board of directors made its choice.

While the impact of a decision upon the value of purely financial claims such as shares of stock or bonds can often be determined from the changes in the market prices for those claims,[50] the valuation of the impacts upon employee or local community wealth will usually involve much more tentative and subjective assessments. For example, determining the net impact of a corporate decision upon the aggregate value of a corporate entity to its employees would involve first of all determining as the pre-decision value baseline the following figure: the present value of the combined expected stream of salary payments to each of those employees over their projected future careers with the firm,[51] plus the present value of the combined expected stream of non-economic satisfactions provided to each of those employees by their employment over and above their financial compensation, minus the present value of the combined stream of "disutilities" imposed upon each employee by having to do the work necessary to satisfy their em-

50. Market price measures of the impacts of the competing options not chosen by the board of directors would of course not exist, and those "road not chosen" hypothetical, counterfactual impacts would be far more difficult to estimate.

51. As a matter of principle the present value of the expected future stream of payments to future employees of the firm should also be included, although, as a practical matter, it is likely to be impossible to establish the identity or timing or length of tenure of those future employees.

ployment obligations.[52] When calculating the value of purely financial claims against the corporate entity, one can to a first approximation reasonably assume that there are no significant benefits provided to those claimants in excess of the market value of their claims, and that there are no significant disutilities involved in holding those claims. These assumptions of course would each be most unreasonable with regard to employee claims, and even though this comprehensive calculation concerning the value of the corporation to its employees may prove quite difficult,[53] it is a necessary aspect of an overall fiduciary duty compliance assessment.

Once the pre-decision baseline net present value to employees has been calculated, the same algorithim would have to be applied to calculate the post-decision present value of the corporate entity to its employees,[54] as well as the post-decision present value of the corporate entity to the employees had any one of the other competing options under consideration been adopted instead. These calculations may be far more complex than the previous baseline calculation. For example, if any employees are terminated (or have their salaries and/or work responsibilities reduced) as a result of the decision (or would have been as a result of any of the other options being compared), it will be necessary to consider as an offset to their losses of salary due to their termination (or salary/responsibility reduction) the present value of any salary payments or other satisfactions that they will obtain, net of any new "disutilities" imposed, in the employment alternatives they have (or would) pursue. If any new employees are hired (or old employees promoted) as a result of the decision (or would be under one of the alternatives being considered), their net gains should be included in the post-decision aggregate corporate value, and to be properly calculated one must subtract from their net corporate benefits the net rewards they were previously obtaining from their former occupations.

From a contractarian perspective one should also consider the net impacts upon the employees of other firms whose employment situations are affected in some indirect fashion by the movement of employees to and from the subject corporation, since they too would presumably have participated in and offered appropriate "bribes" of up to a certain size to protect their interests in the hypothetical initial

52. This latter adjustment obviously will sharply reduce the net present value of the corporate entity to its employees!

53. And, of course, the estimation of the hypothetical impacts upon employees of the policy options not chosen would prove even more difficult.

54. *Id.*

Coasian negotiations establishing the corporate entity,[55] and would thereby have contracted to be included among the fiduciary duty recipients. Communitarians would of course also call for their inclusion, although basing this upon the different premise of the importance of worker interests generally to community welfare. As a practical matter, however, this second-order impact (and subsequent third- and higher-order general equilibrium impacts) on employee welfare elsewhere in the economy is likely to be impossible to assess with any meaningful degree of precision.

With regard to the impacts of corporate decisions upon the members of the local community (or multiple communities) in which the corporation is situated, even where there is no formal contractual relationship between the corporation and the members of the community it is appropriate from either the contractarian or the communitarian perspective to also consider those impacts in the fiduciary duty assessment. Such local communities should be broadly defined to include all persons outside of the corporation's shareholder/bondholder/employee groups who nevertheless are de facto stakeholders in that corporate decisions may have significant implications for their welfare. The relevant members of such local communities would include the corporation's customers and suppliers, and those persons who are more indirectly impacted through their relationships with those customers and suppliers, as well as any other persons who for reasons of geographical proximity or otherwise are indirectly affected by corporate actions.

The rationale for this broad inclusion of de facto stakeholder groups under the fiduciary duty umbrella is clear. To contractarians, once again, the members of such local communities should count as de facto stakeholders because they would presumably also have participated in the hypothetical *ex ante* Coasian negotiations establishing the contours of contractual rights through their willingness to offer "bribes" of up to a certain size to the other stakeholders if necessary to obtain benefits or avoid costs. To communitarians, in contrast, the right of members of local communities in which the corporate entity is situated to have their interests considered is almost an article of faith not in need of intellectual justification. Either way, the impact upon members of the local community is a clearly relevant concern for the fiduciary duty compliance assessment.

When attempting to value the impacts of corporate decisions upon local community-type stakeholders based on the perceived "external" benefits conferred (or costs imposed) upon the community by the cor-

55. I offer here the obligatory citation. Ronald Coase, *The Problem of Social Cost,* 3 J.L. & ECON. 1 (1960).

poration, however, even greater measurement problems are presented than by the difficult assessments discussed above that are necessary to measure the impacts upon employees. One must once again first determine the pre–decision baseline value of the corporate entity to the local community. To do this, one must determine the present value of the steam of expected community benefits (not including any employment benefits to corporate employees, which have already been counted), and then subtract the present value of any costs the corporation imposes on the community, such as "external" costs, tax subsidies, etc.[56] One must then calculate this figure post–decision, as well as for the hypothetical post-decision situations had any of the other available options been chosen, and then compare the net impacts upon the community for each possible alternative. If the result of the decision (or any of the rejected alternatives) impacts any communities, either by increasing or reducing the corporate entity's employment presence or otherwise, the net impacts of these effects must be included. These community impacts in general are likely to be even more difficult to estimate than are the prior employee impact calculations because there are unlikely to be any useful "market" figures available to assist at all in making these calculations.

The final and most straightforward calculation that would be required would be to aggregate the net impact upon all stakeholder groups combined of each option that was considered, and then compare these net impacts to one another to see whether the course of action chosen provides the largest possible net benefit to the overall corporate entity. If the course of action with the largest net benefit is in fact the option the corporation did pursue, then its board has satisfied the fiduciary duty of care requirement. If one of the other options considered would have had a greater net benefit, then the board has violated its fiduciary duty to the corporate entity as a whole. It must be kept in mind that the fiduciary duty requirement should be deemed satisified so long as the overall combined impact on the corporate entity of the decision is the most favorable possible, even if one or more of the stakeholder groups are injured by the decision made. In more technical terms, it should not be necessary that the decision results in a Pareto-improvement with regard to the each of the different stakeholder classes, so long as it results in the largest Kaldor-Hicks improvement possible among the set of options that were considered.[57]

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56. Once again, this difficult measurement exercise will also have to be conducted for each of the policy alternatives that was not chosen by the board of directors.

57. For a discussion of the Pareto—improvement and Kaldor-Hicks—improvement criteria, see Gregory Scott Crespi, *The Midlife Crisis of the Law and Economics Movement: Confronting the Problems of Nonfalsifiability and Normative Bias*, 67 NOTRE DAME L. REV. 231, 234-37 (1991).

C. THE PRACTICAL SIGNIFICANCE OF THE NEW LOCUS OF FIDUCIARY DUTIES

In assessing the potential significance of respecifying fiduciary duties to run to the corporate entity as a whole, broadly defined, one must keep in mind the practical significance of the existing fiduciary duty regime. The courts have universally applied the very deferential business judgment rule when compliance with the fiduciary duty of care is at issue.[58] Under the business judgment rule jurisprudence courts will generally limit their inquiry to whether the board has acted in good faith and on a reasonably informed basis in making the decision at issue, with the initial presumption being in favor of the board, and unless it is demonstrated that these procedural requirements are not met the courts will usually not question the merits of the decision. Furthermore, under the law of most state jurisdictions, corporations can adopt charter provisions that shield their directors from financial liability for violations of the duty of care.[59] As a practical matter, therefore, the existing fiduciary duty of care standard provides directors only with an aspirational norm, an exhoratory statement of good practice, rather than subjecting them to an enforceable legal duty.

A respecified fiduciary duty of care running to the entire corporate enterprise would almost certainly be implemented by the courts with at least the same degree of deference to board decisions as is currently exhibited. A procedure-oriented business judgment rule review would again be substituted for consideration of the merits of the decision at issue. I am convinced of this because as I have demonstrated above the calculations required to assess whether a decision satisfies this respecified fiduciary duty are easily an order of magnitude more complex and subjective than are those calculations that are required to determine only whether a decision maximizes the value of a corporation's common shares. Even a judge who was willing to strictly scrutinize the consequences of the decision at issue on common share values relative to the hypothetical impacts that the other options considered might have had would be more reluctant to second-guess the much more complex assessments of the relative combined impacts on bondholders, employees, and local community de facto stakeholders of the options considered. It seems reasonable to predict that since the assessment required would be much more difficult, the standard of

58. "[A]s a practical matter, a negligent director is more likely to be hit by lightning after leaving her board meeting then she is to pay damages." Blair and Stout III, 149 U. PA. L. REV. at 1791.

59. *See, e.g.*, D.G.C.L. § 102(b)(7) (1999).

review is likely to be even more deferential and procedural in character than at present.

The application of this respecified fiduciary duty of care would therefore in practice almost certainly be limited primarily to a business judgment rule assessment of the procedures that had been followed. This assessment would, however, probably be a somewhat more extensive inquiry than is done at present since under the new fiduciary duty standard for a decision to be "reasonably informed" the board would likely be required to show that they had considered information relevant to assessing the magnitude of the relative impacts of their choices on all affected stakeholders and not the common shareholders alone. One would also expect the state legislatures to again quickly respond to this respecified fiduciary duty, as they did after *Smith v. Van Gorkom*[60] with amendments to their statutory opt-in provisions that were based on Delaware General Corporate Laws section 102(b)(7), that would allow firms to shield their directors from liability for violations of this broader fiduciary duty as well.

What this all would mean, in practice, is that the new fiduciary duty would resemble in significant regards the earlier exclusive fiduciary duty to shareholders in that it would largely play the role of an aspirational norm rather than an enforceable legal directive. However, one should not minimize the importance of aspirational norms in shaping the behavior of corporate directors.[61] Norms do matter, and I hope that I have made clear in this article that it would probably lead to more efficient resource utilization if those boards of directors that are engaged in TPM–style governance of public corporations were encouraged by the courts to aspire to maximize the value of the overall corporate entity rather than to attempt to maximize the value of the corporation's common shares.

IV. CONCLUSION

Margaret Blair and Lynn Stout's TPM of corporate governance is an interesting and promising framework that merits even more schol-

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60. 488 A.2d 858 (Del. 1985).

61. Blair and Stout III, 149 U. PA. L. REV. at 1744, which states:

> By articulating a social expectation that directors will exercise due care, judicial opinions on the duty of care may influence directors' behavior not so much by changing their external incentives as by changing their internal preferences. This approach explains the schizophrenic quality of modern case law on the duty of care, which generally exhorts directors to meet a high standard of behavior while simultaneously declining to impose liability for failing to meet that standard.

Id. (citations omitted). *See also id.* at 1787 which states, "[T]rust-based analysis suggests that the central purpose of fiduciary duty law is to induce trust behavior . . . the law expects the fiduciary to internalize commitment . . . ."

arly attention and criticism than the substantial amount it has so far received. Their basic argument is that the TPM has been widely adopted by public corporations because it better accomodates their governance needs than does the conventional agency model with its associated shareholder primacy norm, and that it has been and indeed should be embraced by the courts as the paradigmatic form of governance of public corporations. In this article I have attempted to show that if the courts in fact do come to embrace the TPM as the dominant form of corporate governance they should in principle also respecify the locus of the fiduciary duties of these boards of directors to run to the corporate entity as a whole, broadly defined, rather than exclusively to the corporation's common shareholders.

The determination of whether a board has met this respecified duty of care to the entire corporate entity, however, proves to be a very complex calculation requiring difficult and subjective assessments of the impacts of the decision at issue, as compared to the probable consequences of the other options that were considered, on shareholders, bondholders, employees, and the de jure and de factor stakeholder members of the "local communities" in which the corporation is situated, including its customers, suppliers, local residents and other persons indirectly affected. The difficulties and uncertainty inherent in such a complex determination would likely lead courts to continue to apply a deferential and procedure-oriented business judgment rule assessment rather than attempt to scrutinize the merits of the decision.

The respecified fiduciary duties that are most consistent with the TPM corporate governance framework would therefore resemble the existing fiduciary duties in one significant regard in that they would continue to provide in practice only an aspirational norm rather than an enforceable substantive legal standard. However, since aspirational norms do have some influence on behavior, if the TPM in fact becomes the dominant corporate governance paradigm then the respecification of the locus of fiduciary duties to run to the corporation as a whole is likely to lead to at least modest efficiency gains in corporate policies.