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WE NEED A NEW 21st CENTURY CORPORATE MODEL

ABSTRACT

This Article traces the evolution of the corporate legal model over the past 50 years and suggests we need a new 21st century model. In Part I we begin with the legal realism movement, then review the broader law and economics movement in the late 20th century and compare it with state common law and then transition to what is known today as financial capitalism of the early 21st century (using Asaf Raz's paper sections as a skeleton). Part II of this article addresses three new models of how corporations should do business this century, namely, the Strine Model, Edman's Pieconomics Model, and then finally the Mayer Model. It then concludes with two methodologies on how to get to where these models want to lead us, namely the creation of new norms and the enhancement of a company's so-called "reputational capital". To go from what "is" to what "ought" to be requires an analysis of how we got here in the first place, what doesn't work, where we need to go, and some new solutions to do so.

TABLE OF CONTENTS

INTRODUCTION

The title of this paper, I believe, is where the proverbial "buck stops" if corporations ever plan to address the major complexities of the 21st century. There are many law and economic academics, and those who practice in the legal field like me, who want better answers than the conventional answers of last century. I submit that the issues are twofold, *viz.* (i) the 21st century problems have become more complex, so they require more complex answers, and (ii) most of last century's business models were not sophisticated enough to solve not only problems of the past, but the complex problems facing us today. In fact, many writers on this topic argue that some of last century's misguided models caused many of the major problems we face today. This is why we need a new 21st century corporate model. Part I of this paper is an elaboration and a different take on Asaf Raz's paper on "legal personhood" that traces back to the last century and surveys the history of legal personhood, property law, agency law, and the shareholder primacy underpinnings of corporate law. In Part II, we look at newer corporate models such as the inclusion of stakeholder constituencies, next a purpose driven model that its author calls "Pieconomics", and lastly Mayer's societally oriented, solutions driven, leveraged business model. I chose these three models because they appear to have a corporate structure that is both realistic and resilient enough to make both the corporate system, and the market system in which it operates, more sustainably. This paper recommends three current models that go beyond Raz's "legal degree of freedom" conclusion. Lastly, I present new norms and the enhancement of a company's reputation capital as a way to get started right now to do the necessary work to implement these 21st century models.

Part I: LOOKING BACK

A lot has been written over the past century about the legal personhood doctrine, but one paper written by Asaf Raz, entitled *Taking Personhood Seriously*, [1] is perhaps a good starting point as a skeletonof sorts on last century's theories as to how we got here. Even though Raz's paper begins with the recent Twitter merger litigation, Twitter, Inc v. Musk C.A. number 2022 WL 16963539 (Del. Ch. No. 15, 2022), [2] nevertheless he chose to "[go] beyond the more immediate aspects of the case" to address the centuries-old, common law concept of "legal personhood" regarding corporations as we know them today. (As he states, legal personhood, to some extent, goes as far back as ancient Rome itself, but we won't go there!) Regarding the *Twitter* merger dispute, Raz qualifies his remarks by stating that "[a] merger is a single, closed end event in contrast to the open-ended, unknown range of a future associated with as an on-going enterprise, which is the central concern of corporate law." [Id. at 5, FN 14.] Nevertheless, mergers can be a **window** to how courts view personhood and to discuss our overall corporate system today. Raz states that legal personhood is the anchoring element to address facts and circumstances that impact current entities, despite the controversy surrounding legal personhood in the last half-century. Most lawyers would agree that corporate personhood remains the definitive state law baseline theory for corporate law today. Assuming personhood is, as he writes, an "*ex ante* ground norm" in various factual contexts, he sets forth three (3) areas of interest, viz; the development of an organizational personhood discourse, three scenes depicting how personhood is operating today and how it is interpreted by the Supreme Court. And for those who dislike the historical nomenclature, he writes that there is "no contradiction between non-human personhood and the economic or social welfare of humans." [Id. at 4-6.] Raz concludes his paper with the two recent, controversial U.S. Supreme Court cases that he believes stand for a "legal degree of freedom" that allows an "actor" to "choose which legal relationship … to engage in [because] the entrepreneurial progress that shapes our life would not be feasible without this legal device." [Id. at 76.] Part I of this paper will address his analysis, unpack his interpretations and implications, and then in Part II introduce some new 21st century models, and in the Conclusion show how to get there with legal personhood or something else.

<u>Corporate Personhood – Some Background</u>

For timeline purposes, Raz's analysis traces the well-known history of legal concepts regarding legal personhood, from the legal realism theory of Dewey and Cohen in the early 1900's, to Jensen and Meckling and the law and economics movement in the 1970's, and finally to Easterbrook and Fischel, who created the construct of corporations as a "nexus of contracts" in the 1990's. So I will use these well-known historical and jurisprudential topics for my analysis. Eventually, these three major 20th century legal theories spilled over into two of the most recent U.S. Supreme Court cases, namely <u>Citizens United v. Federal Election Commission</u>, 558 U.S.

310 (2010) [3] and Burwell v. Hobby Lobby Stores, Inc., 134 S.Ct. 2751 (2014) [4] in the 21st century. Both Supreme Court cases created a further separation from legal personhood precedent to some extent, by the court reverting back to the "association of persons" theory, which has been historically outside traditional corporate theory for the most part. (And as we shall see further, it has also been asserted by the esteemed former Delaware Chief Justice Leo Strine, Jr. that, in these two cases, the Supreme Court Justices simply did not understand the legal personhood theory at all.) So, who does understand the role of legal personhood in modern corporate systems? Raz submits that Professors Henry Hansmann and Rainer Krackman have a better model when, at the turn of this century, together with a growing group of scholars, they put forth their “creditors rights” theory of organizational law both for its institutional value as well as its practical structural value. Raz believes that our current legal system is based on their basic structure explained in 1913 law review article entitled *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning* by Professor Wellesley Hohfeld. In same, Hohfeld sets forth his core jural relations in his famous Hohfeld’s Table of correlative maxims - the legal relationship between two persons known today as “Hohfeld’s rights and duties”. [5] Raz notes that under a Hohfeldian analysis, it is impossible to have a duty without a duty-bearer. [Id. at 33.] In support thereof, one of the most important and well recognized features of corporate law is limited liability which would practically be untenable without the legal personhood theory. In this paper, I will review the above and then transition from 20th century corporate models to arrive at what I consider three better 21st century models and how to get there, so that hopefully they will help begin to solve current complex problems in corporate law. So let’s get started.

So, like the hedgehog in the seminal book *The Hedgehog and the Fox* by Isiah Berlin [6], Raz believes that the legal personhood common law theory provides a single unified theory in organizational law. (Raz is also a bit of a skeptical realist not unlike the fox.) Personhood theory, he writes, is more than a mere analogy in that it includes property law, contract law, and agency law (consistent with the primacy of law such as the New Private Law “NPL” movement), fiduciary law, and risk and uncertainty in the day-to-day practice of mergers, acquisitions, etc. As such, personhood theory goes beyond superficial corporate metaphors or other constructs used over the years, such as the "nexus of contracts”, shareholders as owners, principal-agent, or the aggregate theory of the firm. Contrary to the limiting aspects of these multiple metaphors, corporate personhood substantively allows directors broader latitude to control an entity within fiduciary law constraints. To prove his point, Raz takes the reader through the common law early history of legal personhood, state law today, and his unifying theory of personhood as a legal degree of freedom. In summary, our current "corporate system" is premised on a <u>legal theory derived from common law</u>, as well as based on "ground norms" of contract law, property, corporate, fiduciary law, etc. As he states, it is the **structure** upon which our common law legal system is built, not metaphysical, but one that "ultimately exists to serve humans [by] attaching one legal concept (rights, duties, and other traits) to another (legal person). … The actual history of current organizational law goes back for the most part to the 16th century, when incorporation involved the creation of a new personality distinct from that of the individual. Its purpose was to "build lasting institutions by locking capital into the entity, which was not available under partnership law or other non-personhood legal frameworks." [Id. at 15 – 16.] It has been simply referred to for centuries as just "legal personhood" and it had a purpose. So, let's first trace some historical legal theory in the 20th century that questioned the usefulness of personhood in the modern era.

<u>Legal Realism</u>

We begin with the legal realism movement that Raz believes started the legal personhood controversy almost 100 years ago. Since then there have been several major critics of the legal personhood theory. In the 20th century, it was challenged by the well-known philosopher John Dewey. In 1926, he wrote in favor of "eliminating the idea of a legal personality until the concrete facts and relations involved have been faced and stated on their own account." As a pragmatist along with Pierce and James, he was part of a movement known as legal positivism that basically "aimed to get rid of scientific and philosophical language of terms that lacked empirical meaning". [Id. at 23, FN 141.] In a paper written by Brian Z. Tamanaha entitled *John Dewey on Law*, [<u>7</u>], he writes that John Dewey's philosophy was very much influenced by Darwin's evolutionary scientific explanations that were prevalent at that time. Dewey was considered a classical pragmatist who believed that "theories, ideas, concepts . . . are tools or instruments that facilitate the achievement of purpose. … Truths are not absolute, but relative to the theoretical framework and the purposes advanced. … No theory is an absolute transcript of reality but that any one of them may have some point of view that is useful … ". [James 1975. 33] The pragmatists set forth their position as a critique of, and contrast to, prevailing philosophical approaches …" [Id. at 2-3.] Of the many papers he wrote on various subjects, Dewey was well known in the legal field for his paper published in 1926 entitled *The Historic Background of Corporate Legal Personality* [8]. The main theme in his paper was that legal philosophies reflect the times in which they were written, so as such they are tied to past systems. Dewey stated his theory that "[i]f ideas, meanings, conceptions, notions, theories, systems, are instrumental to an active reorganization of the given environment, to a removal of some specific trouble and perplexity, then the test of their validity and value lies in accomplishing this work. … [T]he key to acquiring knowledge lies in attention to consequences that follow from actions." (Dewey 1948, 156.) So for Dewey, the scientific models of his time were better solutions.

So being a pragmatist and promoting positive reform, Dewey believed that the law needed to first acknowledge that what was once liberating may now be constraining, when older legal philosophies become **entrenched**. In the category of entrenched constructs, he wrote that legal personhood had become one. Because he believed that legal theories are simply tools, not ends in themselves, they can be modified when the circumstances create new conditions that require newer models. Dewey's research showed that the legal personhood concept can be traced back to the conflict between church and state in the Middle Ages and was a partial solution to that problem at that time. Dewey believed that "the corporation has always been presented the same problem of how to check the tendency of group action to undermine the liberty of the individual, or to rival the political power of the state." [Id. at 667.] At the end of Dewey's paper, after discussing all the historical theories of corporate personhood, he simply concluded that "[t]hus we end where we began: with the statement that the entire discussion of personality . . . is needlessly encumbered with a mass of traditional doctrines and remnants of old issues . . . [As such] it seems to me, it is sufficiently striking to <u>enforce the value of eliminating the idea of personality</u> until the concrete facts and relations involved have been faced and stated on their own account, retaining the word will then do no great harm." [Id. at 673.] [Emphasis added]. So as a classic philosopher of his times, Dewey ends his inquiry with a question, not an answer. But the irony of doing so is that, being a pragmatist and knowing that the legal construct was critical in day-to-day business and legal activities at that time, practically speaking, you can't simply leave such a major void in the legal adjudication of disputes that use this "tool" daily without any "positive" theory to replace it immediately. Academics and philosophers may do that, but conflicts occur every day so you can't, practically speaking, advocate such a void.

Raz has a different take on Dewey. He writes that Dewey's fatal flaw was that other areas of law are not persons either (e.g. contracts, property, agency, etc.), yet all contain rights and duties and contain norms and relationships that are <u>created and effectual all the time by persons</u>. So "without referring to personhood [in corporate matters], it is impossible to state the concrete facts and relations involved . . . on their own account." [Raz at 25.] So, whether you agree or disagree with Dewey procedurally or substantively, he stopped short of solving the problem he articulated so well.

Dewey's critique of legal personhood in the 20th century, based on empiricism, was succeeded by the philosopher Felix Cohen, who attacked the concept of corporate personhood by stating generally that it should be eliminated because it "could not be defined in terms of experience." Cohen's argument was considered the beginning of legal realism – functionalism theory of law. In an article entitled *Realism and Functionalism in the Legal Thought of Felix S. Cohen*, [9] the author Martin Golding writes that, "Cohen's work is of special interest to anyone attempting to come to grips with the realist movement." [Id. at 1033.] In his article, the author attempts to critically examine the leading ideas in Cohen's jurisprudence. Cohen defines law as "a body of rules according to which the courts … decide cases." [Id.] The author writes, "[a]ccording to Cohen, modern ethics is unabashedly utilitarian. The ultimate good is human happiness, which is good in itself; everything else, law included, is good only insofar as it serves as a means to happiness. But a law can not be good in itself. Law can only have instrumental value, and the valuation of law as good or bad is always an open question." [Id. at 1036.] More specifically, what Cohen rejects is the traditional theory of law in which judges follow the law, not create law. Instead, Cohen's so-called "realistic jurisprudence" rejects the notion that rules, principles, and opinions explain judicial decisions as espoused by the traditional approach because Cohen believes that courts and lawyers make decisions based on extra-logical grounds such as moral or ethical grounds. He argues that the traditional theory of law "attempts to set up as a standard of legal criticism, truth or consistency rather than goodness. But neither truth nor consistency can be rivals to goodness.” [Id. at 1047.]

Given the above, what would Cohen replace the traditional common law theory of corporate law with? Unlike Dewey, Cohen's theory is premised on utilitarian ethics, where a law is considered good only if it is “useful”. As such, “Cohen saw the realist definition of law as just one consequence of the adoption of functionalism. (Functionalism, as Cohen described it, is a philosophical doctrine that maintains that “a thing is what it does” or “a thing is its manifestations, its effects, and its relationship with other things” … [As such], all concepts that cannot be defined in terms of the elements of actual experience are meaningless.” [Id. at 1051.]) Simply put, the core of Cohen's theory of law is that all things must be judged through “actual experience”. For example, law as a function of court decisions is basically what courts do. Cohen associated his theories with pragmatism and positivism. To put all this together, as Golding states, assuming functionalism is empirical and valuative, then courts make the law. “As such, a judge’s task is always a legislative-ethical one”. Summarizing, Cohen presented a “fundamentalist theory of meaning and utilitarian ethics”. [Id. at 1053-54.] At a macro-level, Cohen believes that the entire legal system is premised on judges that are agents of social change based on ethical judgments. Therefore, “functionalism is simply a development of utilitarianism … [because] … the distinction between law and its consequences is purely arbitrary”. [Id. at 1056.]

So where does Cohen's functional jurisprudence eventually lead us? In a book review written by Neil N. Bernstein on the LEGAL CONSCIENCE, THE SELECTED PAPERS OF FELIX S. COHEN, [10] Bernstein writes that Cohen attempted to replace the traditional legal meaning of law with his analysis on “the human meaning of law.” What Cohen was arguing is that "[a]ny data that can be shown to aid in the prediction, whether it relates to previous decisions of same or other judges, economic background, social class, work habits or digestion, are relevant: all other information is without significance because law to Cohen was a problem of social activities.” [Id. at 304.] Simply put, law is an ethical-moral issue which judges look at not what is, but rather what ought to be. As Cohen writes, ‘legal criticism is empty without objective description of the causes and consequences of legal decisions. Legal description is blind without the guiding light of a theory of values." [Id. at 304.] Some critics have argued that Cohen's sweeping view of legal jurisprudence fails "to provide any **method** for ascertainment of the fundamentals which make up the good life." [Id. at 304, FN 6.] Other critics of Cohen have argued that his elimination of legal concepts that are non-empirical is tantamount to eliminating whole fields of expertise (including economics), and that such an empirical notion is itself a legal concept that is ironically self-deleting. As we shall see next, contrary to Cohen's ethical-moral views of law, they all took a major turn more recently towards economics, not philosophy.

Law & Economics

• *Jensen and Meckling*

Eventually all these early 20th century movements morphed into the law and economics movement in the mid-1970's, as espoused by Professor Michael Jensen and William Meckling in their seminal work entitled "*The Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*" (1976). [11] As the book name suggests, their work attempted to fuse economic principles with corporate legal theory. What is striking if you read the paper today, almost 50 years after it was written, is that you wonder how they were ever able to convince any practicing attorney into believing their unsupported premise (in the introduction, no less) that sets up the legal foundation for their entire economic analysis. They write, "since the relationships between the stockholders and the managers of a corporation fits the definition of a pure agency relationship [emphasis added], it should come as no surprise to discover that the issues associated with the separation of ownership and control in the modern diffuse ownership of corporations are internally associated with the general problem of agency." [Id. at 136.] When I first read this several years ago, I was surprised by how they swept away any sense of complexity by assuming we all agree with their principal-agent theory of entities. Any lawyer would likely have immediately responded by saying "prove it"! Instead, Jensen and Meckling merely pivoted to economics by stating "[w]e confine our attention in this paper to . . . the analysis of agency costs generated by contractual arrangements between the owners and top management of the corporation." That's it! Basically, they skip over legal analysis of **how** their agency theory of corporations is correct, and then magically swap out existing corporate law with their "nexus of contracts" theory. So, what specifically was their underlying premise? Their agency theory is derived from transaction cost economics in which the “principal” delegated work to the “agent”. Then they bolt their reductionist legal construct onto entities, and simply declare shareholders as “principles”, and managers as “agents”. Writers have argued that this reductionist theory was considered a necessary correction to years of so-called “managerialism”, where managers had until then been considered the key employees and the entity was a quasi-agent of the state. Assuming *arguendo*, that their analysis has some validity to it, what happens next is that instead of solving the problem, Jensen and Meckling’s solution created more problems.

It's one thing to propose a new corporate theory, but how did Jensen and Meckling convince mainstream organizations to even consider their reductionist theory? The answer, according to Lawrence Freedman, in his seminal book <u>STRATEGY - A HISTORY</u>, [<u>12</u>] is that Jensen and Meckling assert that the markets were sufficiently efficient to provide a better guide to rationally managing an entity. Once that was accepted, the so-called “rational market theory” morphed from economics into finance, and finance into law. By assuming a so-called “market equilibrium”, they postulated that the group most knowledgeable of what would be considered a successful corporate operation were the shareholders (“financiers”) themselves. [Id. at 526.] Going one step further, Jensen and Meckling propose that an organization should be operated instead as a “nexus of contracts” which would include its entire eco-system of employees, managers, suppliers, and customers. Collectively they form a market system of contractual relations that matched the alleged equilibrium behavior of the stock market. Put another way, an entity was simply a **“market-light”** version of the larger market it operated in, where the parties to these contracts were self-interested individuals with divergent interests. He writes that “companies were viewed as a bundle of assets, formed and reformed according to the demands of the market. The market was all-knowing, while managers were inclined to myopia.” [Id. at 527.] This in turn diminished the need for corporate strategy and management. Once this <u>market determinism</u> was accepted, an entity was just a commodity in need of market discipline, which the shareholders wisdom can provide, and managers judgement and responsibility were minimized. The author summarized his analysis of *The Theory of the Firm* by simply concluding that today “[b]usinesses are now judged by their market value… which encouraged remorseless cost cutting. [Id. At 530-531]

So, there it is; the core reductionist agency assumption that Jensen and Meckling deploy to superimpose their economic market theory on to legal structures. Simply put, just assert that their "theory of the firm" is a pure agency type relationship, and then skip over any discussion of whether it is true or not, and instead just discuss agency costs based on market equilibrium. But as we too often find, the flaw is in the premise itself, because corporate activities are **not** mere agency relationships, and the market is **not** in equilibrium at any given time. Instead, corporations are complex organizations as we all know today. Jensen and Meckling's fatal flaw was not effectively challenged for years. Raz looks differently at it. He writes that "what is shockingly missing from these statements is legal argumentation. In terms of legal theory… the phrase "nexus of contracts" as a description of the corporation is analytically meaningless because contracts can't bind themselves, only persons as parties can, so a contract is a second order legal concept subservient to legal persons. [Raz at 29-30]. Like it or not, "The Theory of the Firm" became the major market ideology of many corporations in the late 20th century. Raz writes that "[w]hile the early generation of law and economics (among other movements) attempted to rely on a fully ex-ante world view, which minimizes and even mocks unpredictability, the oddness of real-life situations and the need for equity and nuance - reality does not align with this attempt." [Raz, at 64-65.]

Summarizing, the problem with Jensen and Meckling's theory is that corporate law is not as simple as a nexus of contracts. Corporate law theory is actually a complex system of private law based on common law, which in turn was based on centuries-old norms. So, what proof do we have today that their underlying rational market theory did not work as they said it would? In his seminal book entitled TRANSACTION MAN – THE RISE OF THE DEAL AND THE DECLINE OF THE AMERICAN DREAM [13] the author Nicholas Lemann goes into great detail on how financial economics took over corporate law. He writes: "[p]ublished in 1976, The Theory of the Firm … stands [today] as just as much of a landmark as Berle and Means book entitled "The Modern Corporation and Private Property" [which] prepared the ground for a great remaking of the corporate relations with government in a way that wound up creating a corporation dominated social order. Theory of the Firm "prepared the ground for blowing up that social order". … Berle and Means thought the corporation was too powerful; Jensen and

Meckling thought the “agent”, meaning the Chief Executive, was not sufficiently responsive to the principle, meaning the shareholders”. [Id. at 114.] As such, Jensen and Meckling figured out a way to make the chief executive behave more like a shareholder. At that point, executive compensation became more and more financially nuanced. Government intervention was out, private ordering was in, and the results speak for themselves. The author writes that, “between 1981 and 1988 alone, there were more than two thousand corporate takeovers a year valued at $1 million dollars, far more than the country had ever seen. … A third of the companies on the Forbes list in 1980 were no longer independent companies by 1990. There were thirty-five thousand of these transactions, worth $2.6 trillion, between 1976 and 1990. … Hundreds of thousands of jobs at the country’s traditional, supposedly unassailable corporations disappeared. … That meant the lifetime job security that had been an unstated point of the corporation social compact was gone … ”. [Id. at 116.] Jensen and Meckling had created a “market revolution that [they] considered healthy, indeed necessary”, … but there was a problem in paradise, and the author believed that it came about from the premise of their whole theory - the Efficient Market Hypothesis (“EMH”), that had two big problems. One was information asymmetry (i.e. imperfect pricing because not all market participants had legal access to accurate information) and the other problem was behavioral economics (i.e. humans are naturally prone to misperceive reality). If both issues were correctly understood, then markets do not always behave efficiently and so that would entail some sort of government intervention because the “principal – agent” theory does not solve these two issues. Paradise lost.

Years later, Jensen finally realized his so-called “alignment” construct (i.e. managers with shareholders) did not work. So, around the year 2004 he recanted it with a new solution of emphasizing “integrity” as a fundamental business practice. He considered it “positive but not normative”. [Id. at 130.] The author quotes Jensen himself as asserting that integrity was “an unambiguous and actionable access to the opportunity for superior performance, no matter how one defines performance. [Id. at 131.] Put another way, Jensen gave up on aligning executive compensation incentives and replaced it with changing the executive. Too little, too late. (See the early 21st Century Theory section below for further details.)

• *Easterbrook and Fischel*

The final major legal theory of the 20th century which began in the 1990s. For that we turn to a book written by Easterbrook and Fischel entitled THE ECONOMIC STRUCTURE OF CORPORATE LAW published in 1991. [14] Easterbrook and Fischel treated a corporation as an "aggregate" of people, but at the same time, denied that the members of the aggregate had any actual duties arising from its activities. In their seminal book their theory shifts the law to economic constructs in the last decade of the late 20th century. Their law and economics movement still holds sway today in many quarters.

In Chapter 1, entitled *The Corporate Contract,* they set forth the classic debate last century regarding the tension between corporate management and shareholders. They cite what they call numerous "tools" that managers used to stay in control, such as the "enabling" type corporate statutes that provide managers broad powers, the Business Judgment Rule (i.e. a litigation tool where judges allow entities wide discretion in business decisions without second-guessing them), the unequal bargaining power between small groups of investors and management, the doctrine of freedom of contract, and the private ordering theory of the market. With all these powerful corporate "managers tools", Easterbrook and Fischel believe that shareholders needed to be protected. To do so, they created a new theory that asserted that behind the curtain of a corporation as an organization, it was first and foremost "a financing device and not otherwise distinctive. [Id. at 10.] As such, shareholders were merely "residual claimants" (i.e. they get paid last), so their theory justifies shareholders getting the highest returns because they bear the greatest risk. (As for the issue of limited liability, the co-authors conveniently explain it as merely an attribute of a shareholders' position - not the corporation.) When Easterbrook and Fischel proposed their theory, it ran contrary to contemporary corporate law because they attempted to strip the corporate structure of its key features and functions in order to conclude that the notion of a corporation as a separate entity from its shareholders was just for convenience. So, once they decoupled the existing corporate construct, from its existing historical structure, they replaced it with their reductionist theory of a "nexus of contracts" structure. According to their "nexus of contracts" theory, the company charter itself is a boilerplate type agreement amongst the founders, and any gaps in the parties' original agreements can be filled in later with fiduciary law and "gap-filler" terms (e.g. the U.C.C.). The vague rationale for their theory is that because contract law and social contracts had been a part of philosophy and government for centuries, why not use these constructs for corporate law and simply sweep away existing corporate law altogether? Some critics considered their approach just simplism.

So what is the goal of an entity if it is just a "nexus of contracts"? Easterbrook and Fischel simplistically states, "who cares", so long as the parties agreed to whatever they signed up for. Simply put, corporate purpose is irrelevant. They readily admit that profit and social welfare goals are not perfectly aligned when they wrote that. "[w]hen costs fall on third parties - pollution is the common example - firms do injury because the harm does not come back to them as a private cost. … But banning pollution is no panacea". … No rearrangement of corporate governance structures can change this. ... [So] to view pollution . . . or other difficult moral and social questions as governance matters is to miss the point". [Id. at 39.] So, what is their point? Their point is that the fundamental purpose of business is to make a profit for its shareholders, and because parties "agreed" upon the process, Easterbrook and Fischel relegate social costs to what the parties agreed to up front. If not done initially, then "what they would have agreed to" given the facts and circumstances thereafter. In other words, it's all about the "intent of the parties" – basically a contract model interpretation. Basically they created a reductionist theory of corporate law, as an off shoot of contract law. As such, their premise appears to be repackaged "freedom of contract" theory. [Id. at 39.] Raz asserts in his paper that they tried to "have their cake and eat it too". He criticizes their basic structure because to him it harkens back to early 20th century philosophy of Dewey and Cohen legal realism movement, so it is just repackaged old ideology. He believes that the law can create first order entities, and second order norms, to manage those human persons in corporations that are operated with both fiduciary duties and contractual obligations.

So how have some legal critics viewed Easterbrook and Fischel's theory? A more recent critique came from an article entitled "*The Win-Win that Wasn't; Managing to the Stock Markets Negative Effects in American Workers and Other Corporate Stakeholders"*, by Aneil Kouvali and Leo E. Strine, Jr., [15] The co-authors [K&S] view Easterbrook and Fischel's theory as follows:

- Easterbrook and Fischel simply assume that if corporations are operated to maximize stockholders' profits, and to be highly responsive to their needs, then it would benefit all of society. The premise for their theory is that stockholders are merely "residual claimants" (i.e. a debtor-creditor construct where debtors get paid first and shareholders last). Since the shareholders receive most of the marginal gains and incur most of the marginal costs, they have the right incentives to exercise discretion. Simply put, stockholders can only win if the other stakeholders win first. The problem with this so-called "trickle-down" theory espoused by Easterbrook and Fischel is that it fails to address external costs, worker safety, communities and creditors, product market and healthy competition, and financial markets. "[I]n that imagined environment, a corporate governance regime that encouraged ruthless focus on what stockholders at any moment demand would [somehow] lead to shareholder prosperity. But this is another way of saying that Easterbrook and Fischel assumed all the important problems away, because we can assume the existence of other tools – other institutions and markets - that will ensure that stockholder wealth generation is always aligned with social wealth generation." [Id. at 309-310.] Simply put, Easterbrook and Fischel's **assumptions were unrealistic**.

- Secondly, Easterbrook and Fischel's theory (referred to as their "win-win prediction") was to "define shareholder wealth maximation as the basic objective of corporate law because it assists the other constituencies automatically. If a firm's shareholders profit from a move, it must be the case that other constituencies benefit as well. But this suggestion also ignores the possibility of maneuvers that increase shareholder profits by squeezing other constituencies more effectively: win-lose changes that are **negative on net**." [Id. at 314.] Easterbrook and Fischel treat shareholders as a "dispersed and powerless group" which has been proven entirely false today. Most Americans have their pension plans with institutional investors. Shareholder power is concentrated in the hands of a few large institutions. Furthermore, the share of taxes paid by corporations has dramatically decreased which, in turn, shifts the obligation to the government. In addition to shareholder concentration in power, with respect to its relationship with the government and taxpayers as a group, corporations have increased their use of various corporate tools, such as dividends and buybacks, to return capital, so shareholders are hardly mere residual claimants. Consequently, this forces costs and risks onto other constituencies. (One of the most profound examples of this is climate change where its substantial costs are not picked up by the corporations that produce it.) Summarizing this point, the co-authors state that Easterbrook and Fischel's claim that corporate behavior as a win-win amongst companies, investors, and society, is simply **not credible**.

- Lastly, K&S assert that "[t]he residual claimant theory rests on the notion that unless other stakeholders receive their full returns, then stockholders cannot gain. … [However], <u>stockholders take-claim all the time, and often in advance of other stakeholders</u>. The rules against distributions without adequate capital are far too lax to protect stakeholders from this risk, and there is no serious argument that stockholders are really residual claimants, except insofar as in occasional cases. … And when risk-taking led by investors goes wrong, the investor class has been the beneficiary of huge government subsidies, even while others suffering harm … received far less government wealth. U.S. government has bailed out the financial sector repeatedly. … A core Easterbrook and Fischel's assumption is that the market generally prices risk well, and that it is a reason to trust it, and to allow its forces to act on corporations. … The Efficient Capital Market Hypothesis ("ECMH") is not a promise that the market is right at any time, only a theory that says that it is extremely difficult to build a portfolio that will durably outperform a market . . ." [Id. at 334 – 336.] The history of bailouts demonstrates that financial markets are not an adequate protection for corporate stakeholders and society against the dangers of speculation and overreaching. K&S assert that a model of corporate law that simultaneously exalts stockholder interests, and subordinates the interests of other stakeholders is not a recipe for a win-win. "… [H]istory has shown that depending on powerful economic interests to act in a manner that is socially responsible, that does not externalize their costs of business to others, and that creates shared prosperity, **is naïve**." [Id. at 336.] The co-authors emphatically conclude that "[[t]he Easterbrook and Fischel] theory claim that making societally important corporate governance more to the whims of the stock market would be a win-win for investors, other corporate stakeholders, and our society as a whole, has emerged **as an empirical matter is implausible**. Easterbrook and Fischel at bottom, failed to contend with the real-world realities that allow investors – especially intermediaries like institutional investors who are agents for others - to profit by shifting distributions to themselves and costs to workers, creditors, consumers, and taxpayers. Not only that, although they say other stakeholders should look to other bodies of law for protection, the intellectual and political movement they helped lead systematically rolled back those protections and undermined the institutions such as the NLRB and EPA, that enforced them. [Easterbrook and Fischel] ignored the reality that corporations had been encouraged to, and have used, their entrusted capital to erode those protections." [Id. at 337.]

K&S's bottom line is that Easterbrook and Fischel's theory claiming that "if corporations were run to maximize the profits of stockholders, and be highly responsive to their demands, that would benefit all of society" turned out to be false. [Id. at 308.] Win-Win never happened. Again, Easterbrook and Fischel's theory "ignores a possibility of maneuvers that increased shareholder profits by squeezing other constituents more effectively: win-lose changes that are negative on net." [Id. at 314] It then becomes a "cycle of extraction" by stockholders to squeeze out more and more gains for themselves. The authors assert that the ultimate paradox is that corporate governance that focuses on maximizing the immediate wealth of the company specific shareholders, does not even maximize the overall economic welfare of equity investors because it basically pushes companies to the "edge of irresponsibility" viz.; shortcuts that harm all stakeholders to satisfy the shareholders demands. What is worse, Easterbrook and Fischel disingenuously asserted that stakeholders could rely on external legal protections outside of corporate law, but then they promote the erosion or repeal of these laws. The predictable result is that "[i]f the government fails to impose "new costs" on firms to force them to internalize the consequences of their conduct, firms will practice socially destructive behavior." [Id. at 322.] Like the famous 20th century economist Milton Friedman who opposed unions, civil rights and environmental laws, Easterbrook and Fischel likewise point to the law to solve problems, and then oppose these laws when it was time to do so. An entire generation of corporate law theory, espoused by Easterbrook and Fischel, and promoted by Friedman-Reagan economic views in the 1980s, according to these critics is based on a false premise and made false predictions.

What then is the answer to these various misguided 20th century legal theories? K&S conclude that we "should heed the lessons of history and the need for guarantees of fairness and efficiency, which ensure that corporations are encouraged to make money the right way, by producing products and services that create sustainable value, net of externalities, and through the respectful treatment of all their stakeholders . . . The way forward depends on sustainable wealth creation that is based on more than forcing costs onto third parties… .” [Id. at 338.] I agree that this is where we are today, viz., a loss of a whole generation to unrealistic corporate practices, and the damages therefrom. The last paragraph of the K&S article succinctly states as follows: “Although government regulation is an essential part of the solution, giving corporate boards to tend to groups other than shareholders can also play a useful role. Given the failings of regulation, labor markets, product markets, and capital markets, corporations that strive only to maximize their stock price will predictably engage in socially destructive behavior. It is only by considering the needs of **other constituents** that corporate boards can fund and help implement true win-win for our nation and the world.” [Id.] [Emphasis added.]

Given these various 20th century theories of corporate law, how did state courts, where corporate common law originally came from, treat personhood theory? Let’s see.

State Common Law

Because legal personhood comes from state common law, let’s briefly contrast all these reductionist 20th century corporate models discussed above with Delaware common law at this point. Why? Simply because Delaware law is where most law practitioners look to the law of corporations for many reasons (not addressed herein). Attorneys who know Delaware corporate law have looked upon it as the jurisdiction where differences between management and shareholders have significantly played out for years. As Raz points out in his paper, at a more fundamental level, it is also where corporate legal personhood doctrine gets formed on a case-by-case basis, without corporate metaphors and theories such as realism, aggregate, agency, etc. Likewise, and just as important as he states, Delaware courts do so without conflicting with "the promotion of economic, social, or other extra-legal objectives”. [FN 1 at 47.] It is not possible to summarize the history of Delaware corporate personhood theory in such a brief article here, but three seminal Delaware cases Raz cites to support his position on legal personhood are as follows (with some further details that I have added. These cases are considered a “change in control” type contests, which raise the issue to whom does the board of directors owe their fiduciary duties in a potential conflict between the corporation and its shareholders?

(1) In Unocal Corp. v. Mesa Petroleum Company, Del. Sup. Ct. 493 A.2nd 946 (1985), [16] a hostile takeover case, the Unocal directors decided to fight a hostile tender offer attempt by one of its shareholders - Mesa. The court held that directors can take into consideration the impact of other "constituencies" beyond shareholders as long as they did so in good faith and with due care. More specifically, the Delaware Chancery Court held that even though the corporation was not a party to the takeover, the Unocal directors had the power to block the transaction if it could be harmful to the corporation itself. So, there was a legitimate corporate purpose that was reasonable in relation to the threat in blocking the take-over (i.e. junk bond financing), because it was not in the best interest of the company itself. The court held that to ignore this issue would cause a possible violation of a director's fiduciary duty to the corporation.

(2) Revlon Inc.v. MacAndrews and Forbes Holdings, Inc., Del. Sup. Ct. 506 A. 2nd 173 (1986), [17] was another hostile takeover case, where the incumbent board was resisting an unwelcome takeover offer. The Delaware Chancery Court held that a director's fiduciary duties are owed to the corporation itself as a rule. However, once the take-over was inevitable, it provides an exception – but only an *ad hoc* duty to the shareholders. *Revlon* was a limited exception, and regardless the *Revlon* directors had no per se duty to shareholders. Revlon's lock up options are not illegal if they are not detrimental to the corporation, but here the court held that because they burdened the shareholders by preventing competitive bidding to get the higher current value for the shareholders, the lock up was improper. (Lawyers and judges began thereafter to call these duties simply "*Revlon* duties".)

(3) In Paramount Communications, Inc. v. Time, Inc. Del. Sup. Ct. 571 A.2nd 1140 (1989), [18] the issue was what triggers *Revlon* duties of the board of directors? In this case, Paramount launched a hostile takeover bid for Time, Inc. The Delaware Chancery Court held that the directors owed their fiduciary duties to the entity itself, and not its shareholders. As such, the *quantitative* issue of maximizing the price can be rejected by directors if the opposing bid has other *qualitative* features that they find are in the best interest of the entity. So, the court restated the Unocal doctrine, and clarified the prior *Revlon* decision, by stating that the requirement to maximize shareholder value was not a "per se duty" of directors to maximize shareholder value even in the context of a takeover. The test is not maximizing the shareholder price, but rather the

question is did the directors act in good faith as a corporate fiduciary? The open-ended analysis mandated by *Unocal* is not intended to lead to a simple mathematical exercise. (Both in this case, and the *Revlon* case, the business judgment rule was ultimately applied, so the court did not substitute its opinion for that of the directors.)

These important Delaware cases are an example of corporate state law in the 1980's take-over era. As you will see, the corporate framework of "legal personhood" was upheld albeit it was tenuous by the end of the 20th century. Again, the court will not substitute its own judgment for the directors unless there is a showing that the directors' decision was primarily based on a breach of a fiduciary duty to the corporation because directors owe a fiduciary duty to the corporation first and foremost. So, in corporate control-type cases (e.g. a hostile takeover), courts will give the corporate board of directors a degree of deference if they acted in good faith to determine whether the transition was reasonable in relation to its corporate purpose. Again, Raz cites these corporate control-type cases to support the personhood theory, which originated in common law. Assuming so, then the narrower question is how does such a fictitious personality differ legally from that of a natural person? How many constitutional protections that limit government power regarding natural persons extend to corporations, and when does the efficiency of the corporate personhood theory get outweighed by its ineffectiveness as being constraining as Dewey claims? For that issue, let's look at the current century and see what happened to these economic theories and common law decisions.

Early 21st Century Theory

The question is how did these 20th century theories, such as the principal – agent and nexus of contracts theory fare in this century? In the excellent book "SAMUELSON – FRIEDMAN, THE BATTLE OVER THE FREE MARKET" the author Nicholas Wapshott [20] states that Jensen & Meckling's corporate theory, based on the rational market theory, metaphorically "crashed" with the market in 2008. I have paraphrased below some key facts in the market crash that Wapshott summarizes as follows. In March 2008, Bear Sterns, America's 5th largest investment bank loaded with subprime loans, was on the edge of bankruptcy, so investors rushed to cash out. As a result, the Federal Reserve agreed to underwrite $30 billion of its mortgage securities because it was “too big to fail”. On September 7th, 2008, Fannie Mae and Freddie Mac, the two great mortgage lenders, received an emergency loan of $25 Billion from the Treasury. So, they were now basically owned by the government. On September 15th, 2008, Lehman Brothers filed for bankruptcy with $600 billion in assets, but $572 billion in loans to borrowers, making it highly vulnerable. On September 16th, 2008, one day later, AIG filed for bankruptcy. To stop the domino-effect, the Federal Reserve agreed to buy AIG with a loan of $85 billion in exchange for 80% of AIG equity. [Id. at 273–76.] Given the above facts, at that point in 2008, the author states that effectively the free market was no longer free. Financial institutions stopped lending, credit markets froze, and financial businesses ground to a halt. Wapshott concludes that “it was not exactly 1929 all over again, but the financial freeze of 2008 was to prove just as profound in its effect on the U.S. and world economy." [Id. at 276.] As a result, in September 2008, Congress was asked to provide $700 billion in emergency bank bailout funds to buy up troubled assets. When Congress voted against it "the Dow Jones plunged 770 points, the largest single-day fall in prices in Wall Street history. Chastened by the market verdict, Congress revisited their TARP decision and voted a second time on October 3rd, this time agreeing to fund the program in full.” [Id.]

Given the facts above, what is a key take-away that relates to Jensen and Meckling’s theory is that "by denigrating over many decades’ government intervention of any sort, Milton Friedman and others had invited the return of do-nothing Hooverism. … The events of 2008 undermined the logic of the rational-expectations school who argued that those who operate the markets know enough to avoid catastrophe. Why had there been no "rational expectation" of a financial freeze?” [Id. at 278] As the author states "… America was to endure a painful, decade-long haul out of the ditch. Recovery was woefully slow. Friedman's championing of the free market had been hugely successful in his lifetime, but the financial freeze shook the commonly held belief that free-market forces, left to their own devices, would act to ensure the perpetual prosperity, full employment, and growth that Americans demanded. The same tone-deaf legislators who had voted down TARP led the charge against any federal government action that would hasten a recovery. There was talk that bailing out companies presented a “moral hazard" that would encourage recklessness among financiers confident in the knowledge that the government would step in and save them at the last moment. But the principle that the government should keep out of the way and let the market do its worst had been shaken to destruction. In the heat of the crisis, no respected economist could be found to argue that it would be better to watch the economy fall off a cliff and wait for the market to provide a solution. **Friedman's perennial prescription, to give the market time to cure itself, was not found wanting; it wasn't even considered**." [Id. at 278.] [Emphasis added.] Looking back at these 2008 statistics, it was the year that so-called bail-out financial economics replaced the crashed, unfettered market theory of the 20th century.

Wapshott ultimately concludes that whatever positive thoughts remained that Friedman economics was still valid in light of the 2008 free market crash, could not be reconciled with the COVID pandemic crisis and how it was handled around 10 years later. He writes "the COVID crisis dealt a severe blow to Friedman's desire for smaller government and the removal of government from interference in the marketplace. The federal government was now in total control of the market, and decided which businesses were allowed to operate, which lived, which died. The universal response to COVID among responsible governments was that only "big government" could provide the wherewithal to limit, then overcome, the pandemic. Countries with small or incompetent governments . . . could not cope with the medical disaster that overtook them. Even in the United States, where the notion of "big government" had long been besmirched by conservatives quoting Friedman as their inspiration, there was little argument among federal government ranks that the temporary closure of large parts of the economy was the only responsible action. . . . The COVID pandemic showed not only that big government was necessary but that it was both the lender of last resort and the only means of keeping the tens of millions suddenly made unemployed from starving . . ." [Id. at 288.] Once again, bail-out economics saved the "free market". In one of his last interviews, the esteemed economist Paul Samuelson of MIT simply said "[Freidman] is a bright guy as you would ever meet. … However, I think that it is a tragedy when somebody takes the wrong train in life." [Id. at 296.] Even the former Federal Reserve Chairman Paul Volcker said back then that "it should be clear that among the causes of the recent financial crises was an unjustified faith in rational market expectations, market efficiencies, and the techniques of modern finance." (Paul Volcker *Financial Reforms: Unfinished Business*, N.Y., Review of Books (27 October 2011). [20] Simply put, the “market light” theory espoused by Jensen and Meckling, and Easterbrook and Fischel based on the free market theory, proved to be untenable.

So, are there any legal scholars that put forth an alternative theory for corporations in the 21st century? As briefly mentioned, Raz believes that the work of Professor Henry Hansmann and Reiner Krackman [“H&K”], published in 2000, entitled The Essential Role of Organizational Law, [21] was a better theory. Because their paper was a response to the reductionist, contractarianism of Easterbrook and Fischel. Hansmann and Krackman’s common law theory was that the central role of organizational law was “to provide for the creation of a pattern of creditors’ rights … that could not practically be established otherwise." [Id. at 37.] Such “asset partitioning” as it is called, **aligns with** the legal personhood theory of corporate law as a system that, Raz believes, creates a "legal degree of freedom" beyond human persons as actors. As such, it refutes the reductionist-realist movement of the last century. Although Hansmann and Krackman focused on property and contract law constructs in their analysis, Raz states that they should have kept going and affirmatively stated that “corporate law is simply corporate law” (albeit it has subsumed portions of property law, contract law, and agency law). Their work is cited by Raz as pivotal to a renewed legal personhood construct for this century, but he thinks **it did not go far enough.** But Raz does not answer the question of how far does he think the new legal degree of freedom should go? But before we address that issue, yet another hurdle arose from none other than the U.S. Supreme Court itself. Let’s look at it.

In the two recent United States Supreme Court cases, *Citizens United* and *Hobby Lobby*, [See FN. 3 and 4] the court addressed the alleged constitutional rights of unencumbered political speech, and freedom of religion of a fictitious person – respectively. In both decisions, the Supreme Court held that a corporation is merely “an association that has taken on a corporate form". Justice Alito went further to state that ‘it’s a fiction [to] include corporations within [the] definition of person, and that humans’ “own” corporations. Such sweeping statements contradict not only over a century of Supreme Court legal personhood precedent, but also state common law decisions that run contrary to his conclusion. Constitutional rights have in the past been extended to corporations under **a real entity theory** without dismantling the legal construct of personhood itself. So, the Supreme Court **aggregate of individuals** theory is considered by some corporate lawyers as being fatally flawed as it, for the most part, lacks legal precedent (despite the court's attempt to limit its application). What is worse, as Raz states, these federal judges have lost touch with private law, state law, the Erie doctrine, etc. and what Chief Justice Roberts himself described as the courts primary constitutional role which is to just call "balls and strikes" (to use his own baseball analogy). In a recent book by Adam Winkler entitled WE THE CORPORATIONS – HOW AMERICAN BUSINESSES WON THEIR CIVIL RIGHTS, (2018), [22] the author turns to former Delaware Supreme Court Chief Justice Leo Strine, Jr. for his thoughts on these two Supreme Court cases. He cites Strine's speech at Yale Law School, in which Strine bluntly states that the Supreme Court Justices "don't know much about corporate law". More specifically, in the *Citizens United* case, the court unrealistically stated that a disgruntled shareholder can simply sell their shares if they don't like the corporate activities thereof. But as Strine writes, the reality is that most shares are indirectly owned by intermediaries, such as pension and mutual funds, so shareholders have no access to the procedures of corporate democracy. Furthermore, the "use of proxy voting give[s] management nearly unfettered control over corporate election outcomes. And with regard to intermediaries, investors don't choose what stocks the intermediaries invest in or even which intermediaries manage these funds in some circumstances". [Id. at 385.] Simply put, Strine states that corporations are not associations of people, they are **juridical persons**. This distinction important because under long-standing corporate law, a corporation is "an independent legal entity, separate from the people who own and work for it. Because of the legal shield of personhood, "stockholders . . . were not personally responsible for the corporate debt . . . [so] the victim had to sue the corporate entity itself, not the members of the corporation." [Id. at 386.] Strine's view is shared by many other critics of these two court decisions as well.

Regarding the second Supreme Court case mentioned above, the *Hobby Lobby* case, Strine states that "there is a whole, deep corporate law problem with figuring out whether a corporation has a religion . . . so what [the justices] did was conflate the family which controlled *Hobby Lobby* with the corporation. The court looked right past the distinct legal status of the corporation . . . As such, the *Hobby Lobby* decision abandoned the principles of corporate personhood." [Id. at 387.] The question should not have been about the Green family's religious beliefs, but whether the corporation itself should be recognized to have religious beliefs. They are two separate issues. As Strine states, the Green family "depended on that separation to protect their personal assets and would have insisted on a strict boundary between them . . . if a customer had fallen in a Hobby Lobby store and sued the Greens personally for damages." [Id. at 387.] The court incorrectly conflated the two issues causing a so-called "**veil-piercing**" problem for shareholders. (The veil-piercing theory is not within the scope of this paper.) Strine goes on to assert that in both cases, the court was not even focusing on the right question, much less get the right answer. Corporations were historically "afforded fewer and more circumscribed constitutional rights because there is a difference between "blood citizens and corporate citizens". Strine states that this is not metaphysics, but rather a basic principle of corporate law. And because the U. S. Constitution is silent on the issue of corporations, at what point does the court cross the line in usurping state statutes and common law with judicial activism which ironically it claims that it does not do? Strine it seems believes they already crossed it.

To put these two decisions in perspective, Winkler addresses the rather sordid history of the original U.S. Supreme Court case of <u>Santa Clara County v. South Pacific Railroad</u>, 118, US 394 (1886) in which the constitutional protection of corporations was addressed. Justice Field had written that corporations should have 14^{th} Amendment rights of legal protection and due process to protect the property rights of its shareholders, even though corporations were not explicitly mentioned in the constitution, nor did the drafters intend to include corporations as persons at the time it was written. (Furthermore, the decision itself did not rest on the rights of personhood but, due to reporter error, it came to be cited as such in subsequent cases.) For Justice Field, it was all about economic liberty, and nation-wide corporations needed it. [Id. at 144-156] So how did the legal "personhood" theory stick? Winkler writes:

> "Philosophers, both at home and abroad, engaged in a lively debate about the nature of the corporation around the turn of the century [i.e. 20^{th} century]. Was the corporation a state-created fiction? Or was it a real entity with a will of its own? American pragmatist John Dewey dismissed the various "theories" of the corporation as inherently indeterminate. Indeed, the shift toward corporate criminal liability had little to do with philosophy. Criminal law came to be applied to corporations because it was a valuable tool to discipline the emerging corporate

> giants of the era. As the Supreme Court would explain in a 1909 case, "the great majority of business transactions in modern times are conducted through these bodies, and . . . to give them immunity from all punishment because of the old and exploded doctrine that a corporation cannot commit a crime would virtually take away the only means of effectually controlling 'business activity'." [Id. at 179.]

Winkler concludes by stating that once corporations were subject to criminal penalties in legislation back then, what excuse can there be to deny them the beneficial protections of the Constitution? Simply put, if corporations can face similar penalties faced by individuals, they should have similar protections. Let's analyze this corporate personhood controversy and Winkler's conclusion a little further. In an article entitled *Does Personhood Matter? – A review of and Response to Adam Winkler's WE THE CORPORATIONS;* Stephen J. Padfield, 20 Tennessee Journal of Business Law, 1009 (2018), [24] the author distinguishes in his view between the concept of "corporate personhood" versus "corporate personality" theory. He reviews Adam Winkler's book and states that he wants to add a "useful adjunct" to same. He begins his paper by surveying the history of corporate law, as presented by Winkler, going back as far as the influential English scholar William Blackstone in 1758, "who describes the corporation as an "artificial person" with a separate legal identity with certain rights, including property, contract, and access to the courts." [Id. at 1012.] He goes into detail on Winkler's distinction between corporate Property Rights (1861 – 1953), which includes the Lochner era (1897 – 1936), and then covers the period entitled "Liberty Rights" (1936 – to date). In the final section of his paper Padfield defines the major theories of corporate personhood, viz; concession theory, aggregate theory, and artificial entity theory, and then he forms his own conclusion on them. Let's discuss his view.

Padfield's analysis starts with the **concession theory** of corporate law that goes way back to the Dartmouth College decision. The court held that "a corporation is an artificial being, invisible, intangible, and existing only in the contemplation of law … The objects for which a corporation is created are universally such as the government wishes to promote. Tr. of Dartmouth v. Woodward, 17 U.S. 518, 636 – 37 (1819). [24] Under this corporate personhood view, the concession theory gives greater deference to the government in regulatory matters. So, although the Supreme Court said in a long line of decisions that certain identity-based political speech of corporations can be regulated, the court held that the *Citizens United* case was different because it did not interfere with government functions (i.e. elections). But as the author states, that is a "hard pill for many to swallow". [Id. at 1019.] Next Padfield reviews the **aggregate/nexus of contracts theory**. He believes it is a major problem because it "blurs the line between the shareholder and the corporation in which they own shares …" [See below.] The next theory he reviews is the **real/natural entity theory**, which he describes as somewhere in between the concession theory (broader government role) and the aggregate theory (like a partnership). Real Entity theory attempts to solve these differences by calling it what it "really" is, viz; a private entity regulated by the state but governed by its board of directors. He considers this more like the private ordering theory of business where the directors and shareholders are considered more like "private citizens". The final corporate theory Padfield writes about is the **functional/realist theory**, as espoused by John Dewey in 1926 in his paper in the Yale Law Journal, as discussed above. He writes that Dewey's paper was considered as "ushering in a sort of Dark Ages for corporate personhood theory, from which we are now just beginning to emerge." [Id. at 1023.] So, Padfield writes that the irony of Dewey recommending the "personhood" theory be abandoned by the legal community until a more functional construct is found, is that in fact the theory of corporate personhood was "a major factor in the legitimizing big businesses and that the other theoretical alternatives could not provide as much sustenance to newly organized, concentrated enterprises". [Id. at 1024, citing Howitz - FN 63.] (As mentioned above, for Dewey to simply state that the theory needs to stop being used until a better one is created ignores the fact that cases are being decided every day in jurisdictions that use the personhood construct as a baseline.) So for substantive and practical reasons, Dewey ultimate recommendation is not helpful. (Padfield also mentions two other minor theories known as the "incidental powers theory" and the "collaborative theory" but they are outside the scope this paper).

Padfield, after reviewing these major legal personhood theories to date, pushes back on Winkler's characterization of *Citizen's United* decision by stating that Winkler "presents the relevant issue as one of piercing the corporate veil versus personhood". [As such, it's a] struggle between disparate poles of personhood and piercing". [Id. at 1026.] To Padfield, the issue of reaching shareholders by skipping over the corporate entity, based on legal personhood, is less a simply ignoring corporate personhood (i.e. piercing of the corporate veil), and more about focusing on 'the aggregate theory of corporate personhood to justify the extension of rights". [Id. at 1028.] (Padfield also briefly discusses the Masterpiece Cakeshop, Ltd v. Colorado Civil Rights Commission, 138 S. Ct. 1719 (2018) [25] where he concluded that the court " ignored the argument that the plaintiff in the case was a corporation, rather than an individual baker, and that such a right of a corporation to claim religious freedom under the U.S. Constitution had not yet been decided, and that such a right should not be granted to corporations." [Id. at 1028.]) Corporations are not natural persons, so one may ask are there any distinctions left between corporate rights and average citizens rights? Padfield asserts that there appears to be a choice between the concession theory and the aggregate theory - but that it is too binary, so he recommends a bifurcated approach in which the concession theory can be used for legal standing and limited liability for shareholders purposes, and the aggregate theory for limited rights for the association of shareholders.

In contrast to Padfield, Raz believes that legal personhood is broad enough, so it is still workable because it provides corporations a "**primary degree of freedom … *ex-ante*, and only eventually does (or does not enter) into the various relationships** …" [Raz at 60.] [Emphasis added.] He writes, "the corporation is not merely about delineating asset pools, it is, first and foremost, about activities." Such legal activities go beyond duties, rights, and obligation type relationships, and could include a corporation adopting religious, political, or cultural stories as described in *Citizens United, Hobby Lobby,* and *Paramount v. Time* (i.e. the Time culture) because a corporation can choose (or not) to benefit its shareholders, (except in a few limited circumstances). Put another way, entities such as corporations are reified (i.e. personified) constructs that go beyond a mere nexus of contracts. The biggest opponents of corporate personhood have consistently been from reductionist thinkers over the past 50 years who chose to ignore the complexities of corporate law. (As you may recall, Raz's defense of the personhood theory of corporate law is better aligned with the more recent structural theory of Professor Henry Smith (i.e. a systems theory of law) and the new private law (NPL) movement. Raz also believes that the "personhood" system of corporate law is more realistic than the realism theory of law itself.) All the major Delaware cases over the past half century demonstrate that the fiduciary duties that directors have are primarily owed to the entity itself. So, stakeholders benefit, not as beneficiaries of any fiduciary duty to same, but rather because the purpose of a corporation is to advance its profit-seeking function for the entity. Regarding agency theory and agency costs, those costs need to be addressed between corporate fiduciaries and the corporation, not the shareholders or anyone else. The bottom line for Raz is that "<u>corporations are not creatures of economics, but creatures of law</u>." [Id. at 70.] [Emphasis added.] A corporation must engage in a lawful pursuit and its fiduciaries are bound to cause it to do so. Shareholders and stakeholders have certain legal rights, but there is no agency or primacy towards either. So, for him personhood still makes sense despite some twists and turns along the way.

Summarizing, for Raz legal personhood is a unifying paradigm for a complex system, based on common law, that provides corporations with a "legal degree of freedom" that goes beyond human personhood to determine its activities ex-ante in an efficient and effective manner. It is just as valid as property law, contract law, or any other legal construct, and it should be respected as such. Penfield believes that his own hybrid model of personhood is relatively open enough as well to accommodate any corporation. And if both theories of corporate personhood focus on the "freedom" the Supreme Court has provided these juridical persons, the follow-up question is what is the limit to it? At some point, the court must distinguish corporate personhood from a human person because the court cannot forever use particular facts and circumstances of a case to carve out more exceptions to the "stare decisis" of over a century of case law on what corporate personhood means. Regardless of what interpretation you prefer, if we get beyond the semantics and assume that legal personhood is a valid theory (which I believe it is despite its awkward name), looking forward how then can corporations positively affect the broader business community that they serve in this century? Let's move on to Part II and look at three (3) organizational legal models that may help answer that question going forward.

Part II: LOOKING FORWARD

Part I was a brief survey of the troubled evolution of major trends in corporate law in the 20th century and early 21st century. In Part II, I will briefly review three new 21st Century corporate models that I believe can pave the way for organizations to better engage with society in a plus-sum type relationship, starting with the Strine Model, next the Pieconomics Model, and finally the Mayer Model. Albeit different methodologies, I believe that they represent a better solution to the on-going challenges corporations face today.

A. The Strine Model

In the introduction to his book entitled ***On The Rule of Law,*** the author Brian Z. Tamanaha [26] writes that "[m]y conviction is that theory is relevant to everyday life, and therefore it should be available to everyone." Directors and managers today operate on various business, legal and financial theories of the most efficient and effective way to run their companies. Let's look at some recent legal models to do so. In a more recent ABA Business Lawyer, the former Supreme Court Delaware Chief Justice Leo Strine, Jr. wrote an article entitled *Good Corporate Citizenship We Can All Get Behind - Toward a Principled Non-Ideological Approach to Making Money the Right Way***.** [27] He writes that his intent was to map out a "… non-partisan, principled conception of good corporate citizenship drawing on shared assumptions of the right and the left about the place of corporations in our society and the realities of corporate governance." [Id. at 329.] His focus is on how a corporation's conduct influences the interests of its stockholders and workers, communities of operations, consumers, taxpayers, and the environment. Strine's baseline is that corporations should support "the basic institutions of the society upon which the corporation depends … [but leave behind] . . . debatable issues of politics and faith largely to human investors, workers and consumers to decide for themselves." [Id.] It's a straight-forward, two-part concept. But is his proposed model an improvement over past corporate models? Strine provides a brief overview of the two prevailing views (i.e. "schools") of corporations today, one that espouses the narrower "shareholder primacy" view, while the other school espouses the broader "stakeholder" view. More specifically.

• The <u>shareholder primacy school</u> of the last century asserts that corporations are simply the tool of the stockholders, a quasi-agency theory of the firm, so to speak. The measure of choice for this shareholder centric school of thought is their focus on increasing corporate profits as the only efficient way to determine how well the corporation is doing. This school is based on the basic legal construct of *principle–agent*. (See Part I, *supra*.)

• The <u>stakeholder governance school</u> in this century that takes into consideration the workers, its customers, taxpayers, the communities where the entity operates, and the environment beyond just the shareholders. This school takes into consideration an eco-system approach to doing business.

So where does Strine's model fit in? He writes that his central goal is to identify some methods by which corporations and institutional investors might improve how they make money the right way. The law confers on corporations certain rights and powers apart from human beings, but the law also has concomitant limitations on its conduct and behavior. Both schools make some positive contributions to corporate stakeholders, but Strine believes that fundamental corporate powers and limitations themselves are amenable to what he calls his "good corporate citizenship model" ("GCC"). Strine derives the structure of his GCC model by asking two simple questions, viz.

"(1) Who gets to determine corporate policy, and

(2) What are the typical statutory boundaries on the ends of corporate governance." [Id. at 335.]

Strine submits that the answer to both questions is uncontroversial. For the **first** question, he states, "the board of directors set corporate policy and oversee management's implementation of it " [Id. at 335.] within the limits of corporate statutes and common law, of course. The answer to the **second** question he states is also uncontroversial because it is well known that a corporation must pursue a lawful business, by lawful means, and through lawful activities, based on state statutes that both enable and restrict them (e.g. by statutory required stockholder approvals on certain key shareholder matters). Regarding directors and officers, the courts equitable review of corporate fiduciary duties (i.e. the fiduciary duty of loyalty and the duty of care) is the general standard for substantive judicial review for lawfulness, and the judicial review process for the lawfulness of corporate business activities is the Business Judgment Rule ("BJR"), used by judges to avoid second-guessing business decisions. (The BJR court rule is beyond the scope of this paper.) Then what about shareholders? Basically, their legal rights are limited to their voting authority per statute, and their corporate charter, subject to the authority of the board's primacy over policy. The corporate board, and selected management, decide the policies of the corporation subject to various corporate rules. Because it is the board's decision how to conduct their business affairs by any lawful means and by any lawful activities, Strine believes that "there is no "right – left" divide (i.e. amongst corporate legal experts at least). Statutory corporate law is already designed to constrain corporate boards' power to embrace certain values with its corporate funds. So, given this broad **can do** discretionary corporate power, the real question is, what **ought** corporations do with their broad powers?

Strine proposes a new corporate model for entities to exercise their power and get beyond what he believes are the past errant corporate legal theories. Basically, he writes that we need to move in a direction supported by what he calls "principles" that constitute best corporate practices widely shared by our society. Strine's premise is that his "good corporate citizenship" model doesn't just rely on regulatory controls (i.e. rules and standards), but rather corporations must create policies that take into consideration corporate rights, concomitant with corporate limitations. Strine asks "are we stuck with corporations that callously seek profit in a manner wholly abstracted from social context, and with none of the real-world heart and soul concerns that animate sole proprietors and ordinary workers in their conduct?" [Id. at 358.] Corporate by-laws and policies are private law, so their **elasticity** enables them to create company specific solutions, within the broader rules of public law as hard stops to errant policies. (His two-tier baseline to corporate governance fundamentally embraces the age-old oath of "first do no harm".) For starters, in his opening policy statement he writes, in pertinent part, that "[m]ake no mistake about it, we know our job is to deliver solid profits for our investors in a sustainable way, but also recognizing that by sustainable we mean sustainable. We are not going to seek profit the wrong way. Our shareholders don't just invest in us, they invest in the entire economy, and they pay taxes and need jobs. They live in the real world . . . we will pay a living wage and benefits . . . and do so in all nations and regions where we operate. We will focus on safety and quality. . . We will try not to harm the environment or contribute to climate change that endangers our economy and well-being." [Id. at 358 – 359.] Strine concludes by noting that neither of the two major schools of thought in corporate law can really take issue with his proposed corporate policies.

What are Strine's corporate principles, and how does he recommend companies implement them? Strine sets forth several board approved sample model policies to address corporations' rights and duties. He divides them into direct interests (i.e. "Tier 1") and indirect interests (i.e. "Tier 2") policies. His Tier 1 model policies take into consideration such matters as (1) ethical profits, (2) sustainability, (3) respect for stakeholders, (4) employee living wages and benefits, (5) safety and quality of its products, and (6) fair taxes, etc. – all for standard approval by the board. For Tier 2 policies, he proposes requiring a more restrictive unanimous vote, such as "the entire board will approve any corporate policies in political and social issues and will only address those more important to the company." [Id. at 366.] So Strine basically sets up two tracts of corporate interests based on their priority to the company business. He asserts that respected scholars in the legal field would agree that his model has, in legal parlance, a "rational basis" with appropriate "guard-rails" as he calls it. <u>Strine calls it a principled approach based on shared values</u>. He then lists a dozen or so sample policies that fit his definitions and goals above. For example, one sample policy states that "[t]he company should avoid] environmental harm or any other harm that might unfairly shift cost from the company to its stakeholders or society". Another policy states that "[i]f the company purports to take positions on external public policy, its positions should result from a deliberative process of the Board of Directors based on the direct relevance of the policy question to the company, and not just reflect the personal view of the CEO without board backing." [Id. at 366.] Strine's list of director policies basically reflects the principles a corporation may espouse on a two-tier basis, based on whether the interest is direct or indirect to the overall company interests (within the limits of corporate law). Put another way, he divides corporate matters into two-tiers, viewed on a sliding scale basis, as to what extent a company should, or should not, approve various proposed company policies. So where do corporate institutional investors fit in? Strine asserts that there should be a "corresponding framework to guide the stewardship role" of the investors. He then provides sample policies to “identify reasonable expectations for portfolio companies to create sustainable value the right way”. For example, one investor policy is to “[d]emand corporations use the suggested guard rails over political and social involvement.” [See Tier 1 & 2 above.] Another Strine investor policy sample is to “[c]hannel engagement efforts toward those inward-facing issues – how is the corporation treating the people its conduct affects? . . .” [Id. at 370.] He goes on to list several other sample policies, but basically his point is that investor policy should track corporate policy in order to create sustainable profits based on growth “net of externalities”.

In the end, Strine’s proverbial bottom-line goal for his Good Corporate Citizenship model is that it’s about “making money the right way [so that] all Americans can get behind it, so it leaves no one out, and does not divide us.” [Id. at 370.] His model is basically a private ordering type model, but with the added obligation that recognizes a corporation’s broader role in a 21st century society. As one well-known jurist put it, Strine’s model goes to the heart of how the legal system and the corporate system intersect, and the policies that private ordering can implement and thereby also avoid over regulation if corporations practice good governance. But does Strine’s solution go far enough? Let’s look at another model for comparison purposes.

B. <u>The Pieconomics Model</u>

In his seminal book entitled “GROW THE PIE, HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT”, (2020), [<u>28</u>] the author Alex Edmans simply writes that it’s all about “purpose”, so he sets forth his model regarding what it means for a company to fulfill its company purpose. For him, defining a company’s purpose is to answer the question of why a company exists, whom it serves, and the role it plays in society. As such, a purpose statement should contain two related dimensions, viz, <u>whom</u> it exists for and <u>why</u> it exists. The <u>who</u> dimension highlights which members an enterprise specifically endeavors to serve. The <u>why</u> explains a company’s reason for being. As Edmans writes, these entity statements don't explain <u>how</u> the specific goods and services a company will be offered simply because they will change over time [Id. at 195.] Most statements of purpose are customer focused, but customers are not the only important stakeholder, so a purpose statement should go beyond customers. [Id. at 195–196.] And the key to achieve company purpose, the author states, is through excellence.

So how does a company achieve excellence in purpose? Once a purpose statement has been approved, it then must go beyond its statement and "live in the enterprise", as he calls it, to be successful. Living purpose basically means two things – embedding purpose internally and also communicating purpose externally. [Id. at 201.] The author lists five ways to do so that I have paraphrased as follows.

(1) <u>Strategy</u>: A company purpose should shape the activities it is involved in to build credibility.

(2) <u>Operating model</u>: A company's operating model needs to align with its core purpose.

(3) <u>Integrated reporting</u>: A company needs to express its goals and objectives in financial and non-financial measurements.

(4) <u>Culture</u>: As the expression goes, culture is "the way we do things around here". Corporate purpose must permeate throughout the company. It's about the principles of doing business the right way.

(5) <u>Directors</u>: Purpose should be a formal duty of the entire board, not a subcommittee function. One way is to "bring the boardroom into the workforce" to hear from colleagues first-hand. Directors can then "set the tone from the top." [Id. at 208-212.]

Given the above, how is Pieconomics different from other current business models? Let's highlight three (3) key features for comparison purposes.

1. <u>CAPITAL</u>: Edmans writes that there are three (3) different types of capital in Pieconomics. They are <u>Shareholder capital</u>, which is the money that shareholders initially contribute to the firm; <u>Stakeholder capital</u> that describes the value of a firm's relationship with its stakeholders, not what they contributed, and lastly, <u>Investor capital</u>, which is the value of the relationships a company has with its investors, which includes investors' belief in the company purpose. [Id. at 207-208.] Successful companies communicate with all three groups of capital.

They listen to their ideas to be successful, and also to preempt confrontation by addressing their issues before they become a problem. So, all three types of capital are important.

2. NETWORK OF RELATIONSHIPS: According to Edmans, building an enterprise around the 20th century “nexus of contracts” theory ignores the human side of business. [See Part I *supra*] He calls this web of transactions legal theory an “empty shell”, where members act out of compliance, rather than commitment. “In contrast, a shared purpose creates a sense of belonging, where members choose to be part of the company because they are inspired by mission even though they could obtain products, salaries, and returns elsewhere.” [Id. at 193.] “This highlights the importance of purpose having a *who* as well as a *why*. An enterprise is a network of relationships, which it must nurture and grow, not just a nexus of contracts.” [Id. at 213.]

3. PROFITS: The author quotes the economist John Kay who stated, "Profit is no more the purpose of a business than breathing is the purpose of living …” and also Larry Fink, the CEO of Black Rock who stated, “purpose is not the sole pursuit of profits, but the animating force for achieving them.” [Id. at 192.] By contrast, according to Edmans, Friedman’s theory of doing business is "pie splitting" based on the the Enlightened Shareholder Value (“ESV”) theory, which is that a corporation’s goal is to maximize profits, and by doing so, it can also grow the pie that may or may not trickle down to stakeholders. According to Edmans, Michael Jensen also agrees with the ESV theory. Both believed in having good relations with stakeholders, but only to create long-term value, so basically any stakeholder value was just a residual outcome means to an end. So the key difference between ESV theory and Pieconomics is that an ESV company’s ultimate goal is to make a profit, and the value to society is just “trickle down” if at all. Pieconomics argues the opposite, namely that a company’s ultimate goal is to create value for society, and by doing so it will increase profits for itself. Profits to investors are obviously important, but investors are not the only members of the firm. The pie includes more than just profits. It includes the value that the enterprise produces to its colleagues, customers, suppliers, environment, communities, and the government through taxes. Profits are an outcome – not a goal.

Summarizing, Edmans' corporate model asserts that to achieve excellence in its purpose, a company must define <u>who</u> it exists for and <u>why</u>, then embed purpose by a business strategy, operating model, integrated reporting, and culture, through its directors, and finally communicate its purpose with shareholders, stakeholders, and investors. "Pieconomics isn't about simply complying with the law – it is about creating social value. *Even if* investors have legal primacy, an enterprise should care about its externalities… . [Id. at 52.] So a company needs to grow the pie, not split the pie, or worse - shrink the pie. "Growing the Pie" means to create more value for society, because doing so is a win-win that benefits both the company, its investors and its stakeholders.

For comparison purposes, Edmans model is more focused on "purpose" by envisioning a different version of capital, relationships, and profits to do so, whereas, Strine's model is based on "principles and policies" for his Good Corporate Citizenship agency type theory. So does Edmans model metaphorically a bridge too far? To find out, let's now look at a third and final model for this century.

<u>C. The Mayer Model</u>

As stated in Part I above, if we take as a baseline the common law "legal personhood" premise that enables an entity to have the <u>freedom</u> to engage in lawful activities as the directors deem important, then what would be a better business model? In the recent book by Colin Mayer entitled CAPITALISM IN CRISES – HOW TO FIX THEM (2024) [<u>29</u>] the author asserts that corporations should first determine their company business purpose, with the interests of their shareholders in mind, but conditional on not profiting from harming people and planet. He begins his theory by asserting that modern corporations are basically a system. As we all know, systems exist to solve problems, so the purpose of a business system, collectively and individually, is to solve problems. Because the market itself is a system, the corporate system operates within the broader economic market system. Within each entity, directors and officers have fiduciary duties of loyalty and care that run to the entity, and that have been defined in both state statutes and case law over the years. So, how are these **systems within systems** interacting with one another today, and how ought they interact with one another in the future? Mayer has his own theory of how it should work. So, let's see.

In his book, Mayer's normative view of a corporation is that it's goal is to direct the production of profitable solutions, with a focus on its core purpose. He contrasts his theory with the more mainstream view today, as espoused by Harvard Professor Bebchuk's economic legal opinion, where a corporation's sole purpose is to take care of its shareholders. [See Maximizing Shareholder Value ("MSV") below.] Mayer considers MSV an internal "self-referential loop", where directors get increased benefits when shareholder price increases. As such, it is an overly narrow description of how a corporation ought to operate as a system, because a corporation's purpose should also link it with its external eco-system, including its current and future environment. The background for the author's fundamental view of corporations is that, as stated above, it is just one system amongst many (i.e. our economic system, education system, eco-system, health system, transportation system, energy system, etc.) We all live and function in various systems that interact with one another, both positively and negatively, due to their scale, complexity, and dynamic character. As Mayer writes, at their basic level, all "systems … possess properties that are no more than an aggregation of their component parts. In one sense that is self-evident, but in another it is not very insightful because it is purely descriptive of what the world is today, but not necessarily what it needs to be. [So] we might overlay this reductionist description with systems that not only possess properties that are distinct from their components, but are also products of higher-order influences . . . [In other words] new systems are created to serve the purpose of solving a new problem or providing a new solution to an old problem". [Id. at 27-28.] He goes on to state that what underscores a systems creation and existence is its purpose to address a problem that individually cannot be solved, but collectively can. Going one big step further, he asserts that purpose "underpins all that we do in our daily life, our working lives, our recreation, and our families. These are not the questions that you are conveniently asked to address in books on the economy and business. The very fact that few economists and books pose these questions reveals a problem . . . [Economists] characterize the world as populated by people who are . . . motivated by their self-interest, and in doing so we make it so. This leads one immediately to conclude that one must motivate people to do anything that incorporates the interest of others." [Id. at 27–31.] This self-interest based theory is what economists get wrong because it confuses cause and effect. He asserts that we need to recognize our collective as well as individual well-being because by contributing to a collective purpose we can achieve more than we can individually. He concludes by stating that purpose is about solving problems. Higher order purposes confer greater agency on the individuals and organizations below. This requires an appreciation of the values that underpin a company purpose, and the criteria by which its performance will be judged.

Fair enough, but how do we fix the current misunderstanding of how corporate systems work? Mayer lists four (4) types of company policies that deal with governance systems that he believes need to be updated. They are paraphrased below.

1. Law and Regulations
   • IS: Directors and officers have duties to enable it to be a successful corporation.
   • OUGHT: To promote the corporate purpose and also protect the public.

2. Ownership and Governance
   • IS: Shareholder rights that are in alignment with corporate governance.
   • OUGHT: Shareholders duty to uphold corporate purpose, and their role in governance to implement same.

3. Measurement and Performance
   •IS: Performance is measured in relation to profits only.
   • OUGHT: Success is measured in relation to corporate purpose and impact.

4. Finance and Investment
   • IS: The goal is maximizing shareholder value specifically.
   • OUGHT: The goal is to promote corporate purpose in partnership with public organizations.

Mayer's point is that, by going from an "is" to an "ought" in these four categories, we can rediscover our common purpose in present and future systems that we live and work in today.

Given Mayer's premise, that corporations are a legal system within an economic system, what is the role of law within this corporate system? Does the current focus of capitalism and corporate law on shareholder privacy still work, or should it be broadened to encompass a wider range of stakeholder interests? By contrast to Mayer's view, Harvard Law Professor Bebchuk asserts the classic MSV theory (as discussed in Part I) in which stakeholders may possibly benefit, but if the corporate activities "benefit stakeholders at the expense of shareholders, then it is bad business and should not be done [because it causes] multiple often conflicting objectives." [Id. at 89.] Simply put, Bebchuk asserts that corporate management today is rewarded to promote shareholders' interests, so that is just how the current system works (i.e. legal positivism). Conversely, Mayer argues a normative theory of corporate law to reflect what **ought** to be, not just what **is**. He writes that "the appeal of this is that it aligns company law, directors' duties, the purpose and reason for the creation and existence of the company, its constitution and governance, and the way it accounts for its activities and reports its profits, with the delivery of solutions to individual, local, national, and global problems without inflicting detriments." [Id. at 90.] He then steps back and asks, "but is this realistic?" Mayer concludes that "the answer is to retain the sole beneficiary from the success of the company as being the shareholder, . . . [but] conditional on and subject to avoidance of detriments for others .... It does not require benefiting others, but it must avoid disadvantaging them." [Id. at 95.] That is what he calls a "just profit".

So, in view of Mayers new theory, where **ought** we to go given current state corporate law as set forth in Part I? According to former Delaware Supreme Court Chief Justice Leo Strine, Jr., mentioned above, under current Delaware law, directors must make shareholders welfare their sole end, and that other interests may be taken into consideration only as a means of promoting shareholder's interests, but the company has no obligation to do so. That is current Delaware law. However, many other states (e.g. Massachusetts) have departed from Delaware precedent and enacted "constituency statutes" which allow directors to consider stakeholder interests beyond shareholders. (Parenthetically speaking, Mayer also mentions benefit corporations, established by various state statutes, that have a dual mission of profit and purpose, which have made a dent in the MSV theory of a business, but he thinks they are not enough.) But if we go one step beyond constituency statutes and argue that a company's purpose should be to produce profits from solutions, not by creating problems, how do we align the duties of corporate directors? Mayer asserts that there are two major legal alignment issues deal with. **First,** "the law can address negative externalities arising from market failures . . . [so that] . . . it can proscribe profiting at the expense of others, . . . but it cannot prescribe profiting for the benefit of others." [Id. at 104.] **Second**, national laws cannot address the disparities that might exist on an international level. Mayer writes that "problem-solving organizations provide a framework within which corporate legal responsibilities can be determined through corporate systems and processes that relate to their ownership, governance, management, and financial arrangements. As such, it goes beyond a mere statement of the object of the firm to being a legitimate source of profits, namely profiting from solving not creating problems for people or the natural world." [Id. at 106.] Mayer believes his theory strengthens the divide between directors and shareholders, the link between the company and society, and also eco-systems in both the environment and the investment chain. The result is that "the corporation is the **transformer** of the system as he calls it, converting individual self-interest into a collective endeavor by injecting financial investment into a problem-solving purpose." [Id. at 109.] And contrary to free market economic theorists, this can be done without a centralized governance. In fact, it encourages "decentralized authority at the level of individual firms by imposing the onus on them to align their interests with those of society and the environment as well as their shareholders". [Id. at 110–111.] By doing so, the author believes that it diminishes reliance on external regulation to impose corrections for market failures. Put another way, if many companies still believe that free markets are the best system, then these private ordering advocates need to step up and address the problems caused by such a system.

Historically speaking, Mayer writes that his model does not shake the foundation of historical corporate models because the historical model is a misconception of ownership. So then where did the current shareholder primacy theory underpinnings come from in the first place? He asserts that it all traces back to William Blackstone in 1765 (see Part 1 above) who famously wrote that "capitalism is an economic system of private ownership of the means of production and their operation for profit, and ownership is a bundle of rights over assets that confer strong forms of authority on its possessors. Blackstone's misconception of the ownership of a company is "inappropriate and detrimental in the context of commercial activities. … Its correction requires a fundamental reconceptualization of the nature of ownership, business, and our capitalist system." [Id. at 115–116.] Mayer disagrees with Blackstone because ownership of the company is basically a claim to its earnings and control rights over the governance thereof. As such the historical association of shareholding as property was by analogy only, because shareholders do not manage the assets of the company, managers do. Second, the property rights of shareholders are much more restricted than individuals over their personal assets. (For example, intangible assets that most companies are reliant upon are not physical assets. Furthermore, you don't <u>own</u> an employee or supply chains etc., you <u>coordinate</u> them.) Mayer states that the issue of shareholders versus stakeholders debate is a false choice between a narrow view versus a broad view of a company. The reality is that it is more of a **continuum** such that calling it one or the another is not accurate because neither group "own" the company, but both have an "interest" in the company. Such an interest is both a right and an obligation. To recap, Mayer believes that a business is a complex system for producing outcomes that is an integral part of even more complex and larger market system. Its "objective is to contribute to, and promote, the success of the systems of which it is an integral part, . . . [by producing] benefits for its constituents - investors, employees, suppliers, [which] is a product of its purpose, not its purpose as such". [Id. at 124–125.]

In conclusion, Mayer writes that the question of ownership "is a **system design** issue … a bundle of rights over assets that confers strong forms of authority on their possessors. Capitalism should be an economic and social system of providing profitable solutions to the problems of people and planet, by private and public owners who do not profit from producing problems for people and planet. In this context, ownership is not just a bundle of rights, but a set of obligations and responsibilities to uphold the delivery of these purposes." [Id. at 142–143.] So then "what's so hard about profiting from producing solutions" he asks? The short answer is unfortunately that even more profits can be gained at the expense of others in numerous ways. For example, environmental pollution, tax avoidance, offshoring, all are done at the expense of others. (He refers to this approach as "chasing the money".) One way to change this behavior is to stop considering the detrimental impacts of company products as mere "externalities". Companies today are beginning to recognize the risks of ignoring previously so-called externalities. To do so, the corporate governance framework must change beyond just "inputs and outputs" to also include "outcomes and impacts". Corporations must create a 21st century model that includes not just internal governance of its activities, but also external governance. This requires engaging with those impacted by its activities, both internally and externally. *Internal governance* is about connecting corporate purpose with a company strategy and capital allocation decisions to ensure it is a core part to what the business does daily. *External governance* is about connecting the company with other organizations, and other parties on which it depends, to deliver its problem-solving purpose for those it impacts. You need both to be successful.

So **how** can companies establish the appropriate internal and external governance arrangements to do so? The author has co-led an institute at Oxford University on how to embed problem solving purposes into a business by using what he calls the SCORE framework for internal and external governance components, as paraphrased below.

(1) **S**implify the corporate purpose for clarity.

(2) **C**onnect the corporate purpose internally with company strategy and capital allocation and external governance with other systems.

(3) **O**wn the problem-solving purpose by policies, procedures, structures, values, and culture.

(4) **R**eward performance based on creating outcomes of impact measurements and incentives to achieve same.

(5) **E**xemplify organizational purpose through communication and narratives to bring its purpose to life. [Id. at 150-51]

The author submits that "what emerges is the central role that governance and leadership play in corporations that recognize profit as being derivative of solving problems, not producing them. Governance in this context moves well beyond its narrow and damaging focus of just aligning managerial interests with those of its shareholders, to one that seeks to promote the identification and implementation of the profitable resolution of problems. The role of the board in this context is not simply to oversee the determination of the corporate purpose . . . [but] also ensuring that every part of the organization recognizes its contribution to the problem-solving nature of the business . . .". [Id. at 160.]

Putting all these concepts together, Mayer normatively believes that a corporation fundamentally converts financial resources of investors into purpose driven outcomes. Again, how to do so is a systems design issue with the purpose of solving problems. But how does owning an “interest” as well as owning a “problem” realistically work? He asserts that corporations must make five investments: namely, people, places, nature, innovation, and ideas. These five investments are relational, not transactional, so the corporation must align its values and culture with all parties involved. Financial risks of the firm are just a start. Corporate governance must go beyond inputs and outputs, and also address outcomes and impacts. This requires a corporate governance system that goes beyond aligning the Board of Directors with shareholder profits, to a system that produces solutions in a profitable manner, using his scorecard framework. And if profit is derivative of the work of a successful corporation’s purpose at the level of management and workers, He asserts that we need to reframe our business models to include non-financial valuations for the purpose of investment approvals, and resource allocation decisions, to ensure both adequate financial returns and to deliver environmental and social benefits. Traditional accounting systems measure output only, wealth accounting looks at value, not cost, and entity accounting sees profit as net of cost of maintaining its components to sustain existing activities. As such, accountants value nature to simply maintain the productive capability of the asset whereas economists look at natural capital for its sustainability features for all of society. If we assume that nature has intrinsic value, then accounting for it solely as its productive capability as an asset will undervalue it, and result in its eventual demise. To solve this issue, Mayer writes that we need to use accounting methods that both maintain and restore natural capital, and economic methods to value it, and create additional investments to avoid destroying it in the future. (One example is the more recent accounting methods of the ISSB that require both single materiality (more of an investors view) as well as double materiality accounting (more of a non-investor view) to derive a truer cost of natural capital.)

Summarizing what this all means, Mayer theorizes that there is a fundamental problem with current business models in that the accounting is basically aligned with property legal constructs that go way back in history, not with problem-solving today. To get to the point where they are measured properly, we need to get beyond measuring just inputs only, and start measuring impacts and outcomes as well, both negative and positive. Such a cost-benefit analysis will consider value benefits that are driven by a corporation's purpose. Mayer refers to this as a Leveraged Business Model ("LBM"). In his LBM model, finance goes beyond being just a deferential funding system, and instead begins to assess and invest in companies that can succeed in delivering solutions to today's complex problems. So how does a company get started? Basically, we must recognize that the market needs to stop decoupling private corporate performance from public interest. Rather, a company needs to determine its corporate purpose and then create both internal and external governance systems that align purpose with corporate values and culture, etc. Or as Mayer simply concludes, we need to go from the "theory of the firm" to the "purpose of the firm".

CONCLUSION

This paper was divided into two parts, "Looking Back" and "Looking Forward". To address the questions left open in both, this Conclusion is so divided as well.

I

With respect to Part I, as you recall in Dewey's famous 1926 article entitled *The Historic Background of Corporate Personality*, he wrote that the concept of the corporation as a "fictitious personality" became entangled in the "social reality" of the term itself. As such, when such entanglements become too complex, he writes that eventually "the value in eliminating the idea of personality until the concrete facts and relations involved have been faced and stated on their own account: retaining the word will then do no great harm". (Id. at 673.) So, Dewey concludes that if "legal personality will not provide law adequate for the complex industrial relations of today, then old non-legal doctrines which once served to advance rules of law are obstructive today. … The root difficulty in present controversies about natural and associated bodies may be that while we oppose one to the other or try to find some combining union of the two, what we really need to do is to overhaul the doctrine of personality which underlies both." [Id. at 657 – 58.] Dewey bases his analysis on his review of the history behind the term's dual meaning that was useful in medieval times, not as used today. The problem is that what Dewey doesn't mention is that the term "corporation" is not mentioned in the U.S. Constitution, which is a huge issue when trying to address whether an "association of persons" has constitutional rights.

To then suggest the elimination of the term without a replacement legal doctrine is basically ignoring the need for such a doctrine in on-going disputes in courts throughout the country every day. So how do we solve that problem? Let's see.

Linguistically speaking, regarding definitions, Dewey writes that there are "two radically different types of definitions; first, the type inherited from the Greek logic reflecting a definite metaphysical conception regarding the nature of things. This definition proceeds in terms of essential and universal inhering nature. There is another mode of definition which proceeds in terms of *consequences*. In brief, for the later a thing is – as defined as – what it does." [Id. at 660.] He then attributes to the pragmatist Charles S. Pierce the rule that a definition is a function of its effects from the "right mutual relations" of things. He concludes that "the definition of a legal subject is thus a legitimate, and quite conceivably a practically important matter. But it is a matter of analysis of facts, not of a search for an inhering essence". [Id. at 661.] So where do the two U.S. Supreme Court decisions fit into these definitions? In the cases of *Citizen United* and *Hobby Lobby*, Raz concluded that these two decisions presented "an innovative theory of personhood" that provide corporations a "legal degree of freedom". Is he correct or is he just glossing over the court just asserting its power to define the word regardless of historical precedent? Even Padfield concluded, regarding *Hobby Lobby* that "suffice it to say that a bald assertion by the court that unleashing the full force of corporate treasuries on our political debates would not interfere with governmental functions is a hard pill for many to swallow." [Padfield at 1019.] And as we all now know, political spending by corporations creates risk for both the company (i.e. lack of control of 527 groups) as well as the country (influence of major donations on elections). So with such differing opinions, can we ever answer Dewey's century old question of what constitutes a positive corporate law construct for personhood?

One place to look linguistically for an answer is Mayer's theory that a corporation is basically a **system**. Put another way, if we choose to go beyond metaphors (or perhaps a metonym because real persons form associations), can we solve Dewey's problem of calling this so-called "right-and-duty unit" a **system** to be more realistic? The NPL has referred to it as a system, and Mayer uses the expression of a "system design issue" in his model, so is the term helpful? In her recent book entitled SYSTEMS ULTRA - MAKING SENSE OF TECHNOLOGY IN A COMPLEX WORLD, [30] the author, Georgina Voss discusses the linguistic ramifications of using the term “system” in technology parlance. She writes as follows: “Language implicates reality: the ideas we attach to things become things in the world. We use metaphors to describe things that elude our grasp, and fictions and metaphors allow an imaginary concept to be legitimated. These metaphors and stories are produced in a crucible of time, place, and culture. These narratives are hugely influential in the design, regulations, and reception of large-scale technologies and infrastructures. They shape how we expect the world to work.” [Id. at 11.] Voss then cautions us about the term “systems”. She writes as follows: “The language around systems is neutral, describing structures and behavior - but as we’ve seen, they are powerful culturally mediated meanings attached to what we expect of systems. [We need] awareness of the power relations that course through them. … I am nervous about pushing more and more different metaphors into the mix in the search for something to better describe the overall “thing” because metaphors, analogies and fictions have meanings of their own, which then get mistaken for what the system actually does. Can we approach these things, collectively, together?” [Id. at 25, 27.] So, the question is whether defining a corporation as a “system” is just going from one metaphor, loaded with baggage, to another? And the word “system” is not mentioned in the U.S. Constitution, so again it would not be very helpful regarding constitutional rights, even though the concept is relevant in terms of what a corporation does.

So, then how should we view the three new 21st century models addressed in Part II above? Is Strine’s GCC model simply private ordering - Rev. 2, so not very realistic as Dewey may say (i.e. too little, too late)? And what about Edmans’ purpose driven Pieconomics model? It may get beyond the boardroom with its heightened principles like the Strine model promotes, but is it realistic for most corporations to create substantial social value? And if Mayer’s LBM suggests that it is basically a “system design issue”, can that address the Voss’ linguistic issue of the inherent power dynamics hidden behind such an amorphous term? So, whether it is a principles-based model, a purpose driven model, or a system redesign model, to solve problems today means one must ask the question “is society better off” when we transition to such a new model? So are we forever stuck with the term “legal personhood” (a legacy term for sure) that the U.S. Supreme Court has pretty much defined now as very broad in response to the question of what kind of person is the corporation? If not, it remains to be seen whether the Supreme Court will weigh in further, or side-step the issue, in upcoming cases, but it seems that *stare* *decisis* is not enough to rely on anymore. (See two recent Supreme Court cases Loper Bright Enterprise v. Raimondo, 603 U.S. ___ (2024) (Chevron federal agency rule-making deference doctrine overturned) and West Virginia vs. E.P.A., 597 U.S. 697 (2022) (de novo review required for "major questions") But if we believe that it is more of a linguistic issue as Ross writes, "can we approach these things, collectively, together"? [Ross at 27.] If neither, how can we "move the needle" so to speak.

II

With respect to Part II, all the 21st century models above seem to conceptually agree that it's time to get beyond the "unfettered" market theories that prevailed in the last century, and pivot to a more corporate purpose driven system that align private interests with public interests. Solutions will be company specific of course, but a 21st century model for companies can be a plus sum external/internal solution to replace the past zero-sum internal solutions. So HOW do we get started with these 21st century newer models? I submit we look at two ways to do so, viz; (i) creating new norms, and (ii) enhancing reputational capital.

• *New Norms*

In his seminal book entitled REALISM WITH A HUMAN FACE, (1990), [31] in Chapter 1 of the same name the author Hillary Putnam sets forth his 5 Principles of Norms, three of which are pertinent here. They are as follows:

1) "Our norms and standards … are historical products; they evolve in time."

2) "Our norms and standards of anything … are capable of reform. There are better and worse norms and standards."

3) "Our norms and standards always reflect our interests and values. Our picture of intellectual flourishing is part of, and only makes sense as part of, our picture of human flourishing in general." [Id. at 21-24.]

So what does he mean by these Principles of Norms more specifically?

Regarding #1, Putnam writes that because norms often conflict, “there is a feedback loop [in which] we discover facts which themselves lead to change in the pictures that inform those norms and standards (and thus, indirectly, to a change in the norms and standards themselves).” [Id. at 25.]

Regarding #2, Putnam believes that norms and standards can be improved, and that such improvement is more individualistic.

Regarding #3, Putnam writes that “our image of the world cannot be justified by anything but its success as judged by the interests and values which evolve and get modified at the same time, and in intersection with, our evolving image of the world itself. [As such], the absolute “fact/value” dichotomy has to be abandoned” [Id. at 29.] So, given Putnam’s norms as a skeleton framework, how have other writers viewed norms and standards more recently, and how helpful are they in solving new corporate models? In an article entitled *The End of Cyber-Anarchy”,* the renowned author Joseph S. Nye Jr., stated that to get started in any major transition requires that we establish new norms. He writes that “[n]orms are not effective until they become common state practice, and that can take time. . . . [S]ome scholars have argued that norms have a natural life cycle. They often begin with norm-entrepreneurs, individuals, organization social groups and official commissions that enjoy an outsize influence on public opinion. After a certain gestation period, some norms reach a tipping point, when cascades of acceptance translate into a widespread belief and leaders feel that they would pay a steep price for rejecting it. . . . Economic change can also foster a demand for new norms that might promote efficiency and growth.” [Id. at 39 – 40.] Given the above, can the three 21st century corporate models discussed in Part II, support new norms to be implemented right now in a business? The law can catch up eventually, but we urgently need to move forward now given the various exigencies that require today’s problems be solved today, not “someday” or even worse, never. We need more “norm-entrepreneurs”, as Nye calls them, that collectively will change the business eco-system.

Tanisia Fazal agrees with Nye in her recent article entitled *The Power of Principles, What Norms Are Still Good For*. [33] By analogy, he writes that despite the current dismay recently at various state actors that violate the sovereign territory of other states, "beneath the surface, norms in fact work as a powerful motivator and constraint. They live at the heart of the biggest foreign policy debates in Washington". [Id. at 148.] The primary critics of norms in the 20th century were the so-called "realists" such as historian James Shotwell, philosopher John Dewey, and lawyer Solomon Levinson who argued that norms were too utopian. So, they put forth their so-called more "realistic" strategy in the early 20th century, they called the 1928 Kellogg-Brand pact, that renounced war as an instrument of national policy as one example. They argued that the pact would eliminate violence. It didn't. So, what did work in the last century? The author writes that policy norms continue to shape history, post-World War II, such as when "Eleanor Roosevelt chaired a group of lawyers, representatives, non-governmental organizations, and state bureaucrats from around the world who produced the Universal Declaration of Human Rights: the foundation for today's human rights regime. … Today, norms are a central part of international relations theory" citing numerous examples, such as the demise of the South Africa apartheid system, [and] the stigma against chemical and nuclear weapons, and humanitarian aid." [Id. at 149-150.] Given same, norms can constrain actions as well as have strength, substance, and cycles, and norms have their own types of systems in which actors interact with one another. Fazal qualifies her optimistic conclusion by stating that the power of norms is never guaranteed, because "to be effective, norms need maintenance – they must be cultivated, enforced, and sometimes adjusted and maintenance requires long-term thinking and accepting short-term costs." [Id. at 154.]

Given the above, although various specific corporate models were not successful overall last century, some norms in general were very successful. So, can we begin right now with new norms to shape new corporate models and if so, which ones?

• *Reputational Capital*

Besides new norms, what is another good way and reason for companies to begin to pivot to a new 21st century corporate model? I submit the answer for many companies is to address corporate reputation capital to pivot to a newer model. In his article entitled *#ReputationMatters! A Critique of the Event-Driven Suits Model* [34] the author Mark I. Gross asserts that empirical studies have shown that reputation contributes at least 50% to a company stock price, and that damage to reputation causes upwards of 66% of stock price declines upon revelation of the wrong-doing. As such, “reputation” should be considered in any analysis of materiality, causation, and damages. [Id. at 263.] So what can businesses do right now to strengthen their reputation? First, let's look at the supporting evidence of how the author determined such significant numbers in his analysis of what he referred to as “Reputation Capital”. (Although his article focuses much of its attention on how to calculate damages in securities fraud class actions, arising from event-driven (e.g. illegal conduct) claims versus catastrophic events, we will focus instead on corporate “Reputation Capital” in general.) The author supports his position by stating, “corporations invest billions to burnish their image, which translates into brand loyalty, increased sales, and enhanced investor confidence.” [Id. at 283] According to the renowned corporate attorney Martin Lipton, a “focal point” of investors has been the importance of corporate culture and the ways in which it is tied to the preservation and creation of value. In support thereof, Lipton quotes a State Street study that found that “intangible assets” (e.g. human capital and culture) comprise an average of 52% of a company market value. (Parenthetically he also asserts that corporate reputation is a major enhancer of business resiliency as well.) Lipton writes that “[e]conomists define reputation as the value of the quasi-rent stream that accrues when counterparties offer favorable terms of contract because they believe the Firm will not act opportunistically toward them.” [Id.] Given reputation capital’s contribution to the bottom-line results, corporations actively cultivate their reputations. The value of a company’s Reputational Capital is reflected in its stock market price. As some have noted: “[R]eputational Capital often constitutes a significant fraction of a company’s market value. . . . Because reputational value depends on the perception of investors and other stakeholders, it is highly sensitive to negative information regarding the company, its management, or its products.” [Id. at 284.] And even if no major wrong-doing is found, investor dissatisfaction and negative public relations create unnecessary and unwanted risk factors that affect a company’s bottom line.

So, let’s look at reputational capital from a different angle. In a book chapter written by Jonathan M Karpoff entitled *Does Reputation Work to Discipline Corporate Misconduct?* [35] the author attempts to measure the loss of a company’s business reputation. He states that, “[t]he upshot is that people and businesses can invest in reputation just as they invest in machinery, R&D, and human capital. Viewed this way, reputation is a valuable asset . . . even though it is not transparent on a firm’s balance sheet. [Id. at 363-364.] Although the author goes into significant detail on the break-out of why reputational costs are so high (citing the famous Xerox case as an example), his conclusion is that only 20% of the loss was the reversal of Xerox's artificial share price inflation. The rest of the reputational capital loss was due to "impaired operations" when managers lose their jobs or divert their time to the investigations, the increase in the cost of capital due to poor internal controls, etc. and the loss of customers. [Id. at 366-367.] Karpoff then provides further measurements for loss of reputation in the Xerox case. He states that the stock price decline represented a combination of legal penalties of roughly 9%, a reversal of artificial share inflation of 24%, and the balance of 67% due to lost reputation per the Karpoff, Lee, and Martin data (2008). The author concludes that "[T]hese results support the argument that financial reporting violations carry large penalties. The largest penalties are not from regulators or private lawsuits. Rather, they are from the firm's investors and other counterparties … [who are] … protecting their own interests by requiring a premium to do business with firms that are less trustworthy than they previously believed." [Id. at 370.] The author concludes that "the portion of a firm's loss that cannot be explained by such direct costs is a measure of that firm's reputational loss." [Id. at 374.]

Regardless of what methodology you use to determine loses, both authors agree that the loss of Reputational Capital is significant, and that it applies to all types of corporate activities (not just misrepresented financial statements) both direct and indirect, and the size of it far exceeds direct costs (i.e. fines, penalties, and lawsuit settlements). So an investment in Reputational Capital, like other capital investments, is very important for risk management purposes.

So how do norms and Reputational Capital this relate to the new 21st- century corporate models proposed in Part II above? The answer is that "Stakeholders" may be an elusive term to the self-referential internal business models of the 20th century, but in the 21st century these counterparties, when analyzing how they will do business with other companies, will depend on how that company does business in general. That is not new, but what is new is that the data shows that one's reputation is a significant cost risk of doing business in the eco-system in which a company operates. Reputational Capital data shows not only on negative implications, but also on the positive implications on what model of business you choose. The reductionist business models of the 20th century should be replaced by “relationship-based” models of this century. And if a company plans to pivot to a newer model, it needs to focus on its corporate culture to do so. That also requires new norms for new corporate models, so that both internal and external governance systems are addressed.

In conclusion, corporations in the 21st Century have new geopolitical and geoeconomic risks that require them to address so-called “externalities” in the past but today are considered more likely to be “internalities”, de-coupling or de-risking vulnerable supply chains, and adapting to new national security laws that collectively demonstrate the need for introducing newer corporate culture models. Most corporations have the capacity to make the transition, but it will require them to rethink their systems to include better norms to replace too many zero-sum norms of the past century, a deeper sense of a company’s purpose and types of capital, and a recognition that corporate purpose and state action are not antithetical. Basically, a better model is needed for a better 21st century corporation, regardless of the model’s name.

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