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Grant M. Hayden, Matthew T. Bodie
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RECONSTRUCTING THE CORPORATION

From Shareholder Primacy to Shared Governance

Modern corporations contribute to a wide range of contemporary problems, including income inequality, global warming, and the influence of money in politics. Their relentless pursuit of profits, though, is the natural outcome of the doctrine of shareholder primacy. As the consensus around this doctrine crumbles, it has become increasingly clear that the prerogatives of corporate governance have been improperly limited to shareholders. It is time to examine shareholder primacy and its attendant governance features anew, and reorient the literature around the basic purpose of corporations. This book critically examines the current state of corporate governance law and provides decisive rebuttals to long-standing arguments for the exclusive shareholder franchise. *Reconstructing the Corporation* presents a new model of corporate governance – one that builds on the theory of the firm as well as a novel theory of democratic participation – to support the extension of the corporate franchise to employees.

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To my mom, Julie Hayden, who is probably
embarrassed to be associated with someone who
writes about corporate governance.
G.M.H.

To my parents Joan and Tom Bodie, who taught
me the importance of fairness and a love of
the underdog.
M.T.B.

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PREFACE

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

This claim may seem absurd in light of the current reign of shareholder primacy throughout the United States, the European Union, and developing nations. The academic network behind shareholder primacy remains resolute; almost all corporate law scholarship pivots around the central idea of shareholder control. Shareholder wealth maximization is so firmly ensconced as the governing norm that some scholars have declared the end of corporate law history.¹

But underneath the superficial agreement is a roiling mass of disputes and divisions. The field is more fractured than ever before. The prospect of real shareholder empowerment, through proxy access or shareholder bylaws, has split the academy into subgroups that advocate for divergent approaches. Activist investors have gone from the saviors of shareholder rights to short-term opportunists who should be marginalized. Money is being shoveled like never before into passive index funds and exchange-traded funds – the absentee landlords of stock ownership. Recent corporate law scholarship focuses on the problems of “principal costs” generated by investor governance and even touts the advantages of nonvoting shares.² Corporate and economic luminaries such as the Nobel laureate Oliver Hart, Michael Jensen, and Delaware Chief Justice Leo Strine are questioning the stability of shareholder primacy as a regulatory norm.³ Even the Business Roundtable – an organization of CEOs at major U.S. companies – proclaimed that every group of stakeholders is “essential,” while committing to “deliver value to all of them, for the future success of our companies, our communities and our country.”⁴

This shift away from shareholder primacy follows a set of problematic trends that corporations have created or exacerbated. Climate change continues unabated, with market economies failing to deliver the crisis-level change in energy production and consumption that is necessary to stem disastrous warming. Income inequality has reached staggering levels – the gap between the middle class and the 1 percent, 0.1 percent, and 0.01 percent is reminiscent of the Roaring Twenties or the Gilded Age. Workers’ wages have remained largely stagnant, while executive compensation and corporate profits continue their climb. Rather than going into workers’ pockets, the vast majority of the 2018 corporate tax cuts were plowed into stock buybacks.⁵ And the millennial generation has still not economically recovered from the financial crisis a decade ago – a crisis that left Alan Greenspan in a state of “shocked disbelief” at the banks’ failure to protect shareholder equity.⁶

With the standard economic approaches on the ropes, we’d expect to see alternatives rise to fill the gaps in corporate governance theory. But there is a dearth of such alternatives. Advocates of stakeholder theory have provided the consistent yin to the yang of shareholder primacy (or, perhaps more accurately, have played the Generals to shareholder primacy’s Globetrotters). They reject the idea that the corporation should maximize shareholder wealth and instead argue that it should promote the interests of all corporate participants: shareholders, customers, employees, suppliers, and communities alike. But turning stakeholder theory into governance reality has long proven to be an intractable puzzle. To date, stakeholder theorists have left the shareholder franchise alone and crossed their fingers for more ecumenical firm decision-making, which makes the Business Roundtable’s proposal look a little less radical (and a little more self-serving).

So we find ourselves at a curious point in the history of the corporation. Shareholder primacy is well entrenched in law and in practice, but its intellectual foundations do not stand up to scrutiny. In particular, the main arguments for the exclusive shareholder franchise have been exposed: they are riddled with faulty assumptions about the nature of shareholder preferences and are oftentimes inconsistent with the basic economic principles thought to underlay them. But most corporate law scholars, rather than develop new arguments or at least rehabilitate the old ones, have been content to place those difficulties to one side and attend to the finer details of corporate governance. And, when pressed, the scholars who do address these issues tend to move, somewhat

opportunistically, between one or more of the several justifications for the current corporate voting scheme.

For this reason, one of the principal tasks in this book is to pin down and scrutinize in one place all of the main arguments for the shareholder franchise. That is, we need to start with a thorough assessment of the state of the arguments for the exclusive shareholder franchise. The corporate form, at bottom, is a legal mechanism that allows a variety of groups – shareholders, employees, suppliers, and others – to coordinate their activities in a process of joint production. As we reconstruct corporate governance, we need to, at a minimum, reassess which of these stakeholders should have their preferences captured through voting – the most powerful feature of corporate control – and which through contract.

As part of this undertaking, we will be setting forth a new model of corporate governance that synthesizes our understandings of business organizations derived from the economic theory of the firm and from democratic participation theory. Building on eighty years of research into the nature of the firm, we derive a governance model based on joint production, in which the participants within the firm have a right to participate in the governance of the firm. In assessing the appropriate governance responsibilities, we will look to democratic participation theory to calculate the preferences of the participants in the enterprise through markers that are accurate and manageable. Together, both economic and democratic theories support a model for corporate theory that incorporates employees and shareholders expressly into the inner sanctum of corporate governance, while leaving other stakeholders to manage their interests through contract and regulation.

Reconsideration of shareholder primacy and the exclusive shareholder franchise is long overdue. We hope that this contribution to the corporate law literature will provide a base for others exploring the foundational questions of the field, as we unsettle established doctrines and propose a new way of thinking about these legal engines for our economy.

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Earlier versions of some portions of this book were first worked out in some of the law review articles we've written over the last decade. Those articles include: *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 *Cardozo Law Review* 445 (2008); *Arrow's Theorem and the Exclusive Shareholder Franchise*, 62 *Vanderbilt Law Review* 1217 (2009); *Shareholder Democracy and the Curious Turn Toward Board Primacy*, 51 *William and Mary Law Review* 2071 (2010); *The Uncorporation and the Unraveling of "Nexus of Contract" Theory*, 109 *Michigan Law Review* 1127 (2011); *The Bizarre Law and Economics of Business Roundtable v. SEC*, 38 *Journal of Corporation Law* 101 (2012); *Larry from the Left: An Appreciation*, 8 *Virginia Law & Business Review* 121 (2014); *Shareholder Voting and the Symbolic Politics of Corporation as Contract*, 53 *Wake Forest Law Review* 511 (2018); *The Corporation Reborn: From Shareholder Primacy to Shared Governance*, 61 *Boston College Law Review* (forthcoming 2020); and *Codetermination in Theory and Practice*, 73 *Florida Law Review* (forthcoming 2021). We'd

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