MODES OF DISCOURSE IN THE CORPORATE LAW LITERATURE: A REPLY TO PROFESSOR EISENBERG

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The American Law Institute's Corporate Governance Project[1] is one of the most comprehensive and controversial attempts to "modernize" American corporate law.[2] Much of the controversy surrounding the Project is undoubtedly due to its authors' bold attempt to change various established doctrines of corporate law rather than merely restate them. One of the controversial reforms originally proposed by the Project involved changes in the structure and composition of corporate boards of directors.[3]

In a recent article, we called into question the need, efficacy and shareholder welfare consequences of mandatory changes in the composition of corporate boards of directors as proposed by the

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1. Principles of Corporate Governance and Structure: Restatement and Recommendations (Tent. Draft No. 1, 1982) [hereinafter Draft No. 1]; Principles of Corporate Governance: Analysis and Recommendations (Tent. Draft No. 2, 1984) [hereinafter Draft No. 2].

2. The project has generated a large volume of commentary. For a small sample, see *ALI Corporate Governance Project*, 37 U. Miami L. Rev. 169 (1983); *American Law Institute's Corporate Governance Project*, 52 Geo. Wash. L. Rev. 495 (1984); *Current Issues in Corporate Governance*, 45 Ohio St. L.J. 513 (1984); Fischel, *The Corporate Governance Movement*, 35 Vand. L. Rev. 1259 (1982) [hereinafter Fischel, *Corporate Governance*]; Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 Stan. L. Rev. 927 (1983) [hereinafter Scott].

3. *See* Draft No. 1, *supra* note 1, § 3.03(a). This section provides:

> Corporate law should provide that at least a majority of the directors of a large publicly held corporation shall be free of any significant relationships with the corporation's senior executives, unless a majority of the corporation's voting securities are owned by a single person or a family group.

Id.

American Law Institute (ALI).[4] Our approach, in a nutshell, was to suggest conceptually and demonstrate empirically that corporate managements, in response to a variety of institutional pressures, have facilitated the evolution of efficient governance structures. We concluded that such evolutionary changes eliminated the need for the imposition of mandatory structural reforms. In a critique of our research appearing in the same symposium issue, Professor Melvin Eisenberg—the Chief Reporter on the Project and a long-time advocate of corporate changes—implied that a nutshell was the appropriate container for this conclusion.[5] We naturally disagree with the substance of this assessment and find revealed in the very nature of its presentation a more transcendent issue that should be aired.

A careful review of Professor Eisenberg's "New Modes of Discourse" suggests to us that Professor Eisenberg's goal was not merely to point out what he perceived as conceptual and methodological errors in our research design, as is standard practice in the process of scientific research. Rather, the goal apparently was the larger one of proving that the scientific method is a "new mode of discourse," and one that should not be allowed to intrude on the traditional style of discourse familiar to legal scholars. In many respects this is simply an attack on the propriety of the type of authentication process employed by "law and economics" scholars. Unfortunately, his critique contains so many conceptual errors and misrepresentations of the economic theory of the corporation that it cannot be more than a catalyst to a debate among others about the appropriate methodology in analyzing corporate law proposals. Moreover, it is entirely insensitive to the reasonableness requirements of empirical science.

The purpose of this article is to present a detailed rebuttal to Professor Eisenberg's attack on our scholarship. Section I discusses the value of quantitative research as a guide to public policy and responds to Professor Eisenberg's attack on the quality of our empirical work. A major point of this section is that his "old" mode of discourse does not contain any mechanisms designed to explicitly identify the relevant trade-offs involved in the implementation of public policies. Section II presents a detailed rebuttal of Professor

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4. Baysinger & Butler, *Revolution Versus Evolution in Corporation Law: The ALI's Project and the Independent Director*, 52 GEO. WASH. L. REV. 557 (1984) [hereinafter Baysinger & Butler, *Revolution Versus Evolution*].

5. Eisenberg, *New Modes of Discourse in the Corporate Law Literature*, 52 GEO. WASH. L. REV. 582 (1984) [hereinafter Eisenberg, *New Modes*].

Eisenberg's critique of our conceptual analysis. A careful reading of Professor Eisenberg's comments suggests that he has not captured the subtleties of many of the recent developments in the economic theory of the corporation. In Section III, we respond to Professor Eisenberg's claim that our research is politically motivated. While our research is conservative in the tradition of positive economic science,[6] it is certainly not politically motivated. The final section presents some concluding comments.

I. PROFESSOR EISENBERG ON QUANTITATIVE SOCIAL SCIENCE RESEARCH

Professor Eisenberg correctly detects in our work something other than a simple desire to understand the process by which a particular governance arrangement evolves. Our interest in the American Law Institute's Corporate Governance Project was initially the result of dissatisfaction with what we believe to be the excessive use of unsupported assertions in traditional legal discourse. From the perspective of economic analysis, legitimate proposals for changes in institutional constraints should (1) demonstrate some deviation between the real and ideal; (2) demonstrate that the deviation is large enough to justify any costs likely to result from change; (3) spell out what the costs might be; and (4) provide evidence that the particular change is likely to be both efficacious and cost effective. Proposals for change can meet this standard through several procedures, including the generation of logically and empirically refutable hypotheses.[7] Our paper was an attempt to demonstrate that in advocating their board structure and compositional "reforms," Professor Eisenberg and the ALI had not satisfied any of these conditions. Naturally, this objective translated into conservative policy. It is ironic that this conclusion was reached by a methodology that Professor Eisenberg correctly identifies as radical vis-a-vis traditional legal reasoning in this area. A fundamental issue, therefore, concerns the choice of the appropriate method for conducting public policy analysis. Professor

6. *See* G. STIGLER, *The Politics of Political Economists* in ESSAYS IN THE HISTORY OF ECONOMICS 51 (1965) (tendency for positive economic analysis to lead to conservative policy recommendations).

7. The scientific methodology used by economists involves the deduction of the effects of an institutional change and the empirical verification that the hypothesized results follow from the change. *See* M. FRIEDMAN, *The Methodology of Positive Economics* in ESSAYS IN POSITIVE ECONOMICS 3 (1960).

Eisenberg criticizes our empirical research partly because he believes that our work is not very well done, but mostly on the basis of hostility toward the use of quantitative analysis in legal research. This section deals with his criticisms related to our empirical work.[8]

A. *The Value of Quantitative Research*

The authentication of the ideas central to corporate governance "reform" provides a clear example of a situation where the scientific method is appropriate. Each normative assertion about the desirability of some change is easily converted into a conceptually refutable and empirically testable hypothesis; data is available, and there is no shortage of sophisticated statistical techniques available for analysis. All we are suggesting is that policymakers can treat reform proposals as testable hypotheses, which is what they are, and reduce their reliance on consensual verifiction (an old mode of discourse).[9] The recent growth in the influence of the economic approach to law demonstrates that such methods are indeed useful.

Consequently, it is entirely inappropriate for Eisenberg to claim that:

> Implicit in [the papers by Baysinger and Butler and MacAvoy] is the assumption (which often seems to underlie much of the quantitative work in the corporate area) that

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8. Many of our comments also apply to Professor Eisenberg's appraisal of MacAvoy's work. MacAvoy, *ALI Proposals for Increased Control of the Corporation by the Board of Directors: An Economic Analysis* (1983), in Statement of the Business Roundtable on the American Law Institute's Proposed Principles of Corporate Governance and Structure: Restatement and Recommendations (Feb. 1983) [hereinafter Business Roundtable].

9. A description of the nature of consensual verification provides:

> On the continuum of human thinking, at one end is pure science; at the other end pure myth. One is sustained entirely by systematic logical procedures, the other by consensual verification by contemporaries, by their predecessors represented through prevailing traditions, or by posterity for those who expect historic vindication. The crucial distinction is one of procedures, not of end results . . . . Both systematic authentication and consensual approval can be further broken down. Systematic authentication involves a testing of the logical structure of a theory for internal consistency and a testing of the theory's results for external consistency with the observable facts of the real world. . . . Ideas which lack logical, empirical, or general consensual support may still sustain themselves as acceptable to a consensus of those who regard themselves as special guardians of a particular truth—i.e., as the consensual reference group that really matters.

T. SOWELL, KNOWLEDGE AND DECISIONS 5 (1980).

> a legal rule cannot be justified unless its value has been proved by quantitative data that meets the social scientists' test of statistical significance. Of course, this is an argument against almost all law, because in almost all aspects of life—including almost all corporate law—experience does not lend itself to such measurement. The proposals in the ALI Project draw on traditional empirical sources of law, such as practical observation of corporate operations, data collected by various institutions concerning corporate practice, the ABA's Corporate Director's Guidebook and The Overview Committees of the Board of Directors, and widespread (although not universal) perceptions concerning the reasonable expectations of investors, the way to preserve public confidence in corporate governance, and what constitutes fairness.[10]

First, it is not our claim that a rule of law cannot be justified unless its significance has been established through quantitative analysis. Rather, we simply suggest to those responsible for public policy formulation that, in instances where there is no crisis at hand, those proposing rule changes demonstrate the value of such changes by any practical means available.[11] If the ALI claims that changes in

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10. Eisenberg, *New Modes, supra* note 5, at 593.

11. In some areas of public policy, a thorough analysis of important issues must be delayed as circumstances force an immediate decision. Antitrust litigation is perhaps the best example of this type of situation. The business community often creates new practices upon which the courts must rule before economists have had an opportunity to analyze fully the subtle economic features of the arrangement. *See generally* Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984) (economic analysis lagging behind the law). Since the American Law Institute has failed to demonstrate an emergency in corporate governance, there is apparently "no rush." The Penn Central collapse happened a long time ago, yet it still provides what may be characterized as "the exception proving the rule."

12. Professor Eisenberg's reliance on consensual verification to the exclusion of other means of authentication is further illustrated by the claim that "every part of the Project has been subjected to the most extensive examination and debate imaginable." Eisenberg, *New Modes, supra* note 5, at 589. This statement is accurate only to the extent that social scientists and other legal scholars who do not choose to participate in policy analysis using the "traditional style of scholarly discourse" have been excluded from the lists of qualified examiners and debaters. In general, the ALI's approach has been dominated by legal thought. The ALI's hearings included perfunctory testimony by economists, but economists have not had much influence on the development of positions. *See, e.g.*, Business Roundtable, *supra* note 8, at 4-5, 20-27 ("The Reporters are all lawyers, whose experience with governing major commercial and industrial organizations is, perforce, limited."). Of course, such an exclusion is the very purpose of Professor Eisenberg's critique, so he at

board composition will make shareholders better off, then the ALI should (1) demonstrate quantitatively that shareholders are presently suffering relative to viable alternative rules and (2) that the proposed rule will make them sufficiently better off to justify any costs associated with the change.

Second, the list of traditional sources of law offered by Eisenberg is empirical only to the extent that anything one can perceive or read about is empirical. The term "empirical" should refer to systematically collected and authenticated facts, not the opinions of colleagues and practitioners.[12] Consensual verification of ideas is useful, but only to the extent that the group forming the consensus is informed by the type of data relevant for drawing conclusions in a given policy matter.

The following claim provides the foundation for Professor Eisenberg's critique of our empirical research on the relationship between board composition and corporate performance:

> The burden is not on the ALI to justify drawing on the traditional sources of empirical evidence, but on those who claim that statistically significant quantitative data is not simply a useful tool but an indispensable condition to the justification of law. An examination of Butler's and Baysinger's and MacAvoy's papers will illustrate just how far short of carrying that burden the critics have fallen.[13]

The burden of justifying the methods used in evaluating policy proposals rests with those of us who see some value in systematic authentication processes. This article was written with that objective in mind. However, it would be helpful to have someone familiar with the traditional mode of discourse explain why the collected wisdom of legal scholars and practitioners is *necessarily* superior to alternative modes of discourse. Hopefully such an explanation would contain more than an assertion that "priority in time establishes superiority in application."

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least preserves a measure of internal consistency. Yet the fact remains that instead of engaging in productive scholarly interaction, Professor Eisenberg is attempting to insulate his old mode of discourse from methodological competition. The attempt to erect such an artificial barrier to entry is commonplace where potential competitors emerge on the scene to threaten monopolized markets. The logic of discouraging such tactics is no less valid in the marketplace of ideas than in the markets for goods and services.

13. Eisenberg, *New Modes, supra* note 5, at 593.

B. Attack on the Quality of Our Empirical Work

We shall now consider that part of Eisenberg's critique concerned with the rigor of our empirical analysis. A review of our work will reveal that our objective was to detect any difference in the measure of shareholder welfare among large corporations as a result of changes in board composition in 266 firms randomly selected from the *Fortune* 1000. This difference was measured by comparing the accounting return to investors. Thus, the claim that our research was not very well done is inconsequential because it was not intended to be the definitive work on the role of the board of directors in the large public corporation; the research criticized by Eisenberg was exploratory.[14]

A major goal of the research, as mentioned earlier, was to demonstrate that quantitative methods *could* be applied to authenticate ideas central to corporate governance "reform." Consequently, Professor Eisenberg's comments were directed at work largely in process but suggestive enough to make the primary points we intended: (1) that evolutionary changes in the composition of the board have proceeded without government intervention; (2) those changes have apparently resulted in desirable (even from Professor Eisenberg's perspective) changes in corporate performance; and (3) the degree of board independence necessary for "good" performance appears to be considerably less than that advocated by the ALI. This goal was accomplished.

Of course, there are certain criticisms of our empirical work that should be addressed to clear the record. Specifically, Professor Eisenberg objects to our measure of performance, our classification of directors as to their independence, and our sample.[15]

1. Measure of Financial Performance

The claim that return to investors "in any given year" is unreliable because it may depend on "factors exogenous to current management, such as embargoes, changes in the tax law, and the strategic decisions of prior managers"[16] is both inaccurate and irrelevant. First, our measure was an average over three years; second,

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14. *See* Baysinger & Butler, *Corporate Governance and the Board of Directors: Performance Effects of Changes in Board Composition*, 1 J.L. ECON. & ORG. 101 (1985).

15. *See* Eisenberg, *New Modes*, *supra* note 5, at 598-603.

16. *Id.* at 597.

the whole purpose of using a large sample in this type of work is to moderate the confounding effect of the idiosyncracies to which Eisenberg refers. We are interested in central tendencies in performance, which in a large sample are not much affected by such things as tax law changes as long as the anomalous effects are as likely to affect firms with independent boards as they are to affect firms that do not have independent boards. Return to investors was chosen because the only superior measure of shareholder welfare—change in unanticipated stock market return—is inappropriate in a cross-sectional research design.

2. Director Classifications

We created director categories as proxies for the potential level of board independence in order to examine the effect of changes in board composition. For this exercise, we chose to place directors into one of three classes on the basis of directors' backgrounds and affiliations—monitors, executive, and instrumental.[17] Of course, it

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17. Baysinger & Butler, *Revolution Versus Evolution*, *supra* note 4, at 568-69, stated:

> Corporate boards fulfill a number of functions for their corporations. They may be classified into three broad, possibly overlapping, components based on directors' affiliations and the functions they fulfill: monitoring, executive, and instrumental. The board's monitoring component is comprised of truly independent or outside directors. To be independent, a director must not be currently employed by the firm, or have any strong psychological or economic dependence upon its hired managers. A director who depends upon the management for his or her position, is related to senior managers by blood or marriage, or represents an organization that does a significant amount of business with the firm is viewed as incapable of making or acting upon a critical appraisal of management and thus cannot be part of the monitoring component. As this description suggests, the monitoring component's primary function is to police management and to ensure that its behavior conforms to shareholders' interests.
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> Directors in the executive component are closely aligned, either economically or psychologically, with the top management of the corporation. Included in this component are current and former employees of the firm, executives affiliated with subsidiaries of the firm, and persons related to senior managers. Executive-component directors provide firm-specific expertise, psychological support, and information that the firms' decision makers may draw upon in formulating and implementing high-level strategies.
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> The board's instrumental component consists of directors placed on the board for functional reasonse other than monitoring or disciplining management. Some view instrumental directors as a source of managerial

would be better to have a complete audit of any given director's relationship with the managers upon whose board he serves. However, that would truly eliminate the possibility of gaining any empirically useful understanding of the issue at hand, since such information, where not proprietary, could only be gathered by a psychologist working in conjunction with a tax accountant. Consequently, if a director's affiliation suggested that he or she was more likely to provide independent monitoring services to the firm rather than consulting services, we were satisfied to classify the person as an independent monitor rather than an instrumental director.

Nonetheless, Professor Eisenberg is concerned that, as a result of our classification strategy, "the size of the monitoring component in the sample corporations may have been significantly underestimated."[18] This concern is illegitimate because in empirical work one is concerned not simply with bias, but with *systematic* bias. As long as there is no reason to expect a correlation between performance and the degree to which we underestimated the monitor category, assuming we actually did underestimate it, then empirically estimated *comparisons* between board composition and performance are *not* biased. Consequently, our findings, contrary to Professor Eisenberg's evaluation, do show a slight correlation between performance and changes in board independence over time in our sample of firms. Although empirical results never prove anything, our results do suggest a tendency worth further study.

3. The Sample

Professor Eisenberg's final criticism of our empirical work questions our method of ascertaining the welfare consequences of a rule requiring a majority of independent directors or, more drastically, a rule requiring that all directors except the chairman be independent. Our analysis of the 266-firm sample suggested a nonlinear relation

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wisdom for improving decision making. Others have suggested that directors serve to link organizations and are able to rationalize certain transactional failures that arise between business organizations. Lawyers, consultants, and financiers provide advice or counsel to inside managers. Directors who are decision makers in other firms that have a vertical relationship with the firms they serve as directors may create a bond among interdependent firms. Thus, an instrumental component that is conceptually distinct from both the inside, executive group and the independent, outside group is useful.

18. Eisenberg, *New Modes*, *supra* note 5, at 601.

between increases in board independence and performance over time. This result would have been adequate for our purpose of suggesting that before legislative changes are made, policy makers study further the veracity of strong claims that a rule requiring a majority of independent directors will enhance shareholder welfare.

Nevertheless, in order to investigate the issue further, we examined a selection of firms whose performance had been judged to be clearly outstanding over the time period of interest. Our method was to isolate a group of top performing firms as subjectively evaluated by the participants in a *Fortune* magazine survey of corporate leaders. On the basis of this additional (versus substituted) data, we concluded that there was further reason to question the assumption, implicit in board reform proposals, that more independence is always or even generally better than less. We derived this conclusion from an inspection of a table that listed the percent of directors in independent and non-independent director categories for high performance firms. This inspection revealed that among a small sample of high performance firms, the percent of independent directors ranged from zero to sixty-six percent, with considerable variance. Of course, that evidence is all that is necessary to support the point that firms can perform well without having independent boards, and that is all we wished to point out.

Professor Eisenberg claims that this second data base provides results that conflict with our original sample upon which we based the following conclusion—that once thirty percent of the board was independent, further increases in the number of independent directors would not necessarily "produce" increases in performance.[19] The basis for his criticism was the finding, from the second data set, that among high performers three-fourths had boards with more than thirty percent *independent* directors. However, we did not include the list of low performers, which would have shown that the boards of these firms often have boards composed of more than thirty percent *independent* directors, because that finding was redundant. Yet, when the low and high performers are combined, as they were in the 266-firm sample, we find that both high performers and low performers have boards composed of a majority of independent directors and thus meet the ALI's standards. The obvious policy position, then, is that mandated increases in board independence could actually hurt the performance of some high performing firms. This, we feel, was

19. Baysinger & Butler, *Revolution Versus Evolution, supra* note 4, at 575.

the important conclusion of our exploratory analysis and remains so despite Professor Eisenberg's critique.

The value of quantitative analysis in legal and public policy research is an empirical question. That is, such an approach is useful if those who must struggle with the creation and enforcement of legal rules find it useful. Certainly, in the valuation of wrongful injury cases and in the disposition of many antitrust matters, quantitative methods have proven very helpful. Moreover, it would seem that the value of quantitative analysis is best determined by the light it casts on issues amenable to such analysis. Obviously, we feel that our research has contributed to a better understanding of the implications of mandatory changes in corporate board composition.

II. PROFESSOR EISENBERG ON AGENCY THEORY

A rich body of literature on the economics of the corporation—which is also referred to as agency theory, theory of the firm, or transactions cost economics—has been developed in recent years.[20] These theoretical developments have provided many valuable insights into an understanding of the effects of legal rules on the relationship between managers and shareholders. Throughout his critique of our article, Professor Eisenberg makes both general and specific criticisms of agency theory. These criticisms reveal a rather distorted view of agency theory and indicate his lack of appreciation of its contribution to the governance debate. In this section, we examine his view of the corporation and his critique of our conceptual analysis.

A. *Professor Eisenberg's Indictment of the Large Corporation*

The ALI has ascribed the need for mandatory changes in the governance structures of large corporations to perceived imperfections in the external and internal institutions of managerial accountability

20. Some of the more important contributions include Fama, *Agency Problem and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980) [hereinafter Fama]; Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978); Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ANAL. 305 (1976) [hereinafter Jensen & Meckling]; Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259 (1967) [hereinafter Manne, *Two Systems*]; and Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965); Williamson, *Transaction Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233 (1979) [hereinafter Williamson]

in large corporations.[21]According to the ALI, an independent board is crucial because the discipline that is supposed to be provided by shareholders through voting and derivative actions, by the threat of hostile takeovers, and by managers' concern for product market competition is lacking in the large corporation. First, the role of concentrated ownership in large corporations is only now beginning to be explored.[22] We are confident, however, that corporate raiders like Carl Icahn and T. Boone Pickens would find amusing the idea that the board is the sole superior to the CEO.

Second, Professor Eisenberg asserts that oversight of senior managers by junior managers cannot be very effective for ensuring accountability in large corporations:

> Professor Fama has argued that subordinate managers monitor their superiors, presumably by reporting their shortcomings to their superiors' superiors. . . . Probably this kind of reporting occasionally occurs, but it seems highly unlikely that it occurs often, partly because it would violate the chain of command, partly because it would seem disloyal, and mostly because it would be risky in the extreme. The adage "if you strike at a king, kill him" is applicable

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21. For example, Professor Eisenberg stated:

> The discipline of product markets is limited by the fact that a corporation may earn profits and survive for a long period of time despite bad management, just as it may incur losses or even fail despite good management. The discipline of the capital market is blunted by the ability of corporations with large cash flows to meet their capital needs for a long period of time through internal and even external financing, although profits are lower than good management would produce. The discipline of the market for corporate control is limited by a number of elements, including the high transaction costs of takeover bids, the necessity to offer a premium well in excess of market price, the requirements of relevant statutes, the defensive techniques available, the incentives to take over efficiently run as well as inefficiently run companies, and the time lag often experienced by potential acquirors in ascertaining lack of managerial efficiency. Direct review by the body of shareholders is seldom an efficacious instrument of accountability in publicly held corporations because of the disparate and shifting nature of the shareholder body and the complexity of modern management issues. Oversight of managers by more senior managers is undoubtedly very effective as to middle and lower management, but cannot serve to hold accountable the corporation's top management, particularly the chief executive officer.

Eisenberg, *New Modes, supra* note 5, at 583-84.

22. *See, e.g.*, Demsetz & Lehn, *The Structure of Corporate Ownership: Causes and Consequences*, 93 J. POL. ECON. 1155 (1985).

> here. In any event, this type of monitoring, even when it occurs, can apply to a chief executive officer only if the board of directors (the CEO's sole superior) is independent of the CEO.[23]

Stated as a set of interrelated hypotheses, these words are clearly reasonable and nicely outline what could be the central core of several doctoral dissertations in the disciplines of organizational behavior and organization theory. The interesting empirical question, however, concerns the number of CEOs replaced by junior executives. Whether this figure is high or low, one cannot use it as the basis for public policy formulation because in a perfectly operating control system the mere threat of displacement would lead rational CEOs to avoid conduct that would lead to such action. Yet, despite the total absence of authenticated fact, Eisenberg generally uses this type of mythology to support his board reform proposals.

Because external and internal governance mechanisms are imperfect (notwithstanding the role of dividend policy, managerial contracts, profit sharing, proxy fights, etc.), Professor Eisenberg concludes that the board of directors is the key to corporate governance:

> Thus the board of directors and its committees, which do have the ability to hold top management accountable, take on particular significance. Undoubtedly, the character and ability of directors are the most critical elements in the ability of the board and its committees to assure managerial accountability. Nevertheless, assurance of managerial accountability is also closely related to the structure of the board and its committees, and to the objectives of board committee members.[24]

Out of curiosity we asked several of our colleagues in the field of organizational behavior if their training or readings in the areas of group process, committee structure, and the dynamics of leadership could shed any light on the issues raised here. The response was generally that the group decision making process was too complex for simple generalizations. Although some research has been done which suggests that leaders sometimes insulate themselves from the

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23. Eisenberg, *New Modes*, *supra* note 5, at 584 n.4 (citing Fama, *supra* note 20, at 293).

24. Eisenberg, *New Modes*, *supra* note 5, at 584.

influence of committee members regardless of their perceived dependence or independence,[25] the issue is unresolved.

From the foregoing, it is clear that Professor Eisenberg's indictment of the large corporation, or at least his attack on the economic analysis of that institution, is not based on established facts. Some of his conclusions run counter to a large body of literature in economics.[26] However, because many of the hypotheses in that literature have not yet been subjected to empirical verification, Professor Eisenberg's positions cannot yet be rejected. Clearly he believes that the board of directors is the key to the efficient governance of the corporation. Nevertheless, because his conclusions are based on logically refutable hypotheses about the incentive structures operating within a large corporation, it will be fruitful to examine his understanding of some of those relationships.

B. *The Emergence of Institutional Arrangements*

We are accused of attributing to those responsible for the ALI Project the belief "that managers will not generally act in their shareholders' best interests unless formal legal and institutional arrangements force them to do so."[27] This we do, in a sense. We assume that those who advocate the creation of formal legal and institutional arrangements do so because they believe *less formal* legal and institutional arrangements are ineffective. For example, some advocates of the Sherman Act probably based their position on the belief that the less formal common law remedies for monopolistic practices were inferior to the more formal remedies possible under statutory law. Likewise, those interested in corporate governance reform today appear to base their advocacy on the belief that informal market forces, moral training, and private orderings are inferior to formal institutions such as a legal rule requiring that the boards of large corporations be structured and staffed in a certain formal way.

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25. *See generally* Hackman & Morris, *Group Tasks, Group Interaction Processes, and Group Performance Effectiveness: A Review and Proposed Integration* in 9 ADVANCES IN EXPERIMENTAL PSYCHOLOGY (L. Berkowitz ed. 1975); I. JANIS, VICTIMS OF GROUPTHINK: A PSYCHOLOGICAL STUDY OF FOREIGN POLICY DECISIONS AND FIASCOS (1972); Van de Ven & Delbecq, *Nominal Versus Interacting Group Process for Committee Decision-Making Effectiveness*, 14 ACAD. OF MANAGEMENT J. 203 (1971).

26. *See generally* authorities cited *supra* note 20; Easterbrook, *Managers' Discretion and Investors' Welfare: Theories and Evidence*, 9 DEL. J. CORP. L. 540 (1984).

27. Eisenberg, *New Modes, supra* note 5, at 589 (citing Baysinger & Butler, *Revolution Versus Evolution, supra* note 4, at 563).

Assuming this to be a correct interpretation of what we believe "corporate reformers" believe, there is clearly no basis for Eisenberg's claim that

> [t]his is a strange sort of criticism from economists who, like Baysinger and Butler, subscribe to the so-called agency-cost theory [especially since] [t]he thrust of this theory is that, in the absence of formal constraints, agents will frequently not act in their principals' interest—just what "corporate reformers" are said to believe.[28]

Lest anybody misapprehend that the thrust of agency theory is as Professor Eisenberg describes it, it should be noted that agency theorists do not claim that agents will frequently not act in their principals' interest absent formal constraints. First, agency theory is based on the assumption that while many agents will act in the best interests of their principals even in the absence of any attempt to monitor them, as long as some agents may be expected to disregard their principals' interest, *and it is costly for the principal to determine, ex ante, who will and who will not*, then institutional arrangements that reduce the prospect of opportunism can serve to reduce transaction costs. Had Professor Eisenberg taken the care to understand agency theory, he would have been less suprised at our simple declarative. Moreover, agency theory does not claim that "in the absence of formal constraints, agents will frequently not act in their principals' interest."[29] Rather, we believe that agency theory suggests that (1) in the absence of formal constraints there will emerge informal market and non-market constraints to harmonize conflict within the corporation and (2) in the absence of governance structures of all sorts there will be no agents and no principals whose interests they may disregard.

Governance structures, which characterize and define the large corporation, are believed to reduce transaction costs and promote complex contractual exchanges.[30] In light of the evolution of various informal governance mechanisms and given the current degree of formal constraint, we question whether proposed changes in corporate governance (e.g., a rule for board structure and composition) will

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28. *Id.*
29. *Id.*
30. *See generally* Williamson, *Corporate Governance*, 93 YALE L.J. 1197 (1984) (publicly held corporation in the manfacturing sector).

be cost effective at the margin. Professor Eisenberg's decision to lecture us on the salutory effects of managerial morality merely suggests a misunderstanding of agency cost theory.

C. *Misrepresentation of Our Conceptual Analysis*

Professor Eisenberg claims that we "intended to show that the potential agency-cost problem has not materialized as a result of market forces and voluntary responses to those forces."[31] Actually, we only attempted to summarize the opinion of those who do not perceive the need for the ALI's particular program of reform. We attempted to summarize a view of corporate governance in which there is no need for government intervention mainly because of the belief that market forces provide adequate controls over managerial behavior.[32] We intended only to characterize this view; we do not necessarily subscribe to it. This should have been obvious. Eisenberg also falsely attributes to us the proposition that the "corporate-agency problem has not materialized, due to the competitive product, capital, and managerial labor markets, which provide managers with incentives to act in their shareholders' best interest."[33] In fact, all that any student of agency theory will claim is that in balance, the combined effect of governance structures is to reduce transaction costs to a level that renders institutional change, at that particular moment, uneconomical. Yet Eisenberg criticizes agency theory for "marching up the hill and then back down again."[34] That is, he criticizes us for claiming that the large corporation poses an agency-cost problem, a problem which in reality does not exist because of various governance structures that have evolved. This criticism seems malicious; naturally in order to provide an explanation for governance structures it is necessary to describe the transaction failures that might arise in their absence.[35]

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31. Eisenberg, *New Modes, supra* note 5, at 593 n.43.

32. *See generally* Baysinger & Butler, *Revolution Versus Evolution, supra* note 4.

33. *Id.* at 594. Eisenberg also implicitly adds to the list the operation of the board of directors and the market for directorial services. *Id.*

34. *Id.* at 595.

35. That is, most economic analyses of the emergence of governance mechanisms or other institutional arrangements begin by analyzing the world in the absence of transaction or agency costs. In the absence of agency costs, there is no principal-agent problem, as monitoring is perfect. Adding the agency costs to the relation leads to the analysis of institutional arrangements designed to reduce agency costs.

D. *Professor Eisenberg's Critique of Agency Theory*

As for Eisenberg's critique of agency theory itself, he once again fails to comprehend the major works in the field. Eisenberg begins his analysis at a good starting point when he accurately quotes the leading authority in the field in defining the agency cost problem: "[i]f both parties to the (principal-agent) relationship are utility maximizers there is good reason to believe that the agent will not always act in the best interests of the principal."[36] However, he then proceeds to complain that "[i]n its purest form, the hypothesis does not tell us much: 'not always' could be one out of two cases or two million."[37] This quibble illustrates a fundamental misapprehension of such foundational assumptions which, in this instance, are not intended to describe transactions quantitatively but rather to characterize human nature as it is. For the purpose of analyzing the institutions of contract, it is clearly appropriate and important to note that rational parties will be concerned that the people they deal with will "not always" perform as promised. The frequency of such non-performance is wholly irrelevant; even one case of reneging can be economically important.[38]

Furthermore, Professor Eisenberg claims that agency theory "seems implicitly to assume a state of nature in which there are no internal constraints on the agent, such as socialization and the acceptance of legal norms, and no informal constraints, such as the importance of one's reputation as a human being."[39] This is inaccurate. Agency theory only claims that whatever the effect of these informal constraints on behavior may be, people are still concerned about the potential for opportunistic behavior when they engage in economic transactions.[40] Professor Eisenberg's unsubstantiated belief that "[m]any or most lawyers . . . would believe that internal constraints are at least as important as external constraints; that agents, like other people, will normally attempt to conform their behavior to social aspirations embodied in law and in social morality"[41] is thus irrelevant. A simple analogy can be made; while we believe

36. Jensen & Meckling, *supra* note 20, at 305.
37. Eisenberg, *New Modes, supra* note 5, at 594.
38. *E.g.*, the situation involving uranium supplies to public utilities.
39. *Id.*
40. Professor Oliver Williamson has described opportunism as "self interest seeking with guile." Williamson, *supra* note 20, at 234 n.3.
41. Eisenberg, *New Modes, supra* note 5, at 594.

that most people will normally drive carefully, we still drive defensively. Professor Eisenberg's attempt to demonstrate the importance of "the aspirational role of law" in the governance of corporate contracting merely demonstrates his failure to understand that agency theory is concerned with institutions that deal with the residual uncertainty people face within the context of various informal constraints on behavior.

Professor Eisenberg also attempts to ridicule agency theorists by attributing to them the belief that "market forces alone will result in the installation of monitoring institutions or incentive structures that will eliminate agency costs, or at least drive such costs down to an irreducible minimum."[42] Professor Eisenberg appears to misunderstand the definition of agency costs. Agency costs include not only the direct costs associated with corporate control problems, but also the costs of monitoring agents through legal or market governance structures.[43] Thus, the establishment of monitoring devices merely reveals that the costs of monitoring are justified by reducing the costs of an agent's deviation from the behavior that would occur if the agent and principal were one. As a result of the separation of ownership and control, and the threat of managerial discretion, agency costs will never equal zero. Notably, Professor Eisenberg's failure to quote agency theorists directly not only gives the impression that he is unfamiliar with the relevant literature, it also allows the creation of ideas that are not a part of agency theory. Future empirical research may discover the relative influence of laws created by legal scholars as opposed to institutions created by contracting parties. As for now, whether market forces alone will accomplish anything is merely an assumption upon which various testable hypotheses are based.

Yet Professor Eisenberg is ready to challenge the descriptive accuracy of this assumption concerning the influence of informal incentives and constraints on the creation of governance: "The chief executive officer of a publicly held corporation has every incentive to install mechanisms that will monitor the competence and performance of his subordinates. He has considerably less incentive to install mechanisms that will monitor his own competence and performance."[44] This is incorrect *a priori*. The relative strength of man-

42. *Id.* at 595.
43. *See generally* Jensen & Meckling, *supra* note 20.
44. *See id.*

agerial incentives with respect to installation of these mechanisms is unknown. It is, however, rational for a manager to install mechanisms that will facilitate monitoring. We have described this incentive structure previously:

> Those who have a comparative advantage at running the business become managers, but they must persuade other participants that they will not use their informational advantage to harm those participants. Managers must select governance structures that ameliorate shareholders' rational concerns. Both managers and investors gain from effective governance. Managers do not want a structure that grants them "too much" autonomy, because investors who fear excessive corruption and ineptitude will bid down the price of shares. Investors do not want a structure that imposes "too much" control over managerial decision making, because it imposes excessive costs on the organization and permits other shareholders to abuse the system; again prices fall. Optimal controls bring higher prices. Thus, the control of managerial discretion in open corporations is best viewed as an incremental process, which, when brought into proper balance, yields minimum costs of equity capital.[45]

Similar incentives explain the use of performance bonds, warranties, and bond covenants. In this regard, Professor Eisenberg's error only suggests more strongly the potential value of new modes of discourse in the corporate law literature.[46]

E. *Evolutionary Success of the Corporation*

Another proposition falsely attributed to us by Professor Eisenberg is that the "evolutionary success of the corporation as an

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45. *See* Baysinger & Butler, *The Role of Corporate Law in the Theory of the Firm*, 28 J. LAW & ECON. 179, 180 (1985) [hereinafter Baysinger & Butler, *Role of Corporate Law*].

46. In this regard, we should point out that we do not accept Professor Eisenberg's unsupported assertion that "[a] powerful moral force, grounded on this fundamental legal proposition [stewardship], works to keep managerial conscience generally consistent with the shareholders' interests." Eisenberg, *New Modes*, *supra* note 5, at 596. This is merely another of the many unsupported assertions that serves only to maintain Eisenberg's status as a practitioner of his particular "traditional style of scholarly discourse," a style that has necessitated the creation of a new school of legal analysis (law and economics). Moreover, although we are

organizational form demonstrates that market governance has successfully solved the corporate-agency problem."[47] Professor Eisenberg thus claims to have discovered our excess enthusiasm for "the market": "Given that the corporation has always been embedded in a rich matrix of law and morality concerning conflicts of interest, how can it possibly be assumed that the success of the corporation in overcoming conflict-of-interest problems is due solely to market forces?"[48] How indeed? Only someone looking for a political motive in our research could commit such an error. As we indicated elsewhere, law and market forces work together to rationalize the potential agency problem in corporations.[49]

Professor Eisenberg also claims that:

> [Baysinger and Butler] misconceive how evolution works. Evolution can select only from among those species it happens to find. A form that is successful is not necessarily the best form, but only the best-adapted among the forms that nature has so far produced. Therefore, even if the corporate form did entail greater agency-cost problems than did competing flora and fauna, the corporation's other survival traits—such as limited liability, perpetual life, and free transferability of ownership interests—might be so advantageous that they would have overcome the agency-cost disadvantage. To put this more directly, in a competition between (1) a corporate form that had moderate agency-cost problems but carried limited liability, perpetual life, and free transferability of ownership interests, and (2) non-corporate forms that had somewhat less of an agency-cost problem but lacked limited liability, perpetual life, and free transferability of ownership interests, it is not too hard to see which form would have been likely to succeed.[50]

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hesitant to address such comments for fear that we may lend them some legitimacy, it seems clear to us that individuals (including managers) often engage in activities that give them a "guilty conscience." That is, conscience does not always constrain managerial behavior.

47. Eisenberg, *New Modes, supra* note 5, at 596.

48. *Id.*

49. *See* Baysinger & Butler, *Role of Corporate Law, supra* note 45, at 179; Baysinger & Butler, *Race to the Bottom v. Climb to the Top: The ALI Project and Uniformity in Corporate Law*, 10 J. CORP. L. 431 (1985) [hereinafter Baysinger & Butler, *Race to the Bottom*] (section of article entitled "A Trade-off Approach to Corporate Governance Structure"). *See also* Manne, *Two Systems, supra* note 20.

50. Eisenberg, *New Modes, supra* note 5, at 596-97.

It is easy to state, given the benefits of hindsight, which type of organizational form will survive and be preferred. It is important to note, however, that the process that generated the form that Professor Eisenberg claims is so obviously superior took years of trial and error with different types of rules for shareholder liability, share transferability, and life of the corporation.[51] The corporate attributes that Professor Eisenberg lauds did not evolve to general usage until the beginning of jurisdictional competition in the late nineteenth century.[52] Competition between states in the production of laws, just as competition between corporations in markets for goods and services (and, incidentally, competition between public policy analysts in the marketplace of ideas), tends to have socially beneficial consequences in terms of increased efficiency.[53] One effect of the implementation of Professor Eisenberg's policy proposals would be to destroy this competition and create a monopoly in corporation law based on his own ideas of what is "best."

Professor Eisenberg extends his criticism of our evolutionary view:

> The problem with Baysinger's and Butler's evolutionary analysis, however, goes even deeper than that. Corporations are not natural forms, like tigers. They are man-made forms, like hybrid corn. To argue, as Baysinger and Butler do, that the success of the corporate form shows that lawmakers should now get out of the corporate picture, is like arguing that the success of hybrid corn shows that agricultural geneticists should now get out of the corn picture.[54]

This is a total misconception of our point about the evolution of the law. First of all, unlike tigers, individuals within corporations can make conscious decisions to adopt one form of corporate law or another. As discussed above, corporate managers have incentives to adopt the form of corporate law that is best for them and their

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51. *See generally* Butler, *Nineteenth Century Jurisdictional Competition in the Granting of Corporate Privileges*, 14 J. LEGAL STUD. 129 (1985) (examining methods of legal and economic historians and studying the development of a national free market in corporate privileges).

52. *Id.*

53. *See generally* Baysinger & Butler, *Race to the Bottom*, *supra* note 49; and Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U.L. REV. 913 (1982).

54. Eisenberg, *New Modes*, *supra* note 5, at 597.

shareholders.[55] If managers consistently make mistakes, including the failure to adopt new and "modern" legal reforms, they and their firms will be threatened with extinction or takeover.

Our second response relates to Professor Eisenberg's extreme efforts to imply a political motive into our research. As a result of his incorrect perceptions, he assumes that we resist all change in corporation law. Nothing could be further from the truth. What we object to is his efforts to impose *his* preferred set of changes on *all* corporations. We have no objection to allowing any particular state to adopt his recommendation. As long as firms are allowed to choose among various sets of corporation laws, then the evolutionary process can work. Under such a scenario, Eisenberg's proposals merely expand the set of options available to firms. However, if Professor Eisenberg were allowed to impose his reforms on all states in the name of "modernization," that would be the equivalent of saying that farmers can use only one type of hybrid corn regardless of climatic conditions in their locale. We believe that our analogy is closer to the truth than is his. Once again, we must remind Professor Eisenberg that today's "modernization" can quickly become tomorrow's "Ice Age."[56] Moreover, there is no guarantee that a legal scholar of his stature will be around to straighten out the mess in the next generation.

III. POLITICAL OBJECTIVES AND FALSE ATTRIBUTION

One of the major themes running through Professor Eisenberg's "New Modes of Discourse" is that while our research assumes the form of scholarly discourse, it was intended to serve the purposes of political debate. More specifically, Professor Eisenberg attributes to us the belief that corporate law cannot be usefully modernized because corporate law is irrelevant. He incorrectly assumes that we were not scientific in our research and that we had developed our policy positions based on certain political beliefs before we began our scientific inquiry. For example, Eisenberg notes:

> Over the years, numerous proposals to modernize corporate law have been made in the scholarly literature. Many of these proposals have in turn been criticized in the traditional style of scholarly discourse, and the result has been a con-

55. *See supra* text accompanying notes 44-45.
56. Baysinger & Butler, *Revolution Versus Evolution, supra* note 4, at 579-80.

> tinuing and productive debate about corporate law. Within the last ten years or so, however, a newer style of discourse has emerged in response to proposals to modernize corporate law. This new style has two modes. Both employ the form of scholarly discourse, but the techniques of political debate. The first mode criticizes proposals on the basis of their supposed provenance, rather than addressing the merits of the proposal itself. The second mode offers criticism that purports to be based on data generated by rigorous quantitative analysis, but in fact is based on conclusory statements that are unsupported by any reliable data.[57]
>
> A portion of the corporate law literature has taken an unfortunate turn. Some of it trades on irrelevant matters of provenance, and some of it trades on wholly unreliable quantitative data. *The result is discourse that has the appearance of scholarship but the substance of political debate.* No proposal for the modernization of corporate law is immune from criticism, but this portion of the literature seems to treat the body of corporate law as immune from modernization.[58]

From this we gather that we are charged with politicizing the corporate governance reform debate by advocating not the status quo, but the superiority of market forces over law as a regulator of corporate conduct (i.e., corporate law cannot be modernized because it is irrelevant with respect to the various market constraints facing managers as presented in the economic literature on the theory of the firm[59]). This charge is surprising in light of our view of corporate law as expressed in a recent article:

> The corporation is a nexus of contracts. Some scholars have argued that the contractual view of the firm implies that markets will lead managers to adopt optimal governance structures and that legal rules are irrelevant. The latter claim is implausible because markets do not operate costlessly. Legal rules may reduce the costs of reaching and adhering to optimal contracts, but the particulars of optimal contracts differ from firm to firm. For example, the optimal

57. Eisenberg, *New Modes, supra* note 5, at 582.
58. *Id.* at 608 (emphasis added).
59. *See, e.g.*, Jensen & Meckling, *supra* note 20; Fama, *supra* note 20.

> structure for a closely held firm is not the same as that of a firm with widely scattered holdings. This implies that state corporation laws also should differ and that firms will select their state of incorporation adaptively.[60]

In attacking our scholarship as being politically motivated, Professor Eisenberg has misinterpreted our perspective on the value of legal controls in corporate relations. As a matter of fact, we do not in any way question the value of corporate law as an element in the governance structure of large corporations. Nor do we question the ability to modernize corporate law. We do question, however, the presumption, found in some legal discourse, that legal scholars are the *only* parties competent to judge whether legal institutions are fit or in need of reform. As our paper suggests, corporate managers, to say nothing of self-regulating agencies such as the stock exchanges, also seem quite capable of detecting legal disequilbria and making incremental changes in their institutional structures. It appears that Professor Eisenberg is simply disturbed that parties other than legal scholars employing the "traditional style of scholarly discourse" can penetrate the mysteries of corporate law as effectively, or sometimes more effectively, than traditional legal scholars.

A further problem with Professor Eisenberg's attack on our research as being politically motivated is that he is clearly criticizing and questioning putatively non-interventionist conclusions rather than offering a critique of our methodology. Professor Eisenberg accuses us, along with Roberta Karmel[61] and Paul MacAvoy,[62] of presenting our case, not because we are concerned over efficiency in corporate governance or shareholder welfare, but because we are wedded to the Chicago school of governmental non-intervention.[63] To call our research political is a misrepresentation because all that we question is the method by which Professor Eisenberg's "traditional style of scholarly discourse" establishes the need for reform and authenticates the idea that any particular reform is safe and effective.

As indicated above, Professor Eisenberg begins his critique of

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60. Baysinger & Butler, *Role of Corporate Law, supra* note 45, at 179.

61. Karmel, *The Independent Corporate Board: A Means to What End?*, 52 GEO. WASH. L. REV. 534 (1984).

62. Business Roundtable, *supra* note 8.

63. The Chicago school of thought is most often associated with Milton Friedman, George Stigler, and Richard Posner, among others. *See generally The Fire of Truth: A Remembrance of Law and Economics at Chicago, 1932-1970*, 20 J.L. & ECON. 163 (1983) (transcript of conference on the "Intellectual History of Law and Economics," edited by Edmund W. Kitch).

the papers by ourselves, Karmel and MacAvoy with the claim that our real political objective was to denigrate the role of law in the regulation of corporate contracting. Because there is no evidence of this objective to be found in our paper, Professor Eisenberg adopts the tactic of false attribution. For example, he develops the theme that certain "new modes of discourse" display a form of Manichaeism—"a dualistic religious system involving a basic doctrine of conflict between Light (absolute good) and Darkness (radically evil.)"[64] He then claims that our article "effectively divides the world into 'defenders of the corporation' (Light) and 'corporate reformers' (Darkness)."[65] If we are to interpret this as a claim that we believe the supporters of the American Law Institute's Corporate Governance Project are "radically evil," then our lack of psychological training leaves us without any comment save the obvious denial.[66]

The claim that we see the world as one of defenders and reformers "of the corporation" is simply not supported by the text of our article.[67] We believe that the literature contains many challenges to the putative efficacy of the current system of corporate governance, vis-a-vis shareholder welfare and "social performance."[68] We also believe that there is another body of literature that effectively refutes

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64. Eisenberg, *New Modes, supra* note 5, at 587.

65. *Id.* at 588.

66. Professor Eisenberg's concern about our alleged Manichaeism also leads him to engage in a classic attempt at consensual verification:

> Any claim that all thought about corporate law falls into just two schools completely misses the richness and complexity of the subject and is likely to lead to a significant mischaracterization of the positions of those who do not adhere to the School of the Light. For example, neither of Karmel's two schools captures my own views, *which I think many others would share.*

Id. (emphasis added). Two comments about this passage are required. First, it is unequivocally true that among the entire set of legal scholars familiar with the ALI's proposal that a majority of directors in large corporations meet the ALI's requirements for independence from management, some would basically agree and some would basically disagree with the need for change in the current structure of corporate law. Second, for this particular issue, there would seem to be only one possible reason to attempt to make things more complex than they really are, and that is to maintain discussions of corporate governance as the sole preserve of traditional legal scholars (such as Professor Eisenberg) who (according to him) are the only persons capable of dealing with the "richness and complexity" of "The Law."

67. In another article, however, we divided the parties on different sides of an issue into two groups—corporate performers and corporate federalists—for reasons of analytical convenience. Our theoretical contribution in that paper was, in fact, to show that neither position was correct under all circumstances. *See generally* Baysinger & Butler, *Race to the Bottom, supra* note 49.

68. *See generally* A. BERLE & G. MEANS, THE MODERN CORPORATION AND

the belief that changes in the status quo would, on balance, improve the current corporate governance system.[69] It would seem reasonable to state that respected scholars occupy both sides of the issue about whether corporate reform is necessary; but there is far from unanimity on either side.

Professor Eisenberg makes the claim that "virtually every serious student of corporation law, whether an academic or a practicing lawyer, has some change in corporation law that he would like to see made and that he would justify" on the ground that the change would improve the position of shareholders, society, or both.[70] Some wish for changes in the rules governing derivative actions to make them easier; others would feel better if it were more difficult to bring such actions. Still others, perhaps, would like keys to the executive washroom made available to the assembly-line workers. There is no end to this type of "analysis." Thus, Professor Eisenberg wonders how "are we to determine which proposals for change seek to 'reform' the corporation and which seek to 'defend' it?"[71] Professor Eisenberg's rhetorical question has little to do with our characterization of current legal opinion concerning the merits of mandating a majority of independent directors for large corporations. The "serious student" passage does illustrate, however, that Professor Eisenberg harbors the presumptions that (1) virtually all students of corporation law who do not see the need for change are not serious, (2) this must include us and, incidentally, (3) shareholders are a group apart from "society." Obviously, we disagree. Unfortunately, as he freely admits, it is not difficult to find a number of legal scholars who support almost any superficially reasonable proposal for changing *or* maintaining the status quo.

IV. CONCLUDING COMMENTS

Professor Eisenberg's critique of our research is deficient on several grounds. Our rejoinder is based on his misinterpretation of

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PRIVATE PROPERTY (1932); M. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS (1976); Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974).

69. *See generally* N. WOLFSON, THE MODERN CORPORATION: FREE MARKETS VERSUS REGULATION (1984); Fischel, *Corporate Governance, supra* note 2; and Scott, *supra* note 2.

70. Eisenberg, *New Modes, supra* note 5, at 588 (emphasis added).

71. *Id.* at 588-89.

our empirical analysis, his reliance on consensual verification, his misunderstanding or misrepresentation of agency theory, and his unjustified accusation that our scientific research is politically motivated. It is our opinion that his critique of our work adds little value to the corporate governance debate. Rather, it merely provides evidence of his provincial concern over both the success of proposals he has long advocated and the value of his "old" mode of legal discourse that so far provides the only visible means of support for his proposals. Our concern, however, is not to promote "the market" as a form of corporate governance but to promote a greater appreciation of the power of self-regulation and private ordering in the governance of contractual relations than many legal scholars seem to have. If this is political, then Professor Eisenberg properly questions our research. Others, we trust, will see it differently.