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The Corporation Reborn: From Shareholder Primacy to Shared Governance

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Abstract: The consensus around shareholder primacy is crumbling. Investors, long assumed to be uncomplicated profit-maximizers, are looking for ways to express a wider range of values in allocating their funds. Workers are agitating for greater voice at their workplaces. And prominent legislators have recently proposed corporate law reforms that would put a sizable number of employee representatives on the boards of directors of large public companies. These rumblings of public discontent are echoed in recent corporate law scholarship, which has cataloged the costs of shareholder control, touted the advantages of nonvoting stock, and questioned whether activist holders of various stripes are acting in the company's best interests. Academics who support stronger shareholder rights are accused of pandering to special interest groups or naively seeking a panacea in a plebiscite. As critical theorists have documented over time, the foundations of the shareholder primacy model have always been compromised. In particular, the arguments for a core feature of the modern corporation—the exclusive shareholder franchise—have been revealed as the product of flawed assumptions, misapplied social choice theory, and a failure to hold true to the fundamental precepts of standard economics. It is time to look at such governance features anew, and reorient the literature around the basic purpose of corporations: to provide a legal mechanism for business firms to engage in the process of joint production. In this Article, we present a new shared governance model, one that builds on the longstanding theory of the firm as well as a novel theory of democratic participation. These twin arguments, economic and political, both counsel in favor of extending the corporate franchise to employees as well as shareholders, and, importantly, provide a way to distinguish these two constituencies from other corporate stake-

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holders when it comes to governance rights. We conclude by assessing the current status of a shared governance system in Germany and advocating for further theoretical and empirical inquiry into shared governance structures that provide for joint shareholder and employee participation.

INTRODUCTION

It is a remarkable moment in corporate law. Everything is about to change. The status quo of shareholder primacy clings stubbornly on, full of its old power in appearance, and yet it is a façade. It is the Soviet Union after the fall of the Berlin Wall. It is Persia after Thermopylae, the British Raj after the Salt March, disco after the Ramones. We are at the beginning of the end.

This claim may seem absurd in light of the dominance of shareholder primacy theory throughout the United States, the European Union, and developing nations. The academic network behind shareholder primacy remains resolute; almost all corporate law scholarship pivots around the central idea of shareholder control.[1] It is almost twenty years since Henry Hansmann and Reinier Kraakman's declaration about the end of corporate law history,[2] and shareholder wealth maximization remains the governing norm.

But underneath the superficial agreement is a roiling mass of disputes and divisions. The field is more fractured than ever before. The prospect of real shareholder empowerment, through proxy access or shareholder bylaws, has split the academy into subgroups that advocate for divergent approaches.[3] Activist investors have gone from the saviors of shareholder rights[4] to short-term opportunists who should be marginalized.[5] Money is

[1] Ann M. Lipton, *Shareholder Divorce Court*, 44 J. CORP. L. 297, 300 (2018) ("Most modern theories of the corporation subscribe to what is known as 'shareholder primacy,' i.e., the notion that directors have, or should have, a commitment to manage the corporation in a manner that benefits the shareholders.").

[2] *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) ("There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value.").

[3] *See, e.g.*, Lipton, *supra* note 1, at 300 (discussing "sharply divergent views of the precise nature of directors' legal obligations"). The Bainbridge-Bebchuk debate over the role of shareholder participation in management is one example. *Compare* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 835 (2005) (arguing that shareholders should have increased governance power), *with* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 550 (2003) (advocating for a director primacy model).

[4] *See* Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1089 (2015) (noting research in finance that "public disclosures of the purchase of a significant stake by an activist . . . are accompanied by significant positive stock-price reactions as well as followed by subsequent improvements in operating performance");

being shoveled like never before into passive index funds and exchange-traded funds—the absentee landlords of stock ownership.[6] Important recent scholarship focuses on the problems of "principal costs" generated by investor governance[7] and touts the advantages of nonvoting shares.[8] Leaders in the field such as Nobel Laureate Oliver Hart,[9] Michael Jensen,[10] and former Delaware Supreme Court Chief Justice Leo Strine[11] are questioning the stability of shareholder primacy as a regulatory norm. The corporate law centre cannot hold.

Now that shareholder primacy is losing its grip on the corporate world, for the first time in a very long time we can start to see the outlines of what will come after. The next wave in corporate governance is coming, and it will include workers. For too long, labor has been left outside of the corporate governance gates. But we now see concrete examples of the coming change. Recent bills proposed by Senators Tammy Baldwin and Elizabeth

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Mark Hulbert, *A Good Word for Hedge Fund Activism*, N.Y. TIMES (Feb. 18, 2007), https://www.nytimes.com/2007/02/18/business/yourmoney/18stra.html [https://perma.cc/ZDB9-BWNP].

[5] *See* Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1874 (2017) (discussing the dangers of hedge-fund activism); James B. Stewart, *Hedge Funds Should Be Thriving Right Now. They Aren't.*, N.Y. TIMES (July 12, 2018), https://www.nytimes.com/2018/07/12/business/hedge-funds.html [https://perma.cc/A6J2-Z2VH].

[6] *See, e.g.*, Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 494 (2018) (noting that millions of investors have moved their money from actively managed mutual funds to passively managed funds); Bryan Borzykowski, *The Trillion-Dollar ETF Boom Triggered by the Financial Crisis Just Keeps Getting Bigger*, CNBC (Sept. 14, 2018), https://www.cnbc.com/2018/09/14/the-trillion-dollar-etf-boom-triggered-by-the-financial-crisis.html [https://perma.cc/9T7R-E783] ("In 2008, U.S. investors had $531 billion in ETFs; that's jumped to more than $3.4 trillion today, according to Statistica.").

[7] Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 770 (2017).

[8] Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687, 694–700 (2019).

[9] Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 248 (2017).

[10] Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 12 BUS. ETHICS Q. 235, 235 (2002) (arguing that corporations should pursue "maximization of the long-run value of the firm" rather than shareholder wealth maximization).

[11] Leo E. Strine Jr., *Toward Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing Between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future* 1 (Harvard John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 1018, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3461924 [https://perma.cc/A6JS-RGN] (opining that "[t]he incentive system for the governance of American corporations has failed in recent decades to adequately encourage long-term investment, sustainable business practices, and most importantly, fair gainsharing between shareholders and workers.").

Warren provide workers with representation on the board of directors.[12] The Walkout for Change by Google workers demanded, in part, the appointment of an employee representative to Google's board.[13] The German system of codetermination, where workers elect up to half the members of the corporate supervisory board, showed its strength and resilience in the recovery from the global economic crisis.[14] And new managerial methodologies providing for participatory management and employee voice are increasingly popular around the globe.[15] Policymakers, workers' advocates, and workers themselves are looking anew at the corporate structure and asking why workers have been left out.

Despite these murmurings of fundamental change, corporations have more legal and economic power than ever before. Over the last decade, corporate profits have hovered between nine and eleven percent of the U.S. gross domestic product—the highest sustained average percentage on record.[16] Recent tax changes have dramatically slashed corporate tax bills and returned billions of dollars to corporate coffers.[17] And the power of the corporate form continues to expand. By providing corporations with individualized constitutional and statutory rights of expression, the Supreme Court's decisions in *Citizens United v. Federal Election Commission*[18] and *Burwell*

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[12] Accountable Capitalism Act, S. 3348, 115th Cong. (2018); Reward Work Act, S. 2605, 115th Cong. (2018).

[13] Noam Scheiber, *Google Workers Reject Silicon Valley Individualism in Walkout*, N.Y. TIMES (Nov. 6, 2018), https://www.nytimes.com/2018/11/06/business/google-employee-walkout-labor.html [https://perma.cc/285Q-K3A2]; *see also* Sheera Frenkel, Mike Isaac, Cecilia Kang & Gabriel J.X. Dance, *Facebook Employees Stage Virtual Walkout to Protest Trump Posts*, N.Y. TIMES (June 1, 2020), https://www.nytimes.com/2020/06/01/technology/facebook-employee-protest-trump.html [https://perma.cc/WRB2-PVNS].

[14] *See infra* Part III.C.

[15] *See, e.g.*, FREDERIC LALOUX, REINVENTING ORGANIZATIONS: A GUIDE TO CREATING ORGANIZATIONS INSPIRED BY THE NEXT STAGE OF HUMAN CONSCIOUSNESS (2014); BRIAN J. ROBERTSON, HOLACRACY: THE NEW MANAGEMENT SYSTEM FOR A RAPIDLY CHANGING WORLD (2015).

[16] *Corporate Profits After Tax (Without IVA and CCAdj)/Gross Domestic Product*, FED. RES. BANK ST. LOUIS, https://fred.stlouisfed.org/graph/?g=1Pik [https://perma.cc/4D9X-NM4G]; *see also* Tim Worstall, *Why Have Corporate Profits Been Rising as a Percentage of GDP? Globalisation*, FORBES (May 7, 2013), https://www.forbes.com/sites/timworstall/2013/05/07/why-have-corporate-profits-been-rising-as-a-percentage-of-gdp-globalisation/#6a27a3fb2a6e [https://perma.cc/2XBL-H78U]. At the same time, workers' wages and salaries have reached their lowest percentage of GDP. *Compensation of Employees: Wages and Salary Accruals/Gross Domestic Product*, FED. RES. BANK ST. LOUIS, https://fred.stlouisfed.org/graph/?g=2Xa [https://perma.cc/FC3J-5H9C]; Michael Madowitz & Seth Hanlon, *GDP Is Growing, but Workers' Wages Aren't*, CTR. FOR AM. PROGRESS (July 26, 2018), https://www.americanprogress.org/issues/economy/reports/2018/07/26/454087/gdp-growing-workers-wages-arent/ [https://perma.cc/FZ7M-7EAB].

[17] Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (codified as amended in scattered sections of 26 U.S.C.) (cutting the corporate tax rate from 35% to 20%).

[18] 558 U.S. 310 (2010).

v. Hobby Lobby Stores, Inc.[19] have extended the corporation's powers even more deeply into politics, religion, and culture. This unprecedented extension of corporate power renders the law of corporate governance more important than ever before. Within the corporation, the shareholder franchise has long been the critical control feature. The justifications for this exclusivity are well worn at this point, even if they remain somewhat slippery. One model describes the corporation as a nexus of freely bargained contracts, and therefore presumptively the most efficient way to structure firm governance.[20] Another justification is that shareholders are owners of the corporate residual, and they have the appropriate incentives to make good firm decisions.[21] Rights to the residual provide shareholders with a common interest in maximizing corporate profits, which reduces their tendency to squabble about firm decisions and allegedly eliminates the possibility of voting cycles infecting board elections.[22] Scholars who believe in shareholder wealth maximization but nevertheless believe in centralized board authority have tinkered around the edges of these standard economic accounts by emphasizing the importance of board or managerial discretion.[23]

But these traditional arguments for the shareholder franchise are falling apart—not only from criticisms by outsiders, but also through conflicts from inside the house. It is now well-recognized that shareholders across the board have heterogeneous, rather than homogenous, interests that diverge along a number of dimensions.[24] Scholars are losing trust in share-

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[19] 573 U.S. 682 (2014).

[20] *See* Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1, 9 (2002) ("The dominant model of the corporation in legal scholarship is the so-called nexus of contracts theory."); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1418 (1989) ("The corporation is a complex set of explicit and implicit contracts, and corporate law enables the participants to select the optimal arrangement for the many different sets of risks and opportunities that are available in a large economy.").

[21] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 67–68 (1991) (justifying the corporate franchise based on shareholders' interests in the residual).

[22] *See* Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 405 (1983) (discussing KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (2d ed. 1963)).

[23] *See, e.g.*, Bainbridge, *supra* note 3; Lynn A. Stout, *On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialism (in the Closet)*, 36 SEATTLE U. L. REV. 1169, 1184 (2013).

[24] *See* Goshen & Squire, *supra* note 7, at 791 (describing "several sources of conflict among shareholders, including differing investment horizons and needs for cash payouts, empty voting, and competing outside interests"); Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 505 (2008) ("It is becoming increasingly clear, for example, that shareholders have many different types of interests in a corporation.").

holders with significant power,[25] and there is even support for nonvoting shares and passive shareholding.[26] Those academics who support strengthened shareholder power are accused of supporting special interests and shadow agendas.[27] The house of the exclusive shareholder franchise is collapsing in on itself.

With the standard economic approaches on the ropes, we'd expect to see alternatives rise to fill the gaps in corporate governance theory. But there is a dearth of such alternatives. Most progressive scholars, at this point, have left the shareholder franchise alone and cross their fingers for more ecumenical firm decision-making.[28] Stakeholder advocates have not put forth convincing theoretical distinctions among constituencies that might tell us which group preferences are best captured by governance and which by contract.[29] The growth of B-Corps and benefit corporations has created a parallel corporate ecosystem outside of the traditional one where shareholder primacy has been watered down or diminished—but not replaced.[30] Even those who dare to dream big have—up to now—checked

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[25] Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1258 (2008) ("[A]ctivist shareholders are using their growing influence not to improve overall firm performance, as has generally been assumed, but to profit at other shareholders' expense."); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1750 (2006) ("[S]hareholder voting is properly understood not as a primary component of the corporate decisionmaking structure, but rather as an accountability device of last resort, to be used sparingly, at most.").

[26] Lund, *supra* note 8, at 697–98; Lund, *supra* note 6, at 497 (arguing that passive funds should not have voting rights).

[27] *See, e.g.*, Bainbridge, *supra* note 25, at 1754 (claiming that Lucian Bebchuk's argument for shareholder empowerment would help "precisely the institutions most likely to use their position to self-deal—that is, to take a non-pro rata share of the firm's assets and earnings—or otherwise to reap private benefits not shared with other investors"); Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 451 (2014) ("Bebchuk is the sincere champion of one group of 'agents' wielding power and authority over others' money—the money managers who control most of the investments belonging ultimately to ordinary Americans who are saving to pay for their retirements and for their children's education—against another group of 'agents' that he believes is somehow more conflicted—the agents who actually manage corporations that make real products and deliver useful services (i.e. 'productive corporations').").

[28] *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 290–91 (1999) (describing directors as trustees for stakeholders).

[29] Kent Greenfield has come the closest to proposing a redesigned board of directors, but he did not lay out specifics. *See, e.g.*, KENT GREENFIELD, THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES 149 (2006) ("The specifics will be difficult but not impossible: employees could elect a proportion of the board; communities in which the company employs a significant percentage of the workforce could be asked to propose a representative to the board; long-term business partners and creditors could be represented as well.").

[30] Dana Brakman Reiser, *Theorizing Forms for Social Enterprise*, 62 EMORY L.J. 681, 682 (2013) ("Enthusiasts argue social enterprises will have a more positive and sustainable impact on

their expectations at the door.[31] Forces are amassing but still scattered and diffuse.

The reconstruction of corporate governance theory, at minimum, needs to reassess which stakeholders should have their preferences captured through the most powerful feature of corporate control—voting—and, just as importantly, which stakeholders should not. To answer this question, we will return to the theory of the firm and reconsider the purposes of corporations and what it means for governance. We will also develop a new theory of democratic participation designed to assess which interested parties should have their preferences captured through an electoral process. Both of these theories—the economic theory of the firm and the political theory of democratic participation—support a model that incorporates employees expressly into the inner sanctum of corporate governance. And both of these theories also give us the tools to distinguish between insiders—shareholders and employees—and other stakeholders whose interests in a typical corporation are best captured in ways other than voting rights.

In sum, this Article catalogs the main shortcomings of existent corporate governance theory and proposes a shared governance model of the firm to replace it. We begin, in Part I, by recounting the intellectual foundations of the shareholder primacy norm.[32] In doing so, we will focus on the core feature of that norm—the exclusive shareholder franchise—and the arguments put forth in support of it.[33] These arguments have a range of problems: they are based on a number of faulty empirical assumptions; they misapply basic economic and social choice theory; and, in the end, they often rely on a bit wishful thinking on the part of legal scholars determined to paper over the cracks in their theories.[34] This has left the scholarly case for shareholder voting—most of which comes out of the law and economics tradition—on the verge of collapse.[35]

In the central sections of the Article, we develop a theory of shared corporate governance. In Part II, we begin to reconstruct corporate governance scholarship by returning to and reinvigorating the longstanding theory

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people and planet than ordinary for-profit businesses."); Heerad Sabeti, *The For-Benefit Enterprise*, HARV. BUS. REV., Nov. 2011, at 98.

[31] Brett H. McDonnell, *Strategies for an Employee Role in Corporate Governance*, 46 WAKE FOREST L. REV. 429, 442 (2011) (stating that "large legal changes that would strongly encourage or mandate significant employee involvement [in corporate governance] are politically quite unlikely to succeed").

[32] *See infra* Part I.

[33] *See infra* notes 41–64 and accompanying text.

[34] *See infra* notes 65–130 and accompanying text.

[35] *See infra* notes 131–138 and accompanying text.

of the firm.[36] This theory, born out of a desire to explain why business firms exist apart from markets in the first place, not only is consistent with but also militates in favor of greater employee participation in corporate governance.[37] As participants in joint production, employees should also have voting rights within the firm. In Part III, we develop a new theory of democratic participation that helps explain which corporate constituents should be extended the corporate franchise rights (and, just as importantly, which should not).[38] This theory—fully consistent with mainstream democratic theory and informed by voting rights jurisprudence—also counsels in favor of extending voting rights to employees in ordinary corporate governance situations.[39] We will also present the example of German codetermination as an empirical proof of concept.[40] In the end, the economic theory of the firm and the democratic theory of participation provide the foundation for a new vision of corporate governance, one that includes workers and shareholders, labor and equity, for the benefit of all corporate stakeholders.

I. CORPORATE GOVERNANCE AND ITS DISCONTENTS

A. Shareholder Primacy and the Exclusive Franchise

Shareholder primacy, a version of corporate governance that assigns priority to shareholder interests above all others, has been the consensus governance model in corporate law for at least thirty years, and arguably for over a century.[41] The exclusive right of shareholders to elect the board of directors has been around even longer, dating back to the proliferation of corporations in the nineteenth century.[42] But while corporate law currently embodies both of these governing principles, they are not necessary components of the corporate form.

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[36] *See infra* Part II.

[37] *See infra* notes 139–260 and accompanying text.

[38] *See infra* Part III.

[39] *See infra* notes 261–323 and accompanying text.

[40] *See infra* notes 324–359 and accompanying text.

[41] Delaware law, which holds primacy of place in our corporate law ecosystem, has consistently upheld the shareholder primacy norm. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360 (Del. 1993) ("[D]irectors are charged with an unyielding fiduciary duty to protect the interests of the corporation and to act in the best interests of its shareholders."); *see also* E. Norman Veasey, *Should Corporation Law Inform Aspirations for Good Corporate Governance Practices—or Vice Versa?*, 149 U. PA. L. REV. 2179, 2184 (2001) (stating that Delaware law adopts the norm of shareholder primacy).

[42] *See* Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1347, 1351–53 (2006) (noting that shareholders have had voting power extending back to the earliest corporations).

Under our federalized system, corporations are creatures of state corporate law. Even though state corporate law allows for a great deal of organizational flexibility, actual governance structures are remarkably uniform. Delaware corporate law, for example, does not even require a corporation to have a board,[43] and yet all corporations have them. The board controls the firm and has the ability to legally bind the corporation to its decisions.[44] Shareholders elect the directors at the annual shareholders meeting by in-person voting or the use of proxies.[45] Directors must act in the corporation's interests and are bound by certain fiduciary duties, primarily the duties of good faith, care, and loyalty.[46] However, directors generally delegate the actual job of running the business to the corporation's executive officers, primarily through a hierarchy of employees headed by the chief executive officer.[47] This structure, where shareholders elect the directors who in turn select the officers to run the corporation, replicates itself in corporations from every state. And the critical feature of corporate governance control—who gets to vote, about what, and under what circumstances—has also been fixed: the corporate franchise belongs to shareholders and shareholders alone.

Shareholders have held the right to vote within the corporation since its inception.[48] Although shareholder primacy has its roots in the 1919 Michigan Supreme Court case *Dodge v. Ford Motor Co.*,[49] it did not achieve full force until the law and economics movement in corporate law combined with the advantageous tax treatment of stock options.[50] By the mid-2000s, the share-

[43] DEL. CODE ANN. tit. 8, § 141 (2019).

[44] *Id.* § 141(c)(1)–(2).

[45] *Id.* § 211(b).

[46] Matthew T. Bodie, *Employees and the Boundaries of the Corporation*, *in* RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 86 (Claire A. Hill & Brett H. McDonnell eds., 2012).

[47] *See, e.g.*, DEL. CODE ANN. tit. 8, § 142(a) ("Every corporation organized under this chapter shall have such officers with such titles and duties as shall be stated in the bylaws or in a resolution of the board of directors which is not inconsistent with the bylaws . . . .").

[48] Dunlavy, *supra* note 42, at 1351–53.

[49] 170 N.W. 668 (Mich. 1919).

[50] Shareholder primacy proponents touted the importance of stock-oriented performance incentives for management to provide the proper incentives. *See, e.g.*, 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. In 1993, Congress amended the tax code to prohibit the deduction of executive compensation over $1,000,000 unless it was performance-based. I.R.C. § 162(m) (2018); *see* Gregg D. Polsky, *Controlling Executive Compensation Through the Tax Code*, 64 WASH. & LEE L. REV. 877, 879 (2007) ("The purpose of this legislation was to enhance shareholder wealth in two ways: by reducing the overall level of executive compensation and by influencing the composition of executive compensation arrangements in favor of components that were more sensitive to firm performance."). The end result was a dramatic increase in the use of stock options in executive

holder primacy norm oriented not only academic theory but also boardroom practice.

The classic justification for the shareholder franchise is that shareholders are the "owners" of the corporation and therefore should have the right to control it.[51] The law and economics justification has centered around the shareholder's right to the "residual"—namely, the residual profits remaining after all other claimants have been paid.[52] Because shareholders are paid last, the argument goes, they have the best set of incentives for governing the company.[53] Along with the shareholder primacy norm, the "nexus of contracts" theory of the corporation is also popular in economics and legal academic circles.[54] Under this theory, the corporation does not really exist and instead should best be considered as a cluster of contractual agreements among a variety of parties. The nexus of contracts approach counsels for a "hands-off" or default-rule approach to corporate law, as the corporation is conceived as a set of voluntarily chosen relationships between different parties.[55]

In their foundational work on the law and economics of corporate law, Frank Easterbrook and Daniel Fischel married these two theories into a simple, intertwined structure. Their book, *The Economic Structure of Corporate Law*,[56] reaffirmed the shareholder primacy norm by arguing that shareholders are the most economically vulnerable of the corporation's participants. This vulnerability, coupled with their shared preference for wealth maximization, means that shareholders should be accorded the basic governance rights of the corporation.[57] Thus, according to Easterbrook and Fischel, the other participants in the corporation agreed, through their own contracts, to provide shareholders with residual rights to the corporation's

compensation. Polsky, *supra*, at 906 ("It is widely believed that § 162(m) contributed significantly to the explosion of compensatory stock options that began in the late 1990s.").

[51] Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1190–92 (2002). This is one of the "bad" arguments. *Id.*

[52] EASTERBROOK & FISCHEL, *supra* note 21, at 67 ("The reason [that shareholders vote] is that the shareholders are the residual claimants to the firm's income.").

[53] *See* MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 21 (1995) ("Because shareholders are in this residual claim position, most economists argue that they have the greatest incentive to see that the company makes good business decisions and uses its assets wisely to earn profits.").

[54] *See* Grant M. Hayden & Matthew T. Bodie, *Shareholder Voting and the Symbolic Politics of Corporation as Contract*, 53 WAKE FOREST L. REV. 511, 513 (2018).

[55] *Cf.* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 544 (1990) (developing the "triviality hypothesis"—namely, that "appearances notwithstanding, state corporate law is trivial: it does not prevent companies—managers and investors together—from establishing any set of governance rules they want").

[56] *See* EASTERBROOK & FISCHEL, *supra* note 21.

[57] *Id.* at 67–68.

profits and the voting rights that come with them.[58] The shareholder primacy norm provided the overriding purpose to the corporate form, while the nexus of contracts theory demonstrated how the parties reached this arrangement through voluntary agreements.

From this core law and economics framework have blossomed divergent approaches to some of the central corporate debates of the last twenty years. One group of theorists has focused on providing shareholders with stronger legal powers within the corporation.[59] Such powers include the power over corporate political spending, the right to access the company's proxy ballot, and a prohibition on staggered boards.[60] Others, such as Steven Bainbridge's director primacy theory[61] and Margaret Blair and Lynn Stout's team production theory,[62] rallied around various versions of board primacy. Although these board primacy scholars disagree with each other on the appropriate goals of the corporation, they all believe that a governance system that is less responsive to shareholders will allow the board to make better decisions.[63]

Significantly, all of these theorists, like Easterbrook and Fischel before them, are committed to corporate governance structures in which shareholders alone elect board members and vote on other matters of importance. The original justifications for the exclusive shareholder franchise, many of which are now more than four decades old, continue to be cited, recited, and relied upon by the universe of scholars of corporate governance.[64]

B. Cracks in the Foundational Arguments

While these arguments for the shareholder franchise continue to hold sway, substantial cracks have appeared in their foundations.[65] As we catalog these arguments and some of their shortcomings, it is important to realize that our critiques do not question the basic principles of standard economics or social choice theory thought to underlie the arguments. Instead, we take

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[58] *Id.* at 17, 37.

[59] *See, e.g.*, Bebchuk, *supra* note 3 (arguing for greater shareholder power).

[60] *See* Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83 (2010); Lucian Arye Bebchuk, *The Case for Shareholder Access: A Response to the Business Roundtable*, 55 CASE W. RES. L. REV. 557 (2005); Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 STAN. L. REV. 885 (2002).

[61] Bainbridge, *supra* note 3.

[62] Blair & Stout, *supra* note 28.

[63] *See* Grant Hayden & Matthew T. Bodie, *Shareholder Democracy and the Curious Turn Toward Board Primacy*, 51 WM. & MARY L. REV. 2071, 2089–92 (2010).

[64] Including us.

[65] *See* EASTERBROOK & FISCHEL, *supra* note 21.

those principles as given, and discuss their misapplication in the context of corporate governance. It is our sense that corporate governance scholars often start from basic economic principles only to discard them when they run into (what they perceive as) problems. These arguments, in other words, will be evaluated by the standards that their proponents set for themselves.

1. The Contractarian Argument

One of the most basic arguments for the exclusive shareholder franchise is that it, like any feature of corporate governance, is presumptively efficient because it is the product of freely bargained contracts.[66] In this view, the corporation itself is nothing more than a nexus of contracts.[67] Although it's often hard to tell whether the corporation as contract is intended to be a literal or metaphorical description, there's no doubt that it has done heavy rhetorical work in the service of the law and economics vision of the corporation. If all corporate constituents agree to a governance system in which shareholders alone have voting rights, who's to say they've got it wrong?

Over time, even the most die-hard contractarians have conceded that this description of the corporation is not literally true—there are some key features to modern corporations that cannot be reduced to contract.[68] The most prominent of these is the signature feature of the corporate form: limited liability.[69] Limited liability cannot be replicated by contract, but is instead a concession granted by the state to corporations in exchange for the ability to tax and regulate them in various ways.[70] Corporations are not re-

[66] For extensive discussion of this argument, see William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989); Melvin A. Eisenberg, *The Conception That the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819 (1999); Hayden & Bodie, *supra* note 54; Grant M. Hayden & Matthew T. Bodie, *The Uncorporation and the Unraveling of "Nexus of Contracts" Theory*, 109 MICH. L. REV. 1127 (2011); Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779 (2006); Lewis A. Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel*, 89 COLUM. L. REV. 1449 (1989).

[67] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976) (providing the original description of the theory); *see also* EASTERBROOK & FISCHEL, *supra* note 21, at 1–39 (providing one of the most prominent iterations of the theory).

[68] LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 67–75 (2010) (describing the mandatory elements of the corporate structure); Fred S. McChesney, *Economics, Law, and Science in the Corporate Field: A Critique of Eisenberg*, 89 COLUM. L. REV. 1530, 1537 (1989) ("Admittedly, as a descriptive matter state corporation codes and other sources of law contain many mandatory terms that parties cannot contract around . . . . [T]o claim that contractarians would deny the existence of coercive legal rules is to accuse them of blindness or stupidity.").

[69] *See* RIBSTEIN, *supra* note 68, at 79; Hayden & Bodie, *supra* note 66, at 1137–39.

[70] *See* RIBSTEIN, *supra* note 68, at 138; Hayden & Bodie, *supra* note 66, at 1138.

ducible to a set of contracts; indeed, if contracts were sufficient, then there would be no need for corporate law in the first place.[71]

As corporate governance theorists shifted to using the nexus of contracts more metaphorically, their reliance on contract theory becomes somewhat self-defeating.[72] Easterbrook and Fischel, for example, argue that corporate law provides the "ideal" contract that most participants would themselves develop and saves the parties from the transaction costs of developing it on their own.[73] This argument, though, proves too much, as the theory then assigns itself with the task of assigning preferences—something that economists are generally loath to do. Moreover, the preferences of these particular hypothetical constituents do not reflect the preferences of actual constituents, even the shareholders themselves. And there's certainly no independent reason to think that the rest of the corporate constituents would agree on such particularized governance features like the exclusive shareholder franchise.[74]

This contractarian theory of the corporation turns out to be based on idealized, fictionalized versions of shareholders and other corporate constituents. And these fictional constituents, by and large, just happen to agree with normative law and economics principles and the current structures of corporate governance.[75] But their supposed approval of every contemporary feature of corporate governance is nothing more than Panglossian wish fulfillment on the part of their creators. In the end, this contractarian argument in favor of the exclusive shareholder franchise is both descriptively wrong and normatively hollow.

2. The Residual Argument

The principle that all shareholders have a similar interest in the corporate residual, the leftover operating profit after all the costs have been paid, has long been central to the idea of shareholder voting.[76] Because maximizing the residual maximizes the return to shareholders while leaving all other constituents (like creditors, employees, and suppliers) contractually satis-

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[71] Hayden & Bodie, *supra* note 66, at 1127 ("A corporation is not a contract.").

[72] For a more complete description and critical evaluation of this move to metaphor to save the contractarian position, see Hayden & Bodie, *supra* note 54, at 538–46.

[73] *See* Easterbrook & Fischel, *supra* note 20, at 1418 (observing that "much of corporate law is designed to reduce the costs of aligning the interests of managers and investors").

[74] *See* Hayden & Bodie, *supra* note 54, at 539–41.

[75] *See id.* at 541–42. For a more extensive discussion of this idea, see Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021 (1996).

[76] *See* EASTERBROOK & FISCHEL, *supra* note 21, at 67–69.

fied, under this theory shareholder control over a corporation will increase efficiency by maximizing residual profits.[77]

According to shareholder primacy theory, shareholders are best positioned to be assigned the vote because they have relatively homogeneous interests in maximizing the residual.[78] More specifically, they alone have a single-minded focus on corporate profits.[79] Over the last couple of decades, however, this assumption of shareholder homogeneity has broken down.[80] Many shareholders have interests in the firm that go beyond a simple desire to maximize the residual, including majority shareholders, shareholders with disproportionate voting rights, members of voting trusts, bribed shareholders, hedged shareholders, sovereign wealth funds, and employee and management shareholders.[81] In each case, those shareholders have interests that may temper or override their shared interest in the residual. In addition, shareholder heterogeneity is not simply a matter of shareholders with discrete competing interests. There is also heterogeneity among otherwise similarly situated shareholders with respect to their definitions of wealth maximization—shareholders, for example, with different time horizons or risk preferences.[82] Defined-benefit pension funds have a definition of wealth maximization that would lead to different outcomes than a hedge fund, or a flash trader.

The recent importance of environmental, social, and governance (ESG) investing highlights another problem with shareholder primacy. As economists should recognize, shareholder wealth maximization is not the same thing as shareholder utility maximization. Shareholders do in fact value things other than profit maximization, and corporate governance should be structured to allow them to express their preferences on tradeoffs in corporate decision-making.[83] The recent surge in ESG investing provides tan-

[77] *See id.* at 35–39, 67–69; *see also* Sean J. Griffith, *Opt-in Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority*, 98 TEX. L. REV. 983, 1006 (2020) ("As residual risk bearers, shareholders are exposed to the consequences of all corporate actions going forward. This gives shareholders the best incentive of all corporate constituents to monitor corporate decision-making. Hence, shareholders alone vote.").

[78] *See* EASTERBROOK & FISCHEL, *supra* note 21, at 69–70.

[79] *See id.*; Griffith, *supra* note 77, at 1009–10 ("[S]hareholder wealth maximization is often posited or assumed not because it is the highest and best thing for real-life shareholders but because it is the most that can be assumed about shareholders as a class.").

[80] *See* Goshen & Squire, *supra* note 7, at 791; Hayden & Bodie, *supra* note 24, at 505.

[81] *See* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 574–92 (2006); Hayden & Bodie, *supra* note 24, at 477–98.

[82] *See* Anabtawi, *supra* note 81, at 579–83; Hayden & Bodie, *supra* note 24, at 492–94. For a thoughtful review of the short-termism debate, see Michal Barzuza & Eric L. Talley, *Short-Termism and Long-Termism* 12–21 (Va. Law & Econ., Research Paper No. 2, 2016).

[83] *See generally* Hart & Zingales, *supra* note 9 (arguing that shareholders have interests beyond simply maximizing profits).

gible evidence of disparate shareholder interests, with these funds estimated to represent one-quarter of the funds under management—roughly $12 trillion.[84] Surveys show that three-quarters of Americans have an interest in sustainable investing—evidence that non-maximizing investments may continue to grow.[85] In fact, misguided notions that shareholder wealth maximization is a *required* investing strategy may be artificially propping up wealth maximization approaches.[86]

Finally, it is simplistic to say that shareholders are the only ones with an interest in the long-term value of the corporation. Employees may receive more discrete and regular payments, but they too have an ongoing interest in the success of the operation. Assuming that employees are paid by "contracts" that are set in economic stone makes it easy to ignore that, over time, the corporate power of shareholders puts workers at a significant bargaining disadvantage.[87] If shareholders alone elect the board, then the board will naturally favor the will of their electorate.[88] This dynamic has played out over time: wages have remained stagnant despite a booming economy, while corporate profits have grown at a staggering rate.[89] Employees may have some market power, but they also have firm-specific capital that cannot be moved, and they generate the value that the firm holds

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[84] *See* Mark Miller, *Bit by Bit, Socially Conscious Investors Are Influencing 401(k)'s*, N.Y. TIMES (Sept. 27, 2019), https://www.nytimes.com/2019/09/27/business/esg-401k-investing-retirement.html [https://perma.cc/HZZ3-BZ4R].

[85] *See* Paul Sullivan, *Investing for Social Impact Is Complicated. Here Are 4 Ways to Simplify It.*, N.Y. TIMES (May 3, 2019), https://www.nytimes.com/2019/05/03/your-money/impact-investing-standards.html [https://perma.cc/CY6J-WA8U]; *see also* Dieter Holger, *What Generation Is Leading the Way in ESG Investing? You'll Be Surprised.*, WALL STREET J. (Sept. 10, 2019), https://www.wsj.com/articles/what-generation-is-leading-the-way-in-esg-investing-youll-be-surprised-11568167440 [https://perma.cc/K5LR-95QB] (noting that millennials have the highest percentage of interest in ESG investing, but that Gen X is catching up in interest and likely has more ESG assets under management).

[86] Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and ESG Integration*, 90 U. COLO. L. REV. 731, 734–35 (2019) ("[D]ue to outdated understandings of 'social investing,' some decision makers still worry that any strategy that considers environmental or social impacts will breach their fiduciary duties.").

[87] BLAIR, *supra* note 53, at 256–57.

[88] Leo E. Strine, Jr., *Corporate Power Is Corporate Purpose II: An Encouragement for Future Consideration from Professors Johnson and Millon*, 74 WASH. & LEE L. REV. 1165, 1177 (2017) ("The boards of these corporations did not view themselves as having any national loyalties or loyalties to other constituencies, they viewed themselves as elected officials in the republic of equity capital.").

[89] *See* Emmanuel Saez & Gabriel Zucman, *Wealth Inequality in the United States Since 1913: Evidence from Capitalized Income Tax Data*, 131 Q.J. ECON. 519 (2016) (discussing diverging income inequality); Floyd Norris, *Corporate Profits Grow and Wages Slide*, N.Y. TIMES (Apr. 4, 2014), http://www.nytimes.com/2014/04/05/business/economy/corporate-profits-grow-ever-larger-as-slice-of-economy-as-wages-slide.html [https://perma.cc/J4AE-E8EJ] (discussing the rise in corporate profits and fall of employee compensation).

through its brand, trademark, and good will.[90] Because shareholders control the company, they control the brand, the goodwill, the ongoing business. Combined with the at-will rule and the dramatic decline in union representation, employees have remarkably little power within the firm, despite their ongoing interest in the business.

3. The Arrow's Theorem Argument

Shareholder heterogeneity also undercuts another fairly prominent argument for the exclusive shareholder franchise: the argument from Arrow's theorem. Easterbrook and Fischel first raised concerns, based on Kenneth Arrow's impossibility theorem, that corporate constituents with heterogeneous preferences would be more likely to produce intransitive election results or voting cycles.[91] This, in turn, would lead firms to "self-destruct."[92] This argument has since been repeated by a wide range of law and economics corporate governance scholars.[93]

As discussed earlier, shareholders actually have quite heterogeneous preferences with respect to corporate decision-making. But the Arrow's theorem argument falls apart long before we get to the nature of shareholder preferences: it is based on a misguided application of the theorem from the start.[94] First, even if shareholders agree on an underlying goal of wealth maximization, that does not mean they agree on the best strategies or board candidates to achieve that goal.[95] Second, the argument ignores the enormous democratic cost of avoiding possible voting cycles: prohibiting interested parties from voting based upon their purported preferences.[96] Third, the argu-

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[90] Dan L. Burk & Brett H. McDonnell, *Trademarks and the Boundaries of the Firm*, 51 WM. & MARY L. REV. 345, 363 (2009) ("The positive reputation associated with a trademark is due to the work of many persons associated with the firm owning that mark over time."). Unlike employees' general skills that could be used anywhere, firm-specific capital refers to employees' specific knowledge or skills that are tied to a particular company. *See* Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313, 354 (1985) (distinguishing human capital, which the person carries with them (such as education), from firm-specific capital, which is lost when the employee leaves the firm to go to another).

[91] *See* EASTERBROOK & FISCHEL, *supra* note 21, at 69–70.

[92] *Id.* at 70.

[93] *See, e.g.*, HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 41–42 (1996); Blair & Stout, *supra* note 28, at 257; Gregory K. Dow, *The New Institutional Economics and Employment Regulation*, *in* GOVERNMENT REGULATION OF THE EMPLOYMENT RELATIONSHIP 57, 69 (Bruce E. Kaufman ed., 1997).

[94] For a critical evaluation of this argument, see Grant Hayden & Matthew Bodie, *Arrow's Theorem and the Exclusive Shareholder Franchise*, 62 VAND. L. REV. 1217 (2009). For a condensed version, see Hayden & Bodie, *supra* note 54, at 524–30.

[95] *See* Hayden & Bodie, *supra* note 94, at 1230–32.

[96] *See id.* at 1232–34.

ment utterly fails to analyze the likelihood or cost of cyclical election outcomes in corporate elections, and, under some fairly straightforward assumptions, both are likely to be very low or nonexistent.[97] The argument from Arrow's theorem for the exclusive shareholder franchise is not at all compelling.

4. The Argument for Board Primacy

Competing corporate law theories in the law and economics tradition sometimes offer more realistic stories about corporate law doctrine. But they also do little to question the underlying structures of corporate control.[98] Stephen Bainbridge's "director primacy" theory well describes the ambivalence of Delaware corporate law towards the relationship between shareholders and the board of directors.[99] But his theory ultimately fails to explain why directors should be given relatively unchecked authority over the operation of the firm.[100] Similarly, Margaret Blair and Lynn Stout's "team production" model accurately takes into account the many participants in the life of the corporation.[101] Their model, however, also leaves it to a shareholder-elected board to somehow manage these relationships appropriately.[102]

Whether they be "Platonic guardians" (Bainbridge)[103] or "mediating hierarchs" (Blair and Stout),[104] there are no governance structures in place to ensure that actual directors live up to the faith that these accounts place in their ability to manage the firm for all constituents. In both cases, the ultimate check on the board is left in the hands of the shareholders alone. And both simply rely on earlier law and economics arguments to justify the retention of the exclusive shareholder franchise.[105] Those committed to board primacy provide no independent arguments for this fundamental mechanism of corporate control.

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[97] *See id.* at 1234–39.

[98] For an overview and critical evaluation of the various forms of board primacy theory, see Hayden & Bodie, *supra* note 63.

[99] *See generally* STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE (2008) (discussing the tension between shareholders and the board of directors in corporate governance).

[100] *See* Hayden & Bodie, *supra* note 63, at 2089–92.

[101] *See generally* Blair & Stout, *supra* note 28 (recognizing that integrating many participants in a public corporation can lead to qualitatively different results).

[102] *See* Hayden & Bodie, *supra* note 63, at 2089–91, 2112–20.

[103] Bainbridge, *supra* note 3, at 560.

[104] Blair & Stout, *supra* note 28, at 280.

[105] *See* Hayden & Bodie, *supra* note 63, at 2101–11.

C. New Challenges for the Primacy Model

Along with the flaws in the traditional law and economics model for corporate law, there are new concerns about the tremendous weight placed on shareholders within the model: specifically, the idea of shareholder wealth maximization as the focus of the enterprise, as well as the ability of shareholders to handle their governance responsibilities. These developments provide additional momentum for rethinking corporate governance.

1. A Return to Corporate Purpose

Since the early twentieth century, the idea that a corporation has a particular "purpose" for itself has pretty much been a nonstarter. But corporate law originally required corporations to establish a specific purpose as part of the incorporation process.[106] The purpose specified the nature of the business to be established and provided a sense of the corporation's scope. In a real sense, the purpose established the legal boundaries of activities for participants within the firm.[107] The purpose requirement was enforced through a legal action based on ultra vires, or "beyond the powers." Under this doctrine, shareholders could sue the corporation if it went beyond the scope of its purpose, as established in the charter.[108] Because it limited the reach of corporate power to enumerated purposes, the ultra vires doctrine was "an important tool to protect the state's interest in restricting the power and size of corporations and to protect the shareholders from managerial overreaching."[109]

As corporations became more commonplace and less attention was paid to the specific charters, the ultra vires doctrine began to break down. Although ultra vires prohibitions remain on the books in almost every

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[106] Louis K. Liggett Co. v. Lee, 288 U.S. 517, 554–55 (1933) (Brandeis, J., dissenting in part) ("At first, corporations could be formed under the general laws only for a limited number of purposes . . . .").

[107] JOSEPH K. ANGELL & SAMUEL AMES, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS AGGREGATE 60 (Morton J. Horwitz & Stanley N. Katz eds., Arno Press Inc. 1972) (1832) ("[T]he general powers of a corporate body must be restricted by the nature and object of its institution.").

[108] Adam J. Sulkowski & Kent Greenfield, *A Bridle, a Prod, and a Big Stick: An Evaluation of Class Actions, Shareholder Proposals and the Ultra Vires Doctrine as Methods for Controlling Corporate Behavior*, 79 ST. JOHN'S L. REV. 929, 930 (2005) ("The ultra vires doctrine historically allowed a shareholder to sue to prevent a company from engaging in an activity outside of the specific parameters of its corporate charter.").

[109] Kent Greenfield, *Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality (with Notes on How Corporate Law Could Reinforce International Law Norms)*, 87 VA. L. REV. 1279, 1302 (2001).

state,[110] corporations learned to have as broad of a corporate purpose as possible.[111] Today, even though corporations are allowed to have specific purposes, for-profit companies generally follow specific language: the corporation is formed to conduct and transact all lawful business activities allowed under the laws of the state.[112] The goal of shareholder wealth maximization became *de rigueur* at all corporations.[113]

But there is a growing sense that corporations should have goals that go beyond merely the creation of wealth for equity holders. Some scholars propose refocusing the aims of the corporation largely within existing legal structures. Ronald Colombo, for example, suggests that corporate directors exercise their agency obligations on behalf of the shareholder owners in a way consistent with an Aristotelian understanding of ownership—one that takes account of the common good and, by implication, the interests of other stakeholders.[114] Other approaches involve the creation of new legal structures for the expression of these goals. One example is the growth of business organizations tailored to include socially beneficial purposes. Benefit corporations are a form of business organization created by state statutes to promote a more socially-responsible orientation within the business.[115] The

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[110] Sulkowsi & Greenfield, *supra* note 108, at 945 ("The incorporation statutes of forty-nine states allow these states to dissolve a corporation or enjoin it from engaging in ultra vires activities—that is, activities outside of the corporation's authority.").

[111] *See, e.g.*, Recent Cases, *Corporations*—Ultra Vires*: What Acts Are* Ultra Vires*—Ill-Defined Objects of Incorporation*, 32 HARV. L. REV. 285, 290 (1919) (discussing a corporate purpose "enabling the company to carry on almost every conceivable kind of business which such an organization could adopt").

[112] Joan MacLeod Heminway, *Corporate Purpose and Litigation Risk in Publicly Held U.S. Benefit Corporations*, 40 SEATTLE U. L. REV. 611, 618 (2017).

[113] Lynn A. Stout, *The Toxic Side Effects of Shareholder Primacy*, 161 U. PA. L. REV. 2003, 2004 (2013) ("Many, and possibly most, public companies now embrace a shareholder-centered vision of good corporate governance that emphasizes 'maximizing shareholder value' (typically measured by share price) over all other corporate goals."); *see also* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010) ("Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders.").

[114] *See* Ronald J. Colombo, *Ownership, Limited: Reconciling Traditional and Progressive Corporate Law Via an Aristotelian Understanding of Ownership*, 34 J. CORP. L. 247 (2008); *see also* Susan J. Stabile, *A Catholic Vision of the Corporation*, 4 SEATTLE J. SOC. JUST. 181, 186 (2005) (arguing for a corporate purpose that takes account of human dignity as grounded in Catholic social thought). Without proposing any real changes in the legal regime, however, it's difficult to see how these attitude changes would be accomplished.

[115] *See* Matthew J. Dulac, *Sustaining the Sustainable Corporation: Benefit Corporations and the Viability of Going Public*, 104 GEO. L.J. 171, 175 (2015) ("A benefit corporation is a for-profit corporation with a stated public benefit that operates in a responsible and sustainable manner; in other words, it pursues the dual mission of making a profit and achieving some social good."); Brett McDonnell, *Benefit Corporations and Strategic Action Fields or (the Existential Failing of*

signal change from corporation to benefit corporation is its rejection of the shareholder primacy norm for a more socially-beneficial corporate purpose. This purpose must fit within the rubric of "social benefit" as defined by the state statute. Although most states provide a relatively broad definition,[116] state benefit corporation law usually includes some mechanisms for enforcing the "benefit" component, such as benefit reporting, a benefit officer, fiduciary duties related to the benefit, or ultra vires actions if the purpose is ignored.[117]

Traditionally organized companies are also feeling pressure to adopt purposes and principles beyond maximizing shareholder wealth. There is, of course, the possibility that such efforts are primarily for public relations.[118] But there seems to be an increasing interest in authentic efforts to make a business about more than simply making money. At companies that follow participatory or self-managed internal governance, the purpose of the organization becomes the core around which the organization operates.[119] Corporate social responsibility experts argue that the principles and purpose should be baked into the corporation's everyday operations.[120] Focusing on a purpose above and beyond shareholder wealth challenges the driving spirit of shareholder primacy.

2. Principal Costs & Shareholder Disengagement

Dual-class voting structures at such tech titans as Facebook and Google, as well as the previously untested waters of nonvoting shares as distributed by Snap Inc., have raised anew the wisdom of deviating from the traditional one-

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Delaware), 39 SEATTLE U. L. REV. 263, 280 (2016) ("State statutes legally define benefit corporations. These statutes sit atop the basic business corporation statute. That is, benefit corporations *are* business corporations, subject to all of the rules of the business corporation statute, except insofar as the benefit corporation statute provides different or additional rules.").

[116] Delaware defines public benefit as "a positive effect (or reduction of negative effects) on 1 or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature." DEL. CODE ANN. tit. 8, § 362(b).

[117] Heminway, *supra* note 112, at 618.

[118] *See* Miriam A. Cherry & Judd F. Sneirson, *Beyond Profit: Rethinking Corporate Social Responsibility and Greenwashing After the BP Oil Disaster*, 85 TUL. L. REV. 983, 985 (2011) (identifying the problem of "faux CSR").

[119] *See* Matthew T. Bodie, *Holacracy and the Law*, 42 DEL. J. CORP. L. 619, 635 (2018).

[120] V. Kasturi Rangan, Lisa Chase & Sohel Karim, *The Truth About CSR*, HARV. BUS. REV., Jan.–Feb. 2015, https://hbr.org/2015/01/the-truth-about-csr [https://perma.cc/CVY2-9Y93] (contending that the main goal of CSR practices should be "to align a company's social and environmental activities with its business purpose and values").

share, one-vote paradigm.[121] Traditionally, corporate governance advocates have seen the one-share, one-vote paradigm as inviolate, and have pressured companies to eschew dual-class or non-voting share structures. But there has been a recent and somewhat surprising trend towards a theoretical justification for deviations from the one-share, one-vote scheme.

It is no accident that these arguments come at a time when investments in massive, passive index funds is increasing apace.[122] Index funds exist solely to own shares in an established set of financially successful companies while charging fees that are as low as possible. Any effort to investigate the issues at play in any particular election, or—in extreme circumstances—to run and fund a proxy challenge to incumbent directors, will cost the fund's participants while providing benefits to participants in the other index funds, who spend nothing.[123] Such activity will redound to the detriment of the particular fund, as all funds get the benefit but only the particular fund incurs the cost.[124] In a world where the index sets the investment portfolio, funds compete on cost, and every extra analyst becomes an unnecessary luxury.

The extraordinary growth of index funds causes substantial problems to a corporate governance model based on the shareholder franchise. Voting rights require information to be meaningful. If a voter is not informed on the choice at hand, the voter will not make a rational choice. Either the voter will still vote, introducing whimsy and capriciousness into the process, or the voter will abstain. Neither option is effective if the system is built on informed choice and the resulting market discipline.

In response to these funds with large masses of insensate stock holdings, corporate law scholars have pushed back against the assumptions of the traditional law and economic model. In developing their theory of "principal costs," Zohar Goshen and Richard Squire argue that the field has been too focused on agency costs—namely, the inefficiencies generated by the delegation of control from shareholders to directors and managers.[125] They point out that shareholder governance decisions can lead to "competence costs," arising from lack of information or talent, and "conflict costs," relating to the conflicts between different goals within the shareholder group.[126] Shareholders

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[121] Steven Davidoff Solomon, *Snap's Plan Is Most Unfriendly to Outsiders*, N.Y. TIMES (Feb. 3, 2017), https://www.nytimes.com/2017/02/03/business/dealbook/snap-ipo-plan-evan-spiegel.html [https://perma.cc/DNY5-XL57].

[122] Lund, *supra* note 6, at 494.

[123] *Id.* at 495.

[124] *Id.*

[125] Goshen & Squire, *supra* note 7, at 769 (using the term "agency-cost essentialists" for scholars who "treat the reduction of agency costs as the essential function of corporate law").

[126] *Id.* at 770–71.

delegate their governance authority to management in order to address these costs.[127] In particular, shareholder competence costs grow as shareholders become less knowledgeable about the corporation and its leadership. The problem of ignorant equity holders is so severe in Dorothy Lund's view that she argues for regulatory restrictions on voting rights for large, passive funds.[128] Excluding their shares from the voting pool will give a larger role to more informed and deserving shareholders.[129] If voting rights are useless or restricted, then shareholders may begin to question their value. Nonvoting shares—an unspeakable taboo for modern corporate law—may actually be a better deal if shareholders do not have the information sufficient to translate their preferences into voting choices.[130]

These new approaches deeply unsettle shared premises of modern corporate law theory. And they do so working within the shared normative framework of shareholder primacy. One might expect that at least some scholars would have proposed even more radical deviations from settled corporate law doctrine. Alas, thus far, that has not been the case.

D. The Stakeholder Alternative

In contrast to shareholder primacy, the stakeholder model of the corporation, also called the communitarian or multifiduciary model,[131] proposes that corporate governance should take all stakeholders in the corporate enterprise into account, rather than limiting governance power to shareholders.[132] As an oppositional theory, stakeholder theory has largely served to act as a rhetorical brake on some of the excesses of shareholder primacy.[133] But it often ends up reinforcing the status quo. If anything, stakeholder the-

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[127] *Id.* at 771 ("[P]rincipal costs are more fundamental than agent costs, as the goal of reducing them is the reason that investors delegate control to managers . . . .").

[128] Lund, *supra* note 6, at 497.

[129] *Id.*

[130] Lund, *supra* note 8, at 745.

[131] *See* Simone M. Sepe, *Directors' Duty to Creditors and the Debt Contract*, 1 J. BUS. & TECH. L. 553, 561 (2007) (noting that "communitarians . . . . advocate a multifiduciary model where all corporate stakeholders benefit from the attribution of directors' fiduciary duties"); *see also* David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, *in* PROGRESSIVE CORPORATE LAW 1, 11–12 (Lawrence E. Mitchell ed., 1995) (discussing the use of the multifiduciary model by communitarian corporate law scholars).

[132] *See* Millon, *supra* note 131, at 11–12 (discussing efforts to provide protections to nonshareholder constituencies); Blair & Stout, *supra* note 28, at 293–94 (arguing that directors owe a duty to the corporation and that the corporation consists of all of the stakeholders who are responsible for the business of the enterprise).

[133] For a discussion of those excesses, see Matthew T. Bodie, *AOL Time Warner and the False God of Shareholder Primacy*, 31 J. CORP. L. 975 (2006); William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002).

ory expands upon the discretion provided to the board and the board-selected management to follow their own judgment in contravention of the will of the shareholders.

The most tangible contribution of stakeholder theory to corporate law has been the constituency statute, the law in a majority of states (but not Delaware).[134] The constituency statute provides directors with the discretion to take the interests of all stakeholders into account when making certain types of decisions.[135] Directors need not take other interests into account, and there is generally no remedy for other stakeholders. These statutes are just a way of insulating directors from claims that they failed to do enough for shareholders when contemplating a tender offer, merger, or factory shut-down.

The real problem with stakeholder theory is that it is not, at least at present, a real theory of corporate governance. Stakeholder theory lacks a model for allocating governance rights and responsibilities among the participants.[136] The theory is more in tune with the nexus of contracts approach, as it treats all the participants in the firm as deserving of governance consideration. But it fails to develop a system for managing the different stakeholders within the firm. Stakeholder theory does not, for example, argue that corporations are simply contractual nexuses and thus should not exist as legal entities.[137] Nor, more surprisingly, have stakeholder theorists sketched out a system whereby all stakeholders can participate in firm governance. Instead, stakeholder theorists have largely glommed on to the existing structure of corporate law, where shareholders elect directors who appoint officers.[138]

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[134] Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REG. 209, 215 tbl.1 (2006) (finding that thirty-one states have constituency statutes).

[135] Some are limited to takeover/mergers, while others apply to all decisions. Millon, *supra* note 131, at 11–12.

[136] *See* Joseph Heath, *Business Ethics Without Stakeholders*, 16 BUS. ETHICS Q. 533, 543 (2006) (arguing that stakeholder theory creates "extraordinary agency risks" because of the potential for conflicts); Eric W. Orts & Alan Strudler, *Putting a Stake in Stakeholder Theory*, 88 J. BUS. ETHICS 605, 611 (2009) (arguing that stakeholder theory fails to provide a system of mechanisms for governance, other than "balancing" stakeholder concerns).

[137] Instead, many stakeholder theorists also ascribe to the entity view of the corporation, which argues for treating the corporation as a state-created separate entity. Martin Petrin, *Reconceptualizing the Theory of the Firm—From Nature to Function*, 118 PENN ST. L. REV. 1, 24 (2013) ("CSR scholars and stakeholder theorists have justified consideration of broader stakeholder interests by characterizing the firm 'as not merely a legal fiction but rather as a moral organism with social and ethical responsibilities,' or built upon the view of the corporation as 'an entity existing in time' and as a 'distinct person.'" (citations omitted)).

[138] *See* Hayden & Bodie, *supra* note 63, at 2113 (discussing examples); *cf.* Emily Winston, *Managerial Fixation and the Limitations of Shareholder Oversight*, 71 HASTINGS L.J. 699 (2020)

II. THE FIRM AND GOVERNANCE STRUCTURES

If we are to move beyond the current shareholder primacy model of corporate governance, we need a theory of governance to ground our new conception of the corporation. Economic theory is based, broadly, on the principle of efficiency. The "theory of the firm" is a subdiscipline of economics that focuses particularly on issues of organization and governance.[139] The literature on the theory of the firm asks: why do we have firms, rather than markets?[140] This literature offers a sustained interdisciplinary inquiry into the nature of firms and their legal representations.[141] While much of the current work in other social sciences, such as psychology and sociology, dovetails with economic theory and provides additional insights into the basic economic models,[142] the theory of the firm offers a starting point for these inquiries and a basis upon which to build an alternative academic narrative.

A. Applying the Theory of the Firm to Corporate Governance

Research into the theory of the firm seeks to answer a fundamental question: Why do we even have firms at all? Markets allocate resources based on the best information available at the time.[143] Firms, however, operate outside of this market structure, standing like "lumps of butter coagulating in a pail of buttermilk."[144] The law reflects this differentiation, as market transactions are generally governed by contract, while firms are created as specific legal entities with their own identity—partnerships, corporations, and limited liability companies (LLCs), among others. Firms are meant to operate outside the market. But why?

In early neoclassical economics, the theory of the firm was quite rudimentary; the firm was simply a black box that took in inputs and produced

(arguing for a reduction of shareholder governance power through stakeholder reporting and stakeholder-focused managerial compensation).

139 ERIC W. ORTS, BUSINESS PERSONS: A LEGAL THEORY OF THE FIRM, at ix (2013).

140 Oliver Hart, *An Economist's Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757, 1757–65 (1989) (discussing various theories of the firm).

141 ORTS, *supra* note 139; Scott E. Masten, *A Legal Basis for the Firm*, 4 J.L. ECON. & ORG. 181 (1988).

142 *See* Matthew T. Bodie, *The Post-Revolutionary Period in Corporate Law: Returning to the Theory of the Firm*, 35 SEATTLE U. L. REV. 1033, 1057 (2012) (noting that "the different social science disciplines—economics, psychology, sociology, anthropology—are increasingly borrowing from one another and bleeding into each other's work"); *see also* THE FIRM AS A COLLABORATIVE COMMUNITY: RECONSTRUCTING TRUST IN THE KNOWLEDGE ECONOMY (Charles Heckscher & Paul S. Adler eds., 2006) [hereinafter COLLABORATIVE COMMUNITY] (taking an organizational behavior approach).

143 F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 520 (1945).

144 R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 388 (1937) (quoting D.H. ROBERTSON, THE CONTROL OF INDUSTRY 85 (1930)).

outputs.[145] No further dissection was undertaken. The black box, however, did differentiate between what was inside the firm and what was outside: employees and capital assets were inside, while customers and suppliers were outside.[146] Despite its crude form, this conception of the firm was useful in early economic modeling and retains that purpose even today.

An exploration of the internal workings and purpose of the firm begins with the work of Ronald Coase.[147] In an oft-quoted passage from his concise masterpiece, *The Nature of the Firm*, Coase considered the firm-market distinction:

> Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-co-ordinator, who directs production. It is clear that these are alternative methods of co-ordinating production. Yet, having regard to the fact that if production is regulated by price movements, production could be carried on without any organisation at all, well might we ask, why is there any organisation?[148]

In answering this question, Coase turned to a theory of transaction costs. Contracting through markets and using the price mechanism can be costly. For certain transactions, Coase posited, it is cheaper to simply direct the production to occur rather than contracting for it each time. The hierarchy of the firm allows such transactions to be carried out by fiat, rather than through pricing, negotiating, and drafting a contract for each transaction.[149] In other words, hierarchical governance within the firm was more efficient than market transactions.

Coase's theory of the firm relies heavily on the idea of the employment relationship. The structural differentiation between firm and market is the relationship between individual employees and the firm's ownership or management. The employment relationship is not based on individual spot transactions, but rather an ongoing organizational relationship. As Coase

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[145] Reza Dibadj, *Reconceiving the Firm*, 26 CARDOZO L. REV. 1459, 1462 (2005) ("The predominant model of microeconomics, neoclassical price theory, assumes simply that the firm is a black box that maximizes profitability.").

[146] Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-governing Corporation*, 149 U. PA. L. REV. 1619, 1631 (2001).

[147] Coase, *supra* note 144.

[148] *Id.* at 388.

[149] *Id.* at 390–92.

famously noted: "If a workman moves from department *Y* to department *X*, he does not go because of a change in relative prices, but because he was ordered to do so."[150] The relationship between the firm and the employee is the primary distinction between the firm and the market. It is the reason for the firm's existence.

Coase cemented this conclusion when he considered "whether the concept of a firm which has been developed fits in with that existing in the real world."[151] His answer? "We can best approach the question of what constitutes a firm in practice by considering the legal relationship normally called that of 'master and servant' or 'employer and employee.'"[152] He then quoted at length from a treatise concerning the common law "control" test, which provides that "[t]he master must have the right to control the servant's work, either personally or by another servant or agent."[153] He concluded: "We thus see that it is the fact of direction which is the essence of the legal concept of 'employer and employee,' just as it was in the economic concept which was developed above."[154] For Coase, the employer-employee relationship defined the firm.[155]

Coase saw the nature of the firm as a hierarchical one in which managers controlled the efforts of employees. But the relationship between firm and employee need not be hierarchical. In an important response to Coase's work, Armen Alchian and Harold Demsetz also focused on the relationship of employees with other participants within the structure of the firm.[156] Alchian and Demsetz argued that Coase's focus on control, authority, and direction was misleading.[157] They put it this way, memorably: "Telling an employee to type this letter rather than to file that document is like my telling a grocer to sell me this brand of tuna rather than that brand of bread."[158] Because employees are generally hired and fired at will, neither the em-

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[150] *Id.* at 387.

[151] *Id.* at 403.

[152] *Id.*

[153] *Id.* at 404 (citation omitted).

[154] *Id.*

[155] *See* Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L. & POL'Y REV. 265, 296–97 (1998).

[156] Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 777 (1972) ("When a lumber mill employs a cabinetmaker, cooperation between specialists is achieved within a firm, and when a cabinetmaker purchases wood from a lumberman, the cooperation takes place across markets (or between firms).").

[157] *Id.* ("To speak of managing, directing, or assigning workers to various tasks is a deceptive way of noting that the employer continually is involved in renegotiation of contracts on terms that must be acceptable to both parties.").

[158] *Id.*

ployer nor the employee is bound to continue the relationship by any contractual obligations.[159]

Alchian and Demsetz instead took a more holistic approach, focusing on the firm's role in coordinating production in the midst of a variety of inputs. Team production is what separated firms from markets. Alchian and Demsetz defined team production as "production in which 1) several types of resources are used and 2) the product is not a sum of separable outputs of each cooperating resource."[160] As a result, team production applies when the coordinated effort increased productivity, after factoring out the costs associated with monitoring and disciplining the team.[161]

The lack of "separable outputs" is the key problem that the firm is designed to manage. When capital providers and workers join together to carry on a business, it is difficult to assess the relative importance or value of the individual contributions to that business in an easily measurable and ongoing formula. Firms allow these contributors to work together, sell their joint product, and then use the firm to manage both responsibilities and spoils. Alchian and Demsetz argued that a specialized, independent monitor was likely the best way of manage these issues.[162] That central monitor—the recipient of the residual profits—would be the firm itself: a legal "person" who contracts for all other team inputs.[163] The legal entity—such as the corporation—serves the role of coordinator.

The Alchian and Demsetz joint-production model includes employees as well as investors within the definition of the firm. The purpose of the Alchian-Demsetz firm is to manage labor and capital through the coordination of team production. Although outside shareholders contribute capital, they are relegated to the outer circles of power, as Alchian and Demsetz express skepticism about their ability to perform the monitoring function. Alchian and Demsetz ask:

> In sum, is it the case that the stockholder-investor relationship is one emanating from the *division* of *ownership* among several

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[159] *Id.* ("Long-term contracts between employer and employee are not the essence of the organization we call a firm.").

[160] *Id.* at 779.

[161] *Id.* at 780.

[162] *Id.* at 782–83.

[163] Alchian and Demsetz set forth the following characteristics of the firm:

> (a) joint input production, (b) several input owners, (c) one party who is common to all the contracts of the joint inputs, (d) who has the rights to renegotiate any input's contract independently of contracts with the other input owners, (e) who holds the residual claim, and (f) who has the right to sell his central contractual residual status.

Id. at 783.

> people, or is it that the collection of investment funds from people of various anticipations is the underlying factor? If the latter, why should any of them be thought of as the owners in whom voting rights, whatever they may signify or however exercisable, should reside in order to enhance efficiency? Why voting rights in any of the outside, participating investors?[164]

As the theory of the firm literature continued to develop, the critical question remained why some economic activities take place in markets and others take place within firms. The transaction-costs model identifies the types of contractual difficulties which are likely to lead to firm governance rather than market solutions.[165] In situations where contributions and compensation can be harder to define, the parties will be left with incomplete contracts that require a governance structure to prevent opportunism.[166] This opportunism will be particularly problematic where one or both of the parties must invest significant resources in assets specific to the particular firm, project, or transaction.[167] This asset specificity makes the parties susceptible to hold-ups from their contractual partners in the absence of a system of governance. Firms can be useful in providing the structures that deter opportunism.[168]

The "property rights" theory of the firm, developed in a series of articles by Sanford Grossman, Oliver Hart, and John Moore, argues that firms are necessary as a repository of property rights for assets used in joint production.[169] By owning the property outright, the firm prevents the problem

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[164] *Id.* at 789 n.14.

[165] Jeffrey T. Macher & Barak D. Richman, *Transaction Cost Economics: An Assessment of Empirical Research in the Social Sciences*, 10 BUS. & POL. 1 (2008) (discussing transaction costs approach). *See generally* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING (1985).

[166] Oliver E. Williamson, *Why Law, Economics, and Organization?*, 1 ANN. REV. L. & SOC. SCI. 369, 373 (2005) ("Governance problems are posed when incomplete contracts (to include unforeseen contingencies) are combined with opportunism.").

[167] George S. Geis, *The Space Between Markets and Hierarchies*, 95 VA. L. REV. 99, 107–08 n.28 (2009) ("Oliver Williamson has significantly expanded upon Coase's initial insight by discussing the importance of bundling relationship-specific assets into a firm to avoid counterparty opportunism, and, more generally, by showing how a proper conception of transaction costs should include both the direct costs of managing relationships and the opportunity costs of suboptimal governance decisions.").

[168] *See* WILLIAMSON, *supra* note 165, at 114–15; OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE 47–48 (1996).

[169] *See* Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691 (1986); Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755 (1988); Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119 (1990). *See generally* OLIVER HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE (1995).

of the commons (in which no one holds property rights over valuable assets) as well as the problem of the anticommons (in which property rights are divvied up among too many disparate actors). The Grossman-Hart-Moore model dictates that those who contribute the most valuable and most asset-specific property to the joint enterprise should control the firm.[170] They are not only most necessary to the firm's success, but also the most vulnerable to hold-up problems as the joint enterprise moves forward in time.

The "access" model "define[s] a firm both in terms of unique assets (which may be physical or human) and in terms of the people who have access to these assets."[171] Raghuram Rajan and Luigi Zingales define access as "the ability to use, or work with, a critical resource."[172] As Rajan and Zingales make clear, "[t]he agent who is given privileged access to the resource gets *no new residual rights of control*. All she gets is the opportunity to specialize her human capital to the resource and make herself valuable."[173] Combined with her right to leave the firm, access gives the employee "the ability to create a critical resource that she controls: her specialized human capital. Control over this critical resource is a source of power . . . ."[174] Gordon Smith has further developed this "critical resource" theory of the firm in outlining a theory of fiduciary duties that are responsible to vulnerabilities created by critical resources.[175]

Employees' contributions to the firm—often described as "human capital"—can be characterized as assets of both the firm and the employee. Some types of human capital are portable, such as education or general skills, but other types are specific to the firm and cannot be taken by the employee elsewhere. To the extent an employee has invested in firm-specific human capital, she is subject to opportunistic behavior because she cannot plausibly threaten to use that capital at a rival firm. One aspect of this capital—knowledge—has served as the basis for a new set of ap-

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[170] D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1404–05 (2002) ("The central insight of the property rights theory of the firm is that an appropriate allocation of ownership rights over the assets of a firm reduces the likelihood that one party will unfairly take advantage of the other participants within the firm.").

[171] Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q.J. ECON. 387, 390 (1998).

[172] *Id.* at 388.

[173] *Id.*

[174] *Id.*

[175] Smith, *supra* note 170, at 1404 ("[T]the critical resource theory reveals that the beneficiary's vulnerability emanates from an inability to protect against opportunism by the fiduciary with respect to the critical resource.").

proaches to the firm.[176] Knowledge-based theories focus on the need to produce, distribute, and ultimately retain valuable knowledge-based assets within the firm.[177] Choices between centralized and multi-divisional organizational structures,[178] or between covenants not to compete and employee stock options,[179] are made to manage the control of knowledge within the firm. Along the same lines, a capability-based theory of the firm focuses on employees' firm-specific knowledge and learning that can be translated into joint production.[180] Another perspective on the firm, this time from organizational theory, sees the firm as a "collaborative community" in which employees work together toward common goals.[181]

Looking over the trajectory of the theory of the firm, we see that the primary concern has been over the shape and internal organization for these entities that operate outside of the standard market relationships. And the theories of the firm all seem to acknowledge the important role of workers within the firm. Going back to Coase, the firm was designed to manage the relationship between those who started or managed the business and those who worked for the business. The work of the business was best managed internally, rather than through external markets. And the firm itself was made up of those who worked for the firm, along with those who "managed" the firm—also workers—and those who "owned" the firm through financial assets.

B. The Legal Construction of Firm Governance

Because the firm is the primary organizational engine of economic activity and growth, the internal governance of the firm takes on supreme importance. The corporate form, and its systematic exclusion of employees from governance, is not endemic to economic organization. Partnerships, for example, were the original legal structure for organizing a group of peo-

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[176] *See* Érica Gorga & Michael Halberstam, *Knowledge Inputs, Legal Institutions, and Firm Structure: Towards a Knowledge-Based Theory of the Firm*, 101 NW. U. L. REV. 1123 (2007); *see also* Katherine V.W. Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721 (2002) (discussing legal conceptions that govern the ownership of human capital within the workplace).

[177] Gorga & Michael Halberstam, *supra* note 176, at 1137 (criticizing the property rights theory for failing to account for the importance of employees as assets).

[178] *Id.* at 1173–83.

[179] *Id.* at 1183–92; *cf.* Oren Bar-Gill & Gideon Parchomovsky, *Law and the Boundaries of Technology-Intensive Firms*, 157 U. PA. L. REV. 1649, 1686–88 (2009) (discussing the role of covenants not to compete in managing innovation within the firm).

[180] Thomas F. McInerney, *Implications of High Performance Production and Work Practices for Theory of the Firm and Corporate Governance*, 2004 COLUM. BUS. L. REV. 135, 139.

[181] *See* Paul S. Adler & Charles Heckscher, *Towards Collaborative Community*, *in* COLLABORATIVE COMMUNITY, *supra* note 142, at 11, 13.

ple into a firm. Unlike corporations, partnerships have never required an explicit grant of authority from the government to operate.[182] In fact, courts can determine that a group of people had been operating as a partnership even if they had never declared themselves to be partners or considered themselves to be within a partnership.[183] Instead, the test is whether the parties had formed an "association of two or more persons to carry on as co-owners a business for profit."[184] There are numerous examples where people working together on the assumption that the worker was an employee turned out to be partners under the law.[185]

Under the default rules of a partnership, all participants have equal voting rights and equal rights to vote on partnership matters.[186] The control rights in a partnership extend even to ordinary, everyday matters of the business.[187] Of course, "one partner, one vote" is only the default rule. Partners who contemplate varying levels of input and interest will generally construct a partnership agreement that allocates votes as well as shares of the residual profits according to mutual agreement.[188] Partners are free to divvy up voting power according to contributions, seniority, experience, involvement, and other factors relevant to governance. The default rules are a bit more structured for the limited partnership, the limited liability partnership, and the LLC. These organizations envision participants with stakes in the residual who do not participate in management. For example, limited partnerships must make clear who the managerial partners are, and who the limited partners are.[189] LLCs have what is known as "chameleon" manage-

[182] *See* D. GORDON SMITH & CYNTHIA A. WILLIAMS, BUSINESS ORGANIZATIONS 34 (2004) ("[N]o formalities are required to form a partnership."); Christine Hurt, *Partnership Lost*, 53 U. RICH. L. REV. 491, 497 (2019) ("Partnerships existed at common law in England and in the United States before partnership acts were promulgated in the 1800s.").

[183] *See, e.g.*, Bass v. Bass, 814 S.W.2d 38, 41 (Tenn. 1991) (holding that "it is not essential that the parties actually intend to become partners").

[184] UNIF. P'SHIP ACT § 202(a) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2013).

[185] *See, e.g.*, Holmes v. Lerner, 88 Cal. Rptr. 2d 130, 132 (Ct. App. 1999); Smith v. Redd, 593 So. 2d 989, 991 (Miss. 1991); Ingram v. Deere, 288 S.W.3d 886, 891 (Tex. 2009).

[186] UNIF. P'SHIP ACT § 401(h).

[187] *See id.*

[188] *See, e.g.*, Day v. Sidley & Austin, 394 F. Supp. 986, 992 (D.D.C. 1975) (discussing how "statutory rules governing the rights and duties of the partners are 'subject to any agreement between them'" (citation omitted)).

[189] *See* UNIF. LTD. P'SHIP ACT § 303 (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2013) (providing that "[a] debt, obligation, or other liability of a limited partnership is not the debt, obligation, or other liability of a limited partner"). Under the original Uniform Limited Partnership Act, however, limited partners may be subject to liability as managing partners if they participate in the governance. UNIF. LTD. P'SHIP ACT § 7 (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1916) ("A limited partner shall not become liable as a general partner unless . . . he takes part in the control of the business.").

ment: "the firm can choose either direct partnership-type control by the members or centralized control by managers that is closer to, but not as rigid as, the limited partnership format."[190] Participants in these enterprises have substantial flexibility in arranging the division of ownership and control rights.

The corporation, in contrast, represents a shareholder-oriented governance structure—one that leaves out other participants. In smaller corporations known as closely held corporations, the same basic corporate structure is used, but these businesses must adapt the corporate form's rigidity for their purposes.[191] Many closely held companies have different classes of shares as a method of allocating control among different groups of shareholders.[192] In addition, shareholders may agree to certain voting arrangements, such as the pooling of votes into a voting trust or an agreement to vote together.[193] These voting arrangements consolidate a group of disparate shareholders into a majority and provide protection to minority shareholders over certain critical matters.[194] Corporate law can also protect minority shareholders against undue oppression through specifically tailored equitable relief. Such oppression often relates to the ability of minority shareholders to partake in other aspects of the corporate pie—specifically, employment.[195] Even if shareholders are all sharing equally in the profits, the minority oppression doctrine may still order the majority shareholders to approve a dividend or to provide employment opportunities within the company for minority shareholders.[196]

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[190] Larry E. Ribstein, *The Evolving Partnership*, 26 J. CORP. L. 819, 843 (2001).

[191] *See* Donahue v. Rodd Electrotype Co. of New Eng., Inc., 328 N.E.2d 505, 511 (Mass. 1975) (defining closely held corporations as having: "(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation").

[192] Preferred stock is particularly common in start-up corporations. Venture capital investors prefer to invest with preferred stock, which converts into common stock with multiple voting shares if certain triggers are reached. William W. Bratton, *Venture Capital on the Downside: Preferred Stock and Corporate Control*, 100 MICH. L. REV. 891, 892 (2002) (noting that "[c]onvertible preferred stock is the dominant financial contract in the venture capital market").

[193] *See, e.g.*, FRANKLIN A. GEVURTZ, CORPORATION LAW 486–96 (2000).

[194] Perhaps the most famous example of such a trust involves the Ringling family of circus fame. *See* Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling, 53 A.2d 441, 447 (Del. 1947) (upholding such a trust).

[195] *See, e.g.*, Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 664 (Mass. 1976) (finding "no legitimate business purpose" to the majority shareholders' decision to suspend a minority shareholder's salary, fail to reelect him as a director, and fail to appoint him as an officer); Leslie v. Bos. Software Collaborative, Inc., 14 Mass. L. Rptr. 379 (Super. Ct. 2002) (minority shareholder terminated from his position as treasurer by majority shareholders).

[196] For a further discussion of the protection of minority shareholders vis-à-vis the protection of political minorities, see Anupam Chander, *Minorities, Shareholder and Otherwise*, 113 YALE L.J. 119 (2003).

This divergence between the cookie-cutter structure of corporation governance and the more tailored approaches of other systems suggests that corporations could reconsider their lockstep approach. And in fact, recent developments in shareholding structures illustrate a breakdown in the one-share, one-vote consensus model. Companies such as Facebook, Google, and Snap have stock structures that grant the company founders special control rights beyond their common stock holdings.[197] Preferred stock is also used to provide control rights in certain circumstances, such as the failure to make a payment or the approach of the company's dissolution.[198] Companies are getting creative in order to accommodate the special circumstances of their particular business firm.[199]

More broadly, corporate law needs to dig deeper into the theory of the firm. It needs to reexamine the premise that corporate governance is only about shareholders, directors, and officers. In particular, corporate law policymakers and theorists need to look at all of the corporation's stakeholders and determine if governance rights are appropriate as a way of managing their preferences. Prior to recent proposed legislation,[200] the U.S. corporate law community has not seriously entertained any significant changes to the corporate franchise. Even team-production proponents have only prodded the board of directors to consider the interests of stakeholders.[201] With the power structures already in place, it makes little sense to imagine a stakeholder-rights theory without any positive governance power for stakeholders. As former Delaware Supreme Court Chief Justice Leo Strine has emphasized:

> Under the DGCL [Delaware General Corporate Law] only stockholders have the right to vote for directors; approve certificate amendments; amend the bylaws; approve certain other transactions, such as mergers, and certain asset sales and leases; and en-

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[197] Lund, *supra* note 8, at 694.

[198] STEPHEN M. BAINBRIDGE, CORPORATION LAW & ECONOMICS 66–67 (2002) ("[P]referred stock may have a preference over common stock with respect to dividends and/or liquidation."). Preferred shares have often been ignored in the debate about shareholder wealth maximization, with the assumption that the shareholders in question are the common stockholders. *See id.* at 66 (noting that preferred stock is "an odd beast, neither wholly fish nor wholly fowl"); William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. PA. L. REV. 1815, 1820 (2013) ("Preferred stock sits on a fault line between two great private law paradigms, corporate law and contract law. It is neither one nor the other; rather, it draws on both.").

[199] *See* Goshen & Squire, *supra* note 7, at 773 ("[B]ecause the impact of a given governance structure on control costs is firm-specific, there is no particular governance structure that can be described as intrinsically good, bad, welfare enhancing, or inefficient.").

[200] *See, e.g.*, Accountable Capitalism Act, S. 3348, 115th Cong. (2018); Reward Work Act, S. 2605, 115th Cong. (2018).

[201] Hayden & Bodie, *supra* note 63.

> force the DGCL's terms and hold directors accountable for honoring their fiduciary duties. In the corporate republic, no constituency other than stockholders is given any power.[202]

Voting rights are the only way to provide a real voice to preferences within the corporation's governance structure.[203]

C. A Shared Governance Model of the Firm

1. Participation in Joint Production

Corporations exist to facilitate economic production.[204] The corporate form is not the same thing as a business; an actual business consists of ideas, relationships, economic activity, and legal rights. The corporate form is part of this mix.[205] The corporation is a legal fiction that creates rights and duties; the business firm is the ongoing social phenomenon that is the business. The legal part of the business equation is meant to facilitate the social and economic phenomenon.

The economic distribution of the responsibilities for production, as well as the distribution of the fruits of production, will ultimately rest in the hands of those with organizational power. Much of the debate in corporate law over the last forty years—perhaps even the last century—has concerned the distribution of corporate power between the board, the officers, and the shareholders.[206] Shareholder advocates have pushed for corporate law re-

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[202] Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 763–66 (2015); *see also* Leo E. Strine, Jr., *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 135–36 (2012) ("[T]he continued failure of our societies to be clear-eyed about the role of the for-profit corporation endangers the public interest.").

[203] Smith, *supra* note 170, at 1458 (contemplating "that the key residual ownership right in the corporation is the right to elect directors").

[204] RIBSTEIN, *supra* note 68, at 4 ("The corporation undeniably has driven business growth in the United States since the Industrial Revolution.").

[205] William A. Klein, *The Modern Business Organization: Bargaining Under Constraints*, 91 YALE L.J. 1521, 1521 (1982) (arguing that "the most useful way to analyze the modern business enterprise is to interpret the terms of the economic arrangements of a firm (partnership, corporation, cooperative) and the terms of the related economic arrangements that should not be analyzed separately from the firm (distributorship, loan agreement, employment contracts) as a series of bargains subject to constraints and made in contemplation of a long-term relationship").

[206] For the beginnings of the debate over the separation of ownership and control, see ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932). *See* Jensen & Meckling, *supra* note 67, at 309–28 (discussing the problem of agency costs in light of the separation of ownership and control).

forms that provide more direct power to stockholders.[207] Management and stakeholder advocates have argued that boards need more insulation from shareholders and less scrutiny, even if their ultimate aims remain shareholder wealth maximization.[208] In this second group, there is a subset of advocates who argue that stakeholders such as employees, creditors, consumers, and communities deserve some protection within the process.[209] But stakeholder supporters generally provide directors with the freedom to merely consider all stakeholder interests, rather than granting voting power to these stakeholders.[210]

If the firm is designed to help manage a system of joint production, then the governance of the firm should include those who participate in the joint production. The distinction between markets and firms is this distinction between the use of straightforward contracts to manage relationships and the need for governance mechanisms to manage relationships.[211] Firms involve the complexities of ongoing joint production between participants who cannot reduce their interactions simply to contractual performance metrics. Instead, the participants create another entity—the firm—to serve as the locus of their production and to structure both the inputs required by the participants and to divvy up the outputs among them.

Shareholders and employees are invested in the firm in such a way that they need firm governance to protect against opportunism. When it comes to their contractual vulnerability, shareholders are indeed situated differently from other capital providers (such as creditors).[212] Shareholders invest their money into the firm with no ability to withdraw it and subject to uncertain payoffs, largely at the discretion of management.[213] Employees are also firm investors.

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[207] *See, e.g.*, Bebchuk, *supra* note 3 (arguing that shareholders should have more power in corporate governance decision-making).

[208] *See, e.g.*, Bainbridge, *supra* note 3, at 550; Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 754 (2007); Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 804–05 (2007).

[209] *See, e.g.*, Blair & Stout, *supra* note 28, at 313.

[210] Hayden & Bodie, *supra* note 63, at 2113 (discussing the "strange turn" against stakeholder board representation).

[211] *See* Bengt Holmstrom, *The Firm as a Subeconomy*, 15 J.L. ECON. & ORG. 74, 80 (1999) ("When contracts are incomplete in the sense that they cannot incorporate all future contracting opportunities, governance becomes consequential.").

[212] *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 21, at 68–69; Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 FORDHAM L. REV. 1161, 1197 (2010) (discussing the problem of "shareholder oppression" and vulnerability, and the inability of contracts to unequivocally protect such shareholders).

[213] *See* Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387, 392 (2003) (citing the importance of "resource commitment" or capital lock-in as a critical reason for the success of the corporation as a private enterprise).

They have invested their labor, reputations, and firm-specific individual capital in the firm and cannot not pull these investments out.[214] Under the law, they are compensated on a more regular basis, and with less discretion, than shareholders.[215] However, they still operate within the firm, as opposed to suppliers and outside contractors who provide their services through markets.[216]

Fig. 1

***	**Inside Firm**	**Outside Firm**
Labor	Employees, Management	Independent Contractors, Suppliers
Capital	Shareholders	Creditors

The theory of the firm supports a governance model that includes employees. Theory of the firm scholars have long appreciated the importance of the employee to our conception of the firm.[217] Ronald Coase looked to the relationship between employer and employee to demonstrate empirical

[214] *See* Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283, 302 (1998) (noting that firm-specific "skills make a worker more valuable to her present employer, but also make her more vulnerable to a firm's opportunistic behavior"); Andrew Keay, *Stakeholder Theory in Corporate Law: Has It Got What It Takes?*, 9 RICH. J. GLOBAL L. & BUS. 249, 268 (2010).

[215] As late as the nineteenth century, employees worked for terms as long as a year and were not entitled to any contractual payment if they left before the end. *See, e.g.*, Stark v. Parker, 19 Mass. (2. Pick.) 267, 292–94 (1824) (denying any contractual recovery for an employee who left after nine months of a twelve-month job); Britton v. Turner, 6 N.H. 481, 491–92 (1834) (denying contractual recovery but allowing for recovery under restitution). Now, however, wage and hour laws require payment for time worked and periodic payments made to the employee. *See generally* Fair Labor Standards Act of 1938, Pub. L. No. 75-718, 52 Stat. 1060 (codified as amended at 29 U.S.C. §§ 201–219 (2018)) (mandating that employees receive pay for their hours worked).

[216] Scholars have made a case for consumer governance rights in a limited set of circumstances. *See* HANSMANN, *supra* note 93, at 149–223 (discussing specific instances of customer-owned enterprises); David G. Yosifon, *Consumer Lock-in and the Theory of the Firm*, 35 SEATTLE U. L. REV. 1429, 1430 (2012) [hereinafter Yosifon, *Lock-in*] (arguing that "a departure from the shareholder wealth maximization norm and an embrace of a multi-stakeholder corporate governance regime may be necessary to overcome agency problems associated with consumer lock-in"); David G. Yosifon, *The Consumer Interest in Corporate Law*, 43 U.C. DAVIS L. REV. 253, 302 (2009) [hereinafter Yosifon, *Consumer Interest*] (arguing that consumers are inadequately represented in corporate governance).

[217] *See, e.g.*, Coase, *supra* note 144, at 401–05 (incorporating the employer-employee relationship in constructing the concept of a firm).

support for his theory of the firm.[218] Armen Alchian and Harold Demsetz argued that the importance of the firm (as separate from the market) stems from the need to coordinate production from a variety of inputs.[219] Team production applies—and firms replace markets—when the coordinated effort increases productivity, after factoring out the costs associated with monitoring and disciplining the team.[220] Margaret Blair and Lynn Stout relied on this notion of team production in developing their stakeholder-based theory.[221]

By adding employees to the governance mix, we are not opening it up to all stakeholders. The non-separable inputs within team production really belong to employees and shareholders.[222] Shareholders provide capital that is taken within the firm and turned into discretionary funds.[223] Employees work together under the aegis of the firm to produce goods or services in a manner that generally cannot be separated out to assign specific values.[224] Other participants are not integrated into the team production process, and, thus, do not need to work within the firm.[225] Creditors provide money on fixed terms.[226] Suppliers and independent contractors provide specific services outside of the firm's scope. Consumers purchase the goods or services after the production process is complete.[227] And the surrounding community regulates the firm as it does all other individuals and organizations within

[218] *See id.* at 403 ("We can best approach the question of what constitutes a firm in practice by considering the legal relationship normally called that of 'master and servant' or 'employer and employee.'").

[219] *See* Alchian & Demsetz, *supra* note 156, at 778 (describing the firm as a "centralized contractual agent in a team productive process" (emphasis omitted)).

[220] *Id.* at 780.

[221] *See* Blair & Stout, *supra* note 28, at 275–76 (analyzing the "team production problem" arising when "a number of individuals come together to undertake a team production project that requires all to make some form of enterprise-specific investment" that "leave them vulnerable to opportunistic exploitation by other team members").

[222] *See id.* at 249 ("If the team members' investments are firm-specific . . . and if output from the enterprise is nonseparable . . . serious problems can arise in determining how any economic surpluses generated by team production . . . should be divided.").

[223] *See id.* at 277 ("Providers of financial capital—shareholders and even, potentially, some creditors—are, by this agreement, just as 'stuck' in the firm as are providers of specialized human capital.").

[224] *Id.* at 261.

[225] *See id.* at 269 (arguing that "shareholders, executives, and employees" are the main players on the "corporate 'team'").

[226] *But cf.* Alan J. Meese, *The Team Production Theory of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629, 1652–55 (2002) (arguing that "[t]here is no doubt that creditors who loan money to publicly held corporations thereby make a team-specific investment" but that they are "less vulnerable to opportunism when trading with publicly held corporations" when compared to other team members).

[227] *See* Yosifon, *Consumer Interest*, *supra* note 216, at 259 (discussing the cabined role of some consumers in the transacting process).

its jurisdiction. If we say that all of these participants engage in the team production process, it proves too much—then all participants in the market would be engaged in commerce with one another. Employees and shareholders are part of that team production process in a way that stakeholders outside the firm are not.[228]

Concern for the fates of other stakeholders is understandable and may, in some circumstances, warrant a species of governance protection. Creditors, for example, may receive specific protections when the company is close to bankruptcy as a way of mitigating their particular vulnerabilities in such situations.[229] Certain consumers may have the type of long-term, invested interests, such that some governance and/or ownership rights may make sense.[230] In the main, however, government regulation will be the most straightforward way of managing issues that arise and are not amenable to contractual resolution. Creditors have statutory rights within bankruptcy.[231] Consumer protection laws can place mandatory terms or disclosure re-

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[228] Some stakeholder theorists have advocated specifically for employee governance rights. GREENFIELD, *supra* note 29, at 149 (advocating for a special role for employees in corporate law, including the possibility of board representation); Brett H. McDonnell, *Strategies for an Employee Role in Corporate Governance*, 46 WAKE FOREST L. REV. 429, 429–31 (2011) (assessing "a number of possible strategies for creating a role for employees in corporate governance"); *see also* Brett H. McDonnell, *Employee Primacy, or Economics Meets Civic Republicanism at Work*, 13 STAN. J.L. BUS. & FIN. 334, 334 (2008) (promoting employee primacy); Marleen O'Connor, *Labor's Role in the American Corporate Governance Structure*, 22 COMP. LAB. L. & POL'Y J. 97, 98–99 (2000); 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, 1189 (1991). Others have noted that employees have a stronger or the strongest case among stakeholders for participation in governance. Millon, *supra* note 131, at 19 (noting that "[t]he most compelling theoretical arguments for nonshareholder protection have focused on employees," and that the "relative inadequacy of bargaining power and other disadvantages may more seriously impede bargained-for protection for employees than for other nonshareholder groups").

[229] *See, e.g.*, Robert P. Bartlett, III, *Shareholder Wealth Maximization as Means to an End*, 38 SEATTLE U. L. REV. 255, 296 (2015) ("[C]ourts should revert to their traditional focus on policing against the bargaining failures that can occur when investors use directors to address the incomplete contracting challenges that are replete in corporate finance."); Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance*, 57 UCLA L. REV. 115, 119 (2009) (arguing that "bank creditors and other private lenders often enjoy significant oversight and influence over managerial decisions"). For a discussion of the possible expansion of fiduciary duties to creditors, see Frederick Tung, *The New Death of Contract: Creeping Corporate Fiduciary Duties for Creditors*, 57 EMORY L.J. 809, 814–15 (2008) [hereinafter Tung, *Fiduciary Duties*].

[230] *See* HANSMANN, *supra* note 93, at 149–68 (discussing consumer ownership); Yosifon, *Lock-in*, *supra* note 216, at 1449–59 (discussing types of lock-in situations).

[231] *See* Tung, *Fiduciary Duties*, *supra* note 229, at 842 ("By the time the firm is in distress, its creditors will enjoy differing rights (including payment and priority rights), differing stakes in the continuation of the borrower firm, and differing contract protections.").

quirements on firms.[232] Environmental protections address externalities by imposing costs on firms (and individuals) for creating those externalities.[233] But corporate governance, like all firm governance, should be addressed by solving problems that arise within the firm structure—problems related to team production.[234] Employees and shareholders are the stakeholders engaged in the process of team production within the firm.[235]

2. Information Within the Firm

A system of shared governance better reflects the flow of information within the firm. Information has always been the strange paradox at the heart of corporate law theory. Shareholders delegate governance power to management because they do not have the time or resources to get the information necessary to make independent governance decisions. And yet shareholder primacy asks shareholders to vote with sufficient knowledge and understanding to curb agency costs and direct the corporation efficiently. This paradox has come into fuller view of late, as theorists raise powerful concerns about the "competence costs" of principal governance[236] and the voting rights of passive funds.[237]

Employees have information about the firm that they obtain through their everyday experience with the company without additional cost. Yet they have no formal governance mechanisms for using this information to

[232] *Cf.* Mark E. Budnitz, *The Development of Consumer Protection Law, the Institutionalization of Consumerism, and Future Prospects and Perils*, 26 GA. ST. U. L. REV. 1147, 1169 (2010) ("Despite the many state and federal statutes that have been enacted in the last forty years to regulate consumer transactions, the underlying contract between the company and the consumer remains crucial in determining the rights and liabilities of the parties.").

[233] Individual shareholders at individual companies can no doubt use corporate law and governance to advance environmental concerns. *See* Sarah E. Light, *The Law of the Corporation as Environmental Law*, 71 STAN. L. REV. 137, 140 (2019) (concluding that "the law governing the corporation throughout its life cycle—corporate law, securities regulation, antitrust law, and bankruptcy law—should be understood as a fundamental part of environmental law"). For a discussion of the use of voting power to provide stakeholders with influence in benefit corporations, see Brett H. McDonnell, *From Duty and Disclosure to Power and Participation in Social Enterprise*, 70 ALA. L. REV. 77, 124 (2018).

[234] *See* Blair & Stout, *supra* note 28, at 250 ("[P]ublic corporation law can offer a second-best solution to team production problems because it allows rational individuals who hope to profit from team production to overcome shirking and rent-seeking by opting into an internal governance structure we call the 'mediating hierarchy.'").

[235] Note that a shared governance structure for the firm would align with William Bratton's description of the corporate purpose: "corporate law should facilitate corporate attempts to maximize productive output (and hence wealth) in a competitive economy, encouraging long-term investment at the lowest cost of capital, subject to exterior regulations that control externalities." William W. Bratton, *Framing a Purpose for Corporate Law*, 39 J. CORP. L. 713, 723–24 (2014).

[236] Goshen & Squire, *supra* note 7, at 785–90.

[237] Lund, *supra* note 6, at 497.

help guide the company. The overwhelming majority of private sector employees are not represented by a union.[238] Even if employees are represented by a union, that union has no formal right to bargain with the company over issues of managerial prerogative, such as new product lines, marketing, acquisitions, or the composition of the board.[239] The formal mechanism for employee input is the proverbial suggestion box.

In the 1980s and 1990s, both academic and popular business literature explored ways in which firms could better process and utilize information held by employees.[240] The success of Japanese businesses led many to investigate ways in which Japanese firms better integrated employee decision-making.[241] Internal systems involving "quality circles" and "quality improvement teams" were heralded as a way of drawing employee know-how into daily operations.[242] Such methods stood in opposition to hierarchical management structures and the Taylorist method of production, which held that managers generated the information and disseminated it down the ladder.[243] Although many of these structures are in use today,[244] they almost never extend to the higher reaches of the corporation, where true power sits.

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[238] *Union Members Summary*, U.S. BUREAU LAB. STAT. (Jan. 22, 2020), https://www.bls.gov/news.release/union2.nr0.htm [https://perma.cc/X6D6-CA4G] (finding that 6.2% of private-sector employees are unionized).

[239] Employers only need to bargain about terms and conditions of employment; they need not discuss areas within the "core of entrepreneurial control." NLRB v. Wooster Div. of Borg-Warner Corp., 356 U.S. 342, 349 (1958) (discussing the mandatory subjects of collective bargaining); SAMUEL ESTREICHER & MATTHEW T. BODIE, LABOR LAW 144–50 (2d ed. 2020).

[240] For a sampling of the legal academic literature—much of it involving employee ownership—see MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY (1995); JOSEPH R. BLASI, EMPLOYEE OWNERSHIP: REVOLUTION OR RIPOFF? (1988); HANSMANN, *supra* note 93, at 66–119; THE NEW RELATIONSHIP: HUMAN CAPITAL IN THE AMERICAN CORPORATION (Margaret M. Blair & Thomas A. Kochan eds., 2000); PAUL C. WEILER, GOVERNING THE WORKPLACE (1990); Alan Hyde, *In Defense of Employee Ownership*, 67 CHI.-KENT L. REV. 159, 160 (1991).

[241] *See, e.g.*, ROBERT E. COLE, WORK, MOBILITY, AND PARTICIPATION: A COMPARATIVE STUDY OF AMERICAN AND JAPANESE INDUSTRY (1980); Jon Gertner, *From 0 to 60 to World Domination*, N.Y. TIMES MAG., Feb. 18, 2007, at 34.

[242] *See, e.g.*, JOSEPH M. JURAN, JURAN ON QUALITY BY DESIGN (1992); DAVID I. LEVINE, REINVENTING THE WORKPLACE: HOW BUSINESS AND EMPLOYEES CAN BOTH WIN (1995); PAUL LILLRANK & NORIAKI KANO, CONTINUOUS IMPROVEMENT: QUALITY CONTROL CIRCLES IN JAPANESE INDUSTRY (1989); Erin White, *How a Company Made Everyone a Team Player*, WALL STREET J., Aug. 13, 2007, at B1.

[243] *See* Katherine Van Wezel Stone, *Labor and the Corporate Structure: Changing Conceptions and Emerging Possibilities*, 55 U. CHI. L. REV. 73, 143–46 (1988) (discussing Taylorism in the workplace).

[244] New managerial methodologies providing for participatory management and employee voice are increasingly popular around the globe. *See, e.g.*, LALOUX, *supra* note 15; ROBERTSON, *supra* note 15.

This gap between knowledge on the employees' part and power on the shareholders' part seems inefficient. Shareholders and employees could work together to pool their information and their power to police decisions of management. To take just one example: the process of carrying out a corporate combination, such as a merger or sale of substantially all of a corporation's assets, generally follows a prescribed pattern. After some set of the top corporate officers agree to the deal, the companies secretly and expeditiously conduct due diligence using high-level management and outside consultants. If this hastily-conducted due diligence uncovers no problems, the boards approve the combination and announce the deal to the public and shareholders. The shareholders generally have a couple of months to digest the proxy materials and media reports before they vote to approve or quash the merger. If the combination receives shareholder and regulatory approval, the combination ultimately goes into effect.[245] There are strategic reasons for the structure of this process: secrecy prevents poaching and keeps failed negotiations under the rug.[246] While this secrecy serves a purpose, it also narrowly restricts both the information and the perspectives that can be brought to bear. As a result, corporate combinations are extremely top-down affairs. From start to finish, the typical corporate combination is hampered by the absence of critical information. Employees are a natural fit to help overcome this information deficit because they have specialized information from the shop floor that is often undervalued by expensive corporate consultants.[247]

Employees also have information about the agency costs associated with managerial opportunism—information that shareholders are not likely to have. While directors may be expected to police such opportunism, there are a variety of reasons to doubt their effectiveness. First, the directors themselves may be in on the deal; the firm may decide to award bonuses to directors as well as managers.[248] Second, directors may already feel beholden to managers. Top-level executives have significant power over the board

[245] For a discussion of this phenomenon in the context of the AOL-Time Warner merger, see Bodie, *supra* note 133.

[246] *See, e.g.*, Basic, Inc. v. Levinson, 485 U.S. 224, 234–35 (1988) (discussing the importance of keeping merger negotiations secret).

[247] *See, e.g.*, MICHAEL J. PIORE & CHARLES F. SABEL, THE SECOND INDUSTRIAL DIVIDE: POSSIBILITIES FOR PROSPERITY 231–36 (1984) (discussing the practice of "flexible specialization" on the shop floor); *see also* MIKE ROSE, THE MIND AT WORK: VALUING THE INTELLIGENCE OF THE AMERICAN WORKER, at xxxiv (2004) (discussing the various intelligences of different types of workers).

[248] *See* Lewis v. Vogelstein, 699 A.2d 327, 331–33 (Del. Ch. 1997) (discussing the issues surrounding a stock option grant to directors).

nomination and reelection process[249] as well as the directorial compensation process.[250] Personal ties help cement the feelings of loyalty and friendship.[251] Third, directors are part-timers; they themselves do not have the same quantity and depth of information that employees have. Boards may end up trusting that investment bankers, compensation consultants, and other advisors dealt with the compensation issue sufficiently, when in fact these advisors have their own set of conflicts.[252]

Although their interests may diverge in other contexts, employees are ideally situated to join with shareholders in an effort to police management. Indeed, this already appears to be taking place. Labor unions, for example, have become much more involved in traditional corporate governance activism.[253] In the 1980s, unions were generally antagonistic to shareholder concerns and supported anti-takeover tactics such as constituency statutes.[254] Unions and union-associated pension funds, however, have joined the side of shareholders in pushing through shareholder-friendly corporate governance measures.[255] Pension fund managers have been at the forefront in governance efforts to strengthen shareholder voting rights,[256] rein in the power of the chief executive officer,[257] and fight fraud and abuse by insiders.[258] These measures suggest an ongoing role for union activism: an alliance with shareholders in an effort to maximize long-term growth for shareholders and other

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[249] LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 25–27 (2004).

[250] *Id.* at 27–31 (discussing how top-level managers can financially reward directors).

[251] Brian G.M. Main, Charles A. O'Reilly III & James Wade, *The CEO, the Board of Directors and Executive Compensation: Economic and Psychological Perspectives*, 4 INDUS. & CORP. CHANGE 292, 304 (1995).

[252] *See* BEBCHUK & FRIED, *supra* note 249, at 37–39; *see also In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 704–11 (Del. Ch. 2005), *aff'd* 906 A.2d 27 (Del. 2006) (discussing the process through which Michael Ovitz was hired by the Walt Disney Company in 1995). Despite denying the duties of care and good faith challenges against the Ovitz hiring, Chancellor Chandler acknowledged that "the compensation committee met *for one hour*" to discuss the terms of Michael Ovitz's compensation along with the compensation packages for various Disney employees, 121 stock option grants, top-level executive Robert Iger's employment agreement, and board member and compensation committee chair Irwin Russell's $250,000 "compensation for negotiating the Ovitz deal." *In re Walt Disney Co.*, 907 A.2d at 708.

[253] *See* Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018 (1998).

[254] *Id.* at 1036.

[255] *Id.* at 1045. ("The amazing thing about these union-sponsored shareholder proposals is how ordinary they are, from the perspective of any institutional investor."). *See generally* DAVID WEBBER, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON (2018) (describing a wide-range of shareholder initiatives undertaken by public-union pension funds).

[256] WEBBER, *supra* note 255, at 45–78.

[257] *Id.* at 111–51.

[258] *Id.* at 164–80.

stakeholders. Employee board representation would provide a conduit for this kind of agency-costs information for the ninety-three percent of private-sector employees who are not represented by a union.[259] Whether unionized or not, employees have an interest in working with shareholders to prevent executives from taking advantage of the other stakeholders in the company.

Consumers, suppliers, creditors, and other stakeholders—unlike employees—all sit outside the firm and are less likely to have the breadth and depth of understanding that employees have. These stakeholders will have some slice of information about the firm by dint of their market relationships, and in certain circumstances those relationships may justify limited governance input or even governance rights.[260] As a matter of course, however, employees are much more likely to hold information that would usefully contribute to the governance process and be in a position to share it.

The theory of the firm separates those who engage in the ongoing business of the firm from those who contract with the firm from the outside. Those inside the corporation should have their preferences captured through more direct governance mechanisms such as voting and those outside through processes like contract or regulation. Under this understanding of the firm, employees are the classic insiders, a conclusion that's only reinforced by more recent work on the generation and flow of information within firms. The economic theory of the firm, then, provides a powerful argument for extending the corporate franchise to employees.

III. Democratic Participation and Shared Governance

When it comes to the corporate franchise, the theory of the firm provides a solid economic foundation for separating the interests of shareholders and employees from those of other corporate constituents. It is not, however, the only theoretical justification for that separation. In this Part, we explore the lessons that democratic theory has to offer corporate governance. In particular, we look at governance from the broad perspective of preference aggregation and develop a theory of democratic participation that allows us to determine whose preferences are best captured through voting rather than contract. We then apply that framework to corporate governance and find that it, too, counsels in favor of shared governance between shareholders and employees.

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[259] *Union Members Summary*, *supra* note 238 (finding that 6.2% of private-sector employees are unionized).

[260] For a discussion of various ownership structures for different types of firms, see HANSMANN, *supra* note 93.

A. Corporations and Democracy

All of the institutions that comprise modern market-based societies—from large governments to small businesses—employ decision-making structures designed to take account of their constituents' preferences. They sometimes rely on compacts or contracts, which are thought to ensure the preference satisfaction of everyone involved.[261] Once institutions reach a certain size and complexity, though, contracts alone cannot do the job: they must resort to some type of voting mechanism to aggregate preferences. This is true of almost all institutions, both political and corporate, that claim to serve some sort of constituency. It is certainly true of the modern corporation.

Since corporate governance involves, at least in part, the use of voting mechanisms to aggregate preferences, it seems reasonable to turn to political theory in analyzing its structures and relationships. Public choice theory, with its emphasis on the interests of different groups and its analysis of the effect of different structures on outcomes, would seem to present a natural methodology for studying corporate governance.[262] More generally, political theory concerns the allocation and transfer of power in decision-making and the roles of different institutions in the governance of a polity. That said, economics, so far, has dominated corporate law to the almost complete exclusion of political theory, perhaps because corporate law theorists are sometimes suspicious of political analogies (despite borrowing what they think is useful).[263] And while we obviously think economics has its place in the discussion, politics may also be instructive at the fundamental level of the structure of the corporation.

This is not to say that political and corporate institutions, or political and corporate voting, are the same thing. For example, those who currently vote in corporate elections—shareholders—may enter and exit the corporation more freely than citizens can move between polities; and shareholder voting, as currently structured, is a relatively meaningless exercise in terms

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[261] *See, e.g.*, Stephen E. Ellis & Grant M. Hayden, *The Cult of Efficiency in Corporate Law*, 5 VA. L. & BUS. REV. 239, 248–49 (2010).

[262] *See generally* DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE (1991) (discussing the public choice theory, its incorporation of interest groups, and its application to public law).

[263] *See* Blair & Stout, *supra* note 28, at 256–57, 323–24; Ian B. Lee, *Citizenship and the Corporation*, 34 LAW & SOC. INQUIRY 129 (2009) (discussing how economic theory has dominated corporate law and arguing that political theory should play a larger role). Public choice theory has been used in corporate law in the context of competition between states, competition within states, and competition between the states (particularly Delaware) and the federal government. *See, e.g.*, RALPH K. WINTER, GOVERNMENT AND THE CORPORATION (1978); Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 469–73 (1987); Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2493 (2005).

of exerting influence over most corporate decisions.[264] These points are well taken. But at some level of generality, both types of institutions purport to have governance structures designed to aggregate preferences. The purpose of a system of governance is to manage different interests despite the opportunities for conflict.[265]

For that reason, examining how voting works in political institutions may help illuminate some of the arguments around corporate governance law.[266] The disagreements over corporate governance law, after all, aren't usually about whether to structure corporations to maximize the preference satisfaction of their constituents, broadly defined, but rather how best to do so. The same types of questions animate discussions of both political and corporate voting.

One central set of questions, of course, is which constituents count, and how do we identify them and best capture their preferences. But there are other, related questions as well. Should the voting system be direct, representative, or some mixture of the two? If representative, what is the basis for representation, and how responsive should the system be? Existing work on these questions in the political realm can help us think about the structure of governance within the corporation.

1. Interested Parties

The right to vote is seen as the most basic of political rights.[267] Voting is a way of integrating preferences into a governance system. Systems that aggregate preferences typically limit input to people who have a stake or

[264] Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy*, 63 WASH. & LEE L. REV. 1389, 1397–1404 (2006).

[265] THE FEDERALIST NO. 10, at 43 (James Madison) (Garry Wills ed., 1982) (defining faction as "a number of citizens, whether amounting to a majority or a minority of the whole, who are united and actuated by some common impulse of passion, or of interest, adversed to the rights of other citizens, or to the permanent and aggregate interests of the community"); *see also* David Ciepley, *Is the U.S. Government a Corporation? The Corporate Origins of Modern Constitutionalism*, 111 AM. POL. SCI. REV. 418, 431–32 (2017) (making a connection between the structure of corporate charters and colonial charters).

[266] Michael S. Kang, *Shareholder Voting as Veto*, 88 IND. L.J. 1299, 1325 n.144 (2013) (analogizing the theory of shareholder voting as veto to consociationalism, which "is a system of national governance that permits rival socio-ethnic groups a mutual veto . . . over sensitive issues of government policy").

[267] *See, e.g.*, Reynolds v. Sims, 377 U.S. 533, 555 (1964) ("The right to vote freely for the candidate of one's choice is of the essence of a democratic society, and any restrictions on that right strike at the heart of representative government."); JOHN RAWLS, A THEORY OF JUSTICE 61 (1971) (describing political liberty as "the right to vote and to be eligible for public office").

interest in the enterprise.[268] When possible, the degree of input may be calibrated with the weight of that interest, or the strength of those preferences.[269] We aggregate the preferences of interested parties to ensure more thoughtful decision-making and lend a measure of legitimacy to electoral outcomes. And, indeed, most discussions of governance systems—corporate and political—take it for granted that input should be limited to those with an interest in the enterprise.[270] After that, though, the disagreements start almost immediately. They resolve into a couple different issues. First, who has interests that are sufficiently substantial to merit some kind of input into the future of the enterprise? Second, how are those interests best captured: through mutual agreement, voting, or some mixture of the two?[271]

The modern corporate structure dictates that the shareholders have their preferences captured through voting—primarily by voting on boards of directors, but also, in some cases like mergers or dissolutions, more directly—and all other constituents, from employees to suppliers to customers, have their preferences captured largely through individual agreements.[272] From the perspective of preference aggregation, voting is used to capture an ongoing set of preferences that are then translated into a system of governance for the firm. As an institutional entity, the firm needs a process whereby it can make decisions, effectuate actions, and carry on business. The shareholders have been designated as the body politic whose preferences are collated through various voting procedures.

The basic corporate stakeholders—those with an interest in firm decision-making—are fairly well known. Employees, shareholders, suppliers, customers, contractors, and even the community at large all have interests in the operation of a typical corporation. The nature of their interests, of course, may vary tremendously between groups and, as we've seen before, even within groups.[273] This is true both with respect to the content of their preferences (what they care about) and the strength of the preferences (how much they care about it). With few exceptions, both democratic and economic

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[268] *See* Melvyn R. Durchslag, Salyer, Ball, *and* Holt: *Reappraising the Right to Vote in Terms of Political "Interest" and Vote Dilution*, 33 CASE W. RES. L. REV 1, 38–39 (1982); Hayden & Bodie, *supra* note 24, at 452–56; Grant M. Hayden, *The False Promise of One Person, One Vote*, 102 MICH. L. REV. 213, 251–61 (2003).

[269] *See* Hayden & Bodie, *supra* note 24, at 456–58; Hayden, *supra* note 268, at 248.

[270] *See* Hayden & Bodie, *supra* note 24, at 452–60, 463–64.

[271] These two questions are not unrelated, but in order to think through some of the issues here, we think it helps to keep them separated.

[272] *See supra* notes 56–58 and accompanying text (describing Easterbrook and Fischel's argument that other constituents, through their own contracts, have agreed to give voting rights to shareholders).

[273] *See supra* notes 80–83 and accompanying text (describing the wide range of interests that shareholders have).

theorists take the contents of preferences as they come. In politics, for example, we don't prevent people from voting because of whom they support or what they believe.[274] Standard economics treats preferences much the same way, or, if anything, elevates them to an even more exalted position. Revealed preference theory holds that the best way to tell what consumers want is to observe their purchasing decisions.[275] Economists do not typically claim that consumers didn't (or shouldn't) really want something—they just register existing preferences and build their theories accordingly.

The strength of constituent interests is a different matter. While we don't tell citizens or consumers what to care about, we do make basic decisions about the structure of governance based on how much we think they care and how much they have at stake in the outcome of government or firm decision-making. Ideally, in both polities and corporations, we figure out who has strong interests in the enterprise and assign them the right to vote—a voice in the governance process.[276] Those with a sufficient level of interest vote; those with even more interest may get some type of additional weight added to their vote.[277] We believe that those with strong preferences about a matter are the ones who deserve to have their preferences aggregated.

Though it makes sense as an initial matter to tie voting to preference strength, we immediately run into a problem: we do not have a foolproof way to measure the strength of anybody's preferences.[278] We could, of course, just ask people how strongly they felt about an election outcome. But, with voting or, more generally, governance, tied to interest, people would have an incentive to strategically misrepresent the strength of their preferences. And even if we had accurate reports from people about how strong their interests were in an election, we lack a method of neutrally comparing those reports to those of others who report having an interest. There is no universal scale upon which to measure people's preference

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[274] For example, this is the intuition that underpins Kenneth Arrow's condition of democratic fairness typically referred to as universal admissibility. *See* Grant M. Hayden, *Some Implications of Arrow's Theorem for Voting Rights*, 47 STAN. L. REV. 295, 298 (1995); *see also* WILLIAM H. RIKER, LIBERALISM AGAINST POPULISM: A CONFRONTATION BETWEEN THE THEORY OF DEMOCRACY AND THE THEORY OF SOCIAL CHOICE 217 (1982).

[275] *See* Herbert Hovenkamp, *The Limits of Preference-Based Legal Policy*, 89 NW. U. L. REV. 4, 4–6 (1994).

[276] *See* Hayden & Bodie, *supra* note 24, at 452–60, 463–64.

[277] *See id.* at 456–58; Hayden, *supra* note 268, at 248.

[278] *But cf.* Christopher S. Elmendorf & Abby K. Wood, *Elite Political Ignorance: Law, Data, and the Representation of (Mis)Perceived Electorates*, 52 U.C. DAVIS L. REV. 571, 574 (2018) (noting that "[r]ecent technological developments . . . and the application of ever more sophisticated machine-learning algorithms to merged voter, consumer, and social media databases may, before long, yield a vastly more detailed and accurate picture of voter preferences").

strength—no way, in other words, to carry out interpersonal utility comparisons in a completely objective manner.[279]

For these and other reasons, our political system has not generally relied upon first-person reports to assess preference strength and, thus, the right to participate. Instead, it has relied upon other proxies, or markers, for a person's interest in the outcome of an election.[280] Throughout our history, states have relied on a wide variety of such markers, such as property-holding, taxpaying, or residency.[281] Ultimately, the decision is this: whether the person, based on certain factors relative to their person, should have the right to participate in governance.

2. Marking Voter Interest

The search for a good marker for voter interest boils down to finding an indicator that is both accurate and manageable.[282] The accuracy of a marker is a measure of how well it picks out the group of people who have a sufficient interest in the outcome of an election. A marker could be off by either including too many people who lack a sufficient interest or excluding people who have a strong interest; in other words, it could be overinclusive or underinclusive. With an overinclusive marker, we risk extending the franchise to those with a weak or nonexistent interest in the election, thus diluting the votes of those with a stronger interest. An underinclusive marker is even worse: it leads to outright disenfranchisement of those with a real stake in the outcome.[283] When it comes to assigning weight to votes, the accuracy of the marker depends on whether and how well it can be calibrated to the strength of voter preferences.

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[279] For a summary of the problem of making interpersonal utility comparisons, see Hayden, *supra* note 274, at 236–47; Richard H. Pildes & Elizabeth S. Anderson, *Slinging Arrows at Democracy: Social Choice Theory, Value Pluralism, and Democratic Politics*, 90 COLUM. L. REV. 2121, 2129 (1990) (discussing the difficulty of "democratic voting rules or procedures for collective decision making [that] would be able to aggregate existing individual preference rankings into a single, consistent collective outcome"). For more general background in the area, see JAMES GRIFFIN, WELL-BEING: ITS MEANING, MEASUREMENT, AND MORAL IMPORTANCE 113–20 (1986). *See generally* INTERPERSONAL COMPARISONS OF WELL-BEING (Jon Elster & John E. Roemer eds., 1991); Peter J. Hammond, *Interpersonal Comparisons of Utility: Why and How They Are and Should Be Made*, *in* INTERPERSONAL COMPARISONS OF WELL-BEING, *supra*, at 200, 238–254.

[280] *See* Hayden & Bodie, *supra* note 24, at 454.

[281] *See id.* at 454–56; Hayden, *supra* note 268, at 255–59; *cf.* Paul David Meyer, *Citizens, Residents, and the Body Politic*, 102 CALIF. L. REV. 465, 468 (2014) (arguing that lawful permanent residents should have voting rights).

[282] For an extended discussion of this, see Hayden & Bodie, *supra* note 24, at 460–62.

[283] *See id.* Of course, we could stitch together more than one underinclusive marker and better capture voter interest.

Of course, we have no direct way of assessing the accuracy of any marker because, as mentioned above, we have no direct way of measuring and comparing preference strength to begin with. Instead, as in any other situation, we have to make educated guesses about how much various people are affected by the decision-making of a particular elected body and assume that the people more strongly affected will be those with stronger electoral preferences. These judgments about the strength of people's interest may be contested, but they are essential to get any voting system up and running.

We make these kinds of judgments all the time in the political arena. The early freehold requirements, for example, were an attempt to capture one's stake in an election, and they were fine as far as they went (that is, those with a large amount of property did have an interest in elections). But they were underinclusive because they disenfranchised large numbers of property-less people who were, nonetheless, also greatly affected by the exercise of governmental powers.[284] More contemporary requirements, such as residency and citizenship, seem like better (though still imperfect) markers of voter interest. For example, those who are residents within the jurisdiction of a particular government are subject to its police powers, taxation, and services, and thus have quite a bit at stake in an election. Residency isn't a perfect indicator, of course. It's a little underinclusive, in that it fails to capture those who work or own property in one place and reside in another. At times, it can also be overinclusive, as when it allows people to vote who plan to move out of town right after election day. But despite debates around the margins, most agree that residency is a more accurate marker for voter interest than, say, owning property.[285] And, in the United States, when state and local governments tinker too much and try to use markers that are too overinclusive or underinclusive, they are often disallowed from doing so for that very reason.[286] New York, for example, attempted to limit voting in certain school district elections to people who either had school-aged children or owned or leased taxable property in the school district.[287] The United States Supreme Court, in addressing New York's attempted voting limitation in *Kramer v. Union Free School District No. 15*, acknowledged that voting may be tied to interest, but struck these particular markers as both

[284] *See id.* at 461.

[285] *See id.*

[286] *See, e.g.*, Richardson v. Ramirez, 418 U.S. 24, 79 (1974); Kramer v. Union Free Sch. Dist. No. 15, 395 U.S. 621, 632 (1969); Doe v. Rowe, 156 F. Supp. 2d 35, 55–56 (D. Me. 2001); Hellebust v. Brownback, 824 F. Supp. 1511, 1519–20 (D. Kan. 1993); Ortiz v. Hernandez Colon, 385 F. Supp. 111, 118 (D.P.R. 1974), *vacated*, 429 U.S. 1031 (1977) (mem.).

[287] *See Kramer*, 395 U.S. at 622–24.

overinclusive and underinclusive.[288] The Court explained that "[s]tatutes granting the franchise to residents on a selective basis always pose the danger of denying some citizens any effective voice in the governmental affairs which substantially affect their lives."[289]

Of course, we could always come up with some more extensive survey of voter interest to get a better fix on whether any particular person has a strong interest in the outcome of an election.[290] For example, perhaps a survey reveals that while both Luke and Ben are residents of a certain town, Ben plans to move away in just a few weeks. A third potential voter, Milo, lives nearby, but works and owns property in town, including the house where his elderly, dependent mother lives. With such information, we might conclude that, while residency is a good starting point, our additional information reveals that, really, Luke and Milo have sufficient interest in the jurisdiction to vote, and Ben, despite his current residency, does not. But this kind of individualized preference information would be incredibly costly to obtain, much less keep up to date. And, of course, if we obtain this information by asking everyone about their interests, we'd worry about strategic misrepresentation.[291] But, in any case, an ongoing process of surveying everyone about their potential interests in every jurisdiction is simply unworkable, which brings us to the second feature of any good marker: its manageability.[292]

Democratic institutions have long valued markers for voter interest that are easily managed. The property-holding and taxpaying requirements of old were not only useful because they ensured that voters had a financial stake in election outcomes, but did so with information that was readily available to the state. In fact, the state and local governments that ran the elections usually had lists of both property holders and taxpayers, which made it very easy to administer the voter rolls.[293] Residency has been a little harder to pin down—state and local governments do not usually have ready lists of all of their residents—so residency is often confirmed by requesting some sort of identification with a name and address on it (a utility bill, for example). Nevertheless, if one's residency is questioned, it is ultimately something that can be easily confirmed. Manageability, then, is a key feature of any marker used to pick out a potential voter's interest in the outcome of an election.

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[288] *Id.* at 632 n.15.

[289] *Id.* at 626–27.

[290] *See* Hayden & Bodie, *supra* note 24, at 462.

[291] *See id.*

[292] *See id.* at 461.

[293] *See id.*

B. Who Should Vote?

Developing a method of aggregating individual preferences, then, demands that we first figure out whose preferences to aggregate. This typically involves finding some way to measure the level of interest that a potential voter has in the outcome of an election. Because we do not have direct, reliable access to that kind of information, we usually depend upon some sort of marker for that interest. We generally divide the electorate into those whose preferences can be expressed through voting, and those whose preferences cannot. Until now, corporate governance has allowed only shareholders to express their preferences through votes. But it is time to reexamine this reality.

As detailed earlier, the longstanding theory of the firm counsels that two groups of constituents—shareholders and employees—have a special relationship to the corporation that militates in favor of assigning voting rights to them. This provides symmetry between contribution and participation. In this Section, we argue that core features of democratic theory—the tie between voting and interest, and the accompanying need for markers of that interest—point in the same direction. Here, too, there are features of shareholders and employees that allow us to distinguish them from other stakeholders. Most simply, their relationship with the firm gives them the accurate and manageable markers of interest that other corporate constituents, in ordinary business situations, lack.

1. Shareholders

For shareholders, the value of the capital contribution and the percentage of the dividend interest provide fairly quantifiable measures of the shareholder's interest in the corporation. Putting aside any outside interests of the shareholder, the allocation of one vote for each share accurately correlates to the shareholder's financial interest in the corporation.[294] The system of one share, one vote calibrates the level of interest with the level of input. Shareholding, in other words, appears to be an accurate and manageable marker of interest in a corporation, and thus shareholders should be accorded voting rights.

The familiarity of this conclusion, however, belies the complicating factors of this democratic argument for shareholder voting. Although shares are originally sold for the same price during the initial public offering, public-

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[294] EASTERBROOK & FISCHEL, *supra* note 21, at 72 ("The most basic statutory rule of voting is the same in every state. It is this: all common shares vote, all votes have the same weight, and no other participant in the venture votes, unless there is some agreement to the contrary. Such agreements are rare.").

ly traded shares soon enter the marketplace, where their values may change drastically over time. One shareholder may have purchased Facebook shares for $30 in 2012, while recent shareholders may have paid over $200.[295] Although everyone's shares may have the same value at any given moment in time, individual shareholders have likely invested different amounts per share to obtain those shares (and votes).

Shareholders also have differing interests outside the firm. Those outside interests may swamp the shareholder's interest in the corporation's residual. Shareholders may tailor their financial holdings to match shareholder voting power with countervailing interests in derivatives or short positions.[296] They may have personal interests, such as family ties[297] or religious and political values,[298] that conflict with the principle of shareholder wealth maximization. The shareholders themselves may be social investing funds,[299] sovereign wealth funds,[300] or an algorithm.[301] Pension funds may want to promote worker power, while hedge funds may want to make a quick sale after juicing up the price. Shareholders do not have "pure" interests as shareholders, no more than citizens have "pure" interests in the republic.

There is also an accuracy issue when it comes to measuring shareholder preferences in that it may not be worth the shareholder's time and investment to correlate the vote in question accurately with the shareholder's preferences. The shareholder interest for those holding only a few shares is rather weak. The move to passive index funds further removes the shareholder's interests from any effort to express those interests through a vote.[302] Fully diversified shareholders are close to indifferent to the fortunes of any particular corporation.

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[295] *Cf.* Matt Phillips, *Facebook's Stock Plunge Shatters Faith in Tech Companies' Invincibility*, N.Y. TIMES (July 26, 2018), https://www.nytimes.com/2018/07/26/business/facebook-stock-earnings-call.html [https://perma.cc/982M-ZDZS].

[296] *See* Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 816 (2006); Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775, 780 (discussing "economically encumbered" and "legally encumbered" shares).

[297] Benjamin Means, *Nonmarket Values in Family Businesses*, 54 WM. & MARY L. REV. 1185 (2013).

[298] *See* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005).

[299] *See* Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381 (2020).

[300] *See* Ronald J. Gilson & Curtis J. Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 60 STAN. L. REV. 1345 (2008).

[301] *See* Tom C.W. Lin, *The New Investor*, 60 UCLA L. REV. 678, 680 (2013).

[302] *See* Lund, *supra* note 6, at 497 (proposing that lawmakers should restrict truly passive funds from voting at shareholder meetings because of their lack of interests in voting).

There are also underappreciated difficulties in the manageability of shareholder voting. Shareholder governance is still centered around the idea of the annual shareholders meeting, which the corporation, in theory, expects the shareholders to attend.[303] If unable to attend, shareholders designate their voting power to proxies, who then act on their behalf. Shareholders receive proxy ballots from the incumbent board, which makes the process much easier while subverting its democratic nature. Add to this the fact that modern shareholding is generally managed through intermediaries who hold the shares on behalf of the actual owner.[304] As Ewan McGaughey pointed out, it's quite often the case that "[a]sset managers control shareholder voting rights with other people's money."[305] Confusion over voting rights can abound in the context of custodial ownership, short sales, lending shares, and changes in ownership after the record date.[306] Trading shares is also accomplished through lightning-fast technology, and the allocation of particular shares to particular holders has not caught up with this technology.[307] Although certain reforms may address particular uncertainties over voting rights for particular shares,[308] there remain difficulties in matching up particular shareholders with voting rights in a particular election.

But despite these concerns, shareholders have sufficiently defined interests to provide accurate and manageable markers for their voting rights. They have a clear stake in the outcome of decision-making. They have a straightforward way to calibrate the strength of their interest. And because shareholders provide unencumbered capital to the corporation in exchange for certain rights to the residual profits, they cannot register their preferences

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[303] William K. Sjostrom, Jr., *The Case Against Mandatory Annual Director Elections and Shareholders' Meetings*, 74 TENN. L. REV. 199, 201 (2007) (discussing the "mandatory requirement under state corporate law and stock exchange listing standards that public corporations hold annual shareholders' meetings for the election of directors").

[304] Leo E. Strine, Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. CORP. L. 1, 6–7 (2007) (discussing the "separation of ownership from ownership," namely that "the equity of public corporations is often owned, not by the end-user investors, but by another form of agency, a mutual fund, or other institutional investor").

[305] Ewan McGaughey, *Democracy in America at Work: The History of Labor's Vote in Corporate Governance*, 42 SEATTLE U. L. REV. 697, 746 (2019).

[306] Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1231 (2008) ("The inescapable complexity combined with the already well-studied issues of shareholders' rational apathy and free rider problems detract from the case for shareholder voting.").

[307] George S. Geis, *Traceable Shares and Corporate Law*, 113 NW. U. L. REV. 227, 228–29 (2018) (noting the failure to connect particular shares with their owners in the context of electronic trading).

[308] *Id.*

meaningfully through agreement alone; they need a governance mechanism. Shareholder voting rights are designed to manage those preferences.

2. Employees

Employment is also an accurate and manageable marker of interest in the success of a corporation. Employees have an interest in the value of the corporation as expressed through their continued employment. Workers contribute to the process of joint production through their labor and create both specific value (creation of a particular good or service) and longer-term indefinite value (the value of the ongoing business as expressed through good will, trademark, and share price). Employees receive wages and benefits and may, in some cases, participate as shareholders through a 401(k) plan. But they also have an interest in the ongoing business of the company simply by virtue of having a job. This job renders them participants in the ongoing production and entitles them to a voice in the joint production process through the governance of the firm.

As compared with shareholders, it is simultaneously easier and more difficult to correlate employment interests with a schema of voting rights within the firm. Employees are smaller in number, easier to keep track of, and have an attachment to the firm that makes the logistics of election participation easier to manage. Yet, there are additional factors that could complicate the assignment of particular voting interests to employees. First, the category of employment is less clearly defined than the category of shareholder. The test for "employment" has traditionally been the common-law control test, which asks whether the employer has the right to control the action of the employee within the scope of employment.[309] The test has uncertain boundaries and can result in uncertainty over whether a particular worker is an employee or an independent contractor.[310] At the same time, however, corporations officially designate their employees for tax purposes and withhold employee income taxes.[311] This tax designation would be a

[309] RESTATEMENT (SECOND) OF AGENCY § 220(1) (AM. LAW. INST. 1958) (defining a servant/employee as: "a person employed to perform services in the affairs of another and who with respect to the physical conduct in the performance of the services is subject to the other's control or right to control").

[310] *Id.* § 220 cmt. c (noting that the employment relationship is "one not capable of exact definition"); Matthew T. Bodie, *Participation as a Theory of Employment*, 89 NOTRE DAME L. REV. 661, 682–83 (2013) ("Courts and commentators continue to bemoan [the control test's] inability to deliver clear answers.").

[311] Firms are expected to differentiate between employees and independent contractors over a host of provisions, including whether taxes need to be withheld, 26 U.S.C. §§ 3401(c), 3402 (2018), whether the firm must pay a share of Social Security and Medicare, *id.* §§ 3101, 3121(d), and unemployment taxes, *id.* §§ 3301, 3306(i), for the worker, and depending on if the workers

relatively straightforward way to delineate employees in the first instance, and then workers could contest that designation if they felt improperly excluded from the employment rolls.

Corporations may also struggle over the specific voting rights to be granted to each employee. The easiest system to administer would allocate one set of voting rights to each employee. But employees might object to this allocation along a variety of lines, arguing instead that employees with more seniority, higher wages, more hours, or greater stature within the company deserve greater voting rights. Unlike a unit of shares, a unit of "employment" is not the same for each employee in terms of interest in the firm. The conflict over the allocation of employee voting rights is one reason why commentators have argued against them.[312]

But this disparity between shareholders and employees can also be overstated. As discussed above, shareholder voting rights are not always allocated along the lines of "one share, one vote." Many of the largest and most prominent companies—Google, Facebook, Viacom—have allocated voting rights disproportionately among shareholder groups to give a group of founders, family members, or insiders more power relative to their fellow stockholders. These companies made this choice based on competing interests in providing more governance to a select group based on that group's role within the firm.[313] Similar analyses could apply in the employee voting rights context: the company could design a system of voting rights based on the relative importance of employee voice to the company.[314] For now, corporations would face the choice of a straightforward allocation of employee voting rights—one employee, one vote—or decide to assign voting rights based on a more nuanced analysis of employee interests.

One other structural concern with adding employee voting rights into the corporate governance mix is their potential incommensurability with shareholder voting rights. If we have one share, one vote on one side, and one employee, one vote on the other, how will we match up these two sys-

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count as employees for benefit plan purposes, *id.* § 410(a). The IRS defines employees based on the common-law control test. *Id.* § 3121(d)(2) (defining an employee as, among other definitions, "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee").

[312] Henry Hansmann, *Employee Ownership and Unions: Lessons from the Airline Industry*, *in* EMPLOYEE REPRESENTATION IN THE EMERGING WORKPLACE: ALTERNATIVES/SUPPLEMENTS TO COLLECTIVE BARGAINING 573–80 (Samuel Estreicher ed., 1998); HANSMANN, *supra* note 93.

[313] *See* Lund, *supra* note 8, at 714–37 (discussing the benefits of a disproportionate voting structure).

[314] Recent innovations in employee participatory governance structures include holacracy and other participatory (or "evolutionary") management structures. *See* LALOUX, *supra* note 15; ROBERTSON, *supra* note 15.

tems? How many shares' worth of votes will one employee have? But matching up two sets of voters is by no means impossible, and it's certainly not a reason to shut out a group of otherwise qualified constituents from board elections.

When it comes to allocating voting power between shareholders and employees, we imagine that most corporations would want to take one of two approaches. The first would provide for separate systems of voting rights in which there would be no need to measure commensurability. So, for example, shareholders would vote for a set of shareholder directors, and employees would vote for a set of employee directors. The voting rights would not need to be commensurable as they would be participating in different elections. Both the German system of codetermination[315] and bills recently introduced in the United States Senate track this approach.[316]

The second possible system would combine shareholders and employees into a single electorate. The corporation would then have to make a judgment about how to weight the votes of individual shareholders and employees. Corporations following this approach would probably start with a judgement about the general allocation of voting power between shareholders and employees, and then translate that into individual voting weights. So, for example, a corporation could decide that employees should have roughly forty percent[317] of the voting rights within the corporation, and then allocate votes between the two groups based on this rough proportion.[318]

At this stage, it's enough to say that the logistical challenges are not insurmountable.[319] More importantly, they do not justify the exclusion of a set of corporate participants from participation in governance. Employees are participants in the firm and contribute their efforts to the process of joint

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[315] Andreas Rühmkorf, *Stakeholder Value Versus Corporate Sustainability: Company Law and Corporate Governance in Germany*, *in* THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY 232, 232–45 (Beate Sjåfell & Christopher M. Bruner eds., 2019); Ewan McGaughey, *The Codetermination Bargains: The History of German Corporate and Labor Law*, 23 COLUM. J. EUR. L. 135, 136 (2016).

[316] Accountable Capitalism Act, S. 3348, 115th Cong. (2018); Reward Work Act, S. 2605, 115th Cong. (2018); *see also* ISABELLE FERRERAS, FIRMS AS POLITICAL ENTITIES: SAVING DEMOCRACY THROUGH ECONOMIC BICAMERALISM (2017) (discussing a system of bicameralism for shareholders and employees).

[317] *Cf.* Accountable Capitalism Act, S. 3348, 115th Cong. (2018) (assigning employees with voting rights to 40% of the board).

[318] One problem with this type of system is that if one group or the other has a majority of the votes, they can completely dictate the outcomes of winner-take-all elections.

[319] The mixed interests of employees and shareholders comes into play in startup companies, where founders and employees generally have equity positions along with wages and benefits. For a discussion of the unique governance challenges in new companies poised for growth, see Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155 (2019).

production. They should not be excluded from governance simply because we currently have systems in place that find it easier to exclude them.

3. Other Corporate Constituents

The theory of the firm and the theory of democratic participation both counsel in favor of extending the corporate franchise to shareholders and employees. Those two groups deserve voting rights because they are within the economic firm—they participate in a process of joint production as carried on by the firm. They also have the accurate and manageable markers of interest that allow for the creation of a workable system of corporate governance. The same, however, cannot be said of other corporate constituents.

Along with the theory of the firm, democratic participation theory provides a second means of separating the insiders—shareholders and employees—from other constituents outside the corporation. With most firms, it doesn't make sense to capture the preferences of creditors, customers, suppliers, and other constituencies though the franchise. This is both because their interests in the success of the firm are not as significant as those of the insiders and because their status and relationship with the firm do not provide particularly accurate or manageable markers of that interest. For those reasons, participation theory generally counsels against extending the franchise to these outside stakeholders.

Take, for example, the customers of a large corporation. Customers certainly have some relationship with a firm such that they have a stake in, and preferences regarding, its success. But their interests in the continued success of the company are more tenuous, and their ongoing contacts with the company, even assuming the planned obsolescence of the latest product, are likely to be relatively sporadic. Their status as customers is not a particularly strong marker for interest in the future success of the firm. It's also not a particularly manageable marker, given that the company's interaction with the person may be limited to the point of sale, if that; after that, tracking the customers becomes more difficult.[320] The same may be said of a corporation's suppliers, though the relationship may be a little closer there, and the markers a little more manageable. Similarly, creditors may have manageable markers—amount of debt, for example—but they structure their capital investment as repayable and often secured, while shareholders provide their equity contributions with no expectation of repayment.

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[320] This may change with the increased online interaction between consumers and producers, particularly on social media. *See* SHOSHANA ZUBOFF, THE AGE OF SURVEILLANCE CAPITALISM 135–37 (2019).

Of course, there may be certain types of customers, suppliers, or even creditors who enjoy a continuous and significant relationship with a corporation such that they have a more significant interest and it's easy to identify them for the purpose of extending the franchise. Some utility customers, for example, have that kind of relationship with their providers.[321] And in those situations, democratic participation theory may counsel in favor of extending them voting rights.[322]

Democratic participation theory is certainly flexible enough to deal with unique customer bases and the possible rise of accurate and manageable markers of constituent interest, and assign voting rights accordingly.[323] For now, though, in the regular course of corporate governance, it militates in favor of extending voting rights to shareholders and employees and leaving the interests of other constituents to contract or government regulation.

C. The German Experience

Shareholder primacy is so deeply entrenched in American corporate law and scholarship that it's sometimes difficult to imagine any other way of thinking about the corporation. This lack of imagination may help explain why arguments for the shareholder franchise—despite their shortcomings—continue to plod along in the background of an awful lot of scholarship. There are, however, alternative models, some of which involve employee representation.

The United States may not have much of a history of employee involvement in corporate governance,[324] but a majority of European Union and OECD countries give employees access to corporate boards.[325] Of these,

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[321] HANSMANN, *supra* note 93, at 168–73 (discussing how rural electrical cooperatives involve ownership by customers); Yosifon, *Lock-in*, *supra* note 216, at 1449–59 (arguing that consumers may have ongoing interests through lock-in purchases).

[322] In the nineteenth century, shares in companies providing vital infrastructure services such as transportation, banking, and insurance were often purchased by local merchants and farmers who used those services. These low-stakes shareholders were protected by restricted voting schemes which gave their shares more power within the governance structure. Scholars have debated whether these protections were more a form of investor protection or consumer protection. *Compare* Dunlavy, *supra* note 42, at 1354–56 (investor protection), *with* Henry Hansmann & Mariana Pargendler, *The Evolution of Shareholder Voting Rights: Separation of Ownership and Consumption*, 123 YALE L.J. 948, 953–54 (2014) (consumer protection).

[323] *See, e.g.*, McDonnell, *supra* note 233, at 124 (discussing the use of voting rights to manage stakeholder interests within socially oriented business enterprises).

[324] For a comprehensive rundown, see McGaughey, *supra* note 305.

[325] For a recent list of countries, see Ewan McGaughey, *Votes at Work in Britain: Shareholder Monopolisation and the "Single Channel,"* 47 INDUS. L.J. 76, 79–80, 79 n.17, 80 fig.1 (2018). For information on countries outside of Germany, see Klas Levinson, *Codetermination in Sweden: Myth and Reality*, 21 ECON. & INDUS. DEMOCRACY 457 (2000); Caspar Rose, *The Challenges of*

Germany's system of codetermination is perhaps the most well-known.[326] It has also been in place for decades as part of a large, modern economy, making it an exemplar.[327]

Codetermination laws dictate the composition of the supervisory boards for large German companies.[328] The degree of employee representation depends on a number of factors, including the type of industry, the number of employees, and a few other factors.[329] Generally speaking, corporations with fewer than 500 employees have supervisory board members elected by shareholders; corporations with 500 to 2,000 employees must have one-third of their board members elected by employees; and those with more than 2,000 employees have one-half of their supervisory board members elected by employees.[330] Thus, in Germany, we see a longstanding

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Employee-Appointed Board Members for Corporate Governance: The Danish Evidence, 9 EUR. BUS. ORG. L. REV. 215 (2008); Milan Utroša, *Works Councils and Co-Determination in Slovenia*, 1 SE. EUR. REV. 23 (1998); Eivind Falkum, Inger M. Hagen & Sissel C. Trygstad, *Participation and Codetermination Among Norwegian Employees* (June 2010) (unpublished conference paper), https://faos.ku.dk/pdf/iirakongres2010/track2/38.pdf [https://perma.cc/D6ZX-V7FT].

[326] The term "codetermination" actually describes two very different features of German corporations, and we are using the terminology from Otto Sandrock & Jean J. du Plessis, *The German System of Supervisory Codetermination by Employees*, *in* GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT 167, 169 (Jean J. du Plessis et al. eds., 3d ed. 2017). "Social codetermination" involves employee representation on shop-level works councils at all companies with at least five employees. *See id.* at 169–71. "Supervisory codetermination," on the other hand, describes employee representation at the level of the corporate board. *See id.* at 169.

[327] *See* Robert Scholz & Sigurt Vitols, *Board-Level Codetermination: A Driving Force for Corporate Social Responsibility in German Companies?*, 25 EUR. J. IND. REL. 233, 233–34 (2019).

[328] *See* Sandrock & du Plessis, *supra* note 326, at 172–78. Germany uses a two-tiered board system. *See* Jean J. du Plessis et al., *An Overview of German Business or Enterprise Law and the One-Tier and Two-Tier Board Systems Contrasted*, *in* GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT, *supra* note 326, at 1, 8–13. Supervisory boards are roughly analogous to corporate boards in the United States, exercising general oversight of the company and appointing members of the management board. *See* Jean J. du Plessis & Ingo Saenger, *The General Meeting and the Management Board as Company Organs*, *in* GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT, *supra* note 326, at 63, 73; Jean J. du Plessis & Ingo Saenger, *The Supervisory Board as Company Organ*, *in* GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT, *supra* note 326, at 105, 133–53. The management board, much like the officers in the United States, run the company and make the day-to-day business decisions. Thilo Kuntz, *German Corporate Law in the 20th Century*, *in* RESEARCH HANDBOOK ON THE HISTORY OF CORPORATE AND COMPANY LAW 205 (Harwell Wells ed., 2018).

[329] *See* Sandrock & du Plessis, *supra* note 326, at 182–83.

[330] *See* JOHN T. ADDISON, THE ECONOMICS OF CODETERMINATION: LESSONS FROM THE GERMAN EXPERIENCE 103 (2009); Jean J. du Plessis & Ingo Saenger, *An Overview of the Corporate Governance Debate in Germany*, *in* GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT, *supra* note 326, at 17, 48–49; Sandrock & du Plessis, *supra* note 326, at 173–78; Otto Sandrock, *German and International Perspectives of the German Model of Codetermination*, 26 EUR. BUS. L. REV. 129, 131–32 (2015). In most of these large companies with

example of shared corporate governance, with shareholder and employee representatives working side by side on the supervisory boards of major companies.

For decades, codetermination has received little more than passing attention from American corporate governance scholars.[331] It shows up most often in a variant of the contractarian argument for the exclusive shareholder franchise. Codetermination, it is argued, must be inefficient because it has not been voluntarily adopted by American firms. In fact, the only way a firm would end up with employee board representation is if you force it to do so, as Germany does by law. Nobody freely chooses codetermination; it is therefore less efficient than having shareholders run the show.[332]

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one-half codetermination, employees enjoy "quasi-parity" because shareholders elect the chair (and potential tiebreaker vote). In the coal, iron, and steel industries, however, there is a neutral chair (and tiebreaker), giving the employees "full parity," or a truly shared system of governance. *See* Sandrock & du Plessis, *supra* note 326, at 173–76. This is true of companies in these sectors at a lower threshold—1,000 instead of 2,000 employees. Volkswagen is a special case. Along with fifty percent representation for the workers, the government of Lower Saxony also has seats on the board, which gives the workers a de facto majority (because of traditional government support for the workers). In addition, the voting rights of individual shareholders are limited to a maximum of twenty percent for any particular shareholder. Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit Beschränkter Haftung in Private Hand [Law on the Privatization of Equity in the Volkswagen Limited Liability Company], July 21, 1960, ELEKTRONISCHER BÜRGERLICHES GESETZBUCH [BGBL] I, at 585, last amended by Gesetz [G], July 30, 2009, BGBL I, at 2479, art. 14c (Ger.), https://www.gesetze-im-internet.de/vwgmbh_g/BJNR005850960.html [https://perma.cc/R3VB-DUSJ]; *see also* JACK EWING, FASTER, HIGHER, FARTHER: THE VOLKSWAGEN SCANDAL 57 (2017).

[331] *See, e.g.*, BAINBRIDGE, *supra* note 99, at 47–49 (discussing codetermination for a few pages); CORPORATE LAW AND ECONOMIC ANALYSIS 295–96 (Lucian Arye Bebchuk ed., 1990) (one passing reference to codetermination); EASTERBROOK & FISCHEL, *supra* note 21, at 69 (again, one passing reference to codetermination); HANSMANN, *supra* note 93, at 110–12 (a few pages); JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 230 (2008) (some passing references to the German system). *But see* EMPLOYEES AND CORPORATE GOVERNANCE 163–235 (Margaret M. Blair & Mark J. Roe eds., 1999) (a lengthy examination of codetermination).

[332] The argument may have been first (and in any case, most forcefully) made by Michael Jensen and William Meckling in the late 1970s. Michael C. Jensen & William H. Meckling, *Rights and Production Functions: An Application to Labor-Managed Firms and Codetermination*, 52 J. BUS. 469, 473–75, 503–04 (1979). Many other scholars have made variants of the same point. *See, e.g.*, Luca Enriques, Henry Hansmann, Renier Kraakman & Mariana Pargendler, *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 79, 106 (John Armour et al. eds., 3d ed. 2017); ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 129–30 (1993); Stephen M. Bainbridge, *Privately Ordered Participatory Management: An Organizational Failures Analysis*, 23 DEL. J. CORP. L. 979, 1054 (1998) (noting that "German codetermination was created by sweeping statutory mandates" and concluding codetermination was unlikely to be adopted through private ordering); George W. Dent, Jr., *Stakeholder Governance: A Bad Idea Getting Worse*, 58 CASE W. RES. L. REV. 1107, 1115 (2008) (arguing that "[s]takeholder theory has been around for a long time" and that "[i]f it held any promise, some

In the last few years, however, the key assumption underlying the argument—that codetermination can only arise through fiat, not voluntary agreement—has itself been revealed to be false. Ewan McGaughey, a legal historian and economist, recently showed that German codetermination first arose through collective agreements and only later was enacted into law.[333] This history shows that the American law and economics scholars are not just wrong on this point, but may have the picture completely backwards: German codetermination was created by agreement not once but twice, while the law was sometimes used to quash it.[334] There are also many reasons to believe that a shared system of governance might not emerge from a free market of industrial relations even if it is more efficient than the existing system.[335]

Theoretical arguments aside, how well has codetermination worked in Germany? Much of the scholarship evaluating the system has centered on its role in promoting broader goals such as social cohesion and fairness.[336] The bottom-line, economic effects of codetermination are either seen as secondary or as necessarily following from the achievement of these societal goals.[337] That is, codetermination is viewed less in terms of an economic system than as one designed to promote a well-functioning democracy and help prevent social division—in particular, the division between labor and capital. And, on this broad level, it is thought to be quite successful.

There are, however, a number of studies assessing the economic effects of codetermination, with a consensus that has shifted back and forth

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firms would try it"); Hansmann & Kraakman, *supra* note 2, at 445 ("The growing view today is that meaningful direct worker voting participation in corporate affairs tends to produce inefficient decisions, paralysis, or weak boards, and that these costs are likely to exceed any potential benefits that worker participation might bring."). For the most recent entry in this genre, see Jens Dammann & Horst Eidenmüller, *Codetermination: A Poor Fit for U.S. Corporations* (Eur. Corp. Governance Inst., Working Paper No. 509, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3565955 [https://perma.cc/4K2Y-UKP2].

[333] *See* Ewan McGaughey, *The Codetermination Bargains: The History of German Corporate and Labor Law*, 23 COLUM. J. EUR. L. 135 (2016).

[334] *See id.* at 170.

[335] *See, e.g.*, David I. Levine & Laura D'Andrea Tyson, *Participation, Productivity, and the Firm's Environment*, *in* PAYING FOR PRODUCTIVITY: A LOOK AT THE EVIDENCE 183 (Alan S. Blinder ed., 1990) (arguing that codetermination needs to be adopted on a broad scale because individual firms may find themselves in a prisoners' dilemma with regard to their existing entitlements and constituents); Simon Renaud, *Dynamic Efficiency of Supervisory Board Codetermination in Germany*, 21 LABOUR 689 (2007) (arguing that codetermination may not emerge because allocation and distribution may not be separated, information asymmetries may exist, and transaction costs in introducing such a system may be too high).

[336] *See* ADDISON, *supra* note 330, at 2.

[337] *See id.*

over the last four decades.[338] Some early studies from the 1980s found that codetermination had very little impact on corporate performance.[339] Those studies, however, were criticized on a number of methodological grounds,[340] and several more sophisticated evaluations in the 1990s and early 2000s gave a more pessimistic account, finding that codetermination was associated with, among other things, lower productivity and lower profits.[341] That consensus, though, soon gave way to a third phase in the literature, one that both reversed the principal findings of the second-phase studies (finding them to be artifacts of a particular method of assessment)[342] and found that codetermination was also modestly associated with greater innovation.[343] A couple of modern financial studies on the market value of the firm bolstered these more optimistic assessments and found that "prudent" levels of employee representation led to better board decision-making by improving

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[338] For the best summary of the literature through 2008 and a discussion of the three initial phases of research detailed below, see *id.* at 108–121; *see also* Uwe Jirjahn, *Ökonomische Wirkungen der Mitbestimmung in Deutschland: Ein Update* (The Hans Böckler Found., Arbeitspapier No. 186, 2010), https://www.econstor.eu/bitstream/10419/116646/1/hbs_arbp_186.pdf [https://perma.cc/9MY2-S343].

[339] *See, e.g.*, Giuseppe Benelli, Claudio Loderer & Thomas Lys, *Labor Participation in Corporate Policy-Making Decisions: West Germany's Experience with Codetermination*, 60 J. BUS. 553 (1987) (finding no real differences between firms with codetermination and without codetermination across a variety of measures of performance); Michael A. Gurdon & Anoop Rai, *Codetermination and Enterprise Performance: Empirical Evidence from West Germany*, 42 J. ECON. & BUS. 289 (1990) (finding codetermination led to higher profitability but lower productivity); Jan Svejnar, *Relative Wage Effects of Unions, Dictatorship and Codetermination: Econometric Evidence from Germany*, 63 REV. ECON. & STATS. 188 (1981) (finding codetermination associated with higher earnings in the iron and steel industry but not in the coal mining industry).

[340] *See* ADDISON, *supra* note 330, at 109. Those early studies were criticized for reasons that included "sample size, data frequency (in the case of stock returns), lack of controls for other relevant economic or organizational variables, focus on a single event, and narrow reach." *Id.*

[341] *See, e.g.*, Theodor Baums & Bernd Frick, *Co-determination in Germany: The Impact of Court Decisions on the Market Value of Firms*, 1 ECON. ANALYSIS 143 (1998) (finding that court rulings that expanded or restricted codetermination had no real effect on share price); Felix R. FitzRoy & Kornelius Kraft, *Economic Effects of Codetermination*, 95 SCANDINAVIAN J. ECON. 365, 374 (1993) (finding that the shift to quasi-parity codetermination in 1976 had negative effect on productivity); Gary Gorton & Frank A. Schmid, *Capital, Labor, and the Firm: A Study of German Codetermination*, 2 J. EUR. ECON. ASS'N 863, 863 (2004) (finding that moving from one-third to quasi-parity codetermination negatively affected shareholder wealth).

[342] *See, e.g.*, Felix FitzRoy & Kornelius Kraft, *Co-determination, Efficiency, and Productivity*, 43 BRIT. J. INDUS. REL. 233 (2005); *see also* ADDISON, *supra* note 330, at 115–16, 120. The negative findings in the second phase of studies may have been artifacts of the cross-section estimation they used, which (by definition) did not control for firm heterogeneity or firm-specific effects. ADDISON, *supra* note 330, at 115, 120.

[343] *See, e.g.*, Kornelius Kraft, Jörg Stank & Ralf Dewenter, *Co-determination and Innovation*, 35 CAMBRIDGE J. ECON. 145 (2011); *see also* ADDISON, *supra* note 330, at 116.

monitoring and thus reducing agency costs.[344] This third, rather optimistic phase of assessment brought us right up to one of the most profound tests of all systems of corporate governance: the global financial crisis.

The financial crisis did not spare any of the world's major economies, but some recovered more quickly than others. Germany, in particular, recovered more quickly and more thoroughly than many other countries, and did so, at least in part, because of its corporate governance model.[345] While economic downturns are always difficult for companies and their employees, codetermination allows the management of many companies "to more easily seek the consent of its workforce for carrying out more or less drastic measures."[346] In Germany, these measures include a system (*Kurzarbeit*) that temporarily reduces the working hours (and salaries) of many of the employees.[347] This avoids painful layoffs and allows companies to retain their core workforces, which in turn allowed the economy as a whole to avoid the worst of the economic slump.[348] This led one group of scholars to conclude: "Particular to Germany was the social partners' willingness to work together during this specific economic hardship . . . . [I]t cannot be denied that the *quality* of industrial relations was a factor in overcoming the crisis."[349]

A number of new studies came out during and after the period of recovery that were consistent with the third phase of the literature, showing that codetermination generally had positive economic effects for a variety of constituents, including shareholders. One of the stronger results came from a 2020 study by Simon Jager, Benjamin Schoefer, and Jörg Heining, which showed that shared governance "resulted in positive rather than negative effects on capital formation."[350] This shift toward more capital-inten-

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[344] *See* Larry Fauver & Michael E. Fuerst, *Does Good Corporate Governance Include Employee Representation? Evidence from German Corporate Boards*, 82 J. FIN. ECON. 673, 674 (2006); *see also* Renaud, *supra* note 335.

[345] *See* Jean J. du Plessis et al., *Preface to* GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT, *supra* note 326, at vii; Sandrock, *supra* note 330, at 136. For some brief comparisons of the German recovery to that of other countries, see Michael C. Burda & Jennifer Hunt, *What Explains the German Labor Market Miracle in the Great Recession?*, 42 BROOKINGS PAPERS ON ECON. ACTIVITY 273, 273–75 (2011).

[346] *See* Sandrock, *supra* note 330, at 134.

[347] *See* Sandrock & du Plessis, *supra* note 326, at 188–89, 193; Sandrock, *supra* note 330, at 134.

[348] *See* Lutz Bellmann et al., *The German Labour Market Puzzle in the Great Recession*, *in* PRODUCTIVITY PUZZLES ACROSS EUROPE 187, 187–88 (Philippe Askenazy et al. eds., 2016); Sandrock & du Plessis, *supra* note 326, at 188–89, 193; Sandrock, *supra* note 330, at 134.

[349] Bellmann et al., *supra* note 348, at 229.

[350] *See* Simon Jäger, Benjamin Schoefer & Jörg Heining, Labor in the Boardroom 29 (Aug. 25, 2020) (unpublished manuscript), http://economics.mit.edu/files/17273 [https://perma.cc/C2Nb-F9NU].

sive production may be the result of worker involvement in investment decisions, the fact that worker representatives may have longer-term views than shareholders or executives, or because shared governance generally facilitates cooperation between firms and their employees.[351] Shareholders, it turns out, may be better off investing in firms where employees have a stronger governance role.

Employees, too, fared better (by their own measures) under codetermination. A recent study by E. Han Kim, Ernst Maug, and Christoph Scheider confirmed that employees at full-parity codetermined firms are better protected against layoffs during industry downturns.[352] This job security, however, comes at the price of significantly lower wages. Employees at codetermined firms pay a premium equal to 3.3% of their wages for this employment insurance.[353] Importantly, this swap of wages for job security has no effect on shareholders one way or the other.[354]

Codetermination also benefits other corporate constituents, usually because their interests line up with those of employees. Employee representation, for example, turns out to be good for creditors because both groups are keenly interested in the stability and long-term survival of the firm.[355] Codetermination is also positively related to a firm's commitment to substantive corporate social responsibility (CSR) measures, including setting concrete goals on emission reductions, the publication of a separate CSR report (or section in its annual report), and the presence of a job security (no-layoff) policy.[356] These kinds of secondary effects, along with recent performance of the German economy, may have begun to change the way people view codetermination.[357] Indeed, by 2016, its popularity among the German people rose to an all-time high.[358]

So what does all this mean? To start with, the success of the German system serves as an empirical rejoinder to the hypothetical arguments used

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[351] *See id.*

[352] E. Han Kim, Ernst Maug & Christoph Schneider, *Labor Representation in Governance as an Insurance Mechanism*, 2018 REV. FIN. 1251, 1286.

[353] *Id.* at 1279, 1286. The benefit of this employment insurance was really only experienced by white-collar and skilled, blue-collar employees; unskilled, blue-collar workers do not receive much in the way of job security protections. *Id.* at 1286. The authors of the study attribute this finding to the lack of real representation of unskilled workers on supervisory boards. *Id.*

[354] *Id.* at 1286. A similar finding was made in another recent paper. *See* Jäger, Schoefer & Heining, *supra* note 350, at 25 (finding "no increases in wages or rent sharing in shared governance firms").

[355] Chen Lin, Thomas Schmid & Yuhai Xuan, *Employee Representation and Financial Leverage*, 127 J. FIN. ECON. 303, 321 (2018).

[356] *See* Scholz & Vitols, *supra* note 327, at 243–44.

[357] *See* Sandrock & du Plessis, *supra* note 326, at 188.

[358] *See id.*

by law and economics scholars to justify the exclusive shareholder franchise. Codetermination was born of consensual agreement at a time when labor and capital had roughly equal bargaining power, and only later became enshrined in law. German firms have not been paralyzed by more heterogeneous board electorates. And they have not been destroyed by voting cycles. As discussed in Part I, the arguments against employee representation were already in trouble on their own theoretical terms;[359] the presence of a significant, well-functioning counterexample should be decisive. Those committed to the proposition that economic and social choice theory somehow dictate the exclusive shareholder franchise need to overhaul their old arguments or come up with some new ones.

Codetermination also serves as a kind of proof-of-concept when it comes to our model of shared corporate governance. The arguments we make in favor of adding employee representatives to corporate boards, just as the arguments against, are largely theoretical. They necessarily sweep quite broadly, and don't attend to many of the mechanical details of how to best structure a shared governance system, much less how to get from here to there. Germany provides an example of how such a system might work. And recent research suggests that it is working quite well for a variety of corporate constituents, including shareholders.

CONCLUSION

We have reached a critical point in the development of the corporation. Investors, long assumed to be uncomplicated profit-maximizers, are looking for ways to express a wider range of values in allocating their funds. Employees are agitating for greater say at their workplaces: resisting mandatory arbitration clauses, objecting to corporate expressions of political and religious views, and questioning the distribution of the profits of their labor. In turn, state and federal politicians are beginning to respond to these issues both on their own terms and, more significantly, by thinking more broadly about the fundamental structure of corporate governance.

At the same time, the intellectual foundations of the modern corporation continue to disintegrate. The law and economics justifications for some of the core features of the modern corporation, the shareholder primacy norm and the exclusive shareholder franchise, are exposed. Those arguments, it turns out, rely on flawed assumptions about the nature of shareholder preferences, misapply basic social choice theory, and often contradict some of the fundamental precepts of standard economics that are purported

[359] *See supra* notes 41–105 and accompanying text.

to support them. Their proponents are now at the point where they are unwilling to defend these arguments and yet strangely reluctant to abandon them, choosing instead to continue to rely on them without comment. The construction of the modern corporation is under a great deal of pressure, from within and without.

As we must to move away from the existing corporate order, we need to acknowledge the shortcomings (and the strengths) of its intellectual framework and begin to develop new models of firm governance. In this Article, we cataloged the arguments for the exclusive shareholder franchise and, one by one, found them lacking, usually on their own terms. We then presented a new model of corporate governance that builds on eighty years of research into the nature of the firm and finds further support in a new theory of democratic participation that ensures the proper aggregation of constituent preferences through accurate and manageable markers. In sum, this Article sets out the intellectual framework that will allow investors, employees, and policymakers to navigate the collapse of the shareholder primacy norm and, at the same time, provides a positive argument for the inclusion of workers in the future of corporate governance.