Part IV. Solutions

Corporations, as we have seen, are best understood as political forums: self-governing, quasi-autonomous, usually bureaucratic, organizations with a more or less determinate process for making decisions. Various participants (including customers, suppliers, investors, managers and employees) simultaneously seek cooperation to create a collective product – and compete over the distribution of the material goods they've produced. Corporate law channels both the cooperation and the competition, but only mildly: the participants struggle, among other things, over the rules by which they struggle. Indeed, corporate law even frees them to struggle over who is entitled to be considered a participant, and the issue is hotly contested.

Corporations are no more property than they are land: human organizations must be governed rather than owned, and, in any event, under current corporate law publicly traded corporations have no one (or group, or role) that has all, or even many, of the rights of ownership. In particular, the common claim that shareholders "own" public corporations is simply wrong: so long as the firm remains publicly traded, shareholders, taken singly or collectively, have no right to direct the firm, no right to destroy it, no right to use it for their personal purposes or according to their personal tastes. They have, instead, the political right to vote for representatives who govern the firm, but also have no ownership rights. Shareholders own their shares, and under current law only shares get to vote, but they no more own the corporation than citizens own the city in which they vote.

Similarly, corporations are not "agents" of the shareholders. Under standard agency law, principals can direct their agents, agents must follow the direction of their principals and must set aside the agents' own interests when they conflict with the principals', and the relationship can be ended at any time by either side regardless of any agreement to the contrary. Corporate law differs on each point. Corporate employees are agents of the corporation, but the law requires that corporate directors be independent actors concerned with the interests of the firm, not its shareholders. Indeed, under the doctrine of piercing the corporate veil, any firm that forgets that neither firm nor directors are agents of shareholders is in danger of having courts refuse to accept its corporate existence. The key factor that courts rely on in "piercing the corporate veil" and holding shareholders liable for corporate obligations is that the shareholders have treated the corporation (or the corporation's agents) as the shareholders' agents. Corporate law is extremely flexible, but that's just not allowed.

Academic claims that corporations are "moments in the market" or a "nexus of contracts" are no less misleading. Corporations must be distinctly different from markets to survive in competition with them. They seek advantages over the "workaday morality of the marketplace" by limiting contract norms and, instead, primarily operating under norms of agency and fiduciary duty. They use planning to avoid the predictable failures of the price mechanism. And they avoid the problems of a perpetually underfunded and often incoherent public sector by developing internal decisionmaking systems rather than depending solely on external governmental support as markets, with their inherent collective action problems, must. Within the firm, the market's price mechanism is avoided by planning, the market regulator's quality supervision is preceded by internally created controls, and the larger political systems' battles are supplanted by internal policy and personality struggles that, sometimes, can escape the weight national politics places on abortion, spousal fidelity or tribal loyalties.

In short, corporations are political organizations devoted to creating a common good and distributing it. They make the services and products we depend on, and more importantly, the jobs we center our lives around, and they are the primary forum in which we argue about distribution of the material and less material rewards – money, dignity, status and prestige – that they create.

In this, they are essentially similar to the state itself. Our Constitution begins by dedicating the organization it creates to "promote the common welfare." To be sure, there were some issues – maintaining slavery and certain fundamental freedoms – that the constitution's authors thought had to be resolved in advance, but in general, they simply created a framework to guide our political conflicts into decisions. Even on the most important issue they feared to leave to the future – slavery – the most important and lasting decision they made was to overweight the representation of the slave states in the Senate and the Electoral College, not their explicit protections of the slave trade or property rights in human beings. Our politics have the results they have today not because the authors of the Constitution decreed that we would subsidize farmers and provide welfare to business corporations, while leaving effective environmental protection or economic growth policies to another day, but because they empowered certain actors and disempowered others and those initial power distributions led to others and so on in an ever changing, historically dependent feedback cycle, so that today cities are underrepresented, low-population states must be bought off, and incumbent industries–especially if they have the right geographical locations—can purchase power in the systems that matter.

Corporate law, as well, proceeds largely though deciding who will decide rather than explicitly pre-determining the decisions. And in corporate law as in constitutional law, the most important issues are the process issues. We get the corporate results we do not because the Delaware legislature or other enactors of corporate law set out the results they intended, but because our law empowers some parties and disempowers others, creates rules for decisions that make some decisions easier than others, gives some players (or types of players) blocking power and denies it to others… – and because of the unpredictable complexities of the way particular acts by particular people at particular times happen to affect others at that moment. Tolstoy's meditations on history in War and Peace, not an engineering plan, are the guide we need to understand them.

Still, we know some things. We know that for a generation, the benefits of increased productivity have gone to a tiny percentage of the population: the economy grows, but fewer and fewer of us share in it. Moreover, with the exception of the brief period of internet related euphoria, growth itself seems to be distinctly slower than it was in the days of greater equality: instead of trading equality for greater wealth for the least well-off, as John Rawls suggested we might, we've given up equality to get less wealth for all. As standard political theory and some versions of macro-economic modeling suggest, losing equality has also led to corruption, making rent-seeking more attractive and reducing cooperation and trust. We know that our system over-produces carbon in the atmosphere and over-consumes energy from sources that endanger world peace. We know that we spend far more than other countries on medical care, yet receive less in return. We know that our employer-based retirement system has collapsed, and that we are the only advanced capitalist country with no family-support system or passenger railroad system. We know that too many people who'd like long-term stable jobs are forced into short term and unstable ones. And that as a society we waste increasing amounts of time and money creating work-arounds for problems that arise because of that lack of stability – because we can no longer count on agreements or institutions to be around for the long term, we need to make things, and our relationships, flexible and changeable and disposable instead of stable and committed.

And we have several centuries of political thought about the ills of autocratic politics and how to solve, or at least ameliorate, them. The problems of inequality and the temptations of the powerful to view the rest of society as mere tools for upper class glory are not new.

Our major companies increasingly resemble monarchies tempered with a dose of irresponsible aristocracy. CEOs, like medieval monarchs, offer lip service to the ideals of the common good, sometimes strive to support the interests of their aristocrats, the stock market, and too often they treat everyone around them as mere tools to their own personal ends.

Still, it seems safe to say that self-interestedness – notwithstanding the increasingly imperial sums our CEOs appropriate themselves from the corporate exchequer – is less of a problem than poor decisionmaking and simple misguidedness. We probably wouldn't begrudge them their extraordinary remuneration if they were earning it by providing solid jobs for Americans doing productive, useful work at decent rates of pay. But they aren't.

In all of this, our problem is not dissimilar from the issues confronting early modern Europeans seeking to lift the yoke of monarchy. And we don't need to invent solutions out of whole cloth – we've inherited at least the outlines of how to make our firms work for us. I don't mean guillotines or Glorious Revolutions. But I do mean the basic lessons of the struggle for political freedom since the eighteenth century:

- Separation of powers to create countervailing forces is the best way to deal with the problem of policing the police.
- Freedom of debate, although it makes life harder for the powers that be, generally also improves their decisionmaking.
- Representative democracy, for all its failings, works better than any alternative we've discovered.
- Democracy is only worthy of the name if the rights of citizenship are extended to all subjects of the government.
- The decolonization movement established the principle that the inhabitants of a state are entitled to be its citizens, that is, to have a state that views their good as its goal instead of viewing them as nothing more than a means to improve the lot of someone else – a colonial motherland or a domestic kleptocracy. The same principle should apply to most large corporations: the employees who act as the firm are entitled to have the firm view them as part of it, not merely an expense to be minimized or a resource to be exploited with more or less enlightenment.

- Majorities, or the powerful who rule in their name, will often seek to use their power to create still more power, so that they can take – and keep – a disproportionate share of the commonweal; any successful regime must build in safeguards to assure that office holders do not use their office to create a dynasty.
- Rules, and the rule of law, are more important than any individual for the success of the whole, and law must start at the top. A CEO who believes the law does not apply to him, is a CEO who will end up destroying himself or the system.
- Size matters. Often, the most important issue in a democracy is who is in the voting district – once you know that, you know how the vote will go on important issues and whether it can be bought on less visible ones. Large entities bargain differently from small ones and can influence other decisionmakers in different ways. While there are no easy answers, it is clear that anti-trust needs to be approached from a political perspective that extends well beyond pricing power. Formal monopoly power is often less important than ability to influence the political process – to obtain laws, regulations, and interpretations that privilege the company over its employees, customers, and existing and potential future competitors.

These are commonplace aphorisms, utterly uncontroversial in the abstract (if not always in specific concrete situations), that have guided democratic republicans for two centuries. My goal in this section is simply to apply them to the business corporation as we know it. As a program for actual legal reform, these reforms, or any of them, could be adopted voluntarily by specific firms, or they could be imposed by any state that chooses to abolish the internal affairs doctrine and impose its own law on corporations doing business in the state, or by the Federal government under its constitutional responsibility to regulate interstate commerce.

1. The common welfare

Perhaps the most fundamental reform we need today is barely legal at all. In the political sphere, by the late middle-ages theorists, if not always kings themselves, had clearly established that the purpose of the state was to promote the common welfare – not simply the personal self-interest of the king, or even the king and nobility. Placing a partial interest over the interest of the whole is the sin of "faction" in the language of Hamilton and Madison's Federalist Papers; in the pithier word of the older theorists it is, simply, corruption.

In our corporate world, over the last generation we have gone in the opposite direction. A generation and a half ago, CEOs knew that they were supposed to say that the corporate goal was to produce jobs, services and products for Americans. Today, the accepted line is different: corporations exist, as the Wall Street Journal repeats daily, to make money for shareholders.

Ideas are important. If corporate decisionmakers believe that they are supposed to be seeking to make money for shareholders, they will run their companies differently than if they believe that they are supposed to be creating good and fulfilling jobs. I don't mean that CEOs are likely to act as selfless "agents" following this command with no regard for their self interest. The shareholder centered claim, at least, is so hard to justify that it is hard to believe that it could have that much power. But most people try to do what they are supposed to do much of the time, at least when they do not have strong pressures in other directions.

The first step towards a more successful and more just corporate sector is to transform the modern shareholder-centered ideology into something more defensible.

Incorporation is so easy and commonplace that we forget what an astonishing privilege it is: for the price of a filing fee and a few pages of form-book paperwork, anyone can obtain exemption from a vast array of ordinary rules of law.

Historically, the common law was most suspicious of incorporation because it appeared to be a derogation of sovereignty: a group of people arrogating to themselves the right to collective decisionmaking, internal law making and collective punishment. These are the rights of sovereigns; a corporation is, in effect, a little state within the state – worms in the entrails of the state, in Hobbes' graphic attack – and thus a threat to the state's own integrity.

The rhetorical appeal of this claim has diminished with familiarity. But the reality has not. Our largest corporations command resources – money, people, and in many cases, physical force – that dwarf most of our governments. Private security forces are larger than public ones. Most disputes we have with our employers and the corporations we do business with are resolved by the corporation's own internal dispute resolution processes; even when we have a theoretical right to appeal to the state's courts, it is usually entirely impractical. Large corporations routinely use their power to influence state agencies: threatening to move jobs to other jurisdictions, donating to campaigns, choosing their regulators, playing off one state against another.

Perhaps more startling to modern individualists, the right to incorporate is the right to make a group into an individual, with effects all across the law. If a group of consumers or employees or employers choose to coordinate their bargaining the market, they will be in immediate and clear violation of common law bars on conspiracy in restraint of trade and statutory anti-trust laws. But if they form a corporation, the law treats them as an individual, and an individual cannot conspire with himself – miraculously, coordinated bargaining becomes legal by the simple expedient of filing a piece of paper.

Ordinary tort law holds that people who wrongfully injure other people must make the victim whole. Moreover, under ordinary agency law, if I hire someone to work for me, and they wrongfully hurt someone in the process, I am responsible for the injuries: after all, it would be radically unfair for me to profit from my agent's work but refuse to pay the associated costs. Contract law is similar: when people make contracts, they are obligated to fulfill them or pay damages to make the victims of their breach whole. Agency law, once again, holds that people who make contracts indirectly, by having an employee or other agent make them as their representatives, are nonetheless bound. If the principal is getting the benefit of the bargain, the principal should also pay the costs.

But corporations are considered to be separate from the people who work for them, invest in them, operate them and profit from them. This is true whether the profit is labeled profit and paid out as dividends, or whether it is called something else and paid to corporate participants as salary, rent, interest, mark-up of goods or services sold to the corporation or discount of goods or services bought from it: the rule is simply that only the corporation is liable for contracts that it enters into or torts that it commits. By the simple expedient of filing a piece of paper, individuals can abrogate the entire law of contract and tort. Suddenly, they are permitted (with only minimal limitations on their ability to extract funds from the corporation) to profit from their economic activities, contracts and potential torts, without taking responsibility for the costs they create for other people.

Murder for profit is clearly criminal. But it is perfectly legal to profit from a corporation that kills – by intentionally selling known poisons in an addictive or quasi-addictive form, as manufacturers of cigarettes or corn syrup do, or by operating mines or chemical plants or oil wells facilities in an unsafe manner, even aware that deaths will inevitably result. Even if the business's activities are clearly illegal, there are few points of law clearer than the rule that investors in a corporation that acts illegally or immorally will not be civilly, let alone criminally, liable for the firm's activities – regardless of how much they profited from it.

Since the very beginning of the modern era, it has been fundamental to the law of property and trusts that we no longer allow entailments, the medieval practice of allowing property owners to determine the use of their property long after their death. Under the bars on "dead hands," the dead are restricted in how long they can control the living – trusts, for example, traditionally have been required to terminate no more than 21 years after the death of an identifiable person alive at formation. Real property law has long had similar restrictions on attempts of property owners to make decisions that will last long after their deaths. These rules are under attack in several parts of the United States today, as some states seem prepared to return to medieval stasis if that is the cost of allowing rich families to avoid capital gains and estate taxation.

But corporate law offers a far easier route to avoid ordinary law, with no legislative action required. A corporation is allowed to last forever. It need never pay estate taxes or realize gains at death, because it will never "die." It offers a clear and simple way for property owners to create a structure that will control their property long after their death. Most dramatically, in this country, John Harvard's bequest in 1638 is still controlled by his desires as expressed long before Independence. But more prosaically, many of the corporations created by the Robber Barons of the late nineteenth century and the early twentieth continue to dominate our economy long after their creator's deaths. Rockefeller is long gone but Exxon and Chevron continue the work of his Standard Oil Company. Walt Disney is dead, but his corporation continues to control his corporations. JP Morgan has gone the way of all flesh, but the House of Morgan, now allied with Rockefeller's Chase, continues to dominate, and occasionally threaten to collapse, our economy as JPMorganChase and Morgan Stanley.

Democratic republics, such as our own, define a group of people subject to the government's jurisdiction as citizens and grant them rights and privileges not granted to non-citizens. Most importantly, governments treat the good of the citizens as the good of the country: it is incoherent to say that a policy is good for America but bad for Americans. Secondarily, but far from trivially, citizens are granted rights to participate in government and politics that are not always extended, and rarely guaranteed, to others. Citizens have rights of free speech, rights to contribute to electoral campaigns, rights to lobby that non-citizens may be denied: for example, the US government feels free to bar certain aliens from speaking to American citizens, we and many other countries severely restrict foreign contributions to our political campaigns, and lobbyists for foreign nationals or foreign governments are subject to special registration and regulatory regimes. Moreover, citizens have the right to live in the United States and move freely both inside the country and across its borders; non-citizens do not.

But corporate law changes all this. Anyone, regardless of citizenship, may form an "American" corporation by filing the requisite forms. Anyone, regardless of citizenship, may invest in and profit from an "American" corporation by all of the usual means (with the sole exception of working for it as an employee within the borders of the United States). An "American" corporation, in turn, can operate anywhere in the world, for the benefit of people anywhere in the world, and so on. Yet, under recent Supreme Court decisions, even a corporation partly composed of non-US nationals apparently can nonetheless assert rights normally available only to American citizens or persons on US soil.

Similarly, many rights and responsibilities of Americans depend on the state in which we are domiciled, including laws of marriage, divorce and child custody, inheritance and taxation. Ordinarily, an American must intentionally reside in a particular state in order to make that state the person's domicile. Conversely, states are constitutionally limited in the extent to which they may apply their law outside of their own territory and normally may not apply their own law to individuals or transactions unless the state has a substantial connection to them.

Corporate law, however, creates an enormous exception. Corporate organizers, whether Americans or not, who wish to have large parts of their economic relations governed by the law of Delaware are free to elect Delaware law without residing their or, indeed, having any substantial connection to Delaware at all. Conversely, Delaware routinely regulates the governance affairs of national economic enterprises even though the effects are overwhelmingly outside of Delaware.

Not only does Delaware tax inhabitants of the rest of the US without offering them representation, it regulates the core of their economic lives. Delaware, not NY, decides who may speak for the largest New York employers, who may decide what the corporation's policies will be on matters of the most intense concern to New York citizens, employees and consumers, and what assets will be available if the corporation breaches its obligations under New York law. This is an astonishing breach of the most fundamental principles of sovereignty.

In short, corporate law grants extraordinary privileges to those who are permitted to act in corporate form. Why? One answer must be crystal clear. It is not to benefit shareholders. Shareholders are, in the main, large pools of anonymous capital managed by professionals under rules that are largely corporate themselves. It is hard to imagine any argument that the reason we create massive exceptions to ordinary rules of law is simply to allow other corporate-like entities to profit. One doesn't abrogate democracy and sovereignty just in order to benefit a poorly regulated pot of money, let alone another corporate entity.

Shareholders sometimes claim the rewards due entrepreneurs. Capitalist systems must reward innovators and entrepreneurs, although we teach that in reasonably competitive markets the rewards will be limited and quickly competed away. But shareholders are not entrepreneurs; in public companies they must be, in their shareholder role, passive investors. Shareholders have no special claim on corporate proceeds; anonymous pots of investment money purchasing claims from other anonymous pots of money will only rarely be significant contributions to corporate success. People working as corporate employees, not institutional shareholders, will ordinarily be the source of the corporation's ideas, technologies, skills and commitments. Investment capital, in any reasonably successful firm, comes primarily from retained earnings – that is, from charging customers more than employees and suppliers insist on being paid – not from stock sales. To the extent that companies want to expand faster than retained earnings would allow, they typically borrow from banks or issue bonds; shareholders (or, more often, their predecessors in interest) are rarely significant sources of company capital.

Conversely, shareholder primacy advocates sometimes make utilitarian claims – that shareholders will somehow make better corporate decisions than corporate managers. The truth, surely, is the opposite. Corporate managers, as we have seen, face difficult tasks in institutions that are not always well designed for good decisionmaking. For reasons of ordinary bureaucratic failure or out of implicit or explicit corruption, they often perform poorly. But to think that shareholders would do better defies common sense.

First, there is the problem of the division of labor. Managers, for all their problems, are trained in management. Shareholders, in contrast, are operated by people whose primary training is in trading, or buying and selling securities or companies. It is hard to see why lack of training in the relevant skills would increase the odds of success. Second, there is the problem of information. Corporate decisionmaking, like all decisionmaking, frequently suffers from incorrect and inaccurate information, self-serving analyses, willful blindness and the like. However, managers are present in the firm – the work there. Shareholders, in contrast, are often limited only to publicly available information outside the firm, generated by managers. Moreover, our shareholders hold diversified portfolios, which is another way of saying that they have very little time or ability to focus on any particular company. Why would anyone think that, as between two sets of professionals, the set with less information, less time and less implicit understanding would be the better performers?

Third, there is the problem of corruption: that professionals may (and sometimes surely will) place their personal interests ahead of the interests of the institution. Managers clearly succumb to this temptation; there is no other plausible explanation of the shockingly huge pay CEOs award themselves. But it is completely clear in both law and popular culture that managers, as agents of the corporation, are obligated to act in the company's interests – even the most egregiously overpaid CEOs nearly always remember to explain their rewards as necessary to obtain their services and thus a good deal for the company. Shareholders, in contrast, owe no duty at all to the company. They are entitled, both as a matter of law and popular culture, to treat it in a purely exploitative manner. Moreover, as a matter of professional training, the professionals who operate shareholding institutions – traders and private equity fund managers and the like – have a long institutional commitment to the notion that the only reason to come to work in the morning is to make as much money for yourself as an individual. While managerial culture has moved in that direction rather dramatically in the last generation, there are still remnants of an older view that professionals do a professional job because it is the professional thing to do. It is somewhat implausible that adding an additional layer of professionals, who are not fiduciaries and do not think of themselves as owing any obligation to any ideal other than getting rich fast, will solve the problems we have of professional fiduciaries acting in an unprofessional manner. On the contrary.

In short, shareholders are extraordinarily poorly suited to make corporate decisions. Most shareholders, of course, are themselves institutions. But while corporations are specialized to make operating decisions, institutional investors are specialized in making trading decisions. Putting shareholders in charge of operating corporations, thus, basically means taking professionals who know about running businesses, and subjecting them to the authority of professionals whose training has nothing to do with running businesses. Worse still, corporate success nearly always requires developing a specific set of human relations among a specific set of human beings: firms do best when they consist of a group of people working together as a team. But the people who run stockholders are trained as traders. They buy and sell on a largely anonymous market and are trained to see other traders mainly as targets to be exploited, rather than teammates with whom to build cooperative enterprises. Moreover, any modern stockholder has a widely diversified portfolio of investments and understands that its portfolio may increase or decrease in value due to many factors that have little connection to, and may often be in conflict with, the success of a particular company in creating a useful product or satisfying jobs. Indeed, most stockholders are entirely capable of structuring circumstances under which they are most likely to make money if a particular firm does not (most simply, by holding more shares of a competitor, but increasingly commonly by direct bets against companies through shorts on the company's shares or debt).

Finally, the strangest part of the claim that corporations should be run in shareholder interest because shareholders are most qualified to run them is that corporate law generally bars shareholders from operating corporations. Boards have a fiduciary obligation to exercise independent judgment, not to follow instructions from the shareholders that elect them. Shareholders are barred from using the shareholders meeting to govern the firm. Piercing the veil doctrine holds that shareholders who avoid these principles and act as the principals of the firm will be treated like real principals – they are liable for firm obligations because they have not treated the corporation as a separate entity.

We need, then, to firmly establish this fundamental point. Corporations do not exist for shareholders. We do not create all the special privileges of corporations simply to allow a handful of traders to make money at the expense of their trading partners, let alone by siphoning money out of firms for the benefit of anonymous providers of a purely fungible commodity.

Instead, corporations exist to promote the interests of the community as a whole, and more specifically, the interests of all corporate participants. In the language of politics, shareholder primacy theorists are contending that corporations ought to be seen as a kind of aristocracy, in which the organization exists solely to promote the interests of a subset of the people (or in this case, roles and non-human participants) that participate in it, while the others may rightfully be treated as outsiders. On this view, corporate managers ought to treat Americans, whether dependent on or contributing to the firm in consumer, producer, employee or investor roles, as mere helots: outsiders to be treated well or badly only to the extent that someone else benefits. In effect, shareholder primacy theory urges that we treat ourselves as the inhabitants of a colony, to be exploited more or less benevolently, in the interest not of us, but of the imperium – the Stock Market.

In a democratic world, this argument is unacceptable. Corporations are critical institutions which we require for a decent life. They, therefore, must be run on behalf of us.

The first step is to accept that all corporate constituencies – not only the shares – should be treated as citizens. Under the shareholder centered paradigm, as under conventional corporate accounting, when employees do well, the company is thought to do worse: their interests and its interests are in opposition. In partnerships, in contrast, accountants (and ordinary observers) assume that if the partners do well, that is good for the firm. We need to bring our understanding of corporations closer to our understanding of partnerships. High pay and good jobs are good things, not bad things. Obviously the firm must be able to meet its bills – but, just as with a partnership, the point is not to meet the bills by squeezing insiders. The US isn't better off if its citizens are worse off; the same is true of GM.

The second step will be inevitable. Once we have rejected self-colonization in our corporations, once we have decided that our organizations should treat us as ends rather than means, once we have decided that the corporation is a tool to our goals and we are not mere tools to its goal – then corporations must ask, like any republic, the key questions of governance. How can a self-governing entity be run so as to promote the interests of its citizens?

2. Power Corrupts: the importance of countervailing institutions

In ordinary politics, we take it as an article of faith that powers ought to be divided. Plato's search for a philosopher king is futile. Hobbes was wrong: freedom and security do not come from giving one person supreme authority over everyone else. Instead, the best way to assure liberty, competence and stability is to have multiple, overlapping, institutions that supervise each other. When multiple authorities approach the same problem, professionals with different commitments and training see problems from different perspectives; the ensuing debate, messy as it is, gives rise to better results.

In our major corporations, however, the reigning rules of governance seem to be right out of the Dictatorship of the Proletariat. A largely self-appointed leadership manipulates a not-terribly-fair-to-start-with elective system to get the results it wants. Dissenters are excluded – fired rather than executed or imprisoned, but excluded nevertheless. Executives, often working under five year plans, spend their time producing results that their superiors can measure, or reporting what they think those higher up want to hear, even when everyone knows that what can be measured is only roughly correlated with what is actually desired. Dilbert's daily reports of Potemkin Villages erected by the incompetent to deceive the blind are only a satirical exaggeration of the issues debated daily in the Wall Street Journal – while the scandals, when they break, go far beyond. Enron's collapse, powered by an internal culture of endemic deceit, displayed rottenness worthy of the former USSR's bureaucratic fictions.

As in any monarchy or dictatorship, corporate power struggles are sub-rosa. Junior executives too often maneuver to rise in the ranks by taking credit where none is due, impressing impressionable superiors and quietly undermining rivals. Meanwhile, at the top, boards of directors, like the old Comintern, routinely approve every whim of the Leader by unanimous vote (ratified, when necessary, by predictably huge margins of voted shares), until the day on which the palace revolt comes to fruition and the old Leader is replaced by a new one.

Our usual solutions to these problems are well-understood and easily applied to large corporations. We need countervailing institutions and the space to develop public opinion – no more than Montesquieu called for under the Ancien Regime.

All large, institutionalized corporations – perhaps those with over 1000 employees, or with securities traded on a public exchange – should be required to have a range of countervailing power structures and protections for discussion, debate and information.

Two are most important: the ombudsman, and the auditor.

Information is the key to good governance. Any hierarchal system has problems passing information up the hierarchy and directives down. An Office of the Ombudsmen provides an alternative information structure. Employees, customers and suppliers who may know about wrongdoing or errors should have a way to by-pass the ordinary chain of command in order to get information into the hands of someone charged with doing something about it. Obviously, this can only work if the Ombudsman uses the information to stop the wrongdoing rather than punish the tattler. But an independent office, staffed by professionals who take the job seriously, and supported by the primary hierarchy can radically improve bureaucratic compliance with rules and ensure that decisionmakers at the top get the information they need. (Of course, this assumes that the top is interested in compliance and making sound decisions, which presents additional issues).

More radically, we need to bring some of the lessons of governmental transparency into the corporate sector. All successful governments have audit offices that, like the GAO, are authorized to investigate and inspect quite broadly. Successful corporations generally have similar internal offices. But American law has been quite rigid in separating the governmental inspectors from corporate ones: governmental auditors and regulators generally cannot inspect corporate activities unless the comply with privacy rules developed to protect citizens in their homes.

Corporations are not citizens, and corporate workplaces are quite different from homes. Individual employees have no legal or constitutional rights protecting their privacy from their employers – corporate managers are free to rifle through their subordinates desks and email. In contrast, our governmental representatives are highly restrained in inpecting the actions of corporate office holders. These doctrines are, quite simply, backwards.

If corporations are to have a vibrant culture of debate internally, individual members must have some degree of privacy protection. Workplaces are not homes, and there is no reason why an office desk should be treated as sacred space. Nonetheless, employees should have some reasonable expectation of privacy in their personal email, even if it is on a company computer.

Conversely, effective regulation requires information. Banking regulators and the IRS have broad powers to inspect firms that are closer to the authority the GAO has within the Federal Government than to the power police have to enter citizens' homes. This model needs to be expanded.

3. Democracy.

Our major corporations are beginning to show pathologies well known from the politics of failed states. Political philosophers as far back as the Greeks contended that rulers who could count on long tenure would be less likely to be corrupt than ones who feared overthrow. A dictator's incentives are to steal as much as possible before he is overthrown; a hereditary monarch, in contrast, has an interest in making the country strong and wealthy, since he expects to bequeath its power and affluence to his heirs.

In recent years, we've seen CEO compensation increase and length of tenure decrease. I suspect that at least part of the correlation is explained by the classic political theories. The Wall Street mantra of "I'll be gone, you'll be gone" – meaning, don't worry about consequences that won't show up for a few more quarters – is increasingly part of Main Street corporate culture as well. Executives who are rapidly shifted from assignment to assignment, or who move from company to company with ease, promote their careers by creating quick appearances (and taking quick bonuses) without regard for long term consequences. And the easiest way to generate a quick appearance of profit is to stop spending on the future. Advertising, R&D and training are all expensive. Eliminating them provides an instant boost to profits; the costs will be someone else's problem. Mergers and acquisitions, which create a moment of great accounting discretion, work much the same way: a short-term oriented executive can pull expected income into sooner quarters while pushing expenses back later. Current profits will look better; later ones will look worse, but that will be on the next guy's watch. If the stock market doesn't notice – and it rarely does – you can even justify giving yourself a large bonus, preferably in stock options that will jump in value even faster than your reported profits. If you know you are only around for a short time, the temptation to put self-interest over the collective interest may be irresistible.

To the Greeks and even more so the medievals, the hereditary tenure of monarchs seemed preferable to the alternatives they knew. We have long since rejected that view in our politics (although it seems to have some adherents in the world of Imperial CEOs and shareholder primacy). Instead, we've moved to replace hereditary monarchs and their sycophantic courtiers with elected representatives and professional appointees.

Corporate law appears to follow this democratic republican model and, indeed, shareholder advocates frequently invoke the cause of "shareholder democracy." Shares, after all, elect the board, which looks a lot like a legislature, and the board appoints the CEO, who, with his subordinates bears some resemblance to an executive and its agencies.

But "shareholder democracy" as we know it today violates the most fundamental principles of democracy. First, most citizens are disenfranchised. Shares vote. Other corporate participants do not.

In particular, the participants who both know the most, have the deepest commitments to the firm, and are most dependent on it – the employees – are entirely disenfranchised under standard American corporate law. Second, even among the voting role, votes are allocated on a supremely anti-democratic principle – proportional to investment instead of to membership. There is no ideal of one person one vote in corporate America. Third, votes are freely bought and sold together with the shares that hold them, and as derivative instruments become more sophisticated and more readily traded, increasingly votes can be separated from the other economic rights and characteristics of the shares. As Black and Hu have detailed, it is not hard today for an outsider with no other connection to the firm, to purchase votes while completely protecting itself from any economic consequences if the firm does well or poorly.

Two basic reforms are essential.

First, it is long past time to move to universal employee suffrage. We, like some of our competitors, should mandate that in large firms, at least half the board be elected by employees voting on a basis of one person one vote. Large partnerships have long extended the vote to their professionals, and universities delegate significant powers to faculty employees. This principle ought to be extended to other corporations as a matter of basic democracy.

Not incidentally, employee representation on the board is likely to improve board decisionmaking. Employees, as a group, have more of a vested interest in the status quo than the stock market; being human they are inherently somewhat conservative, committed and rooted. Shares, in contrast, are freely traded by professionals who are trained to respond only to profit, regardless of other considerations. Profit, however, cannot be made regardless of other considerations; particularly in the corporate sector, it generally results from convincing employees to work together as a team. As Napoleon demonstrated and democracies have repeatedly proven since, people who believe themselves to be part of a team, led by leaders who they've had a say in choosing, work harder, fight better, and are likely to prevail over those motivated merely by the far weaker forces of carrots, sticks and self-interest. If we want to unleash the true power of the corporate system, we need to convince employees that they really are team members. And that requires actually making them team members, not just mouthing slogans. First, the vote.

But boards need to represent more than simply equity holders and employees. Customers also have essential interests and essential information. Ideally, boards ought to adopt a tripartite form, with one part representing employees, a second representing capital, and a third representing consumers, neighbors and the general public affected by corporate decisions.

The boards of large corporations, however, have relatively little to do with ordinary decisionmaking, and elections to the board are hardly likely to arouse the passions of US Presidential campaigns. Nor should they.

Effective corporate governance, therefore, should go beyond the board. Using the faculty meeting as an inspiration but not a model, corporate law ought to provide for Representative Councils in large firms. These councils would encompass professionals and employees, either directly or through representatives, and have authority to act for the corporation in matters of working conditions. The goals are two fold: both to increase democratic control and to create a countervailing authority, with interests and powers different from the standard executive hierarchy. The bureaucratic hierarchy, answerable ultimately to the CEO and the Board, is always likely to promote important values of measureability, responsiveness to investors and customers, and the instability of the marketplace. The councils, in contrast, are likely to weight other values more heavily: professionals sense of the right way to do a job, quality of product and work life, community in the workplace. Successful firms need to balance these values; having official representatives of each will make it more likely that they reach balance rather than lip service and one sided domination.

4. The problems of democracy

Democracy, as Churchill allegedly said, is the worst system of governance except for all the others. Bringing increased democracy into our corporations will bring a host of new problems – some firms, indeed, may succumb to the gridlock that threatens to cripple our Federal government.

Of course, markets help. Democratic, dictatorial or imperial, any firm that does not do a sufficiently adequate job of solving its governance problems will eventually fail. Hopefully, the demand that corporations treat all their participants as valued and valuable, the increased transparency and debate stemming from increased respect for privacy, the alternative information structure of the ombudsman, and the increased solidarity of representation of all important constituencies, will lead to fewer spectacular failures in the manner of Enron or Lehman. Perhaps, involving employees more will allow firms to head off multi-decade strides in the wrong direction in the manner of GM. With luck, for every firm crippled by interminable internal debate, or which splits as it becomes obvious that differences are irreconcilable, there will be several others that are saved from the waste and inefficiency of acquisitions for empire building, reorganizations for personal aggrandizement, leaders who seek to push problems and expenses into the future, and so on. AIG's leadership seems to have been unaware of the risks it was taking, but those lower down understood what was going on; GE's leader created an appearance of perpetual profit via acquisitions, but people in the trenches had to have understood that some of the appearance was simple illusion. Harnessing that knowledge and those commitments is more likely to help than harm.

Still, one point is essential. Business corporations succeed in part because they have a limited mission. We don't do a very good job running them – but we don't have too, because they are not as hard to run as even relatively simple governments. Making a saleable product or service, even while also trying to ensure that jobs are relatively satisfying or plentiful, or that investors receive reasonable returns on their investments, are easier tasks than the multi-faceted balancing of conflicting values we delegate to our governments. Corporations will lose much of their utility if they become fora for debating the same conflicts we debate in Congress or the City Council: the relationships between men and women, change and stability in mores, the meaning of equality and citizenship, the degree to which our landscape, and ecosystem, ought to be changed to accommodate cars or people, our relations with French Fries and Arab oil, and the like.

Elections and representation inside the firm should be limited to the relatively manageable issues of corporate governance: creating useful products and decent jobs without imposing undue costs on others.

This means that we need one further and essential change in corporate law. Corporations ought to be severely limited in the degree to which they lobby our governmental institutions or interfere in governmental electoral politics. In a democratic market economy, it is democracy that determines the limits of markets; the reverse can never work.

Corporations must remain – regardless of internal decisionmaking – ultimately servants of the markets: if they cannot produce something that consumers are willing to pay for, while paying their employees and suppliers of capital and raw materials enough to keep them happy, they will, and should, fail. Ultimate decisionmaking authority, thus, remains in those markets.

Markets, however, only function and only make decisions within a specific legal framework. Rules of property, contract, fraud, torts, safety, labor regulation, consumer protection and disclosure, anti-discrimination restraints, principles of equal treatment (or their absence), environmental protection, zoning laws and the various subsidies and requirements given or imposed by assorted governmental entities determine the winners and losers in markets. That framework is the key debate of politics: that is where we decide whether we want markets that put a car (or two) in every garage, or a light rail connection in every neighborhood, whether we want markets that require young mothers to work or discourage them from doing so, whether we wish to allocate medical research to the diseases of the wealthy or the young.

Corporations are not well organized to reflect these debates under current law, and my proposed reforms would change that little. Instead, when corporations enter the political debate, they can only represent economic incumbents seeking to preserve the results of the past: corporations have political power to the extent that they have assets from past success, and they are most likely to use that money in politics precisely when markets no longer offer the best opportunity for them. Corporate political interventions, therefore, are highly likely to be both anti-market, anti-capitalist, and anti-democratic: special pleading for economic incumbents who wish to entrench themselves or use the tools of politics to protect themselves from markets.

This won't always be true – markets often invite a Gresham's Law race to the bottom, in which the least scrupulous player sets a level of cheating that others must match to compete. Businesses that wish to maintain standards often have no choice but to appeal to government regulators to bar their unscrupulous competitors from passing off inferior products as something they are not, or dumping costs onto people, or ecosystems, that are not in a position to complain.

But as a general rule, the separation of the economic and political spheres is a good thing. Markets succeed in part because they have no respect for incumbents; we often will be worse off if the incumbents can avoid the markets by buying the politicians.

Accordingly, we need a set of special rules for corporate interventions in politics. I'd start with this: no corporation may decide to intervene in a political campaign or referendum by direct expenditures or contributions unless it does so by resolution of its board, followed by approval of a majority of its employees, and a majority of its American shareholders voting on a basis of one person one vote. I assume that most managers, most of the time, will prefer abstaining from electoral politics to invoking this decision process, and that is as it should be. Corporations ought to stay out of politics except in the most extreme situations, and when they do enter, it ought to be under the direction of the entire firm and all those who created the assets that are to be expended in influencing Americans. Managers are hired, and board members elected, to run companies, not to represent corporate participants in Congress; if extraordinary circumstances require them to take on that additional role they should not have free access to corporate funds, which after all are not theirs, without actual approval of the corporation.

Lobbying is more complicated, in part because of the difficulty of drawing a line between lobbying and the essential function of businesses in educating regulators, who, after all, are unlikely to be able to regulate intelligently what they do not understand.

Here too, however, the core idea is clear. Corporations are not citizens and have no right to be heard or respected in the political forum. They are tools for our goals – just like the governmental bureaucracies they so closely resemble. If we decide that their education is simply miseducation – that, for example, cigarette companies should not be allowed to use the profits from addiction to spread misinformation or fund phony science in order to increase addiction – that must be the prerogative of the people and their elected representatives. The question is only who is sovereign, the people or their corporations.

Within the firm, the rules ought to be similarly clear. A decision to attempt to influence a government decision, policy or regulation is an extraordinary decision. It should be made high in the corporate structure, by an organ that is aware of and responsive to the varied views of the citizens who make up the firm. In firms with the tripartite board or Employee Councils I have suggested above, lobbying decisions should go to these responsive institutions and not be the pure prerogative of agents serving, or not serving, a principal that has not spoken in its own voice. In firms that stick to the conventional CEO centered structure with no representative body, every decision to engage in a lobbying campaign should be contingent on approval of at least its broad outlines by the corporation as a whole, using the voting method specified above for campaign contributions.

4. Disclosure and transparency

Our Federal corporate law, which we call securities law, has long been centered on a different metaphor than state corporate law. State law originated in the metaphor of corporations as self-governing polities that I have tried to reinvigorate, but in the last century it has been deeply influenced by the upstart (and contradictory) images of shareholders as owners of property, trust beneficiaries, principals of agents, individualist contractors in a Smithian market and even entrepreneurs. Federal law, in contrast, is driven by an image of shareholders as consumers of a particularly helpless sort. If the state law shareholder takes on some of the potency of a virile entrepreneur, the Federal shareholder is generally seen as a widow or orphan, in need of the benevolent protection of the authorities.

This metaphor of shareholder as consumer supports the main thrust of Federal regulation: disclosure. In a political system still deeply influenced by notions of consumer sovereignty, consumer protection is inherently fraught. On the one hand, for consumers to be sovereign, they must be allowed to choose as individuals; if we determine best practices collectively, we lose the advantages of dispersed decisionmaking, the potential advantages of variation in a changing world, and necessarily increase the possibility of imposing one-size-fits-all policies inappropriately.

On the other hand, it is patently obvious that producers always have the upper hand over consumers – producers have seen the sausage making process, while consumers only see the sausage. If consumers buy – as they must – based on what they can see, producers can get away with producing appearance rather than substance. Moreover, if consumers realize that producers have learned how to cheat them with appearances, the consequence is, in George Akerloff's phrase, a market for lemons: consumers will protect themselves by refusing to pay for quality they cannot be sure they are getting, and producer will be unable to produce anything but the appearances that consumers will pay for. We get low quality used cars ("lemons") even though we'd prefer to pay more for ones that work; beautiful tomatoes instead of ones with taste. This natural feature of markets, as well as other well-understood market failures, including the tendency of markets to quickly reduce "choice" to minor variations on a highly standardized theme, means that consumers are frequently unable to guide markets in directions that they'd like. In a form of the fallacy of composition quite similar to Hobbes' paradox of security in the state of nature or modern theories of arms races, the more power individual consumers have, the less ability they have to get what they actually want.

Moreover, the paradox is deeper still. Information is perhaps the most valuable commodity in any market – and especially in a market for investments, such as the securities markets the Federal corporate law system seeks to enhance. For the securities market to perform its key social function – moving savings from savers to investors who can use the capital efficiently – traders must be trading based on information about the underlying real investments.

But markets have a great deal of trouble rewarding and pricing information.[i] The equilibrium market price for any commodity is its marginal cost of production – but the marginal cost of existing knowledge zero. As Thomas Jefferson said, knowledge is like the flame of a candle. I can give you a light for your candle without losing any of my own. This means that markets will tend to price existing knowledge well below its value or, more importantly, the cost to produce new knowledge. With no expected profit, markets left to their own won't produce new knowledge.

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The Federal securities laws are perhaps the most effective attempt to resolve this paradox

In a market system still driven by the view that consumers should be soverSo, rather than determine best practices and enforce them, the Federal securities acts The Federal system is, in effect, our most effective consumer protection statute, a far more elaborate and enforceable version of the nutrition labels on most packaged food products. If consumers are to be able to protect themselvesCuriously, if perhaps not entirely coincidentally, the disclosure system simultaneously

XX. Reversing the state action doctrine error: corporations should be subject to constitutional restrictions, not entitled to claim unwritten rights against us.

V. Conclusion

We are in a moment of crisis. Our most important institutions are failing. Our corporate system no longer seems capable of producing enough jobs, of paying ordinary people decent wages that reflect their productivity, or of respecting the needs of the people and ecosphere outside them. They have grown powerful enough to dominate our political processes, making it impossible for governments to govern without weighting entrenched corporate interests above the needs of citizens and the country. Yet internally, these extraordinarily powerful, largely autonomous and self-governing entities, defy the principles of a democratic era.

The thesis of this book is simple, although its elaboration has been complex. We have allowed the fog of metaphors with which we surround corporations and corporate law to confuse us. The earliest metaphor remains the best: corporate governance is about government, because corporations are quite similar to states in many respects. Our largest, multinational economic institutions are semi-autonomous, self-governing entities, with, like states, enormous power for good and evil, and large numbers of people who are both dependent on them and necessary for their success. The moment we realize they are fundamentally political institutions, created for the fundamentally political purpose of creating a better life for their participants, much becomes clear that was obscured by the newer metaphors of property, contract, trust law, agency and market. Our central issue is not the separation of ownership and control, but making subjects into citizens.

We know a great deal about governing political entities – political philosophers and practical thinkers have been considering the issues for as long as we have records. In a democratic age, we have reached consensus on the broad outlines of how to make governments work best: the ancient and medieval teaching that the decisionmakers must understand that their job is to promote the good of the whole, not their own personal ambition or the interests of particular powerful factions; the eighteenth century teachings associated with Montesquieu of division of powers, overlapping authorities supervising each other, and a free and robust debate leading to informed public opinion; the nineteenth century commitment to universal citizenship and equal protection, backed up in the twentieth century by elections with universal and equal suffrage. We understand a great deal about the benefits and costs of transparency, the corruption problems associated with excessive pay for leaders or undercompensation of subordinates.

The time for rule by self-proclaimed emperors is over. Our CEOs increasingly combine the excessive consumption of Louis XIV with the ineffectual rule of Louis XVI. Fortunately, we have better tools for reform than did the subjects of the Ancien Regime. We need not guillotines and Terror but the rule of law – and laws that rule even these creatures that we have so long allowed to set their own terms.

Crisis, as the cliché has it, is opportunity. We can take the great liberal revolutions of the Enlightenment, the sources of our liberty and dignity to their next logical step, extending the principles of republican self-government, separation of powers, democracy and personal rights to the multi-national corporations that dominate much of our life. Or we can ignore the lessons we have inherited from the past, and muddle on to the next crisis. Better, I think, to work from the successes we have and understand. That is the task ahead.

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[i] James Boyle, Shamans, Software and Spleens (1996); Stiglitz, {Efficient levels of inefficiency article}