Returning Markets to the Center of Corporate Law

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This Article examines how the two blind spots of economics—markets and the interior of firms—combined over the past 40 years to create the modern corporate governance regime.

The focus of corporate law reformers over the past four decades on achieving ex-post welfare outcomes ignored the traditional centrality of supporting ex-ante market behaviors in corporate law. Corporate law was originally designed from the bottom up to promote the activities of bargaining, experimentation, and competition. None of these activities are currently much in evidence around the governance of public companies.

The current corporate governance regime has not succeeded, even on its own terms, and it has seriously damaged the relevant markets. This Article joins a trend in recent legal scholarship of pointing out the intrinsic social value of market activities and their importance in making sense of legal doctrine. Economic efficiency arises from market activities like bargaining and experimentation that are, themselves, inefficient. The modern corporate governance regime has forgotten this fact.

I. INTRODUCTION

The corporate form was developed to facilitate markets, but almost nowhere in contemporary debates about corporate law does this fact seem to matter. Somehow, markets, and the private bargaining and experimentation that make up market behavior, became subordinate to conceptions of corporations as creators of wealth for shareholders[1]

1. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) ("There is no longer any serious competitor to the view that corporate law should principally strive to

or as the supplier of benefits to other constituencies.[2] This is a surprising development. Corporations spend all of their resources in commercial activities conducted in dozens or hundreds of different markets; their very structure is designed to facilitate these activities, as well as to create markets in the ownership and management of the corporations themselves.

The inattention of corporate law to the markets that, in practice, dominate their existence is understandable as it replicates a blind spot in neo-classical economics generally. Nobel Prize-winning economist Douglass North observes:

> [T]he neo-classical paradigm is devoid of institutions, and [P]areto efficiency is meaningless when it comes to exploring different institutional structures and their implications for economic performance through time. The currently fashionable growth models of economists do not confront the issue of the underlying incentive structure that is assumed by their models.[3]

In fact, despite their centrality to welfare economists' models, the actual institutional arrangements and incentives of the markets themselves are usually ignored.[4] Ronald Coase

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increase long-term shareholder value."); *see also* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1465 (2007) (discussing "the shift to shareholder value as the primary corporate objective"); Tiago Cardao-Pito, *Classes in Maximizing Shareholders' Wealth: Irving Fisher's Theory of the Economic Organization in Corporate Financial Economics Textbooks*, 11 CONTEMP. ECON. 369, 369 (2017) ("A survey of contemporary academic textbooks in corporate financial economics shows that these books are based on promoting Irving Fisher's (1906) specific theory of the organization, which advocates that organizations exist to create wealth for their owners/shareholders."); ORG. ECON. COOP. & DEV., OECD PRINCIPLES OF CORPORATE GOVERNANCE 6 (1999) ("Common to all good corporate governance regimes, however, is a high degree of priority placed on the interests of shareholders . . . Reflecting such considerations, the Principles recognise the role of these stakeholders and encourage active co-operation with them in creating wealth . . . ."); William Lazonick & Mary O'Sullivan, *Maximizing Shareholder Value: A New Ideology for Corporate Governance*, 29 ECON. & SOC'Y 13, 13 (2000) ("Over the past two decades the ideology of shareholder value has become entrenched as a principle of corporate governance among companies based in the United States and Britain."); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 6 (1991) ("[S]elf-interested entrepreneurs and managers, just like other investors, are driven to find the devices most likely to maximize net profits. If they do not, they pay for their mistakes . . . . The firms and managers that make the choices investors prefer will prosper relative to others.").

2. E. QUINN & ANJAN V. THAKOR, THE ECONOMICS OF HIGHER PURPOSE 3 (2019) ("Higher purpose is a prosocial goal [beyond business purpose] that is defined not in terms of economic output but in terms of the contribution the organization makes to society."); Rebecca Henderson & Eric Van den Steen, *Why Do Firms Have "Purpose"? The Firm's Role As a Carrier of Identity and Reputation*, 105 AM. ECON. REV. 326, 327 (2015) ("We define 'purpose' as a concrete goal or objective for the firm that reaches beyond profit maximization."); Abagail McWilliams, Donald S. Siegel & Patrick M. Wright, *Corporate Social Responsibility: Strategic Implications*, 43 J. MGMT. STUD. 1, 1 (2016) (defining corporate social responsibility to include "actions that appear to further some social good, beyond the interest of the firm and that which is required by law"); *see generally* Leo E. Strine, Jr., *Stewardship 2021: The Centrality of Institutional Investor Regulation to Restoring a Fair and Sustainable American Economy*, 24 U. PA. J. BUS. L. 1 (2021) (addressing modern trends in corporate stewardship); *What Are the Principles for Responsible Investment?*, PRINCIPLES FOR RESPONSIBLE INV., https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment [https://perma.cc/5L48-XEKD] (discussing stewardship and ESG principles, and arguing that companies should implement such policies).

3. Douglass C. North, *The Evolution of Efficient Markets in History* 1 (Econ. Hist., Working Paper No. 9411005, 1994).

4. RONALD COASE, THE FIRM, THE MARKET, AND THE LAW 7–8 (Univ. of Chi. Press 1988)

noted, "Although economists claim to study the working[s] of the market, in modern economic theory[,] the market itself has an even more shadowy role than the firm."[5] This Article argues that the tremendous influence of neo-classical economics on modern corporate law debates replicates this blind spot.

Markets should be taken seriously as the most important feature in the life of business corporations. This Article argues the following: (1) well-functioning markets are socially important, independent of their wealth-creating function; (2) a regulatory preoccupation with maximizing wealth has the practical effect of adversely affecting the operation of markets; and (3) corporate law's preoccupation with improving efficiency thus impairs economic outcomes. It argues that regulators of corporate governance should concern themselves with the impact of their prescriptions on the markets surrounding corporations rather than guesses about the impact of their prescriptions on shareholders' (or other constituents') wealth.[6]

Part I of this Article discusses the importance of modern, impersonal markets, their status as artificial and highly contingent achievements, and how corporate law helped create early modern markets. Part II of this Article reviews the empirical evidence finding that markets are intrinsically valuable, independent of their immediate welfare outcomes. Part III examines how efficiency is a poor fit for corporate law, and in practice, typically finds itself in an antagonistic relationship to markets. Part IV traces the recent impact of efficiency norms on the market for corporations. Part V provides evidence that the current corporate governance market is broken. Part VI concludes and provides brief recommendations for reform.

II. MODERN MARKETS ARE CONTINGENT

Adam Smith claimed that humankind has a natural "propensity to truck, barter, and exchange one thing for another."[7] However, the mere exchange of products and services falls far short of a healthy, modern market. A market offers incentives for participants to enter, facilitates repeated impersonal exchanges among large groups of people, and produces predictable beneficial outcomes for participating individuals. Healthy markets must attract a critical mass of persons interested in buying or selling a commodity. They must be free of violent expropriation and other forms of predatory behavior, possess a means of efficiently settling disputes, provide disclosure incentives (and penalties) that permit price discovery, and allow for experimentation and innovation. They must also

("[D]iscussion of the market itself has entirely disappeared . . . . Markets are institutions that exist to facilitate exchange . . . to reduce the cost of carrying out exchange transactions . . . . In an economic theory which assumes that transaction costs are nonexistent, markets have no function to perform . . . . [W[hen economists do speak of market structure, it has nothing to do with the market as an institution . . . the influence of social institutions which facilitate exchange being completely ignored.").

5. *Id.* at 7.

6. This part of my argument is indebted to the work of F. A. Hayek. *See* F. A. Hayek, *The Use of Knowledge in Society*, 53 AM. ECON. REV. 519, 519 (1945) [hereinafter Hayek, *Use of Knowledge*] ("The peculiar character of the problem of a rational economic order is . . . the fact that the knowledge of the circumstances . . . exists . . . solely as dispersed bits of incomplete . . . knowledge which all the separate individuals possess."); F. A. HAYEK, *Competition as a Discovery Procedure*, *in* NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS 179 (1978) [hereinafter HAYEK, *Competition*].

7. ADAM SMITH, THE WEALTH OF NATIONS 18 (Elec. Classics Series, 2005 ed., 1776).

operate in predictable ways, as most transactions reflect expectations about the future.[8]

While markets often arise spontaneously, as in the case of black markets,[9] the quality of markets can vary widely depending on the laws, institutions, and norms in place.[10] Sometimes, we talk about markets as if they were a purely negative phenomena: activity that arises in the absence of regulation.[11] If that were true, we would expect modern, large-scale, impersonal markets to flourish in places where the writ of government was unknown. Instead, we generally see that the weaker the state and its regulatory apparatus, the weaker the markets in that country.[12] Somalia, which lacked a central government for 15 years, and the tribal regions of Pakistan, are not notable for the quality of their markets.[13]

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8. *See, e.g.*, GUILLAUME HAERINGER, MARKET DESIGN: AUCTIONS AND MATCHING 4–5 (2017); NATHAN B. OMAN, THE DIGNITY OF COMMERCE: MARKETS AND THE MORAL FOUNDATIONS OF CONTRACT LAW 23–29 (2016).

9. John McMillan & Christopher Woodruff, *Private Order Under Dysfunctional Public Order*, 98 MICH. L REV. 2421, 2423 (2000) ("In the right circumstances, [markets] can be achieved spontaneously."); Robert Sugden, *Spontaneous Order*, 3 J. ECON. PERSPS. 85, 86 (1989); *see, e.g.*, JOHN MCMILLAN, REINVENTING THE BAZAAR: A NATURAL HISTORY OF MARKETS 16 (2003) (discussing markets arising spontaneously in refugee and prisoner of war camps) [hereinafter MCMILLIAN, REINVENTING THE BAZAAR]; DANIEL OKRENT, LAST CALL: THE RISE AND FALL OF PROHIBITION (2010) (discussing markets arising for alcohol during prohibition).

10. DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE 34, 120 (1990) ("[Markets] vary in their complexity, from those that solve simple exchange problems to ones that extend across space and time and numerous individuals . . . . Their effectiveness . . . varies widely . . . ."); MCMILLIAN, REINVENTING THE BAZAAR, *supra* note 9, at 14 ("The problem in developing countries is not that markets are absent; it is that they are working badly"); R. A. Raford, *The Economical Organization of a P.O.W. Camp*, 12 ECONOMIA 189, 191–92 (1945) (discussing, in the context of prisoner of war camps, how the permanent camps had well-developed markets whereas transit camps were disorganized with large variations in the barter price of an item).

11. ROGER MIDDLETON, GOVERNMENT VERSUS THE MARKET: THE GROWTH OF THE PUBLIC SECTOR, ECONOMIC MANAGEMENT, AND BRITISH ECONOMIC PERFORMANCE C. 1890-1979 (1996) (discussing the debate in Britain over the relationship of government and the market); Adam Smith was very clear that institutions matter. *See, e.g.*, SMITH, WEALTH OF NATIONS, *supra* note 7, at 620–24 (discussing the importance of institutional incentives in the work of academics).

12. S. R. EPSTEIN, FREEDOM AND GROWTH: THE RISE OF STATES AND MARKETS IN EUROPE, 1300–1750 (2000) (arguing state formation was the principal driver of market growth in Europe); *see also* Avner Greif, *Political Organizations, Social Structure, and Institutional Success: Reflections from Genoa and Venice During the Commercial Revolution*, 151 J. INST. & THEORETICAL ECON. 734, 735–36 (1995) (discussing the relationship between the strength of economic growth and rise of a central political authority in Genoa and Venice); TILMAN ALTENBURG & WILFRIED LUTKENHORST, INDUSTRIAL POLICY IN DEVELOPING COUNTRIES: FAILING MARKETS, WEAK STATES 107–42 (2015) (analyzing a selected number of case studies to determine structural design, defects, and successes in weaker state markets).

13. Peter Chalk, *Case Study: The Pakistani-Afghan Border Region*, *in* UNGOVERNED TERRITORIES: UNDERSTANDING AND REDUCING TERRORISM RISKS 49, 53–64 (Angel Rabasa et al eds., 2007) (discussing the lack of government and economic markets in Pakistan border region); PETER D. LITTLE, SOMALIA: ECONOMY WITHOUT A STATE (2003) (discussing the way the loss of a central state affects Somalian economic activity); *see generally* Victor Nee, *The Role of the State in Making a Market Economy*, 156 J. INST. & THEORETICAL ECON. 64 (2000) (discussing the importance of the State in China's economic growth); Hernando De Soto & Robert E. Litan, *Effective Property Rights and Economic Development: Next Steps*, 2001 BROOKINGS-WHARTON PAPERS FIN. SERVS. 251 (2001) (discussing the relationship between a robust legal system of property rights and market development); Erik S. Reinert, *The Role of the State in Economic Growth*, 26 J. ECON. STUD. 268 (1999) (describing the role of government sector in promoting economic growth in Europe since the Renaissance).

For most of human history, and in many parts of the world today, the dominance of economic life by impersonal markets has been rare.[14] Economic life has instead been characterized by transactions within small, cohesive communities,[15] through administrative fiat,[16] or dominated by violent expropriation.[17] Herodotus, for example, claimed the Persian empire had no marketplaces.[18] Economic historians talk about the "institutional revolution" that preceded the industrial revolution by creating the necessary institutional and normative structures.[19] This was particularly necessary for the transition from regulated, local, low-volume, medieval markets to modern, relatively unregulated, large-scale markets characterized by transactions between strangers.[20] Douglass North observed that "[t]he historical study of economic growth is a study of institutional

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14. Mark Casson & John S. Lee, *The Origin and Development of Markets: A Business History Perspective*, 85 BUS. HIST. REV. 9, 15 (2011) ("[T]he development of markets was slow, complex, and not always linear"); JOSEPH HENRICH, THE WEIRDEST PEOPLE IN THE WORLD: HOW THE WEST BECAME PSYCHOLOGICALLY PECULIAR AND PARTICULARLY PROSPEROUS (2020) (discussing how the West's development of impersonal modern markets is historically unique); DOUGLASS C. NORTH, JOHN JOSEPH WALLIS & BARRY R. WEINGAST, VIOLENCE AND SOCIAL ORDERS: A CONCEPTUAL FRAMEWORK FOR INTERPRETING RECORDED HUMAN HISTORY (2009); MCMILLAN, REINVENTING THE BAZAAR, *supra* note 9, at 11 ("[S]peeding the economic growth of poor countries . . . requires . . . revamping their market-supporting institutions.").

15. *See* RICHARD H. BRITNELL, THE COMMERCIALISATION OF ENGLISH SOCIETY 1000–1500, at 194 (2d ed. 1996) (noting that early market enforcement mechanisms were designed to maintain the commercial advantages of local merchants); Avner Greif, *Institutions and International Trade: Lessons from the Commercial Revolution* 82 AM. ECON. REV. 128, 128 (1992) (describing the institutional innovations required before inter-community trade could begin again in the 11th–14th centuries after many centuries of decline); Rachel E. Kranton, *Reciprocal Exchange: A Self-Sustaining System*, 86 AM. ECON. REV. 830, 843–44 (1996) (discussing how informal personalized exchanges characterized early economic activity and the reasons they persist in an era where anonymous market alternatives are available); Philip Mirowski, *The Rise (and Retreat) of a Market: English Joint Stock Shares in the Eighteenth Century*, 41 J. ECON. HIST. 559, 577 (1981) (describing how as the eighteenth-century stock market in London declined, supply of capital reverted to "local attorneys, *ad hoc* trade credit, and kinship").

16. *See, e.g.*, GARETH DALE, KARL POLANYI: THE LIMITS OF THE MARKET 143 (2010) ("[I]n archaic trade . . . the market . . . and gift forms are marginal; it is predominantly 'administered' by states, or by semi-political bodies such as chartered companies.").

17. *See, e.g.*, Stephen Haber, Noel Maurer & Armando Razo, *When the Law Does Not Matter: The Rise and Decline of the Mexican Oil Industry*, 63 J. ECON. HIST. 1, 3–5 (2003) (discussing the limitations of a government's ability to expropriate an industry, and the mitigating effect those limitations have on reducing property rights).

18. HERODOTUS, THE HISTORY OF HERODOTUS 1 (Issac Littlebury trans., 1976).

19. *E.g.*, DOUGLAS W. ALLEN, THE INSTITUTIONAL REVOLUTION: MEASUREMENT AND THE ECONOMIC EMERGENCE OF THE MODERN WORLD (2012); Paul R. Milgrom, Douglass C. North & Barry R. Weingast, *The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs*, 2 ECON. & POL. 1, 4–14 (1990); Larry Neal & Stephen Quinn, *Networks of Information, Markets, and Institutions in the Rise of London as a Financial Center in the Seventeenth Century*, 8 FIN. HIST. REV. 7, 25–26 (2001); RICHARD N. LANGLOIS & PAUL L. ROBERTSON, FIRMS, MARKETS AND ECONOMIC CHANGE: A DYNAMIC THEORY OF BUSINESS INSTITUTIONS (1995); Avner Greif, *Commitment, Coercion and Markets: The Nature and Dynamics of Institutions Supporting Exchange*, *in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 727 (Claude Ménard & Mary M. Shirley eds., 2005) ("Markets rest upon institutions.").

20. DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 12–17 (1990); *see generally* Douglass C. North, *Markets and Other Allocative Systems in History: The Challenge of Karl Polanyi*, 6 J. EUR. ECON. HIST. 703 (1977) (analyzing Polanyi's theoretical structure and how interpersonal markets operate to explain "the different allocation systems that have characterized economic organization"); R. A. Dodgshon, *Changing Evaluation of Space*, *in* HISTORICAL GEOGRAPHY OF ENGLAND AND WALES 260, 264–68 (R. A. Dodgshon & R. A. Butlin eds., 2d ed., 1990).

innovations that permit increasingly complex and productive exchanges to be realized by reducing the transaction (and production) costs of such exchanges."[21]

Modern markets are thus a creation and achievement, not an automatic feature, of human existence. Their contingency is visible wherever one looks in history. By the early eighteenth century, the British had created a well-functioning stock market that seems to have been roughly as efficient at pricing shares as its modern equivalents.[22] By the end of the century, however, this market had "devolved," and capital was once again sourced through local, ad hoc, personal channels.[23] As we shall see, something very like this is occurring in America.

In a similar way, the first wireless spectrum auction in the United States, in 1994, was an unqualified success.[24] But the structure used in America was inappropriate in other contexts: markets for wireless spectrum failed spectacularly in Germany in 1999 and the Netherlands in 2000.[25] In both cases, the markets established by regulators interfered with price discovery, set perverse incentives, and failed to draw in new entrants.[26]

As the experience of Europe with spectrum markets suggests, even with existing examples, copying successful markets is quite hard. The most visible example of this is the transition of Russia in the 1990s from an economy managed by government fiat to one ostensibly regulated by markets.[27] The logic behind the "shock therapy" adopted by Russian policymakers was that the mere creation and transfer of alienable property rights in state enterprises to Russian citizens would lead, without additional supports, to well-functioning markets of the sort visible in the West.[28] Little attention was paid to the norms, institutions, and laws (often developed over centuries) that supported market activity in the West.[29] The result was the creation of healthy markets in some parts of the Russian economy, but the failure of markets in other areas that were dominated instead by state-facilitated expropriation, organized crime-imposed barriers to new entrants, and a truncated market of a few oligopolistic firms content with earning rents rather than competing against one another.[30]

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21. North, *supra* note 3, at 1; *see also* SIR HENRY SUMNER MAINE, ANCIENT LAW: ITS CONNECTION WITH THE EARLY HISTORY OF SOCIETY, AND ITS RELATION TO MODERN IDEAS 170 (1861) ("[T]he movement of progressive societies has hitherto been a movement *from Status to Contract* . . . .").

22. Mirowski, *supra* note 15, at 575 ("[A]lthough the eighteenth-century share market was not perfectly efficient, it did perform its function to a significant degree.").

23. *Id.* at 576–77.

24. HAERINGER, *supra* note 8, at 108–09.

25. *Id.* at 109–11.

26. *Id.*

27. EDWARD P. LAZEAR, ECONOMIC TRANSITION IN EASTERN EUROPE AND RUSSIA: REALITIES OF REFORM 323, 329–30 (1995).

28. MARSHALL I. GOLDMAN, THE PIRATIZATION OF RUSSIA: RUSSIAN REFORM GOES AWRY 58–65 (2003); JESSE NORMAN, EDMUND BURKE: THE FIRST CONSERVATIVE 238–39 (2013) (discussing the ways Russia lacked the social institutions that make markets work and, as a result, liberalization in Russia "assisted the loss of public assets to the new oligarchs").

29. NORMAN, *supra* note 28; Theodore P. Gerber & Michael Hout, *More Shock than Therapy: Market Transition, Employment, and Income in Russia, 1991—1995*, 104 AM. J. SOCIO. 1, 37–38 (1998); *see generally* John Marangos, *Was Shock Therapy Really a Shock?*, 37 J. ECON. ISSUES 943 (2003) (analyzing shock therapy and its effect on the Russian economy).

30. PREM SHANKAR JHA, THE PERILOUS ROAD TO THE MARKET: THE POLITICAL ECONOMY OF REFORM IN RUSSIA, INDIA AND CHINA 36–56 (2003); *see also* DIEGO GAMBETTA, THE SICILIAN MAFIA: THE BUSINESS

Even when a market exists and generates many transactions, it can still function poorly.[31] One well-known example is the inefficiency of many labor markets.[32] For example, legal hiring often presents serious timing issues, as legal employers face incentives to make hiring decisions years before the student completes his or her legal studies, well before a realistic appraisal of their academic performance can be made.[33] Similar problems afflict many labor markets for new professionals, but it is possible to solve these types of problems by designing better market institutions.[34]

The corporate form developed over time to facilitate modern markets in three different ways. It did this by first creating an entity that survived the death of a founder (unlike a traditional partnership), permitting the capital of many different people to be pooled together, separating ownership and control in ways that permit investors unfamiliar with a business to entrust their money to experienced managers, and by providing checks on managerial opportunism.[35] This made the corporate form a superior vehicle for competing in a wide range of existing markets.[36] Second, these features of the corporate form

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OF PRIVATE PROTECTION 253 (1992) (discussing the mafia as an economic enterprise that provides substitutes to well-functioning markets); Vladimir Mau, *The Role of State and Creation of a Market Economy in Russia* (Bank of Fin. Inst. for Econ. in Transition, Discussion Paper No. 23, 2011), https://ssrn.com/abstract=1914300 [https://perma.cc/4796-LG3L] (discussing the role of institutions in economic growth in Russia); Stefan Hedlund, *Such a Beautiful Dream: How Russia Did Not Become a Market Economy*, 67 RUSSIAN REV. 187 (2008) (describing how the market economy failed to take hold in Russia); Shlomo Maital & Ben-Zion Milner, *Russia and Poland: The Anatomy of Transition*, 36 CHALLENGE 40 (1993) (describing the transition between a socialism and market-based economy).

31. A famous example of this includes the market-pricing of IPOs. *See* Roger G. Ibboston, Jody L. Sindelar & Jay R. Ritter, *The Market's Problems with the Pricing of Initial Public Offerings*, 7 J. APPLIED CORP. FIN. 66 (1994) (describing the difficulty with IPOs due to a lack of an operating history); Michelle Lowry & G. William Schwert, *Is the IPO Pricing Process Efficient?*, 71 J. FIN. ECON. 3 (2004) (discussing key facts in the IPO pricing process). Another example is the problem of high-frequency trading on security exchanges. *See* MICHAEL LEWIS, FLASH BOYS: A WALL STREET REVOLT (2014) (discussing Brad Katsuyama and electronic trading); Eric Budish, Peter Cramton & John Shim, *The High-Frequency Trading Arms Race: Frequent Batch Auctions As a Market Design Response*, 130 Q. J. ECON. 1547 (2015) (discussing how high-frequency trading is a flaw of the market design).

32. *See, e.g.*, Amanda Pallais, *Inefficient Hiring in Entry-Level Labor Markets*, 104 AM. ECON. REV. 3565 (2014); Ryan Craig, *Fixing the World's Most Inefficient Market*, Forbes (July 17, 2020), https://www.forbes.com/sites/ryancraig/2020/07/17/fixing-the-worlds-most-inefficient-market/?sh=785d3aeb3-bbf [https://perma.cc/9R7Z-63X2].

33. *See, e.g.*, Christopher N. Avery et al., *The Market for Federal Judicial Law Clerks*, 68 U. CHI. L. REV. 793 (2001) (discussing the market for law clerks that, at the time, was often an open market two years in advance of employment); *see also* Alvin E. Roth & Xiaolin Xing, *Jumping the Gun: Imperfections and Institutions Related to the Timing of Market Transactions*, 84 AM. ECON. REV. 992, 1000–07 (1994) (discussing the timing issues for prestigious law firm and federal clerkship jobs).

34. HAERINGER, *supra* note 8, at 173–96.

35. While early joint-stock companies offered many opportunities for managers to work in their personal interest, they also pioneered methods of controlling agency costs such as non-compensating wage differentials, requiring employees to post performance bonds, and carefully monitoring employee behavior. *See, e.g.*, Ann M. Carlos, *Principal-Agent Problems in Early Trading Companies: A Tale of Two Firms*, 82 AM. ECON. REV. 140 (1992) (discussing agency costs in the Hudson Bay Company and Royal African Company).

36. RON HARRIS, GOING THE DISTANCE: EURASIAN TRADE AND THE RISE OF THE BUSINESS CORPORATION 330, 370–71 (2020) (discussing how the corporation provided a competitive advantage in traditional trading relationships); RICHARD N. LANGLOIS & PAUL L. ROBERTSON, FIRMS, MARKETS AND ECONOMIC CHANGE: A DYNAMIC THEORY OF BUSINESS INSTITUTIONS 3–5 (1995) (discussing how the corporate form facilitated systemic innovations that required simultaneous changes in multiple steps of production).

permitted the creation of new markets, such as those brought into existence by the overseas trading voyages of the early modern period.[37] These markets could not have existed without a way of achieving the larger scale and spread of risk made possible by the corporate form. Finally, the separation of ownership and control, transferability of shares, limited shareholder liability, and the development of disclosure mechanisms such as audits and a financial press created a market for ownership interests in businesses themselves.[38]

These are not achievements to be taken lightly. Economic historians generally believe the invention of the corporation was one of the crucial factors leading to the economic rise of Western Europe in the modern period.[39] Even now, one of the factors used to predict the development of countries is the ease and efficiency of incorporating a business.[40] Corporations also facilitated the rise of modern impersonal markets generally:

> [T]he shift from personal to impersonal exchange . . . was essential to the economic rise of Europe. Personal exchange, or cooperation, was based on family, locality, or ethnic kinship ties. Impersonal exchange between strangers was traditionally confined to simple and instantaneous bartering or cash transactions. The shift in Western Europe from family firms and closed partnerships to the joint-stock corporation constituted more than just a switch from one organizational form to another. It was a shift from personal cooperation to impersonal cooperation.[41]

III. The Intrinsic Value of Markets

This Article argues that markets are central to corporate law while social welfare outcomes are merely secondary. This idea is part of a growing literature on the normative importance of markets in areas of law long dominated by economic wealth maximization

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37. Ann M. Carlos & Stephen Nicholas, *Theory and History: Seventeenth-Century Joint-Stock Chartered Trading Companies*, 56 J. ECON. HIST. 916, 917 (1996) (arguing early companies were an efficient institutional response to long-distance trade).

38. Ross L. Watts & Jerold L. Zimmerman, *Agency Problems, Auditing, and the Theory of the Firm: Some Evidence*, 26 J.L. & ECON. 613, 614 (1983) ("[T]he audit existed early in the development of business corporations (1200) and evolved gradually into the type of audit required by the first English companies act (1844).").

39. ROBERT MONKS & NELL MINOW, CORPORATE GOVERNANCE 100 (5th ed. 2011) ("This notion of stock ownership has been indispensable in the extraordinary rise of Western Europe and the United States over the past half millennium."); *see generally* Timur Kuran, *Why the Middle East Is Economically Underdeveloped: Historical Mechanisms of Institutional Stagnation*, 18 J. ECON. PERSP. 71 (2004) (discussing the absence in Islamic law of the concept of a corporation and the consequent weaknesses of civil society); Avner Greif, *The Fundamental Problem of Exchange: A Research Agenda in Historical Institutional Analysis*, 4 EUR. REV. ECON. HIST. 251 (2000) (analyzing the historical evolution of institutions); Greif, *supra* note 19 (discussing how markets and political institutions co-evolve).

40. The World Bank measures the ease of incorporation in various countries as a measure of regulatory quality. *See generally* *Ease of Doing Business Rankings*, WORLD BANK, https://archive.doingbusiness.org/en/rankings [https://perma.cc/4434-QSP9]. Empirical studies find the World Bank's measure of the ease of incorporation is positively associated with economic growth. Boudhiaf Messaoud & Zribi El Ghak Theheni, *Business Regulations and Economic Growth: What Can Be Explained?*, 2 INT'L STRATEGIC MGMT. REV. 69, 73–74, 77 (2014); Marek Hanusch, *The Doing Business Indicators, Economic Growth and Regulatory Reform* (World Bank, Pol'y Rsch. Working Paper No. 6176, 2012).

41. HARRIS, *supra* note 36, at 2.

norms.[42] The most prominent are recent works in contract law by Nate Oman,[43] Daniel Markovits,[44] Alan Brudner,[45] and Roy Kreitner.[46] Professor Oman, who has probably done the most work along these lines, summarizes his thesis that the "indifference of contract theorists to markets is a mistake" because "contract law exists primarily to support markets and . . . the moral and political value of markets as a social institution undergirds its justification."[47] He emphasizes that the value of markets is not solely derived from their role in efficiently allocating resources and thus generating wealth.[48] He argues instead that markets are intrinsically valuable.[49] The quality of contract rules are thus connected to their effectiveness at creating and sustaining the messy private bargaining and experimentation that make up market transactions.[50]

In addition to contract law, legal scholars have made similar types of market-focused arguments to explain and rationalize such disparate fields as property law[51] and antitrust.[52]

42. These arguments are derived from law and economics approaches. *See generally* A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS (2d ed. 1989) (illustrating how to assess legal issues from a normative approach, combining economic and social considerations); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003) (making the claim that economic efficiency should be the only concern governing contract law as applied to agreements between commercial firms).

43. *See generally* OMAN, *supra* note 8 (arguing that markets are about more than economic efficiency); Nathan B. Oman, *Markets As a Moral Foundation for Contract Law*, 98 IOWA L. REV. 183 (2012) [hereinafter Oman, *Markets As a Moral Foundation*] (concluding that "[m]arkets provide the moral foundations for contract law"); Nathan B. Oman, *The Failure of Economic Interpretations of the Law of Contract Damages*, 64 WASH. & LEE L. REV. 829 (2007) (analyzing normative legal theories); Nathan B. Oman, *Unity and Pluralism in Contract Law*, 103 MICH. L. REV. 1483 (2005) (analyzing competing theories of the law).

44. Daniel Markovits, Guido Calabresi Professor of L., Inaugural Lecture at Yale Law School (Apr. 9, 2012).

45. *See generally* ALAN BRUDNER & JENNIFER M. NADLER, THE UNITY OF THE COMMON LAW (2d ed. 2014) (proposing an approach that combines formalism and functionalism by emphasizing the centrality of markets).

46. *See generally* Roy Kreitner, *Voicing the Market: Extending the Ambition of Contract Theory*, 69 U. TORONTO L.J. 295 (2019) (analyzing markets under various theories).

47. Oman, *Markets As a Moral Foundation*, *supra* note 43, at 187.

48. *Id.* at 187 ("[Markets] do far more than simply allocate resources, and our understanding of their workings and possible social functions cannot be exhausted by the tools of the rational-actor model and efficiency analysis.").

49. *Id.* at 228.

50. *See* OMAN, *supra* note 8, at 155 (discussing the effect of only enforcing contract terms that a consumer is subjectively aware of, ignoring boilerplate terms, and resolving all other questions with default terms on private bargaining and experimentation).

51. *See, e.g.*, Malcolm Lavoie, *Property and Local Knowledge*, 70 CATH. U. L. REV. 637 (2021) (utilizing the impact of "local knowledge" on market decisions about property use as a vehicle to justify and analyze property law); Carol M. Rose, *Property as the Keystone Right*, 71 NOTRE DAME L. REV. 239, 355 (1996) ("[C]apitalist property has a kind of moral and cultural infrastructure that we may have mistakenly thought was simply natural, whereas in fact it is learned through sustained commercial practice, and lost when those practices deteriorate."); CAROL M. ROSE, PROPERTY AND PERSUASION (1994) (collecting essays that analyze property law, its justification, and its analytical framework); Carol M. Rose, *Giving, Trading, Thieving, and Trusting: How and Why Gifts Become Exchanges, and (More Importantly) Vice-Versa*, 44 FLA. L. REV. 295 (1992) (discussing how the area of gifts is made complicated by finding the intriguing truth that there is a reciprocal nature in both exchanges and gifts).

52. *See, e.g.*, Lina M. Khan, *Amazon's Antitrust Paradox*, 126 YALE L.J. 710, 717 (2017) [hereinafter Khan, *Antitrust Paradox*] ("[G]auging real competition in the twenty-first century marketplace . . . requires analyzing

There may be reasons to question the "hipster antitrust" movement,[53] but it is reasonable to ask, as Professor Lina Khan does, whether "consumer welfare, typically measured through short-term effects on price and output—fails to capture the architecture of market power in the twenty-first century marketplace."[54] Is it possible that digital platforms—like those maintained by Amazon or Google, where the same firm both regulates and competes in the market—produces flawed environments for trade? Is it possible that network effects, combined with the sale of valuable data, produce firms (like Facebook) that simultaneously provide customers with low prices (indeed, "free" services) while, at the same time, preventing a market from arising by presenting insurmountable barriers to new entrants and acquiring firms that present substitutes? Whatever the answers, these are the kinds of questions that at least emphasize the importance of markets themselves, over and above their wealth effects on consumers.

The argument that markets are intrinsically valuable is a very old one. Montesquieu wrote that "Commerce is a cure for the most destructive prejudices; for it is almost a general rule, that wherever we find agreeable manners, there commerce flourishes; and that wherever there is commerce, there we meet with agreeable manners."[55] Passages like this gave rise to the name of the tradition: *doux commerce*.[56] When Voltaire visited England, what impressed him was not the way modern markets generated wealth, but their effect on their participants:

> Take a view of the Royal Exchange in London, a place more venerable than many courts of justice, where the representatives of all nations meet for the benefit of mankind. There the Jew, the Mahometan, and the Christian transact together, as tho[ugh] they all profe[sse]d the same religion, and give the name of the Infidel to none but bankrupts. There the Presbyterian confides in the Anabaptist, and the Churchman depends on the Quaker's word.[57]

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the underlying structure and dynamics of markets."); Lina M. Khan, *The Separation of Platforms and Commerce*, 119 COLUM. L. REV. 973 (2019) (discussing market disruptions, market structure, and digital markets).

53. *See* Joshua D. Wright et al., *Requiem for a Paradox: The Dubious Rise and Inevitable Fall of Hipster Antitrust*, 51 ARIZ. STATE L.J. 293, 296 (2019) ("We demonstrate that, when evaluated as *evidence-based* policy proposals, the Hipster Antitrust agenda fails to substantiate its claims and promises.").

54. Khan, *Antitrust Paradox*, *supra* note 52, at 716.

55. 1 CHARLES DE SECONDAT BARON DE MONTESQUIEU, THE SPIRIT OF THE LAWS 316 (Thomas Nugent, trans., .Hafner Publ'g Co. 1949) (1748).

56. ALBERT O. HIRSCHMAN, RIVAL VIEWS OF MARKET SOCIETIES AND OTHER RECENT ESSAYS (1986). Other authors in the tradition include Adam Smith. *See* SMITH, *supra* note 7, at 331 ("[C]ommerce and manufactures gradually introduce order and good government, and with them the liberty and security of individuals, among the inhabitants of the country, who had before lived almost in a continual state of war with their neighbours, and of servile dependency upon their superiors."); *see also* DAVID HUME, *On the Independency of Parliament*, *in* ESSAYS MORAL, POLITICAL, AND LITERARY 117 (T.H. Green & T.H. Grose eds., 1882) (utilizing *doux commerce* concepts and arguments); THOMAS PAINE, THE RIGHTS OF MAN FOR THE BENEFIT OF ALL MANKIND 116 (6th ed., 1797) (stating that commerce operates to "cordialize mankind."); JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY (1865) (defining his principles with a foundation of *doux commerce* undertones); ALEXIS DE TOQUEVILLE, DEMOCRACY IN AMERICA 110–12 (Vintage Books, 1945) ("Men learn to think of their fellow men from ambitious motives . . . Men attend to the interests of the public, first, by necessity, afterwards by choice; . . .by dint of working for the good of one's fellow citizens, the habit and the taste for serving them are at length acquired.").

57. DE VOLTAIRE, LETTERS CONCERNING THE ENGLISH NATION 36 (2d ed., London, C. Davis 1741) (emphasis omitted).

Voltaire wrote this in the context of a Europe that had spent hundreds of years in violent conflict over religion. He addressed his country, which had perpetrated massacres in an attempt to secure social peace by eliminating diversity of belief.[58] The *doux commerce* tradition was explicitly concerned with social and moral outcomes, not just economic results. As John Stuart Mill noted, "[T]he economical advantages of commerce are surpassed in importance by those of its effects, which are intellectual and moral."[59]

The *doux commerce* thesis has oscillated in popularity.[60] It's popularity has not been helped by the tendency of defenders of markets to over-claim their merits.[61] Markets don't necessarily produce love or friendship, nor do they inevitably produce social trust.[62] They also do not guarantee peace.[63] All Voltaire claims for the Royal Exchange is that it produces a way of getting along, a kind of impersonal tolerance and cooperation that does not, in fact, require love or deep agreement on important matters.[64] It is true, as the philosopher John Finnis notes, that "[m]any relationships initiated merely for business and private need or advantage . . . ripen into relationships of more or less intense friendship,"[65] but this is not necessary for the thesis that markets are an intrinsically valuable component of civil society.[66]

For much of its history, the *doux commerce* thesis has been the subject of philosophical speculation, but the last 30 years have seen the rise of a body of empirical

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58. For an extensive analysis of Europe's religious wars, see generally JONAS VAN TOL, GERMANY AND THE FRENCH WARS OF RELIGION, 1560–72 (2018); ANDREA FRISCH, FORGETTING DIFFERENCES: TRAGEDY, HISTORIOGRAPHY, AND THE FRENCH WARS OF RELIGION (2015).

59. MILL, *supra* note 56, at 351.

60. John Keane, *Eleven Theses on Markets and Civil Society*, 1 J. CIV. SOC'Y 25, 25 (2005) (discussing the way markets have gone from being seen as central to civil society to being excluded from it); *see also* Albert O. Hirschman, *Rival Interpretations of Market Society: Civilizing, Destructive, or Feeble?*, 20 J. ECON. LITERATURE 1463, 1470–71 (1982) (discussing the way market transactions have changed from being regarded as improving morality to being regarded as fostering immorality).

61. *See generally* NORMAN ANGELL, THE GREAT ILLUSION, 1933 (Ronald Steel ed., Arno Press 1972) (arguing that international trade made the economic costs of war prohibitive and aligned the interests of the establishments of different countries); *see also* Erik Gartzke & Yonatan Lupu, *Trading on Preconceptions: Why World War I Was Not a Failure of Economic Independence*, 36 INT'L SEC. 115, 116 (2012) (arguing that "economic interdependence and the outbreak of World War I has been broadly misinterpreted and that interdependence did not really fail in 1914."). *But see* Philippe Martin, Thierry Mayer & Mathias Thoenig, *Make Trade Not War?*, 75 REV. ECON. STUD. 865, 877–94 (2008) (finding that bilateral trade reduces the number of conflicts, but more open economies increase the likelihood of conflict as dependence on any one trading partner is reduced).

62. Mark L. Movsesian, *Markets and Morals: The Limits of* Doux Commerce, 9 WM. & MARY BUS. L. REV. 449, 473–74 (2018) (observing "levels of social trust in America are quite low," notwithstanding the strong market orientation of that country).

63. Many have made this claim, but one of the first was THOMAS PAINE. *See generally* THOMAS PAINE, RIGHTS OF MAN, COMMON SENSE, AND OTHER POLITICAL WRITINGS 266–67 (Mark Philip ed., Oxford Univ. Press 1995) ("If commerce was permitted to act to the universal extent it is capable, it would extirpate the system of war.").

64. DE VOLTAIRE, *supra* note 57, at 36.

65. JOHN FINNIS, NATURAL LAW & NATURAL RIGHTS 142 (Paul Craig ed., Oxford Univ. Press 2d ed. 2011).

66. JOHN FINNIS, NATURAL LAW & NATURAL RIGHTS 142 (Paul Craig ed., Oxford Univ. Press 2d ed. 2011). *See also* VIRGIL HENRY STORR & GINNY SEUNG CHOI, DO MARKETS CORRUPT OUR MORALS? 107–09 (2019) (summarizing an extensive empirical literature that friendship and love are positively associated with various market activities such as working together, selling to one another, and competing with one another).

literature testing the impact of markets on their participants. In general, this literature strongly supports the claim that markets produce valuable social outcomes and even positively affect the moral outlook and character of market actors. The empirical studies also contradict some of the traditional criticisms of the effect of markets on individuals.

A. The Pro-Social Effects of the Market

Historians have observed changes in moral behavior occurring around the time modern markets were developed. Thomas Haskell noted:

> Conscience and promise keeping emerged in human history, of course, long before capitalism . . . . [I]t was not until the eighteenth century, in Western Europe, England, and North America, that societies first appeared whose economic systems depended on the expectation that most people, most of the time, were sufficiently conscience-ridden (and certain of retribution) that they could be trusted to keep their promises.[67]

This is not an idiosyncratic observation. Max Weber also observed that "along with clarity of vision and ability to act, it is only by virtue of a very definite and highly developed ethical qualities that it has been possible for [a modern entrepreneur] to command the indispensable confidence of his customers and workmen."[68]

This claimed moral change produced by markets may strike some readers as incredible, as most of us assume people in the past were more or less like us—except possibly more drunk.[69] But there is considerable historical evidence that general moral behavior can change.[70] The rise of the feminism, the civil rights movement, and LGBTQ+ advocacy have all had a significant effect on the behavior of modern Americans. Weber and Haskell merely point out that modern, impersonal markets were one of the agents of this change (which included reducing our predecessors' astonishing levels of near-constant drunkness).[71]

In his book *The Moral Foundation of Economic Behavior*, David Rose argues that large-scale economic activity of the sort performed by widely-held corporations, for example, can only exist in places where economic actors can be trusted not to act in self-interested ways when the opportunity arises.[72] Rose points out that modern markets depend

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67. Thomas L. Haskell, *Capitalism and the Origins of the Humanitarian Sensibility, Part 2*, 90 AM. HIST. REV. 547, 553 (1985).

68. MAX WEBER, THE PROTESTANT ETHIC AND THE SPIRIT OF CAPITALISM 69 (1958); *see also* CHARLES TAYLOR, EXPLANATION OF BEHAVIOR (1964); CHARLES TAYLOR, MULTICULTURALISM AND THE POLITICS OF RECOGNITION (Amy Gutmann, ed., 1992) (arguing the growth of capitalism brought with it greater emphasis on personal responsibility and voluntaristic action).

69. Lefineder, *When Did People Stop Being Drunk All the Time?* (July 18, 2023), https://lefineder.substack.com/p/when-did-people-stop-being-drunk [https://perma.cc/PPK6-HQ4D].

70. *See* Ben Wilson, The Making of Victorian Values (2007) (describing the way the distinctive middle-class morality of the Victorian era developed); Tom Holland, Dominion: How the Christian Revolution Remade the World (2019) (describing the abiding changes in European moral outlook produced by its encounter with Christianity).

71. Lefineder, *supra* note 69.

72. DAVID C. ROSE, THE MORAL FOUNDATION OF ECONOMIC BEHAVIOR 4–7, 158–79 (2011). For additional research on the need for trust in economic actors on economic activity, see Quentin Dupont & Jonathan M. Karpoff, *The Trust Triangle: Laws, Reputation, and Culture in Empirical Finance Research*, 163 J. BUS. ETHICS 217 (2020) (analyzing the way in which trust among economic actors impacts financial markets).

on discretion being delegated and exercised by individuals with highly specialized, local knowledge.[73] Other interested parties, including managers, customers, business partners, and shareholders, have a limited ability to observe these market actors' behaviors or even to second-guess those decisions that come to their attention. Law is useless to prevent opportunistic behavior in these circumstances, as most potential violations of trust are invisible, incalculable, and unprovable.[74] Unless market actors consistently reject the opportunities to engage in small and invisible acts of shirking or self-enrichment, large-scale commerce will collapse. Only widely practiced moral integrity of a particular kind can generate the levels of social trust to permit economic activity on a large scale among strangers.[75]

None of these observations will be controversial to someone who has spent time in the markets surrounding corporations.[76] One large manufacturing company audited its records and found that roughly 60–75% of the time the company failed to enter into formal contracts with its customers.[77] Each party trusted the other to act reasonably.[78] The chief economist of Ford Motor Company noted he "was surprised to learn that Ford made billions of dollars of purchases a year through regular suppliers over the telephone with only the skeleton of a contract and with few contract disputes."[79] There is a vast literature on "incomplete" contracts, such as employment agreements, where the relevant markets depend on the trustworthiness of counterparties rather than the law or formalized covenants.[80]

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73. ROSE, *supra* note 72; *see also* Hayek, *Use of Knowledge*, *supra* note 6; HAYEK, *Competition*, *supra* note 6.

74. *See* Stewart Macauley, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOCIO. REV. 55, 65 (1963) ("Finally, the law of contract damages may not provide an adequate remedy even if the firm wins the suit; one may get vindication but not much money.").

75. *See* ROSE, *supra* note 72, at 3 (noting that the "most efficient operation of a market economy . . . requires a 'moral foundation' . . . [that] induce[s] people to think about morality in a way that makes them unwilling to behave in an opportunistic manner even when there is no chance of detection and even when . . . there is possibility of harming anyone"); *see also* Thomas L. Haskell, *Capitalism and the Origins of the Humanitarian Sensibility, Part 1*, 90 AM. HIST. REV. 339, 346 (1985) (detailing that Quaker success in business was linked to reputation of moral superiority); Thomas L. Haskell, *Capitalism and the Origins of the Humanitarian Sensibility, Part 2*, 90 AM. HIST. REV. 547, 547–48 (1985) (arguing that the change in humanitarian sentiment in the 1700s and 1800s, specifically in the context of growing attitudes against slavery, was due to the growth of capitalist markets); William Jankowiak, *Market Reform, Nationalism, and the Expansion of Urban China's Moral Horizon*, 33 URB. ANTHROPOLOGY & STUD. CULTURAL SYS. & WORLD ECON. DEV. 167 (2004) (discussing morality and market reform in urban China); Brandon N. Cline & Claudia R Williamson, *Trust and the Regulation of Corporate Self-Dealing*, 41 J. CORP. FIN. 572, 573 (2016) (finding measures of trust positively associated with large-scale financial market development).

76. *See, e.g.*, Kenneth J. Arrow, *Gifts and Exchanges*, 1 PHIL. & PUB. AFFS. 343, 357 (1972) ("Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time.").

77. Macauley, *supra* note 74, at 60.

78. *See id.* at 61–63 (explaining why the companies may have acted without contracts).

79. William A. Niskanen, *The Soft Infrastructure of a Market Economy*, 11 CATO J. 233, 236 (1991).

80. Oliver E. Williamson, *The New Institutional Economics: Taking Stock, Looking Ahead*, 38 J. ECON. LITERATURE 595, 600–01 (2000) (explaining that due to cognitive limits, all complex contracts are unavoidable incomplete); George Baker, Robert Gibbons & Kevin J. Murphy, *Relational Contracts and the Theory of the Firm*, 117 Q.J. ECON. 39, 47 (2002) (detailing that relational contracts between firms are inherently incomplete); Benjamin E. Hermalin & Michael L. Katz, *Judicial Modification of Contracts Between Sophisticated Parties: A*

Some critics of markets have not denied that trust on one side (and thus, trustworthiness on the other side) is essential for market transactions. Rather, they have argued that the *doux commerce* tradition has it backwards: integrity and trust give rise to the market, not the other way around.[81] In Edmund Burke's initial formulation of this objection, markets are secondary to the cultural capital generated by pre-existing virtues, laws, cultural traditions, and especially religion.[82]

To establish the thesis of this Article, however, it is not necessary to demonstrate that critics like Burke are wrong, but only that markets are at least partially responsible for encouraging trustworthy, cooperative behavior. Religion, culture, and historical contingency can all play their parts, but for this Article to be correct markets have to contribute as well. It is in tracing this kind of causality that recent empirical studies become useful.

In the past 40 years scientists and economists have begun using games to understand the nature and causes of the cooperative behaviors that characterize modern society. These experiments have uncovered large, consistent deviations from the self-interest predicted by narrow economic models of human behavior.[83]

> Hundreds of experiments in dozens of countries, using a variety of game structures and experimental protocols, have suggested that in addition to their own material payoffs, [participants] care about fairness and reciprocity and will sacrifice their own gains to change the distribution of material outcomes among others, sometimes rewarding those who act prosocially and punishing those who do not.[84]

Cross-cultural studies have consistently shown that the factor that best predicts pro-social behavior is exposure to markets.[85] For example, the largest of these studies made use of

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More Complete View of Incomplete Contracts and Their Breach, 9 J. L. ECON. & ORG. 230, 230 (1993) (articulating the role of the judiciary in enforcing incomplete contracts); Rebecca Stone & Alexander Stremitzer, *Promises, Reliance, and Psychological Lock-In*, 49 J. LEGAL STUD. 33, 33 (2020) (empirically investigating the psychology behind fulfilling incomplete contracts).

81. The most prominent of these critics is EDMUND BURKE, REFLECTIONS ON THE REVOLUTION IN FRANCE 68 (Frank M. Turner ed., 2003) ("Even commerce, and trade, and manufacture, the gods of our economic politicians, are themselves perhaps but creatures; are themselves but effects."); *see also* NORMAN, *supra* note 28, at 208–09, 283 (arguing that for Burke, markets came after traditional social organizations like religion).

82. NORMAN, *supra* note 28 at 208–09.

83. DEIRDRE N. MCCLOSKEY, THE BOURGEOIS VIRTUES: ETHICS FOR AN AGE OF COMMERCE 128 (2006) (quoting Vernon Smith, "laboratory experiments also support reciprocity in two person extensive form games under very unfavourable conditions in which we give the self-interest its best shot: *complete anonymity*" at 128); COLIN CAMERER, BEHAVIORAL GAME THEORY: EXPERIMENTS IN STRATEGIC INTERACTION (2003); Ernst Fehr & Simon Gachter, *Altruistic Punishment in Humans* 415 NATURE 137, 138 (2002); Elizabeth Hoffman, Kevin A. McCabe & Vernon L. Smith, *Behavioral Foundations of Reciprocity: Experimental Economics and Evolutionary* Psychology, 36 ECON. INQUIRY 335, 350 (1998).

84. Joseph Henrich et al., *Economic Man in Cross-Cultural Perspective: Behavioral Experiments in 15 Small-Scale Societies*, 28 BEHAV. & BRAIN SCI. 795, 797 (2005); *see also* Robert B. Chaldini, Carl A. Kallgren & Raymond R. Reno, *A Focus Theory of Normative Conduct: A Theoretical Refinement and Reevaluation of the Role of Norms in Human Behaviour*, 24 ADVANCES EXPERIMENTAL SOC. PSYCHOL. 201, 229–31 (1991); VERNON L. SMITH & BART J. WILSON, HUMANOMICS: MORAL SENTIMENTS AND THE WEALTH OF NATIONS FOR THE TWENTY-FIRST CENTURY (2019).

85. Joseph Henrich, *Does Culture Matter in Economic Behavior? Ultimatum Game Bargaining Among the*

three different games (the ultimatum, public goods, and dictator games, all of which use cash rewards to test cooperation, trust, reciprocity, and commitment to fairness).[86] The study ran experiments in 12 countries and 15 small-scale societies exhibiting diversity in economic and social conditions. The researchers found considerable variation in rates of pro-social behavior, but differences in what they termed "market integration" explained "a substantial portion of the behavioral variation."[87] The more involvement a community had with markets by buying and selling products or working for wages, the more likely members of that community were to engage in cooperative, pro-social actions during the experiments.

The impact of market integration on explaining behavioral differences in these experiments was much greater than demographic effects such as gender, age, education, and wealth.[88] Some researchers have hypothesized that "extensive market interactions may accustom individuals to the idea that strangers can be trusted (i.e. expected to cooperate)."[89] This stands in contrast to what we might assume—that cooperation would be more prevalent among members of close-knit pre-commercial societies.

A recent study (by many of the same researchers) looking at ten new cultures found that market integration, which they measured by looking at the percentage of a household's total calories purchased from a market, was again strongly predictive of pro-social, trustworthy behavior.[90]

Other studies have examined the Oromo herding communities of Ethiopia to measure individuals' willingness to cooperate with other Oromo in an economic game.[91] Members of the Oromo are tied to their land by customary rights, so the researchers included as a variable the distance of those lands from the nearest market. The distances ranged from a few hours of travel time to a full day. The study found that people who lived closer to

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Machiguenga of the Peruvian Amazon, 90 AM. ECON. REV. 973, 974–78 (2000) (finding that a slash-and-burn horticulturalist tribe in the Amazon behaved much less pro-socially than western game players); Joseph Henrich et al., *In Search of Homo Economicus: Behavioral Experiments in 15 Small-Scale Societies*, 91 AM. ECON. REV. 73, 74 (2001) (finding that the higher the degree of market integration, "the greater the level of cooperation in experimental games"); David P. Tracer, *Market Integration, Reciprocity, and Fairness in Rural Papua New Guinea: Results Form a Two-Village Ultimatum Game Experiment*, *in* FOUNDATIONS OF HUMAN SOCIALITY: ECONOMIC EXPERIMENTS AND ETHNOGRAPHIC EVIDENCE FROM FIFTEEN SMALL-SCALE SOCIETIES 232 (Joseph Henrich et al. eds., 2004) (finding higher levels of trust associated with greater market integration); Jean Ensminger, *Market Integration and Fairness: Evidence from Ultimatum, Dictator and Public Good Experiments in East Africa*, *in* FOUNDATIONS OF HUMAN SOCIALITY: ECONOMIC EXPERIMENTS AND ETHNOGRAPHIC EVIDENCE FROM FIFTEEN SMALL-SCALE SOCIETIES 356 (Joseph Henrich et al. eds., 2004); Qin Tu & Erwin Bulte, *Trust, Market Participation and Economics Outcomes: Evidence from Rural China*, 38 WORLD DEV. 1179, 1185 (2010); Henrich, *Economic Man*, *supra* note 79; CAMERER, *supra* note 83, at 11 (noting equilibrium play [of the sort predicted for utility maximizers] is only observed in tribal societies isolated from markets).

86. Henrich et al., *supra* note 84, at 794–95.

87. *Id.* at 797.

88. *Id.* at 809–10; *see also* CAMERER, *supra* note 83.

89. Henrich et al., *supra* note 84, at 813.

90. Joseph Henrich et al., *Markets, Religion, Community Size, and the Evolution of Fairness and Punishment*, 327 SCI. 1480, 1482 (2010).

91. Michael Kosfeld & Devesh Rustagi, *Leader Punishment and Cooperation in Groups: Experimental Field Evidence from Commons Management in Ethiopia*, 105 AM. ECON. REV. 747, 771 (2015); *see also* Devesh Rustagi, Stefanie Engel & Michael Kosfeld, *Conditional Cooperation and Costly Monitoring Explain Success in Forest Commons Managements*, 330 SCI. 961, 963 (2010) (finding the further a group is from a market the lower its forest management outcomes are).

markets were more cooperative. This was true even after statistically controlling for wealth, gender, literacy, and many other variables. A similar study of tribesmen in Burundi resulted in similar findings.[92]

Researchers have discovered that simply priming a randomized group of study participants to think in terms of markets increases the amounts they send to strangers in standard trust games.[93] "Using randomized control, we find evidence that priming markets leaves people more optimistic about the trustworthiness of anonymous strangers and therefore increases trusting decisions, and in turn, social efficiency . . . . [W]e can interpret our results as evidence in favor of the hypothesis that market participation increases trust."[94] Another study found that business executives show more trust (and are more trustworthy) than undergraduate students.[95]

The effect of markets has an impact on behavior and attitudes even if we isolate only the competitive aspect of markets, their least obviously pro-social element. Workers randomly assigned into a competitive labor market exhibited more cooperative attitudes than those who were randomly assigned to be paid fixed amounts outside of that market.[96] "Competitively structured work experiences increased non-utilitarian value choices, non-utilitarian commitments towards out-group members, and [charitable] donations by productive workers."[97]

The rise of modern markets is associated with greater levels of personal honesty.[98] As Adam Smith observed, and as many experiments by behavioral economists have confirmed,[99] "When a person makes perhaps twenty contracts in a day, he cannot gain so

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92. Maarten Voors et al., *Violent Conflict and Behavior: A Field Experiment in Burundi*, 102 AM. ECON. REV. 941, 953 (2012) ("[S]ocial behavior . . . [is] negatively associated with [increasing] distance to the market . . . .").

93. *See generally* Omar Al-Ubaydli et al., *The Causal Effect of Market Priming on Trust: An Experimental Investigation Using Randomized Control*, 8 PLOS ONE 1 (2013).

94. *Id.* at 6.

95. Ernst Fehr & John A. List, *The Hidden Costs and Returns of Incentives—Trust and Trustworthiness Among CEOs*, 2 J. EUR. ECON. ASS'N 743 (2004); *see also* STORR & CHOI, *supra* note 66, at 205–12 (detailing the results of their empirical study demonstrating markets teach moral behavior).

96. *See* Daniel L. Chen, Markets and Morality: How Does Competition Affect Moral Judgment 19 (June 2011), (unpublished manuscript), http://www.asrec.org/wp-content/uploads/2015/10/Morality.pdf [https://perma.cc/EZ9S-TAHF] (finding "competition fosters empathy").

97. *Id.* at 3. Defenders of markets often point to the much higher rates to charitable giving and volunteerism in the United States relative to less market-oriented countries as supporting evidence. Mark A. Zupan, *The Virtues of Free Markets*, 31 CATO J. 171, 181–82 (2011). But it is impossible to disentangle correlation and causation in this area. *See* Meina Cai et al., *Individualism, Economic Freedom, and Charitable Giving*, 200 J. ECON. BEHAV. ORG. 868 (2022) (discussing statistical results, and how those results cannot determine causation).

98. MCCLOSKEY, *supra* note 83. McCloskey's evidence amusingly includes comparing the frequency of dishonesty and betrayal in the plots of Shakespeare and other Elizabethan authors with the frequency of this behavior in modern playwrights such as Ibsen and O'Neill. *Id.*; *see also* JOHN MUELLER, CAPITALISM, DEMOCRACY & RALPH'S PRETTY GOOD GROCER 44 (1999) (highlighting as modern markets became more central, "business behavior . . . became noticeably more honest during the nineteenth century . . . .").

99. *See, e.g.*, Thomas R. Palfrey & Howard Rosenthal, *Repeated Play, Cooperation and Coordination: An Experimental Study*, 61 REV. ECON. STUD. 545, 545 (1994) (describing "whether discounted repeated play leads to greater cooperation and coordination than one-shot play in a public good environment"); Dustin H. Tingley & Barbara F. Walter, *The Effect of Repeated Play on Reputation Building: An Experimental Approach*, 65 INT'L ORG. 343, 343 (2011) (examining "reputation building through a series of incentivized laboratory experiments"); Jordi Brandts & Neus Figueras, *An Exploration of Reputation Formation in Experimental Games*, 50 J. ECON.

much by endeavouring to impose upon his neighbours, as the appearance of a cheat would make him lose."[100] A vast body of cross-country research on institutional determinants of corruption levels find that it is not the size of government that matters, but whether contracts and property rights are enforced and whether markets determine how resources are allocated.[101]

BEHAV. & ORG. 89, 89 (2003) (presenting "results from experiments with finitely repeated games with complete and incomplete information"). For real world discussions of markets and honesty, see James A. Brickley, Clifford W. Smith & Jerold L. Zimmerman, *Business Ethics and Organizational Architecture*, 26 J. BANKING & FIN. 1821, 1834 (2002) (discussing the impact unethical behavior has on the markets); Robert Augustus Hardy & Julia R. Norgaard, *Reputation in the Internet Black Market: An Empirical and Theoretical Analysis of the Deep Web*, 12 J. INSTITUTIONAL ECON. 515, 518–19 (2016) (finding the importance of honesty in an online black market); Lily Hua Fang, *Investment Bank Reputation and the Price and Quality of Underwriting* Services, 60 J. FINANCE 2729, 2729 (2005) (discussing "the relation between investment bank reputation and the price and quality underwriting"); Cindy R. Alexander, *On the Nature of the Reputational Penalty for Corporate Crime: Evidence*, 42 J. L. & ECON. 489, 490 (1999) (discussing "emerging evidence on the reputational penalties that public corporations pay for federal crimes"); Jonathan M. Karpoff, Scott D. Lee & Gerald S. Martin, *The Costs to Firms of Cooking the Books*, 43 J. FIN. & QUANTATIVE ANALYSIS 581, 582 (2008) (examining "the penalties imposed on . . . firms targeted by SEC enforcement actions for financial misrepresentation") ; Sudheer Chava, Kershen Huang & Shane A. Johnson, *The Dynamics of Borrower Reputation Following Financial Misreporting*, 64 MGMT. SCI. 4775, 4776 (2018) (discussing "dynamics of borrower reputation in bank loan markets following revelations of financial misreporting by the borrower"); Qingbo Yuan & Yunyan Zhang, *The Real Effects of Corporate Fraud: Evidence from Class Action Lawsuits*, 56, 59 ACCT. & FIN. 879 (2014) (discussing "whether fraud revelation through shareholder class action affects corporate financing and investment policies"); Stefan Zeume, *Bribes and Firm Value*, 30 REV. FIN. STUD. 1457 (2017) (discussing "firm-level evidence of the U.K. Bribery Act's impact on foreign operations, such as revenue, opening and closing of subsidiaries, and M&A activity"); Steven N. Kaplan, Mark M. Klebanov & Morten Sorenson, *Which CEO Characteristics and Abilities Matter?*, 68 J. Finance 973, 974–76 (2008) (demonstrating that CEO integrity predicts the success of private equity acquisitions); Luigi Guiso, Paola Sapienza & Luigi Zingales, *The Value of Corporate Culture*, 117 J. FIN. ECON. 60, 75 (2015) (showing that a survey-based measure of corporate integrity is positively related to firm value).

100. ADAM SMITH, LECTURES ON JUSTICE, POLICE, REVENUE, AND ARMS 254 (1896).

101. P. Graeff & G. Mehlkop, *The Impact of Economic Freedom on Corruption: Different Patterns for Rich and Poor Countries*, 19 EUR. J. POL. ECON. 605, 606 (2003); *see also* Steven Yamarik & Chelsea Redmon, *Economic Freedom and Corruption: New Cross-Country Panel Data Evidence*, 32 J. PRIV. ENTER. 17, 19 (2017) (stating that "[w]ith regard to the components of freedom, we find that rule of law, open markets, and regulatory efficiency lower corruption"); Luca Pieroni & Giorgio d'Agostino, *Corruption and the Effects of Economic Freedom*, 29 EUR. J. POL. ECON. 54, 66 (2013) (noting that "the largest and most significant effect on corruption . . . [is] exerted by the legal system to protect property rights and contracts"); Wayne Sandholtz & William Koetzle, *Accounting for Corruption: Economic Structure, Democracy and Trade*, 44 INT'L STUD. Q. 31, 47–48 (2000) (finding economic freedom is the strongest predictor of lower levels of corruption); Abdiweli M. Ali & Hodan Said Isse, *Determinants of Economic Corruption: A Cross-Country Comparison*, 22 CATO J. 449, 461 (2003) (finding economic freedom inversely related to corruption); John Gerring & Strom C. Thacker, *Do Neoliberal Policies Deter Political Corruption?*, 59 INT'L ORG. 233, 250 (2005) (finding corruption increases with government regulation of market transactions); Shrabani Saha, Rukmani Gounder & Jen-Je Su, *The Interaction Effect of Economic Freedom and Democracy on Corruption: A Panel Cross-Country Analysis*, 105 ECON. LETTERS 173, 173 (2009) (discussing the "impact that democracy and economic freedom have on the existing level of corruption and its interactive effect"); Ce Shen & John B. Williamson, *Corruption, Democracy, Economic Freedom and State Strength: A Cross-National Analysis*, 46 INT'L J. COMP. SOCIO. 327, 327 (2005) (examining the "structural causes of corruption"); Rajeev Goel & Michael Nelson, *Economic Freedom Versus Political Freedom: Cross-Country Influences on Corruption*, 44 AUSTL. ECON. PAPERS 121, 121 (discussing "whether economic freedom or political freedom serves as a deterrent to corrupt activity") (2005); Richard M. Ebeling, *Corruption Rises as Economic Freedom Falls*, FOUND. FOR ECON. EDUC. (Aug. 7, 2017),

B. The Effects of Markets on Society

Jane Jacobs observes that the safety of sidewalks is maintained by shopkeepers and others with an interest in preserving order, not by formal law enforcement——there aren't enough police, nor would we wish to live in a society where there were enough.[102] Similarly, Professor Oman suggests that markets "generate a set of moral habits——virtues——that support a liberal political order."[103] He goes on to state that "[i]ronically . . . in pluralistic societies, the market provides a much better example of cooperation among those with competing visions of the good than does [liberal] politics."[104] He notes in this regard the bitter, polarized, and acrimonious nature of much political discourse, as well as the signal failure of various schemes of "public reason" to generate consensus and exclude fundamental private commitments, like religion, from the public square.[105] He further notes, "Well-functioning markets are perhaps of the single most effective social practice for managing the pluralism of incommensurable beliefs."[106]

When we examine the empirical evidence for these claims we find that the pro-social behavior in experiments involving individual is visible across entire countries. Researchers find that generalized levels of trust and cooperation (measured through responses to the World Values Survey) are promoted by market institutions.[107] Using instrumental variables, the researchers argue that causality runs from stronger markets to higher levels of trust rather than the other direction.[108] We might expect that close-knit and collectivist societies, such as Japan, would have higher levels of trust than more dynamic and individualistic societies such as the United States, but that is not true.[109] The very necessity of encountering many different strangers in market transactions in the United States apparently produces higher levels of pro-social behavior.[110]

In addition to trust and cooperation, markets produce greater levels of tolerance by requiring empathy from market participants. For example, a supplier cannot effectively sell

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https://fee.org/articles/corruption-rises-as-economic-freedom-falls/ [https://perma.cc/5EXT-K8NF] (noting that the most corrupt nations of the EU are those that had been part of the former Soviet bloc).

102. JANE JACOBS, THE DEATH AND LIFE OF GREAT AMERICAN CITIES 32 (1992) ("No amount of police can enforce civilization where the normal, casual enforcement of it has broken down.").

103. OMAN, *supra* note 8, at 19.

104. Oman, *Markets As a Moral Foundation*, *supra* note 43, at 194; *see also* STORR & CHOI, *supra* note 66, at 239–43 (summarizing empirical literature that fails to find democratic institutions are associated with trust, tolerance, or lower levels of corruption in the way market institutions are associated with these positive outcomes).

105. OMAN, *supra* note 8, at 51 ("Whatever the merits of public reason as a theory, it does not reflect actual practice in liberal democracies.").

106. Oman, *Markets As a Moral Foundation*, *supra* note 43, at 195; *see also* Daniel Markovits, Yale Prof. of Law, Inaugural Address: Market Solidarity: Price as Commensuration, Contract as Integration (Apr. 9, 2012), (arguing that participation in the price system requires no agreement on base values as it allows interactions on the basis of prices, without the need to engage the opposing perspectives of counterparties); ROSE, *supra* note 72, at 70–71 (noting that it is the expectation of surplus value that causes people to bargain and transact in markets, no moral exhortation required).

107. Niclas Berggren & Henrik Jordahl, *Free to Trust: Economic Freedom and Social Capital*, 59 KYKLOS 141, 142 (2006).

108. *Id.* at 161.

109. Michael W. Macy & Yoshimichi Sato, *Trust, Cooperation, and Market Formation in the U.S. and Japan*, 99 PROCS. NAT. ACAD. SCIS. 7214, 7214 (2002).

110. *Id.*; *see also* Virgil Henry Storr, *The Market As a Social Space: On the Meaningful Extraeconomic Conversations that Can Occur in Markets*, 21 REV. AUSTRIAN ECON. 135, 135 (2008) (examining a sociological study of economics within Austria).

something to another person without trying to understand the buyer's needs and point of view.[111] Markets render social status such as class, kinship, race, and religion largely irrelevant and force participants to bargain with each other, an acknowledgement of at least formal equality.[112] Actually, markets require more than formal equality; they require participants to subordinate themselves to their customers or clients. There is a reason that European aristocrats historically looked down on those in trade.[113] The "customer is boss" may be a necessary attitude for a successful business, but it is beneath the dignity of an aristocrat.[114] It was the French aristocrat, Alexis de Toqueville, who pointed out that "men learn to think of their fellow men from ambitious motives."[115]

Cross-country regressions using attitudes towards homosexuals as a measure of tolerance find that "more freedom-inducing and secure market institutions appear to foster tolerance."[116] Looking at developments in the United States, market actors consistently led public institutions in extending equal protections to people who identify as LGBTQ+. More than 300 of the Fortune 500 companies had formal, written non-discrimination policies in place in 2003, well before the adoption of similar policies in a majority of U.S. states and the federal government.[117] One of the major factors determining whether an American state government adopted a non-discrimination law was whether its largest corporations had already adopted a similar policy.[118] Fortune 500 companies also led in the creation of anti-

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111. GEORGE SIMMEL, CONFLICT AND THE WEB OF GROUP AFFILIATIONS 61–62 (1955); Virgil Henry Storr, *The Impartial Spectator and the Moral Teachings of the Market*, *in* THE OXFORD HANDBOOK OF FREEDOM (David Schmidtz & Carmen E. Pavel eds., 2018); *see also* J.R. Clark & Dwight R. Lee, *Markets and Morality*, 31 CATO J. 1, 1 (2011) (arguing that systems based on personal caring foreground religion, ethnicity, nationality, kinship, and other characteristics that separate, rather than unite, people). The impersonal character of the market thus constitutes the only opportunity to achieve at least formal equality. *Id.*

112. Roy Kreitner, *Voicing the Market: Extending the Ambition of Contract Theory*, 69 U. TORONTO L.J. 295, 296 (2019) ("[Scholars] claim that it is intrinsically good for people to take part in contractual relations and to recognize one another in a formal sense."); *see also* Daniel Markovits, *Contract and Collaboration*, 113 YALE L.J. 1417, 1417–42 (2004) (elaborating on contractual relationships).

113. John H. Kautsky, THE POLITICS OF ARISTOCRATIC EMPIRES 177–87 (1997).

114. *Id.* at 178.

115. TOQUEVILLE, *supra* note 56, at 110.

116. Niclas Berggen & Therese Nilsson, *Does Economic Freedom Foster Tolerance*, 66 KYKLOS 177, 181 (2013); Indra de Soysa & Krishna Chaitanya Vadlamannati, *Free Markets and Civil Peace: Some Theory and Empirical Evidence*, *in* ECONOMIC FREEDOM OF THE WORLD: 2014 ANNUAL REPORT 225 (James Gwartney, Robert A. Lawson & Joshua C. Hall eds., 2014) (finding that economic freedom has a statistically positive relationship with "greater calm between distinct ethno-linguistic and religious groups within countries"); Eric Neumayer & Indra De Soya, *Globalization and the Empowerment of Women: An Analysis of Spatial Dependence via Trade and Foreign Direct Investment*, 39 WORLD DEV. 1065, 1066 (2011) (finding that an openness to trade improves Women's social rights); Michael D. Stroup, *Separating the Influence of Capitalism and Democracy on Women's Well-Being*, 67 J. ECON. BEHAV. & ORG. 560, 562 (2008) (finding market institutions associated with greater gender equality); Michael D. Stroup, *Does Economic Freedom Promote Women's Well-Being?*, *in* ECONOMIC FREEDOM OF THE WORLD: 2011 ANNUAL REPORT 179 (James Gwartney, Robert A. Lawson & Joshua C. Hall eds., 2011).

117. *Pass the Gay Rights Bill*, CHI. TRIB. (Mar. 19, 2003), https://www.chicagotribune.com/news/ct-xpm-2003-03-19-0303190061-story.html [https://perma.cc/4FLV-PN28].

118. *See* Roddrick A. Colvin, *Innovation of State-Level Gay Rights Laws: The Role of Fortune 500 Corporation*s, 111 BUS. & SOC'Y REV. 363, 380 (2006) (suggesting "that the higher the percentage of Fortune 500 companies with nondiscrimination policies in a state, the more likely the state will be to adopt a gay rights policy").

discrimination policies relating to gender expression.[119] In addition to the pro-social channels we have been analyzing, market actors were responding to simple economic incentives. As far back as the turn of this century, researchers had found that market success in American metro areas depended on their levels of diversity (as measured by the population of gay and foreign-born residents).[120] This was true even if the Bay Area and Silicon Valley were removed from the data.

It would be absurd to argue that markets alone are the solution to intolerance—there is ample evidence of great injustices to minorities persisting for protracted periods in market societies—but making an absurd argument is not necessary for this Article's thesis. It is enough if markets contribute, even modestly, to the levels of tolerance in a society.[121]

Increased levels of trust and tolerance lead, as one might expect, to more peaceful societies. Markets "provid[e] a mechanism by which those with sharply differing religious, moral, and political beliefs can peacefully cooperate."[122] George Soros notes that, contrary to the caricature of commercial life as characterized by competition red in tooth and claw, the dominant experience of market actors is cooperation with strangers and co-workers.[123]

One of the better-known facts in comparative studies on the effect of institutions on civil outcomes is that economic freedom, largely measured by the strength of market institutions, is positively correlated with respect for human rights and lower levels of ethnic conflict.[124] Professor Patrick McDonald conducted an empirical analysis of over 200 wars

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119. Christin L. Munsch & C. Elizabeth Hirsh, *Gender Variance in the Fortune 500: The Inclusion of Gender Identity and Expression in Nondiscrimination Corporate Policy*, *in* 20 GENDER AND SEXUALITY IN THE WORKPLACE 151, 152 (Christine L. Williams & Kirsten Dellinger eds., 2010) (observing that prior to the Obama administration's adoption of nondiscrimination rules relating to gender identity, more than 200 Fortune 500 companies had formal policies of this type).

120. Richard Florida & Gary Gates, *Technology and Tolerance: Diversity and High-Tech Growth*, 20 BROOKINGS REV. 32, 35–36 (2002).

121. *See generally* GARY S. BECKER, THE ECONOMICS OF DISCRIMINATION (1957) (discussing how market forces discourage discrimination); *see also* EDWARD L. AYERS, THE PROMISE OF THE NEW SOUTH: LIFE AFTER RECONSTRUCTION 17–18 (1992) (discussing how railways resisted segregation as creating an unnecessary expense and alienating a class of customers until legislative action was taken by Southern state governments). ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 328–29 (1974) ("[W]hat is desired is an organization of society optimal for people who are far less than ideal, optimal also for much better people, and which is such that living under such an organization itself tends to make people better and more ideal.").

122. OMAN, *supra* note 8, at 19.

123. George Soros, *The Capitalist Threat*, THE ATLANTIC (Feb. 1997), https://www.theatlantic.com/magazine/archive/1997/02/the-capitalist-threat/376773/ [https://perma.cc/PAN2-ELWT]; *see also* Muzafer Sherif, *An Experimental Approach to the Study of Attitudes*, 1 SOCIOMETRY 90 (1937) (showing that performing cooperative tasks induces positive sentiments towards others).

124. *See, e.g.*, Indra de Soysa & Krishna Chaitanya Vadlammanati, *Do Pro-Market Economic Reforms Drive Human Rights Violations? An Empirical Assessment, 1981–2006*, 155 PUB. CHOICE 163, 163 (2013) (finding that "a strong positive association between reforms towards more free markets with regard to governments' respect for human rights"); Indra de Soysa & Hanne Fjelde, *Is the Hidden Hand an Iron Fist? Capitalism and Civil Peace, 1970–2005*, 47 J. PEACE RSCH. 287, 287 (2010) ("Peacemakers [that] build institutions that reward productive investment . . . ultimately gain their legitimacy on the back of good economic performance and well-functioning markets."); Ariel Benyishay & Roger R. Betancourt, *Civil Liberties and Economic Development*, 6 J. INSTITUTIONAL ECON. 281 (2010) (finding a close relationship between individual rights to housing, employment and educational opportunities, as well as property rights, has an outsize effect on long-term economic growth); de Soysa & Vadlamannati, *supra* note 116, at 4 ("The growth of commerce marginalizes violence because it binds people meaningfully in a way suited to addressing the collective dilemmas stemming from violence—theft and

spanning beyond two centuries and found that private property and competitive market structures have a major impact of promoting peace between states.[125] Markets are much more causally influential in this regard than, for example, democratic political institutions, which multiple scholars have found possess little correspondence with peaceful outcomes.[126]

In relation to civil wars specifically, democratic institutions and per capita income have little impact on the probability of violence breaking out.[127] Markets, again measured in terms of economic freedom, have an enormous impact on the chances of a civil war occurring. "[R]aising economic freedom by one standard deviation above its mean value reduces the model's overall prediction of civil war risk at the mean values of all variables by 375%, which is substantively quite large."[128] It is not even necessary for ethnic or religious opponents to work together; simply exposing opponents to the financial consequences of conflict is enough to push them in the direction of compromise. In one experiment conducted in 2015 in advance of an Israeli election, Israeli and Palestinian financial assets were randomly assigned to Israeli voters along with incentives to actively trade those assets.[129] The activity of trading in financial markets systematically shifted voting preferences towards parties more supportive of the peace process.[130]

C. The Adverse Consequences of Markets

Markets have been criticized from the beginning of the modern era for their capacity to corrupt good morals.[131] We have already seen how some aspects of this critique, such as the claim markets make individuals more selfish and less prone to cooperate, have been refuted by a large body of modern empirical evidence. However, some aspects of this critique remain. Montesquieu wrote, "in countries where one is affected only by the spirit of commerce, there is traffic in all human activities and all moral virtues; the smallest

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deprivation."); Evan Osborne, *Economic Freedom, Ethnic Separatism, and Ethnic Conflict*, 44 J. DEVELOPING AREAS 367, 367 (2010) (noting that "evidence indicate[s] that government restrictions on commerce promote separatism and conflict").

125. *See generally* PATRICK J. MCDONALD, THE INVISIBLE HAND OF PEACE: CAPITALISM, THE WAR MACHINE, AND INTERNATIONAL RELATIONS THEORY, 77–110 (2009) ("[D]omestic institutions associated with capitalism, namely private property and competitive market structures, have promoted peace between states over the past two centuries.").

126. *See id.* at 77–110 ("[T]his research program evaluate[s] whether democracy and international trade promoted peace during the post-World War II period."); Havard Hegre et al., *Towards a Democratic Civil Peace? Democracy, Political Change, and Civil War, 1816—1992*, 95 AM. POL. SCI. REV. 33, 38–44 (2001) (finding little correspondence between levels of democracy and civil peace); Michael D. Ward, Brian D. Greenhill & Kristin M. Bakke, *The Perils of Policy by P-Value: Predicting Civil Conflicts*, 47 J. PEACE RSCH. 363, 372–74 (2010) (finding insignificant connections between democratic institutions and peace); Tor G. Jakobsen & Indra de Soysa, *Give Me Liberty or Give Me Death! State Repression, Ethnic Grievance, and Civil War, 1981—2004*, 11 CIV. WARS 137 (2009) (finding that increasing democracy fuels ethnic war); JACK L. SNYDER, FROM VOTING TO VIOLENCE: DEMOCRATIZATION AND NATIONALIST CONFLICT (2000) (arguing that rushing to establish a democratic government can cause more conflict).

127. Indra de Soysa & Vadlamannati, *supra* note 116, at 3–8.

128. *Id.* at 9.

129. Saumitra Jha & Moses Shayo, *Valuing Peace: The Effects of Financial Market Exposure on Votes and Political Attitudes*, 87 ECONOMETRICA 1561, 1561–63 (2019).

130. *Id.*

131. HIRSCHMAN, *supra* note 56, at 110–12.

things, those required by humanity, are done or given for money."[132] This is the commodification point we today most often associate with Marx: the subordination of both private and public realms to the logic of the market.[133]

In a recent law review article, Professor Stephen Clowney reviews the empirical evidence around commodification and concludes that there is little evidence market transactions distort human experience.[134] He conducts his own empirical study by interviewing art appraisers and male escorts to determine if their professional activities interfered with "the transcendent joys of art and sex."[135] He found that "escorts routinely experience sexual intimacy with loved ones and art appraisers find pleasure in visiting museums. Respondents spoke emphatically on this point. In fact, many interviewees indicated that contact with the market actually enhanced their appreciation for truly hallowed things."[136]

Similarly, the alienating effects of market competition assumed by generations of social critics appears to be wrong. Rather than animosity, researchers find that market competition produces friendships among executives across competing firms, and that these social bonds appear to result in economic as well as social benefits.[137] Indeed, sociologist Ray Pahl notes that "[c]ounter to what is assumed in much modern social theory, it was precisely the spread of market exchange in the eighteenth century that led to the development of new benevolent bonds."[138]

A final criticism of markets relates to their outcomes. Markets produce inequality and they can produce serious externalities (such as carbon emissions).[139] These sorts of issues were well understood by the pro-market thinkers of the eighteenth and nineteenth

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132. MONTESQUIEU, THE SPIRIT OF THE LAWS 338–39 (Anne Cohler et al., eds., 1989). A similar point was made by Adam Smith. Mark L. Movsesian, *Markets and Morals: The Limits of* Doux Commerce, 9 WM. & MARY BUS. L. REV. 449, 457 (2018) ("Commerce, Adam Smith maintained, would train people in habits of prudence.").

133. KARL MARX & FREDERICK ENGELS, THE COMMUNIST MANIFESTO (2005) ("The bourgeoisie, wherever it has got the upper hand, has put an end to all feudal, patriarchal, idyllic relations. It has . . . left no other nexus between man and man than naked self-interest, than callous 'cash payment.' It has drowned out the most heavenly ecstasies of religious fervour, of chivalrous enthusiasm, of philistine sentimentalism, in the icy water of egotistical calculation. It has resolved personal worth into exchange value . . . ."); *see also* MICHAEL SANDEL, WHAT MONEY CAN'T BUY: THE MORAL LIMITS OF MARKETS 11 (2012) (arguing market societies are "a place where social relations are made over in the image of the market"); STORR & CHOI, *supra* note 66, at 34–39 (discussing the evolution of this critique of markets); Nancy L. Schwartz, *Distinction Between Public and Private Life: Marx on the Zōon Politikon*, 7 POL. THEORY 245, 249 (1979) (discussing Marx's view on politics and society).

134. *See* Stephen Clowney, *Does Commodification Corrupt? Lessons from Paintings and Prostitutes*, 50 SETON HALL L. REV. 1005, 1018–1031 (2020) (reviewing the three studies usually claimed to demonstrate the validity of the commodification thesis and finding that they either are about other things, or that they suffer from serious methodological problems and their conclusions have been overturned by subsequent researchers and evidence).

135. *Id.* at 1010.

136. *Id.*

137. *See, e.g.*, Paul Ingram & Peter W. Roberts, *Friendship Among Competitors in the Sydney Hotel Industry*, 106 AM. J. SOCIO. 387 (2000) (discussing how direct competitors built relationships and found improvements as a whole in their shared hotel industry).

138. RAY PAHL, ON FRIENDSHIP 54 (2000).

139. *See, e.g.*, ARTHUR M. OKUN, EQUALITY AND EFFICIENCY: THE BIG TRADEOFF, 11–12 (1975) (discussing market inequality using carbon emissions as an example of a common externality).

century.[140] One way they maintained their support for markets was by pointing out that markets are the best solution to some of these adverse social outcomes.[141] Adam Smith, for example, was no friend of inequality, and thought that the tendency of competitive markets to push the returns on commercial activity to its costs was a key remedy.[142] The rate of profit, he wrote, was "always highest in the countries which are going fastest to ruin."[143] Mostly, however, members of the *doux commerce* intellectual tradition were comfortable praising markets because they admitted the importance of other social institutions. They were not anarcho-capitalists.

Similarly, this Article does not argue that market outcomes are always—and in every respect, desirable—or that markets provide the sole legitimate means of social organization. Rather, this Article merely argues that markets are generally quite valuable and that they provide the best explanation and justification for corporate law.[144] Corporate law is an important area of law, but it is not the only one, and I do not argue that it should displace tax, environmental, human rights, or employment law.[145] I argue, however, that at its core, corporate law is about facilitating market transactions, not least in governance of the corporations themselves, and that in ignoring this fact, corporate law has grown into a barrier to valuable market behavior.

IV. MARKETS VERSUS EFFICIENCY IN CORPORATE LAW

"The central norm[ative] concept in economics is productive and allocative efficiency . . . ."[146] Efficient outcomes are wealth maximizing,[147] so when economics encountered corporate law, the focus of corporate law quickly became shareholder wealth maximization, to be achieved by driving out (to the extent possible) the inefficiencies that

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140. *See, e.g.*, HIRSCHMAN, *supra* note 56; Donald J. Boudreaux & Roger Meiners, *Externality: Origins and Classifications*, 59 NAT. RES. J. 1 (2019) (developing the concept of externalities and how the term had lost some of its meaning at the time); CAMPBELL MCCONNELL, STANLEY BRUE & SEAN FLYNN, *Public Goods, Externalities, and Information Asymmetries*, in ECONOMICS (18th ed. 2009).

141. *See, e.g.*, Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1 (1969) (arguing various problems, such as moral hazard, are best resolved by markets); Carl J. Dahlman, *The Problem of Externality*, 22 J.L. & ECON. 141 (1979) (reducing externalities and market failures to transaction costs and imperfect information which may be better resolved by markets than government action).

142. *See generally, e.g.*, Deborah Boucoyannis, *The Equalizing Hand: Why Adam Smith Thought the Market Should Produce Wealth Without Steep Inequality*, 11 PERSP. ON POL. 1051 (2013) (explaining Adam Smith's policy perspective and his motivations); SAMUEL FLEISHACKER, A SHORT HISTORY OF DISTRIBUTIVE JUSTICE (2004) (same).

143. Adam Smith, *Adam Smith on Monopoly: The 'Mean Rapacity, the Monopolizing Spirit,'* 27 ANTITRUST L. & ECON. REV. 27, 32 (1996).

144. For the same point in contract law see Oman, *Markets As a Moral Foundation*, *supra* note 43, at 224.

145. BRYCE TINGLE, HARD LESSONS IN CORPORATE GOVERNANCE (Cambridge Univ. Press, forthcoming) (arguing that corporate governance is poorly suited to effect many of the social outcomes desired of it and that these outcomes are better pursued through traditional regulation).

146. Russell Hardin, *Magic on the Frontier: The Norm of Efficiency*, 144 U. PA. L. REV. 1987, 1987 (1996); *see, e.g.*, Jules L. Coleman, *Economics and the Law: A Critical Review of the Foundations of the Economic Approach to Law*, 94 ETHICS 649, 672 (1984) ("Most economic analysis involves Kaldor-Hicks and Pareto optimality. Neither of these can be grounded in utilitarian moral theory."); *see generally*, THOMAS SOWELL, BASIC ECONOMICS 5 (3d ed. 2007) (discussing generally the basic tenants of economic study).

147. *See* Kenneth J. Arrow & Gerard Debreu, *Existence of an Equilibrium for a Competitive Economy*, 22 ECONOMETRICA 265 (1954) (offering a mathematical proof of this proposition).

arise from the corporate form, particularly the separation of ownership and control.[148] In fact, "[t]he agency model . . . prescribes maximal shareholder value creation as the only efficiency-generating (and thus legitimate) objective of the firm, leading to the optimization of economic output in the economy."[149] Professors Easterbrook and Fischel reiterate this: "[t]he corporation will flourish when the gains from the division of labor exceed the augmentation of the agency costs."[150]

A. A Focus on Efficiency Displaces Markets

Markets obviously have something to do with efficiency, so naive observers of corporate law could be forgiven for believing no conflicts exist between the two. Indeed, there is a generally held assumption that economics-inflected approaches to corporate law "cumulatively tend to produce market institutions."[151] Nonetheless, where markets tend to produce efficient outcomes, a focus on efficiency often fails to produce markets.

As a normative ideal, economic efficiency provides ample reason for the law to intervene in markets.[152] Inefficiencies in market processes can be produced by externalities, informational asymmetries, strategic behavior, laziness, irrationality, and the risk that market actors bring competing moral priorities such as distributional equity or deontological justice to their decisions.[153] A particular problem for markets is the ubiquity

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148. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 12–16 (9th ed. 2014) (arguing that the purpose of law is to maximize wealth); Alexander Styhre, *The Making of the Shareholder Primacy Governance Model: Price Theory, the Law and Economics School, and Corporate Law Retrenchment Advocacy*, 8 ACCT. ECON. & L. 1 (2017) (discussing the connection between the adoption of economics perspectives on corporate law and the rise of the shareholder wealth maximization norm); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 357 (1976) ("Both the law and the sophistication of contracts relevant to the modern corporation are the products of a historical process in which there were strong incentives for individuals to minimize agency costs."); Stephen E. Ellis & Grant M. Hayden, *The Cult of Efficiency in Corporate Law*, 5 VA. L. & BUS. REV. 239, 240 (2010) ("The standard view in corporate law holds that corporations are organized to maximize shareholder wealth."); Thomas A. Smith, *The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty*, 98 MICH. L. REV. 214 (1999) (discussing how shareholder maximization can lead managers to make inefficient choices).

149. Styhre, *supra* note 148, at 11–12; Brian R. Cheffins, *Corporate Governance Since the Managerial Capitalism Era*, 89 BUS. HIST. REV. 717, 731 (2015) (stating that "[("The situation changed as corporate governance became more closely associated with shareholder interests, with many economists ultimately equating the term with mechanisms designed to ensure that suppliers of finance obtained a satisfactory risk-adjusted return on their investment"); *see also*, Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 669 (2006) (explaining shareholder wealth maximizing approaches to corporate law by noting that "Efficiency analysis depends critically upon goal specification").

150. EASTERBROOK & FISCHEL, *supra* note 1 at 11.

151. Hardin, *supra* note 146, at 2015; *see also* Avery Katz, *Taking Private Ordering Seriously*, 144 U. PA. L. REV. 1745 (1996) (describing how a single aspect of private ordering has been overemphasized at the expense of others).

152. Demsetz, *supra* note 141, at 1 ("The view that now pervades much public policy economics implicitly presents the relevant choice as between an ideal norm and an existing 'imperfect' institutional arrangement."); Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U. PA. L. REV. 1643, 1643 (1996) ("According to economic theory, the justification of regulation begins with the identification of a failure in the incentive structure of markets.").

153. Katz, *supra* note 151, at 1746; Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697, 1727–30 (1996); Kreitner, *supra* note 46, at 326 ("Markets are at times an opportunity to recruit others to our projects, not only because they are financially profitable but also because they are normatively attractive.");

of transaction costs. The Coase theorem, for example, with its promise of efficient outcomes, depends on frictionless bargaining—and there never was such thing.[154] One study found that roughly 40% of the entire U.S. economy consisted of transaction costs.[155] The economist Stanley Fischer observes that "transaction costs have a well-deserved bad name as a theoretical device . . . [partly] because there is a suspicion that almost anything can be rationalized by invoking suitably specified transaction costs."[156]

Richard Posner argued that wherever the conditions of the Coase theorem—zero transaction costs and cooperative behavior—were not met, the law could step in by "mimicking" the outcomes of a more frictionless market.[157] This is a recipe for much more law and much less market, regardless of how confident you are in our ability to "mimic" an institution whose principal value is its ability to produce outcomes reflecting vastly more information than any central authority could possess.[158] Indeed, Coase himself pointed out that, "in an economic theory which assumes that transaction costs are nonexistent, markets have no function to perform …".[159] The attempt to replace (or "improve") market outcomes thus directly degrades an institution that, as we have seen, produces important social goods over and above its contributions to efficient outcomes.[160]

The truth is that market behavior, with its messiness, mistakes, experimentation, disparate objectives and priorities, time- and resource-consuming bargaining, and many failures, does not appear efficient.[161] It is here that the neoclassical blind spot about market

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C.W. Maughan & Kevin McGuinness, *Towards an Economic Theory of the Corporation*, 1 J. CORP. L. STUD. 141, 160–63 (2001) (discussing the costs of bargaining).

154. R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 29–30 (1960); Coleman, *supra* note 146, at 657, 665; *see also* Cento G. Veljanowski, *The Coase Theorems and the Economic Theory of Markets and Law*, 35 KYKLOS 53 (1982) (describing the Coase theorems).

155. John J. Wallis & Douglass C. North, *Measuring the Transaction Sector in the American Economy, 1870—1970*, *in* LONG-TERM FACTORS IN AMERICAN ECONOMIC GROWTH 95, 121 tbl. 3.13 (Stanley L. Engerman & Robert E. Gallman eds., 1992).

156. Stanley Fischer, '*Long-Term Contracting, Sticky Prices and Monetary Policy': A Comment*, 3 J. MONETARY ECON. 317, 322 n.5 (1977).

157. POSNER, *supra* note 148; *see also* POLINSKY, *supra* note 42, at 27–36 (illustrating how to assess legal issues from a normative approach, combining economic and social considerations); Coleman, *supra* note 146, at 666 (arguing convincingly that zero transaction costs are also likely to block exchanges); Carl J. Dahlman, *The Problem of Externality*, 22 J. L. & ECON. 141, 151 (1979) (observing that the "literature on welfare economics abounds with examples of" claims the government must intervene in markets because of "the implicit comparison of a world with transaction costs with one with zero transaction costs").

158. Hayek, *Use of Knowledge*, *supra* note 6; *see also* Mario J. Rizzo, *The Mirage of Efficiency*, 8 HOFSTRA L. REV. 641, 658 (1980) (arguing that "the substantial information requirements that must be satisfied in order to identify efficient legal rules make efficiency impractical as a standard"); Cooter, *supra* note 152, at 1646 ("[E]fficiency requires decentralization to become more important, not less, as economies become more complex."); Shahar Dobzinski, Noam Nisan & Sigal Oren, *Economic Efficiency Requires Interaction*, 118 GAMES & ECON. BEHAV. 589, 590 (2019) (exhibiting "situations where interaction [among market actors] allows exponential savings in information transfer, making the economic calculation problem tractable for interactive markets even when it is intractable for a centralized planner").

159. COASE, THE FIRM, THE MARKET AND THE LAW 7.

160. Richard H. Pildes, *The Destruction of Social Capital through Law*, 144 U. PA. L. REV. 2055, 2067 (1996) (describing the ways law can destroy social capital by displacing markets).

161. *See, e.g.*, James M. Buchanan, *Politics, Policy, and the Pigouvian Margins*, 29 ECONOMIA 17 (1962) (stating that competitive markets do not satisfy the conditions for optimality); Maughan & McGuinness, *supra* note 153, at 148, 161–63 (setting out a model for economically efficient markets that few real-world markets

activities creates problems because it lacks a theoretical framework for understanding what types of inefficiencies are important or essential to maintaining a market.[162] When, in other words, should the law intervene?

The practice in much of corporate law scholarship and policymaking over the past forty years has been to indiscriminately propose interventions everywhere the author discovers inefficiencies (or "transaction costs" and "failures") in the market.[163] As Ronald Gilson notes, the modern innovations in corporate law were motivated by "the hypothesis [that] better governance yields more efficient production."[164] Efficiency alone was the justification for reform.

A partial list of the structures urged on corporations (occasionally by regulatory fiat, often by powerful third parties such as proxy advisors) includes: majority and then supermajority independent boards;[165] board committees, then wholly independent board committees;[166] pay-for-performance compensation structures;[167] the use of equity incentives (originally stock options, then restricted share grants) to align managers with shareholders;[168] say-on-pay votes (to further ensure alignment);[169] majority voting on

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could ever approximate); *see also* C. William Maughan & Robert J. Townsley, *What is a Good?*, (1999) 10 J. INTERDISC. ECON. 91, 104 (1999) (describing some of the impossible demands of rationality assumed by the basic economic model); Demsetz, *supra* note 142, at 19 (describing all of the ways that real markets differ from the ideal demanded by normative efficiency). Not even F.A. Hayek defended markets as perfectly efficient. *See generally* Bruce Cadwell, *Hayek and Socialism*, 35 J. ECON. LITERATURE 1856 (1997) (describing market socialism); SMITH, *supra* note 7, at 29 (described the inefficiency of markets by stating that "[i]t is adjusted, however, not by any accurate measure, but by the higgling and bargaining of the market, according to that sort of rough equality which, though not exact, is sufficient for carrying on the business of common life").

162. North, *supra* note 3; COASE, *supra* note 4.

163. These failures include all deviations from a perfect market where both parties are rational, both parties have perfect information, neither party has significant market power; there are no externalities, and there are no transaction costs.

164. Ronald J. Gilson, *Corporate Governance and Economic Efficiency: When do Institutions Matter?*, 74 WASH. U. L.Q. 327, 327 (1996); *see also* Daniel Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1262 (1982) ("As residual claimants on the firm's income stream, shareholders want their agents——the firm's managers——to maximize wealth.").

165. *E.g.*, *United States: Proxy Voting Guidelines, Benchmark Policy Recommendations*, INSTITUTIONAL S'HOLDER SERVS., INC. 20 (Nov. 19, 2020), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf [https://perma.cc/7EUM-BUA5]; *2021 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice United States*, GLASS LEWIS 28 (2021) https://www.glasslewis.com/wp-content/uploads/2020/11/US-Voting-Guidelines-GL.pdf?hsCtaTracking=7c712e31-24fb-4a3a-b396-9e8568fa0685%7C86255695-f1f4-47cb-8dc0-e919a9a5cf5b [https://perma.cc/N7G8-Q4FX]; *CalPERS Proxy Voting Guidelines*, CAL. PUB. EMP.'S RET. SYS. 2 (Apr. l 2021), https://www.calpers.ca.gov/docs/proxy-voting-guidelines.pdf [https://perma.cc/KFQ7-S99V].

166. *E.g.*, Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 301, 302, 116 Stat. 745 (setting out an independent audit committee requirement).

167. *E.g.*, INSTITUTIONAL S'HOLDER SERVS., Inc., *supra* note 165, at 42; GLASS LEWIS, *supra* note 165, at 36; CAL. PUB. EMP.'S RET. SYS., *supra* 161, at 4; LUCIAN A. BEBCHUK & JESSE M. FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004).

168. *E.g.,*, INSTITUTIONAL S'HOLDER SERVS, Inc., *supra* note 165, at 45, GLASS LEWIS, *supra* note 165, at 44; CAL. PUB. EMP.'S RET. SYS., *supra* note 165, at 6; Brain J. Hall, *What You Need to Know about Stock Options*, 78 HARV. BUS. REV. 121, 122 (2000); Stephen Bryan, Lee Seok Hwang & Steven Lilien, *CEO Stock-Based Compensation: An Empirical Analysis of Incentive-Intensity, Relative Mix, and Economic Determinants*, 73 J. BUS. 661 (2000).

169. *E.g.*, Dodd-Frank Wall Street Reform and Consumer and Protection Act, 12 Pub. L. No. 11-203, § 929-

directors;[170] eliminating staggered boards;[171] separating the CEO and chair roles;[172] increasing board independence by increasing diversity;[173] restricting director "overboarding;"[174] forbidding interlocking directorships;[175] eliminating poison pills (or, more rarely, adopting them);[176] prohibiting loans to insiders;[177] adopting social responsibility measures;[178] insisting that firms exclusively pursue either shareholder wealth maximization or constituency-maximizing outcomes, depending on political

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Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o) § 951; INSTITUTIONAL S'HOLDER SERVS., Inc., *supra* note 165, at 41; CAL. PUB. EMP.'S RET. SYS., *supra* note 165, at 4–5.

170. *E.g.*, Canada Not-for-Profit Corporations Act and the Competition Act, S.C. 2018, c 8 (Can.); *TSX Company Manual*, TORONTO STOCK EXCH. (Nov. 12, 2020), https://decisia.lexum.com/tsx/m/en/item/454460/index.do#!fragment/zoupio-_Toc88424793/BQCwhgziBcwMYgK4DsDWszIQewE4BUBTADwBdoAvbRABwEtsBaAfX2zgA4OAWAJm4DsATgDMASgA0ybKUIQAiokK4AntADk6iREJhcCRcrWbtu-SADKeUgCE1AJQCiAGUcA1AIIA5AMKOJpGAARtCk7GJiQA [https://perma.cc/9TLP-WXWG]; Stephen J. Choi et al., *Does Majority Voting Improve Board Accountability*, 83 U. CHI. L. REV. 1119, 1121 (2016).

171. *See e.g.*, Lucian A. Bebchuk, John C. Coates & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 STAN. L. REV. 885 (2002).

172. For example, duality was criticized right from the beginning of agency cost theory. Eugene Fama & Michael Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 331 (1983). See INSTITUTIONAL S'HOLDER SERVS., Inc., *supra* note 165, at 16; CAL. PUB. EMP.'S RET. SYS., *supra* note 165, at 8–9; James Brickley, J.L. Coles & Gregg Jarrell, *Leadership Structure: Separating the CEO and Chairman of the Board*, 3 J. CORP. FIN. 189 (1997) (discussing the current upsurge in activist shareholder initiatives to effect this change).

173. INSTITUTIONAL S'HOLDER SERVS., Inc., *supra* note 165, at 61; GLASS LEWIS, *supra* note 165 at 26–27; CAL. PUB. EMP.'S RET. SYS., *supra* note 165, at 2; Cal. Corp. Code §§ 301.3, 2115.5 (West); Luis A. Aguilar, *Merely Cracking the Glass Ceiling Is Not Enough: Corporate America Needs More than Just a Few Women in Leadership*, SEC. AND EXCH. COMM'N (May 22, 2013), https://www.sec.gov/news/speech/2013-spch052213laahtm [https://perma.cc/MN3R-GJF6]; Alexander Osipovich, *Nasdaq's Board-Diversity Proposal Wins SEC Approval*, WALL ST. J. (Aug. 6, 2021) https://www.wsj.com/articles/nasdaqs-board-diversity-proposal-faces-sec-decision-11628242202 [https://perma.cc/KZM9-7XF5].

174. *E.g.*, INSTITUTIONAL S'HOLDER SERVS., Inc., *supra* note 165, at 11 (directors are overloaded when they sit on more than five public boards); CAL. PUB. EMP.'S RET. SYS., *supra* note 165, at 2 (directors are overloaded when they sit on more than four public boards); *see also Comparison of Corporation Governance Principles and Guidelines: United States*, WEIL, GOTSHAL & MANGES LLP 21–22 (2013), https://corpgov.law.harvard.edu/wp-content/uploads/2012/02/Weil_Comparison-of-Corp-Gov-Practices.pdf [https://perma.cc/V565-5FMF]; James J. Drury III & James J. Drury IV, *The Weight of America's Boards: Ranking America's Largest Corporations By the Governance Capacity of Their Boards*, JAMES DRURY PARTNERS (2020), https://jdrurypartners.com/wp-content/uploads/2020/09/Weight-of-Americas-Boards-2020.pdf [https://perma.cc/MFU3-ECWZ].

175. *E.g.*, INSTITUTIONAL S'HOLDER SERVS., Inc., *supra* note 165, at 9–10; GLASS LEWIS, *supra* note 165, at 20.

176. *E.g.*, Marcel Kahan & Edward Rock, *Anti-Activist Poison Pills*, 99 B.U. L. REV. 915 (2019); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

177. *E.g.*, Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 402, 116 Stat. 745.

178. *E.g.*, Larry Fink, *Larry Fink's 2021 Letter to CEOs: The Power of Capitalism*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter# [https://perma.cc/EKC6-RFNZ]; *Business RoundTable Redefines the Purpose of a Corporation to Promote "An Economy That Serves All Americans*,*",'* BUS. ROUNDTABLE (Aug. 19, 2019) https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/7W4G-XACH]; *A Blueprint for Responsible Investment*, PRINCIPLES FOR RESPONSIBLE INV., https://www.unpri.org/download?ac=5330 [https://perma.cc/V6EF-MXRK] (explaining that the first principle is incorporating ESG issue into investment analysis and decision-making process).

outlook;[179] mandating employee representation on the board;[180] banning stock buybacks;[181] increasing shareholder influence through proxy access;[182] taking steps to reduce shareholder influence by restricting shareholder proposals;[183] mandatory voting by institutional shareholders;[184] and much more. The sheer scale and success of the arguments

179. *E.g.*, Lynn Stout, *New Thinking on Shareholder 'Primacy'*, 2 J. ACCT. ECON. & L. 1, 2 (2012); Leo E. Strine, *Corporate Power is Corporate Purpose 1: Evidence from my Hometown* (Univ. of Penn., Inst. L. & Econ., Working Paper No. 16-34, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2906875; Margaret Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 291 (1997-1998); Hansmann & Kraakam, *supra* note 1; Ronald J. Gilson & Charles K. Whitehead, *Deconstructing Equity: Public Ownership, Agency Costs, and Complete Capital Markets*, 108 COLUM. L. REV. 231 (2008); Edward Rock; *Adapting to the New Shareholder-Centric Reality*, 161 PENN. L. REV. 1907 (2013); Richard M. Frankel, S.P. Kothari & Luo Zuo, *Why Shareholder Wealth Maximization Despite Other Objectives*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (May 23, 2018), https://corpgov.law.harvard.edu/2018/05/23/why-shareholder-wealth-maximization-despite-other-objectives/; LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC (2012); Robert B. Thompson, *Anti-Primacy: Sharing Power in American Corporations*, 71 BUS. LAW. 381 (2015-2016); Bradley Benson et al., *Deviations From Expected Stakeholder Management, Firm Value, and Corporate Governance*, 40 FIN. MGMT. 39 (2011); David Millon, Radical Shareholder Primacy, 10 U. ST. THOM. L.J. 1013 (2013); Stephen M. Bainbridge, *Director Primacy: The Means and Primacy*, (Univ. of Fla. Levin Coll. of L. Working Paper No. 17-20, 2017), https://scholarship.law.ufl.edu/cgi/viewcontent.cgi?referer=https://www.google.ca/&httpsredir=1&article=1004&context=working; Oliver Hart, *An Economists View of Fiduciary Duty*, 43 U.T.L.J. 299 (1993); Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325 (2013); Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637 (2006); Elizabeth Warren, *Companies Shouldn't Be Accountable Only to Shareholders*, WALL ST. J. (Aug. 14, 2018), https://www.wsj.com/articles/companies-shouldnt-be-accountable-only-to-shareholders-1534287687 [https://perma.cc/M8F5-CXNW].

180. Accountable Capitalism Act, S. 3348, 115th Cong. (2018); Carew S. Bartley, *The Accountable Capitalism Act in Context and Its Implications for Legal Ethics*, 33 GEO. J. LEGAL ETHICS 373, (2020); Warren, *supra* note 179; Edith Ginglinger, William Megginson & Timothée Waxin, *Employee Ownership, Board Representation, and Corporate Financial Policies*, 17 J. CORP. FIN. 868 (2011) (discussing France's experience); Larry Fauver & Michael E. Fuerst, *Does Good Corporate Governance Include Employee Representation? Evidence from German Corporate Boards*, 82 J. FIN. ECON. 673 (2006).

181. Chuck Schumer & Bernie Sanders, *Schumer and Sanders: Limit Corporate Stock Buybacks*, N. Y. TIMES (Feb. 3, 2019), https://www.nytimes.com/2019/02/03/opinion/chuck-schumer-bernie-sanders.html [https://perma.cc/E3Q3-T34X].

182. INSTITUTIONAL S'HOLDER SERVS., Inc. *supra* note 165, at 20; Dodd-Frank Wall Street Reform and Consumer and Protection Act, 12 Pub. L. No. 11-203, § 971,124 Stat. 1376, 1871 (2010).

183. *SEC Adopts Amendments to Modernize Shareholder Proposal Rule*, SEC (Sept. 23, 2020), https://www.sec.gov/news/press-release/2020-220 [https://perma.cc/79RX-7WJU]; *Final Report*, ONTARIO CAP. MKTS. MODERNIZATION TASKFORCE 70 (Jan. 2021), https://files.ontario.ca/books/mof-capital-markets-modernization-taskforce-final-report-en-2021-01-22.pdf [https://perma.cc/H66A-KGSE].

184. 17 CFR § 275.206(4)–(6) (2003); Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 653–54 (2009). The 2003 change followed a similar reform in 1988, when the U.S. Department of Labor announced that ERISA pension fund fiduciaries had a duty to make informed decisions about how they voted the shares in their portfolios. *See also* Comment Letter from Alan D. Lebowitz, Deputy Assistant Sec'y of the Dep't of Lab., to Helmuth Fandl, Chairman of the Ret. Bd. of Avon Prods. (Feb. 23, 1988) (stating that pension fund advisors' fiduciary duties respecting the management of employee benefit plans include how proxies should be voted); Interpretive Bulletin Relating to Written Statements of Investment Policy, Including Proxy Voting Policy or Guidelines, 29 C.F.R. § 2509.94-2 (2022); Report of Proxy Voting Record, 17 C.F.R. § 270.30b1-4 (2022).

for intervening in the market for corporations has been astonishing.[185] One observer called the modern changes to the governance market "something like a hundred-year flood of reform."[186]

Corporate law's encounter with economics did not have to go this way. A concern for maximizing societal wealth could have manifested itself in a skepticism about interfering with market processes.[187] After all, it is widely accepted that markets are an important part of generating the modern era's unprecedented level of wealth.[188] However, the influence of wealth maximization norms on academics and regulators in corporate law was instead largely directed into debates around various market interventions like those listed above.[189]

The sphere of commercial activity targeted by these policy debates is the "governance market." To understand this market, it is important to stop thinking of corporations in the way deprecated by the economist Oliver Williamson as "the firm-as-production function."[190] Simplifying corporations in this makes them easy to model, and for that reason, this model dominates most agency-cost inflected discussions of corporate governance, but it leaves out a great deal.[191] Instead, Williamson argues that we must "consider the firm as a governance structure in which internal structure has economic purpose and effect."[192] Corporate governance is the way the company organizes itself, sets priorities, establishes culture, makes decisions, and allocates financial claims.[193]

Shareholders, managers, customers, employees, creditors, business partners, and other constituencies come together in the governance market to generate the norms, practices,

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185. One thing that stands out when one reviews efficiency arguments in corporate law is the degree to which efficiency fails to decide questions. Even the most basic issues of shareholder versus director control, or shareholder primacy versus various stakeholder schemes, remain unresolved, at least to the extent a consensus among scholars appears elusive. *See* Eric A. Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 863 (2003) (demonstrating the indeterminacy of economic approaches to law).

186. Robert B. Thompson, *Delaware, the Feds, and the Stock Exchange: Challenges to the First State As First in Corporate Law*, 29 DEL. J. CORP. L. 779, 791 (2004); *see* THE CORPORATE GOVERNANCE REV. 366 (Willem J. L. Calkoen ed., 10th ed. 2020) ("Corporate governance in the United States has changed dramatically over the past 30 years . . . ."); Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987 (2008) (describing the dramatic impact of these changes on corporate executives).

187. Of course, not all virtues can be collapsed into a utility function like wealth maximization. *See* MCCLOSKEY, *supra* note 83, at 111.

188. *See* William Easterly, *In Search of Reforms for Growth: New Stylized Facts on Policy and Growth Outcomes*, (Nat'l Bureau of Econ. Rsch., Working Paper No. 26318, 2019); Kevin B. Grier & Robin M. Grier, *The Washington Consensus Works: Causal Effects of Reform, 1970—2015*, 49 J. COMPAR. ECON. 59 (2021); STORR & CHOI, *supra* note 66, at 83–133 (summarizing evidence market-based economies produce better material outcomes).

189. Brian R. Cheffins, *The History of Corporate Governance* (Eur. Corp. Governance Inst., Working Paper No. 184/2012, 2012).

190. Williamson, *supra* note 80, at 602.

191. OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING 32 (1985) (arguing for "a different and larger conception of the economic problem than . . . the imperative 'Maximize profits!'").

192. *Id.*

193. For example, corporate governance includes the decision to put customers ahead of other constituencies in corporate operations. *See* ROGER L. MARTIN, FIXING THE GAME: BUBBLES, CRASHES, AND WHAT CAPITALISM CAN LEARN FROM THE NFL (2011) (describing different corporate priorities among firms).

structures, strategies, and personalities that will govern the operation of the corporation.[194] Creditors may not lend money if the corporation appears too willing to take on risk.[195] Shareholders may sell their shares if the company loses the interest or ability to generate profits. Employees may choose to work elsewhere if the corporation seems like it will abandon them quickly whenever opportunity arises. Business partners and suppliers may not make informal firm-specific investments if they feel they can't trust the corporation to treat them fairly over the life of those investments.[196] Customers abandon companies whose actions manifest a contempt for their values.[197] Senior executives won't join a corporation unless the governance environment will allow them to pursue their vision.[198] Whether a CEO gets and keeps her job is not entirely up to the board. Shareholders, employees, business partners, and even customers, get a say. A CEO who creates problems with employees, or who can't close transactions with important customers, is a CEO whose job is in jeopardy.[199]

Who rises to the top, what they do there, how they are monitored and regulated, and what options for business strategies are available, are all determined to a significant degree by the bargaining and decisions that make up the governance market. The market sets the terms on which various corporate constituencies will cooperate, whether they will enter the market, and how they will behave once there. It is where new kinds of bargains for the firm—experiments——are tested and either succeed or fail.[200] It is the most important market in which corporations participate because it affects the corporation's behavior and success in all of the other markets it joins.

Professor Gordon Smith notes that "[p]ared to its core, 'corporate law' is the set of rules that defines the decisionmaking structure of corporations."[201] The governance market as I define it is the central preoccupation of corporate law.

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194. *See* Maughan & McGuinness, *supra* note 153, at 144 ("[T]here is often an emphasis on agency theory that understates the importance of corporations in reducing the costs of multiple contracting.").

195. Bill B. Francis et al., *The Effect of State Antitakeover Laws on the Firm's Bondholders*, 96 J. FIN. ECON. 127, 128 (2010).

196. *See, e.g.*, William C. Johnson, Jonathan M. Karpoff & Sangho Yi, *The Bonding Hypothesis of Takeover Defenses: Evidence from IPO Firms*, 117 J. FIN. ECON. 307, 329 (2015) (finding that firms deploy takeover defenses at the time of IPO precisely when they have large customers, dependent suppliers, or strategic partners at).

197. *See, e.g.*, Stefan Hoffman & Stefan Müller, *Consumer Boycotts Due to Factory Relocation*, 62 J. BUS. RES. 239 (2009); Ibrahim Abosag & Maya F. Farah, *The Influence of Religiously Motivated Consumer Boycotts on Brand Image, Loyalty and Product Judgment*, 48 EUR. J. MKTG. 2262 (2014).

198. PETER THIEL, ZERO TO ONE: NOTES ON STARTUPS, OR HOW TO THE BUILD THE FUTURE, 184–89 (2014); Jerry Davis, *The Simple Reason Tech CEOs Have So Much Power*, FAST CO. (Apr. 3, 2021), https://www.fastcompany.com/90620747/dual-class-voting-tech-ceo-power [https://perma.cc/8N7Y-8YQ7].

199. *See, e.g.*, Kellen Browning & Gregory Schmidt, *Blizzard Entertainment President Steps Down After Workplace Protests*, N.Y. TIMES (Aug. 3, 2021), https://www.nytimes.com/2021/08/03/business/blizzard-entertainment-activision.html [https://perma.cc/CF7L-J8CR] ("Employees who organized last week's walkout said Mr. Brack's departure was just a start.").

200. Nathan B. Oman, *A Pragmatic Defense of Contract Law*, 98 GEO. L. J. 77, 99–103 (2009) (discussing importance of variation and experimentation in generating socially useful outcomes in contract law).

201. D. Gordon Smith, Response, *The Dystopian Potential of Corporate Law*, 57 EMORY L.J. 985, 990 (2008).

B. Efficiency, Unlike Markets, Is Not Central to Corporate Law

The way efficiency concerns create a demand for interventions in the governance market is only one aspect of the problem it creates for corporate law. Wealth maximization as a legal norm runs into the same problems in corporate law as it does elsewhere in the legal firmament.[202] Traditional corporate law appears deeply concerned about fairness, expectations, and enforcing bargains, which conflicts with the idea that it ought to just maximize efficiency.[203] Pareto-optimality, which is all we can realistically hope for in the legal allocation of resources and rights, says nothing about how it is achieved.[204] It could be achieved by diktat, expropriation, or fraud.[205] The interminable corporate law debate around insider trading illustrates this point. On one side of the debate, economics-inflected scholars have pointed out that permitting and incentivizing insiders to trade on information they alone possess would lead to more efficient price discovery.[206] It seems safe to say, however, that the law has criminalized insider trading because it seems unfair to other market actors.[207] In fact, to the extent policy outcomes drive legal decision-making in this area, it is a concern that market participation would decline if the law permitted some participants to take advantage of others.[208]

While market-facilitation sits at the very center of corporate law, efficiency is a late arrival often ignored in real world legal argument. Reviewing the origin and development

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202. *See, e.g.*, STEPHEN A. SMITH, CONTRACT THEORY 132 (2004) ("[A]rguably the most important objection to efficiency theories of contract law is that they regard contract law as non-transparent, as hiding its own foundations"); Jules Coleman, *The Normative Basis of Economic Analysis: A Critical Review of Richard Posner's* The Economics of Justice, 34 STAN. L. REV. 1105, 1116 (1982) (book review) ("[W]ealth maximization fails to satisfy even the most minimal conception of what it means to treat individuals as equals, with due respect and concern."); Ellis & Hayden, *supra* note 148, at 250–62 (making additional arguments against efficiency as a legal norm in corporate law).

203. *See generally* Russell Hardin, *Magic on the Frontier: The Norm of Efficiency*, 144 U. PA. L. REV. 1987, 1987 (1996) ("There is a grievous theoretical problem with a principle of efficiency, namely, how to handle allocations across interacting parties.").

204. *See generally* Jules L. Coleman, *Efficiency, Exchange, and Auction: Philosophic Aspects of the Economic Approach to Law*, 68 CALIF. L. REV. 221, 222 (1980) (recognizing the difficulty in "[d]istinguishing the good from the bad in law and economics").

205. ANDRE COMTE-SPONVILLE, A SMALL TREATISE ON THE GREAT VIRTUES: THE USES OF PHILOSOPHY IN EVERYDAY LIFE 26 (Catherine Temerson trans., 2002) (noting the way a focus on ends justifies unpalatable means by stating that "[a]ll the barbarities of [the twentieth] century were unleashed in the name of the future").

206. Henry G. Manne, *Insider Trading and Property Rights in New Information*, 4 CATO J. 933, 935 (1985); ZVI BODIE, ALEX KANE & ALAN J. MARCUS, INVESTMENTS 108 (9th Canadian ed., 2019) (discussing research that shows insider trading "actually improves market efficiency by accelerating the price adjustment process" giving "some support to the view that this 'victimless crime' is actually beneficial"). *See also* Kevin S. Haeberle & M. Todd Henderson, *Making a Market for Corporate Disclosure*, 35 YALE J. ON REGUL. 383, 385 (2018) (arguing that allowing some investors to buy early access to insider information would lead to greater efficiency in corporate disclosures).

207. Patricia H. Werhane, *The Indefensibility of Insider Trading*, 10 J. BUS. ETHICS 729, 729–30 (1991); Jennifer Moore, *What is Really Unethical About Insider Trading?*, 9 J. BUS. ETHICS 171, 172–74 (1990); Hayne E. Leland, *Insider Trading: Should It Be Prohibited?*, 100 J. POL. ECON. 859, 860 (1992) (stating that "[("The Securities Exchange Act of 1934 justifies the regulation of insider trading on the presumption that such activity is 'unfair' to outside investors.").

208. *See, e.g.*, SEC v. Tex. Gulf Sulphur, 401 F. 2d. 833, 848, 852 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) (the use of Rule 10b-5 to prohibit insider trading was intended to ensure "that all investors trading on impersonal exchanges have relatively equal access to material information" and all market participants "should be subject to identical market risks").

of modern American corporate law, Professor Vasudev notes that "efficiency was not the starting point of the changes that occurred in corporate law beginning from the 1880s. Rather[,] the efficiency argument was developed, ex post, to rationalize the libertarian state that corporate law attained."[209]

We have already seen that the core elements of the modern corporation (limited liability, the separation of ownership and control, transferability of shares, artificial existence, permanence, checks on opportunism, and disclosure requirements) are essential to facilitate the participation of corporations in markets, to create new markets, and to create markets in the financial claims and control of corporations themselves.[210] But the changes occurring in the late 19th and early 20th centuries that Professor Vasudev alludes to created the modern business corporation by further enhancing its market orientation.

The most profound change was new legislation providing general authorization to incorporate rather than relying on special acts of the legislature. Special legislative acts chartering corporations contained grants of monopoly or extracted other anti-competitive advantages for the new firm (including, of course, the privilege of incorporation itself).[211] They were also available only to well-connected members of society.[212] Corporate law manifested its hostility to these kinds of special privileges by judges doing their best to reading down monopoly rights granted by legislative charter wherever possible.[213] In the middle of the 19th century, state constitutions began changing to follow New York in mandating that "[c]orporations may be formed under general laws; but shall not be created by special act."[214] Tennessee's 1870 constitution specifically identified the harm it was seeking to remedy: "No corporation shall be created or its powers increased or diminished by special laws."[215] The modern incorporation statutes adopted by most states were, in their nature, designed to facilitate new entrants into markets and to prevent monopolies and other legal barriers to market competition.[216]

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209. P. M. Vasudev, *Corporate Law and Its Efficiency: A Review of History*, 50 AM. J. LEGAL HIST. 237, 237–38 (2010).

210. *See supra* text accompanying notes 35–42; Styhre, *supra* note 148, at 6 (stating that "("[I]n the US, corporate law demonstrates a long-term commitment to private ownership and market creation . . . ."); MARK ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE, AND POLITICAL PRECONDITIONS TO SEPARATING OWNERSHIP FROM CORPORATE CONTROL 1 (1996) ("The Public Corporation—with its distant shareholders buying and selling on the stock exchange—is the dominant form of enterprise in the United States."); Brian R. Cheffins, *Law As Bedrock: The Foundations of an Economy Dominated By Widely Held Public Companies*, 23 OXFORD J. LEGAL STUD. 1, 1 (2003) ("[T]he 'Berle-Means corporation' must inevitably be the dominant paradigm in a market economy.").

211. Steven G. Calabresi & Larissa C. Leibowitz, *Monopolies and the Constitution: A History of Crony Capitalism*, 36 HARV. J.L. & PUB. POL'Y 983, 1068–73 (2013).

212. *See* Vasudev, *supra* note 209, at 253 (discussing changing opinion in favor of the proposition that "[i]ncorporation must no longer be a discretionary privilege that legislatures could dispense to a select few who had special access and resources").

213. *Id.* at 259–60.

214. N.Y. CONST. art. VIII, § 1 (1846); *see also* Oman, *supra* note 200, at 89.

215. TENN. CONST. art. XI, § 8 (1870).

216. American corporate law has historically tried to foster competitive markets in ways that didn't survive into the 20th century, such as confining corporations to their state of incorporation, putting a ceiling on the permitted amount of capital, limitations on what they could charge or the activities they could undertake,. *See* Oman, *supra* note 200, at 261–64.

During its 19th century evolution, corporate law developed another of its dominant characteristics: protecting bargains. Bargains are the key element in market transactions.[217] The bargains enforced by corporate law can be found embedded in the by-laws or articles of the corporation;[218] they may appear in the disclosure issued by corporations,[219] or they may merely exist in the "expectations" of counterparties.[220] Many commercial arrangements involving corporations are not reduced to formal written documents either for reason of cost, time, or to preserve flexibility.[221] Before there were formal legislative rules governing the treatment of some constituencies, American courts created legal rules that protected the implied bargains found in their reasonable expectations. Creditors were protected by the trust fund doctrine originally formulated by a court in 1824, which prevented shareholders from withdrawing capital unless the company could discharge its debts.[222] Employees' ex ante expectation of being paid was protected by creating an exception to corporate limited liability by imposing enforceable obligations on shareholders personally for unpaid wages.[223]

When courts enforced these bargains, they appeared to be (for all intents and purposes) concerned about promise-keeping and fairness rather than the impact of their decisions on overall societal wealth.[224] Steven Smith observes about similar legal decisions in contract law that "[t]here is virtually no point of contact . . . between the legal explanation and the efficiency-based explanation."[225] This is because there is a profound conflict between corporate law's preoccupation with the parties' past behavior, agreements, and expectations, and the forward-looking focus on outcomes required by wealth maximization norms. Corporate law looks backward to market interactions; economics points forward to their wealth effects.

Recent empirical research supports the traditional focus of corporate law on ex ante market conditions. Numerous behavioral economics experiments involving the interaction between individuals find that manipulating intentions or the context of participants' interactions (all market-related ex ante conditions) has a greater effect on their choices than

217. *Id.* at 193; OMAN, *supra* note 8.

218. *See, e.g.*, N. Mins. Inv. Corp. v. Mundoro Cap. Inc., 2012 B.C.S.C. 1090 (Can.); Blackrock Credit Allocation Income Tr. v. Saba Cap. Master Fund, Ltd., 224 A.3d 964 (Del. 2020); Blue Lion Opportunity Master Fund, L.P. v. HomeStreet Inc., No. 18-2-06791-O SEA, 2018 WL 11350008 (Wash. Super. Ct. Apr. 3, 2018).

219. Securities Act, R.S.O. 1990 c S.5, s 1(1), 122(1)(a) and (b) (Can.); Securities Exchange Act of 1934, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78a).

220. *See, e.g.*, George W. Dent, Jr., *Independence of Directors in Delaware Corporate Law*, 54 U. LOUISVILLE L. REV. 73 (2016) (arguing for a change in how Delaware approaches the evaluation of independent directors to prevent unjust bias); Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1 (2006) (explaining that although there has recently been explicit case law recognition of a duty of good faith, the duty has been present implicitly long beforehand).

221. Macauley, *supra* note 74; Baker, Gibbons & Murphy, *supra* note 80.

222. Wood v. Dummer, 3 Mason 308 (Me. 1824); R.R. Co. v. Howe, 74 U.S. 392. (1868).

223. JAMES WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780–1970, at 27 (1970).

224. *See, e.g.*, BCE Inc. v. 1976 Debentureholders, [2008] 3 S.C.R. 560, 587, 590, 597, 603 (Can.) (analyzing arrangements under s. 192 of the CBCA as a method of protecting stakeholders from ex post alterations of their rights; defining the oppression remedy in relation to stakeholder expectations; indicating one consideration is whether a stakeholder "could have taken steps to protect itself").

225. STEPHEN A. SMITH, CONTRACT THEORY 133 (2004).

varying payoffs.[226] The fact is that the conditions of the market appear to be more important than the ex post wealth outcomes in generating behavioral outcomes.

In *Salomon v. Salomon*, arguably the most important English corporate law decision, none of the Lords appear to have believed that the result in that case was efficient.[227] In fact, they noted that it would create transaction costs as creditors must, as a result of the decision, do the work of inquiring about the solvency of a corporation rather than relying on the law to place their interests ahead of insiders.[228] The main point of the court was that bargains should be upheld and not subjected to ex post revision regardless of what one might think of the result.[229] This keeps the market activity of ex ante bargaining at the moral center of corporate law.

The making and keeping of bargains was facilitated by the increasing freedom directors had to make decisions with very little interference from other constituencies.[230] Referring to the changes that began around 1880 to create the modern American corporation, Professor Vasudev notes a "shift of corporate powers from the shareholders to the directors."[231] This shift was accomplished by reducing the matters shareholders were permitted to vote on, replacing a requirement for shareholder unanimity with majority rule, permitting the creation of non-voting shares and dual-class voting structures, removing fetters on issuing new shares, and providing directors with new areas over which they had complete discretion.[232] "There is little material to suggest that the changes were shaped by the idea that they would promote the efficiency of business corporations."[233]

Professors Blair and Stout observed that "the directors are trustees for the corporation itself—mediating hierarchs whose job is to balance team members' competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together."[234] Empirical research confirms that firms which adopt governance structures that preserve director independence from shareholder influence, for example, are able to obtain more debt and cheaper debt than companies without that freedom,[235] have higher

226. See the discussion in SMITH & WILSON, *supra* note 84, at 87; *see also*, Kevin A. McCabe, Vernon Smith & Michael LePore, *Intentionality Detection and 'Mindreading:' Why Does Game Form Matter?*, 97 PROC. NAT'L ACAD. SCIS. 4404 (2000).

227. Salomon v. Salomon & Co. Ltd., [1896] UKHL 1, [1897] 1 AC 22.

228. *Id.* at 40 (Lord Halsbury referred to this process as "taking the trouble" to investigate).

229. *Id.* at 46 ("No one need trust a limited liability company unless he so please, and that before he does so he can ascertain, if he so please, what is the capital of the company and how it is held."); Lord MacNaghten referred approvingly to a decision that reversed an attempt to impose ex post considerations in similar circumstances. *Id.* at 52.

230. Stephen M. Bainbridge, *Director v. Shareholder Primacy in the Convergence Debate*, 16 TRANSNAT'L L. 45, 48 (2002) (shareholder control rights in incorporation statutes are still "so weak that they scarcely qualify as part of corporate governance"); Jeffrey M. Lipshaw, *The False Dichotomy of Corporate Governance Platitudes*, 46 J. CORP. L. 345 (2021).

231. Vasudev, *supra* note 209, at 268; *see also* Smith, *supra* note 194, at 5 ("Substantive statutory constraints on board power have largely been abandoned or eviscerated in modern corporation statutes.").

232. Vasudev, *supra* note 209, at 270–73.

233. *Id.* at 273.

234. Blair & Stout, *supra* note 179, at 280–81; *see also* Stephanie Ben-Ishai, *A Team Production Theory of Canadian Corporate Law*, 44 ALTA. L. REV. 299 (2015); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporation Governance*, 97 NW. U. L. REV. 547 (2003); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006).

235. Bill Francis et al., *The Effect of State Antitakeover Laws on the Firm's Bondholder*s, 96 J. FIN. ECON. 127 (2010).

R&D expenditures as a proxy for long-term planning,[236] were less likely to require a bailout following the 2008 financial crisis,[237] and have better relationships with large customers or suppliers.[238] The most likely channel through which these effects flow is that boards relatively free from outside influence are better able to make credible long-term bargains because, in part, they are more trustworthy.[239] This trustworthiness is important because, as Douglass North reminds us, "[e]ven in the modern western world the costs of contract enforcement in a world characterized by the assumptions of economic theory (where all the players maximized at every margin) would be prohibitive."[240]

The logic of granting autonomy to directors persists in corporate law even when it appears to directly conflict with wealth-maximizing norms. The legislative and judicial efforts to preserve board control over takeovers provides an example.[241] If wealth maximization was the most important factor, then takeovers should always go to the shareholders, without interference from the board, because takeovers are nearly always conducted at premium to the market.[242] Instead, the Delaware courts permit directors to

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236. Martijn Cremers & Simone M. Sepe, *Board Declassification Activism: Why Run Away from the Evidence?* 5–6 (June 23, 2017) (unpublished paper), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2991854 [https://perma.cc/6D4G-BTLF]*; see also* Martijn Cremers & Simone M. Sepe, *Board Declassification Activism: The Financial Value of the Shareholder Rights Project* (June 2, 2017) (unpublished paper), https://ssrn.com/abstract=2962162 [https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2962162] (discussing how declassification of boards leads to greater value and profitability).

237. Nadia Saghi-Zedek & Amine Tarazi, *Excess Control Rights, Financial Crisis and Bank Profitability and Risk*, 55 J. BANKING & FIN. 361, 371 (2015); Reint Gropp & Matthias Köhler, *Bank Owners or Bank Managers: Who is Keen on Risk? Evidence from the Financial Crisis*, (ZEW Ctr. for Eur. Econ. Rsch., Discussion Paper No. 10-013, 2010)*; see also* Alan Dignam, *The Future of Shareholder Democracy in the Shadow of the Financial Crisis*, 36 SEATTLE U. L. REV. 639, 643–58 (2013) (discussing the failures of banks during the 2007–2008 financial crisis); Daniel Ferreira et al., *Shareholder Empowerment and Bank Bailouts*, (London Sch. of Econ., Working Paper No. 345, 2013), (investigating the hypothesis that the impact of shareholder empowerment caused more bank bailouts).

238. William C. Johnson, Jonathan M. Karpoff & Sangho Yi, *The Bonding Hypothesis of Takeover Defenses: Evidence from IPO Firms*, 117 J. FIN. ECON. 307, 329 (2015)*; see generally* Bryce C. Tingle, *Two Stories about Shareholders*, 58 OSGOODE HALL L.J. 57, 96, 105–106 (2021) (discussing how customers or suppliers are more likely to invest when there are takeover defenses that ensure shareholders will not appropriate the investments in the event of a takeover).

239. *See* Baker, Gibbons & Murphy, *supra* note 80 (noting the importance to firms of enforcing relational contracts); OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975)*; see also* Douglas Cumming, Bryce C. Tingle & Feng Zhan, *For Whom (and for When) Is the Firm Governed? The Effect of Changes in Corporate Fiduciary Duties on Tax Strategies and Earnings Management,* 27 EUR. FIN. MGMT. 775 (2021) (finding a move to a constituency jurisdiction is associated with less risky tax avoidance strategies).

240. North, *supra* note 3, at 2.

241. Robert M. Daines & Jon D. Hanson, Review Essay, *The Corporate Law Paradox: The Case for Restructuring Corporate Law*, 102 YALE L. J. 577 (1992) (discussing the conflict between board control over takeovers and the efficiency norm).

242. *See* B. Espen Eckbo, *Bidding Strategies and Takeover Premiums: A Review*, 15 J. CORP. FIN. 149 (2009) (investigating bidding behavior during takeovers); *see also* Gregor Andrade, Mark Mitchell & Erik Strafford, *New Evidence and Perspectives on Mergers*, 15 J. ECON. PERSPS. 103 (2001); Gregg A. Jarrell, James A. Brickley & Jeffry M. Netter, *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSPS. 49 (1988); Michael C. Jensen & Robert S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5 (1983); Bryce C. Tingle & Eldon Spackman, *Do Corporate Fiduciary Duties Matter?*, 4

prevent offers from proceeding if they can provide any justification that isn't obviously self-interested,[243] and the vast majority of U.S. jurisdictions have passed constituency statues with the same intent.[244]

V. EFFICIENCY VERSUS MARKETS DURING THE MODERN ERA

We can summarize the character of corporate law immediately prior to the arrival of legal notions of economic efficiency in the 1970s: it had developed over several centuries to provide a distinctly "enabling" approach to business.[245] Boards had considerable discretion to engage in formal and informal ex ante bargains; there was a wide-range of corporate governance structures, and there was room for experimentation and the incremental development of firm-specific deals with various stakeholders, including financial claim holders.[246]

The character of corporate law can be seen in the artifacts that pre-date the corporate governance reforms of the 1990s. Easterbrook and Fischel's textbook is a useful example, as it was published right at the beginning of what *The Financial Times* referred to as "the decade of corporate governance."[247] Easterbrook and Fischel's text emphasizes the sheer range of alternatives then open to market actors in how they organized and ran widely-held corporations.[248] After noting that the governance structures of different types of companies ought to be different, they wrote that "[t]he best structure cannot be derived from theory; it must be developed by experience."[249] They repeat this point several times by saying that "Just as there is no right amount of paint in a car, there is no right relation among managers, investors, and other corporate participants".[250] They clearly have markets in mind for this, "The corporation and its securities are products in financial markets to as great an extent as the sewing machines or other things the firm makes."[251] Markets can and should produce corporate governance. Easterbrook and Fischel continue by stating:

> Costs of knowing about a firm's governance are low. Firms and teams of managers can compete with each other over the decades to design governance

ANNALS CORP. GOVERNANCE 272 (2019) (discussing how corporate fiduciary duties, when changed in nature, do not impact takeover premiums).

243. Paramount Comm. Inc v. Time Inc., 571 A.2d 1140 (Del 1989); Paul L. Regan, *What's Left of Unocal*, 26 DEL. J. CORP. L. 947 (2001).

244. Jonathan M. Karpoff & Michael D. Wittry, *Institutional and Legal Context in Natural Experiments: The Case of State Antitakeover Laws*, 73 J. FIN. 657 (2018).

245. Eric W. Orts, *Corporate Law and Business Theory*, 74 WASH. & LEE L. REV. 1089, 1092 (2017).

246. Barry D. Baysinger & Henry N. Butler, *Corporate Governance and the Board of Directors: Performance Effects of Changes in Board Composition*, 1 J.L. ECON. & ORG. 101 (1985) (arguing against board reforms, which at the time included mandating a majority of independent directors, and promoting the benefits of "[t]he laissez-faire attitude of the state toward board composition"); Kenneth B. Davis, Jr., *Discretion of Corporate Management to Do Good at the Expense of Shareholder Gain——A Survey of, and Commentary on, the U.S. Corporate Law*, 13 CAN. U.S. L.J. 7 (1988) (discussing to what extent management can make a decision motivated by purely altruistic intentions at the expense of shareholders); Brain R. Cheffins, *The History of Corporate Governance* (Eur. Corp. Governance Inst., Working Paper No. 184, 2012) (tracing the history of corporate governance from the 1970s to the 1990s).

247. Moira Conoley, *Moves to Halt Another Decade of Excess*, FIN. TIMES (Aug. 5, 1999).

248. EASTERBROOK & FISCHEL, *supra* note 1, at 6.

249. *Id.* at 5.

250. *Id.* at 14.

251. *Id.* at 4.

> structures and to build in penalties for malfeasance. There is no substantial impairment to the operation of the competitive process at the level of structure.[252]

Even the ultimate aim of corporate actions, which we might expect Easterbrook and Fischel to argue must reflect shareholder wealth concerns, were left to the market:

> [W]hat is the goal of the corporation? Is it profit, and for whom? Social welfare more broadly defined? Is there anything wrong with corporate charity? Should corporations try to maximize profit over the long run or the short run? Our response to such questions is: who cares? If the *New York Times* is formed to publish a newspaper first and make a profit second, no one should be allowed to object. Those who came in at the beginning consented, and those who came later bought stock the price of which reflected the corporation's tempered commitment to a profit objective.[253]

Contrast this confidence in the governance market with the current vast literature on the "correct" objective of the corporation and how we should enforce it.[254]

Some may not trust Easterbrook and Fischel to reflect the circumstances accurately; they were engaged in a project when they wrote *The Economic Structure of Corporate Law*, so their agenda exceeded merely reporting facts on the ground. In order to persuade readers, however, their text had to describe a world that plausibly resembled the one those readers inhabited. Before the 1990s, the structure and operations of widely held firms presented considerable heterogeneity.[255] The governance market was a prominent fact. The lists of best practices proposed in 1992 by the UK's influential Cadbury Committee would not have been necessary if this heterogeneity hadn't existed.[256]

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252. *Id.* at 7.

253. EASTBROOK & FISCHEL, *supra* note 1, at 35–36.

254. *See, e.g.*, Warren, *supra* note 179 (suggesting that a company has obligations to more than solely its shareholders); *Principles for Purposeful Business*, THE BRIT. ACAD. FUTURE OF THE CORP. 1, 8 (Nov. 2019), https://www.thebritishacademy.ac.uk/documents/224/future-of-the-corporation-principles-purposeful-business.pdf [https://perma.cc/SYT7-HNJR] (stating that "the purpose of business is to solve the problems of people and planet profitably, and not profit from causing problems"); William W. Bratton, *Framing a Purpose for Corporate Law*, 39 J. CORP. L. 713 (2014) (exploring whether the goal of corporations should extend beyond profit maximization to include social welfare components); Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) (discussing whether the incorporation of a specified power to intervene would provide shareholders with the means to address governance issues); Lynn A. Stout, *New Thinking on "Shareholder Primacy*,*"* 2 ACCT. ECON. L., art. 4, 2012, at 1 (arguing that corporate goals exceed the "shareholder primacy" rule); Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563 (2021) (noting that the corporate social responsibility movement pushed corporations to emphasize environmental, social, and governance (ESG) considerations in their operations).

255. *See* Cheffins, *supra* note 149, at 1 (noting that prior to the rise of corporate governance from the 1970s to the 1990s, public companies functioned in a managerial capitalism era); Cheffins, *supra* note 189, at 2 (stating that as corporations prospered after World War II, "the internal governance of companies was not a high priority"); Eric Hilt, *History of American Corporate Governance: Law, Institutions, and Politics*, 6 ANN. REV. FIN. ECON. 1 (2014).

256. *See* COMM. ON THE FIN. ASPECTS OF CORP. GOVERNANCE, REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE 15–18 (1992) (listing best practices for boards of companies registered in the United Kingdom); PETER DEY, WHERE WERE THE DIRECTORS? GUIDELINES FOR IMPROVED CORPORATE GOVERNANCE IN CANADA 4–6 (1994), (calling for fully independent audit committees).

It no longer does.[257] According to Spencer Stuart, virtually every widely held company now replicates even those governance structures not imposed by regulations. In the United States, 98% of the S&P 500 firms had annual board performance evaluations;[258] 85% of the directors are independent (essentially all companies have super-majority independent boards); and 62% of these companies have eliminated *all* inside directors except the CEO.[259] 90% of boards are not classified;[260] 89% have some form of majority voting;[261] 72% have deferred compensation plans; 91% don't provide meeting fees,; and 89% of boards now reject the once ubiquitous stock options.[262] Further, 94% of firms have director share ownership requirements[263] and 98.4% of the Russell 1000 don't use poison pills.[264] They tend to have similar board committees (including committees that regulations do not require), the same policies on subjects such as director service on other boards, and they appear to generally hire people with the same backgrounds.[265] This monoculture is even more prevalent in other English-speaking countries.[266] Martin Lipton observed, "The governance and takeover defense profiles of U.S. public companies have been transformed by the widespread adoption of virtually all of the 'best practices'. . . ."[267]

For people who don't work in the governance market every day, the scale and granularity of our interventions may come as a surprise. One way to get a sense of the scope of our governance market interventions is to look at ISS QuickScore, which rates the "quality" of a corporation's governance arrangements. It contains 92 factors that the governance industry expects to see reflected in a corporation's governance.[268] Similarly, the voting guidelines and FAQs published by ISS, which publicly-listed issuers regularly

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257. *See* Bryce C. Tingle & J. Ari Pandes, *Reversing the Decline of Canadian Public Markets*, 14 SCH. PUB. POL'Y PUBL'NS 1, 21 (Apr. 27, 2021) (stating that "the empirical evidence suggests corporate governance best practices do nothing to improve corporate performance").

258. SPENCER STUART, 2020 U.S. SPENCER STUART BOARD INDEX 21 (2020).

259. SPENCER STUART, 2019 U.S. SPENCER STUART BOARD INDEX 15 (2019).

260. *Id.*

261. *Id*.

262. *Id.* at 29–31.

263. *Id.* at 31.

264. Ethan Klingsberg, Paul Tiger & Elizabeth Bieber, *A Look at the Data Behind Recent Poison Pill Adoptions*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 24, 2020), https://corpgov.law.harvard.edu/2020/04/24/a-look-at-the-data-behind-recent-poison-pill-adoptions/ [https://perma.cc/6HMS-ZLNZ].

265. *See* SPENCER STUART, *supra* note 259, at 16 (noting common limitations on directors serving other boards); *id.* at 26–28 (describing that "71% of boards have more than the three NYSE-mandated committees" and that "committee chairs are most likely to be retired CEOs, other corporate executives and investors").

266. For example, among the 100 largest Canadian companies, 83% had voluntary "say on pay" votes; 100% had board performance reviews; 97% had minimum share ownership requirements for non-executive directors (84% calculate this minimum based on annual director retainers), and 98% had adopted majority voting. SPENCER STUART, *supra* note 259, at 33–40. In 2019, 81% of board members among Canada's 100 largest companies were independent. *Id.* at 22.

267. Martin Lipton, *Some Thoughts for Boards of Directors in 2018*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 30, 2017), https://corpgov.law.harvard.edu/2017/11/30/some-thoughts-for-boards-of-directors-in-2018/ [https://perma.cc/R8AC-2Y8S].

268. Guhan Subramanian, *Corporate Governance 2.0*, HARV. BUS. REV. (Mar. 2015), https://hbr.org/2015/03/corporate-governance-2-0 [https://perma.cc/7NL2-X3TD]; *see ISS Governance Quickscore 2.0: Overviews and Updates*, INSTITUTIONAL S'HOLDER SERVS., INC. 1, 9 (Jan. 2014), https://www.issgovernance.com/file/files/ISSGovernanceQuickScore2.0.pdf [https://perma.cc/S2W2-53F7] (stating that over 200 factors exist, but that applicability varies by region).

consult, now run to 124 pages.[269] ISS' materials reflect the widespread consensus about corporate governance, visible throughout the materials published by other third parties in the governance market.[270] Boards feel immense pressure to fall in line because they are surrounded by calls to adopt these governance practices. They also have incentives to preserve positive relationships with the institutional shareholders that uncritically accept them.[271]

One could perhaps justify these extensive interventions in the governance market if large efficiency gains sufficiently offset the social costs of curtailing the bargaining, experimentation, and compromise that would otherwise characterize corporate governance-related market behavior. However, as anyone familiar with the empirical literature knows, little evidence suggests that the various practices imposed on corporations improve outcomes, and considerable evidence instead indicates that they make outcomes worse for at least some companies.[272] In a series of papers, I reviewed the empirical evidence around the outcomes generated by best practices in board governance,[273]

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269. *See generally* INSTITUTIONAL S'HOLDER SERV., Inc., *supra* note 165; *Compensation Policies Frequently Asked Questions*, INSTITUTIONAL S'HOLDER SERV., INC., (2022), https://www.issgovernance.com/file/policy/active/americas/US-Compensation-Policies-FAQ.pdf [https://perma.cc/4TCX-SFBT]; *United States Compensation Policies and the COVID-19 Pandemic*, INST. S'HOLDER SERV., INC. (2021), https://www.issgovernance.com/file/policy/2022/americas/US-Compensation-Policies-and-the-COVID-19-Pandemic.pdf [https://perma.cc/EV84-N7QM]; *United States Policies and Procedures (Non-Compensation) Frequently Asked Questions*, INST. S'HOLDER SERV., INC. (2023), https://www.issgovernance.com/file/policy/active/americas/US-Procedures-and-Policies-FAQ.pdf [https://perma.cc/PY3G-LXJN]; *United States Equity Compensation Plans Frequently Asked Questions*, INST. S'HOLDER SERV., INC. (2022), https://www.issgovernance.com/file/policy/active/americas/US-Equity-Compensation-Plans-FAQ.pdf [https://perma.cc/6ZNZ-HL8Y]; *United States Pay-for-Performance Mechanics*, INST. S'HOLDER SERV., INC. (2023), https://www.issgovernance.com/file/policy/active/americas/Pay-for-Performance-Mechanics.pdf [https://perma.cc/6KM8-A2ZC]; *United States Peer Group Selection Methodology and Issuer Submission Process Frequently Asked Questions*, INST. S'HOLDER SERV., INC. (2022), https://www.issgovernance.com/file/policy/active/americas/US-Peer-Group-FAQ.pdf [https://perma.cc/V634-CC7U].

270. *See, e.g.*, CALPERS, *supra* note 165 (listing the CalPERS proxy voting guidelines); *Summary of the Proxy Voting Policy for U.S. Portfolio Companies*, VANGUARD GRP. 1–20 (2020), https://www.wlrk.com/docs/Vanguard_Funds_Summary_of_the_proxy_voting_policy_for_U.S._portfolio_companies.PDF [https://perma.cc/92R7-MT95] (describing general positions on recurring proxy proposals for American corporations); *BlackRock Investment Stewardship: Proxy Voting Guidelines for U.S. Securities*, BLACKROCK, INC. 1–26 (2023), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf [https://perma.cc/UE9F-NAE6] (providing issue-specific proxy voting guidelines); PROXY VOTING GUIDELINES, FIDELITY INV. 1–12 (2022), https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/Full-Proxy-Voting-Guidelines-for-Fidelity-Funds-Advised-by-FMRCo-and-SelectCo.pdf [https://perma.cc/3ZEM-LGCA] (explaining proxy voting procedures).

271. *See* Calkoen, *supra* note 186, at 355–56 (discussing power of proxy advisors); Bryce C. Tingle, *Expressive Voting and Irrational Outcomes in Corporate Elections*, 67 MCGILL L.J. 72, 84–108 (2021) (analyzing majority voting policies) [hereinafter Tingle, *Expressive Voting*]; Bryce C. Tingle, *What is Corporate Governance? Can We Measure It? Can Investment Fiduciaries Rely on It?*, 43 QUEEN'S L.J. 223 (2018) (examining the relationship between corporate governance scores and future corporate performance) [hereinafter Tingle, *Can We Measure*].

272. *See generally* Tingle, *Can We Measure*, *supra* note 271.

273. Bryce C. Tingle, *What Do We Really Know About Corporate Governance? A Review of the Empirical Research Since 2000*, 59 CAN. BUS. L. J. 292 (2017).

executive pay,[274] shareholder voting,[275] and various types of shareholder intervention such as proposals, takeovers, and proxy activism.[276] In every area, the results are so disappointing as to call into question the entire project.[277] None of the governance practices reliably produce measurable gains to efficiency or shareholder wealth. This result should not surprise anyone familiar with the literature comparing market outcomes to centrally-directed planning.[278] In many cases, governance practices have been imposed on corporations even in the face of abundant prior empirical evidence that they were ineffective or harmful.[279] Unlike mistakes arising out of market interactions, the flawed market interventions we discuss affect all public firms and have persisted for a long time.

Some may object that we define market interventions too broadly. Many of the governance practices that public companies face are not imposed by regulatory fiat. Instead, proxy advisors, think tanks, media outlets, and powerful institutional shareholders promote them.[280] These private participants in the governance market comprise what is sometimes called the "governance industry."[281] Shouldn't the actions of proxy advisors and these other members of the governance industry be included as behavior endogenous to the market?

It is not helpful to think of markets as defined by whatever happens outside of government regulation. On the one hand, government regulation is demonstrably necessary

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274. Bryce C. Tingle, *How Good Are Our 'Best Practices' When It Comes to Executive Compensation? A Review of Forty Years of Skyrocketing Pay, Regulation, and the Forces of Good Governance*, 80 SASK. L. REV. 387 (2017) [hereinafter Tingle, *Best Practices*]; Bryce C. Tingle, *Framed! The Failure of Traditional Agency Cost Explanations for Executive Pay Practices*, 54 ALTA. L. REV. 899 (2017) [hereinafter Tingle, *Framed*].

275. Tingle, *Expressive Voting*, *supra* note 271; Bryce C. Tingle, *The Agency Cost Case for Regulating Proxy Advisory Firms*, 49 U.B.C. L. REV. 725 (2016) [hereinafter Tingle, *Agency Cost*]; Bryce C. Tingle, *Bad Company! The Assumptions Behind Proxy Advisors' Voting Recommendations*, 37 DALHOUSIE L.J. 709 (2014) [hereinafter Tingle, *Bad Company*].

276. *See generally* Tingle, *supra* note 238.

277. Tingle, *Agency Cost*, *supra* note 275 (calling into question the idea that agency cost problems should be a central concern of corporate governance); Tingle, *Can We Measure*, *supra* note 271 (calling into question that corporate governance structures matter); Tingle, *Expressive Voting*, *supra* note 271, at 18 (calling into question whether "best practices" for all, or most, companies even exist).

278. *See* Hayek, *Use of Knowledge*, *supra* note 6, at 520 (stating that the economic problem of society "is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know"); HAYEK, *Competition*, *supra* note 6, at 9 (viewing "competition systematically as a procedure for discovering facts which, if the procedure did not exist, would remain unknown or at least would not be used"); Shahar Dobzinaki,Noam Nisan & Sigal Oren, *Economic Efficiency Requires Interaction*, 118 GAMES & ECON. BEHAV. 589, 589 (2019) (determining that interaction between individuals is necessary for obtaining efficient economic allocations); MCCLOSKEY, *supra* note 83, at 190 (stating that "the economic scientist cannot expect to outguess the business person").

279. *See generally* Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779 (2011); Roberta Romano, *Quack Corporate Governance*, 28 REGUL. 36 (2005) [hereinafter Romano, *Quack Corporate Governance*]; Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 117 YALE L. J. 1521 (2005) [hereinafter Romano, *Quack Sarbanes-Oxley Act*].

280. *See generally* Tingle, *Expressive Voting*, *supra* note 271 (arguing that shareholders do not always behave rationally and are influenced by outside forces); *see also* Tingle, *supra* note 238, at 72–73 (stating that parties displacing corporate law include stock exchanges, proxy advisors, and a large governance "industry" comprised of media outlets, think tanks, academics, and pressure groups).

281. Tingle, *supra* note 273, at 294 ("We have created an entire industry around corporate governance consisting of lawyers, professional directors, academics, trade associates, pressure groups, think tanks, proxy advisors and consulting firms.").

for markets to exist, certainly for markets in artificial creations of statute——like corporations——to exist. On the other hand, private actors can wreck markets. Why else would we traditionally be concerned about monopolistic firms or predatory behavior by private actors? Markets aren't defined by the presence or absence of either government or private parties; they are defined by the presence of certain kinds of activities. The most important of these activities are experimentation, cooperation, competition, and bargaining.[282] The question is not whether proxy advisors count as belonging to the market by reason of some abstract institutional characteristic, but whether their activities reduce experimentation and bargaining in the governance market. Professor Stout describes the problem:

> Rather than evolving naturally from the collective needs of those who have a long-term stake in the business world—entrepreneurs, executives, employees, creditors, and the majority of investors deciding whether or not to buy shares—the philosophy of shareholder primacy [and I would add every other aspect of the current governance regime] was an attempt at top-down "intelligent design" by a small cadre of academics and policy entrepreneurs.[283]

The inefficiencies or "market failures" targeted by these third-party reformers were, of course, the result of earlier market activity producing other sorts of bargains.[284] For example, beginning in the late 1970s, scholars began arguing that the presence of inside directors on boards was the result of failures in the market activity that produced corporate governance. They theorized that financial claims holders had, for various reasons, failed to either recognize the advantages of, or advance the use of, independent directors in firms.[285] Managers had somehow broken the market for corporate governance as described by Easterbrook and Fischel, and the result was insufficiently independent boards doing a sub-optimal job of monitoring management.[286]

To remedy this market failure, stock exchanges, regulators, proxy advisors, and other members of the "governance industry" all worked over the next several decades to create boards dominated by independent directors.[287] In the 1950s only 25% or so of U.S. board

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282. Rebecca Hollander-Blumoff & Matthew T. Bodie, *The Market As Negotiation*, 96 NOTRE DAME L. REV. 1257, 1259 (2021) ("[T]he idea of 'the market' is . . . something of a black box . . . . But the market is not an entity . . . it is instead a set of transactions . . . .").

283. Lynn A. Stout, *On the Rise of the Shareholder Primacy, Signs of its Fall, and the Return of Managerialism (in the Closet)*, 36 SEATTLE U. L. REV. 1169, 1180–81 (2013); *see also* Orts, *supra* note 245, at 1094 (discussing the takeover of corporate law positions in most law schools by law and economics scholars).

284. *See supra* notes 157–80 and accompanying text (discussing reasonings behind market intervention).

285. *See generally* Eisenberg, *supra* note 220; Bengt Holmström, *Moral Hazard and Observability*, 10 BELL J. ECONOMICS 74 (1979); Stephen A. Ross, *The Economic Theory of Agency: The Principal's Problem*, 63 AM. ECON. REV. 134 (1973); Michael Spence & Richard Zeckhauser, *Insurance, Information, and Individual Action*, 61 AM. ECON. REV. 380 (1971); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980).

286. *See supra* text accompanying notes 248–52; Gordon, *supra* note 1, at 1469; Elmer W. Johnson, *An Insider's Call for Outside Direction*, HARV. BUS. REV. (Mar.–Apr. 1990), https://hbr.org/1990/03/an-insiders-call-for-outside-direction [https://perma.cc/UE2Z-YSK5].

287. *See, e.g.*, Robert B. Thompson, *Delaware, the Feds, and the Stock Exchange: Challenges to the First State As First in Corporate Law*, 29 DEL. J. CORP. L. 779, 792–93 (2004) (discussing New York Stock Exchange proposed listing standards requiring "at least a majority of a corporation's directors as well as all members of the audit, compensation, and governance committees be independent"); *NYSE Listed Company Manual Section 303A*

members were independent.[288] By 2005 it was 70% and by 2019 it was 85%.[289] On many boards today the only inside director is the CEO. What happened following this revolution in the board room? A meta-analysis of research on the impact of independent directors in 1999, making use of 54 earlier studies, found no connection between independence and performance.[290] Literature reviews in 2002, 2003, and 2007 came to the same conclusion.[291] Subsequent studies find either no impact or a negative impact on firm value as a result of increasing board independence.[292] The impact of independent directors is

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Corporate Governance Standards Frequently Asked Questions, N.Y. STOCK EXCH. (July, 28, 2021), https://www.nyse.com/publicdocs/nyse/regulation/nyse/FAQ_NYSE_Listed_Company_Manual_Section_303A_7_28_2021.pdf [https://perma.cc/VJ6Z-S38U] (defining and answering director-related questions); RALPH NADER, MARK J. GREEN & JOEL SELIGMAN, TAMING THE GIANT CORPORATION 8 (1976) ("Through a federal charter instrument[,] new rights and remedies can be accorded [to] citizens by making the large corporate structure more anticipatory, self-correcting, and sensitive to public needs."); BUS. ROUNDTABLE, *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation*, 33 BUS. L. 2083, 2108–09 (1978) (noting NYSE required companies to establish "a committee made up solely of directors independent of management"); Eisenberg, *supra* note 220, at 20 (noting Delaware General Corporate Law Section 144 states "a transaction between a corporation and its directors or officers will be deemed valid if approved by a majority of the independent directors"); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 287 (1977) (recognizing the capability of "state corporation codes or private bodies such as stock exchanges from imposing" independent board member requirements.); *National Policy 58-201: Corporate Governance Guidelines*, ONTARIO SEC. COMM'N, §§ 3.1–3.2, 3.10, 3.15, (June 17, 2005) (requiring corporate governance to consist of a "majority of independent directors."); Canada Business Corporations Act, R.S.C. 1985, c C-44, § 171(1) (Can.) (requiring corporate audit committee to have "a majority of whom are not officers or employees of the corporation or any of its affiliates."); *Unofficial Consolidation: National Instrument 52-110 Audit Committees,* ONTARIO SEC. COMM'N pt. 3 (Nov. 17, 2015), https://www.osc.ca/sites/default/files/2020-09/rule_20151117_52-110_unofficial-consolidation.pdf [https://perma.cc/K69L-5TCH] ("[E]very audit committee member must be independent."); *Canada: Proxy Voting Guidelines for TSX-Listed Companies Benchmark Policy Recommendations*, INSTITUTIONAL S'HOLDER SERVS., INC. 10–11 (Nov. 19, 2020), https://www.issgovernance.com/file/policy/active/americas/Canada-TSX-Voting-Guidelines.pdf [https://perma.cc/MAV5-KHSP] ("Best practice corporate governance standards recommend that the board should have: A majority of independent directors"); *see also* Tingle, *supra* note 273, at 297 (arguing independence is mostly the only quality of a director that drives voting outcomes).

288. *See* Gordon, *supra* note 1, at 1565 (showing board compositions of independent directors in 1950, 1955 and 1960 were just under 25%).

289. *Id.*; SPENCER STUART, 2019 U.S. SPENCER STUART BOARD INDEX 8 (2019), https://www.spencerstuart.com/-/media/2019/ssbi-2019/us_board_index_2019.pdf [https://perma.cc/YC37-YF4X].

290. *See* Dan R. Dalton et al., *Number of Directors and Financial Performance: A Meta-Analysis*, 42 ACAD. MGMT. J. 674, 681 (1999) ("We found no evidence of a moderating influence of board composition on the board size-firm financial performance relationship.").

291. *See* Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. L. 921, 933 (1999) (finding "no evidence that board composition affects the overall quality of financial reporting by U.S. firms."); Benjamin E. Hermalin & Michael S. Weisbach, *Boards of Directors As an Endogenously Determined Institution: A Survey of the Economic Literature*, 9 ECON. POL'Y REV. 7, 12 (2003) (discussing previous studies that "do not find any relationship between board composition and firm performance."); Dan R. Dalton et al., *Chapter 1: The Fundamental Agency Problem and Its Mitigation*, 1 ACAD. MGMT. ANNALS 1, 33 (2007) ("There is . . . no evidence to suggest that the independence in the composition of boards of directors is related to corporate financial performance . . . .").

292. *See, e.g.*, Eric Fogel & Andrew M. Geier, *Strangers in the House: Rethinking Sarbanes-Oxley and the Independent Board of Directors*, 32 DEL. J. CORP. L. 33, 52 (2007) (explaining that a 2007 study of 254 public companies on 50 industries found "the worst ROE [return on equity] performers in each of 50 industries have approximately the same percentage of independent directors as the best ROE performers in each industry. No

particularly adverse for companies with significant R&D operations (a proxy for technically demanding and specialized businesses) or that present complex operational challenges (such as managing risk in an investment bank).[293]

A meta-analysis of all the research analyzing the impact of independent directors on executive pay found they produced no effect.[294] Indeed, the massive growth in executive pay over the past three decades occurred while independent directors came to dominate boardrooms.[295] Independent directors don't do a better job at identifying and terminating underperforming CEOs than insider-dominated boards.[296] Independence is also not associated with fewer accounting restatements or lower levels of fraudulent disclosure.[297]

It turns out the reformers were wrong. The market as it existed in the 1970s, producing significant numbers of inside directors, does not appear to have been the result of an

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pattern emerges to suggest that it makes any difference at all to shareholders' financial return whether a board has a higher or lower percentage of independent directors . . . ."); Sanjai Bhagat & Brian Bolton, *Corporate Governance and Firm Performance*, 14 J. CORP. FIN. 257, 258 (2008) (explaining that a 2008 study covering more than 20 years and containing up to 20,000 samples for some of the variables, found "board independence is negatively correlated with contemporaneous and subsequent operating performance . . . ."); M. Babajide Wintoki, James S. Linck & Jeffry M. Netter, *Endogeneity and the Dynamics of Internal Corporate Governance*, 105 J. FIN. ECON. 581, 604 (2012) (explaining that a 2012 study of 6000 firms over 22 years and using more sophisticated statistical techniques to measure casual effects, determined there is "no causal relation between board size or independence, and firm performance . . . ."); *see also* Sebastien Gay & Chris Denning, Corporate Governance Principle-Agent Problem: The Equity Cost of Independent Directors 1 (Oct. 17, 2014) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2468942 [https://perma.cc/47X9-A3E3] (stating that "a majority of independent directors on the board has an overall negative effect on stock returns").

293. *See, e.g.*, David H. Erkens, Mingyi Hung & Pedro Matos, *Corporate Governance in the 2007–2008 Financial Crisis: Evidence from Financial Institutions Worldwide*, 18 J. CORP. FIN. 389, 398–99 (2012) (stating that independent directors associated with worse outcomes at financial firms during the 2008 crisis); Ran Duchin, John G. Matsusaka & Oguzhan Ozbas, *When Are Outside Directors Effective?*, 96 J. FIN. ECON. 195, 210–11 (2010) (stating that independent directors do best in industries that are non-technical and where the cost of obtaining information about the firm's business is low); Jeffrey L. Coles, Naveen D. Daniel & Lalitha Naveen, *Boards: Does One Size Fit All?*, 87 J. FIN. ECON. 329, 330–33 (2008) (stating that independent directors do worse when R&D is important); Kenneth Lehn, *Corporate Governance and Corporate Agility*, 66 J. CORP. FIN. 1, 4 (2021) (noting that the costs of transferring knowledge to independent directors inhibits corporate agility); *see also* Frederick Tung, *The Puzzle of Independent Directors: New Learning*, 91 B.U. L. REV. 1175, 1177 (2011) ("Outside directors will always suffer informational disadvantages relative to insiders, and this disadvantage will be greater in firms where outsiders have greater difficulty acquiring information about the firm.").

294. Yuval Deutsch, *The Impact on Board Composition on Firms' Critical Decisions: A Meta-analytic Review*, 31 J. MGMT. 424, 424 (2005) ("The results provide little support to agency theory's predictions on the impact of board composition on critical decisions that involve a potential conflict of interest between managers and shareholders . . . ."); *see also* Ronald Anderson & John Bizjak, *An Empirical Examination of the Role of the CEO and the Compensation Committee in Structuring Executive Pay*, 27 J. BANKING & FIN. 1323, 1323 (2003) (finding no link between independent directors and executive compensation).

295. Tingle, *Best Practices*, *supra* note 274, at 412.

296. *See generally* Eliezer M. Fich & Anil Shivdasani, *Are Busy Boards Effective Monitors?*, 61 J. FIN. 689 (2006) (finding that independent but busy boards perform similarly to inside-dominate but busy boards).

297. *See* Tingle, *supra* note 273, at 305 (discussing lack of evidence "that independent directors on the audit committee improve the quality of financial reporting."); *see generally* David B. Farber, *Restoring Trust After Fraud: Does Corporate Governance Matter?*, 80 ACCT. REV. 539, 560 (2005) (finding that "credibility was still a problem" for fraudulent firms since increasing percentages of independent board members). This was also the finding in Dain C. Donelson, John McInnis & Richard D. Mergenthaler, Jr., *The Effect of Corporate Governance Reform on Financial Reporting Fraud*, 1 J.L. FIN. & ACCT. 235, 269 (2016) (analyzing 877 firms that fraudulently manipulated their financial statements and finding that they had the same percentage of independent directors as the control sample).

obvious failure. Inside directors know the business better than other directors. They aren't solely reliant on the CEO for information about what is going on in the company. They are better able to evaluate the merits of the firm's technical R&D initiatives; they are more likely to spot problems with corporate strategy, and they are better connected to other actors in the firm's markets. Insiders are less likely to evaluate corporate performance solely on the basis of share price, and they are less concerned about their reputation with the investor community. There are many reasons, therefore, why financial claim holders and the other important constituencies that form around a corporation might have preferred, or at least not objected to, large numbers of insiders on corporate boards.

Looking back, we see in the case of independent directors that academics and policy makers assumed, without much introspection, that they could improve upon the outcomes generated by the market. They ignored the fact that even imperfect markets tend to perform better than various academic models predict.[298] Akerlof's markets for lemons suggests that a market for used cars will not survive if the dealers know a great deal more about cars than buyers.[299] His model is frequently deployed as a rationale for a variety of interventions in the market for corporate governance.[300] But used car dealers do, in fact, know a great deal more about the cars on their lots than the average customer, and yet, the used car market continues to flourish.[301] The market has apparently found solutions to the problem without mandated disclosure and independent parties supervising it. Instead, the market has developed mechanisms to solve the problem, such as the dealer's need to develop a good reputation, her use of warranties and refund policies, the buyer's use of third-party sources of information, and the review of specific cars by outside experts (either third party services or the purchaser's more knowledgeable friends).[302]

298. For example, quasi-monopolies work better than simple versions of economic theory predicts. Megan McArdle, *The War of Amazon, Apple and Other Near-Monopolies*, BLOOMBERG (Oct. 1, 2015), https://www.bloomberg.com/opinion/articles/2015-10-01/the-war-of-amazon-apple-and-other-near-monopolies [https://perma.cc/J5SB-4UCD]; Michael Hirsh, *Big Talk on Big Tech—But Little Action*, FOREIGN POL'Y (Apr. 6, 2021), https://foreignpolicy.com/2021/04/06/big-tech-regulation-facebook-google-amazon-us-eu/ [https://perma.cc/CAA7-4JXQ]. Externalities are also much less of a problem than is generally assumed so long as market participants can act on adjusted expectations. Donald J. Boudreaux & Roger Meiners, *Externality: Origins and Classifications*, 59 NAT. RES.RES. J. 1, 24–28 (2019). Recent research supporting markets' resilience is provided by looking at the impact of the market-focused 1990s-era reforms often referred to as the "Washington Consensus." Grier & Grier, *supra* note 188; Easterly, *supra* note 186.

299. George A. Akerlof, *The Market for "Lemons:" Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECONOMICS 488 (1970).

300. *See*, *e.g.*, Dale Arthur Oesterle, *The Inexorable March Toward a Continuous Disclosure Requirement for Publicly Traded Corporations: "Are We There Yet?"*, 20 CARDOZO L. REV. 135 (1998); Kai Werner, *Justifying Mandatory Disclosure in Contemporary U.S.-Securities Regulation*, 2008 FREILAW: FREIBURG L. STUDENTS J. 1 (2008); Steven E. Kaplan, Pamela B. Roush & Linda Thorne, *Andersen and the Market for Lemons in Audit Reports*, 70 J. BUS. ETHICS 363 (2007).

301. JAMES M. LACKO, PRODUCT QUALITY AND INFORMATION IN THE USED CAR MARKET, FED. TRADE COMM'N (1986), https://www.ftc.gov/sites/default/files/documents/reports/product-quality-information-used-car-market/231975.pdf [https://perma.cc/M2MY-ZMUY] (finding that the asymmetric information possessed by dealers has no impact on used cars less than eight years old and cars more than eight years old bought from a dealer are actually ranked higher than those purchased, for example, from members of the public through an advertisement).

302. For a discussion of how markets facilitate transactions in environments with asymmetric information, see e.g., James A. Brickley, Clifford W. Smith, Jr. & Jerold L. Zimmerman, *Business Ethics and Organizational*

It is tempting to look at these solutions as terribly inefficient. Wouldn't mandatory disclosure be more efficient in producing net positive wealth outcomes? Maybe, —though the outcomes produced by mandating independent directors should give us pause.[303] Even if there was a net gain in efficiency, what would be lost? The dealer and the used car purchaser would have many fewer interactions. The dealer would not need to engage in community activities to demonstrate her trustworthiness. She would not need to support children's sports teams to signal her commitment to building a long-term reputation in the community. Indeed, her reputation for integrity would be significantly less important to everyone, including herself. The buyer, for his part, would not need to talk to friends and acquaintances about the car to get a sense of its reliability and value. There would be no need for trusted third-party sources of information. The pro-social, cooperative behavior that markets require—the trusting and being trustworthy—would be eliminated. Maybe a mandatory disclosure regime would still be worthwhile, but it isn't a straightforward decision produced by an economic model.

VI. THE DECLINE OF THE GOVERNANCE MARKET

Parts III and IV explored the introduction of wealth maximization norms into corporate law, and how that involved two simultaneous moves. First, it introduced considerations that were foreign to traditional corporate law, which was historically not interested in efficiency per se. Second, it shifted corporate law's purpose from facilitating ex ante market behavior to maximizing ex post returns.

Evidence that these moves adversely impact governance market activity is necessarily indirect, but it is visible almost everywhere. First, market actors regularly tell us that they hold aspects of the new market for governance in low regard. In a typical, recent survey of directors, more than half of them expressed skepticism about various trending governance practices.[304] Almost every time a new governance practice is introduced by regulation or

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Architecture, 26 J. BANKING & FIN. 1821 (2002) (discussing the ways third parties provide information in support of market transactions); Paul R. Milgrom, Douglass C. North & Barry R. Weingast, *The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs*, 2 ECON. & POL. 1 (1990) (discussing the role of reputation in facilitating markets); Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981) (discussing how investment in advertising and corporate brands provides incentives supporting market transactions); Paul Resnick et al., *The Value of Reputation on eBay: A Controlled Experiment*, 9 EXPERIMENTAL ECON. 79 (2006) (showing how customer rating schemes facilitate transactions).

303. Also giving us pause is the paucity of evidence that mandatory securities disclosure has price effects. For demonstrations of the lack of evidence on this issue, see for example, George J. Stigler, *Public Regulation of the Securities Markets*, 19 BUS. LAW. 721 (1964); Gregg A. Jarrell, *The Economic Effects of Federal Regulation of the Market for New Securities Issues*, 24 J.L. & ECON. 613 (1981); Carol J. Simon, *The Effect of the 1933 Securities Act on Investor Information and the Performance of New Issues*, 79 AM. ECON. REV. 295 (1989); Luis F. Moreno Trevino, *Access to U.S. Capital Markets for Foreign Issuers: Rule 144A Private Placements*, 16 HOUS. J. INT'L L. 159, 195 (1993); Elisabeth de Fontenay, *Do the Securities Laws Matter? The Rise of the Leveraged Loan Market*, 39 J. CORP. L. 725 (2014).

304. *See*, *e.g.*, *PwC's 2016 Annual Corporate Directors Survey*, GOVERNANCE INSIGHTS CTR., PWC (2016), https://www.pwc.com/us/en/corporate-governance/annual-corporate-directors-survey/assets/pwc-2016-annual-corporate-directors-survey.pdf [https://perma.cc/L7N7-M9W9]. Fifty-nine percent of directors ranked diversity considerations not "very important." *Id.* at 4. 66% expressed some concern about proxy access. *Id.* at 9. 65% don't believe in mandatory retirement policies and 90% oppose term limits. *Id.* at 10. Only small minorities have

through the agency of powerful third parties, directors and other market actors express skepticism about the change.[305] Even the firms' professional advisors, who are paid to assist boards with evolving governance practices, express skepticism about the trajectory of governance changes.[306] The best evidence we have suggests that boards of directors are dragged into new governance arrangements that they do not regard as in the company's best interests.[307] They may be biased or wrong, but the people most familiar with the company are generally unconvinced. One striking finding is that governance practices are now adopted by companies even when the managers and directors are aware, as demonstrated by insider share sales, that it will be value-destroying.[308]

A second sign that the market for governance has been adversely affected is that the governance arrangements of firms, with very different issues and challenges have come to resemble one another in almost every way. The process described by Easterbrook and Fischel, in which the governance arrangements of a corporation evolved through market bargaining is nowhere in evidence. We currently live in a world of one-size-fits-all

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a high regard for dialogue with shareholders. *Id.* at 11. 96% of directors believe activists are too focused on the short-term. *Id.* at 14. 93% believe proxy advisors have too much power. *Id.* at 14. 57% feel shareholders have too much say in governance. *Id.* at 14. Less than half of the directors indicated their boards acted on their annual board self-evaluations. *Id.* at 18. A majority don't believe risk committees are useful. *Id.* at 29. 72% don't believe say-on-pay has reduced executive compensation levels. *Id.* at 33. An earlier study found that a variety of governance best practices typically supported by more than 75% of polled investors failed to get support from even 25% of directors. *What Matters in the Boardroom: Director and Investor Views on Trends Shaping Governance and the Board of the Future*, PwC (2014), https://www.pwc.pl/pl/pdf/forum-rad-nadzorczych/pwc-what-matters-in-the-boardroom-director-investor-views.pdf [https://perma.cc/M93K-WZZ8].

305. *See*, *e.g.*, Silvia Ascarelli, *Corporate Europe Is Skeptical About Tougher Governance Codes*, WALL ST. J. (Oct. 7, 2004), https://www.wsj.com/articles/SB109710683845238701 [https://perma.cc/N98K-3JH7]; Beckey Bright, *Investors Are Skeptical of Success of Sarbanes-Oxley, Poll Finds*, WALL ST. J. (Oct. 14, 2005), https://www.wsj.com/articles/SB112912865268466716 [https://perma.cc/H8TN-S45X].

306. Carol Liao, *A Canadian Model of Corporate Governance*, 37 DALHOUSIE L.J. 559 (2014).

307. *See., e.g.*, Ctr. for Cap. Mkt., Comment Letter on the Proxy Advisory Services Roundtable File No 4-670 (Feb. 24, 2014), https://www.sec.gov/comments/4-670/4670-12.pdf [https://perma.cc/EMU7-LFG4]; Comment Letter on Issues Raised at the Proxy Advisory Firm Roundtable (Jan. 10, 2014), https://www.sec.gov/comments/4-670/4670-11.pdf [https://perma.cc/PF4G-4S8J]; NASDAQ OMX, Comment Letter on Proxy Advisory Firm Roundtable File Number 4-670 (Dec. 4, 2013), https://www.sec.gov/comments/4-670/4670-8.pdf [https://perma.cc/8WZU-79NZ]; Kerry Shannon Burke, *Regulating Corporate Governance Through the Market: Comparing the Approaches of the United States, Canada and the United Kingdom*, 27 J. CORP. L. 341 (2002) (The United Kingdom and Canada refuse to follow United States-style corporate governance rules); *see also*, Sanjai Bhagat, Brain Bolton & Roberta Romano, *The Promise and Peril of Corporate Governance Indices*, 108 COLUM. L. REV. 1803 (2008) (noting that Sarbanes-Oxley style governance rules are alien, even in the U.S. tradition).

308. David F. Larker, Allan L. McCall & Gaizka Ormazabal, *Proxy Advisory Firms and Stock Option Repricing*, 56 J. ACCT. & ECON. 146 (2013); *see also* David F. Larket, Allan L. McCall & Brian Tayan, *The Influence of Proxy Advisory Firm Voting Recommendations on Say-on-Pay Votes and Executive Compensation Decisions*, CONF. BD. 4 (Mar. 2012), https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survey-2012-proxy-voting_0.pdf [https://perma.cc/KLE2-JXPP]; Matt Bloom & George T. Milkovich, *Relationships Among Risk, Incentive Pay, and Organizational Performance*, 41 ACAD. MGMT. J. 283 (1998) (results of the study found that higher-risk firms relying on incentive pay of the sort preferred by the governance industry performed more poorly than higher-risk firms that did not emphasize incentive pay); Young H. Baek & Jose A. Pagan, *Executive Compensation and Corporate Production Efficiency: A Stochastic Frontier Approach*, 41 Q.J. BUS. & ECON. 27 (2002); David F. Larcker, Allan L. McCall & Gaizka Ormazabal, *Outsourcing Shareholder Voting to Proxy Advisory Firms*, 58 J. L. & ECON. 173, 176, 203 (2015) ("[The] policies of the proxy advisory firms . . . induce the boards of directors to make compensation decisions that decrease shareholder value.").

corporate governance.[309] This might be unproblematic if the monoculture imposed by regulators and proxy advisors was best for every company. We now have sufficient empirical research to say that this is not true.[310]

We can summarize the first two points as follows: directors do not generally regard new governance practices as valuable to their firms, but they nevertheless feel compelled to adopt them regardless of their idiosyncratic circumstances, and subsequent empirical research strongly suggests the directors' original skepticism is usually correct.[311]

The third piece of evidence that the market for governance is not working as it once did is the absence of experimentation in governance arrangements.[312] Of course, this is implicit in the development of a homogeneous governance system across firms, but it is visible in other ways. The most dramatic American experiments in corporate governance currently underway involve firms legally organized as "benefit corporations" or "social enterprise corporations."[313] None of these companies have entered the public stock markets where the governance monoculture exists.[314] There are a couple public companies certified as "B-Corps" (Etsy[315] and Laureate Education), but that is only *a couple* out of nearly 2000 privately held B-Corps that choose to remain private—including prominent names like Patagonia, Method, and New Belgium Brewing.[316] In the case of Etsy, originally organized

309. *See, e.g.*, Joseph A. McCahery & Erik P.M. Vermeulen, *Understanding the Board of Directors After the Financial Crisis: Some Lessons for Europe*, 41 J.L. & SOC'Y 121, 131 (2014) ("[T]he fear of inadvertently 'shirking' the risk oversight responsibilities (which could result in reputational damage and imprisonment) has resulted in a short-term, check-the-box mentality."); Richard Bozec & Mohamed Dia, *Convergence of Corporate Governance Practices in the Post-Enron Period: Behavioural Transformation or Box-Checking Exercise?*, 12 CORP. GOVERNANCE 243 (2012) (finding the convergence in corporate governance appears to be the result of box-checking exercises rather than substantive consideration of the merits); SPENCER STUART, *supra* note 258, at 15–18. Even ISS deprecates what it calls "one-size-fits-all approaches, though that it is what it imposes on firms." *See* Tingle, *Bad Company*, *supra* note 275, at 738–44.

310. Tingle, *Best Practices*, *supra* note 274; Tingle, *Can We Measure*, *supra* note 271; Tingle, *supra* note 271; Tingle, *Framed*, *supra* note 274; Tingle, *Bad Company*, *supra* note 275.

311. *See*, *e.g.*, Sridhar R. Arcot & Valentina G. Bruno, *One Size Does Not Fit All, After All: Evidence from Corporate Governance*, 1ST ANN. CONF. EMPIRICAL LEGAL STUD. (2007) (finding companies that default from consensus corporate governance structures in the United Kingdom outperform peers); Jeffrey L. Coles, Naveen D. Daniel & Lalitha Naveen, *Boards: Does One Size Fit All?*, 87 J. FIN. ECON. 329 (2008); Onur Kemal Tosun, *Changes in Corporate Governance: Externally Dictated vs Voluntarily Determined*, 73 INT'L REV. FIN. ANALYSIS 101, 608 (2021).

312. Robert B. Thompson, *Why New Corporate Law Arises: Implications for the 21st Century*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019) (innovation in corporate governance is now rare).

313. Carol Liao, *A Critical Canadian Perspective on the Benefit Corporation*, 40 SEATTLE U. L. REV. 683 (2017); Carol Liao, *Corporate Governance Reform for the 21st Century: A Critical Reassessment of the Shareholder Primacy Model*, 43 OTTAWA L. REV. 187 (2011).

314. Brett H. McDonnell, *Benefit Corporations and Public Markets: First Experiments and Next Steps*, 40 SEATTLE U. L. REV. 717, 724–25 (2017).

315. *See* Stephen Gandel, *This Is the Worst Performing IPO of 2015*, FORTUNE (June 8, 2015), https://fortune.com/2015/06/08/etsy-ipo-worst-2015/ [https://perma.cc/PPM3-RBJ7] (Etsy was not welcomed by the public markets, and Fortune dubbed it "the worst performing IPO of 2015").

316. Alana Semuels, *Rampant Consumerism Is Not Attractive. Patagonia Is Climbing to the Top——and Reimagining Capitalism Along the Way*, TIME (Sept. 23, 2019), https://time.com/5684011/patagonia/ [https://perma.cc/3CJR-DHZ7]; Dennis Lomonaco, *Be Nice or Leave: The Pragmatic Case for B-Corps*, FORBES (Jan. 22, 2018), https://www.forbes.com/sites/forbesagencycouncil/2018/01/22/be-nice-or-leave-the-pragmatic-case-for-b-corps/?sh=70769b2d4621 [https://perma.cc/X63R-36TL]; Jena McGregor, *What Esty, Patagonia and*

as a benefit corporation, an encounter with hedge fund activists after it went public resulted in the immediate loss of its CEO, then the abandonment of its B Corp certification, and finally any claim to possessing a distinctive corporate governance structure.[317] This is how monocultures are created.

Even highly-popular novel corporate forms find themselves forced to follow the blueprint of our homogeneous governance system if they go public. The most popular form of new business entity in the United States is the LLC.[318] One reason for its popularity is the freedom it provides to experiment with new corporate governance arrangements, even permitting the elimination of the fiduciary duty.[319] In one representative year, more than three times as many Delaware LLCs were formed than corporations.[320] Only a handful of these firms have chosen to enter the public markets, however.[321] Of those that have entered the public markets, all but a tiny minority have brought their arrangements into something roughly resembling the governance market consensus.[322]

The fourth piece of evidence that the governance market for widely-held corporations is broken is the conspicuous unwillingness on the part of corporations to enter the market.[323] American public markets have lost approximately half of the companies they possessed in 2000.[324] Canada's TSX and the United Kingdom's LSE have experienced similar declines over the same period.[325] In both cases, the evidence strongly suggests that the problem is caused mainly by the reluctance of new firms to go public. In America, new listings for the past two decades have averaged less than one-third of the total number of companies that went public in an average year between 1980 and 2000.[326]

Warby Parker Have in Common, WASH. POST (Apr. 20, 2015), https://www.washingtonpost.com/news/on-leadership/wp/2015/04/20/what-etsy-patagonia-and-warby-parker-have-in-common/ [https://perma.cc/G47Z-E9NF].

317. STEPHEN M. BAINBRIDGE, THE PROFIT MOTIVE: DEFENDING SHAREHOLDER VALUE MAXIMIZATION 164–65 (2023).

318. Rodney D. Chrisman, *LLCs are the New King of The Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States Between 2004–2007 and How LLCs Were Taxed for Tax Years 2002–2006*, 15 FORDHAM J. CORP. & FIN. L. 459, 459–60 (2009) ("The limited liability company . . . is now undeniably the most popular form of new business entity in the United States.").

319. Paul M. Altman, Elisa Erlenbach Maas & Michael P. Maxwell, *Eliminating Fiduciary Duty Uncertainty: The Benefits of Effectively Modifying Fiduciary Duties in Delaware LLC Agreements*, AM. BAR ASS'N: BUS. L. TODAY (Feb. 28, 2013), https://www.rlf.com/wp-content/uploads/2020/05/6930_Altman-Maas-Maxwell-0213.pdf [https://perma.cc/R7FJ-AQMT].

320. Winnifred A. Lewis, *Waiving Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 82 FORDHAM L. REV. 1017, 1020 n. 32 (2013).

321. *See generally* Suren Gomtsian, *The Governance of Publicly Traded Limited Liability Companies*, 40 DEL. J. CORP. L. 207 (2015).

322. *Id.* (noting that of the 20 public LLCs that existed in 2013, only 3 had eliminated the fiduciary duty and 16 created conflict-of-interest rules for managers).

323. *See* Craig Doidge, Andrew Karolyi & René M. Stulz, *The U.S. Listing Gap*, 123 J. FIN. ECON. 464 (2017) (stating that "the U.S. now has abnormally few listed firms given its level of development and the quality of its institutions").

324. Tingle & Pandes, *supra* note 257, at 9; Bryce C. Tingle, J. Ari Pandes & Michael J. Robinson, *The IPO Market in Canada: What a Comparison with the United States Tells Us About a Global Problem*, 54 CAN. BUS. L.J. 321, 327–28 (2013) [hereinafter Tingle, *IPO Market*].

325. Tingle & Pandes, *supra* note 257, at 5–6; JOHN KAY, THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION MAKING 24 (2012).

326. Jay R. Ritter, *Re-Energizing the IPO Market*, *in* RESTRUCTURING TO SPEED ECONOMIC RECOVERY (2013).

A reluctance on the part of potential participants to enter a market is the most direct evidence that the market is damaged.[327] I have argued elsewhere that the prominent alternative explanations for the collapse in the IPO market have difficulty accounting for the facts in a single country and completely fail to explain why the collapse is occurring across many different countries.[328] Britain and Canada avoided the worst of the Sarbanes-Oxley era regulation. They have different market structures and different industries dominate their listings, but they have virtually identical governance regimes as the United States, and they are experiencing identical declines.[329]

Corporate managers are clear that one of the main reasons they try not to go public is to avoid the governance market we have created over the past thirty years.[330] They prefer private markets. This isn't because managers have less oversight in the private markets; the reverse is generally the case. Private equity funds, venture capitalists, and angel investors all tend to sit on private company boards and negotiate for extensive control rights.[331] It is unlikely that executives prefer private markets because they can avoid exposing matters to shareholder scrutiny.[332] Rather, it is the quality, not the quantity, of shareholder oversight that distinguishes a VC appointing a sizable minority of the board from its public market-facing institutional investor counterpart that, by contrast, knows little about the company and bases its governance decisions on proxy advisor recommendations or the arguments of short-term activists.

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327. HAERINGER, *supra* note 8, at 4 (describing the need for market "thickness"). Public markets have, notionally, some advantages over private markets which should not leave us sanguine about their decline. They are more efficient at price discovery (because they allow shorts); they provide an exit for some various private market actors while allowing others to remain in the company; they historically allow longer term business plans (private market investments have a targeted term of around five years); they facilitate greater diversity and competition (as the main alternative exit for a private investment is a sale to a larger industry competitor); they provide the information that benchmarks even private investments, and they permit citizens to understand what is going on with America's most important and powerful institutions.

328. Tingle, Pandes & Robinson, *IPO Market*, *supra* note 324; Tingle & Pandes, *supra* note 257.

329. Tingle & Pandes, *supra* note 257.

330. Louis Daniel Wilson, Can Regulatory Reform Reverse the Decline of Public Markets in Canada? Assessing the Factors Impacting Decisions by Corporate Leaders to Avoid Canadian Public Listings (Mar. 30, 2020) (Ph.D. dissertation, Western University); Tingle & Pandes, *supra* note 257; Tingle, *IPO Market*, *supra* note 324; Patrick Galleher, *Why More Business are Choosing to Stay Private*, FORBES (Feb. 26, 2020), https://www.forbes.com/sites/forbesfinancecouncil/2020/02/26/why-more-businesses-are-choosing-to-stay-private/?sh=4e19fcd76400 [https://perma.cc/RCS9-7M3C] ("Private companies are also not beholden to the whims of shareholders."); Udeni Salmon, *Why Are Companies Choosing to Steer Clear of Public Markets?*, CONVERSATION (July 4, 2017), https://theconversation.com/why-are-companies-choosing-to-steer-clear-of-public-markets-79557 [https://perma.cc/XQZ6-S59J] (discussing the ways staying private allows executives to avoid elements of our current governance regime); Sean Silcoff, *Private is the New Public: The Problem with Tech Stars Chasing Private Money as They Don't File IPOs*, GLOBE & MAIL (Jan. 10, 2020), https://www.theglobeandmail.com/business/technology/article-private-is-the-new-public-the-problem-with-tech-stars-chasing-private/ [https://perma.cc/KH24-XWK8] (which includes the typical observations that "[n]obody wants to deal with the public markets anymore," "avoided costs and the burdens of public reporting and the steady barrage of questions from investors and analysts," and "there are the shareholder activists who often dog public companies").

331. *See generally* BRYCE C. TINGLE, START UP AND GROWTH COMPANIES IN CANADA, A GUIDE TO LEGAL AND BUSINESS PRACTICE (3d ed. 2018).

332. *See, e.g.*, Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L. J. 445, 462 (2017) (making this claim).

The quality of governance is higher for private firms because the governance market for these firms largely continues to exist intact. Michael Dell wrote an op-ed in the Wall Street Journal a year after he took Dell out of the public markets in which he claimed, "Privatization has unleashed the passion of our team members who have the freedom to focus first on innovating for customers in a way that was not always possible when striving to meet the quarterly demands of Wall Street."[333] By 2018, Dell was worth nearly triple what it had been the day it left the public markets five years earlier.[334]

Private companies are generally free to select the aims, board composition, legal structures, and voting arrangements that they want. Academics who study the private governance market emphasize that "a corporate governance framework for non-listed companies is highly contractual in nature."[335] Constituencies that form around private firms can still bargain ex ante, "to improve their governance structure and maximize the value of their investment."[336] Researchers find, for example, that going private leads to significant increases in long-term innovation.[337] They also find evidence that, to the extent they can be isolated statistically, the corporate governance arrangements of private firms lead to superior operating performance compared to public peers.[338]

When U.S. companies do go public, they often have non-conforming governance arrangements. For example, they are much more likely to have interlocking directorships[339] and are much more likely to have "busy" or "overboarded" directors.[340] These heterogenous corporate governance arrangements persist even in the context of the going public transaction in which companies have "every incentive to adopt governance structures that appeal to outside investors."[341] For their part, the companies that choose to

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333. Michael Dell, *Going Private Is Paying Off for Dell*, WALL ST. J. (Nov. 24, 2014), https://www.wsj.com/articles/michael-dell-going-private-is-paying-off-for-dell-1416872851 [https://perma.cc/F9CU-7DLV].

334. Chaim Gartenberg, *Rise of Enterprise: How Michael Dell Played the Game and Saved His Company from the Brink*, THE VERGE (Aug. 13, 2018), https://www.theverge.com/2018/8/13/17644234/michael-dell-enterprise-technology-consumer-laptop-private-public-emc [https://perma.cc/6SB5-L82B]; Guadalupe Gonzalez, *5 Years After $24.4 Billion Deal to Go Private, Dell Will Become a Public Company Again*, INC (Dec. 12, 2018), https://www.inc.com/guadalupe-gonzalez/michael-dell-takes-company-public-again.html [https://perma.cc/BE4N-Z222]. Some of this growth may be due to a lower than fair market price being paid in the going private transaction. Connie Guglielmo, *Dell Officially Goes Private: Inside the Nastiest Tech Buyout Ever*, FORBES (Oct. 30, 2013), https://www.forbes.com/sites/connieguglielmo/2013/10/30/you-wont-have-michael-dell-to-kick-around-anymore/?sh=304787e42a9b [https://perma.cc/5GRT-SRUA].

335. *See, e.g.*, JOSEPH A. MCCAHERY & ERIK P.M. VERMEULEN, CORPORATE GOVERNANCE OF NON-LISTED COMPANIES 8 (2008).

336. *Id.* at 144.

337. Josh Lerner, Morten Sorensen & Per Strömberg, *Private Equity and Long-Run Investment: The Case of Innovation*, 66 J. FIN. 445 (2011).

338. Viral V. Acharya et al., *Corporate Governance and Value Creation: Evidence from Private Equity*, 26 REV. FIN. STUD. 368 (2013).

339. David F. Larcker, Eric C. So & Charles C.Y. Wang, *Boardroom Centrality and Firm Performance*, 55 J. ACCT. & ECON. 225 (2013).

340. Laura Field, Michelle Lowry & Anahit Mkrtchyan, *Are Busy Boards Detrimental?*, 109 J. FIN. ECON. 63, 67 (2013).

341. Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 802 (2007); *see also* Richard J. Sandler & Joseph A. Hall, *Corporate Governance Practices in US Initial Public Offerings*, CONF. BD. (Apr. 2014), https://www.davispolk.com/files/sandler.hall_.directors.notes_.article.apr14.PDF [https://perma.cc/HQ2R-H44V] ("The fact that companies appear largely isolated from these [governance]

leave the public markets are often the ones apparently resisting the imposition of some new governance practices such as splitting the CEO and Chair roles.[342]

The really noteworthy fact, however, is that new entrants to the public markets try to adopt structures that will permit them to escape the governance aspects of those markets. The most dramatic method is to list with dual-class shares.[343] More than a quarter of new firms now list with multiple classes of stock possessing unequal voting rights.[344] The percentage of companies using this approach to stave off the governance market has more than doubled in the last decade.[345] Companies with dual-class share structures include Google, Facebook, LinkedIn, Yelp, Kayak, and Zillow.

Dual class share structures aren't the only way for new market entrants to try to escape the governance market. Most of the other structures designed to preserve board independence from outside pressure are deployed by companies going public. In 2018, only 8% of the S&P 500 had a classified board,[346] but 90% of IPO companies had one.[347] 89% of large public companies had adopted majority voting policies,[348] but only 6% of IPO firms followed suit.[349] Roughly 40% of large public companies prohibit shareholders from calling a special meeting,[350] but 84% of IPO companies go public with this prohibition.[351] This is exactly what it looks like: new entrants to our public markets trying to keep themselves free from the current corporate governance regime.

Even if they stay in the public markets, boards try hard to retain their historic discretion over corporate decisions. Whatever they might say, the opinions of managers must be discerned by their behavior, and, whenever possible, they have a clear tendency to structure the corporation's affairs so as to avoid the cost, uncertainty, and delay of, for

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concerns at IPO time once again raises questions about the strength of the link between corporate governance 'best practices' and perceptions of shareholder value.").

342. Charlie Weir, David Laing & Mike Wright, *Incentive Effects, Monitoring Mechanisms and The Market for Corporate Control: An Analysis of the Factors Affecting Public to Private Transactions in the U.K.*, 32 J. BUS. FIN. & ACCT. 909 (2005) (finding, for example, that companies that choose to go private are less likely to have previously separated the functions of CEO and board chair in response to evolving best practices); *see generally* Xi Wu, SEC Regulations and Firms (2020) (Ph.D. dissertation, New York University) (ProQuest) (finding increases in SEC regulation pushes companies out of the public markets).

343. *See, e.g.*, Dhruv Aggarwal et al., *The Rise of Dual-Class Stock IPOs*, 144 J. FIN. ECON. 122 (2022); Paul Gompers, Joy Ishii & Andrew Metrick, *Incentives vs. Control: An Analysis of U.S. Dual-Class Companies* (Nat'l Bureau Econ. Rsch., Working Paper No. 10240, 2004); Lund & Pollman, *supra* note 254, at 49 (discussing the ways dual-class stock has been used to advance different legitimate business interests for the past century).

344. *Corporate Governance Practices in US Initial Public Offerings (Excluding Controlled Companies)*, DAVIS POLK 3 (2018), https://www.davispolk.com/files/2018_non-controlled_ipo_survey.7.9.2018.pdf [https://perma.cc/W7MK-EGJ5].

345. *Id.*; Lynn A. Stout, *On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialism (in the Closet)*, 36 SEATTLE U. L. REV. 1169, 1182 (2013).

346. SPENCER STUART, 2018 UNITED STATES SPENCER STUART BOARD INDEX 15 (2018).

347. DAVIS POLK, *supra* note 344, at 2. This echoes the prevalence of poison pills among earlier generations of IPO companies. *See also* Michael Klausner, *Institutional Shareholders, Private Equity, and Antitakeover Protection at the IPO Stage*, 152 U. PA. L. REV. 755 (2003).

348. SPENCER STUART, *supra* note 346, at 15.

349. DAVIS POLK, *supra* note 344, at 2; Sandler & Hall, *supra* note 341, at 4.

350. Colin J. Diamond, Michelle Rutta & Danielle Herrick, *Reminders for US Public Companies for the 2019 Annual Reporting and Proxy Season*, WHITE & CASE (Dec. 5, 2018), https://www.whitecase.com/publications/alert/reminders-us-public-companies-2019-annual-reporting-and-proxy-season [https://perma.cc/2C3F-2MCQ].

351. DAVIS POLK, *supra* note 344, at 15.

example, a shareholder vote.[352] Research in Australia and the United States finds that companies structure their private placements to avoid crossing a threshold that would lead to a special shareholder meeting.[353] When the stock exchange rules in Australia changed the threshold from 10% to 15% of outstanding shares, private placements changed in size from new issuances falling just below the 10% threshold to new issuances falling just below 15%. Among other things, this suggests that companies under the earlier regime were deliberately raising less capital than they required just to avoid a shareholder vote. Corporate managers similarly try to avoid shareholder votes in the merger context even though in practice these votes are overwhelmingly supportive.[354]

When evaluating why boards no longer take their companies public it is important to keep in mind that, outside of the dysfunction in the governance market, the economic incentives provided by the public markets remain intact. Listed companies have generally been awarded higher valuations than they ever received in the previous century. Public companies are also now paying directors and executives more than ever before.[355] Executive pay as a percentage of corporate profits is now twice as high as it was in 1990.[356] It is only the governance aspects of the public markets that have grown less appealing. As Professor Steven Kaplan observes succinctly, "We've made it miserable to be a public company."[357]

VII. CONCLUSION

Ethical philosopher Sissela Bok once observed that "whatever matters to human beings, trust is the atmosphere in which it thrives."[358] This is certainly true of corporations, where multiple empirical studies find trust associated with the kind of large firms essential

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352. STEPHEN M. BAINBRIDGE, MERGERS AND ACQUISITIONS 56 (3d ed. 2012) ("[A]voiding shareholder voting is the goal of most transaction planners most of the time.").

353. James L. Park, Equity Issuance, Distress, and Agency Problems: The 20% Rule for Privately Issued Equity (Mar. 12, 2014) (dissertation, Korea University); Jun-Koo Kang & James L. Park, *Private Placements of Equity and Firm Value: Value Enhancing or Value Destroying?*, 56 J. FIN. & QUANTITATIVE ANALYSIS 2072 (2021); Howard Wei-Hong Chan & Rob Brown, *Rights Issues Versus Placements in Australia: Regulation or Choice?*, 22 CO. & SEC. L.J. 301, 304–10 (2004).

354. Mason et al., *Does Shareholder Voting Matter? Evidence from the Takeover Market*, 53 WAKE FOREST L. REV. 157, 170 (2018) (finding companies structure transactions to avoid shareholder votes and there is no difference in returns between these transactions and transactions where votes are held); Franklin A. Geuvurtz, *The Shareholder Approval Conundrum*, 60 B.C. L. REV. 1831, 1843 (2019) (shareholders approve mergers and sales by overwhelming margins); *see also* Yair Listokin, *Management Always Wins the Close Ones*, 10 AM. L. & ECON. REV. 159, 160 (2008) (describing how shareholder voting proposals do not always represent shareholder opinion).

355. Tingle, *Best Practices*, *supra* note 274, at 389–90; Tingle, *IPO Market*, *supra* note 324, at 337; Tingle, *Framed*, *supra* note 274, at 900.

356. Lawrence Mischel & Natalie Sabadish, *CEO Pay in 2012 Was Extraordinarily High Relative to Typical Workers and Other High Earners*, ECON. POL'Y INST. 4 (2013), https://files.epi.org/2013/ceo-pay-2012-extraordinarily-high.pdf [https://perma.cc/VU55-7ZWB].

357. Hal Weitzman, *Is the US Economy 'Going Dark'?*, CHI. BOOTH REV. (May 30, 2023), https://www.chicagobooth.edu/review/is-us-economy-going-dark#:~:text=%E2%80%9CThe%20that%20more%20capital,Herren%20Lee%20in%20October%202021 [https://perma.cc/V3JF-A6XS].

358. SISSELA BOK, LYING: MORAL CHOICE IN PUBLIC AND PRIVATE LIFE 31 (1999).

for economic growth.[359] Very few human institutions appear to produce trust at rates comparable to markets. Markets not only have positive effects on their participants, but they also provide a way of getting along in a pluralistic society, a modus vivendi that does not depend on agreement about fundamental things or a universal love that is usually the province only of saints.

Corporate law has always, at its core, been about facilitating markets. It created an entirely new scale for the crucial market behaviors of bargaining, experimentation, competition, and cooperation. The modern turn in corporate law of ignoring these ex ante market activities in favor of increasing efficiency is alien to the traditional normative and doctrinal structure of corporate law.

While wealth maximization provided corporate law scholars and regulators with a research agenda for more than 40 years, it also led to many regulatory and other interventions into the governance market, seriously damaging it. There is little evidence that today's widely-held firms' governance arrangements are the result of firm-specific bargaining or experimentation. The efficiency gains have proven elusive. The most concrete result is that fewer enterprises are interested in participating in the market at all.

Professor Guhan Subramanian recounts a story that parallels hundreds that may be found in business-related media over the past three decades.[360] A director attending a program at Harvard Business School mentioned that his board decided against hiring "a talented external candidate for CEO" because he would have required an above-market compensation package.[361] The directors agreed the candidate was the best match for what the company needed. They wanted to hire him and thought he was worth the additional pay. But, since the proxy advisors and institutional shareholders would have punished the board, they decided to hire someone else. This is what dumb corporate governance looks like.

A. Changing the Orientation of Corporate Law Scholarship

As the problem was initially created by a philosophical shift among academics towards accepting the normative case for wealth maximization, this intellectual shift needs to be reversed. Corporate law would improve if a great deal more scholarly activity was devoted to measuring the impact of various legal initiatives on ex ante market activities. In other words: would the reform in question bring more entrants into the market? Encourage bargaining and experimentation? Provide a basis for cooperation that would otherwise not occur? This means trusting the market to produce efficient outcomes, which shouldn't require insurmountable levels of faith. We have plenty of experience in other parts of the economy that inefficient market behaviors produce efficient outcomes.

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359. Rafael La Porta et al., *Trust in Large Organizations*, 87 AM. ECON. REV. 333, 334 (1997); Paul J. Zak & Stephen Knack, *Trust and Growth*, 111 ECON. J. 295, 297 (2001); Stephen Knack & Philip Keefer, *Does Social Capital Have an Economic Payoff? A Cross-Country Investigation*, 112 Q.J. ECON. 1251, 1260 (1997) (finding that trust is clearly related to economic growth); *see generally* Sanjay Banerjee, Norman E. Bowie & Carla Pavone, *An Ethical Analysis of the Trust Relationship*, *in* HANDBOOK OF TRUST RES. 303 (Reinhard Bachmann & Akbar Zaheer eds., 2006) (discussing the empirical research on the importance of trust for economic growth, including innovation).

360. Subramanian, *supra* note 268.

361. *Id.*

What would this look like in practice? A straightforward example is provided by the assumption that increasing shareholder power relative to managers will improve outcomes.[362] This is an aspect of what Professors Pollman and Lund refer to as "the corporate governance machine," a norm that operates in the background in such a way as to irresistibly convert all corporate governance proposals into measures to increase shareholder wealth.[363] The traditional critiques of new governance initiatives either consist of arguments that the proposed change will not deliver the promised improvement to shareholder wealth, or arguments that the proposal will disadvantage the outcomes experienced by other constituencies.

A concern for the condition of the governance market itself would lead us to instead ask whether the proposal will increase or diminish market activity. We currently have a public market in which there is no evident reluctance on the part of investors to participate. Indeed, these investors have been prepared to pay an increasingly large premium for companies in this market.[364] On the other hand, we see evidence of a considerable reluctance on the part of issuers to enter public markets, and those that do enter often engage in extraordinary legal efforts to escape shareholder power.[365] A concern for ex ante market conditions might lead us to ignore all the arguments about whether the new initiative will improve outcomes for some group, and instead lead us to decide the question on the basis of what is most likely to encourage, rather than discourage, new business entrants to the public markets.

Another example exists in the area of executive compensation. In this area, a concern for ex ante conditions might lead to evaluating whether an initiative that increases shareholder power will result in more or less bargaining and experimentation. The best evidence suggests that, we have created a compensation monoculture in which boards generally follow the best practices recommended by institutional shareholders, even when they believe they are not in the interests of the corporation.[366] Thus, we might conclude that reforms increasing shareholder power in this area are precisely the opposite direction that reforms should take. Instead, scholarly debate might consider what tweaks we can make to the current governance market to provide more room for experimentation and real bargaining between shareholders and directors around corporate compensation decisions. The discussions we have now in the public market bear no resemblance to the discussions that occur in the much healthier private market.

362. *See* Tingle, *Expressive Voting*, *supra* note 271 (discussing shareholder voting rights); Tingle, *Two Stories*, *supra* note 238 (discussing the role of shareholders).

363. Lund & Pollman, *supra* note 254 (discussing corporate governance).

364. Beth Kindig, *The IPO Glut of 2020: Why Valuations Have Gone Too Far*, FORBES (June 18, 2021), https://www.forbes.com/sites/bethkindig/2021/06/18/the-ipo-glut-of-2020-heres-why-valuations-have-gone-too-far/?sh=364f00465c2e [https://perma.cc/4CWX-VH6F]; Leonce L. Bargeron et al., *Why Do Private Acquirers Pay So Little Compared to Public Acquirers?*, 89 J. FIN. ECON. 375 (2008) (discussing shareholder premiums).

365. *See supra* notes 320–37 and accompanying text (discussing public markets).

366. Tingle, *Best Practices*, *supra* note 274 (discussing changes in best practices promoted by shareholders); Tingle, *Framed*, *supra* note 274 (discussing executive compensation); *see supra* text accompanying notes 353–54.

B. Regulatory Changes

Two regulatory initiatives stand out as relatively straightforward. First, regulators and stock exchanges should simply eliminate their regulations around corporate governance.[367] Nearly all of these rules—from independent directors, to board committees, to say-on-pay—don't improve outcomes, but do displace market activity. Given the social utility of the activities that make up the governance market for corporations, the only time a one-size-fits-all governance structure should be allowed is when there is an extensive body of empirical literature confidently suggesting material improvements in wealth outcomes. Corporate law needs to stop accepting market interventions where there is no such evidence,[368] where there is contradictory evidence,[369] or where the effects are minor at best.[370] All other reforms should be motivated by the goal of improving and increasing market bargaining, experimentation, and cooperation.

The second regulatory initiative would involve curbing the power of proxy advisory firms. These firms are the de facto regulators of corporate governance in America, and the best practices they impose on firms are seldom supported by empirical evidence.[371] A concern for markets would mean gradually adjusting the regulations around proxy advisors until we saw evidence of heterogeneity and experimentation once again in the governance market. In fact, the SEC may have begun this process.[372]

There is no such thing as a perfect market. The attraction of the wealth maximization norm was that it provided a bright-line test for reforms (though it is astonishing to what degree reforms' actual performance against this standard has been ignored). A concern for markets does not offer anything like this. It is a return to the common law tradition of

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367. For example, Canada's securities commissions once considered eliminating even the watered-down best practices recommended in response to Sarbanes-Oxley era reforms in the United States. *See* Ontario Securities Commission [OSC], *Request for Comment Proposed Repeal and Replacement of NP 58–201 Corp. Governance Guidelines, NI 58-101 Disclosure of Corp. Governance Practices, and NI 52–110 Audit Comm., and CP 52–110 CP Audit Committees* 31 OSCB 12158, (Dec. 19, 2008); Ontario Securities Commission [OSC], *Canadian Securities Administrators' Staff Notice 58–305—Status Report on the Proposed Changes to the Corporate Governance Regime* 32 OSCB 9347 (Nov. 13, 2009).

368. See *supra* text accompanying notes 283–93.

369. Bainbridge, *supra* note 279; Romano, *Quack Corporate Governance*, *supra* note 279 (discussing corporate finance initiatives through Congress).

370. An example is provided by Bebchuk et al., who argued for policies that made shareholder activism easier on the basis of research that, according to one measure, found activism produced negative long-term effects and on another measure found activism produced extremely minor positive long-term effects. *See* Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085 (2015). Subsequent research using the same data found significant negative effects when the targets of activist campaigns were matched with better controls. *See* Martijn Cremers et al., Hedge Fund Activism and Long-Term Firm Value 4–5 (unpublished manuscript), https://ccl.yale.edu/sites/default/files/files/leo16_Sepe.pdf [https://perma.cc/C8WN-QRBP]; *see also* Ed deHann, David Larcker & Charles McClure, *Long-Term Economic Consequences of Hedge Fund Activist Interventions*, 24 REV. ACCT. STUD. 536 (2019) (finding no evidence of post-activism performance improvements); Yvan Allaire & François Dauphin, *The Game of "Activist" Hedge Funds:* Cui Bono*?*, 13 INT'L J. DISCLOSURE & GOVERNANCE 279, 293–94 (2016) (also finding no evidence of performance improvements).

371. *See generally* discussion in Tingle, *Bad Company*, *supra* note 275 at 717–22 (discussing proxy advisory firms' influence over shareholders' voting decisions and its effects on directors).

372. SEC Staff Legal Bulletin No. 20 (IM/CF) (June 30, 2014). Similar calls for reform in the market for proxy advice have occurred from prominent voices in places like Canada. *See generally* ONTARIO CAP. MKTS. MODERNIZATION TASKFORCE, *supra* note 183.

muddling along, making incremental improvements with an eye to improving the condition of the market, so as to draw in ever more participants and to allow them to produce ever more ingenious arrangements amongst themselves.