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CORPORATE ACCOUNTABILITY AND REGULATORY REFORM

Robert B. Reich*

The corporate form of business organization has served as an efficient device for transforming the contributions of investors, creditors, workers, managers, and suppliers into products of greater value to consumers and then distributing that increase in wealth back to each contributor. This seemingly tidy arrangement belies a number of difficult questions. How should the costs and benefits of corporate activity be allocated among the contributors given the risks and costs that each bears? How should they be allocated to others affected by corporate activity, such as neighboring citizens who suffer from a contaminated environment or consumers who must choose between products of varying quality and price?

The costs and benefits of corporate activity often fall unevenly. It is commonly assumed, for example, that all parties benefit when innovative managers produce better products at lower cost. If the innovation creates pollution or toxic wastes, however, benefits come at the expense of neighboring citizens. If the innovation threatens the health or safety of employees, all other parties benefit at the employees’ expense. If it causes consumers to pay for repeated repair work or to contract cancer ten years after using the product, then consumers sacrifice their well-being for the benefit of other parties. If managers deceive shareholders into thinking that the corporation is more profitable than it is, shareholders subsidize everyone else. There are no generally accepted economic, political, or ethical criteria for deciding which of these interests should be preferred. Each “invests” in the enterprise by contributing venture capital, credit, labor, managerial talent, new ideas, or supplies, by living with noise or pollution, or by purchasing a final product. Therefore, each bears some risk for the sake of possible gain and no interest is inherently more deserving of a higher net rate of “return” on its investment in the enterprise than any other.

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How, then, are the costs and benefits of corporate enterprise to be allocated? In practice, the allocation has usually been determined by market exchanges through which these parties bargain with one another. Greater financial risks may require higher possible returns to motivate potential shareholders and bondholders to contribute capital; greater workplace risks may require hazardous-duty pay to attract workers; greater product risks may require money-back guarantees or discount prices to attract consumers; higher levels of noise or pollution may require lower real estate prices to attract home buyers. Such market exchanges are shaped by laws that define private property and establish rules for contracting between parties.

Increasingly, however, the allocation of corporate costs and benefits has been determined collectively through laws and regulations that set precise limits on industrial contamination, impose specific safety requirements on the workplace, establish minimum standards of product quality and safety, and impose a particular structure of corporate governance. Those who favor collective

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3. E.g., 40 C.F.R. §§ 405.10-126 (1979) (establishing effluent standards for dairy product processors); id. §§ 420.10-282 (establishing effluent standards for iron and steel manufacturers); 7 N.J. Admin. Code §§ 14:2.1-.7.6 (Supp. 1979) (establishing water pollution standards); id. §§ 27:2.1-.3.7 (establishing air quality standards).

4. E.g., 29 C.F.R. §§ 1915.1-1917.84 (1979) (establishing workplace safety requirements for shipbuilding, repairing, and breaking); 12 N.Y. Codes, Rules & Regs. §§ 10-1.1 to -4.8 (1963) (establishing workplace safety and health requirements for foundries); id. §§ 12.1-.29 (1971) (establishing standards for air quality in factories).


6. E.g., 16 C.F.R. § 1303 (1979) (banning lead-containing paint and certain consumer products bearing lead-containing paint); id. §§ 1615-1616 (establishing flammability standards for children's sleepwear); 6 N.Y. Codes, Rules & Regs. § 221.2 (1972) (banning surface-coat spray materials containing asbestos).

7. E.g., Cal. Corp. Code §§ 601-604 (West 1977 & Supp. 1979) (mandating shareholders' meetings and requiring shareholder consent to certain transactions);
decisionmaking contend, among other things, that market exchanges do not adequately protect people from entering into uninformed agreements that are against their better interest, that in market exchanges costs often fall upon innocent third parties who did not even tacitly agree to bear them, and that managers of large corporations possess discretionary power virtually unconstrained by the market. It is also argued that the resulting allocation of corporate costs and benefits within market exchanges is often unfair, even if efficient, and that no party should be financially induced to bear certain risks.

In contrast, those who advocate employing market exchanges instead of collective decisionmaking to allocate corporate costs and benefits, point out that legislatures normally are incapable of both developing the requisite expertise and negotiating the compromises necessary to enact detailed standards of corporate behavior.
Alternatively, administrative agencies, dependent on regulated industries for data and for future employment of agency personnel, are often incapable of maintaining an arm's-length relationship with the industries. Procedures designed to overcome this coziness by providing the public with the right to intervene in regulatory proceedings, gain access to agency records, observe agency deliberations, and challenge agency conclusions on appeal have resulted in agonizing delay and red tape. Many of these procedures are regularly employed by competitors seeking either a strategic advantage over rivals or a means of postponing administrative action. In addition, the regulations that emerge from this process are notoriously inefficient and uncoordinated, often undermining productivity and distorting markets.

Proposals for rendering the corporation more accountable to one or more affected parties, and for reforming the regulatory process to make it more politically accountable and efficient come as twin responses to these problems. Such proposals typically seek either to improve the functioning of market exchanges or to improve the processes of collective decisionmaking. For example, attempts to require corporations to disclose business or professional


18. E.g., Administrative Procedure Act § 10(a), 5 U.S.C. § 702 (1976); MICH. COMP. LAWS ANN. § 2.4-301 (Supp. 1979).


20. See C. SCHULTZE, supra note 13, at 46-57; Breyer, supra note 13, at 560-78.
relations between board members and the existence of standing audit and compensation committees,\(^1\) to have independent accountants certify the accuracy of the company's financial records,\(^2\) to have corporations disclose workplace\(^3\) and product risks,\(^4\) to strengthen antitrust laws,\(^5\) and to require corporations to either compensate third parties directly or purchase marketable permits if they pollute the environment\(^6\) all seek to improve the efficiency of market exchanges. They rely upon the decentralized price system and free trades between parties to determine an optimal level of cost and benefit for each party affected by corporate enterprise.

In contrast, attempts to require that a majority of board members be outsiders,\(^7\) that shareholders be permitted to vote cumula-

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23. E.g., Occupational Safety & Health Act § 6(b)(6)(A), 29 U.S.C. § 655(b)(6)(A) (1979) (requiring employers to give notice to employees of employer's inability to comply with OSHA standards and employer's request to OSHA for variance); id. § 6(b)(7), 29 U.S.C. § 655(b)(7) (requiring labels or other appropriate warnings to ensure that employees are informed of all hazards to which they are exposed); CAL. LAB. CODE § 6408 (West Supp. 1979) (requiring employers to post information regarding safety protections and obligations of employees, provide opportunity for employees or employee representatives to observe monitoring of employee exposure to hazards, allow access by employees or their representatives to accurate records of employee exposures to potentially toxic materials or harmful physical agents).
27. E.g., Hearings on Corporate Rights and Responsibilities Before the Senate Comm. on Commerce, 94th Cong., 2d Sess. 241, 246 (1976) (statement of Harvey Goldschmid, Prof. of Law, Columbia Univ.); id. at 338, 339 (statement of Detlev
tively for board members,\(^2\) that proxy machinery be made available to shareholders,\(^2\) that nonshareholding parties affected by corporate activity, such as workers, consumers, suppliers, and neighboring residents, also be represented on the board or be allowed to participate in the selection of board members,\(^3\) and that representatives of various interests be funded to participate in regulatory agency proceedings\(^3\) all seek to improve the efficiency of collective decisionmaking. They rely primarily upon negotiation and agreement—typically by a majority of participants—to determine how corporate costs and benefits should be allocated.

The corporate governance debate is primarily about how to allocate the costs and benefits of corporate activity among those affected by it. Proposals to reform the corporation run the gamut

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from market-perfecting strategies to methods of improving collective decisionmaking to demands for corporate altruism. What has been missing is a systematic analysis of these various proposals within a framework that allows them to be compared and evaluated. This Article seeks to provide such a framework. It offers a means of viewing the twin debates over regulatory reform and corporate accountability through the lens of economic and political analysis. From this perspective, the choice between market-perfecting strategies and proposals to improve collective decisionmaking turns largely on each alternative's relative efficiency in accommodating affected interests and approximating, however imperfectly, an allocation of corporate costs and benefits to which all affected parties would agree. While equity considerations figure prominently in political decisions about the corporation, this Article also suggests that corporate altruism, standing alone, may not be justifiable. The framework suggested here serves as only one of many possible starting points for discussing corporate accountability and regulatory reform. If I convince the reader of nothing more than that the host of proposals for reforming corporate governance and regulatory agencies can and should be viewed together as an integrated system of accountability, this Article will have succeeded.

**MARKET-PERFECTING STRATEGIES**

If all parties potentially affected by a proposed corporate activity could bargain with one another free from the cumbersome costs of transacting such bargains,\(^3^2\) and if all who stood to gain fully compensated those who stood to lose, the activity would, by definition, improve total welfare.\(^3^3\) Unanimous agreement to such a bargain would signal an improved allocation of corporate risks and benefits,\(^3^4\) to the extent that no one can be made better off without


\(^{33}\) Modern welfare economics is premised on the philosophic notion that overall welfare will be improved by any change pursuant to which those who gain can fully compensate those who lose and still come out ahead; actual compensation need not be undertaken. See Hicks, *The Foundations of Welfare Economics*, 49 ECON. J. 696 (1939); Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 ECON. J. 549 (1939). Unanimous agreement to a proposed change, therefore, is not a prerequisite to an improvement in overall welfare, but it at least provides an indication that an improvement has occurred since all potential losers from the change have acquiesced in it.

\(^{34}\) Alternative optimal conditions are possible. Optimality only describes a situation where it is impossible to improve any one party's condition without making
making someone else worse off to the same extent. Market exchanges would replicate such theoretical bargains if each party had (a) perfect information about whether its interests were being met by other parties; (b) alternative parties with whom it could deal as easily; and (c) costless means of organizing the market to avoid “free-riders,” who obtain the benefit of the bargain without sacrificing anything of their own; “hold-outs,” who can reap special advantages because their acquiescence to the bargain is necessary; and negative “externalities,” unaccounted for side-effects on third parties.

In the real world of imperfect information, market power, free-riders, hold-outs, and externalities, however, the costs of transacting such theoretically perfect bargains is often prohibitive. It is often difficult, if not impossible, to locate, inform, gain the assent of, coordinate, compensate, and police all parties potentially affected by an activity when many disparate individuals are involved. To the extent that these interests overlap, bargaining may occur automatically and informally. The self-sufficient island dweller can be expected to weigh the costs of a proposed activity against its benefits, and develop a strategy that maximizes benefits and minimizes costs. But the larger the number of individuals involved, the more costly such bargaining is likely to be. The question, therefore, is which institutional arrangements can best reduce these costs.

**Inadequate Information**

Information is costly to produce and to use. Even when all parties have an incentive to provide one another with truthful information, they will only convey such information when its utility for reaching more informed agreements does not exceed the costs

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of its production and use. Occasionally a party has no incentive to provide even this optimal amount of truthful information.\textsuperscript{37} Thus it may be difficult for parties to evaluate the performance of others with whom they deal, particularly when the market is large and complex. For example, annual reports to shareholders may mislead them about firm performance through the use of accounting techniques that are extraordinarily difficult for most shareholders to evaluate.\textsuperscript{38} Similarly, residents of areas in which toxic wastes are dumped may not learn of the dumping—or its effects—until many years later;\textsuperscript{39} workers may not be told of the hazardous nature of the chemicals or dust particles they breathe at the workplace;\textsuperscript{40} and consumers who suffer injuries as a consequence of product failure may have difficulty attributing the cause of the failure to the manufacturer.\textsuperscript{41}

A market-perfecting response to such ignorance would require the corporation to disclose this information. Labeling and advertising regulations of the Food and Drug Administration and Federal Trade Commission, for example, require that certain manufacturers disclose the contents\textsuperscript{42} and dangers\textsuperscript{43} of their products. The Secu-

\textsuperscript{37} Professor Engel argues that notwithstanding lack of guidance from market exchanges or collective decisionmaking, management has a social duty to alert the government to corporation-engendered risks about which citizens generally are unaware, so that collective decisionmaking within legislatures and regulatory agencies can be more efficient. Engle, An Approach to Corporate Social Responsibility, 32 STAN. L. REV. 1, 70-84 (1979).


\textsuperscript{39} Residents of the Love Canal of Niagara Falls, New York, discovered twenty years after industrial wastes were dumped in their midst that the wastes imperiled their health. INTERAGENCY TASK FORCE ON HAZARDOUS WASTES, N.Y. DEP’T OF ENVT’L CONSERVATION, HEARING OFFICER’S REPORT 27-28 (1979).

\textsuperscript{40} See generally J. PAGE & M. O’BRIEN, supra note 11, at 1-46.

\textsuperscript{41} See Reich, Toward a New Consumer Protection, 128 U. PA. L. REV. 1, 27-28 (1979). Moreover, the incidence of failure may be so small or geographically dispersed that most consumers remain unaware of the problem.

\textsuperscript{42} E.g., 21 C.F.R. § 701.3 (1979) (requiring cosmetics to list their ingredients). Cf. In re Ocean Spray Cranberries, Inc., 80 F.T.C. 975 (1972) (consent order that Ocean Spray would stop advertising their product as "juice" more nutritious than orange juice, and that it would devote twenty-five percent of one year’s advertising budget to clarifying prior advertisements that may have been misleading).

\textsuperscript{43} See sources note 24 supra.
ties and Exchange Commission likewise seeks to ensure that investors receive accurate and timely information about firms. Recent proposals by the Commission to require corporations to disclose facts about board members and board committees are also intended to reduce investors’ unforeseen risks. Similarly, corporate disclosure of workplace hazards permits workers to bargain with management about these dangers.

Such disclosures have their own costs. Data must be collected and tabulated. Product disclosures require extra space in advertising and on labels. Beyond these costs, there is the time and attention of those who would use and rely on the data and who must both assess its relative importance and assimilate the information. If the information is technically complex and difficult to evaluate, its availability may do little to improve the efficiency of market exchanges.

Lack of Alternative Choices

Effective bargaining requires that both parties have the option of withdrawing from the negotiations and seeking alternative bargains elsewhere. Frequently, however, there are no alternative

47. See statutes note 23 supra.
48. For a criticism on cost-benefit grounds of efforts to increase the amount of corporate disclosure, see R. WINTER, GOVERNMENT AND THE CORPORATION 54-56 (1978).
49. Courts have generally held these costs to be minimal, especially when weighed against the gravity of the injury that the failure to warn can cause. See, e.g., West v. Broderick & Bascom Rope Co., 197 N.W.2d 202, 212 (Iowa 1972) (evidence showed that curved tag with warning could have been bonded to each iron sling without great burden to manufacturer); Moran v. Fabergé, Inc., 273 Md. 538, 543-44, 332 A.2d 11, 15 (1975) (since cost of placing warning on label usually minimal, balance almost always weighs in favor of duty to warn). There are, however, a number of indirect social costs in warnings. Twerski, Weinstein, Donaher & Pielher, The Use and Abuse of Warnings in Products Liability—Design Defect Litigation Comes of Age, 61 CORNELL L. REV. 495, 514-17 (1976).
parties with whom to deal. For example, public-utility customers and consumers of products manufactured within highly concentrated industries may find that they have no real choice but to continue dealing with the firm. Similarly, in geographic areas dominated by one or a few large corporations, workers may have no realistic employment alternative because it may be too costly for them to learn new skills or move to new regions. Firms that already have invested heavily in special plant and equipment within a certain locale may find that relocation is too expensive to be a realistic alternative.

The market-perfecting strategy for maintaining enough diversity in the market to ensure realistic choice is largely dependent upon the antitrust laws. Such diversity may be economically costly to attain, however, if it comes at the expense of scale efficiencies. Yet, if we rely on market exchanges as the primary means of improving overall welfare and increasing individual wealth, some sacrifice in scale efficiencies for the sake of diversity may be appropriate. Otherwise, the benefits of scale efficiency are apt to be enjoyed by managers and shareholders at the expense of other parties, such as workers and consumers, who would be unable to bargain effectively for a portion of the benefits since they would have few, if any, alternative parties to whom they could threaten to take their future dealings. Not only might the resulting distribution of

51. A telling illustration of the consumers' bind is offered by Albert Hirschman, who posits two consumer complaints to Ford and General Motors respectively, with each consumer threatening to purchase from the other manufacturer in the future. A. HIRSCHMAN, EXIT, VOICE, AND LOYALTY 27 n.7 (1970).


53. The possibility that one party to a contract might take advantage of the fact that the other party had already invested heavily in assets unique to performance of the contract by appropriating this “quasi-rent,” may require that the contract be long term and cover many such transactions. See Klein, Crawford & Alchian, Vertical Integration, Appropriable Rents, and the Competitive Contracting Process, 21 J.L. & ECON. 297, 302-07 (1978). Such contracts may be so “long term” that they effectively integrate the contracting parties into a single firm. See Williamson, Transaction-Cost Economics: The Governance of Contractual Relations, 22 J.L. & ECON. 233, 238-54 (1979).


55. For a discussion of wealth maximization as the normative basis of economic efficiency, see Posner, Utilitarianism, Economics, and Legal Theory, 8 J. LEGAL STUD. 103 (1979).

56. A number of antitrust decisions have been based on maintaining market diversity, irrespective of whether this comes at the expense of scale efficiencies. See, e.g., FTC v. Procter & Gamble Co., 386 U.S. 568, 580 (1967); Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962).
efficiency benefits and monopoly costs be inequitable, but it might be difficult to estimate whether the benefits in fact exceeded the costs.

Hold-outs, Free-riders, and Negative Externalities

It may be difficult and costly to organize a market exchange. "Hold-outs" present one problem. If the right to pollute a geographic area is contingent upon the purchase of pollution rights from all the homeowners in that region, for example, homeowners who know that their acquiescence is needed might find it profitable to hold out for better terms than they might otherwise deem acceptable. "Free-riders" present a second problem. If the homeowners could purchase clean air by buying out the polluting factories, it would be difficult to exclude noncontributing homeowners from the benefit of the bargain. "Negative externalities" present a third problem. Were such bargaining among affected parties to occur, it might be difficult to identify and compensate all those who might bear the cost of the clean air, such as workers laid off because their polluting factory must close or reduce production.

Eliminating hold-outs, free-riders, and negative externalities often presents a problem exactly converse to that of maintaining diversity, since one cost of organizing various parties into more effective bargaining units may be a reduction in the amount of market diversity and choice. For example, to the extent that workers are permitted to organize themselves either to exclude nonparticipating beneficiaries or to require participation and thereby prevent hold-outs, there are no alternative (nonorganized) workers with whom other parties can effectively deal. Thus a critical issue in evaluating governmental actions that facilitate organization, such

58. See generally Demsetz, supra note 1, at 348-49; Demsetz, Wealth Distribution and the Ownership of Rights, 1 J. LEGAL STUD. 223, 229-31 (1972).
59. See National Labor Relations Act § 8(a)(3), 29 U.S.C. § 158(a)(3) (1976) (allowing union shop). But see id. § 14(b), 29 U.S.C. § 164(b) (states may pass right-to-work laws); ALA. CODE § 25-7-31 (1975) (prohibiting agreement or combination to deny right to work because of membership or nonmembership in labor union); GA. CODE ANN. § 84-804 (1974) ("[c]ompelling persons to join, or refrain from joining, labor organization, or to strike or refrain from striking" shall be unlawful).
60. See National Labor Relations Act § 9(a), 29 U.S.C. § 159(a) (1976) ("[r]epresentatives designated or selected for . . . collective bargaining by the majority . . . shall be the exclusive representatives of all the employees").
as labor laws, is whether market exchanges are helped by such actions more than they are hampered.

Liability rules that enable certain parties to receive compensation from others for injuries to legally protected interests provide an alternative form of organization. Such rules can overcome holdouts, free-riders, and externalities without resort to bargaining units. Since liability rules provide an objective determination of value, it is no longer necessary to secure acquiescence at a subjectively determined price. Accordingly, holdouts are avoided. Free-riders can be minimized through class action or derivative suit provisions that aggregate the individual liability claims of all potential beneficiaries and pay attorney's fees from the aggregate award. And negative externalities can be remedied to the extent that the threat of liability induces corporate managers to account for third-party costs in their decisionmaking. 61

Liability rules have problems of their own, however, that may discourage efficient bargains. First, the appropriate level of compensation is determined by judges, juries, compensation boards, and other third parties, whose decisions may not match what the claimants would have bargained for had they been able to bargain directly in the market. 62 The resulting allocation of costs and benefits therefore may be suboptimal because a greater or lesser amount of compensation might have satisfied the claimant's true preferences. Second, the process of determining liability and the appropriate compensation may be inefficient and costly to the participants since it usually relies on centralized, formal, and time-consuming judicial proceedings. Finally, it may be difficult for potential plaintiffs to discover that they have sustained an injury, particularly if it occurs gradually over many years, or, even if they discover it, to properly attribute it to a certain corporation. 63

61. See generally Calabresi & Melamed, supra note 1; Demsetz, When Does the Rule of Liability Matter?, 1 J. LEGAL STUD. 13, 25-28 (1972).
62. See Calabresi & Melamed, supra note 1, at 1108-10.
63. Courts have begun to grapple with the inequity caused in those situations where the plaintiff has clearly been injured by someone's negligence, but is unable to identify the particular tortfeasor. See, e.g., Hall v. E.I. Du Pont De Nemours & Co., 345 F. Supp. 353, 371-80 (E.D.N.Y. 1972) (six major domestic manufacturers of dynamite caps held liable for plaintiffs' injuries due to explosions, although name of manufacturer destroyed when dynamite caps exploded) (plaintiffs alleged that defendants knew blasting caps were dangerous and that they had agreed among themselves not to place warnings on them); Anderson v. Somberg, 67 N.J. 291, 338 A.2d 1 (jury must find at least one defendant liable when all possible defendants are joined and someone's negligence caused surgical instrument to break and remain lodged in...
Whatever their costs, liability rules have increasingly shaped relationships between shareholders, managers, workers, consumers, and neighbors. Suits for products liability, environmental damage, and workplace hazards have imposed substantial liability on corporations. Although the corporate form limits the extent to which shareholders are liable to other parties, corporate liability indirectly affects shareholders by eroding corporate good will and depleting earnings. This retards future sales and lowers share prices. To mitigate the depletion of earnings, corporations frequently insure themselves against product, workplace, environmental, or personal liability. The size of the insurance premium ideally reflects the riskiness of the enterprise to the potential plaintiff (consumer, neighbor, or worker). The underlying assumption is that, to the extent that the liability system is working efficiently, corporate managers will choose either to pay the higher premium or to reduce the riskiness of their enterprise, whichever is cheaper.

Marketable permits have been suggested as another means of overcoming hold-outs, free-riders, and externalities. In principle, the government can create a permit to pollute or to cause some analogous harm. The price of the permit to the corporation would approximate the cost to affected parties of enduring the harm. If the permit is priced appropriately, an optimal allocation of costs and benefits will result from the corporation's choice between paying for the permit or reducing the harmful effects of the enterprise, whichever is cheaper. Because regulators rather than af-

plaintiff's spine), cert. denied, 423 U.S. 929 (1975); Bichler v. Eli Lilly & Co., N.Y.L.J., July 17, 1979, at 1, col.3 (N.Y. Sup. Ct. July 16, 1979) (drug company manufacturing diethylstilbestrol (DES) held liable because use by plaintiff's mother of DES during pregnancy was proximate cause of plaintiff's vaginal cancer) (plaintiff did not prove that drug her mother took had been manufactured by defendant, but did establish that defendant had played leading role in manufacturing and distributing it—thereby having substantial responsibility, jointly with other manufacturers of drug, for subsequent damages). See generally Comment, DES and a Proposed Theory of Enterprise Liability, 46 FORDHAM L. REV. 963, 972-75 (1978).

64. To be sure, insurance premiums cannot perfectly reflect marginal risk since the transaction costs of achieving such a high correlation are prohibitive. McKean, Products Liability: Trends and Implications, 38 U. CHI. L. REV. 3, 43-44 (1970).

65. See generally G. CALABRESI, THE COSTS OF ACCIDENTS 68-94, 135-73 (1970). Imposing liability on the corporation assumes that shareholders and corporate managers are better situated than consumers, workers, or neighboring residents to choose between avoiding the harm or compensating the other parties for enduring it.

66. See sources note 26 supra.

67. See generally B. ACKERMAN, S. ROSE-ACKERMAN, J. SAWYER & D. HENDERSON, supra note 26, at 263-70.
fected parties set the initial price of the permit, however, the actual, subjective harm may be misstated. Moreover, unlike liability rules, permit systems would not directly compensate affected individuals since the permit would be purchased from the government. On the other hand, marketable permits may be more efficient to administer than liability rules since once purchased they could be resold by the corporation without further governmental involvement.

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To the extent that these market-perfecting strategies can overcome the above described problems, there is less need for a system of corporate governance or for traditional forms of business regulation to render the corporation accountable. The diverse parties with a stake in corporate activity will efficiently allocate costs and benefits among themselves through decentralized transactions. Corporate managers who fail to satisfy shareholders will find that share prices have declined and that their companies are prime targets for a takeover. Consumers, workers, and neighboring residents can rely upon market exchanges, liability rules, and permits to efficiently allocate costs and benefits between them and managers and shareholders. These market-perfecting strategies, however, have their own costs. Providing full disclosures, ensuring market diversity, and overcoming hold-outs, free-riders, and negative externalities all may entail substantial sacrifice. It is therefore appropriate to ask if there are circumstances under which other institutional frameworks outside market exchanges can do the job more economically.

PARTICIPATION-PERFECTING STRATEGIES

An efficient allocation of corporate costs and benefits can also be achieved (at least theoretically) through collective decisionmaking in which all affected parties reach agreement. While market exchanges are characterized by discrete trades between parties and facilitated by decentralized price signals, collective decisionmaking is marked by participation and signaled by votes. When parties become dissatisfied in market exchanges they take their business elsewhere; in collective decisionmaking, dissatisfied parties seek to persuade others to vote their way.

Because the costs of negotiating unanimous agreement among all affected parties is likely to be prohibitive, however, collective decisionmaking typically relies upon a majority vote among representatives of the affected parties. Examples of such collective decisionmaking for the corporation abound. Shareholders are accorded the right to select corporate directors and vote upon certain major issues of corporate reorganization. Workers select representatives for collective-bargaining units, and worker representatives and managers have a legal obligation to seek agreement with one another "in good faith." Creditors have limited rights to participate in corporate decisionmaking when the corporation is reorganized or liquidated under bankruptcy laws. Moreover, all parties can participate in corporate decisionmaking through the political process. That process generates governmentally enforced standards barring unsafe or defective products, setting corporate tax rates, defining the conditions under which corporations can enter or leave a community, and setting minimum requirements for worker safety.

But collective decisionmaking will efficiently allocate the costs and benefits of corporate activity only to the extent that certain "participation imperfections" are overcome. Collective-decisionmaking processes require that (a) political organizing costs do not disproportionately disadvantage diffuse interests that are spread

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69. Less-than-unanimous decisionmaking imposes obvious costs upon those who disagree with the measure. But decisionmaking rules requiring unanimity or near unanimity impose high costs of their own, since they necessitate lengthy bargaining and require strategies to overcome hold-outs. An optimal decisionmaking rule would presumably minimize the likely sum of both costs. See generally J. BUCHANAN & G. TULLOCK, THE CALCULUS OF CONSENT 97-116 (1962).

70. E.g., DEL. CODE ANN. tit. 8, § 211 (1974); N.Y. BUS. CORP. LAW § 703 (McKinney 1963).


75. See sources note 6 supra.


78. See sources note 4 supra.
widely and thinly among participants; (b) voters in the minority are not "impacted" by the majority; (c) the correct balance is maintained between the cost of negotiating agreements and of avoiding "corruption" of representatives; and (d) short-term concerns do not overwhelm more beneficial long-term strategies.

Organization of Diffuse Interests

Even unanimous agreement within a legislature, regulatory agency, or corporate board room may not guarantee an improvement in overall welfare if the political strength of affected parties in the decisionmaking process is not proportional to their numbers and their potential aggregate stake in the outcome. A large and amorphous group, each of whose members is only slightly affected by a decision—such as citizens who may be exposed to toxic wastes—will have difficulty organizing itself to influence the decision. While the large group's total stake may be high relative to other parties, the cost of informing and summoning resources from its far-flung and relatively disinterested members may be even higher. In addition, organizing large groups is hampered by the cost of overcoming free-riders. Conversely, a small group, each of whose members has a high stake in a given decision—such as corporations who dump the toxic wastes—can organize itself with relative ease even though its total stake is lower than that of the larger group. Thus the vigor and success with which parties are likely to participate in legislative, regulatory, or corporate decisionmaking may have little relation to the overall gains or losses at stake.

Participation-perfecting strategies seek to improve the match between political strength and overall stake in the outcome by lowering the cost of organizing. One such strategy is to reduce the amount of organizing that diffuse interests must undertake if they are to participate effectively. For example, public funding of intervenors in regulatory agency proceedings when the intervenors are representative of a larger class of diffused interests reduces the amount of organization required. Similarly, shareholder derivative suits and the award of attorney's fees in those actions per-

79. See note 31 supra and accompanying text.
80. E.g., N.Y. BUS. CORP. LAW § 626 (McKinney 1963). Cf. Surowitz v. Hilton Hotels Corp., 383 U.S. 363, 371 (1966) ("derivative suits have played a rather important role in protecting shareholders of corporations from the designing schemes and wiles of insiders who are willing to betray their company's interests in order to enrich themselves").
81. See N.Y. BUS. CORP. LAW § 626(e) (McKinney 1963) (providing for payment

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mit one shareholder to accomplish what might otherwise require a prohibitive amount of organization.\textsuperscript{82} The amount of required organization is also reduced if participants are permitted to pool their votes according to the strength of their preferences. For example, diffuse shareholder interests gain added influence if they can vote cumulatively for corporate directors.\textsuperscript{83}

If large-scale organization remains a necessity, the decision-making process can be made more visible, thereby reducing the costs of informing diffuse interests about what is at issue.\textsuperscript{84} For example, diffuse interests can more easily organize themselves to participate in regulatory decisionmaking when agencies fully inform the public about their proposed rules,\textsuperscript{85} allow the press and the public to observe their deliberations,\textsuperscript{86} and maintain public records of evidence accumulated in rulemaking proceedings.\textsuperscript{87} Similarly, diffuse interests can more effectively participate in the corporation when management discloses its policies governing employment,\textsuperscript{88} compensation,\textsuperscript{89} investment,\textsuperscript{90} and environmental\textsuperscript{91} policies. The costs of organizing shareholders is also reduced by permitting access to corporate voting lists or proxy machinery.\textsuperscript{92}

\textit{Impacted Minorities}

The very fact that collective decisionmaking dictates the fate of groups of individuals with similar interests implies that individ-

\begin{itemize}
\item 82. For a discussion of shareholder derivative suits, see D. Vogel, \textit{supra} note 30, at 111-15.
\item 83. See sources cited note 29 \textit{supra}.
\item 85. See, e.g., Administrative Procedure Act \S 4(a), 5 U.S.C. \S 553(b) (1976); MASS. GEN. LAWS ANN. ch. 30A, \S\S 2-3 (West 1979).
\item 86. See, e.g., Government in the Sunshine Act, 5 U.S.C. \S 552b (1976); IND. CODE ANN. \S 5-14-1-4 (Burns 1974).
\item 87. See, e.g., Administrative Procedure Act \S 8(b), 5 U.S.C. \S 557(c) (1976); MINN. STAT. ANN. \S 15.0412 (West 1979).
\item 88. For a discussion of Equal Employment Opportunity Disclosure Resolutions, see D. Vogel, \textit{supra} note 30, at 153-56.
\item 89. See, e.g., 17 C.F.R. \S 229.20 (Item 4) (1979).
\item 90. See, e.g., id. \S\S 229.20 (Items 1-2), 240.14c-3.
\item 92. See 17 C.F.R. \S\S 240.14a-7 to -8 (1979).
\end{itemize}
ual preferences will not be uniquely satisfied to the extent possible in market exchanges. Democratic majoritarian politics by definition implies minorities who disapprove of the decision. If majority coalitions were constantly shifting, voters in the majority at one point in time would know that they will need minority members for future majority coalitions. Majority voters would also know that they will be in the minority in some future decisions. Both groups, therefore, could be expected to engage in long-term bargaining, trading off losses in one time period for gains in another. These trades would, over time, compensate all voters for any losses they may incur and therefore approximate unanimity. Thus, viewed over the long term, all participants would agree to the entire series of decisions, notwithstanding their disagreement with specific decisions along the way.

Shifting majorities can be relied on to protect minority interests, however, only if voters in the majority cannot make decisions that irrevocably alter the organization and place certain interests in a permanent minority. The preferred shareholder who finds his or her dividend arrearages eliminated in recapitalization, the minority shareholder who finds that the corporation is being operated by a dominant shareholder in a way that lessens his or her potential return, shareholders who discover that a merger has diluted their voting rights, or even minority citizens who discover that their voting district has been redesigned to dilute the strength of their minority votes are all “impacted” by majorities who do not need their minority votes in the future.

93. The so-called voters’ paradox or cyclical-majority problem suggests that control over the order in which issues are presented for a vote can empower the agenda setter to obtain the results he or she prefers. See generally K. Arrow, Social Choice and Individual Values 94-95 (2d ed. 1963); D. Black, The Theory of Committees and Elections 39-51 (1958); A. Sen, Collective Choice and Social Welfare 38-40 (1970); Plott, Axiomatic Social Choice Theory: An Overview and Interpretation, 20 Am. J. Political Sci. 511 (1976). Thus, unless such control is assigned randomly, majorities who set the agenda can permanently impact minority voters.


95. See Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971).


98. The same result obtains if a majority of participants form a permanent alli-
To avoid impacted minorities, decisions to irrevocably alter the organization might require agreement by substantially more than a majority. Alternatively, particularized rules might govern those votes that could seriously undermine a minority's position—such as a requirement in parent-subsidiary mergers that only common stock be used to pay off minority interests in the subsidiary according to premerger stock-price ratios.

**Negotiation and Corruption**

Because the costs of negotiating directly among all affected individuals about every issue is often prohibitive, collective-decisionmaking processes typically depend upon systems of representation in which individuals elect agents to whom they entrust most decisions. But agents may be corrupted. They may heed their own personal agendas—seeking money, privilege, or power for themselves—rather than represent the best interests of their constituents. Even well-intended agents may become insensitive to constituent views because of the physical or social distance separating them from their constituents.

Accordingly, there may exist a trade-off between the transaction costs of direct negotiations between participants and the "corruption" costs of representative systems. The greater the distance between the agents and the affected parties, the higher the probability that the agents will be corrupted; but remoteness may also be consistent with ease of negotiations and lower costs of reaching agreement. Legislative and regulatory processes exemplify one end of this scale. Parties elect representatives, who in turn appoint administrators to head regulatory agencies, which in turn prescribe standards for corporate managers. Since the final decisions are thereby delegated to relatively few agents, transaction costs of
negotiating agreements are minimized. But since personal agenda setting is possible at every level, corruption costs may be high. An intermediate trade-off occurs to the extent that affected parties participate directly in the regulatory process through broadened rights of standing, intervention, and due process, and through public funding of intervenor groups that are representative of larger interests. The highest transaction costs, but lowest corruption costs, occur when affected interests have a direct voice in corporate management.

Proposals to make a majority of corporate directors outsiders can be viewed as an attempt to reduce the likelihood of corruption in management, since outside directors presumably have no personal financial interest that might compete with their responsibility to represent the best interests of shareholders. Similarly, the call for direct board representation for all parties potentially affected by corporate action—including workers, consumers, and neighboring citizens—can be seen as a means of remedying corruption in regulatory agencies and legislatures, which have responsibility for representing these nonshareholder interests in setting standards for corporate conduct. Thus to the extent that such corruption can be reduced within legislatures (for ex-

103. See Gellhorn, supra note 31, at 362-88; Stewart, supra note 13, at 1748-56.
105. See note 31 supra and accompanying text.
106. See generally sources note 30 supra and accompanying text.
107. See sources note 30 supra and accompanying text. With its announcement on October 25, 1979, that management would nominate Douglas Fraser, president of the United Auto Workers Union, as a director, the Chrysler Corporation became the first major American corporation to agree to place a worker representative on its board. N.Y. Times, Oct. 26, 1979, at 1, col. 4. A demand from an organization of independent dealers seeking similar representation soon followed, and some Congressmen suggested a government representative as well. Chrysler May Face Rush of Candidates For Seats on Board, Wall St. J., Oct. 29, 1979, at 6, col. 5. The Chrysler initiative has roots in European theories of codetermination. The proposal for UAW representation on the Chrysler board was first made in 1975 and was based on a similar proposal made by Chrysler’s British subsidiary to labor unions in the United Kingdom. Murphy, Workers on the Board: Borrowing a European Idea, 27 LAB. L.J. 751, 751-52 (1976). The British had borrowed the idea from long standing practices in Germany, which more recently have spread to the Low Countries and Scandinavia. See Davies, supra note 30, at 257-61; Germany’s Requiring of Workers on Boards Causes Many Problems, Wall St. J., Dec. 10, 1979, at 1, col. 1.
ample, through public financing of election campaigns\textsuperscript{109} and within regulatory agencies (for example, through restricting the "revolving door" of employment from regulatory agency to regulated industry\textsuperscript{110}), there is perhaps less justification for constituent representation on boards of directors. By the same token, a truly effective system of constituent representation on corporate boards may vitiate the need for legislative and regulatory oversight of the corporation.

**Dominance of Short-Term Concerns**

Because voting coalitions are likely to be temporary, and because constituency representatives are likely to be in office for limited periods of time, collective decisionmaking may be dominated by short-term, immediate concerns at the expense of long-term policies. In politics, memories are often short and passions run high. Exigencies of the moment may overwhelm more sensible, incremental solutions. Thus legislators, regulatory agency administrators, and corporate directors and managers may aim for short-term results that immediately satisfy their constituencies and over which temporary compromises can be negotiated, even though the solutions may not be as beneficial over the long term. Representatives may have little to gain from long-term strategies whose payoffs may be years or decades away. By then, different voting coalitions will be seeking trades of different sorts and the representatives themselves may be in different jobs.

In contrast, the decentralized price system automatically applies a discount rate to the future.\textsuperscript{111} Long-term expectations frame every exchange. Prices adjust constantly and incrementally to every new item of information introduced anywhere in the system that may bear upon the future. Indeed, there is fierce competition


\textsuperscript{111} In this respect collective decisionmaking has the same disadvantage as community property. \textit{Cf.} Demsetz, \textit{supra} note 1, at 350-59 (private property internalizes costs of current activity on future value, community property externalizes these costs).
for such data since earlier and better predictions can provide their recipient with important bargaining advantages and large profits.

For these reasons, collective decisionmaking may cause resources to be squandered rather than saved and invested. Corporate managers bent on showing increases in earnings may choose quick growth through merger or acquisition rather than a gradual and more sensible long-term strategy of investment in new plant and equipment.\(^\text{112}\) Legislators may choose to reduce taxes, particularly in an election season, notwithstanding inflationary effects. And regulatory administrators bent on showing quick results may set deadlines for the implementation of certain corporate standards that, because of technological lag, are far more expensive to put into effect in the short term than they would be had the schedule been more gradual and incremental.

The most common participation-perfecting strategy for remedying this predominance of short-term concerns is to insulate representatives from their constituents. Terms of offices may be extended so that representatives need not feel so keenly the pressures to produce short-term results.\(^\text{113}\) Regulatory agencies may be given independent status so that neither Congress nor the President can directly interfere in their decisionmaking.\(^\text{114}\) Corporate managers may be insulated from shareholders by means of corporate board members who have no managerial responsibility.\(^\text{115}\)

To be sure, these strategies for insulating representatives from short-term pressures may be inconsistent with strategies designed to avoid "corruption" and ensure accountability to constituents.

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\(^{112}\) A growing body of literature and a number of studies suggest that management may be responding to short-term goals rather than long-term profit maximization. See, e.g., Bower, On the Amoral Organization, in THE CORPORATE SOCIETY 178, 191-92, 194-95, 198 (R. Marris ed. 1974).

\(^{113}\) See, e.g., H.R.J. Res. 186, 96th Cong., 1st Sess., 125 CONG. REC. H438 (daily ed. Feb. 1, 1979) (proposing one six-year term for President and Vice President; limited number of consecutive three-year terms for Representatives); H.R.J. Res. 168, 96th Cong., 1st Sess., 125 CONG. REC. H339 (daily ed. Jan. 29, 1979) (proposing one six-year term for President and Vice President; limited number of staggered four-year terms for Representatives).

\(^{114}\) There is a broad consensus, for example, that the Federal Reserve Board should remain independent. This independent status is provided by 12 U.S.C. § 250 (1976). For a discussion of independent regulatory agencies, see Dixon, The Independent Commissions and Political Responsibility, 27 ADMIN. L. REV. 1 (1975).

This tension is perhaps inherent in all representative systems of collective decisionmaking.

* * *

Participation-perfecting strategies for governing the corporation thus present a mirror image to market-perfecting strategies. To the extent that these participation-perfecting strategies overcome the problems of diffused interests, impacted minorities, corruption, and the dominance of short-term concerns, there is less need to improve market exchanges. The diverse parties who have a stake in corporate activity can be expected to allocate the risks and benefits among themselves in an efficient manner through collective decisionmaking. As with market perfecting, however, participation perfecting is costly. Improving the allocation of corporate risks and benefits solely by means of collective decisionmaking would entail great expense.

**EQUITY**

To be sure, unanimous agreement among affected parties about corporate costs and benefits may nevertheless result in outcomes that we as a society deem unacceptable. Regardless of its efficiency, the resulting allocation may be inequitable. Workers who accept higher wages in return for undertaking more hazardous assignments, neighboring citizens who purchase or rent real estate at a low price or accept a lower tax rate in return for industrial noise and pollution, and consumers who purchase products at a low price in return for risks to life and health all can be said to have agreed voluntarily to the resulting allocation of corporate costs and benefits. But that allocation, even if efficient, is premised upon an initial distribution of wealth to which they might not have agreed had their agreement been solicited.117 Their voluntary acceptance of these corporate risks for the sake of the benefits that accompany them is voluntary only in terms of the limited choice open to them of accepting such risks or doing without the benefits. Both

116. If income distribution is unfair, the fact of unanimous consent to a proposed change will not cure the unfairness. Arguably, however, if all participants could agree unanimously to principles for allocating costs and benefits, regardless of each participant's own position in the prospective allocation, the resulting outcome would be fair. See generally J. Rawls, A THEORY OF JUSTICE 118-30 (1971). For a discussion of “entitlements” that are to be protected by “inalienability rules,” see Calabresi & Melamed, supra note 1, at 1092-93, 1111-15.

alternatives may be offensive to widely held notions of equity and therefore politically unacceptable. Under these circumstances, collective decisionmaking through governmental entities helps ensure that the allocation of corporate risks and benefits is fair.\textsuperscript{118}

Even if the polity as a whole fails to redress perceived inequities in the allocation of corporate risks and benefits, morally concerned individuals may urge the corporation to undertake unilateral action to improve the lot of certain disadvantaged parties. The call for "corporate social responsibility" often comes in this form. Regardless of whether parties knowingly and voluntarily agree to a given allocation, proponents of corporate social responsibility urge that the allocation be changed: The corporation should provide better working conditions, higher quality consumer products, and a cleaner environment than affected parties would have accepted within perfected market exchanges or perfected collective-decision-making processes. In addition, the corporation should undertake "good deeds," such as investing in ghetto housing, developing training programs for disadvantaged youths, and moving factories into poorer communities.

Often left out of the debate about corporate social responsibility, however, is the fact that these unilateral initiatives are costly. Who is to pay for them? If they are financed by the very parties who are to reap the benefits, then the resulting allocation is not more equitable. On the contrary, these parties arguably are worse off than they were before the initiatives were undertaken since their choices within market exchanges and collective-decision-making processes indicated a preference for doing without the added benefits and added costs. Improvements in product quality financed by price increases, improvements in working conditions made possible through reductions in workers' real earnings, or improvements in environmental quality resulting in reductions in the corporation's level of economic activity within the region all represent "packages" of corporate costs and benefits that consumers, workers, and neighboring citizens presumably do not wish to have. Alternatively, the resulting allocation may merely transfer wealth from some individuals to others within the same group without any

\textsuperscript{118} Increasingly agencies are being called on to accommodate the competing claims of private interest groups. Stewart, supra note 13, at 1683-84, 1712. Professor Posner argues that issues are delegated to administrative agencies to promote "the operation of interest group politics rather than allocative efficiency." R. Posner, supra note 2, at 480.
coherent equitable principle to sustain or guide the decision, as in the case of improved working conditions requiring lay-offs of certain workers.

If, however, the improvements come at the expense of parties who are thought to be more advantaged, such as shareholders, the corporation becomes a vehicle for redistributing wealth. Corporate altruism of this sort is limited by the possibility that reduced earnings will cause the price of the corporation's shares to drop and thereby make it profitable for others to wrest control from current managers and eliminate the altruistic practice.\footnote{119} Some altruism is still possible, however, since the cost of displacing management is often quite high.\footnote{120} The real problem with this alternative is that there are no criteria for determining how much redistribution is appropriate and what form it should take. Corporate managers alone are ill suited to making these decisions. Indeed, it can well be asked whether the corporation is a legitimate vehicle for such redistributions.\footnote{121} Moreover, even if the corporation were justified in redistributing wealth from its more advantaged to its less advantaged members, there are no obvious grounds for deciding who fits within each camp. Shareholders, who include persons dependent on pension funds and insurance companies, are not necessarily wealthier than workers, consumers, or neighboring citizens.

To be sure, the call for corporate social responsibility sometimes sounds like a moral imperative, but it is frequently a strategic one. According to its proponents in this context, corporate social responsibility makes good business sense. Since market exchanges are imperfect and governmental regulation at best is an unsubtle instrument for reconciling private or public interests, it is argued that corporate managers should exercise responsible self-restraint in their dealings with shareholders, consumers, workers, and neighboring citizens.\footnote{122}

This form of corporate social responsibility is defined and justified by virtue of what it accomplishes for the corporation in

\footnotesize{120. This is in part a function of protectionist state takeover statutes. \textit{E.g.}, \textit{Del. Code Ann. tit. 8, § 203} (Supp. 1978); \textit{Iowa Code Ann. §§ 502.212-.215} (Supp. 1979).}  
\footnotesize{121. See Williamson, \textit{supra} note 38, at 65-66.}  
\footnotesize{122. According to Irving Shapiro, Chief Executive Officer of Du Pont, corporate chief executive officers must accept public responsibilities. "I view myself as representing the public." \textit{Phil. Inquirer}, Apr. 4, 1979, at 12, col. 1.}
the long run: Avoiding additional governmental regulation\textsuperscript{123} and achieving long-term profitability.\textsuperscript{124} Additional regulation is the threat; it will be imposed unless the corporation responds to the various sources of public discontent that fuel it. Long-term profitability is the reward; in the long run, business can prosper only in an environment in which all of its constituents are (and feel that they are) treated equitably. At base, this principle of social responsibility derives its meaning both from market exchanges (profits over the long term) and collective decisionmaking (a realistic threat). Rather than being premised on an independent vision of the corporation's proper ethical role in modern society, this principle takes its definition directly from that allocation of corporate risks and benefits to which all affected parties would agree in market exchanges or collective-decisionmaking processes. Its underlying value, therefore, is efficiency, not equity. Since this view of corporate social responsibility is defined by market-perfecting and participation-perfecting strategies, it provides no further insight into how corporate costs and benefits should be allocated.

**Toward Reform**

Corporate reform and regulatory reform lie on a continuum calling for improvements in both market exchanges and collective-decisionmaking processes. Ultimately the machinery of corporate governance, governmental regulation, and market exchanges can be evaluated only as parts of a single integrated system for allocating the costs and benefits of corporate enterprise.

In a theoretical world of perfect market exchanges and perfect collective-decisionmaking processes it would make no difference which was responsible for allocating the costs and benefits of corporate enterprise. Unanimous agreement through either system would signal an improved allocation. But the world is not perfect, and strategies designed to enhance the workings of market exchanges and collective decisionmaking are themselves costly. Viewed in this light, the goal of the various proposals to make the corporation more accountable and to reform the regulatory process is to reduce the cost of approximating unanimous agreement among affected parties about how corporate costs and benefits should be


\textsuperscript{124} Novick, *Cost-Benefit Analysis in the Socially Responsible Corporation*, in *Managing the Socially Responsible Corporation* 74, 77-78, 84-89 (M. Anshen ed. 1974).
allocated. In evaluating these proposals, therefore, the central issue is what combination of them, under what circumstances, will minimize the cost of deriving such an allocation.

To some extent, market-perfecting and participation-perfecting strategies complement one another. Working together, they reduce the cost of deriving an efficient allocation to a greater extent than would either system operating alone. For example, participation-perfecting rules for proxy contests facilitate a market for management control. Inferior management that causes share prices to decline will often be replaced by superior management through a takeover or proxy fight. This replacement ensures a more efficient use of corporate assets than would be the case if market exchanges alone worked to reduce share prices without an opportunity to alter management, or if collective decisionmaking alone provided an opportunity to alter management without a corresponding opportunity to sell shares. A reasonable inquiry, therefore, would seek to discover whether participation-perfecting strategies designed for other parties affected by corporate activity—notably workers, consumers, and neighboring citizens—might similarly complement the market exchanges in which they currently bargain, reducing the cost of accommodating their interests as well.

Market-perfecting and participation-perfecting strategies are also occasionally at odds. For example, proposals to place representatives of all parties potentially affected by corporate activity on boards of directors—including workers, suppliers, creditors, consumers, and neighboring citizens—may improve the efficiency of collective decisionmaking. But these mechanisms may also reduce the efficiency of market exchanges if the same parties are represented on the boards of formerly competitive firms; this will give them the ability to engage in some degree of coordination. Simi-

126. Id. at 112-15.
127. See Manne, The “Higher Criticism” of the Modern Corporation, 62 COLUM. L. REV. 399, 410-11 (1962); Manne, Some Theoretical Aspects of Share Voting, 64 COLUM. L. REV. 1427, 1430-34 (1964). Professor Manne also argues that efficiency would be maximized if shareholders could sell their votes without selling their shares. Id. at 1434-37.
128. It is possible that these actions may violate the antitrust laws. See 15 U.S.C. § 19 (1976) (no person may serve on boards of two or more competitors any one of which has capital, surplus, and undivided profits aggregating more than one million dollars). See generally Steuer, Employee Representation on the Board: Industrial Democracy or Interlocking Directorates?, 16 COLUM. J. TRANSNAT’L L. 255,
larly, proposals calling for a uniform federal incorporation statute to replace existing state statutes\textsuperscript{129} are consistent with participation-perfecting strategies. Shareholders who seek to protect their interests through collective decisionmaking in the corporation otherwise may find that the state statutes, in a "race for the bottom" to attract corporate headquarters, provide little real opportunity for shareholder participation in the corporation.\textsuperscript{130} Yet, federal incorporation may be inconsistent with market-perfecting strategies. It would replace what is now a diverse "market" in corporate management structures with a single, uniform structure about which potential shareholders have no choice. Diversity helps ensure that such structures facilitate the highest shareholder returns; firms will not incorporate (and shareholders will not purchase shares in firms that incorporate) in states whose mandated structures inhibit profit maximization. A uniform structure would provide no such assurance, since it would not indicate to what extent the structure inhibited profit maximization, nor would it offer a self-policing mechanism for remedying any such inhibiting effects.

A decision to undertake either market-perfecting or participation-perfecting strategies will depend upon the nature of the risks and benefits at stake. As we have seen, market-perfecting strategies are likely to be especially costly where (1) the risks are difficult for parties to evaluate, even if information about them is provided; (2) scale economies are substantial, so that policies seeking to maintain diversity in the market would require sacrificing significant benefits; (3) the risks or benefits are likely to be so widespread that bargaining over them by affected parties is unworkable; or (4) risks or benefits are so high that market-perfecting strategies create inequities. In these circumstances, participation-perfecting strategies may offer superior means of accommodation. On the other hand, participation-perfecting strategies are likely to be particularly costly where (1) either risks or benefits—but not both—are spread so widely and thinly over the population that it is difficult to organ-

\textsuperscript{276-96} (1977) (while individual union official's membership on more than one board of directors of competing corporations would violate antitrust laws, membership by different officials of same union with no member holding more than one seat would not be violation).


\textsuperscript{130} See Cary, supra note 129, at 669-86. Professor Winter has sought to address these criticisms directly. R. WINTER, supra note 48, at 7-11, 22-23.
ize diffused interests to participate; (2) it is difficult to guard against irrevocable changes in voting rules by the majority; (3) direct negotiation among affected parties is apt to be long and arduous; (4) it is difficult to guard against corruption of representatives; or (5) constituents’ short-term concerns require that decisionmakers be insulated from them, but such insulation substantially increases the possibility of corruption. Under these circumstances market-perfecting strategies may offer superior means of accommodation.

Which institutional framework can most cheaply achieve an efficient and equitable allocation of the costs and benefits of corporate behavior? The answer varies depending upon the nature of the costs and benefits at issue. Improving market exchanges will sometimes be the best solution; but occasionally such improvements will be too costly and collective decisionmaking will offer a more efficient or equitable means of accommodating all affected parties. Typically, the preferred framework will be a mixture of improved market exchanges and collective-decisionmaking processes.

This analysis can be illustrated by any one of a number of issues currently discussed under the rubric of corporate accountability or regulatory reform. For example, worker safety could be determined by either of two processes based generally upon markets: workmen’s compensation laws, which establish a no-fault liability system by which firms insure their workers against work-related injuries, or collective bargaining between workers and employees, in which working conditions are at issue. Worker safety could also be determined by any of three processes based generally upon collective decisionmaking: Rulemaking by the Occupational Safety and Health Administration, establishing standards for workplace safety; decisions by corporate boards of directors upon which worker representatives sit; or employee stock-ownership plans, by which employees receive voting shares in the corporation and therefore gain an opportunity to vote directly for improved workplace safety. In which of these processes should we place greatest reliance for fairly and efficiently determining an appropriate level of worker safety? Which process is most susceptible to strategies for perfecting markets or improving participation?

A workmen’s compensation system based upon insurance for work-related injuries theoretically could motivate employers and workers to invest in just the right amount of precaution against workplace hazards. To be efficient and fair, however, such a system would have to overcome substantial obstacles. First, the employing firm must be under some pressure from competitors to keep its
prices low, lest the firm be able to choose—out of sheer indifference—to pay higher insurance payments rather than to bear the lower costs of preventing accidents. By the same token, insurance companies must be competitive with one another lest they too be able to set premiums without regard to relative safety. Yet, if there are substantial economies of scale in either the employing firm or insurance markets, such competition may come at too high a price. Second, the recipient of the compensation award may feel that it is either inadequate or overly generous, so that it does not match the subjective injury he or she sustained. Finally, an insurance system may permit workers to be exposed to certain risks that we as a society simply find abhorrent, notwithstanding that workers freely chose to bear them with compensation.

Collective bargaining also has substantial disadvantages that would be costly to overcome. Workers not organized into unions would face enormous transaction costs in attempting to bargain for improved safety. Even organized workers may find it difficult to credibly threaten withdrawal from future dealings if they have no other employment opportunities within the geographic area. Finally, it may be difficult for workers who wish to bargain for safer working conditions to obtain accurate information about the potential dangers at a particular workplace: Some hazards, such as those affecting internal organs, do not become evident for years after exposure; others affect so few workers at any one time that they are difficult to recognize.

Regulatory processes that establish certain minimum standards of workplace safety also have substantial disadvantages. A uniform standard governing diverse workplaces is likely to be either too strict and expensive relative to the safety it achieves in certain work environments, or too lax relative to the safety a stricter standard could achieve in other environments. Because of the enormous variety of potentially serious workplace hazards, however, the costs of deciding upon specific appropriate safety standards for any but a fraction of them is apt to be extraordinarily high. The regulatory agency will find it difficult to obtain enough accurate data to both design appropriate standards and discover failures to comply with them. Finally, regulatory agency personnel may become insensitive to various concerns of workers or employers because agency personnel are physically and psychologically remote from the workplace, or because they are politically dependent upon either workers or employers, but not upon both.

Worker representatives on boards of directors cannot be relied
upon to establish appropriate levels of workplace safety. Worker representatives may simply be outvoted by a majority of the board, which can manipulate the agenda to effectively negate their participation. Alternatively, worker representatives may be more concerned with obtaining highly visible, short-term results—such as higher wages—which will show that the representatives are acting in the workers' behalf, than with less dramatic and long-term benefits associated with improved safety. Finally, worker representatives may become acculturated into the managerial elite, and thereby grow less concerned about representing the interests of workers.

Employee stock ownership also poses substantial problems. Employees' financial interest in the corporation may be disproportionately small relative to their interest in workplace safety. Moreover, the costs of negotiating and reaching agreement among a majority of shareholders about specific standards for workplace safety are apt to be very high. These transactions costs will be even higher if the safety issues are technical, involving complex data about costs and benefits.

Given these obstacles to perfecting any single process for deciding on worker safety, an appropriate strategy would be to assign certain responsibilities to each process according to its comparative advantage over the others. Workmen's compensation schemes, for example, might be relied upon to guarantee adequate compensation to injured workers rather than to motivate firms to invest in an appropriate level of safety, particularly where more perfect competition would be costly to achieve. Collective bargaining might be relied upon to deal with workplace hazards unique to particular firms or industries, rather than to deal with more typical hazards. Regulatory agencies, on the other hand, might be responsible for establishing broad standards for hazards that are likely to arise in a wide variety of workplaces, rather than for attempting to set detailed requirements for a large number of specific, potential hazards. In addition, regulatory agencies could prevent workers from undertaking certain risks that society finds abhorrent, despite the willingness of workers to bear the risk at a freely agreed upon rate of compensation. Worker representatives on boards of directors could help ensure that management develops adequate means for discovering potential workplace hazards and informing workers and regulatory agencies about them in a timely manner. Employee shareholders could seek to have management devote a certain min-
imum percentage of yearly profits toward improving worker health and safety.

None of these responsibilities is beyond the relative competence of the particular market exchange or collective-decision-making process to which it is assigned. Given the existence of the above-mentioned market imperfections and impediments to participation, however, no single process is best equipped to handle the entire job. Together, the mix of processes and responsibilities could help to ensure a fair and efficient allocation to workers of corporate risks and benefits—without requiring that substantial investments be made in perfecting any one process.

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The evaluation of various market-perfecting strategies and proposals to improve collective decisionmaking—running the gamut from new modes of corporate governance to regulatory reform—cannot be undertaken in an analytic vacuum. Each proposal may have a part to play in better accommodating the interests of parties affected by corporate activity; they are inextricably related to one another, and the correct mix is largely dependent upon the risks and benefits at issue. They should be viewed as an integrated system of accountability, not as separate panaceas for all that ails the corporation.