Introduction

In monitoring how management governs publicly traded corporations, the American corporate judiciary bears two major responsibilities. One is to identify who acts on the corporation's behalf. Who has the authority and power to get things done in the corporation's name and, as a result, can be held legally responsible for the corporation's behavior? This is a question about the nature of corporate agency. The other major responsibility of the American corporate judiciary is to define (and limit) how corporations may conduct themselves in civil society. What standards of behavior does the corporate judiciary expect corporate officers to meet? Is the sole legitimate purpose of corporations to maximize profits or growth? Or do the courts expect corporate officers to conform to social norms, to meet extra-economic standards of behavior? These are questions about the nature of corporate purpose in civil society.

Since the founding of America, state courts (particularly today those of Delaware, California, New York, and New Jersey) have borne these two responsibilities. However, the ability of the corporate judiciary to meet either of them was in graver doubt in the late 1980s and early 1990s than at any time since the rise of giant corporations at the turn of the twentieth century. Some reasons for this are well known.

Beginning in the 1920s, business corporations increasingly decentralized their internal structures of authority. In the language of organization theory, corporations evolved from a unidivisional form, where both planning and daily operations were centralized at headquarters, to a multidivisional form. Today, middle managers at divisions are responsible for daily operations while top managers at headquarters dedicate themselves to planning and financing strategies. Yet some corporate divisions today are considerably larger than many centralized corporations were two and three generations ago. Moreover, the basic division of labor struck between middle managers and top managers has been followed by numerous other divisions, and then subdivisions, of power and authority. All of

this complicates judicial efforts to identify *the* corporate agent. If we bring into the picture the increasing tendency of corporations to operate across national markets (often using subsidiaries), and also the increasing economic competition they face in global markets, the courts' difficulties become even more understandable. Who (or what position) is to be held legally responsible for what a corporation does at a particular time, in a particular place?

In addition, the very idea that American state courts ought to identify normative, extra-economic "responsibilities" that corporate officers bear to the larger society, beyond their unavoidable burden to compete effectively in markets, has come under formidable challenge since the mid-1970s. An increasing number of influential judges and law professors—known as legal contractarians—question whether the corporate judiciary as an institution can or should impose *social norms* of behavior on directors, management, and controlling shareholders, and whether this institution is capable of doing so. Contractarians believe the entire matter of trying to define corporate purpose in legal terms is hopelessly anachronistic. How corporate officers conduct themselves within private companies, how they "govern" these companies, is a matter best left to competition in self-regulating product markets and capital markets. In their view, markets impose the only limitations on corporate activity that (a) make sense economically and (b) can be "enforced" with any consistency regardless.

We will see that this position has considerable merit in principle. We will also see, however, that it represents a dramatic departure from long-standing American judicial (and legislative) practice. Economic limitations on corporate purpose are narrowly instrumental and strictly pecuniary in their sanctions. They do not speak to broader issues: Whether and when do corporations either increase or decrease social wealth (what Adam Smith called the wealth of nations)? And whether and when do corporations broadly support or increasingly enervate and then challenge the basic institutional design of a democratic society? These broader issues, and particularly the "societal constitutional" issue of institutional design, continue to inform the behavior of the corporate judiciary, albeit often implicitly. We will call this broader view of corporate purpose, and the general political economic position of which it is a part, *republican vigilance*.

If we keep the issue of institutional design in mind, then contractarians' faith in markets seems disingenuous, and yet it remains a credible point of departure in analyzing the relationship between corporations and law. Their faith is that as long as corporate officers do not violate the same basic

criminal and civil laws that apply to all other citizens, then self-regulating markets will otherwise restrain how they manage large corporate entities sufficiently in any society, and particularly in a democratic society. Contractarians are convinced, as are a great many members of the corporate judiciary and bar today, that however corporate officers decide to govern their firms internally, this cannot possibly pose a threat to a democratic society. We call this article of faith *liberal complacency*, and we will find that it is today's orthodoxy in the corporate judiciary and bar.

We can trace the origin of today's orthodoxy to the 1830s. This is when the corporate judiciary *began* abandoning the quite different general political economic position of the Founders, that of republican vigilance. American state courts began believing as an article of faith that when corporations increase their owners' private wealth, this simultaneously (a) increases social wealth and (b) automatically supports, rather than possibly challenges or enervates, the institutional design of a democratic society. Thus, in the first decades of the nineteenth century, the American corporate judiciary began abandoning concepts (and doctrinal options) that could help state courts to resist contractarians' faith in markets today.

There is a popular way of visualizing how otherwise lawful and profitable exercises of corporate power can harm the larger society. When corporations successfully increase their owners' wealth, they may nonetheless disrupt an existing balance between economic institutions (such as product, capital, and labor markets) and noneconomic institutions (such as families, communities, and voluntary associations).[1] The problem with this popular view, however, is that it does not establish that the existing balance just noted is truly basic to maintaining a democratic society as such. So this way of visualizing what is at stake in judicial monitoring of corporate governance is not one we will pursue here. Rather, we offer social scientists (and judges) a way of identifying (a) those institutional arrangements that are truly basic to a democratic society and (b) when changes in corporate governance unambiguously challenge or enervate these institutional arrangements.

For now, we simply repeat that contractarians have been remarkably successful in establishing liberal complacency as today's orthodoxy. They have convinced a large and growing number of judges and legal scholars that, in principle, otherwise lawful exercises of corporate power do not (and can not) harm the larger society, either purposefully or inadvertently. At best, some judges and legal scholars resist orthodoxy by pointing out that even lawful and profitable corporate behavior can potentially harm particular,

readily identifiable, individuals or groups—say, by laying people off or by moving operations to another location. Yet even these seeming agnostics nonetheless typically assume that such harms can usually be priced so that, in principle at least, "victims" can be fully recompensed. With this, they operate within today's orthodoxy. They follow contractarians in narrowing the issue of corporate purpose to economic factors alone. In turn, they also accept the way contractarians portray the normative, extra-economic duties that the corporate judiciary imposes on corporate officers. Today's orthodoxy holds that these duties are anachronistic displays of "state paternalism." Thus, many judges and legal scholars no longer believe these normative limitations rest on truly settled principles of corporate law doctrine, despite the fact that American state courts have been imposing some of these limitations on corporate officers since the Founding.

Given its two crises of responsibility, the American corporate judiciary remains in the throes of its most thoroughgoing debate over basic principles of corporate law and corporate governance since the first stages of American industrialization and urbanization in the 1870s and 1880s. This was the period when, first, American pragmatism challenged corporate power in principle and then the Progressive movement did so in practice. Today's debate, too, moves well beyond academic concern with legal principles. Changes in legal doctrine covering corporate agency and corporate purpose directly influence the rulings of sitting judges. New judicial rulings on these matters, in turn, either open or close avenues for future corporate behavior. They also (arguably) open or close the same avenues for all other intermediary associations, from hospitals and universities to professional associations. Thus, new rulings on corporate agency and corporate purpose either reflect or anticipate larger shifts in the direction of social change in the United States.

One remarkable fact about today's debate over corporations and law is how little social theorists and other sociologists have participated in it. This is remarkable not only because corporations are the single most significant set of intermediary associations in American society. It is also remarkable because intermediary associations have long been a central concern of political theorists and then social theorists (from James Madison and Alexis de Tocqueville to the pragmatists and the Chicago School). In addition, classical European political philosophers and social theorists (from Georg Wilhelm Hegel to Emile Durkheim and Max Weber) also often drew attention to intermediary associations.

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noteworthy because the two major responsibilities of the corporate judiciary—identifying the corporate agent and defining corporate purpose—are more sociological and institutional than economic or narrowly legal. Indeed, as a social theorist, I do not share legal scholars' fascination with the details of the corporate governance disputes that come before state courts. But I am very interested in whether (and then how) the corporate judiciary as an institution monitors corporate power. I am equally interested in how judges and legal scholars conceptualize what courts are doing, the principles of corporate law doctrine they believe best explain past and present judicial behavior and best predict future judicial behavior. Indeed, I will introduce sociological concepts that, I believe, provide a better account of what the corporate judiciary is doing and why. These same concepts will also allow us to predict what will happen if the corporate judiciary ever takes a "contractarian turn" and monitors corporate power in only narrowly economic ways.

The central contribution of this volume is to explain an empirical state of affairs in the world: How, when, and why does the corporate judiciary impose social norms of behavior on corporate officers in publicly traded companies? Any explanation for such norm-based judicial behavior, in turn, simultaneously provides an answer to three other questions: Why does the corporate judiciary not simply monitor the behavior of corporate officers in strictly market-mimicking ways? Why does it not simply facilitate the workings of product markets, capital markets, and especially a new market for control over corporations? Why does it not state explicitly, as a matter of corporate law doctrine, that the only legitimate purpose of corporations in American civil society is either to maximize profits (for shareholders) or else to maximize growth (for the corporate entity)?

As I introduce sociological concepts that account for the corporate judiciary's norm-based behavior, I simultaneously introduce major issues in today's debate over corporations and law. I also identify major legal scholars (including judges) engaged in this debate. This is a second contribution of this book. Social scientists are largely unaware that in the late 1980s and early 1990s the corporate judiciary suffered from what one prominent judge called "institutional angst." The hostile takeovers and leveraged buyouts of the 1980s cast the corporate judiciary adrift from its traditional moorings in corporate law doctrine. Social scientists are also largely unaware that judges remain "available" today to consider manifestly sociological approaches to the issues of corporate agency and corporate purpose. They seek new doctrinal rationales for normatively mediating corporate

power in today's global economy. Judges have said as much, both implicitly in judicial rulings and more explicitly in speeches and journal articles.

In sharp contrast to the absence of most other social scientists in today's debate over corporations and law, economists are quite involved and quite aware of the controversies preoccupying the corporate judiciary and bar. They have greatly influenced this debate, particularly by lending support to contractarians' calls for courts to take a narrowly economic approach to the issue of corporate purpose. They have thereby helped to steer judges away from the idea that corporate power may carry *institutional* consequences for the larger society. Yet other judges are now convinced that economists and contractarians have gone too far. This is why they are now "available" to consider sociological alternatives, and especially those consistent with the corporate judiciary's more traditional reading of its two responsibilities.

A third contribution of this book is to bring the issue of corporate purpose more fully into view. Here I build on my first book, *Theory of Societal Constitutionalism*. In that volume I proposed that collegial organizations—in contrast to bureaucratic organizations, patron-client organizations, and even formally democratic organizations—uniquely institutionalize fidelity to procedural norms first identified by Harvard legal theorist Lon Fuller. I proposed that this ongoing procedural normative mediation of private power in civil society is what ultimately distinguishes the institutional design of democratic societies from that of formal democracies and imposed social orders. Now, in this volume, I explore whether and when the corporate judiciary protects collegial organizations in corporate governance structures, and endeavors to increase the number of these organizations across corporate America.

A fourth and related contribution of this book is to track the corporate judiciary's drift as an institution beginning in the mid-1970s. We will see that American state courts have been incrementally, unevenly, replacing traditional, substantive normative limitations on corporate power with procedural normative mediations. But we will also see that these courts falter at times in the midst of this still ongoing transition. In turn, legal scholars (to say nothing of economists) fail to isolate the source of this problem. Thus, judges' otherwise promising "procedural turn" is at times overtaken by the corporate judiciary's ongoing drift as an institution. Should it now rely increasingly on economic concepts, as contractarians prefer, or should it otherwise fail to update its own more traditional concepts, continued drift is likely. In today's flux of domestic and global economic change, this could well push the corporate judiciary beyond its institutional angst of the 1980s.

Further drift could result in a state of outright institutional crisis, leading ultimately to federalizing corporate law in whole or in part. Delaware courts in particular have a clear interest in seeing that this does not happen. What is certain, however, is that these courts, and the corporate judiciary as a whole, will not somehow arrive at a new equilibrium state, as if guided by a benevolent hidden hand, in the absence of new concepts that reconnect contemporary judicial practice to this institution's rich, decidedly extra-economic, traditions.

A final contribution of this book is to address larger sociological concerns. As I noted earlier, I am not interested in the details of the American corporate judiciary's activities as an institution. I leave this to legal scholars. I am also not interested in whether and how American (or other) corporations may increase their competitiveness in today's global economy. I leave this to economists. As a social theorist, I am interested in describing and explaining a shift in the direction of institutional change that began in the United States in the mid-1970s, that accelerated in the 1980s, and that concerns many judges and legal scholars today. I am interested in exploring what, if anything, is being done about this shift today by two major American institutions: the corporate judiciary and corporate governance structures. This is an eminently sociological issue.