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Fictional Shareholders and Enronitis

by Daniel Greenwood*

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The Enron problem – managers becoming extraordinarily wealthy while misleading shareholders, creditors and employees about the company's prospects and even driving it into the ground – is widely understood to be the result of too weak a legal mandate supporting the share-centered paradigm of corporate law. Paradoxically, and less widely recognized, it is also the predictable result of too strong a share-centered view of the corporation. The single-valued profit maximization ethos of the share-centered corporation demands that managers teach themselves to exploit everyone around them: it is inevitable that some will learn this lesson so well that they will exploit even those for whose benefit they are supposed to be exploiting.

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I. The Problem

According to the share-centered view of the corporation, the corporation has only one legitimate goal: maximization of share value.[1] All other goals and participants in the firm should be considered as mere tools towards this end: in particular, professional managers acting as the share value norm directs them to, should consider all firm participants (other than the shares) as outsiders, with respect to whom one should decide to cooperate, defect or exploit according to a rational analysis of which practice will maximize share value. Even if the decision is to cooperate, however, the relationship is basically exploitative: the only reason a manager acting in good faith as a professional dedicated to share value maximization would give anything to any corporate participant (other than the shares) is because he or she believes that doing so will result in more profits for the firm's shares.

The share-centered view of the corporation, thus, directs managers to take an essentially amoral, instrumental view of the relationships in which they are enmeshed: all relationships are for an ulterior purpose and when they cease to serve that purpose, they should be abandoned. Indeed, the share-centered profit maximization view suggests that a manager who treats corporate participants in any other way is acting wrongfully, violating role morality and perhaps even the law (although the business judgment rule will make enforcement rather difficult.) For example, it is improper – a violation of role morality – to view employees or suppliers as members of a team to whom long term commitments have been made: managers are expected to treat all of the firm's relationships as arms-length bargaining between competitors.

The short trek from the conventional share-centered view of the managerial role to Enronitis is over-determined: several independent aspects link the two. But the central theme that ties together the routes to Enronitis is the paradox of the managerial role in a share-centered corporation. Managers are expected simultaneously to be selfless servants and selfish masters. On the one hand, managers are directed to be faithful agents, setting aside their own interests entirely in order to act only on behalf of their principals, the shares. But on the other hand, in the service of this extreme altruism, they must ruthlessly exploit everyone around them, projecting on to the shares an extreme selfishness that takes no account of any

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[1]For judicial statement of the share-centered view, see Dodge v. Ford Motor Co., 204 Mich. 459 (1919). I do not use the usual term, "maximization of share*holder* value," because it misleadingly suggests that share prices are the only values that human shareholders hold. As discussed below, it is a dangerously essentializing fiction to pretend that a human shareholder is necessarily better off if her shares increase in price, regardless of the impact of the company's share-value maximizing behavior on other aspects of her life.

interests but the shares themselves, narrowly understood. Having maximally exploited their fellow human corporate participants, managers are then expected to selflessly hand over their gains, ill and justly gotten, to the faceless legal abstraction of the fictional shareholder. Altruism and rationally self-interested exploitation are extreme and radically opposed positions, psychologically and politically. The managerial role is deeply unstable and unlikely to hold.

A. Selfish Shares

In acting altruistically in the interests of their principals (the shares), the manager-agents are directed to ignore the actual human beings who own (often indirectly) the shares.[2] In actual fact, many publically held shares are held by pension funds representing the very employees (and their predecessors) whom managers are directed to treat as arms-length opponents in a competitive negotiating game. Indeed, roughly half the shares of publicly-traded corporations are held by institutions that, in turn, represent roughly the top half of the American income distribution.

For most of these indirect shareholders, shareholdings are only a small portion of their wealth (most of which is, rather, their future earning capacity)[3]; thus actions that are in their

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[2]I have discussed this paradoxical implication of the share-centered analysis at greater length in prior and forthcoming work. See generally Daniel J.H. Greenwood, *Delaware and Democracy: The Puzzle of Corporate Law* (in draft); *Book Review: Corporate Irresponsibility by Lawrence Mitchell*, 12 L. & POLITICS BK REV. 201-204 (2002); *Essential Speech: Why Corporate Speech Is Not Free,* 83 IOWA L. REV. 995-1070 (1998); *Fictional Shareholders: 'For Whom is the Corporation Managed,' Revisited*, 69 S. CALIF. L. REV. 1021-1104 (1996). For further discussion of the implications of taking a share-centered view seriously while acknowledging the actual reality of institutional shareholders, see Henry Hu, *New Financial Products and the Puzzle of Shareholder Welfare*, 69 TEXAS L. REV. 1273 (1991); Henry Hu, *Risk, Time and Fiduciary Principles in Corporate Investment*, 38 U.C.L.A. L. REV. 27 (1990).

[3]Most shareholders hold very small amounts of stock directly or indirectly. See, e.g., EDWARD WOLFF, TOP HEAVY 27 (2000) (stating that in 1998, 48% of households owned stocks directly or indirectly, but the bottom 99% of households own only about as much as the top 1%); LAWRENCE MISHEL ET AL., THE STATE OF WORKING AMERICA 2000/2001 (2001) table 4.3 at 260 (indicating that median net worth, including all assets and liabilities, for Americans was about $60,700 in 1998); table 4.4 (indicating that median financial wealth was less than $37,000); table 4.7 (while nearly half of Americans held equities in 1998, directly or indirectly, only 36.3% of households held more than $5000 worth).

Most stock is owned by the very rich, and for those few individuals, equities are a major part of their wealth. WOLFF, TOP HEAVY 27 (stating that in 1998, almost half of all stock by value was held by the richest 1%, those with net worth over $3.35million. This number, however, does not include pension wealth, which is somewhat less skewed); Edward Wolff, *Recent Trends in Wealth Ownership, 1983-1998* (available at http://www.levy.org/docs/wrkpap/papers/300.html), Table 6 (in 1998, top 1% held 49.4% of stocks and mutual funds, or 42.1% if retirement funds are included); Mishel, supra, at table 4.9 (indicating that in 1998 roughly half of all publicly traded stock was held by households in the top 1.6% of incomes; including indirectly held stock and pension plans, 2/3 of equities were held by households in the top 8.5%).

However, even among the very rich, most income is from wages (suggesting, but not by any means demonstrating, that even for many of the extremely rich most wealth is in the form of job prospects). See, Thomas Piketty & Emmanuel Saez, Income Inequality in the US, 1913-1998, NBER Working Paper Series # 8467 (available at http://www.nber.org/papers/w8467) at figure

interests in their shareholder role are likely to often be in conflict with other, more important, interests. If a firm increases share value by $1 per share by shading its environmental standards or reducing employee benefits, a shareholder holding 100 shares would *lose* value if she cares more than $100 worth about the environmental damage or the benefits, or as is often the case, is one of those employees. Thus, maximization of *share* value may or may not maximize value to the human share*holders*, depending on the relative importance of the individual shareholder's shares as opposed to his or her other relationships with the firm.

Even if maximization of share value were in a particular human shareholder's financial interests, real human beings have other interests beyond their finances, and rarely are as disconnected from social relationships as the constructed fiction that drives the share value maximization model. It would be virtually inconceivable that the entire half of America that holds shares would agree on how to balance their desire for profits in the stock market, on the one hand, with their desires for the many political goods that may conflict with profit. Although it may not be immediately obvious in a market centered politics, sooner or later nearly every human value will conflict with profit, and nearly everyone will find some value that is more important than profit at some point. To name a random few: Safety regulations, whether protecting the environment, consumers, employees or innocent bystanders, generally increase private costs to the hazard-creator, thus reducing its profits, even when they reduce social costs. Maximum profit for particular companies will require efforts that will conflict with particular values of individual investors: advertising products increases demand for them, and most human shareholders will have some product made by a publicly traded company – violent movies, cigarettes, junk food, global warming gases, the music their kids listen to, direct mail, really shoddy plastic toys -- that they wish the world had less of. Particular companies may find foreign trade (or limits on it) profit enhancing, while their individual shareholders may find that position in conflict with other values they hold, even as simple as

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6 (indicating that in 1998, 60% of the income of households in the top .1% of taxpayers was from salary). Piketty & Saez's figures likely overstate the influence of salary income since, first, they do not include capital gains in income, and second, they appear to include stock grants as salary. Moreover, Piketty & Saez's work is derived from income tax returns and therefore likely understates inequality (the rich are more likely to have the sorts of income that are harder to define and capture in an income tax regime).

By lumping together the entire top 1% these numbers understate the true extent of inequality in wealth holdings. Wealth is far more unequally distributed than income. See e.g., Mishel *supra* table 4.1 (top 1% receive 16.6% of all income but hold 47.3% of financial assets). Piketty & Saez's work on income indicates that about 42% of income is received by the top 10% (*supra*, Figure 1), but of the income received by the top 10%, about 1/3 goes to the top 1% (Figures 3, 15), about 40% of that is received by the top .1% (Figure 16) and about half of that is received by the top .01% (calculated from Table 1, Figure 4). It is safe to assume that the fractal character of inequality is even more extreme with respect to wealth, so that if half our financial wealth is held by the top 1%, the bulk of that is held by the top .1%, and so on.

whether the trading partners who are enriched (or impoverished) are countries or elites that should be our allies or enemies.

Maximum profit often will require that a company pick up and abandon a particular locale (especially since, under the perverse American labor unionization rules, that is usually the easiest way to escape unionization and because American localism encourages localities to invite companies to jump ship as they compete in lowering effective enterprise taxation), but human investors live in particular places and often would prefer more stability than profit maximization demands.

Perhaps most significantly for American politics as a whole, maximum profit requires employees who are maximally flexible: the famous American flexible labor market. But that means that we must be willing to be at work rather than raising children or caring for parents; that we must be willing to move locations rather than build deeply rooted communities or multi-generational families; that we must be willing to put one or two careers ahead of marital depth. We are willing to do those things (at least by comparison, for example, with the French). But even so, we all have some limit to our flexibility; the share value maximization directive does not.

Managers are required to ignore these human complexities, instead imagining their shareholders to be essentialized, fictionalized, one-dimensional investors with no commitments, values or relationships beyond the desire that their shares increase in value.[4] Thus, managers are directed to de-humanize even the one group they are not explicitly directed to treat as exploitable resources. Thinking of shareholders as if they were no more than shares — thin fictions interested in nothing but increasing the value of a particular stockholding at any cost to other moral, political or even financial values — managers step out of relationship even with their alleged beneficiaries.

B. Agency v. Market

American law, and American culture generally, present two radically different norms for treating others. The market norm is deeply impersonal, individualistic and competitive: each party is expected to act in his or her own best interest, without regard for personal relationships or personal characteristics. A truly competitive market, like our stock market,

[4]Indeed, managers are urged even to ignore the complexities of shareholders' investment role: a diversified shareholder is likely to have a different financial interest, even in the most narrow sense, than the undiversified fiction. A publicly traded company successfully seizing market share from another publicly traded company does nothing whatsoever for the finances of an index investor: what the stock of the one company gains, the stock of the other will lose. See, *Fictional Shareholders*, supra n. (citing Henry Hu).

is even anonymous. All that counts is the product that is offered for sale and the money that is offered to purchase it. Even where anonymity is impossible, we seek to exclude personal relationships and personal characteristics to the extent possible: nepotism is illegal in the public sector and not wonderful in the private one; discrimination is presumptively improper. In this sphere, it is acceptable — even commendable — for persons with superior information to act on it to the detriment of their trading counterparts: if I recognize that the painting in the flea market is a Rembrandt, I'm entitled to the coup of buying it for the price of a remnant. In the world of the market, people are imagined to be isolated monads, interested only in getting ahead, with no interest in others except as instruments to their own good.[5]

In contrast, the agency norm is relationship based, altruistic and cooperative. Agents are expected to set aside their own interests and work for the benefit of their principal. The image is not of an anonymous market but of parents who sacrifice for their child. Far from anonymity, in this sphere, the agent must treat different people differently; relationships are all that count. Nepotism is not scandalous but required: a mother who treated her child and a stranger indifferently would be acting grossly improperly. This is the world of families or of the Three Musketeers: all for one and one for all. No self-interested rational maximizers invited.

Corporate law constructs the corporation as an oasis of agency law in the market. In the market, employees are arms-length contractors each out for their own self-interested good; as contracting opposites, they and their employers are competitors, entitled (within the rules of a fair battle) to fight for themselves as hard as they are capable. But in the firm, they are agents, required to set aside their own interests to work for their principal, the firm itself. As Cardozo put it in Meinhard v. Salmon,[6]

> "copartners owe to one another... the duty of the finest loyalty. [F]orms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone but the punctilio of an honor the most sensitive ... Loyalty and comradeship are not so easily abjured."

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[5]This section summarizes views I expounded at length in Daniel J.H. Greenwood, *Beyond the Counter-Majoritarian Difficulty: Reconstructing the Law/Politics Distinction Through A Typology of Democratic Decision-making,* 53 RUTGERS LAW REVIEW 781-864 (2001).

[6]249 N.Y. 458 (NY 1928).

The agency rules and the market rules obviously conflict, and much of the interesting areas of corporate law concern the problems that result from the dual role of employees as self-interested market capitalists and altruistic, self-less, agents.

But the share value maximization principle disrupts the delicate balance (or churning conflict) of corporate law. It commands managers, in their role as self-less agents, to treat all their fellow agents according to the workaday norms of self-interested arms length conduct in a competitive market place while simultaneously demanding that they, and the managers themselves, act selflessly. This is an impossible task.

In the long run, people learn to cooperate only with those who cooperate back; only fools and marks will continue to selflessly sacrifice for a firm once they realize that it will uninhibitedly take advantage of their self-lessness as if they were arms-length competitors. Managers, treating firm members like arms-length competitors, destroy the plausibility of the agency role. Once they figure out what is going on, employees treated by the firm at arms length are going to treat it in the same way, whatever the law may say about the obligations of agents. Managers themselves, seeing the firm's relationship with their subordinates as one of mutual exploitation, are likely quickly to see their own relationship in the same light. In short, where share value maximization wins, agency will soon lose.

This key route from share value maximization to Enronitis, then, is straightforwardly psychological. The principle is incompatible with the selfless sacrifice for shares that it demands.

Managers constructing the firm as a tool to the end of share value maximization treat the people with whom they work as means, not ends. Because they see themselves as competitors with the people with whom they are working, they learn as part of their ordinary life to break ordinary social solidarity. This learning to exploit ruthlessly is difficult and transformative, as we saw in the first wave of the 1980s LBO boom, when a generation of managers fought bitterly in opposition to the new dispensation of abandoning ordinary social norms and getting extraordinarily rich. Learning to be a rational maximizer is simply incompatible with being a faithful, selfless agent. As a rule, one does not learn to be a saint by daily sinning.[7]

In the end, the cynicism of the share value maximization view must eat itself alive. The principle commands managers to abandon the ordinary ties of human solidarity: to maximize profit, they must be prepared to sacrifice their co-workers, their suppliers, the cities

[7]Cf. Aristotle (habit creates character).

or communities they operate in. Successful managers learn to live in a world in which there is no loyalty and all relationships are purely instrumental, lasting only so long as they remain mutually beneficial. Only the share relationship is said to be different: but there is no good explanation for why. The rootless, commitmentless, valueless, manager is unlikely to suddenly become loyal, rooted and spiritual just because shares are at stake.

The share value maximization principle teaches managers that they are acting properly only if they treat the people around them as mere tools, to be used or discarded as needed to fulfill the firm's share value maximization ends. But if it is permissible, even required, to treat all the human participants in a firm as tools, why are shares different? Why not exploit them as well?

C. Corporate Finance and the Specialness of Shares

The psychological difficulty of maintaining an extreme lack of commitment in every aspect of professional life but one, of treating every corporate participant as a mere tool but one, of competing with every corporate participant but one is compounded by the problem that on modern views of corporate finance — views that are part of every MBA curriculum — shares are not different from other corporate participants in any significant way.

1. Shares as factors of production

In ordinary usage, the share-centered view of the firm is conflated with the claim that the corporation should profit maximize. Accounting conventions derive from and reinforce this view by treating benefits to shares as profit while benefits to all other corporate participants are treated as costs (with the anomalous exception of stock option grants). As the accountants portray the firm, dividends – unlike payment to any other factor of production – do not reduce profits and – in stark contrast to the legal reality – shares have the sole claim on whatever is left over after other firm claimants are paid ("shareholders' equity").

But from the firm's perspective, dividends are an expense and sales of shares are simply a way of raising money, to a large extent fungible with other methods of raising capital (such as retained earnings or borrowing).

This view, which is common in corporate finance circles and is likely a daily part of most CFOs' decision-making process, conflicts at the most fundamental level with the share centered view, because it treats shares as a cost like all others: just as all other inputs to the firm should be given as little as possible, so too shares. Indeed, for a manager who is accustomed to financing the firm in the cheapest way possible, offering gifts to shares may seem like a violation of the profit maximization principle itself.

From the perspective of corporate managers and the bankers who advise them, shares are fundamentally a way of raising capital, largely interchangeable with the other ways of raising capital — borrowing money or retaining earnings (i.e., paying the various factors of production of the firm less than the revenues from sale of their product). As the nexus of contracts image of the firm makes clear, shares are merely one role among many that make up the firm. To be sure, shareholders who purchase their shares in an IPO contribute cash and some risk holding services, accepting returns that are closely tied to the success of the company.[8] But bond buyers also contribute cash to the firm, and the value and returns of junk bonds fluctuate in close connection with the fortunes of the company. Similarly, employees, especially if they are paid in part in options or stock, if they have significant retirement savings in the company's stock, if they are compensated based on company-seniority, or if they have developed company based skills or commitment not easily marketable or transferable elsewhere, also find their fortunes closely tied to the company's. Indeed, whenever labor markets are not perfectly flexible, employees are likely to be the most closely tied to the company of all: unlike either shareholders or bondholders, they cannot diversify.

The largest source of investment capital in modern large firms is retained earnings, not share or bond issuance. If the firm is able to retain earnings by definition it must be paying its various factors of production less than it is able to sell its product for. This suggests, however, that all the factors of production have contributed capital to the firm: not only have shares foregone dividends, but employees have foregone raises, creditors have foregone higher rates, citizen-taxpayers have foregone higher taxes, and customers have foregone lower prices.

There is no moral or economic reason to assume that one of these factors has a stronger claim on the surplus than the others: the product is a joint effort of all the factors of production, any one of which is likely to be a but-for cause of the company's success. Still, common sense suggests that shares usually will have the weakest economic claim to the surplus. Public shareholders, after all, are perfectly fungible providers of a perfectly fungible commodity in a quite competitive market; it is hard to see why an arms-length contractor would ever give them more than the market price. Of all the various contributors to the final corporate product, they are the most easily replaced.

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[8] Of course, the actual shareholders at any given time are likely to have purchased their shares in the secondary market and did not contribute anything at all to the company.

If shares are just factors of production, though, then the share value maximization norm implodes. That norm teaches managers to treat factors of production as tools to be exploited, or at least given no more than necessary in arms length negotiation. Predictably, some managers will apply precisely the same logic to the shares themselves. What is sauce for the goose is sauce for the gander. If investors have agreed to buy shares that have no legal right to a dividend, why should they get one? To give them one would be a free gift, and the maximization principle teaches managers that they should not give gifts.

At this point, the situation gets even worse. If managers have learned to be maximizers, but reject the argument that they must sacrifice themselves for the shares, for whom will they maximize? The cynic's answer must be correct: share value maximization produces cynics, and cynics work only for themselves. All bonds of loyalty and mutual respect broken, nothing is left for managers but to maximize their own individual wealth before the (always imminent) retirement (or firing) date. This is the logic of corruption: steal as much as possible before the next group of reformers (or aspiring corruptionists) push you out to do the same. For the cynic trained in share value maximization, even the only value permitted by that norm, the only loyalty left, will soon seem just a tool. The new rule will be: maximize share value only to the extent that it is useful for personal pocket lining.

Often, of course, increasing share value will be the best way for managers to line their own pockets. It is easier to take a big piece of pie when the pie is big and growing. Similarly, often the most cynical and instrumental of managers will find that it is instrumentally useful to create a quality product or have happy employees. But there is no necessary connection: an illusion of a quality product will often do just as well as an actual one, particularly in the short term, and similarly, illusions of profits will often do just as well for a while.[9] In the long run, of course, illusions tend to be exposed; but top managers rarely have a long run, and chances are excellent they will be gone before the fictions are apparent even to their authors.

2. The ownership metaphor

If shares are not different because they make a contribution to the firm that is different in kind than other factors of production, perhaps they are entitled to be the special objects of managerial concern for another reason. The traditional claim is that the shares "own" the firm

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[9]See, e.g., Kamin v. American Express, 383 N.Y.S.2d 807 (1976), in which corporate managers successfully defended their decision to characterize a transaction in a way which made the company *appear* more profitable although it in fact made the company's expenses rise (by increasing its tax liability). While one might imagine that a court might simply hold that the decision to pay taxes voluntarily is commendable and patriotic, in fact the court rested its decision solely on the astonishing rationale offered by management: deceiving investors was good for them.

and therefore are entitled to have it be run for them. The problem is, the reason shares need the ownership metaphor to justify their claim to the corporate surplus is precisely because, unlike owners, they have no power to take it on their own.

The ownership metaphor, meant to differentiate shares from other corporate roles, is deeply implausible. In a public firm, shareholders do not act like owners and do not have the normal significance in the firm as a sociological entity of owners (and indeed have few of the legal rights of owners of the firm).[10]

An owner of a fee simple absolute in real estate or the holder of title to chattel has the rights (subject to general legal regulation such as zoning or environmental laws) to decide to what use her property shall be put, has the right to refuse to use it in profit- maximizing ways or even to destroy it, may consume it or save it, apply it to good works or the opposite. Shares, so long as the company remains public, have none of these rights with respect to the corporation. Our system of corporate law and securities markets has no mechanism by which a majority of shareholders could direct (or authorize) the directors to change the use of the corporation's property, place another value ahead of share value maximization or even pursue profit in a particular way. They only have the rights to a pro rata share of any distributions the corporate board chooses to make; the right to vote for that board; and the right to approve or reject certain changes in their rights proposed by the board, without, however, the right to initiate such decisions. In practice, board members are nominated by incumbent management and usually elected without opposition. On the rare occasions where opposition appears, the rules are anything but fair: management's candidates have full access to corporate resources while opponents are on their own. Even if they elect a board, shares have no right to have the board act according to the wishes of the majority of the shares or shareholders. Rather, board members have a fiduciary obligation to act in the best interests of the shares as constructed by the courts without regard for the expressed desires of the shareholders, and that duty is enforceable by even a single share.

Only if shares act with one voice, unanimously, so that there is no plaintiff to enforce fiduciary duties and the board may be disregarded, do shares have the rights of owners. Accordingly, the one serious ownership right that public shareholders have is the potential to sell their shares to a single buyer, that is, to take the company private. But since the

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[10]In the seminal study, Berle & Means recognized that the public shareholders are not owners in any normal sense, but then created decades of confusion by referring to them as "owners" nonetheless. See generally, ADOLF A. BERLE AND GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (rev. ed. 1968).

development of the poison pill and its statutory equivalents, shares no longer have the right even to sell the company unilaterally: prior board approval is required for sale of all the shares just as it always was for sale of the company. Far from being owners, in the usual course shares are just another input into the firm, as we saw above, largely fungible with other financing sources. It is thus hard to see why they should get something that others do not.

Owners in a capitalist society justify their rights by their function: as holders of the right to decide how property should be used, they are potentially entrepreneurial decision-makers. If there is anything that the shareholders of a public firm are not, it is that. Indeed, the closest equivalent to the entrepreneur in the public firm is the top managers themselves, who are the ones to decide what risks to take. It is a short ideological step, and an almost inevitable psychological one, for managers who act like owners to begin to view themselves as the owners in fact.

3. The diversification problem

Shareholders in a modern publicly held firm are diversified portfolios, the interests of which are often contrary to the interests of individual firms in a competitive market. (Diversified portfolios do not benefit when a portfolio company out-competes another portfolio company, particularly if the competition results, as it is supposed to, in collateral benefit to non-publicly traded consumers.)

Moreover, while shareholders do not own the corporation in any meaningful sense, they do have most of the usual panoply of ownership rights with respect to their shares. Shareholders, that is, actually own shares. It is shares that they buy and sell – often with considerations other than the interests of the company represented by the shares they are trading. Every shareholder who buys or sells based on a view that the market has temporarily misvalued a firm's securities is acting in a way that is not congruent with the interests of the company itself.

Shareholders do not consistently act as if they have the interests of the company at heart. Purely fungible providers of a purely fungible commodity, inputs like every other corporate participant, lacking the usual attributes of entrepreneurship or ownership including legal rights to use and control the assets, dehumanized and deracinated by the market and the legal demands of best interest analysis, the shares don't look like the company. No wonder it is difficult for company managers to maintain the fiction that the shares are the company.

D. The Highly Paid Executive Problem

Under the share value maximization principle, managers are directed to view themselves as selfless agents acting only on behalf of the shares. In their mission to maximize

share value, they should treat all employees, including themselves, as mere means to that overriding end: they – like all corporate participants – are valued not for themselves or as ends or values in themselves but merely as tools to increase share value. Perversely, the view of managers as obligated to exploit themselves can lead to an enormous over-valuation of managers.

Since managers are directed to treat themselves as tools, it means that the only justifiable reason to pay themselves is that they are worth more than they are paid: their contribution to the firm is larger than their paychecks. But that basic pay principle works both directions. Employees should be paid less than they contribute. It follows, then, that either managers are not doing their jobs, or they are paid less than they contribute to the firm; which is to say, either they should be fired, or they deserve a raise.

As is well known, top manager pay packages have soared in the last several decades, reaching astronomical levels previously enjoyed only by entrepreneurial owner/founders and their descendants.[11] On the logic of the share value maximization model, this high pay suggests that CEOs are more important and more deserving of high pay than ever before. For when CEOs are seen as outsiders – factors of production and arm-length market participants to be negotiated with according to the norms of the marketplace – there are only two possibilities. Either the CEO is contributing more to the firm than he is taking from it, in which case the firm is exploiting him and he is fulfilling his fiduciary obligation (in his role as an agent of the firm) but clearly is entitled to demand a raise (in his personal capacity as a free-market free agent). Or, he is not pulling his weight, he is exploiting the firm, and he is not merely presumptively incompetent and overpaid, but also dishonest – in breach of his duty as an agent and a professional. In short, he should be fired summarily. The logical conclusion is simple: if the CEO does not deserve to be fired, he deserves to be paid more. Presumably, ordinary processes of cognitive dissonance will prevent most CEOs from concluding that they deserve to be fired; instead, they will conclude that they deserve an ever increasing share of the corporate pie.

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[11]See, e.g., Thomas Piketty & Emmanuel Saez, Income Inequality in the US, 1913-1988, NBER Working Paper Series #8467 (available at http://www.nber.org/papers/w8467), Figure 18 (showing that between 1970 and 1999, a period in which average US salaries were virtually unchanged in real terms, the annual pay of the average CEO of the top 100 US corporations increased from roughly $1.25 million to almost $40 million); id., Figure 21 (showing that the income share of the top .1% of American taxpaying households is now almost as high as it was in the Roaring Twenties); id., Figure 6-7 (showing that while in 1913 the top .1% received most of their income from capital, in 1998, they received 60% from wages: CEOs have overtaken the heirs of the robber barons as our economic elite).

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The model here is similar to but more dramatic than the well-understood way in which the reform of having CEO salaries set by independent committees employing independent consultants led to rapid increases in CEO salaries. Any board that hires a mediocrity to run its company is surely derelict in its duty. By the logic of cognitive dissonance, it follows that boards must believe that the CEO they employ is not mediocre: otherwise they would be obliged to fire him (rarely her). But if he is not mediocre, it would be insulting to pay him a mediocre salary. Similarly, in times of transition, offering a mediocre salary to the newcomer suggests that the board is seeking mediocrity, which would be a dereliction of duty. Accordingly, board members who wish to believe that they are acting in good faith appear to have only three choices: pay the CEO an above average salary, fire the CEO, or resign. When all boards seek to be above average, inflation is a highly predictable result.

Thus, the share value maximization model invites CEOs, acting in good faith on behalf of the firm, to see themselves as underpaid. Simultaneously, it invites directors to see themselves as required to pay above average salaries to top managers. At the same time again, it tells CEOs, in their personal capacities, that their personal interests are, and should be, opposed to the firm's. They, after all, are mere factors of production that the firm should exploit. But that also means that as contracting parties, even if not as agents, they are entitled to exploit the firm if they can get away with it. In most firms, I imagine, the former processes are enough to make CEOs rich beyond imagination. In a few, apparently including WorldCom and Enron, the latter encourages outright theft.

E. Team Spirit

The share value maximization ethos treats all the people with whom managers have day-to-day relations as competitive opponents. On this view — given its clearest academic representation in the metaphor of the firm as a moment in the market — the firm is imagined to be composed of self-interested market participants whose only interest in other human beings is to use them to maximize their own wealth. There are no office romances, or even friendships, in this world.

Contrary to this individualist ideology of mutual exploitation, firms in fact have many team-like and communitarian aspects, and, indeed, successful firms generally are quite unlike moments in the market (if the key to success were to be market-like, firms would be out-

competed by real markets, which are always more market-like than the most market-like firm).[12]

Most Americans spend a good part of their waking day at work; workplaces, therefore, are likely to be major sources of our social lives, relationship building and communities. Not all capitalist labor is alienated, Marx, the share value maximization principle and the human resources department notwithstanding.[13] Many of us make friends at work, see our fellow workers as team members engaged in a common enterprise, and identify with the common project as our own project.

All this is natural, normal and usually for the best: human beings are social animals who seem to seek out opportunities for community building.

Most often, team spirit and community are also helpful to the success of the firm. When people believe they are part of a team, they work harder, demand less in return and enjoy themselves more. Members of a team pull together for the common goal, setting aside individual egos and needs (at least outside of NBA basketball) in order to focus their cooperation in competing with the other side. Soldiers, perhaps the quintessential team members, risk their own lives to protect fellow team members (most personally, their squad members; more abstractly, their fellow countrymen). In risking their lives, they show the highest form of altruism within the team — no profit maximizer would ever be willing to give up life itself for someone else's benefit.

1. Team competitiveness

At the same time, the internal altruism of the team is usually accompanied by intense competition with non-team members, generally seen as opponents in a zero-sum game. Soldiers and football players alike use their intra-group cooperation and altruism in order to attack the enemy, often dehumanized or devalued into gooks, wogs or simply those jerks on the other side of the stadium. Nationalists combine love of the nation with hatred, or at least

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[12]See, OSCAR WILLIAMSON, ECONOMIC INSTITUTIONS OF CAPITALISM 132, 137-40 (describing failure of high-powered incentives inside firms).

[13]Marx makes a distinction between the market and the workplace that, like the arms-length vs. agency distinction I make, emphasizes the differences between the two spheres. However, in his usual heavy handed irony, he describes the market sphere as "a very Eden of the innate rights of man. There alone rule Freedom, Equality, Property and Bentham" in order to emphasize that the rights of the market disappear in the working relationship, which he describes as unmitigated oppression, closely echoing Adam Smith's discussion of pin making. KARL MARX, CAPITAL (Modern Library edition) at 195-6; ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS. Ultimately, both Marx's characterizations are unilluminating with respect to the modern workplace and labor market. For my purposes, the workplace has aspects of attractive human community not seen in Marx or Smith, and the most important aspect of the market is not the "innate rights of man" but that, for good and ill, it is impersonal.

intolerance, of non-nationals; patriots are willing to sacrifice for the good of the country, but understand that good to be in competition with the good of the neighbors. *We* should all pull together, to pull ahead of *them*.

In the corporate world, team competitiveness is reflected in the war-like metaphors of the takeover world – hostile takeovers, barbarians at the gate, white knights, scorched earth and poison pill defense – as well as the zero-sum games of market share competition and the fundamental market rule of 'exploit thy business partner' or take advantages when the opportunity offers.

2. Team pathology

Team spirit is a good so powerful that team players with strong communities seem to live longer and healthier lives.[14] Yet it can easily become pathological: good citizenship easily moves from patriotism to nationalism to xenophobia or worse. Intra-group solidarity and mutual aid can often be accompanied by extreme disregard of larger norms or the claims and humanity of non-group members. In the corporate context, team pathology is common enough, manifesting itself in cheating and law violation. Corporate team members can become so concerned about winning for the team that they disregard external norms requiring solidarity with larger groups of people: driven to win, corporate players begin to feel corporate solidarity justifies cheating customers, evading national taxes, regulatory schemes, or environmental laws. Playing dirty, in short.

Much of Enronitis seems to relate to this pathology of competitive team spirit: outsiders don't count; rules are made to be broken; winning is all that matters. One may disregard the interests of Californians, because the mission is to promote the interests of Enron.

3. In praise of teams

Human communities, the teams I've referred to above, often couple extreme altruism and mutual concern within the group with a striking lack of concern or hostility to those outside the group. The two processes, altruism on the one hand and competitive hostility or arms-length indifference on the other, seem tightly linked in our psychology. Many people have fond memories of war (or a peace movement) as a time when ordinary people came

[14] E.g., RICHARD WILKINSON, MIND THE GAP: HIERARCHIES, HEALTH AND HUMAN EVOLUTION (2001) 11-13 (reporting that social cohesion increases public health; increased inequality worsens health of lower status individuals, while more equal societies have better health largely because equality correlates with cohesion).

together in a common enterprise for the common good, escaping the alienating individuality of ordinary times — even though the common enterprise was hostility to some other group.[15]

In the corporate context, forming the team is one of the key advantages of firms over markets. Markets price better, can incorporate more information than any plan, and have obvious and precise motivators. Firms generally blur and dull those mechanisms and incentives — for example by delinking pay from direct measures of productivity, quality or demand for the individual's products.[16] Team spirit, with its solidarity and internal altruism combined with aggressive competition with outsiders, can be the tool that overcomes the inherent limitations of command and control market displacement, allowing firms to out-compete spot markets.

4. The instability of teams in the share value maximization world

The importance of intra-group team spirit in corporate enterprise is no news: it is a commonplace of managerial training. But the share value maximization principle puts a strange twist on team spirit: it teaches managers that the humans who work for the corporation are not its team but rather the opponents.

Managers who accept the commonplace that team spirit works and also accept that their job is to maximize share value, are bound to live a double life. In order to maximize share value, they must convince their fellow employees that they are all in the game together, part of a common enterprise, sacrificing for a common goal. But the game and the goal is to extract the most value out of the supposed team members and give it away to someone else, a fictional bystander not even present at the game. At the same time that managers are building team spirit, they are required to be looking around for opportunities to shaft their fellow team members.

Indeed, a key advantage of team spirit for rational managers is that team players are not rational maximizers: they give towards the common goal without expecting precise compensation for every act. They are motivated not by self-interest but by community feeling — positive towards fellow community members and negative towards outsiders. But this very altruism opens them to exploitation by a supposed team member who is really an opponent. When someone is giving their all, they are particularly open to being taken all the way.

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[15]Wilkinson reports that civilian health went up in Britain during both World Wars, despite the economic shortages. Id at 12.

[16]See generally, WILLIAMSON, supra; LAURENCE J. PETER & RAYMOND HULL, THE PETER PRINCIPLE (1969); HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE (1996)(each describing apects of problematic internal incentive structures of firms).

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Managers, then, are caught in a double game. The share value maximization principle tells them that their real team is the shares: they are meant to compete with everyone else in order to win one for the shares. To serve their true masters, they must convince their fellow employees, customers and suppliers that they are all on the same team -- that is, that they are engaged in a common enterprise for a common goal. Or, in other words, that they, as managers, are not serving their true masters. Then, they must betray them. Surely only the most extreme of cynics can succeed in this role.

But a manager who has learned to betray those he or she works with every day, pretending to be their teammate while constantly seeking opportunities to exploit their communal good feeling, is a manager who has learned to be dishonest, a dissembler, a traitor to his small community, a breaker of trust. Why, having betrayed his trust to the team that he works with every day, should he remain loyal to a fictional shareholder that doesn't even exist except as a legal abstraction or an investment portfolio?

The share value maximization scheme teaches managers to betray the people with whom they have relationships in order to serve their ultimate master. It should be no surprise that some learn this lesson well enough to betray the master as well. Double agents, in the end, work only for themselves.

In short, share value maximization teaches that the real team is the shares and their servants the managers; but enterprise success depends on creating a team composed of employees and often customers and suppliers as well. The two team notions are incompatible. While the latter requires mutual concern and trust, the former constructs members of the firm as opponents, to be treated somewhere between arms-length according to the norms of the market, in which mutual concern is absent, and active competitive hostility, in a zero sum game in which every gain for one side is a loss for the other. The one requires trust; the other bars it.

Enronitis is a predictable pathological result. The team breaks down into a one-on-one competition of every man to himself and the devil take the hindmost. All that remains of the team spirit is the disregard of rules, the desire to win at all costs, and the depersonalization of opponents, now understood as everyone.

II. Proposed Reforms

Many of the proposed post-Enron reforms are steps in the right direction, although taken as a whole they seem unlikely to solve the problem. A few, however, may well accentuate the pathology, much as the independent compensation committee and tax-law

insistence that salaries over $1 million be performance-based worsened the problem of overpaid executives.

A. Disclosure

First, improved disclosure most likely is a good thing. The prices of publicly traded stocks are related to the profits of the underlying corporation, but as anyone who followed the market on its way up and down in the last few years is aware, the connection can be very loose. Stock markets often price shares based on expected earnings (or on expected price gains resulting from expectations of expected earnings), placing greater weight on trends and patterns than on the current absolute numbers and increasing or decreasing stock prices disproportionately for changes in trends. This provides cynical managers a great incentive to massage the numbers or even lie: a few well timed disclosures can cause a terrific price increase (or avoid a decrease) allowing top managers, who are nearly always near the end of their employment, to cash out before the truth emerges.

Moreover, even managers who have not succumbed to ultimate cynicism may convince themselves that they are doing their jobs by managing reported earnings. The share value maximization ideology perversely suggests that corporations ought to manage their disclosures in the way that maximizes market valuation of their securities, rather than in the way that most accurately reflects their underlying condition: if the goal is to increase the value of shares, and any means will do, why not deceive shareholders for their own good? (Of course, deception cannot be to the good of actual shareholders as a group, but it can effectively increase share price for some period of time, and the latter may be the more salient effect even to managers still trying to act as good faith agents.)

Much market behavior seems to be the result of this perverse incentive: because the market is quite sensitive to changes in disclosure, companies find that they can affect stock price as much by manipulating disclosure as by the more difficult task of out-competing their competition. If reported earnings can be increased, or reported debt decreased, by changes in financing or reporting or strategic acquisitions, the share value maximization ideology suggests that managers ought to do so, even if there is no real economic justification for the action.

The basic problem is managing the company according to the whims and prejudices of the stock market; reforming accounting rules or forcing CEOs to swear that they have not lied will not change that. But accounting anomalies make a bad problem worse. If companies can create reported earnings by "round trip" trades, they will waste social resources and distort their reported earnings by making round trip trades. If executive stock options have

no effect on the company's reported financials, they will be used more. If accounting for merger rules allow the combined company to have higher reported earnings than did the parts of which it was made, companies will combine even when no efficiencies result.

The reforms, of course, will create new and sometimes odd market incentives. If stock options are reported as an expense at the time of issuance based on their Black-Scholes value, and then companies correct the accounting when they are actually cashed in, the effect may be to smooth earnings oddly: when stock prices are down, options will expire unused, and the company will be able to report "earnings" resulting from reversing the too- high estimate of the cost of the options. Marking to market quarterly would lessen the jumps in earnings but not change the effect of generating "earnings" just because the stock price drops.

But overall, surely, honesty is better than deception. The fierce resistence to disclosing options suggests that executives, at least, believe that the market responds to the reported bottom line numbers rather than the underlying reality or even the total information publicly available (which these disclosure reforms will not change), and it seems most likely that they are right.

Moreover, the end-stages of Enronitis involve deliberate deception and outright fabrication. Reforms that seek to increase the independence of auditors, demand stronger audit committees, require rotation of audit partners, separate auditors from consultants, and the like, seem quite likely to catch more fraud and perhaps even limit some of the semi-bad faith gameplaying. Increasing nominal criminal penalties seems less likely to have any effect. These reforms do not, however, change the underlying incentives to cheat, so we should expect that as we close up some obvious routes, clever cynics will find others.

B. Independent Directors

There has been a good deal of discussion of continuing and accentuating the reforms of the last decade, primarily by increasing the number of independent directors; marginally tightening the definition of independence to exclude some former employees, contractual beneficiaries of the company or relatives who might be considered independent today; and by increasing the number of consultants used by audit, hiring and compensation committees.

The model outlined in this paper suggests that these reforms are unlikely to work as expected. If independent directors and their consultants view themselves as working for the shares or fictional shareholders, they will simply increase the perversities of the share value maximization model. By demanding that managers conform to the model, they will accentuate its incoherence: managers will be driven to exploit their corporate team members even more, thus leading former team members to see themselves instead as free agents; top managers

attempting selfless selfishness will sink into self-interested cynicism; corporations attempting to maximize share value will still find that often the easiest way to do that is to show Wall Street what it wants to see, regardless of whether it is what otherwise would make business sense. Top managers will, after a brief slowdown during the current scandals, continue to increase their share of the take, as the ineluctable logic of Lake Wobegon drives consultants and independent directors to conclude that they must pay above-average employees above-average salaries, and the agency principle requires that they convince themselves that their overpaid executives are contributing ever more to the firm as they take more from it.

The reality is that most independent directors are not particularly independent, and that seems unlikely to change: consultants and incumbent managers alike are likely to look for, basically, other CEOs, who in turn are unlikely to criticize their peers too stringently. In any event, even if they had the inclination, directors rarely have the time or information necessary for serious review of company managers (and this problem is likely to be even worse for directors who are not themselves senior managers elsewhere). Thus, directors, nominally independent or not, are not likely to stand in the way of any but the most egregious managerial abuses. But the point of this essay is that truly independent directors, if they are or view themselves as answerable to the portfolios or fictional shares, will just make the problems worse. Enronitis ends in betrayal of the shares, but it begins in share-centeredness itself. Increasing share-centeredness will not cure this disease.

III. Alternatives

A more effective reform program must begin by recognizing the perversity of the share value maximization model and offering an alternative ideology of corporate governance. But it cannot end there: the selfish shareholder may be a legally constructed fiction, but the law and our stock market have given it enormous market power to enforce its fictionalized, constructed will. Directors and managers have only limited ability to unilaterally reject the demands of the share value centered model before the market, as currently regulated, will oust them. Moreover, the easiest reforms — shifting power from the market to managers or boards they effectively dominate — are more likely to empower the truly cynical among managers, the solo players who have lost all social constraints, than they are to create a more desirable corporate ethos. If we free managers from shares, the most likely immediate result is that they will steal more freely.

A. An Alternative Ideology of Corporate Governance

For a start, we need an alternative metaphor to the corporation as its shares, and a different explanation of the purpose and reality of public corporations, one that does not invite

a destructive war of all against all. Hobbes proposed to end his war of all against all by characterizing the state as a corporation.[17] I propose to reverse the process, and recharacterize the corporation as a polis, a community of all its human affiliates, not the shares.

The advantages of the metaphor of the corporation as a quasi-municipality or quasi-state go well beyond the probability that it would induce law faculties to seek political theorists or moral philosophers rather than law&economists to staff their corporate law curriculum.

Principally, the polis metaphor emphasizes the common enterprise of the various corporate participants. Corporate managers instead of conceiving of themselves as selfless, unsituated rational maximizers could rather see themselves as statesmen, promoting the common good of all corporate participants, and, in our multiple-sovereigned system, as participants in the American governance system required to promote the good of all citizens.

On this model, it is clear that the corporate team extends well beyond the shares. It would, therefore, offer a rationale for acting for the good of corporate participants as ends in themselves, rather than simply because treating them in an apparently good way is the best way to extract more out of them.

Statesmanship is difficult and many aspirants to the title have been cynical charlatans or self-interested deluders (even self-deluders). No doubt many managers will be able to explain to their own satisfaction why the common good requires precisely their private good. But unlike the reigning share centered ideology, working for the good of all corporate participants does not require managers to take inconsistent positions, play cynical double games, or deliberately lull people into trusting them when they know they will be required to take advantage of whatever trust they achieve.

Second, the corporation as polis emphasizes the open-endedness of the struggle over corporate surplus. Share-centered models define profit as what is left over after all corporate factors other than shares have been paid, and insists that all those corporate factors be paid as little as possible. The corporation as polis matches economic reality more closely: corporations can out-compete markets only when the combined contributions of all the corporate factors of production (including labor as well as investment capital, whether in the form of debt, equity or retained earnings) produce more in cooperation than they would in

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[17] THOMAS HOBBES, LEVIATHAN (MacPherson, ed.) 226-7 (describing commonwealth as "artificial ... covenant"); THOMAS HOBBES, ELEMENTS OF THE LAW, bk 2, ch 8, para 7 (analogizing body politic to corporation). Cf. EDMUND BURKE, REFLECTIONS ON THE REVOLUTION IN FRANCE ("Nations themselves are such corporations").

market competition. That excess is the corporate surplus, and it is available to be given to any factor of production, none of which has an a priori exclusive claim to it.

On this understanding of corporate surplus, the surplus is called profit if it is retained by the corporation or paid out to shares. If it is paid out to bondholders, it is called attractive interest rates; if it is paid out to employees, it is called decent working conditions, good benefits, competitive wages/salary or hard earned executive stock options; if it is paid out to consumers, it is called every day low pricing; to the government, taxes; to suppliers, high prices; to stockholders of other companies, investment bankers and lawyers, acquisition costs; to architects and builders, a landmark headquarters. Like the apocryphal Aleut languages with 35 words for snow, we have many words for corporate surplus. For political and economic purposes, however, the distinctions are not as important as the commonality: this is money that is available for someone to take and no one "owns" it until the struggle to allocate it has concluded.

Third, the political metaphor emphasizes the political nature of the decisions that must be made. Corporations are not only about increasing share value. They are also about creating jobs for employees and suppliers, and those jobs consist not only of paychecks but also of quality of life and quality of work issues: relationships, individual empowerment, self-improvement and education, health and safety, hours that allow for families, movement and stability in our various communities, support in sickness and old age and for dependents. Corporations also exist to beautify our cities, to provide products for consumers, to support charities, to enhance and not merely destroy our environment.

The share-centered view tells managers that these concerns are illegitimate except when they are illusions. Thus, on the share-centered view, corporate charity is improper unless it is really advertising designed to increase share returns rather than to accomplish a charitable purpose.[18] Working conditions, wages and retirement benefits are just costs to the corporation, justifiable only if they induce workers to work harder or stick around longer and that in turn increases returns to shares.

In contrast, on the polis view, the inhuman and uncivil claims of selfish shares can easily be rejected. Improving working conditions is a good thing because it is a good thing, not because it is a subterfuge to extract more out of employees. Managers who cause their corporations to contribute to social needs are fulfilling their roles as trustees for major

[18] See, e.g., A. P. Smith Mfg.Co. v.Barlow, 98 A.2d581 (N.J. 1953) (upholding charitable contribution on ground that it is really self-interested).

accumulations of social wealth, not stealing from shares. To be sure, firms can do none of these things unless they generate enough income to cover the expenses, but there is a difference between a constraint and a goal.[19] The share-centered vision has the world backwards: far from all of us existing to make shares worth more, the only reason a decent capitalist society allows some shareholders to become indecently rich is because the market is a critical part of improving working conditions and fulfilling social needs. Those are not the means, they are the ends; it is not us who are the tools but the shares.

B. Changes in the Law

Finally, the view of corporation as polis places front and center the democratic deficit of our current corporate governance system. Externally, corporate governance law largely comes from Delaware, not even formally approved by the citizens whom it governs. Internally, corporations are governed by managers who are answerable to boards elected, formally at least, by shares on a basis of dollar proportionality. This is, in political terms, a "herrendemocracy" in which the "herren" — the elite group that adopts democratic norms among its own members while exploiting non-voting inhabitants — are not even people but dollars.[20]

Managers who are expected to manage on behalf of the entire corporation and possibly the public at large, not just its shares, ought to be answerable to the entire corporation and the public at large, not just its shares.

Bringing the public at large into the corporate governance system may be the easier part. First, it requires ending the bizarre choice of law regime under which managers (with share approval) get to choose the corporate law that will govern them. Instead, we should have a genuinely federalist system, in which different states govern corporations under their

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[19]Sometimes, indeed, working to make the world better can also redound to private profit. Bruce D. Butterfield, *Test by Fire: The Story of Malden Mills*, 9/8/96 BOSTON GLOBE 1996 WL 6876498 (recounting that after 1995 fire, Malden Mills decided to retain all employees during rebuilding). Although Malden Mills stated that its decision was not based on profit-maximization calculations, it appears to have redounded to the benefit of company, as sales of its Polartec soared and the unionized plant is strike-free. One shouldn't over emphasize this point: Malden Mills has since filed for bankruptcy. See, SMARTMONEY 2002 WL 2191691(interview with CEO and owner Aaron Feuerstein in which he denies that bankruptcy was related to fire and aftermath). Curiously, even though Malden Mills is closely held , at least one business ethicist claimed that Feuerstein's decision to retain his employees was unethical because it violated the profit maximization principle (and without offering any evidence that in fact the costs to the firm did exceed the benefits). 8/25/02 WASH. POST B07 , 2002 WL 25998598 .

[20]I've discussed the varieties of democratic governance at greater length in Daniel J.H. Greenwood, *Beyond the Counter-Majoritarian Difficulty: Reconstructing the Law/Politics Distinction Through A Typology of Democratic Decision-making,* 53 RUTGERS L. REV. 781-864 (2001); *Akhnai*, 1997 UTAH L. REV. 309-358 (1997 Symposium Issue -- New Approaches to Comparative Law) and *Beyond Dworkin's Dominions: Investments, Memberships, The Tree of Life and the Abortion Question*, 72 TEXAS L. REV. 559-630 (1994)

jurisdiction in substantially different ways — and no state purports to govern corporations that exist primarily outside its borders. Corporations should be governed by the law of the states in which they operate; if the laws appear to cause conflicting regulation, trans-jurisdictional (i.e., national or multi-national) corporations should create legally separate subsidiaries to hold assets in different states — as European corporations long did.

Second, corporate boards should include board members whose portfolio is specifically to represent the public and to promote the interest of the public at large — understood as citizens rather than shareholders, consumers or employees — and who are selected, directly or indirectly, by the public or its representatives.

Third, the fiduciary duty of board members should be clarified to be a duty to the corporation as a whole, understood to include all the people whom it affects, and not (as in the more extreme versions of the share-centered ideology) as a mere duty to shares or fictional shareholders.

In order for this broader duty to function as something more than a defense to shareholders' derivative actions, it must be enforceable by someone other than representatives of the shares — perhaps a public official, if staffing can be found, or perhaps private attorneys general. The courts, no doubt, will continue to emphasize good faith, procedural safeguards and lack of direct personal conflicts of interest, permitting boards great discretion under the business judgment rule. Given the current leniency of judicial review of board action, I do not think that the more amorphous duties of a trustee for the corporation as polis would generate a radically different judicial approach. However, it seems likely to put a significantly different cast on the deliberations of directors attempting to act in good faith, without much affecting those who are not.

Finally, corporate intervention into the general political debate ought to be restricted. As I have argued elsewhere, corporations, particularly when they are governed in accordance with the share value maximization model, are not legitimate participants in democratic debate.[21] At a minimum, direct corporate intervention into campaigns should be restricted well beyond historical norms or the limits of current Supreme Court doctrine.[22] More broadly, we need to find effective ways of limiting corporate lobbying or placing it under the control of all

[21] See generally, Daniel J.H. Greenwood, *Essential Speech: Why Corporate Speech Is Not Free*, 83 IOWA L. REV. 995, 1057-64 (1998).

[22] See, Adam Winkler, *The Corporation in Election Law*, 32 LOYOLA L.A. L. REV. 1243 (1999)(describing election law's treatment of corporations).

the people concerned, not merely managers and their purported beneficiaries the fictional shareholders.

Indeed, the image of corporations as polis emphasizes that in general corporations ought to be seen as on the state side of the great liberal divide between state and society: we need to be protected from them far more than they need protection from our collective will. Current constitutional law, which for over a century has granted corporations the rights of citizens, is precisely backwards: citizens ought to have rights against these government-like entities, and should be as unrestrained in using other governmental entities to regulate them as they are in using state law to regulate municipal corporations or federal law to regulate administrative agencies.[23]

Representing more defined corporate constituencies inside the firm is a more difficult problem and I have only preliminary thoughts on it. The model of the corporation I have used, like the nexus of contracts model from which it borrows, tends to blur the edges of the corporation: this firm is anything but firm. Are consumers, or suppliers, or municipal hosts, members of the corporate team or not? For purposes of corporate governance, and in light of the unexpected results likely from radical changes, I am inclined to take the conservative position that such people, although undoubtably dependent on the firm and necessary for its success, probably should be classified as members of the public at large and represented as discussed above.

In contrast, employees who spend significant parts of their waking lives working for and at the corporation must have some form of representation in the corporate governance structure if the team or polis concept is to be anything other than yet another cynical tool to delude marks into thinking they are being befriended rather than taken. For all the problems of democracy, it remains a far superior alternative to autocracy, kleptocracy or Enronitis. We rejected Parliament's claim to virtually represent the American colonies in 1776; the claims of public corporations to represent the public — or even the corporate team — while granting the vote only to shares are even weaker.

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[23]See generally, Daniel J.H. Greenwood, *Fictional Shareholders: For Whom are Managers Trustees Revisited*, 69 S. CAL. L. REV. 1021 (1996) (arguing, inter alia, that corporations are not citizens that require protection from the state but rather state-like entities from which citizens need to be protected); Adolf A. Berle, Jr., *Constitutional Limitations on Corporate Activity--Protections of Personal Rights from Invasion Through Economic Power*, 100 U. PA. L. REV. 933, 942-53 (1952) (arguing that the state action doctrine does or should not apply to corporations: "The emerging principle appears to be that the corporation, itself a creation of the state, is as subject to constitutional limitations which limit action as is the state itself").