donation to Princeton University was upheld. Berle, however, later clarified that "he did not intend to indicate that Professor Dodd was right all along."[186] Bearing in mind that the *Barlow* court cited long-term business interests among the justifications for the donation to Princeton[187]—a consideration that is fully in line with shareholders' interest—it would seem that Berle was too modest. Berle's late writings from the 1950s reflect a conviction that corporations should, as a normative matter, be engaged in promoting the interests of multiple constituencies.[188] At the same time—much like Dodd of the 1930s—Berle provided no practical details as to exactly how managers could bring about this utopian vision. Perhaps he never believed they could.[189]

Be it as it may, by the mid-1930s, legal doctrine and scholarship in the United States had developed a sophisticated account of the issues pertaining to the maximands of corporate governance. The most important achievement of these analyses is their pointing out the core problem, which is the absence of a coherent system with which the competing interests of corporate constituencies could be furthered, or at least reconciled, by corporate agents. This problem continues to haunt corporate governance analysis to this day.

C. *From the 1950s to the 1970s*

The period from the 1950s through the 1970s witnessed America undergoing several cycles of renewed interest in corporate social responsibility, which is the term that was coined to express promotion of interests of non-shareholder constituencies. These episodes are of lesser import for the purposes of the present study.[190] After World War II and the Korean War, the United States was the single, unchallenged economic

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[186]Adolf A. Berle, Jr., *Foreword* to THE CORPORATION IN MODERN SOCIETY xii (Edward S. Mason ed., 1959), *cited in* Sommer, *supra* note 184 ("It is one thing to agree that this is how social fact and judicial decisions turned out. It is another to admit this was the 'right' disposition; I am not convinced it was.").

[187]*A.P. Smith Mfg. Co.*, 98 A.2d at 590 ("[The donation] was voluntarily made in the reasonable belief that it would aid the public welfare and advance the interests of the plaintiff as a private corporation and as part of the community in which it operates.").

[188]BERLE, *supra* note 184, at 56 ("[T]he modern American corporation understands well enough that it has a 'constituency' to deal with. If its constituents—notably its buyers—are unsatisfied, they will go to the political state for solution.").

[189]Tellingly, Berle titled the fifth chapter of his book, *id.*, *Corporate Capitalism and the City of God.*

[190]These episodes are described in detail in a recent, skillful account by C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century*, 51 U. KAN. L. REV. 77 (2002), on which the following paragraphs draw.

superpower in the world. Large American corporations were without equal foreign competitors in many markets. This sheer economic power, concentrated more than ever before in a small number of giant corporations, drew the attention of American commentators. During the 1950s, journalists, academics, and other critics (including Berle) were musing on the ways to harness corporate power to socially desirable goals.[191] Contemporary contributors were unable to propose specific mechanisms to curb corporate power or direct it in socially beneficial directions.[192] A critical voice came from Yale Law School Dean Eugene V. Rostow. In what reads like an early version of Jensen's argument brought in the beginning of this article,[193] Rostow said:

> "The economist has demonstrated with all the apparent precision of plane geometry and the calculus that the quest for maximum revenue in a competitive market leads to a system of prices, and an allocation of resources and rewards, superior to any alternative, in its contribution to the economic welfare of the community as a whole."[194]

The 1960s and 1970s brought new reasons for concern over corporate social responsibility. Attention was paid to a variety of social and political issues at home and abroad, including the Vietnam War, civil rights and apartheid, consumer protection, and environmental issues. With giant corporations perceived as significant players in these issues (if not outright evil-doers), campaigns were consequently waged for shareholder proposal reform, public interest directors, and federal corporate chartering.[195] These campaigns mostly failed or had a negligible lasting

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[191] *See id.* at 99-110.

[192] *Id.* at 108.

[193] *See supra* note 1 and accompanying text.

[194] Wells, *supra* note 190, at 109 (quoting Eugene V. Rostow, *To Whom and for What Ends Is Corporate Management Responsible?*, *in* THE CORPORATION IN MODERN SOCIETY 63 (Edward S. Mason ed., 1959)).

[195] Under a proposal advanced by Ralph Nader, Mark Green, and Joel Seligman in RALPH NADER *ET AL.*, Taming the Giant Corporation 126 (1976), the board would be composed entirely of outside "professional" directors, working full-time and provided with an independent staff to oversee the firm. Large corporations would be run by a board answerable simultaneously to shareholders, other constituencies, and the general public, with one director specially responsible for employee welfare, another for consumer protection, another for community relations, and so on. As Wells pointedly notes, how exactly a director was supposed to fulfill simultaneous legal responsibilities to shareholders, the general public, and another constituency as well, was not made clear. Wells, *supra* note 190, at 121-23.

For additional calls in a similar spirit, see generally ROBERT A. DAHL, AFTER THE REVOLUTION? AUTHORITY IN A GOOD SOCIETY (rev. ed. 1990); CHRISTOPHER D. STONE, WHERE

effect.[196] Indeed, the most memorable voice from that period is probably Milton Friedman's in his article *The Social Responsibility of Business Is to Increase Its Profits*.[197] In this article, Friedman argued against using corporate resources to promote social goals or moral values in ways not required by law or ethical custom.[198] Friedman remained silent about the content and scope of that "ethical custom" which would legitimate diversion of resources away from maximizing profits. Yet it is clear that such ethical considerations would be extremely narrow.[199]

In terms of positive law too, little has changed in the direction of eroding shareholder primacy. *Barlow* exemplifies a general trend of state legislators to allow corporations to make charitable contributions but did not seriously challenge shareholder primacy. The famous 1968 decision in *Shlensky v. Wrigley*,[200] upholding the directors' decision not to install lights in Wrigley Field despite the loss of potential profits, similarly noted that "the *long run interests of the corporation* in its property value at Wrigley Field might demand all efforts to keep the neighborhood from deteriorating."[201]

D. *Other-Constituency Statutes*

The controversy over the appropriate maximands of corporate governance erupted in earnest again during the 1980s. This was largely due

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THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR (1975).

[196]*See* Wells, *supra* note 190, at 111-23.

[197]Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, § 6 (Magazine), at 33.

[198]*Id.* at 33 ("[A] corporate executive . . . has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom."). *See also* MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133-36 (1962) (presenting similar views).

[199]According to Friedman, "social responsibilities" that do *not* warrant departure from profit maximization include providing employment, eliminating discrimination, reducing pollution, preventing inflation, and fighting poverty. FRIEDMAN, *supra* note 198, at 33.

[200]237 N.E.2d 776 (Ill. App. Ct. 1968).

[201]*Id.* at 780 (emphasis added). *See also* Theodora Holding Corp. v. Henderson, 257 A.2d 398 (Del. Ch. 1969) (using corporate assets for charitable and other non-profit purposes should be in the best long-range interest of the corporation or the best long-range interest of the shareholders). For a contemporary review, see David S. Ruder, *Public Obligations of Private Corporations*, 114 U. PA. L. REV. 209 (1965). Later decisions reaching similar holdings and also relating to claims of corporate waste include Universal Leaf Tobacco Co. v. Congoleum Corp., 554 F.2d 1283 (4th Cir. 1977); Herald Co. v. Seawall, 472 F.2d 1081 (10th Cir. 1972); Boyertown Burial Casket Co. v. Amedco, Inc., 407 F. Supp. 811 (E.D. Pa. 1976); Elco Corp. v. Microdot Inc., 360 F. Supp. 741 (D. Del. 1973); Abramson v. Nytronics, Inc., 312 F. Supp. 519 (S.D.N.Y. 1970).

to the tidal wave of hostile takeovers and the states' response in the form of "other constituency statutes." The title "other constituency statutes" subsumes a variety of state legislative measures intended to expand the scope of discretion of public corporations' managements such that it would include the interests of non-shareholder constituencies.[202] These statutes have engendered numerous legal commentaries,[203] but fortunately, this sizeable literature need not be engaged here for too long.

In the late 1970s and early 1980s, corporate charter amendments were adopted by a few corporations allowing directors, should their corporation become subject to a change of control, to consider the social and economic effects of the acquisition on the target's employees, suppliers, customers, and others.[204] The paradigmatic takeover that ostensibly dominated public perception at the time was the hostile "bust-up" takeover, in which the new controlling shareholder not only ousts the incumbent management but actually liquidates the firm's assets, fires most or all of its employees, and severely disrupts the way of life of small communities, especially in one-factory towns.[205]

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[202]*See* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 26-27 (1992).

[203]Scholarly treatments of other constituency statutes alone are too numerous to cover fully. For concentrated discussions of this issue in the general context of corporate stakeholders, see Symposium, *Defining the Corporate Constituency: For Whom are Managers Fiduciaries?*, 59 U. CIN. L. REV. 319 (1990); Symposium, *Corporate Malaise—Stakeholder Statutes: Cause or Cure?*, 21 STETSON L. REV. 279 (1991) [hereinafter Stetson Symposium]; Symposium, *The Corporate Stakeholder Conference: Introduction*, 43 U. TORONTO L.J. 297 (1993); Symposium, *New Directions in Corporate Law, Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373 (1993). A partial list of individual contributions that pay special attention to constituency statutes would include Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971 (1992); William J. Carney, *Does Defining Constituencies Matter?*, 59 U. CIN. L. REV. 385 (1990); Ronn S. Davids, *Constituency Statutes: An Appropriate Vehicle for Addressing Transition Costs?*, 28 COLUM. J.L. & SOC. PROBS. 145 (1995); Morey W. McDaniel, *Stockholders and Stakeholders*, 21 STETSON L. REV. 121 (1991); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1991); Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C.L. REV. 1189 (1991); Orts, *supra* note 202; Lynda J. Oswald, *Shareholders v. Stakeholders: Evaluating Corporate Constituency Statutes Under the Takings Clause*, 24 J. CORP. L. 1 (1998); Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163 (1991).

[204]Orts, *supra* note 202, at 20.

[205]This public image was intensified with the development of a colorful jargon to describe takeover activity—a jargon that referred to raiders, white knights, poison pills, shark repellants, greenmail, etc. For a glimpse into that period's atmosphere, see, e.g., Anne B. Fisher, *Oops! My Company is on the Block*, FORTUNE, July 23, 1984, at 16; *Who Can Stop the Raiders of Corporate America?*, 291 ECONOMIST 77 (Apr. 7, 1984).

In 1983, Pennsylvania adopted the first other constituency statute.[206] This statute served as a model for several other states.[207] Today, twenty-nine states have statutes that permit, or in one instance requires, the directors and officers of corporations chartered within their states to consider the interests of the standard other constituencies beyond the corporations' shareholders, at least in certain situations (particularly in connection with a change of control).[208] Delaware never adopted a constituency statute of this type. The Delaware Supreme Court, in its 1985 decision in *Unocal Corp. v. Mesa Petroleum Co.*, nonetheless stated that in analyzing the effect of an imminent takeover on the "corporate enterprise," the directors may consider its "impact on constituencies other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[209] Courts in other jurisdictions followed suit and approved of considering the interests of other constituencies.[210] These courts, however, emphasized that such consideration cannot be made unless benefits to shareholders can be identified, thus echoing earlier decisions mentioned above.[211]

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[206]The statute provided that

> [i]n discharging the duties of their respective positions, the board of directors, committees of the board, individual directors and individual officers may, in considering the best interests of the corporation, consider the effects of any action upon employees, suppliers and customers of the corporation, communities in which offices or other establishments of the corporation are located, and all other pertinent factors.

Act of Dec. 23, 1983, No. 1983-92, § 1(B), 1983 Pa. Laws 395, *cited in* Orts, *supra* note 202, at 27.

[207]Orts, *supra* note 202, at 27. For a list of states with other constituency statutes, see Wai Shun Wilson Leung, *The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime that Recognizes Non-Shareholder Interests*, 30 COLUM. J.L. & SOC. PROBS. 587, 613, 620 (1997). For the relevant text of most of the statutes, see Stetson Symposium, *supra* note 203, at 279-93.

[208]*See* Oswald, *supra* note 203, at 4-6 (providing a survey of current statues). The Connecticut statute applies in change-of-control situations, and provides that the directors "shall consider, in determining what he reasonably believes to be in the best interests of the corporation, . . . the interests of the corporation's employees, customers, creditors, and suppliers," as well as "community and societal considerations." CONN. GEN. STAT. § 33-756(d) (2003).

[209]Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

[210]*See* Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1009, 1015-16 (E.D. Wis.), *aff'd*, 877 F.2d 496 (7th Cir. 1989) ("protection of loyal employees, including managers, of the organization is not anathema . . . legitimate concerns for their past conduct of the enterprise and its requirements need not be left to the goodwill of an unfriendly acquirer of corporate control in the jungle warfare involving attempted takeovers"); GAF Corp. v. Union Carbide Corp., 624 F. Supp. 1016, 1019-20 (S.D.N.Y. 1985) (same).

[211]*See* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1282 n.29, 1285 n.35 (Del. 1989) (concluding that, respectively, the board may consider "the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable

It has been noted that the other constituency statutes have received only cursory attention from the courts,[212] and have played a negligible part, if any, in litigation involving directors' decisions.[213] These statutes are generally interpreted as having made hardly any change in American corporate law.[214] This article argues that the reason is twofold. First, advancing the interests of non-shareholder constituencies probably never was the primary reason for the enactment of the other constituency statutes. These statutes should be assessed in light of their typical legislative history, according to which they were enacted in response to hostile takeovers and were lobbied for mostly by managements of potential target firms.[215] Seen in this light, these statues belong to a larger arsenal of anti-takeover defenses that were developed and deployed to help incumbent

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relationship to general shareholder interests"; "an offer [can] be rebuffed, given . . . the alternatives available and their effect on the various constituencies, particularly the stockholders"); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (explaining that the "board may have regard for various constituencies in discharging its responsibilities, *provided there are rationally related benefits accruing to the stockholders*") (emphasis added); *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) ("Delaware's jurisprudence holds that the interests of stockholders are primary and may not be trumped by that of other constituencies, although those interests may be considered if congruent with the interests of the stockholders.").

[212]*See* Orts, *supra* note 202, at 31-35 (analyzing court opinions); Oswald, *supra* note 203, at 7 n.37 (same).

[213]*See* Oswald, *supra* note 203, at 7.

> Judicial interpretation of the constituency statutes to date has been sparse and uninformative, invariably referring to the constituency statutes in only a fleeting and tangential manner. No court has yet provided an analysis of the legality or constitutionality of constituency statutes, or even an explanation of how they should be implemented in specific contexts.

Id.

[214]In 1990, the Committee on Corporate Laws of the Section of Business Law of the American Bar Association (ALI-ABA), as part of the preparation of the Revised Model Business Corporation Act (the Model Act), reviewed the other constituency statutes. "The Committee has concluded that the Model Act should not be . . . amended in [light of these statutes]." The Committee opined, however, "that other constituency statutes may create opportunities for misunderstanding and thus pose potential for mischief unless the courts carefully construe them consistently with existing law." *See* ABA Committee on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2254-55, 2257-61 (1990).

[215]Orts, *supra* note 202, at 24-25. For instance, the Pennsylvania statute was enacted at the behest of the state Chamber of Commerce at a time when two local companies, Scott Paper Company and Gulf Oil, were facing control battles. *Id.* Orts notes, however, that a few statutes were also backed by labor unions—a fact that underscores their consistency with employees' interest. This point should distract one from the argument made in the text. The language of these statues—in principle and perhaps also in practice—benefits employees. Yet the motivation for their enactment came from managements.

managements entrench themselves.[216] The legal technology for thwarting management-unfriendly takeovers has progressed since the mid-1980s such that today it relies on other means.[217] Moreover, once the consideration of other constituencies' interests were brought within the ambit of legitimate managerial discretion—namely, within the ambit of the business judgment rule—chances became slim that parties would litigate over such consideration, similar to other "just say no" anti-takeover defenses.[218]

The second explanation for the low impact that the other constituency statutes have had on American corporate law returns to the subject of this article. Beyond merely mentioning the interests of the regular constituencies—often with the reservation that they should be in line with long-term shareholder interests—these statutes did not provide much guidance as to *how* these apparently conflicting interests should be reconciled. When could employees' interests take precedence over shareholders' interests? Must the benefit accruing to employees be larger than the loss bore by shareholders? How should this calculus be done: per constituency, per capita, per relative investment? Stated otherwise, these statutes raised the very implementation problem that Berle was so keenly aware of, the problem that caused him to abandon his City-of-God principle[219] of managers' trusteeship to multiple stakeholders for a second-best regime of duty to shareholders. To use the words of Berle and Means', what was (and remains) lacking is a convincing "system of community

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[216]*See* Thomas W. Dunfee, *Corporate Governance in a Market with Morality*, 62 LAW & CONTEMP. PROB. 129, 136 (1999) (arguing that this heritage of other constituency statutes taints their status as legitimizing a multi-stakeholder approach to corporate governance).

[217]For a review and analysis of anti-takeover techniques, see, e.g., John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CALIF. L. REV. 1301 (2001); *see also* Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 STAN. L. REV. 885 (2002) (confirming the position that staggered boards do not appear to have a significant beneficial effect on premiums in negotiated transactions, and arguing that the alternative positions provided by others does not convincingly explain the evidence); Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887 (2002) (concluding that overall effective staggered boards did not provide enough benefit in terms of increased premiums, in relation to the added costs of remaining independent, and that takeover rules should be reconsidered in this area).

[218]For a retrospective review of the take-over wave and anti-takeover defenses (particularly the poison pill), see Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 873-88 (2002); *see also* Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 1021-26 (2002) (arguing that while acknowledging the importance and desirability of protecting stakeholders, a board veto should not be the tool for such protection, and should not be the justification for the existence of the board veto).

[219]*See supra* note 188.

obligations" that is framed "with clarity and force."[220] Neither the courts nor academic commentators have succeeded in devising such a system.[221]

E. *Contemporary Analyses and Their Limits*

The debate over other constituency statutes in the late 1980s and early 1990s also rekindled the more general discussion on the maximands of corporate governance and the appropriate beneficiaries of managers' fiduciary duties. This Section maps these approaches and identifies their relative strengths and weaknesses.

1. Traditional Economic Analysis

The traditional law and economics approach to the maximands issue holds simply that the shareholder-value-maximization rule is (1) efficient and (2) workable. Respectively, a multiple-constituency rule is said to be inefficient and unworkable. This line of analysis is represented in its purest form by Frank Easterbrook and Daniel Fischel's 1991 book summarizing their work on corporate law.[222] In line with their general contractual view of the corporation,[223] Easterbrook and Fischel also address the issue of the

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[220]*See supra* text accompanying note 175.

[221]The final version of the ALI's Principles of Corporate Governance similarly reflects the vague rule that directors are allowed to consider the interests of non-shareholder constituencies. The general rule provides that "a corporation . . . should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain." PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1994) (citation omitted). Nevertheless, corporations may pursue non-profit-enhancing objectives in three conditions: (1) such action is required for staying within the boundaries of the law; (2) such action is taken in light of ethical considerations appropriate to responsible conduct of business; (3) a reasonable amount of resources may be dedicated to charitable causes. *Id.* § 2.01(b). The Principles also include a rule covering the specific context of corporate behavior in the face of a hostile takeover bit, which reflects the case law described above. *Id.* § 6.02. That these Principles are vague and leave ample room for reaching different decisions can hardly be denied. Section 2.01(b)(2) in particular imports into corporate decision-making processes a host of potential considerations that are *bound* to be controversial and subject to political inclinations.

[222]EASTERBROOK & FISCHEL, *supra* note 4.

[223]The view of the corporation as a contractual arrangement—or a "nexus of contracts"—raises prickly questions. The nexus metaphor is attributed to Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972), and Michael C. Jensen & William H. Meckling, *The Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). For a critical analysis, see 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); see also William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261 (1992); Jeffrey Nesteruk, *Persons, Property, and the Corporation: A Proposal for a New Paradigm*, 39 DEPAUL L. REV. 543 (1990).

maximands of corporate governance. The pivotal element in this analysis is the notion of "residual claimant," namely, the party (constituency) who is entitled to derive benefits from an enterprise only after all other claims have been satisfied. Easterbrook and Fischel equate this constituency with shareholders. Shareholders are the only constituency whose interest is risky and is determined *ex post factum*. All other constituencies—including creditors and employees—have fixed claims whose value is known in advance, at least in expectancy, or no (valid) claim at all.[224]

Under this analysis, shareholder wealth maximization is the desirable rule because it takes advantage of the firm's strength due to its tendency to maximize wealth in general. Easterbrook and Fischel set aside other social goals such as addressing pollution, bribery, and plant closing, for two reasons:

> "One reason is obvious: a manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither . . . . Agency costs rise and social wealth falls.
>
> Another reason is no less important but more often missed: maximizing profits for equity investors assists the other "constituencies" automatically . . . . In a market economy each party to a transaction is better off.[225]

Thus, the justifications for determining shareholders' interest as the single maximand of corporate governance are both theoretical and practical. The shareholder-wealth-maximization rule arguably increases social wealth and is therefore efficient in comparison to the alternative rule that decreases wealth. This is the traditional argument of the rising-tide-lifts-all-boats type—an alleged "win-win situation."[226] It explicitly ignores other social

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[224]EASTERBROOK & FISCHEL, *supra* note 4, at 36.

> For most firms the expectation is that the residual risk bearers have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock. Other participants contract for fixed payouts—monthly interest, salaries, pensions, severance payments, and the like... Risk bearers get a residual claim to profit; those who do not bear risk on the margin get fixed terms of trade.

Id.

[225]*Id.* at 38.

[226]For similar articulations of this argument, see Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001).

> The utilitarian jupstification [for the shareholder wealth maximization norm] is [that] . . . [i]n the long run, the argument goes, employees and other

issues. Indeed, Easterbrook and Fischel deny that such issues have to do with corporate governance.[227] Other scholars have joined Easterbrook and Fischel's camp of those endorsing shareholder value as the proper maximand relying on a variety of arguments.[228] Common to this commentary is the assumption that shareholder primacy leads to efficient outcomes because it requires corporate decision makers to maximize the corporate residual claim, and consequently, the entire corporate pie and general social welfare.

The practical reason for preferring shareholder value as a unique maximand is that this is a workable rule, or, more accurately, that the alternative multiple-constituency rule would be unworkable. As economist Oliver Hart has put it, calling on management to take the interests of all constituencies into account "is essentially vacuous, because it allows management to justify almost any action on the grounds that it benefits some group."[229]

2. Incomplete Contracts and Power

The traditional economic analysis case for shareholder primacy as described above is susceptible to a number of criticisms. These criticisms

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> stakeholders are overall better off with fluid and efficient capital markets, managers need a simple metric to follow, and both wealth and, in the end, fairness are maximized by shareholders being the corporation's residual beneficiary, with the other claimants getting what they want via contract with the corporation.

Id. See also Allen, *supra* note 223, at 269-70 (same).

[227]EASTERBROOK & FISCHEL, *supra* note 4, at 39 ("To view pollution, or investment in South Africa, or other difficult moral and social questions as *governance matters* is to miss the point."). Many commentators may object to this classification of issues as related or unrelated to corporate governance. Scholars from the progressive corporate law movement, mentioned in the text below, surely would make such objections. Writers, however, not identified with this group also include a broader set of issues in "corporate governance." *See, e.g.*, Dyck & Zingales, *supra* note 116 (discussing the role of the media in pressuring corporate managers and directors to behave in ways that are "socially acceptable," mostly with regard to environmental issues, and sometimes not in line with shareholders' value maximization).

[228]*See, e.g.*, Stephen M. Bainbridge, *In Defense of Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423 (1993); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23 (1991); Jonathan R. Macey & Geoffrey P. Miller, *Corporate Stakeholders: A Contractual Perspective*, 43 U. TORONTO L.J. 401 (1993); Alan J. Meese, *The Team Production Theory Of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629 (2002); Oswald, *supra* note 203; Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923 (1984); Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27 (1996).

[229]Oliver Hart, *An Economist's View of Fiduciary Duty*, 43 U. TORONTO. L.J. 299, 303 (1993).

challenge different aspects of the traditional case; but on the whole they undermine the claim that shareholder primacy is an efficient rule. The central critique of this claim attacks the pivotal distinction between fixed and residual claims on the corporation. Consider the corporation's creditors. In theory, no claim on the firm can be more fixed then those stipulated in a loan agreement, a debenture, and the like. Indeed, courts have underscored the fact that bondholder protection is determined only by the language of the indenture. Thus, bondholders were denied any further vague and open-ended protection under a duty of loyalty paradigm.[230] In light of this legal situation it is no wonder that the legal profession has perfected the art of indenture drafting and developed a comprehensive set of contractual covenants intended to protect creditors in various contingencies.[231]

This apparent perfectness is misleading. Developments in the economic theory of contracts, especially since the late 1980s, have highlighted the problem of incomplete contracts.[232] In contrast to what some scholars and courts may have believed in the past, commercial relationships between corporations and their creditors can never be "exhaustively documented" in a contract.[233] The complete contingent contract—namely, the contract that defines the parties' rights and entitlements in every future contingency—is impossible to achieve.

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[230]*See* Simons v. Cogan 542 A.2d 785, 785-791 (Del. Ch. 1987); *see also* William W. Bratton, Jr., *The Economics and Jurisprudence of Convertible Bonds*, 1984 WIS. L. REV. 667, 668 (1984) ("Courts traditionally have directed bondholders to protect themselves against . . . self-interested issuer action with explicit contractual provisions. Holders of senior securities, such as bonds, are outside the legal model of the firm for protective purposes: a heavy black-letter line bars the extension of corporate fiduciary protections to them.").

[231]The *Simons* court thus referred to the "highly negotiated and exhaustively documented commercial relationship between an issuer of convertible securities and the holders of such securities." *Simons*, 542 A.2d at 791. For a classic survey, see Clifford W. Smith & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants* 17 J. FIN. ECON. 117 (1979).

[232]*See generally* OLIVER HART, FIRMS, CONTRACTS AND FINANCIAL STRUCTURE (1995) (highlighting differences between well-established contractual transactions in market trading, and contracting performed between firms and other types of economic institutions where contractual incompleteness and power play important roles). For further economic analyses, see Douglas B. Bernheim & Michael Whinston, *Incomplete Contracts and Strategic Ambiguity*, 88 AM. ECON. REV. 902 (1998); Sharon Gifford, *Limited Attention and the Optimal Incompleteness of Contracts*, 15 J. L. ECON. & ORG. 468 (1999); Oliver D. Hart, *Incomplete Contracts and the Theory of the Firm*, 4 J. L. ECON. & ORG. 119 (1988); Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755 (1988); Gur Huberman & Charles Kahn, *Limited Contract Enforcement and Strategic Renegotiation*, 78 AM. ECON. REV. 471 (1988); Kathryn E. Spier, *Incomplete Contracts and Signaling*, 23 RAND J. ECON. 432 (1992); Jonathan Thomas & Tim Worrall, *Income Fluctuation and Asymmetric Information: An Example of a Repeated Principal-Agent Problem*, 51 J. ECON.THEORY 367 (1990).

[233]*Cf.* the court's statement in *Simons*, *supra* note 231.

In reality, parties are unable to foresee all future states of the world such that surprises will never occur. Even if all future contingencies were foreseeable the cost of spelling them out, negotiating for an agreed outcome and putting the agreement in writing would be prohibitive. At times, a party may even wish to exploit an informational advantage it has over the other party, if it would not be actionable in court, and abstain from pointing out certain contingencies. Parties may fail to contract on certain contingencies if such contracting would be futile. Such will be the case when it is impossible or prohibitively costly to monitor the other party (the problem of unobservability); or, even when a breach could be detected, the injured party would be unable to prove it to a third party, e.g., a judge (the problem of unverifiability).

These aspects of incomplete contracts link the issue of corporate governance maximands to the agency problem. The myriad reasons for impossibility of complete contingent contracts suggest that in many cases, the rights and entitlements of the parties will be indeterminate. Situations in those which one party (the agent) has the ability to unilaterally affect the interest of the other party (the principal) are likely to be ubiquitous. In these situations, the former has power over the latter.[234]

The logic behind the *Simons* doctrine, under which creditors are protected only by contractual covenants, holds when the firm is solvent and the parties can assess and price the likelihood of default. As the firm nears financial distress, shareholders, as the beneficiaries of corporate officers' fiduciary duties, have an interest that the firm will take excessive risk. Should the contingency of business failure materialize, the loss will be visited on the creditors; but shareholders will reap all the gains (net of financing costs) should the firm succeed. Therefore, one can say that in such cases, shareholders have power over creditors.

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[234]The Restatement (Second) of Agency § 6 defines "power" as follows: "A power is an ability on the part of a person to produce a change in a given legal relation by doing or not doing a given act." RESTATEMENT (SECOND) OF AGENCY § 6 (1958). The Restatement definition comports with the Hohfeldian meaning of this term. In the 1910s, Wesley Hohfeld advanced an elegant diagrammatic model of dyadic relationships between legal statuses that included a dyadic relationship between power and liability. Wesley N. Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 YALE L.J. 710 (1917); Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16 (1913). According to Hohfeld, "the person (or persons) whose volitional control is paramount may be said to have the (legal) power to effect the particular change of legal relations that is involved in the problem." *Id.* at 44. Liability is simply a correlative concept of power, denoting the status of the other party as subject to the first party's power. Hohfeld later consolidated his model in WESLEY N. HOHFELD, FUNDAMENTAL LEGAL CONCEPTIONS AS APPLIED IN JUDICIAL REASONING (Walter Wheeler Cook, ed. 1919; reprint 1964). For a general analysis of Hohfled's framework, see ANDREW HALPIN, RIGHTS AND LAW: ANALYSIS AND THEORY (1997).

Acknowledging the nature of this relationship as one of power, the courts of Delaware voiced guarded willingness to recognize an exception to the *Simons* doctrine. In *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*,[235] Chancellor Allen stated in an *obiter dictum* that when a corporation is in severe financial distress, corporate fiduciaries owe their fiduciary obligation to the "corporate enterprise" rather than to shareholders or any single constituency.[236] "At least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue [sic] risk bearers, but owes its duty to the corporate enterprise."[237] In a situation like this, management may need to harm shareholder value by accepting fire-sale prices for corporate assets.[238] This is because the "board or its executive committee [has] an obligation to the community of interest that sustained the corporation."[239]

Credit Lyonnais and its progeny[240] thus go explicitly against the traditional economic analysis injunction, that shareholder value, as it reflects the residual claim on the corporation, should be the single appropriate maximand. When the indeterminacy of entitlements in the firm cannot be avoided, e.g., during severe financial distress, corporate decision

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[235]No. 12,150, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991), *reprinted in* 17 DEL. J. CORP. L. 1099 (1992).

[236]*Id.* at *108, *reprinted in* 17 DEL. J. CORP. L. at 1156.

[237]*Id.* at *108, *reprinted in* 17 DEL. J. CORP. L. at 1155.

[238]*Id.*

[239]*Credit Lyonnais Bank Nederland*, 1991 Del. Ch. LEXIS 215, at *108, *reprinted in* 17 DEL. J. CORP. L. at 1155.

[240]In a later decision, Chancellor Allen clarified the ruling in *Credit Lyonnais* while repeating the reference to multiple constituencies. *See* Equity-Linked Investors, L.P. v. Adams, 705 A.2d 1040, 1042 n.2 (Del. Ch. 1997).

> [W]here foreseeable financial effects of a board decision may importantly fall upon creditors as well as holders of common stock, as where [the] corporation is in the vicinity of insolvency, an independent board may consider impacts upon all corporate constituencies in exercising its good faith business judgment for the benefit of the "corporation."

Id. (citation omitted). *See also* Official Comm. of Unsecured Creditors of Buckhead Am. Corp. v. Reliance Capital Group, Inc. (*In re* Buckhead Am. Corp.) 178 B.R. 956, 968 (Bankr. D. Del. 1994) (concluding that the board of directors of corporations operating in vicinity of insolvency owes duty to corporate enterprise); Miramar Resources, Inc. v. Schultz (*In re* Schultz), 208 B.R. 723, 729 (Bankr. M.D. Fla. 1997) (reaching the same conclusion as *In re Buckheard* by applying the *Credit Lyonnais* decision).

makers[241] are called to consider the interest of a nebulous "corporate enterprise" and to give regard to its multiple constituencies.[242]

Like earlier calls for multiple-constituency fiduciary duties, the *Credit Lyonnais* doctrine is susceptible to the critique that it is unworkable as it immediately raises the implementation problem identified by Berle. Once the residual-claim yardstick is rejected, corporate decision makers are left with no clear beacon with which they can navigate corporate affairs. Echoing Easterbrook and Fischel, Victor Brudney thus criticizes this line of court rulings, because the current board structure makes "the same persons arbiters for conflicting interests with accountability to none."[243] Brudney indeed opines that "it is hard to see why directors should become . . . [creditors'] fiduciaries, and it is impossible to see how directors can at one time be fiduciaries for both (or all) constituencies."[244]

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[241]One may note anecdotally that somewhat like the situation in *Dodge*, in *Credit Lyonnais* these decision makers included both the majority shareholder and the board of directors.

[242]"Corporate enterprise" thus denotes something different, and arguably broader, than the firm itself as a legal personality. Readers should therefore not be misled by the fact that corporate fiduciaries are commonly said to owe their duties to the corporation. *See, e.g.*, Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939). The real issue is which maximand fiduciaries should choose in fulfilling their obligations toward the corporation.

[243]Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 645-46 (1997). Brudney thus proposes a reformed governance structure for properly considering the conflicting interests of all the constituencies involved:

> [I]t may be necessary and appropriate for the corporate decision-making body (the board and management) to reconcile the interests of the competing claims of stockholders and creditors (and other stakeholders) in maximizing the enterprise's value. If so, that body should by law (1) be so instructed, and furnished with appropriate criteria for decision, and (2) be constituted of appropriately weighted representatives of each class of claimants.

Id. Note the similarity between Brudney's first requirement and Berle's requirement for a system of community obligations" that is framed "with clarity and force." *See supra* text accompanying note 218.

[244]*Id.* at 645-46 n.128. The situation may change materially when the firm is no longer "in the vicinity of insolvency" but is actually insolvent, even if formal bankruptcy proceedings were not initiated. At that point, creditors legally are the residual claimholders such that fiduciary duties should run to them. *See, e.g.*, Federal Deposit Ins. Corp. v. Sea Pines Co., 692 F.2d 973, 976 (4th Cir. 1982); Brandt v. Hicks, Muse & Co. (*In re* Healthco Int'l, Inc.), 208 B.R. 288, 300 (Bankr. D. Mass. 1997) (holding that directors owe fiduciary duties to creditors when a transaction leaves the corporation insolvent or with unreasonably small capital); Odyssey P'ship v. Fleming Cos., 735 A.2d 386, 420 (Del. Ch. 1999) (holding that the board of an insolvent corporation was under a duty to balance the effect of corporate action on "shareholders, creditors and other corporate constituencies"); Geyer v. Ingersoll Publ'ns Co., 621 A.2d 784, 787-90 (Del. Ch. 1992) (acknowledging fiduciary duties to creditors). Note, however, that even insolvent corporations that are in bankruptcy proceedings may face the problem of multiple constituencies. There, the amalgam of constituencies that constitutes the corporate enterprise under *Credit Lyonnais* is replaced with a similar amalgam, which is the estate. *See* LaSalle Nat'l Bank v. Perelman, 82 F. Supp. 2d 279, 292 (D. Del. 2000) (stating that officers and directors of an insolvent corporation have a "fiduciary duty to act in the best interests of the estate as a whole,

The conflict of interest between shareholders and creditors is only specific case that exemplifies the multiple constituency problem. In fact, the constituencies of shareholders and creditors have more in common with one another than most other constituencies since both of them provide capital to the firm. As a result, the relationships between these constituencies are less likely to invoke more general political controversies. The foregoing discussion therefore provides a good example for the general problem.

Similar problems exist between shareholders and other constituencies.[245] In particular, employees have been said to suffer when shareholder value is the unique corporate governance maximand. Many (though not all) employees make considerable investment in firm-specific human capital—namely, skills and knowledge that cannot easily be utilized if the worker moved to a different employer or were left without a job. Workers may not be fully compensated for this investment through their salaries or wages before some unforeseen contingency materializes that threatens their employment.[246] In other words, employees are exposed to

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including its creditors, equity interest holders and other parties in interest"). For an analysis, see Alon Chaver & Jesse M. Fried, *Managers' Fiduciary Duty Upon the Firm's Insolvency: Accounting for Performance Creditors*, 55 VAND. L. REV. 1813 (2002) (arguing that an insolvent firm is likely to have two types of creditors such that the duty to maximize the value of only one category may be inefficient); Jonathan C. Lipson, *Directors' Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA L. REV. 1189 (2003) (arguing that fiduciary duties of distressed corporations should shift only toward relatively weaker creditors, who lack volition, cognition, and exit); Lynn M. LoPucki, The Nature of the Bankrupt Firm: A Reply to Baird and Rasmussen's "The End of Bankruptcy," 56 STAN. L. REV. 645 (2003) (arguing that no single class of residual owners exists in most bankrupt firms). For additional analyses of the relationships between shareholders and creditors as corporate constituencies, see Zipora Cohen, *Directors' Negligence Liability to Creditors: A Comparative and Critical View*, 26 IOWA J. CORP. L. 351 (2001); Laura Lin, *Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485 (1993); Ann E. Conaway Stilson, *Reexamining the Fiduciary Paradigm at Corporate Insolvency and Dissolution: Defining Directors' Duties to Creditors*, 20 DEL. J. CORP. L. 1 (1995); Gregory V. Varallo & Jesse A. Finkelstein, *Fiduciary Obligations of Directors of the Financially Troubled Company*, 48 BUS. LAW. 239 (1992).

[245] *Cf.* Chaver & Fried, *supra* note 244, at 1817 n.9.

> We assume that the only parties affected by managers' decisions upon a firm's insolvency are those holding financial and performance claims against the firm. To the extent that other parties—such as potential tort victims—are affected by managers' decisions, our approach would need to be modified to require managers to account for the interests of these other parties.

Id.

[246] This view thus contrasts with the view of Easterbrook and Fischel and their followers, that employees are similar to other creditors in that they can assess the likelihood of their employer's failure (either directly or by relying on market prices) and can negotiate for a compensation for this expected loss.

the power of corporate decision makers and, consequently to the power of shareholders.

3. The Progressive View

As noted above, American legislators and courts, primarily in the context of other constituency statutes,[247] have opened the door for consideration of the interests of employees by corporate decision makers. Yet, they have provided no guidance as to how such consideration could be implemented. Similarly, legal scholars have called for recognizing fiduciary duties to corporate employees, especially during financial distress.[248] Many of these calls are part of the Progressive Corporate Law movement whose members advocate using and, to the extent necessary, reforming corporate law in order to promote the interests of non-shareholder constituencies, namely, employees, local communities, and the environment.[249]

The Progressive Corporate Law movement is ideologically associated with the communitarian movement headed by Amitai Etzioni and can generally be characterized as of left-of-center persuasion.[250] The communitarian view argues for the ability to choose different rules for

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[247]*See supra* text accompanying notes 201-19.

[248]*See* O'Connor, *supra* note 203 (arguing that directors should owe employees a fiduciary duty to alleviate employee displacement caused by corporate restructuring); Katherine Van Wezel Stone, *Employees as Stakeholders Under State Nonshareholder Constituency Statutes*, 21 STETSON L. REV. 45 (1991) (advocating the creation of fiduciary duties on behalf of employees); *see also* Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283 (1998); Alan Hyde, *Ownership, Contract, and Politics in the Protection of Employees against Risk*, 43 U. TORONTO L. J. 721 (1993); Joseph William Singer, *Jobs and Justice: Rethinking the Stakeholder Debate*, 43 U. TORONTO L.J. 475 (1993).

[249]For general background, see PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995); *see also* Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409 (1993); Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865 (1990); Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215 (1992) (book review); David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223 (1991); David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201 (1990); Lawrence E. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263 (1992); Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565 (1993).For a recent symposium, see Symposium, *Corporate Irresponsibility: America's Newest Export?*, 70 GEO. WASH. L. REV. 890 (2002) (discussing LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT (2001)).

[250]*See, e.g.*, Michael Bradley et al., *The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 LAW & CONTEMP. PROBS. 9, 41-44 (1999). *See generally* AMITAI ETZIONI, THE MORAL DIMENSION: TOWARD A NEW ECONOMICS (1988); AMITAI ETZIONI, THE SPIRIT OF COMMUNITY: THE REINVENTION OF AMERICAN SOCIETY (1993).

different situations in corporate law[251] and for discharging fiduciary duties toward various constituencies on a case-by-case, situation-specific basis.[252] That this would create uncertainty is readily admitted by these scholars and is actually posited as an advantage.[253] The progressive left-wing political characterization of this group contrasts advocates of multiple-constituency corporate governance with some prominent advocates of adhering to shareholder value as a unique maximand, who self-label as political conservatives.[254] To the latter, the need to address multiple interests under uncertainty renders multiple-constituency corporate governance unworkable.[255]

4. Hierarchical Models

The journey through the intellectual history of the stockholder-stakeholder debate would not be complete without noting two interesting recent contributions. Margaret Blair and Lynn Stout have offered a new view on the role of directors in public corporations.[256] Blair and Stout propose the adoption of a view of the corporation as a team to which different constituencies—shareholder, creditors, employees, managers, and communities—contribute, and from which they expect certain returns.[257] Because contracting among constituencies cannot be complete, constituencies constantly have competing claims and each constituency may be exposed to the opportunistic power of other constituencies.[258] The public corporation, it is argued, is better viewed as a "mediating hierarchy"

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[251]Orts, *supra* note 249, at 1581.

[252]O'Connor, *supra* note 203, at 1259.

[253]*Id.*

[254]*See* Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856 (1997).

[255]*See* Stephen M. Bainbridge, *The Bishops and the Corporate Stakeholder Debate*, 4 VILL. J.L. INVESTMENT MGMT. 3 (2003) (arguing that requiring directors to make trade-offs between shareholder and stakeholder interests would prove unworkable).

[256]Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) [hereinafter Blair & Stout, *Team Production*]; Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001) [hereinafter Blair & Stout, *Behavioral Foundations*]; *see also* Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403 (2001) [hereinafter Blair & Stout, *Director Accountability*]; Lynn A. Stout, *Bad and Not-So-Bad Arguments For Shareholder Primacy*, 75 SO. CAL. L. REV. 1189 (2002); Lynn A. Stout, *On the Proper Motives of Corporate Directors (Or, Why You Don't Want to Invite* Homo Economicus *to Join Your Board)*, 28 DEL. J. CORP. L. 1 (2003).

[257]Blair & Stout, *Team Production*, *supra* note 256, at 265-76.

[258]*Id.* at 276-87.

in which the directors are the "mediating hierarchs."[259] The board enjoys ultimate decision-making authority to determine the use of corporate assets and to reconcile all conflicting interests and disputes that may arise among corporate constituencies.[260]

Like any other theory of corporate governance, the mediating hierarch model needs to address two different questions: first, what prevents such powerful hierarchs from using their power for own personal benefit; and second, how should these hierarchs exercise their power to reconcile conflicts of interest among constituencies. Blair and Stout propose an answer to the first question but eschew the second question altogether.[261]

In regards with the problem of curbing managerial opportunism (which is largely beside the focus of this article), Blair and Stout marshal a large body of behavioral research that has looked at people's behavior in social dilemma games. In such games subjects have to weigh their self-interest, usually expressed in some monetary payoff, against the interest of other players. It is now well established that in seeming contradiction to predictions of neo-classical economic theory, subjects quite often behave in ways that appear altruistic: They would sacrifice self-reward to achieve an outcome that benefits others, or act in ways that appear compatible with an abstract ethical principle (e.g., fairness).[262]

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[259] *Id.* at 278-87.

[260] *Id.* at 276-77. Blair and Stout's team production model draws on Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); and their mediating hierarchy view is influenced by Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q.J. ECON. 387 (1998). Blair & Stout, *Team Production*, *supra* note 256, at 265, 271.

[261] Blair & Stout, *Team Production*, *supra* note 256, at 276-87.

[262] As noted in the text, this is the subject of a huge literature. Blair and Stout review some of this literature and apply its major findings to their mediating hierarch model in Blair & Stout, *Behavioral Foundations*, *supra* note 256. For a review, see, e.g., Ernst Fehr & Urs Fischbacher, *Why Social Preferences Matter—The Impact of Non-Selfish Motives on Competition, Cooperation and Incentives*, 112 ECON. J. C1 (2002); *see also* Robyn M. Dawes & Richard H. Thaler, *Cooperation*, 2 J. ECON. PERSP. 187 (1988); David Sally, *Conversation and Cooperation in Social Dilemmas: A Meta-Analysis of Experiments from 1958 to 1992*, 7 RATIONALITY & SOC'Y 58 (1995).

Blair and Stout also argue generally, that managers derive utility from keeping their job in which they serve their corporate constituents well and that corporate law limits managers' ability to enrich themselves at the expense of other corporate constituents. Blair & Stout, *Team Production*, *supra* note 256, at 315. Whether these factors are sufficient for preventing managerial opportunism in extreme settings like a hostile takeover bid is controversial. *See* Bebchuk, *supra* note 218, at 1023 n.133 (questioning the validity of Blair and Stout's argument in the takeover context). For a general critique of the mediating hierarchy model, see Meese, *supra* note 228.

Compelling as it may be, the evidence from behavioral economics is unhelpful in resolving the problem of multiple constituencies' interests. This body of evidence may be relevant primarily to situations that involve conflicts of interest between managers and the corporation or beneficiaries of the corporation. In other words, this evidence may shed light on the type of agency problem, which is relatively less controversial. To the extent that the experimental results carry over to real-life situations, they may mitigate concerns about managerial opportunism. With regard to the conflicts of interest among constituencies, Blair and Stout's approach suggests that directors should not be under the direct control of either shareholders or other stakeholders, although they believe that shareholders would benefit from granting directors discretion to favor other constituencies.[263]

Stephen Bainbridge has advanced a "director primacy" theory that shares major features with Blair and Stout's mediating hierarch model.[264] Drawing on early work by Kenneth Arrow on governance in institutions, Bainbridge argues that authority, rather than consensus, should be the governance mechanism in corporations and that the directors are the proper locus of authority.[265] The board of directors is portrayed not as an agent for the shareholders but rather as "a sort of Platonic guardian serving as the nexus of the various contracts that make up the corporation."[266] Unlike Blair and Stout, Bainbridge holds the view that shareholder value should

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[263]Blair & Stout, *Team Production, supra* note 256, at 255, 304; Blair & Stout, *Director Accountability, supra* note 256, at 424. Blair and Stout, therefore, distance themselves from progressive commentators who have argued that corporate law ought to be reformed to make directors more accountable to stakeholders. Blair & Stout, *Team Production, supra* note 256, at 255.

[264]Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1 (2002) [hereinafter Bainbridge, *Nexus of Contracts*]; Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791 (2002) [hereinafter Bainbridge, *Preliminary Reflections*]; Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003) [hereinafter Bainbridge, *Means and Ends*]; Stephen M. Bainbridge, *Director v. Shareholder Primacy in the Convergence Debate*, 16 TRANSNAT'L LAW. 45 (2002). On the similarity between Bainbridge's model and Blair and Stout's model, see Bainbridge, *Preliminary Reflections, supra*, at 795 n.21.

> As a positive description of corporate governance, director primacy bears some resemblance to Margaret Blair and Lynn Stout's team production model, especially in that both models assume that control over the corporation and its "assets is exercised by an internal hierarchy," at the apex of which sits "a board of directors whose authority over the use of corporate assets is virtually absolute."

Id. (citing Blair & Stout, *Team Production, supra* note 256, at 251).

[265]Bainbridge, *Nexus of Contracts, supra* note 264, at 20 (citing KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 69-70 (1974)).

[266]Bainbridge, *Preliminary Reflections, supra* note 264, at 795.

be the sole maximand of corporate governance.[267] Similar to the claim in traditional economic analysis, the fear is that requiring directors to make trade-offs between shareholder and stakeholder interests would prove unworkable.[268]

F. *A New Look at the Old Debate*

The standard reading of the stockholder-stakeholder debate used to be presented in terms of desirability—that is, whether corporate fiduciaries *should* be accountable to non-shareholder constituencies. As we have seen, modern economic theory teaches that simple economic analysis cannot resolve this question. This Part has shown that below the surface of the question of desirability there lies a more fundamental problem of feasibility—i.e., whether corporate fiduciaries can, be systematically held accountable to multiple non-shareholder constituencies. Berle was the first to identify this problem as the factor that should determine legal policy. Berle strongly believed that accountability to multiple constituencies is desirable but could not think of a way to implement it. Therefore, he advocated accountability only to shareholders as a distant second-best in order to mitigate the adverse effects of insiders' self-interest at a minimum.

Modern economic theory vindicates Berle's position. It also highlights the gravity of the implementation problem in formalizing the notion that the corporation is not a nexus of contracts but rather a nexus of power relationships governed only partially by the law. The interests of various corporate constituencies are inherently indeterminate and, consequently, may be inherently conflicting. The recent contributions by Blair and Stout and by Bainbridge continue the old divide between stakeholderists and stockholderists. These authors explicate the fact that corporate decision makers have both the duty and power to reconcile

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[267]Bainbridge, *Means and Ends*, *supra* note 264, at 550 ("[D]irector primacy claims that shareholders are the appropriate beneficiaries of director fiduciary duties. Hence, director accountability for maximizing shareholder wealth remains an important component of director primacy.") This view has been advanced by Bainbridge well before he put forward the director primacy model. *See* Bainbridge, *supra* note 228, at 1446.

> How would I feel about living in a world governed by the moral rules implicit in the shareholder wealth maximization norm? Frankly, my answer is: "pretty good." . . . That rule has helped produce an economy that is dominated by public corporations, which in turn has produced the highest standard of living of any society in the history of the world.

Id. (citation omitted).

[268]Bainbridge, *supra* note 254, at 6. Bainbridge does not elaborate on the problem of unworkability although this position is compatible with tradition economic analyses that reject recognizing multiple maximands for this reason.

conflicting interests on a constant basis. Notwithstanding the similarity of their basic frameworks, these authors, like many before them, disagree on whether American managers can be trusted to successfully deal with situations that involve multiple considerations, ambiguity and uncertainty.

The theory of values and cognitive style put forward in Part II casts the stockholder-stakeholder debate in a new light that exposes its roots. The polar views in this debate suggest different assumptions about the psychology of American mangers and American culture. The position that shareholder value should be the only maximand of corporate governance reflects a belief that, on average, American managers would find it difficult to function under a multiple constituency accountability regime and are likely to take advantage of such situations to benefit themselves. Proponents of multiple constituency accountability appear to believe that the personal qualities of the average American manager enable her to manage complex situations to the benefit of all corporate constituencies, even without a clear roadmap.

The present theory allows one to move from general assertions of the sort just made to a more rigorous framework that allows for empirical testing. Thus, the debate should be analyzed as a controversy over the values and need for cognitive closure of American managers and other decision makers. The single shareholder-value-maximand position is consistent with the view that managers emphasize values of Conservation and Self-enhancement more than values of Openness to change and Self-transcendence. In accordance with the emphasis on Conservation, the single maximand position also implies that managers' average level of need for cognitive closure may be too high to enable them to simultaneously consider the interests of multiple constituencies while coping with the confusion they entail. The opposite holds for the multiple maximands position: Emphasis on Openness to change and Self-transcendence and low need for cognitive closure that accommodates handling multiple considerations under uncertainty on an ad hoc basis.

As noted above, Tetlock's study of American managers provides evidence in support of this analysis.[269] Tetlock uses political positions to conceptualize and operationalize values at the individual level. In this analysis, political conservatism and libertarianism are contrasted with liberalism in supporting a single versus multiple maximands of corporate governance, respectively. The Schwartz model of individual values offers a superior analytical framework for discussing value-related issues, especially in comparative contexts, and should yield equivalent results.

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[269]Tetlock, *supra* note 48.

The value dimension framework also allows for identifying gaps in existing theoretical accounts. Most theorists have mainly focused on managerial self-interest. This aspect is related primarily to the Self-enhancement/Self-transcendence dimension. Little elaboration if any has been offered in regards to the reconciliation of conflicting interests of third parties by managers. Scholars alternatively assume that this task is feasible or that it is not, without elaborating on factors that may affect managers' ability to cope with this implementation problem. By relating this aspect to the Openness to change/Conservation dimension, this article points to the direction in which further research should continue.[270]

The foregoing analysis leads to an interesting conclusion about the future of the stockholder-stakeholder debate. It also provides an important lesson for policy makers. In brief, this debate is unlikely ever to be resolved. People's positions in this debate appear to be rooted deep in their individual value preferences and cognitive styles. The American society, like every other society, has a wide distribution of individual traits, including value preferences and cognitive styles. The insight that multiple considerations and ambiguity are inherent to managing corporate affairs entails that people will always differ on how best to cope with this task.

Do these insights imply the desirability of legal reform in the United States (specifically, a reform in the direction advocated by stakeholderists)? It appears not. Since the board of directors is the ultimate holder and arbiter of power in the corporation, the question essentially boils down to the one debated by Berle and Dodd, to wit, "To whom are corporate directors trustees?" Once the American jurisprudence had defined the relations between corporate officers and corporate constituencies (and the corporation itself) as relations that rest on power differences, an accountability-based legal regime was the natural response given the legal roots of American corporate law in common law and equity principles. Such a regime precludes loyalty to multiple beneficiaries almost by definition, irrespective of the danger of managerial self-interested opportunism. A legal reform that required directors to discharge their

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[270]Even the more sophisticated accounts, such as Blair and Stout's theory of the board mediating hierarchy, fail to account for the latter aspect in postulating the mechanisms that affect directors' behavior. Blair & Stout, *Behavioral Foundations*, *supra* note 256, points to evidence on other-regarding behavior by (largely Western) subjects. Unfortunately, this evidence has not yet been connected to psychological theories of values, but its underlying theme suggests a relation mostly with the Self-enhancement/Self-transcendence dimension identified by Schwartz. Supposedly, behavioral economics thus far has neglected factors that relate to the Openness to change/Conservation dimension and to the need for cognitive closure. As this article argues, the latter two factors may play a significant role in determining the maximands of corporate governance.

fiduciary duties simultaneously to multiple constituencies would thus resemble trying to fit a square peg into a round hole. It would not matter, for that purpose, whether one classified such multiple-beneficiary duties in the rubric of the duty of loyalty or the duty of care.

Uncovering the psychological roots of the stockholder-stakeholder debate, this article implies that legal reform—no matter how well intentioned it may be—is unlikely to eradicate the consequences of the balance struck by American legislators and courts that focuses primarily on shareholders' interests. The current legal environment apparently is one in which more managers can function given their level of need for cognitive closure. A legal regime that imposes a lower cognitive load allows a wider range of managers to discharge their duties effectively, as it accommodates those managers with a high need for closure. Also, managers with a lower need for closure can still function under a single-maximand regime. Yet by not equally catering to the interests of non-shareholder constituencies, the current regime may be leading to sub-optimal management of firms, as several management scholars argue.[271] What may look to some as unnecessary social waste, however, may actually be a social optimum once the constraint of cognitive style is taken into account.

If the present hypotheses are correct—namely, that a higher level of need for cognitive closure is accompanied by individual emphases on certain values (Conservation and Self-enhancement)—then the current U.S. legal regime also reflects a political balance. Hence, the political overtones of the stockholder-stakeholder debate are simply manifestations of its underlying psychological foundations. No amount of economic analysis is likely to be decisive in the eyes of people who disagree on what is important in life. Tetlock's study demonstrates that these differences cut across many issues unrelated to corporate governance. As for corporate governance, Berle has identified the second-best solution. Subsequent developments in American society apparently have not yet changed its values to an extent that would cause it to reject the shareholder-primacy norm.

Finally, two general points about conclusions that the present analysis does *not* entail deserve noting. First, the present theory improves our understanding of the mechanisms that underlie the choice of maximands for corporate governance. This analysis does not imply, however, that one version of corporate governance is universally better than the other. The fact that some managers (or people in general) have a strong need for cognitive closure, that they prefer security and conformity more

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[271]For a development of this theme, see *infra* Part IV.

than self-direction, etc., does not mean that they would be worse managers. Indeed, the contrary may be true. These managers may also be more decisive, better able to see through the details, and so on. In the same vein, higher Openness to change and lower need for cognitive closure may lead to procrastination—a bad quality for managers.[272]

Second, it may be a mistake to attribute the value preferences and cognitive style associated with either the stockholder or the stakeholder view to proponents of these views. Thus, it would be wrong to assume that advocates of the single shareholder-value-maximand position are all right-wing conservatives with low tolerance for ambiguity and nuance whose early childhood development was somehow impaired.[273] When the discussion revolves on law and policy making, the crucial consideration is which policy would better fit the general, average case. One can be of strong liberal persuasion and bent on dialectical reasoning, yet hold the view that American corporations will be better managed under a single-maximand accountability regime. Adolf Berle is a shining example of the ability to draw the line between one's own values and optimal policy making.

IV. MANAGEMENT THEORIES

Lawyers are not alone in addressing the maximands of corporate governance. Beginning in the mid-1980s, a similar debate among management scholars developed and has been running on nearly parallel tracks with the legal discourse. Both strands of theoretical analysis, however, feature their own versions of the monist, single-constituency shareholder paradigm versus the pluralist, multiple-constituency stakeholder paradigm. Management scholars, however, have made considerable progress with regard to the implementation problem of reconciling multiple conflicting interests. Although it bears important implications for legal analysis, these theories have gone virtually unnoticed among legal commentators.[274] This Part aims to partially remedy this deficiency. Sections A through C review current theories, and Section D assesses them against the theory of values and cognitive style.

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[272]Tetlock, *supra* note 48, provides an excellent discussion of the relativity of these qualities.

[273]*See supra* note 47.

[274]Management scholars writing in the legal literature are aware of this body of knowledge. *See, e.g.*, Bradley et al., *supra* note 250; Dunfee, *supra* note 216; Orts, *supra* note 202. Orts is affiliated with the legal studies department at the Wharton School of Business.

A. *Stakeholder Theory*

Edward Freeman's landmark book *Strategic Management: A Stakeholder Approach* marks the inception of the stakeholder-stockholder debate in management studies.[275] This book was written with a view to helping American managers cope with vast changes that had taken place in their business environment, in particular with the increase in the external demands placed on the corporation in a turbulent period.[276] "External change produces uncertainty,"[277] wrote Freeman. "It makes us uncomfortable because it cannot be readily assimilated into the relatively more comfortable relationship with suppliers, owners, customers and employees."[278] The stakeholder management approach advanced by Freeman was thus designed to help managers reduce uncertainty and discomfort.[279] At the center of this theory stands the concept of stakeholders, defined as follows: "A stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the organization's objectives."[280]

This definition implies that to the traditional list of stakeholders, managers needed to add governments, competitors, consumer advocates, environmentalists, special interest groups, and the media.[281] The crucial feature in this definition of stakeholders, which is one that has engendered heated controversies, is the fact that it is free of legitimacy considerations. In fact, a stakeholder could be anyone, even a terrorist group. Freeman agnostically noted that if a terrorist group could affect the corporation then

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[275] R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH (1984).

[276] *Id.* at *v*, 3-5.

[277] *Id.* at 12.

[278] *Id.* at 12-13.

[279] *Id.*

[280] FREEMAN, *supra* note 275, at 46. This definition of stakeholder draws on earlier definitions in the management literature that grew out of management practice. According to Freeman, it first appeared in 1963 in a memorandum at the Stanford Research Institute (now SRI International, Inc.) as "those groups without whose support the organization would cease to exist." *Id.* at 31. The list of stakeholders originally included shareholders, employees, customers, suppliers, lenders, and society. SRI's work was heavily influenced by concepts that were developed in the planning department of Lockheed and further developed in IGOR ANSOFF, CORPORATE STRATEGY (1965). Freeman, however, traces the history of the stakeholder concept before SRI to Adam Smith and Berle and Means. *See* FREEMAN, *supra* note 275, at 32; R. Edward Freeman & John McVea, *A Stakeholder Approach to Strategic Management*, *in* HANDBOOK OF STRATEGIC MANAGEMENT 189, 189 (Michael A. Hitt et al. eds., 2001).

[281] FREEMAN, *supra* note 275, at 11-22.

managers could not ignore it.[282] One needs only to consider discount airlines after September 11, 2001 to see the point.[283]

The original value-free, practice-oriented version of stakeholder management theory soon gave rise to several branches of analysis that derived different theses from it.[284] One understanding of stakeholder theory is as a descriptive thesis, presenting models that describe what the corporation is. Secondly, stakeholder theory can be viewed as an instrumental thesis, namely, dealing with practical prescriptions for corporations' survival and success in business. The more contentious interpretations of stakeholder theory, however, are the normative and managerial theses. As a normative thesis, the theory's focus is on the legitimacy of claims on the corporation from various groups and individuals. In this view, the theory implies that "each group of stakeholders merits consideration for its own sake and not merely because of its ability to further the interests of some other group, such as shareowners."[285] Finally, stakeholder theory can also be seen as implying a managerial thesis in the sense of prescribing structures and practices for managing stakeholder affairs.[286]

The normative interpretation of stakeholder theory rejects the idea of a single maximand for corporate governance on ethical grounds. Although Freeman originally did not develop this facet of his stakeholder management theory, the fields of business ethics and business and society have embraced stakeholder theory and extensively rely on it. These analyses infuse (or augment) the basic framework with value-based arguments that draw heavily on notions of individual autonomy and

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[282] *Id.* at 45, 53.

> [The] broad notion of "stakeholders" will include a number of groups who may not be "legitimate" in the sense that they will have vastly different values and agendas for action from our own. Some groups may have as an objective simply to interfere with the smooth operation of our business. For instance, some corporations must count "terrorist groups" as stakeholders. . . . Strategies must be put in place to deal with terrorists if they can substantially affect the operations of the business.

Id. at 53.

[283] Nevertheless, opponents of stakeholder theories cite the reference to terrorist groups with an unmistakable innuendo. *See* Jensen, *supra* note 1, at 9 n.1; Elaine Sternberg, *The Defects of Stakeholder Theory*, 5 CORP. GOVERNANCE: INT'L REV. 3, 4 (1997) ("Terrorists and competitors, vegetation and nameless sea creatures, and generations yet unborn are amongst the many groups which are now seriously considered to be business stakeholders.") (footnotes omitted);.

[284] *See* Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory for the Corporation: Concepts, Evidence, Implications*, 20 ACAD. MGMT. REV. 65, 66-67 (1995).

[285] *Id.* at 67.

[286] *Id.*

fairness toward all societal members.[287] Adoption and implementation of stakeholder management as a normative thesis require that managers also subscribe to certain values and to "value-based-management." Managers need to share a core set of values and incorporate these values as a key element of the strategic management process.[288]

An important outcome of grounding stakeholder theory in normative propositions that draw on values and ethics is that the theory immediately becomes political.[289] This outcome can hardly go unnoticed. One, however, may find it difficult to readily classify the theory along a left-right dimension. Freeman himself has provided different political interpretations of stakeholder theory, ranging from liberal to libertarian interpretations.[290] The liberal element of stakeholder theory is based on the notions of autonomy, solidarity, and fairness as articulated by John Rawls[291] and others. This element entails pursuit of basic equality among stakeholders in terms of their moral rights as these are realized in the firm.[292] The libertarian element of this theory is reflected in the theory's reliance on a contractual model, which in turn connotes values of liberty of will and personal freedom.[293] It is worth noting that both positions emphasize promotion of individual autonomy while they differ on the question of the

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[287]For a sample of ethical analyses of stakeholder theory, see, e.g., John R. Boatright, *Fiduciary Duties and the Shareholder-Management Relation: Or, What's So Special About Shareholders?*, 4 BUS. ETHICS Q. 393 (1994); R. Edward Freeman, *A Stakeholder Theory of the Modern Corporation: Kantian Capitalism*, *in* ETHICAL THEORY AND BUSINESS 75 (Tom L. Beauchamp & Norman E. Bowie eds., 4th ed. 1993); Kenneth E. Goodpaster, *Business Ethics and Stakeholder Analysis*, 1 BUS. ETHICS Q. 53 (1991); Thomas Jones, *Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics*, 20 ACAD. MGMT. REV. 92 (1995); Thomas M. Jones & Andrew C. Wicks, *Convergent Stakeholder Theory*, 24 ACAD. MGMT. REV. 206 (1999); Ian Maitland, *The Morality of the Corporation: An Empirical or Normative Disagreement*, 4 BUS. ETHICS Q. 445 (1994); Robert Phillips, *Stakeholder Theory and a Principle of Fairness*, 7 BUS. ETHICS Q. 51 (1997); Robert A. Phillips & Joel Reichart, *The Environment as a Stakeholder?: A Fairness-Based Approach*, 23 J. BUS. ETHICS 185 (2000).

[288]Freeman & McVea, *supra* note 280.

[289]As a normative thesis, stakeholder theory also becomes relevant for legal matters. Given that this theory champions consideration of multiple stakeholders, it is not surprising that Dodd's work is cited as a matter of practice. *See, e.g.*, Donaldson & Preston, *supra* note 284, at 65. As noted above, however, much remains to be done on the interface between corporate law and management theories.

[290]The reader is reminded that these political titles are notoriously difficult to pin down and may connote different political view in different countries. *See supra* note 48 and accompanying text.

[291]JOHN RAWLS, A THEORY OF JUSTICE (1971).

[292]R. Edward Freeman, *The Politics of Stakeholder Theory: Some Future Directions*, 4 BUS. ETHICS Q. 409, 415 (1994).

[293]*See id.* at 415; R. Edward Freeman & Robert A. Phillips, Stakeholder Theory: A Libertarian Defense (Darden Business School, Working Paper No. 01-03, 2001), http://papers.ssrn.com/paper.taf?abstract_id=263514.

appropriate relations between the autonomous person and the larger society. Liberalism more than libertarianism calls on individual persons to consider other social members and voluntarily promote their interests.

Ethical and philosophical considerations aside, stakeholder theory, as a managerial thesis, puts emphasis on the need to pay simultaneous attention to the interests of all appropriate stakeholders.[294] This aspect points to two separate challenges that must be met: (1) identifying all appropriate stakeholders, and (2) managing these stakeholders. With regard to the first challenge, the question "Who is a stakeholder?" has received numerous answers over the years. While some scholars used narrow definitions that focused on the legitimacy of stakeholders' claims (determined on a legal or moral basis), others preferred a broader definition (in line with Freeman's original view) that emphasized the stakeholder's power to influence the firm's affairs, whether or not these are legitimate claims.[295]

In addition, stakeholder management also deals with the problem of balancing stakeholders' conflicting interests beyond the general prescription of conducting case-by-case analyses. What makes this a challenge is the fact that the theory "rejects the very idea of maximizing a single objective function . . . . Rather, stakeholder management is a never-ending task of balancing and integrating multiple relations and multiple objectives."[296] Almost by necessity, stakeholder theory faces severe implementation problems resembling those that have encumbered multiple-constituency theories in corporate law for decades.

B. *The Critique*

It should come as little surprise that stakeholder theory is not without opposition among management scholars. The most prominent opponents are probably Michael Jensen and Elaine Sternberg, a British commentator. Sternberg tends to emphasize the ethical aspects, arguing that stakeholder theory cannot be justified. In brief, it is argued that the fact that some groups may have power over the corporation does not give those groups legitimate authority over it, or the right to hold it to accountable. Stakeholder theory, so runs the argument, is both "deeply dangerous and

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[294]Donaldson & Preston, *supra* note 284, at 67.

[295]*See* Ronald K. Mitchell et al., *Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts*, 22 ACAD. MGMT. REV. 853, 862 (1997). In 1997, these authors counted no less than twenty-seven definitions for stakeholders. *Id.* at 858 tbl. 1.

[296]Freeman & McVea, *supra* note 280, at 194.

wholly unjustified" because it "undermines private property, denies agents' duties to principals, and destroys wealth."[297]

Jensen's critique of stakeholder theory focuses primarily on the problem of multiple maximands.

> What is commonly known as stakeholder theory, while not totally without content, is fundamentally flawed because it violates the proposition that any organisation must have a single-valued objective as a precursor to purposeful or rational behaviour . . . . It is logically impossible to maximise in more than one dimension at the same time . . . . [T]elling a manager to maximise [several objectives] leaves the managers with no objective. The result will be confusion and lack of purpose that will fundamentally handicap the firm in its competition for survival.[298]

Jensen's reasoning weaves together several arguments. First, there is an economic theory argument, under which maximizing the firm's financial value, defined as the sum of equity and other financial claims on the firm, is efficient.[299] Second, there is a governance argument, according to which managers that owe duties to several stakeholders are accountable to none and are bound to prefer their own self-interest.[300] Third, Jensen makes a political objection, because, as a basis for action, stakeholder theory politicizes the corporation.[301] Finally, and most importantly, Jensen makes a psychological argument. Stakeholder theory is deficient under this argument because it confuses managers, and confusion is bound to handicap the firm.[302]

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[297] *See* Sternberg, *supra* note 283, at 6-9; *see also* ELAINE STERNBERG, THE STAKEHOLDER CONCEPT: A MISTAKEN DOCTRINE (1999).

[298] Jensen, *supra* note 1, at 300-01.

[299] *Id.* at 301-04. For a similar analysis, see Anant K. Sundaram & Andrew C. Inkpen, *The Corporate Objective Revisited*, 15 ORGANIZATION SCI. 350 (2004).

[300] Jensen, *supra* note 1, at 305 ("Because stakeholder theory provides no definition of better, it leaves managers and directors unaccountable for their stewardship of the firm's resources . . . . [S]takeholder theory plays into the hands of self-interested managers allowing them to pursue their own self-interest . . . .").

[301] *Id.* at 300.

[302] *Id.* at 301. For similar reasons, Jensen also criticizes a management theory called "The Balanced Scorecard." *Id.* at 310-14. This theory was designed to improve current performance measurement systems by providing alternatives to managing organizational performance exclusively through financial measures. The Balanced Scorecard tracks key elements of an organization's strategy by allowing the organization to view its performance through multiple lenses. *See* ROBERT S. KAPLAN & DAVID P. NORTON, THE BALANCED SCORECARD: TRANSLATING

Now these arguments all ring familiar, of course, as they replicate claims made by lawyers since the inception of the Berle-Dodd dialogue. The novelty in Jensen's position lies not in the economic analysis (which is old, as Jensen indeed emphasizes) but rather in the stress he places on the psychological drawbacks of stakeholder theory. Moreover, inspired by Friedrich Hayek's work on the modern market economy,[303] Jensen seems to hold that financial value maximization is modern while stakeholder management is not only confusing but outright primeval:

> Stakeholder theory taps into the deep emotional commitment of most individuals to the family and tribe. For tens of thousands of years those of our ancestors who had little respect for loyalty to the family, band, or tribe probably did not survive .... Many People are drawn to stakeholder theory through their evolutionary attachment to the small group and family.[304]

Notwithstanding the sharp differences between stakeholder theorists and their opponents over the question "What are the right maximands?," both sides resemble in being unable to provide satisfactory solutions for addressing non-shareholder constituencies. Even a manager who is a staunch believer in shareholder value maximization somehow must deal with workers, local politicians, NGOs, and so forth. To this end, Jensen advances what he calls the "enlightened stakeholder theory."[305] This approach builds on stakeholder theory in terms of designing ways for the firm to manage its relations with all-important constituencies and adds to it the injunction that the maximand of the firms is its long-term market value. This objective function, Jensen surmises, "gives management a way

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STRATEGY INTO ACTION (1996); ROBERT S. KAPLAN & DAVID P. NORTON, THE STRATEGY-FOCUSED ORGANIZATION: HOW BALANCED SCORECARD COMPANIES THRIVE IN THE NEW BUSINESS ENVIRONMENT (2000). According to Jensen:

> The Balanced Scorecard is the managerial equivalent of stakeholder theory. Like stakeholder theory, the notion of a "balanced" scorecard appeals to many, but it is similarly flawed .... Just as in the case of multiple constituencies, ... a decision maker cannot make rational choices without some overall single dimensional objective to be maximised. Given a dozen or two dozen measures and no sense of the tradeoffs between them, the typical manager will be unable to behave purposefully, and *the result will be confusion.*

Jensen, *supra* note 1, at 310-11 (emphasis added).

[303] Jensen, *supra* note 1, at 306-07 (citing Friedrich A. Hayek, *The Fatal Conceit*, *in* THE COLLECTED WORKS OF F.A. HAYEK 14 (W.W. Bartley III ed., 1988)).

[304] *Id.*

[305] *Id.* at 305-10.

to assess the tradeoffs that must be made among competing constituencies."[306] Exactly how managers should assess this tradeoff when long-term market value may call for sacrificing shareholder value remains unspecified. Managers are left to their own devices.[307]

C. *Toward a Dynamic Stakeholder Theory*

Like legal commentators, management scholars of all persuasions share the view that corporate fiduciaries face multiple conflicting claims and interests, which they have to identify and deal with on a constant basis. In contrast with legal commentators, however, management researchers have made some progress toward addressing this challenge. Mitchell, Agle, and Wood advance a model of stakeholder salience that covers both stakeholder identification and stakeholder management. Mitchell and his colleagues argue that the stakeholder framework cannot readily explain the complex considerations that are involved in giving priorities to competing stakeholder claims.[308]

Mitchell and his colleagues claim that beyond identifying stakeholders using the standard test of ability to affect and be affected, a managerial theory also needs to consider stakeholder salience, namely, the factor that can explain to whom and to what managers pay attention. Mitchell and his colleagues propose that classes of stakeholders can be identified by three attributes: "(1) the stakeholder's power to influence the firm, (2) the legitimacy of the stakeholder's relationship with the firm, and (3) the urgency of the stakeholder's claim on the firm."[309] These three attributes together create different levels of stakeholder salience, which indicate to managers whom they should pay attention to.[310]

To define "power," Mitchell and his colleagues combine a variety of definitions, which, in the end, all draw on Max Weber's conceptualization of "the probability that one actor within a social relationship would be in a position to carry out his own will despite resistance."[311] This is essentially the definition employed by the Restatement on Agency and advanced by Hohfeld earlier in the twentieth century.[312] Weber's definition

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[306] *Id.* at 310.

[307] Jensen, *supra* note 1, at 308 (likening this task to telling players to score goals in football or soccer without telling them how to win the game).

[308] Mitchell et al., *supra* note 295, at 854.

[309] *Id.*

[310] *Id.*

[311] *Id.* at 865 (citing MAX WEBER, THE THEORY OF SOCIAL AND ECONOMIC ORGANIZATION (1947)). Other definitions cited by Mitchell et al. are essentially identical.

[312] *See supra* note 232.

is broader in scope in that it also encompasses coercive uses of power, while Hohfeld was interested only in legal relations. This notion of "power" is also central in the concept of governance generally and corporate governance in particular.[313]

The attribute of legitimacy in Mitchell and his colleagues' theory loosely refers to socially accepted or expected structures of behavior. The authors adopt a definition of legitimacy that integrates several approaches that together refer to a generalized perception or assumption about what is desirable, proper, or appropriate within a socially constructed system of norms, values, beliefs, and definitions.[314] Mitchell and his colleagues' definition of legitimacy is nearly identical to definition of "social norms" and "culture" in social psychology and other social sciences. This aspect is addresses below. At this point, one may note that once a theory of stakeholder identification is based on social norms and cultural values, it immediately ceases to be universal and becomes contextual—that is, it depends on characteristics that may (and do) vary across societies and time.[315]

Finally, the attribute of urgency reflects the degree to which stakeholders' claims demand immediate attention. It combines a dimension of time sensitivity (how pressing is the claim in that delays in addressing it would be damaging) and criticality (how important it is to the stakeholder).

The significant contribution of the stakeholder salience model lies in the distinction it makes between stakeholders that *deserve* to be addressed (under any view of corporate governance) and stakeholders whose claim actually *gets* to be addressed. Sometimes, a claim that deserves attention gets neglected while managers invest resources in addressing a claim that should have been ignored. The pivotal factor here is the managers. "[I]t is the firm's managers who determine which stakeholders are salient and therefore will receive management attention," aver Mitchell and his colleagues.[316] Managers' personal characteristics thus play a role as moderators between stakeholders' attributes in the abstract and corporate action. Managers, however, vary greatly in their personal

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[313]*See* Licht, *supra* note 108.

[314]Mitchell et al., *supra* note 295, at 866 (citing Mark C. Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 ACAD. MGMT. REV. 574 (1995)).

[315]Mitchell et al., *supra* note 295, at 866-67 (noting that this definition is representative of sociologically based definition of legitimacy and that analyzing legitimacy should be done at multiple levels, the most common among which are the individual, organizational, and societal).

[316]*Id.* at 871.

capabilities and values. A theory of stakeholder management must therefore account for individual qualities of decision makers.

Empirical support for the theory of Mitchell and his colleagues' was provided by a study conducted by Agle, Mitchell, and Sonnenfeld.[317] These researchers further elaborate the mediating factor of managers' characteristics and argue that they are likely to be connected to managers' individual values of self-interest versus other-regarding interest. They also assert that managerial perception is critical to the salience of stakeholders and that values are critical to perception.[318] Agle and his colleagues surveyed 70 CEOs out of 650 corporations in the Standard and Poor's 500 list and 150 other large U.S. corporations.[319] CEOs were asked to evaluate the aforementioned attributes (power, legitimacy, urgency) for each of Freeman's generic stakeholder groups (shareholders, employees, customers, government bodies, and community/charitable groups). The results provided strong support to the hypothesis that the stakeholder attributes of power, legitimacy, and urgency are indeed related to stakeholder salience. With regard to the moderating role of managers' values, however, the overall pattern of results was one of nonsignificance.[320] Agle and his colleagues also failed to find evidence for a relationship between stakeholder salience and corporate performance and for a relationship between CEO values and corporate performance.[321]

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[317]Bradley R. Agle et al. *Who Matters to CEOs? An Investigation of Stakeholder Attributes and Salience, Corporate Performance, and CEO Values*, 42 ACAD. MGMT. J. 507 (1999).

[318]*Id.* at 510-11 ("In short, we argue that people perceive as important the things that are somehow connected with their values.").

[319]The final number of CEO responses might seem low but is normal for the mail survey methodology, especially for respondents of this seniority level. *See id.* at 513.

[320]Other-regarding CEO values were nonetheless found to significantly moderate the attribute-salience relationship for employees. *Id.* at 520.

[321]The question whether it is profitable to implement a multiple-constituency-oriented corporate governance is of utmost—some would say ultimate—importance, of course. This is a theoretical and empirical question that exceeds the scope of the present article notwithstanding its importance. From a theoretical perspective, it is not clear whether traditional financial performance measures should be dispositive and there is no agreement over measurement methods for non-financial performance, often referred to as "corporate social performance." Current empirical findings are notoriously vague. For a critical review of the evidence, see Joshua Margolis & James P. Walsh, Misery Loves Companies: Whither Social Initiatives by Business? (Harvard Business School Social Enterprise Series Working Paper No. 19, 2001), *available at* http://www.hbs.edu/research/facpubs/workingpapers/papers2/0001/01-058.pdf. In addition to Agle et al., *supra* note 317, see also Shawn L. Berman et al., *Does Stakeholder Orientation Matter?: The Relationship Between Stakeholder Management Models and Firm Financial Performance*, 42 ACAD. MGMT. J. 488 (1999); Jeffrey S. Harrison & R. Edward Freeman, *Stakeholders, Social Responsibility, and Performance: Empirical Evidence and Theoretical Perspectives*, 42 ACAD. MGMT. J. 479 (1999); Amy J. Hillman & Gerald D. Keim, *Shareholder*

D. *Assessment*

The present theory of values and cognitive style lends itself to assessing the major positions in management studies and to generalizing Mitchell and his colleagues' theory. When one considers Freeman's stakeholder management theory and Jensen's critique in light of the present framework, one can readily see how both are grounded in value preferences and the need for cognitive closure. Freeman's original theory is universal in that it does not hinge on a particular profile of value preferences and cognitive style. Nor is this theory tailored to societal values prevailing in the United States or in specific other countries.[322] Stakeholder theory is value-free but not value-neutral. Management in line with this theory is bound to differ in accordance with particular managers' individual characteristics and with the cultural orientations of the country in which they operate. This framework can therefore accommodate political positions, but does not imply specific political persuasions.

In contrast, Jensen's position reflects a view of managers as having a specific set of personal traits only. Jensen portrays managers as individuals with strong preference for values of security, tradition, and conformity (Conservation), and power, achievement, and hedonism (Self-enhancement) and exceedingly high need for cognitive closure. By exaggeration, Jensen's repeating claim, that multiple stakeholders would confuse managers beyond control, might sound as if managers cannot walk and chew gum at the same time. This position can be justified only if one believes that this is a good portrait of the average American manager.

One may further object to Jensen's depiction of the emotions and values of stakeholder theory supporters as vestiges of primeval times. This aspect is best understood against a theoretical backdrop of societal-level value dimensions. There is no denying the fact that communitarian commentators support the multiple constituency version of corporate governance.[323] There is, nonetheless, a significant difference between

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Value, Stakeholder Management, and Social Issues: What's the Bottom Line?, 22 STRATEGIC MGMT. J. 125 (2001); Sandra A.Waddock & Samuel B.Graves, *The Corporate Social Performance-Financial Performance Link*, 18 STRATEGIC MGMT. J. 303 (1997); Gary R.Weaver et al., *Integrated and Decoupled Corporate Social Performance: Management Commitments, External Pressures, and Corporate Ethics Practices*, 42 ACAD. MGMT. J. 539 (1999). For an early theoretical analysis, see Max B.E. Clarkson, *A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance*, 20 ACAD. MGMT. REV. 92 (1995).

[322]Needless to say, the normative interpretation given to Freeman's theory by subsequent scholars is value-laden. Freeman, *supra* note 292. The liberal interpretations of this theory (especially those that rely on Rawls) reflect a blend of Autonomy and Egalitarianism cultural orientations.

[323]*See supra* text accompanying note 249.

stakeholder management and ancient communal preferences. Depending on the context, a widely-followed injunction to consider others may express cultural orientations of Embeddedness or Egalitarianism that prevail in many advanced economies, although not in the United States.[324] Stated otherwise, stakeholderism can be as modern as shareholder primacy is.

Mitchell and his colleagues' stakeholder identification and salience model makes significant progress in the theory of corporate stakeholders by turning it from a static theory into a dynamic one. According to this theory, two factors affect "who gets what" in the business corporation: (1) the values of the society in which the corporation operates; and (2) the personal characteristics of those who control the corporation, whether executive managers or controlling shareholders. Thus, the theory encompasses both societal and individual levels of analysis—a quality that virtually all the analyses in the legal literature seem to lack. In addition, Mitchell and his colleagues' theory implies that at the individual level, several factors may operate, including managers' personal values and different levels of urgency or time pressures. It, therefore, comes close to identifying managers' cognitive style as potentially significant factor in the working of stakeholder management. Time pressure and urgency increase the need for cognitive closure. Managers with higher levels of such need may thus invest personal and corporate resources to deal with more pressing constituencies. They would tend to prefer a simple, single-maximand accountability regime to one that features multiple maximands.[325]

Finally, the present theory points to a possible reason for Agle and his colleagues' failure to find supportive evidence in respect with a moderating role of managers' values in determining stakeholder salience. In order to capture managers' values, Agle and his colleagues used a limited set of value items, which they culled from Rokeach's value inventory.[326] These items all reflect values that belong to the Self-enhancement/Self-transcendence dimension.[327] Agle and his colleagues failed to consider the Openness to change/Conservation dimension, which seems highly relevant for managing multiple stakeholders and is related to the need for cognitive

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[324]*See infra* text accompanying notes 346-49.

[325]The notion of salience, however, may encompass additional factors that bear on perception and other aspects of cognition not dealt with in the present scope.

[326]*See supra* text accompanying note 16.

[327]Specifically, Agle et al. used the items of comfortable life, wealth, helpful, and compassion to produce a measure of self-interestedness versus other-regarding value preference. *See* Agle et al., *supra* note 317, at 514. The equivalents of these items belong to the values of power, hedonism, benevolence, and universalism in the Schwartz individual level model. *See* Table 1 and Figure 1.

closure.[328] Thus, the value dimension framework makes it possible to identify such omissions and to point out directions for future research.

V. A COMPARATIVE PERSPECTIVE

The debate over the maximands of corporate governance is no longer limited to the United States. While the American corporate governance system adheres to shareholder primacy, its German and Japanese counterparts feature stronger protections for employees, creditors, and other non-shareholder constituencies in general. These protections rest on a combination of legal rules, structural arrangements, and informal social norms, sometimes loosely referred to as culture. As it happens, the specific cases of the United States, Germany, and Japan represent wider groupings of corporate governance regimes. This Part demonstrates the usefulness of the value dimension framework in comparative analyses. Section A begins with a comparative review of corporate governance groupings. This is followed by an overview of the convergence dynamics in regards to stockholders versus stakeholders in Section B.

A. *Major Groupings of Corporate Governance*

Systems of corporate governance similar to that of the United States exist in other English-speaking countries, including the United Kingdom, Australia, and Canada.[329] These countries share a legal system that is based on English common law and equity principles (the latter being especially influential in matters of corporate law for historical reasons). Shareholder primacy is the predominant norm in these countries.[330] Subject to the legal doctrine of separate corporate personality, shareholders are assumed to be

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[328]Note that this omission is similar to the one committed by Blair and Stout. *See supra* note 268.

[329]To be sure, differences do exist between corporate governance systems in various English-speaking countries, but they pale in comparison to other countries. For such comparisons, see Kerry Shannon Burke, *Regulating Corporate Governance Through the Market: Comparing the Approaches of the United States, Canada and the United Kingdom*, 27 J. CORP. L. 341 (2002); Brian R. Cheffins, *Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation in the United Kingdom*, *in* CORPORATE GOVERNANCE REGIMES—CONVERGENCE AND DIVERSITY (Joseph McCahery et al. eds., 2002); Brian R. Cheffins, *Corporate Governance Convergence: Lessons from Australia*, 16 TRANSNAT'L LAW. 13 (2002); Ruth O. Kuras, *Corporate Social Responsibility: A Canada-U.S. Comparative Analysis*, 28 MANITOBA L.J. 303 (2002); Janis Sarra, *Corporate Governance in Global Capital Markets, Canadian and International Developments*, 76 TUL. L. REV. 1691 (2002); Paul von Nessen, *The Americanization of Australian Corporate Law*, 26 SYRACUSE J. INT'L L. & COM. 239 (1999).

[330]*See, e.g.*, Bradley et al., *supra* note 250, at 37-38, 48.

the indirect owners of the corporation and only they have voting rights in the election of the board of directors.[331] Public companies in the U.S. and U.K., in particular, tend to be internationally unique in that they have a widely dispersed shareholder body.[332] Finally, The United Kingdom has its own version of a *Dodge*-like precedent.[333] This decision was followed by a legislative amendment somewhat akin to American other-constituency statutes.[334]

In Western Europe, German corporate governance is a prime example of a stakeholder-oriented system.[335] German corporate law directs

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[331]For a detailed comparative analysis of the role of shareholders in common law countries, see Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39 (2000).

[332]*See* Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999). The historical reasons that supported the emergence of dispersed shareholding in the U.S. and the U.K. may be different in each country. *See* MARK J. ROE, Strong MANAGERS, WEAK OWNERS—THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994); Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459 (2001).

[333]Parke v. Daily News Ltd., [1962] Ch 927. In this case, a newspaper publishing company suffered substantial trading losses on its newspapers to the point where it would have dissipated all its assets. The board had decided to sell all the company's assets and to distribute the balance of the purchase money by giving compensation to the company's employees and pensioners beyond their legal and contractual entitlements in order "to alleviate the suffering and hardship which may occur." Citing the famous adage that "[t]he law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company," the *Parke* court held that the intended payments would go forward and that the proceeds of the sale should be distributed to shareholders. *Id.* at 952 (citing Hutton v. West Cork Ry. Co. (1883) 23 Ch.D. 654, 673, C.A.).

[334]Section 309 of the Companies Act 1985 was enacted in 1980 (then part of section 46 of the Companies Act 1980) to respond to the *Parke* decision. This section states that directors are authorized take into account the interests of employees when performing their functions for the company. This duty is to be regarded as a fiduciary duty owed to the company. In addition, section 719 to the Companies Act enables a company to provide for its employees if the company's business is wound up. Under section 309, however, only the company (possibly through its shareholders), not the employees, can challenge the decisions of the directors. The legal situation is identical with regard to section 719. Consequently, and in parallel with U.S. other-constituency statutes, section 309 does not provide employees with substantial protection. *See* Len S. Sealy, *Directors' "Wider" Responsibilities—Problems Conceptual, Practical and Procedural*, 13 MONASH U.L. REV. 164, 177 (1987) (arguing that section 309 "is either one of the most incompetent or one of the most cynical pieces of drafting on record").

[335]The following text draws on Theodor Baums & Kenneth E. Scott, Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany (Working Paper 2003); Mark G. Robilotti, *Codetermination, Stakeholder Rights, and Hostile Takeovers: A Reevaluation of the Evidence from Abroad*, 38 HARV. INT'L L.J. 536 (1997). On German corporate governance, see Thomas J. André, Jr. *Cultural Hegemony: The Exportation of Anglo-Saxon Corporate Governance Ideologies to Germany*, 73 TUL. L. REV. 69 (1998); Hwa-Jin Kim, *Markets, Financial Institutions, and Corporate Governance: Perspectives from Germany*, 26 LAW & POL'Y INT'L BUS. 371 (1995). *See also* FRANKLIN ALLEN & DOUGLAS GALE, COMPARING FINANCIAL SYSTEMS (2000); Mark J. Roe, *Some Differences In Corporate Structure In Germany*,

managers' fiduciary duties to a diverse group of multiple constituencies, including shareholder, employees, and society as a whole.[336] The hallmark of the German system, however, is its codetermination regime, which provides employees with structural protection through representation in corporate institutions. Under German codetermination, firms have a two-tiered board structure. Companies are governed by a managing board (*Vorstand*) that conducts the day-to-day business of the firm and a supervisory council (*Aufsichtsrat*) that elects and monitors the firm's management and approves major corporate decisions. The German Codetermination Act of 1976 mandates that fifty percent of the *Aufsichtsrat* of large firms be elected by shareholders and fifty percent be elected by employees, or by their delegates if the firm is very large.

Employee participation in the supervisory organ is also mandated (with qualifications) in Austria, Denmark, Germany, Luxembourg, the Netherlands, and Sweden.[337] In France, Ireland, Portugal, and other EU Member States, the law includes aspects of employee participation in corporate governance.[338] It should be emphasized that membership in the

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Japan, and the United States, 102 YALE L.J. 1927 (1993) (stating that senior managers share power with active intermediaries within large German and Japanese corporations); *but see* Michael Bradley & Anant K. Sundaram, The Emergence of Shareholder Value in the German Corporation (Working Paper 2003) (arguing that large German corporations have become shareholder-oriented).

[336]Gerard Hertig & Joseph A. McCahery, *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?* (ECGI Working Paper 2003) (citing Heribert Hirte, *Verteidigung gegen Übernahmeangebote und Rechtsschutz des Aktionärs gegen die Verteidigung*, 31 ZEITSCHRIFT FÜR UNTERNEHMENS-UND GESELLSCHAFTSRECHT 623, 643 (2002)). Other commentators are like-minded. *See* Bradley et al., *supra* note 250, at 52 ("[C]orporate law in Germany makes it abundantly clear that shareholders are only one of the many stakeholders on whose behalf the managers must operate the firm."); Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance*, 84 CORNELL L. REV. 1133, 1157 (1999) ("German law takes more seriously the idea that beneficiaries of directors' duties include corporate constituents other than shareholders . . . ."); Timothy L. Fort & Cindy A. Schipani, *Corporate Governance in a Global Environment: The Search for the Best of All Worlds*, 33 VAND. J. TRANSNAT'L L. 829, 846 (2000) ("German corporate law clearly shows that managers must operate the firm for the benefit of multiple stakeholders, not just shareholders."); Klaus J. Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe*, 14 INT'L REV. L. & ECON. 203, 208 (1994) ("Maximization of shareholders' wealth has hardly ever been the objective of German stock corporations.").

[337]Luca Enriques, Silence Is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage (ECGI Law Working Paper No. 07/2003, 2003) (citing Weil, Gotshal & Manges LLP, *Comparative Study Of Corporate Governance Codes Relevant to the European Union and its Member States*, Final Report & Annexes I-III, at 44 (2002)).

[338]*See* Uwe Blaurock, *Steps Toward a Uniform Corporate Law in the European Union*, 31 CORNELL INT'L L.J. 377, 390 (1998); Karel Lannoo, *A European Perspective on Corporate Governance*, 37 J. COMMON MARKET STUD. 269 (1999); Antoine Rebérioux, *European Style Corporate Governance at the Crossroads: The Role of Worker Involvement*, 40 J. COMMON

supervisory board does not give employees formal decision power. Nonetheless, the structural involvement of non-shareholder constituencies in the governance of firms is effective in mitigating informational asymmetries and facilitates informal negotiations among corporate constituencies.

Asian corporate governance systems are perhaps the least comprehensible to the Western observer. For instance, both the Japanese and Korean models of corporate governance rest on a statutory infrastructure that consists of German-inspired civil and commercial codes and American-inspired corporate law. Both countries have nonetheless developed corporate governance systems that differ markedly from the German and American models, from one another,[339] and from other Asian countries.[340] Subject to these reservations, corporate governance in Japanese and Korean corporations tends to rely more extensively on interpersonal relationships. In Korea, these relationships are often based on extended family (clan) kinship. Corporate groups are the predominant form of business organization. Both the Japanese *keiretsu* and the Korean *chaebol* exhibit extensive cross-holdings among corporations that engage in a variety of industrial and financial activities.[341] These Asian systems are

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MARKET STUD. 111 (2002).

[339]For recent discussion of Japan, see, e.g., Hideki Kanda, *Japan*, *in* THE LEGAL BASIS OF CORPORATE GOVERNANCE IN PUBLICLY HELD CORPORATIONS 111 (Arthur R. Pinto & Gustavo Visentini eds., 1998); Hideki Kanda & Curtis J. Milhaupt, Re-examinging Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law (Columbia Law and Economics Working Paper No. 219, 2003); Yoshiro Miwa, *Corporate Social Responsibility: Dangerous and Harmful, Though Maybe Not Irrelevant*, 84 CORNELL L. REV. 1227 (1999); Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions*, 25 DEL. J. CORP. L. 189 (2000). On Korea, see, e.g., Bernard Black, *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness*, 26 J. CORP. L. 537 (2001); Hwa-Jin Kim, *Toward the "Best Practice" Model in a Globalizing Market: Recent Developments in Korean Corporate Governance*, *in* 5 Y.B. L. & LEGAL PRAC. IN E. ASIA 1 (2001); Kon Sik Kim & Joongi Kim, *Revamping Fiduciary Duties in Korea: Does Law Matter in Corporate Governance?*, *in* GLOBAL MARKETS, DOMESTIC INSTITUTIONS CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS (Curtis J. Milhaupt ed., 2003); Jill Solomon et al., *A Conceptual Framework for Corporate Governance Reform in South Korea*, 10 CORP. GOVERNANCE: INT'L REV. 29 (2002).

[340]*See, e.g.*, Douglas M. Branson, *The Very Uncertain Prospect of "Global" Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321, 345-46 (2001) (discussing Indonesia); Benny Simon Tabalujan, *Family Capitalism and Corporate Governance of Family-controlled Listed Companies in Indonesia*, 25 U. NSW L.J. (2002) (same).

[341]For a critical assessment of Japan, see Yoshiro Miwa & J. Mark Ramseyer, *The Fable of the Keiretsu*, 11 J. ECON. & MGMT. STRATEGY 169 (2002); on Korea, *see*, e.g., Daehong T. Jaang et al., Cross Shareholding and Corporate Financial Policy: The Case of Korea (Working Paper 2002).

generally perceived as stakeholder-oriented.[342] Commentators routinely make references to Asian cultures (especially to Confucianism with regard to Korea and Japan) as the bedrock of corporate governance practices.[343]

The preceding sketchy portraits of corporate governance systems in English-speaking, West European, and East Asian countries correspond with the cultural profiles of these regions under Schwartz's cultural-level model. This discussion will focus on the English-speaking versus Western European regions.[344] Although countries in these two groups are usually lumped together as "Western," Schwartz and Ros find that Western European nations and English-speaking nations constitute culturally different regions that cannot simply be characterized as "individualistic."[345] In a global comparison, countries in both regions attribute high importance to the two Autonomy orientations, with West European countries scoring particularly high on Intellectual Autonomy. These regions differ, however, in their locations on the other two dimensions. Western European countries attribute greater importance to Egalitarianism and Harmony, while English-speaking countries (especially American samples) attribute greater importance to Hierarchy and Mastery.

As suggested by the theoretical analysis in Part II, the cultural differences between the United States and Western Europe are consistent with the different positions of these countries in regards to the maximands of corporate governance. Western European countries emphasize the more complex orientations in the two dimensions that concern interrelations in and with the social and natural world. In contrast, the cultural profile of the United States emphasizes less complex orientations that promote power and

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[342]*See* Ronald J. Gilson & Mark J. Roe, *Lifetime Employment: Labor Peace and the Evolution of Japanese Corporate Governance*, 99 COLUM. L. REV. 508, 538 (1999); Shishido, *supra* note 339, at 201 ("[M]any will agree that Japanese corporate practice is employee-oriented rather than pro-shareholder."; Solomon et al., *supra* note 339, at 30-31 (same, with regard to Korea).

[343]*See, e.g.*, Branson, *supra* note 340, at 344-45; Sarra, *supra* note 329, at 1728-29; Meredith Woo-Cumings, Diverse Paths Toward "the Right Institutions:" Law, the State, and Economic Reform in East Asia (ADB Institute Working Paper No. 18, 2001).

[344]In the Schwartz data, Korea's scores reflect societal preferences for Embeddedness over Autonomy, for Hierarchy over Egalitarianism, and for Mastery over Harmony. This profile is consonant with many analyses of Confucian culture. For a cultural value dimension analysis of Korean corporate governance, see Licht, *supra* note 115. Japan presents an exception to the profile of its cultural region. Several samples from Japan reveal strong cultural emphases on orientation that oppose one another. This finding suggests that Japanese culture has evolved in a manner different from most other and/or that is in a period of transition. Sagiv & Schwartz, *supra* note 124, at 424 n.6.

[345]*See* Shalom H. Schwartz & Maria Ros, *Values in the West: A Theoretical and Empirical Challenge to the Individualism-Collectivism Cultural Dimension*, 1 WORLD PSYCHOL. 93, 111 (1995).

control while championing the autonomy of the individual person. One may therefore expect that both regions will develop accountability regimes, but that the Western European accountability will feature multiple constituencies as accountees, while the American accountability will seek to define power hierarchies among constituencies. This is indeed the case.

In addition to promoting shareholder wealth maximization, the combination of Autonomy and Hierarchy also may lead to greater tolerance toward hostile takeovers—a hallmark of American and English corporate governance.[346] Such tolerance reflects acceptance of the pursuit of wealth and power for the benefit of a single constituency or even a few individuals. This may be the case even if ensuing layoffs could be more disruptive in comparison to layoffs in egalitarian societies that maintain better social safety nets. Doubtless, tolerance toward more hostile takeovers also conveys a societal taste for Mastery, an orientation that connotes exploitation. This and other typically American norms[347] share an attitude of legitamacy—ranging from deference to respect to admiration—of individuals who take advantage of their wealth and/or power.

Among the socio-historical variables that might help explain the unique value profiles of Western Europe and the United States, Schwartz and Ros note that "[i]n Western Europe more than in the United States, socialist governments that pursue the politics of the welfare state emerged . . . [whereas in] the United States, perhaps due to impacts of the frontier experience and of large corporations on societal development, welfare socialism did not take root."[348] This conjecture links culture and politics and supports Mark Roe's political theory of comparative corporate governance.[349] According to Roe, the predominance of social democracy in Western Europe explains the rejection of the shareholder wealth

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[346]*See* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1287-90 (1999) (discussing the emergence of a hostile takeover norm in the United States).

[347]Other characteristic norms of American corporate governance include high levels of executive compensation and deference to managerial discretion, as reflected in the (legal) norm of the business judgment rule. *See*, respectively, Edward B. Rock & Michael L. Wachter, *Norms & Corporate Law*, 149 U. PA. L. REV. 1607 (2001); Randall S. Thomas & Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. CIN. L. REV. 1021, 1025-30 (1999).

[348]Schwartz & Ros, *supra* note 345, at 114.

[349]*See* Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000) [hereinafter Roe, *Political Preconditions*]; MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2003). This work extends Roe's groundbreaking work on the political roots of American corporate governance. *See* ROE, *supra* note 332; Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 32-37 (1991).

maximization norm in countries like France, Germany, Italy, and in Scandinavia.[350] The failure of social democracy to take root in the United State enabled the rise of widely dispersed shareholding and the adherence to shareholder wealth maximization.[351]

B. *Seeming Convergence Trends*

Major economic and geo-political processes joined together during the 1990s to broaden the scope of the stockholder-stakeholder debate such that today it spans the entire globe. At the turn of the previous decade, the American economy was still struggling in the wake of the turbulent downsizing period of the 1980s and was, in fact, heading toward a recession. In contrast, the Japanese and German economies were then at the apex of an unprecedented growth period. But then things changed. Japan declined into a deep recession from which it has not recovered to this day. The collapse of the Soviet Bloc from 1989 to the early 1990s created an urgent need for establishing market economies in former Soviet countries. The unification of Germany, which was part of this process, burdened the German economy, while the United States began to grow briskly and re-assumed economic leadership, particularly in hi-tech industries. To complete the picture, a series of financial crises swept Latin America in the mid-1990s, and in the late 1990s another wave of financial crises crippled Asian economies, including several "tiger economies" such as South Korea, that were considered poster children of economic growth.

These events first engendered interest in non-American corporate governance systems with a view toward the adoption of successful features of foreign corporate governance in the United States. Hence, comparative corporate governance was born as an academic field of interest.[352] At first, mostly lawyers were writing on these issues; but, in the mid-1990s economists started to show interest in comparative corporate governance

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[350]Roe, *Political Preconditions*, *supra* note 349, at 543.

[351]*Id.* ("Social democracies do not strongly control public firm agency costs because they do *not* want unbridled shareholder-wealth maximization, and, hence, by weakening shareholder-wealth maximization institutions, they widen the gap between managers and dispersed stockholders. When the gap is wide enough, the large American-style public firm is rendered unstable.").

[352]*See* Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance*, 74 WASH. U. L.Q. 367, 367 (1996) ("In the last few years, comparative corporate governance—German and Japanese corporate governance in particular—has been a hot topic in U.S. law reviews and conferences.") (footnote omitted). The omitted footnote includes an extensive list of law review articles in this spirit, which is nevertheless far from exhaustive.

as well.[353] Corporate governance has drawn tremendous attention in light of a growing consensus that an effective corporate governance system may be a crucial precondition for a thriving market economy. By that time, however, the German and Japanese corporate governance models had lost favor and the Anglo-American model was seen as superior.[354] Germany, along with other European economies, began to embrace the Anglo-American "equity culture" that gives primacy to shareholder value at the expense of other constituencies.[355] Motivated by evidence that corporate governance is necessary for economic performance, international bodies began to endorse corporate governance reform that draws on American features as a standard prescription for transition economies. International aid for distressed economies is conditioned on the implementation of such reforms. Again, Korea is a prominent example.[356]

The shifts of attention, and favor, from American to non-American corporate governance and back again to the American model, were accompanied by parallel shifts with regard to stockholder versus stakeholder interest as the desirable maximands of corporate governance. During the 1990s, corporate governance analysis entered a new phase in which study groups, in the public and private sector alike, began to promulgate codes of principles for optimal corporate governance. The turning point was the 1992 Cadbury Report, commissioned by the Financial

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[353]The pioneering works were produced by La Porta, Lopez-de-Silanes, Shleifer, and Vishny. *See* Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Rafael La Porta et al., *Legal Determinants of External Finance,* 52 J. FIN. 1131 (1997). These studies prompted a flurry of studies that are too numerous to cite here. For a recent review, see Marco Becht et al., Corporate Governance and Control (ECGI Working Paper No. 2/2002, 2002).

[354]Beyond the obvious success of the American economy in the second half of the 1990s, this perception was to a large extent due to the works of La Porta et al., *supra* note 353, which demonstrated strong associations between economic performance and a common law origin of countries' legal systems, and vice versa for civil law origin. *See* also La Porta et al., *supra* note 332; Simon Johnson et al., *Tunneling*, 90 AM. ECON. REV. PAPERS & PROC. 22 (2000). La Porta et al. thus concluded that "[i]n general, differences among legal origins are best described by the proposition that some countries protect all outside investors better than others, and not by the proposition that some countries protect shareholders while other countries protect creditors." Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3, 8 (2000).

[355]*See* André, *supra* note 335; Roger W. Mills & Bill Weinstein, *Beyond Shareholder Value—Reconciling the Shareholder and Stakeholder Perspectives*, 25 J. GEN. MGMT. 79 (2000).

[356]Hwa-Jin Kim, *Toward the "Best Practice" Model in a Globalizing Market: Recent Developments in Korean Corporate Governance*, 2 J. CORP. L. STUD. 345 (2002). On the alleged role of corporate governance in the Korean crisis, see Tomás J.T. Baliño & Angel Ubide, The Korean Financial Crisis of 1997: A Strategy for Financial Sector Reform (IMF Working Paper WP/99/29 1999); Magdi Iskander et al., *Corporate Restructuring and Governance in East Asia*, 36(1) FIN. & DEV. (1999), *available at* http://www.imf.org/external/pubs/ft/fandd/1999/03/iskander.htm.

Reporting Council, the London Stock Exchange, and the accountancy profession.[357] The Report marked a conceptual change with regard to corporate governance reform as it called for "soft regulation"—namely, the use non-binding rules and practices—and underscored the importance of private, market-driven improvements in corporate governance.[358]

The Cadbury Report was followed by similar initiatives in many European countries[359] and in other parts of the world, including Asia and Latin America.[360] A large majority of these documents have been promulgated since 1999. To understand the popularity of these "codes of best principles," one should be aware of two major factors that provided strong incentives for countries and firms to follow this route. The first factor was indeed market-driven. During the 1990s, institutional investors in the U.S. and the U.K. grew in terms of the size of their managed funds and particularly the share of their portfolios earmarked for foreign securities. Some of the largest institutional investors adopted an "active" investment policy, focusing on corporate governance in their portfolio companies, and sought to improve it.[361] These investors also drafted documents on optimal corporate governance that dovetailed the Cadbury Report and its progeny. These two policies combined well to exert pressure on foreign corporations to adopt legal and structural measures that would bring them in line with the recommended "optimum." Investor associations jumped on the bandwagon and contributed their own documents.[362] Building on these developments, a new industry of corporate governance

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[357]REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE (1992) (Cadbury Report), *available at* http://www.ecgi.de/codes/country_documents/uk/cadbury.pdf.

[358]*Id.*

[359]The list includes, by order of promulgation, France, The Netherlands, Spain, Belgium, Greece, Italy, Portugal, Finland, Germany, Denmark, and Austria. The texts of the respective documents are all available at http://www.ecgi.de/codes/all_codes.htm.

[360]The order of promulgation of these initiatives in these regions include: (1) Asia: Japan and Korea and (2) Latin America: Brazil, Mexico, and Peru.

[361]For a review and critical analysis of institutional investor activism, see Bernard Black, *Shareholder Activism and Corporate Governance in the United States*, *in* 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 459 (Peter Newman ed., 1998). On CalPERS's interest in foreign corporate governance as an extension of its interest in corporate governance in general, see, e.g., Claire E. Crutchley et al., *The Shareholder Wealth Effects of CalPERS' Activism*, 7 FIN. SERVICES REV. 1 (1998).

[362]The European Corporate Governance Institute (ECGI) keeps track of corporate governance codes around the world. As of the end of 2004, the ECGI had recorded over 140 such documents, promulgated by 49 countries and four multinational organizations. A comprehensive list of these documents and their text can be found at http://www.ecgi.de/codes/all_codes.htm.

rating services has emerged, which measures compliance with these principles as part of corporate governance consulting.[363]

The second factor to promote the corporate governance code movement is the Principles of Corporate Governance adopted by the OECD Ministers in 1999 and revised in 2004.[364] These non-binding principles are intended to serve as a reference point for countries' efforts to evaluate and improve their own legal, institutional, and regulatory framework. Shortly after their adoption, the OECD and the World Bank signed a Memorandum of Understanding.[365] The signatory parties agreed to adopt the OECD Principles as the point of reference in their corporate governance reform initiatives in both transition economies and developing countries.[366] The parties also established the Global Corporate Governance Forum with a similar mission statement.[367] Moreover, CalPERS and other institutional investors adopted the OECD Principles as guidance for their corporate governance agenda for foreign portfolio companies.[368] These developments obviously have given the OECD Principles clout far exceeding their seeming non-binding character. The Principles now constitute a benchmark for the myriad codes around the world, which in 2004 more than 140.[369]

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[363]The new rating agencies derive lists of features that companies should have in their articles of association, the structure of the board and its committees, and so forth from the codes of best principles (or from similar documents). These ratings may create economic incentives for firms to adopt these features and thus render corporate governance reform genuinely market-driven. For a review and empirical analysis of corporate governance rating based on data from Credit Lyonnais Securities Asia, see Krishna Palepu et al., Globalization and Similarities in Corporate Governance: A Cross-Country Analysis (Harvard University Strategy Unit Working Paper No. 02-041 2002).

[364]*See supra* note 105. The Principles came in the wake of earlier activities. In 1996, the OECD set up a Business Sector Advisory Group on Corporate Governance to review and analyze international corporate governance issues and to suggest priorities for the work of the OECD in this area. The Advisory Group reported in April 1998, and suggested "that the OECD recommended minimum standards of corporate governance to promote fairness, transparency, accountability, and responsibility. Rejecting a 'one-size-fits-all' approach to corporate governance, [it] advocate[d] the need for pluralism and adaptability in corporate governance." *See* Licht, *supra* note 20, at 154 n.8 (citation omitted) (describing adoption of OECD PRINCIPLES).

[365]MEMORANDUM OF UNDERSTANDING BETWEEN THE OECD AND THE WORLD BANK (1999), *available at* http://www.gcgf.org/aboutus/munderstanding.htm.

[366]*Id.*

[367]*See* GLOBAL CORPORATE GOVERNANCE FORUM, CORPORATE GOVERNANCE: AN ISSUE OF INTERNATIONAL CONCERN (2003), *available at* http://www.gcgf.org/about.htm#initiative; THE WORLD BANK, CORPORATE GOVERNANCE: A FRAMEWORK FOR IMPLEMENTATION 22-24 (2001), *available at* http://www.worldbank.org/html/fpd/privatesector/cg/docs/gcgfbooklet.pdf.

[368]Licht, *supra* note 20, at 153-57.

[369]*See supra* note 360.

The upshot of the code of principles movement is that due to either moral suasion or pressure from markets and financial institutions, similar codes of principles are peddled globally today as reflecting optimal corporate governance. These codes cover a variety of issues, but their dominant focus is on boards and board-related issues,[370] with a clear view to improving protection of public shareholders from managers and controlling shareholders alike. This is both understandable and warranted if the concerns of institutional investors are to be addressed such that they would be willing to invest in foreign equities. Still, it is debatable how much of an impact this (apparent) budding consensus might have on the issue of stockholder vs. stakeholder interests.[371]

The OECD Principles consider corporate stakeholders only vaguely and half-heartedly. The Principles state at the outset that "[e]mployees and other stakeholders play an important role in contributing to the long-term success and performance of the corporation, while governments establish the overall institutional and legal framework for corporate governance."[372] When it comes to implementation, however, the Principles adopt a complete deference approach by calling for the recognition rights of stakeholders, but limit the latter only to rights established by law. When law protects such rights, the Principles call for respecting them, albeit weakly, primarily through effective disclosure (transparency).[373] The

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[370]Becht et al., *supra* note 353, at 67.

[371]More generally, one may doubt whether genuine progress toward convergence to a global optimum in shareholder protection could be achieved through the code movement or other standardized legal reforms. For critical discussions, see Katharina Pistor, *The Standardization of Law and Its Effect on Developing Economies*, 50 AM. J. COMP. L. 97 (2002); Janis Sarra, *Convergence Versus Divergence, Global Corporate Governance at the Crossroads: Governance Norms, Capital Markets & OECD Principles for Corporate Governance*, 33 OTTAWA L. REV. 177 (2002). The skeptical tone of these articles stands in contrast with the high spirit that is commonly found in contemporary discussions of corporate social responsibility. *See, e.g.*, Holly J. Gregory & Jane G. Pollack, *Corporate Social Responsibility*, GLOBAL COUNSEL, Mar. 2002, at 41, *available at* www.practiallaw.com/global (surveying codes). The latter discussions often fail to distinguish between declarations in codes and actual corporate or national reality— a mistake that is identical to reading the other constituency statutes in the United States as attesting to a paradigm shift toward favoring stakeholders in this country.

[372]OECD 2004 PRINCIPLES, *supra* note 105, at 12. OECD 1999 PRINCIPLES, *supra* note 105, at 3, used identical language.

[373]Principle IV of the OECD PRINCIPLES, titled "The Role of Stakeholders in Corporate Governance," reads as follows:

> The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
>
> A. The rights of stakeholders that are established by law or through mutual agreements are to be respected.

difficult job of reconciling conflicting interests of various stakeholders is relegated to the board of directors.[374] It should be obvious at this point that in discharging this duty, directors will be affected by their personal values and cognitive styles.

Notwithstanding the OECD Principles, a comparative study of corporate governance codes, relevant to the European Union and commissioned by the European Commission, finds differences in the legal status of stakeholders across Europe, in line with the above review.[375] The traditional differences between British and continental European corporate governance, in regards to non-shareholder constituencies, remain intact notwithstanding calls in the U.K. for assessing risks and opportunities for these constituencies.[376] This study also points to national culture as underlying these differences.[377] Moreover, in the wake of the Enron-WorldCom wave of scandal, the pendulum seems to be shifting back as European fascination with American corporate governance has considerably abated. The European Union recently adopted a policy to promote Corporate Social Responsibility (CSR), defined as "a concept whereby companies integrate social and environmental concerns in their

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B. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

C. Performance-enhancing mechanisms for employee participation should be permitted to develop.

D. Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.

E. Stakeholders, including individual employee and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.

F. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

Id. at 12. The language of the OECD 1999 PRINCIPLES was largely similar.

[374] *See* Nestor Stilpon, INTERNATIONAL EFFORTS TO IMPROVE CORPORATE GOVERNANCE: WHY AND HOW (2001), *available at* http://www.oecd.org/dataoecd/61/1/1932028.pdf ("The Principles make it clear that it is the duty of the board to act fairly with respect to all groups of shareholders and with stakeholders, and to assure compliance with applicable laws.") (Stilpon was Head of Corporate Affairs Division at the OECD).

[375] EUROPEAN COMMISSION, INTERNAL MARKET DIRECTORATE GENERAL, A COMPARATIVE STUDY OF CORPORATE GOVERNANCE CODES RELEVANT TO THE EUROPEAN UNION AND ITS MEMBER STATES 34-37 (2002), *available at* http://europa.eu.int/comm/internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm.

[376] *Id.*

[377] *Id.* at 29.

business operations and in their interaction with stakeholders on a voluntary basis."[378]

A sober analysis of the code of principles movement leads to the conclusion that it has so far had a negligible effect on the stockholder-stakeholder issue. To paraphrase a critique of the English (supposedly) pro-employee legislation the stakeholder-related provisions in the OECD Principles and the codes that follow them may be considered cynical or incompetent.[379] In contrast with the issue of shareholder protection, on which codes adopt strong normative positions intended to improve it, the codes either preserve different national positions, or, in the case of international codes, fully defer to them. Moreover, virtually no progress can be related to the code movement with regard to resolving the implementation problem that has bedeviled proponents of other constituency interests since the time of Berle and Dodd. In light of the cultural orientations to which these issues are linked, this is not entirely surprising.

VI. CONCLUSION

This article has sought to broaden understanding of the *raison d'être* of corporations as reflected in the maximands of corporate governance. The debate over the appropriate maximand has been raging for decades and is still taking place as vigorously as ever. Advances in economic theory have not only failed to resolve this debate, but have established that the problem is graver than what many may have estimated. Notwithstanding this theoretical impasse, corporate managers, and more recently policy makers, around the world face the maximands problem regularly.

This article has put forward a new theory about the factors that determine these maximands. Drawing on recent advances in psychological research, this theory points to value emphases at individual and societal levels and to the need for cognitive closure as such factors. This theory further proposes the notion of complexity of values as an organizing element that may associate certain value emphases with cognitive style. It aims to extend, rather than replace, economic analyses of the maximands issue. Overall, the theory is able to provide explanations for various features of the stockholder-stakeholder debate in the United States and in international settings, to identify gaps in other theoretical accounts, and to

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[378]Several EU bodies are involved in promoting CSR, including the Commission, the Employment and Social Affairs Council, and the Parliament. For a concentration of related documents, see http://europa.eu.int/comm/employment_social/soc-dial/csr/csr_index.htm.

[379]*See* Sealy, *supra* note 334.

generate testable hypotheses for empirical research. Extant evidence supports this theory.