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The Win-Win That Wasn't: Managing to the Stock Market's Negative Effects on American Workers and Other Corporate Stakeholders

Aneil Kovvali[*] *& Leo E. Strine, Jr.*[**]

Easterbrook and Fischel's work suggests that society as a whole would achieve the best results if corporate leaders focused only on raising stock prices, leaving other institutions to tend to all other interests. But the idea that making societally important corporations govern to the whims of the stock market would be a win-win for investors, other corporate stakeholders, and our society as a whole has proven incorrect. At bottom, Easterbrook and Fischel failed to contend with the real- world realities that allow investors to profit by shifting distributions and political power to themselves, while shifting costs and risks to workers, creditors, consumers, and taxpayers. In this Article, prepared for a Symposium celebrating Easterbrook and Fischel's work, we evaluate Easterbrook and Fischel's predictions and find that their failures are attributable to flaws in their assumptions about corporate influence over the political process and the extent to which stockholders could not succeed unless the corporation respected other stakeholders and society.

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I. Introduction

This festschrift highlights the bold and influential work of Frank Easterbrook and Dan Fischel, scholarship that influenced a generation or more of corporate law scholars and, perhaps more important, powerful players in American corporate governance like institutional investors and government policy makers. It is impossible to consider the path that American corporate governance has taken without acknowledging the impact of their thinking, and the ballast their arguments gave to those who drove policies designed to make American public companies more responsive to the immediate demands of the stock market and to tilt governance towards one that would transmit the desires of stockholders, particularly institutional investors with clout, more consistently and rapidly into corporate policy.

In our reflection on their core corporate law scholarship, however, we address a claim of Easterbrook and Fischel that in our view has, as a matter of empirical and lived reality, turned out to be false. That assumption was that if corporations were run to maximize the profits of stockholders, and to be highly responsive to their demands, that would benefit all of society.[1] The concept behind this was that stockholders could only gain if all other stakeholders had their legitimate expectations met, because stockholders were only residual claimants.[2] As a result, it would

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[1] Easterbrook & Fischel explain this perspective in the opening chapter of their book:

> Society must choose whether to conscript the firm's strength (its tendency to maximize wealth) by changing the prices it confronts or by changing its structure so that it is less apt to maximize wealth. The latter choice will yield less of both good ends than the former. . . . [M]aximizing profits for equity investors assists the other 'constituencies' automatically. The participants in the venture play complementary rather than antagonistic roles. In a market economy each party to a transaction is better off.

FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991).

[2] This point becomes clear in their discussion of corporate voting:

> [S]hareholders are the residual claimants to the firm's income. Creditors have fixed claims, and employees generally negotiate compensation schedules in advance of performance. The gains and losses from abnormally good or bad performance are the lot of the shareholders, whose claims stand last in line. As the residual claimants, shareholders have the appropriate incentives (collective choice problems not withstanding) to make discretionary decisions. The firm should invest in new products, plants, and so forth, until the gains and costs are identical at the margin. . . . The shareholders receive most of the marginal gains and incur most of the marginal costs. They therefore have the right incentives to exercise discretion.

Id. at 67–68.

benefit all if we ran corporations to their direction, because that would grow the value of companies in the maximum way, for the benefit of all stakeholders and society as a whole.

They thus posited a win-win because there was no zero-sum game. Because of their uniquely vulnerable status as residual claimants, without the greater protections of law and contractual precedence other stakeholders had, stockholders supposedly could only win if the other stakeholders did.

But this line of reasoning depends on certain assumptions being true. First of all, it requires the corporation to be surrounded by effective institutions that protect stakeholders and prevent stockholders from externalizing costs to them. The government must thus enact and diligently enforce rules that set appropriate "prices" on socially dangerous behavior. And corporations themselves must not use the entrusted capital of others to act on the political process and to tilt the rules of the game away from those conditions, and toward ones where the fair costs of doing business are shifted from equity investors to workers, creditors, consumers, the environment, community members, and taxpayers. Workers must be protected against unsafe and overly taxing conditions of employment. Constraints must be set so that employers cannot lowball vulnerable workers by paying poverty-level wages and benefits, and workers must be secure in their freedom to join together to bargain and claim their fair share of corporate profits when negotiating employment contracts. Communities and creditors who subsidize corporations must genuinely be made whole before stockholders can harvest. Product markets must ensure robust and healthy competition that encourages corporations to do better by customers, and ensure that products are safe and services are not fraudulent. And financial markets must properly value the contributions and risks generated by corporations, so that share prices reflect and reward sustainable, durable growth, not short-term opportunities for harvest.

On those assumptions, stockholders can only gain if societal interests are respected, because stockholders are only able to harvest if those interests are first satisfied. Stockholders, as residual risk bearers, are the most long-term oriented corporate constituency, and thus focus on creating real social wealth. Running corporations for the benefit of shareholders thus best aligns all interests. In that imagined environment, a corporate governance regime that encouraged ruthless focus on what stockholders at any moment demand would lead to shared prosperity.

But this is another way of saying that Easterbrook and Fischel assumed all the important problems away. We are told that corporations and those that study them need not do the hard work of finding ways to help society, because we can assume the existence of other tools—other institutions and markets—that will ensure that stockholder wealth generation is aligned with social wealth generation.

Over the past three decades, the benign assumptions Easterbrook and Fischel used to slough off the worry that making corporations more responsive to investor power would hurt other stakeholders have turned out to be untenable. The argued "win-win" has been a win for one constituency—stockholders—and at best another—top management—to the detriment of those most responsible for corporate success: the workers. The investor class, now more powerful and represented through muscular institutional investors, is far more privileged than workers, and the change in gain sharing has driven inequality to levels not seen since before the New Deal.[3] And evidence suggests that gains to stockholders have come at the expense of debt holders, communities of operation, and taxpayers, as corporations have shifted costs to them and bubble behavior has caused the need for repeated societal bailouts of the investor and financial class.[4]

These shifts have been aided by the use of corporate political power to decrease the external protections for corporate stakeholders and society, and to free corporations to cater more to just their stockholder constituency. With the power of that one constituency going way up and the others, particularly workers, going way down, the distributional effects have not been surprising, and are the opposite of the win-win Easterbrook and Fischel predicted.

In this Article, we briefly survey the realities at odds with Easterbrook and Fischel's win-win prediction, and why there is understandably a demand for rebalancing within corporate governance itself to deal with the actual challenges that Easterbrook and Fischel wished away.

This Article proceeds as follows. Part II briefly introduces Easterbrook and Fischel's win-win argument. Part III sets forth the bottom-line data on the win-win hypothesis, especially as it

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[3] *See* Estelle Sommeiller & Mark Price, *The New Gilded Age*, ECON. POL'Y INST. (July 19, 2018), https://perma.cc/S5UB-EFZ3 (summarizing study showing that share of income earned by the top 1% in 2007 was just shy of the share of income earned by the top 1% in 1928).

[4] *See infra* Part IV.B–D.

relates to American workers, and shows how the reality has fallen far short of the prediction. Part IV shows that these failures were predictable in that the world view of the larger school of which Easterbrook and Fischel are leaders was hostile to the very institutions they argued would protect other stakeholders. Far from being dispersed and powerless, stockholders have become increasingly powerful, aided by the concentration of power in the hands of institutional investors who largely pursue a shareholder primacy agenda.[5] The so-called Reagan revolution, inspired by Milton Friedman and Lewis F. Powell, Jr. (later Justice Powell) and supported by Easterbrook and Fischel, systematically sought to reduce the effectiveness of government institutions that enforced the rights of workers, minorities, and women against discrimination in the workforce and at the ballot box, that policed the antitrust laws, and that protected the environment.[6] Corporations funded efforts to suppress knowledge about climate change and to undercut efforts to clean up the air and water of our nation. Although within the corporate law domain, Easterbrook and Fischel argued that corporations should focus only on stockholder welfare and leave stakeholder and societal welfare to others, corporations picked up on the encouragement of Powell and others and used their power to undermine the legal rights of workers to join a union, to erode the real level of the minimum wage, and to shift value from workers to equity holders.[7] This corporate behavior underscores a historical reality—corporations and their stockholders can profit for decades, and longer, by business operations that are unsafe and unfair to company workers, dangerous to company consumers, and that are environmentally irresponsible.[8] The stockholders of these companies harvest all the time, but often leave injured consumers, a harmed environment, communities with lost taxes, and workers with failed pension plans bearing the actual residual risk. And financial markets can suffer from serious blind spots and biases that prevent them from properly reflecting the full future effects of corporate decisions, and requiring taxpayers and society as a whole to bail out the haves, while leaving the have-nots to bear the brunt of the costs. For all these reasons, an approach to corporate and securities laws that increases the power of just one constituency—stockholders—and that decreases the power of all others will generate

[5] *See infra* Part IV.A.
[6] *See infra* Part IV.B.
[7] *See infra* Part IV.C.
[8] *See infra* Part IV.D.

results that should be obvious to any realist: The constituency with greater power reaps more of the rewards than the others and shifts more of the costs of generating those rewards to the less powerful. Part V concludes.

II. CORPORATE CONTEXT

Easterbrook and Fischel's key move is to define shareholder wealth maximization as the basic objective of corporate law. Though they offer several arguments,[9] a central plank of their platform is a win-win hypothesis: "maximizing profits for equity investors assists the other 'constituencies' automatically."[10] Workers, consumers, and communities will all benefit from a system of corporate law that focuses exclusively on shareholder wealth maximization.

This win-win prediction is central to their work. After using it to justify their preferred end for corporate law, Easterbrook and Fischel go on to propose particular means for achieving that end: a model of corporate governance that would allow temporary majorities of shareholders to exercise control and make a quick buck with financial schemes.[11]

But though they offer a clear win-win prediction, their explanation of the basis for that prediction is muddled and superficial. First, they suggest that: "The participants in the venture play complementary rather than antagonistic roles. In a market economy each party to a transaction is better off. A successful firm provides jobs for workers and goods and services for consumers."[12] Of course, this argument cannot be taken too seriously, or too far. If these constituencies would all benefit from the same corporate conduct, it should not matter whether corporate managers are directed to serve shareholders or other constituencies. All constituencies should agree on what is to be done in their mutual interest and all could share in power over corporate decision-making.

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[9] Among other arguments, Easterbrook and Fischel declare that there is an "expectation" that stockholders "have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock." EASTERBROOK & FISCHEL, *supra* note 1, at 36. They also suggest that any alternative would increase agency costs and allow managers to evade accountability. *Id.* at 38.

[10] *Id.* at 38.

[11] *E.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) [hereinafter Easterbrook & Fischel, *Proper Role of a Target's Management*]; Frank H. Easterbrook & Daniel R. Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733 (1981).

[12] EASTERBROOK & FISCHEL, *supra* note 1, at 38.

Because history suggests that business leaders resist giving other stakeholders a say, and because the history of the laboring class before regulation suggests it is possible for centuries to extract wealth from the toil of the many, we take the more traditional view that power matters and those with it tend to direct gains toward themselves. Within American corporate law, only one constituency, stockholders, had real clout over management when *The Economic Structure of Corporate Law* was written, and Easterbrook and Fischel argued that the stockholders should be made even more powerful.

Second, they suggest that "[w]ealthy firms provide better working conditions and clean up their outfalls; high profits produce social wealth that strengthens the demand for cleanliness."[13] This mechanism is again unclear. It is reasonable to believe that some of the more profitable firms are more likely to depart from strict shareholder value maximization by splurging on workers or the environment. But is that always the case? We do not wish to throw stones at particular companies. Let's just say that it is not difficult to come up with lists of companies that have provided big returns to stockholders while being known for environmental irresponsibility, great consumer harm, unsafe working conditions and poor diversity, equity, and inclusion ("DEI") practices, and low pay to the workers and the regular employment of contracted workers with no rights and trifling wages.

Finally, they posit an identity between increasing shareholder profits and generating overall economic growth. They suggest that this identity has eluded commentators:

> Firms that close plants in one area while relocating production elsewhere are accused of lacking a sense of responsibility to affected workers and communities. Yet such a statement ignores the greater benefits that workers and communities in the new locale enjoy. (They must be greater, or there would be no profit in the move.) . . . All competition produces dislocation—all progress produces dislocation (pity the makers of vacuum tubes and slide rules!)— and to try to stop the wrenching shifts of a capitalist economy is to try to stop economic growth.[14]

This final justification gets at the core of the win-win prediction: a change that increases shareholder profits necessarily represents social progress. If a firm's shareholders profit from a

[13] *Id.*
[14] *Id.* at 38–39.

move, it must be the case that other constituencies benefit as well. But this suggestion ignores the possibility of maneuvers that increase shareholder profits by squeezing other constituencies more effectively: win-lose changes that are negative on net. Put simply, these moves can contribute to an overall shift, where the haves—the owners of equity—win at the overall expense of the many, the workers most responsible for our economy's success, by creating a cycle of extraction at their expense to squeeze out more and more gains for the stockholders. In other words, although it may well be that a corporation can often move to a place where workers or the community are so much worse off that the corporation can cut its cost of operations while somewhat improving the lives of the lower-waged and less-protected workers they have engaged to replace those with better quality wages and rights, that way of "increasing efficiency" is one that does not lift all workers and stakeholders in the long run, but one that encourages a downward spiral in which all workers and stakeholders lose leverage to their ultimate detriment. And, as a matter of reality, stockholders have taken more of the gains of corporate wealth created by American workers as a result of the power shift to investors that Easterbrook and Fischel advocated in *The Economic Structure of Corporate Law*.

III. Flawed Predictions

In this Part, we evaluate whether Easterbrook and Fischel's predictions have held true. We find that they have not. Corporations have created financial returns for shareholders, but largely at the expense of other constituencies like workers. The imbalances in our current system have also left it brittle and less capable of avoiding or responding to crises.

Many studies have documented corporate America's failure to generate shared prosperity, and any survey of results will necessarily be incomplete. But some recent results have been particularly shocking.

In one study, Daniel Greenwald, Martin Lettau, and Sydney Ludvigson explore the reasons for increases in American market equity values.[15] They estimate that between 1952 and 1988, economic growth accounted for the full increase in American equity. But from 1989 to 2017, 44 percent of the increase was driven by

[15] Daniel L. Greenwald, Martin Lettau, & Sydney C. Ludvigson, *How the Wealth Was Won: Factors Shares as Market Fundamentals* (Nat'l Bureau of Econ. Rsch., Working Paper No. 25769, 2021), https://perma.cc/6MYE-BHXD.

a reallocation of rewards from stakeholders—principally labor—to shareholders, 18 percent by a lower risk price, and 14 percent by lower interest rates. Only 25 percent of the increase was caused by genuine economic growth.

In another study, Anna Stansbury and Larry Summers examine the increase in corporate value and the decrease in the share of national income going to labor and conclude that it is a direct result of a decline in worker power:

> The evidence in this paper suggests that the American economy has become more ruthless, as declining unionization, increasingly demanding and empowered shareholders, decreasing real minimum wages, reduced worker protections, and the increases in outsourcing domestically and abroad have disempowered workers—with profound consequences for the labor market and the broader economy. We argue that the reduction in workers' ability to lay claim to rents within firms could explain the entirety of the change in the distribution of income between labor and capital in the United States in recent decades and could also explain the rise in corporate valuations, profitability, and measured markups, as well as some of the decline in the [non-accelerating inflation rate of unemployment].[16]

Stansbury and Summers also note that the same phenomenon may have contributed to inequality: "the declines in unionization and the real value of the minimum wage and the fissuring of the workplace affected middle-and low-income workers more than high-income workers, and some of the lost labor rents for the majority of workers may have been redistributed to high-earning executives (as well as capital owners)."[17]

Importantly, Stansbury and Summers isolate this profound shift in gainsharing away from American workers and toward stockholders from the overall effect of globalization. As they point out, American workers' productivity and resulting corporate profits have grown substantially as the economy has globalized.[18] But what has most changed is that the share of the profits that

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[16] Anna Stansbury & Lawrence H. Summers, *The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy*, BROOKINGS PAPERS ON ECON. ACTIVITY, Spring 2020, at 1, 63.

[17] *Id.* at 8.

[18] *Id.* at 2–3.

corporations generate that goes to workers has diminished substantially, with their former share instead going to stockholders.[19]

Surveying the landscape and collecting a broad range of sources, one of us has commented:

> [T]he world is not an optimistic place. Median income has stagnated since the early 1970s. Productivity increases have slowed and wages never did fully experience the benefit of rapid productivity increases of the last two decades. Economic growth is stagnant. The government has been compelled to provide giant subsidies to corporations engaged in risky commercial conduct. At the same time, the number of American public corporations has declined sharply. Finally, there is a growing disparity between the pay of CEOs and that of average workers, symptomatic of a general increase in inequality.[20]

And that was before the societal and economic crisis prompted by COVID-19. The crisis exposed serious gaps in the preparations of socially important companies. In a broad range of industries, from healthcare to meat processing, companies had relentlessly optimized themselves to maximize immediate shareholder profits within a particular operating environment. As a result, these essential businesses were unable to operate safely at socially required levels when the crisis struck.[21] Having failed to husband adequate reserves in the face of stockholder demands to run "lean balance sheets," many corporations reacted to the pandemic with mass layoffs and by shirking their rent obligations.[22]

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[19] *Id.* at 3–4. Stansbury and Summers' work underscores and is consistent with the outstanding work of, among others, Lawrence Mishel of the Economic Policy Institute on this point. *E.g.*, Lawrence Mishel, *Growing Inequalities, Reflecting Growing Employer Power, Have Generated a Productivity-Pay Gap Since 1979*, ECON. POL'Y INST. (Sept. 2, 2021), https://perma.cc/XGZ2-KE9Z.

[20] Leo E. Strine, Jr., *Who Bleeds When Wolves Bite?*: *A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1950–51 (2017) [hereinafter Strine, *Who Bleeds When Wolves Bite?*].

[21] *See* Aneil Kovvali, *Essential Businesses and Shareholder Value*, 2021 U. CHI. LEGAL F. 191.

[22] *E.g.*, Douglas MacMillan, Peter Whoriskey, & Jonathan O'Connell, *America's Biggest Companies Are Flourishing During the Pandemic and Putting Thousands of People Out of Work*, WASH. POST (Dec. 16, 2020), https://perma.cc/BMF7-EWSE ("45 of the 50 most valuable publicly traded U.S. companies turned a profit . . . . Despite their success, at least 27 of the 50 largest firms held layoffs this year, collectively cutting more than 100,000 workers . . . ."); Taylor Borden, Allana Akhtar, Joey Hadden, & Debanjali Bose, *The Coronavirus Outbreak Has Triggered Unprecedented Mass Layoffs and Furloughs. Here Are the Major Companies that Have Announced They Are Downsizing Their Workforces*, BUS. INSIDER (Oct. 8, 2020), https://perma.cc/B8TZ-LRAD; Conor Dougherty & Peter Eavis, *Tenants' Troubles Put Stress on Commercial Real Estate*, N.Y. TIMES (June 9,

And it turned out that the workers essential to making our economy work turned out to be paid less than most workers and less likely to be white.[23] These essential workers had to put themselves more at risk for less pay. Human beings were exposed to a deadly pandemic so that they could continue to work in unsafe conditions at these companies: our system designated some jobs so essential that the lives of the workers who filled them could be sacrificed. Millions of workers also lost their jobs, suffered reduced wages, and had their housing endangered or lost. Yet as the crisis unfolded and deaths climbed into the hundreds of thousands, share prices reached record highs.

This disparity is not one we point out to blame corporate America for the pandemic; we do not blame it for this disaster for humanity. But the fact that the investor class has seen its returns soar at a time when other corporate stakeholders were struggling to survive highlights again the unreality of the win-win hypothesis of managing corporations to the market.

IV. FLAWED ASSUMPTIONS

In this Part, we evaluate whether Easterbrook and Fischel's assumptions have held true. We find that they have not. They assumed a dynamic where corporate stockholders were weak and dispersed, strong external institutions protected other stakeholders, and there was more slack for management to act in other-regarding ways. These assumptions have not held: a) stockholders are reaggregated and powerful, reducing the space management has to balance fairly the interests of workers, creditors, consumers, communities, and others against the desire of

2020), https://perma.cc/8RNW-DMQS; Leo E. Strine, Jr. & Dorothy S. Lund, *How to Restore Strength and Fairness to Our Economy*, N.Y. TIMES (Apr. 10, 2020), https://perma.cc/Q2PG-W62V ("[M]any businesses did not have sufficient reserves to pay the next month's rent after less than a month of slowdown, and . . . many more furloughed or laid off thousands of workers for the same reason . . . .").

23 *E.g.*, Tiffany N. Ford & Molly Kinder, *Black Essential Workers' Lives Matter. They Deserve Real Change, Not Just Lip Service*, BROOKINGS (June 24, 2020), https://perma.cc/8ABJ-DD2Y ("From bus drivers to security guards to hospital orderlies, Black workers are overrepresented among COVID-19's frontline essential workers (defined as essential workers who must physically report to jobs sites where they face elevated risks of infection). They are especially overrepresented in jobs that put workers' and their families lives at risk without even a family-sustaining living wage."); Elise Gould & Valerie Wilson, *Black Workers Face Two of the Most Lethal Preexisting Conditions for Coronavirus*, ECON. POL'Y INST. (June 1, 2020), https://perma.cc/DH96-86ZN (summarizing finding that Black workers "make up a disproportionate share of . . . essential workers who are forced to put themselves and their family members at additional risk of contracting and spreading COVID-19 in order to put food on the table.").

concentrated short-term stockholders for greater returns; b) external protection of other stakeholders has been compromised, in large measure by corporate influence itself; c) workers in particular have suffered a loss of protection; and d) financial markets have failed to deliver returns correlated to social value created by firms, in part because the government has regularly stepped in to bail out the shareholders of firms that ran socially-destructive risks.

In some ways, our approach is anticipated by the work of Adolf Berle. Berle recognized that corporations must be disciplined by government, by product markets, and by shareholders, and was attentive to the implications of shifts in the real-world effectiveness of and among those institutions.[24]

A. Rising Stockholder Power

Easterbrook and Fischel's writings treat shareholders as a dispersed and powerless group, unable to overcome collective action problems to assert their shared interests.[25] Although this characterization might have had some purchase at the time they wrote, it is entirely inaccurate today.

As a result of the decline in defined benefit pension plans, tax incentives and changes in investment fashions, American savers have increasingly had to place their wealth in the hands of institutional investors.[26] Institutional investors deploy the capital saved in tax advantaged retirement and educational accounts, like 401(k)s and 529 accounts. Such institutional investors often have incentives that systematically differ from the relatively broad and diverse base of human workers and savers whose capital is being deployed, and thus are eager to churn portfolios and to demand rapid short-term financial returns of portfolio

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[24] William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and the Modern Corporation*, 34 J. CORP. L. 99 (2008).

[25] *See, e.g.*, Easterbrook & Fischel, *Proper Role of a Target's Management*, *supra* note 11, at 1170–71; EASTERBROOK & FISCHEL, *supra* note 1, at 171–72; *see also supra* text accompanying note 1; GRANT M. HAYDEN & MATTHEW T. BODIE, RECONSTRUCTING THE CORPORATION: FROM SHAREHOLDER PRIMACY TO SHARED GOVERNANCE 3 (2020) (noting that Easterbrook and Fischel's scholarship argues "that shareholders were the most economically vulnerable of the firm's participants").

[26] *See* Leo E. Strine, Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. CORP. L. 1, 4–5 (2007) (arguing that workers are forced capitalists in the sense that they must turn over a substantial fraction of their earnings to mutual funds participating in 401(k) and 529 accounts if they wish to save for college for their children and retirement for themselves).

companies.[27] Institutional investors implementing passive index-tracking strategies have also grown to enormous size: the "Giant Three" index funds cast approximately 25 percent of the votes in corporate elections.[28] Such index funds have strong incentives to defer to proxy advisory services and "governance arbitrageurs" who also insist upon rapid short term financial returns.[29] As a result of these trends, shareholder power is increasingly concentrated in the hands of a few players that often have a unified agenda. These institutions have pushed corporate governance policies that make corporations more subject to direct stockholder sentiment, more open to the market for corporate control, and more focused on total stock return.[30]

And, even though more Americans are required to invest, the share of stock owned by the affluent remains extremely high, and many less affluent members of our society do not own any stock at all. Therefore, shifts in gainsharing from corporate workers to stockholders exacerbates inequality and prevents workers from building wealth themselves.[31]

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[27] Strine, *Who Bleeds When Wolves Bite?*, *supra* note 20, at 1928.

[28] *E.g.*, Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721 (2019).

[29] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013).

[30] *E.g.*, Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563 (2021) (describing multiple institutional gatekeepers that enforce fidelity to a particular model of shareholder primacy); Strine, *Who Bleeds When Wolves Bite?*, *supra* note 20, at 1916 (describing fund manager acquiescence in efforts to install "a direct democracy, corporate California model–where there is always an opportunity for immediate market sentiments to be heard and where there is no attempt to establish a rational system of periodic votes on issues like executive compensation"); William Savitt & Aneil Kovvali, *On the Promise of Stakeholder Governance: A Response to Bebchuk and Tallarita*, 106 CORNELL L. REV. 1881 (2021). These institutions have scored real victories in advancing their vision of optimal corporate governance, including dismantling classified boards. It is at best unclear whether these victories have actually created shareholder value. *E.g.*, Yakov Amihud, Markus Schmid, & Steven Davidoff Solomon, *Settling the Staggered Board Debate*, 166 U. PA. L. REV. 1475 (2018) (concluding that classified boards create value at some firms, destroy value at some firms, and have no effect at others).

[31] Strine, *Who Bleeds When Wolves Bite?*, *supra* note 20, at 1941–42. For recent statistics, see Lydia Saad & Jeffrey M. Jones, *What Percentage of Americans Owns Stock?*, GALLUP (Aug. 13, 2021), https://perma.cc/7PLQ-5DGZ (stating that only 56% of Americans report owning any stock, and that only 24% of Americans with less than $40,000 in income report owning stock). Because this economic inequality translates into unequal power in society, it also serves to exacerbate racial inequality. *See* Lenore Palladino, *The Contribution of Shareholder Primacy to the Racial Wealth Gap* (Mar. 6, 2020) (unpublished manuscript), https://perma.cc/6M9Y-HB6F; Leo E. Strine, Jr., *Toward Racial Equality: The Most Important Things the Business Community Can Do*, CLS BLUE SKY BLOG (Nov. 2, 2020), https://perma.cc/WMX6-H73E.

Likewise, pressures by stockholders on corporations encourage corporations to engage in rent-seeking against taxpayers, by seeking exemptions from critical sources of revenues for schools, local institutions, and the federal government. The share of taxes paid by corporations has drastically diminished, a reality that undercuts the ability to fund important regulatory agencies essential to stakeholder protection and that shifts the obligation to government more away from the wealthy and toward the average person.[32]

These developments undermine Easterbrook and Fischel's case for strengthening shareholders. Individual shareholders can freely exit their positions and can recapture their capital investment with ease. Because shareholder power is not dispersed or subject to collective action problems, shareholders as a group can also readily force corporations to return capital through dividends and share buybacks. Far from being locked-in and powerless, forced to accept the "residual" remaining after other constituencies have claimed their fair share, stockholders are able to claim early and often, and to force costs and risks onto other constituencies.

This can ultimately damage shareholders themselves. A timely example of the fact that managing companies to benefit solely their stockholders ultimately damages investors is human-created climate change. The sad reality is that the very industry that generated the most climate change—the oil and gas industry—knew and accepted the reality that human carbon emissions were causing climate change that was ultimately unsustainable.[33]

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[32] *See* Thomas L. Hungerford, *Corporate Tax Rates and Economic Growth Since 1947*, ECON. POL'Y INST. (June 4, 2013), https://perma.cc/64DP-3PGE (finding that corporate income taxes accounted for about 30% of total revenues in the 1950s, but only 10% in 2012). Easterbrook and Fischel also ignore the reality that taxing corporations, which are owned on average by wealthier people, has a progressive effect as opposed to imposing taxes at the individual level. *Id.* ("[T]he corporate income tax contributes to the overall progressivity of the tax system to the extent that the corporate tax burden falls on capital. . . . Many tax policy analysts and government agencies distribute the majority of corporate tax burden to capital (between 75 percent and 82 percent)."); Hunter Blair, *As Investment Continues to Decline, the Trump Tax Cuts Remain Nothing but a Handout to the Rich*, ECON. POL'Y INST. (Feb. 4, 2020), https://perma.cc/4PBN-PMKQ.

[33] *E.g.*, Geoffrey Supran & Naomi Oreskes, *Assessing ExxonMobil's Climate Change Communications (1977–2014)*, 2017 ENV'T. RSCH. LETTERS 12 (2017) (presenting study of ExxonMobil documents and public communications, and concluding "that ExxonMobil misled the public"); Shannon Hall, *Exxon Knew About Climate Change Almost 40 Years Ago*, SCI. AM. (Oct. 26, 2015), https://perma.cc/EH4C-PGJD.

Like the tobacco industry before it,[34] this industry responded to this knowledge by suppressing it from the public, and when others presented the evidence, disputing that evidence, while knowing it was correct. This behavior might well have benefited an undiversified stockholder of these particular corporations in the short term. This is by no means certain. Even concentrated shareholders can suffer as managers adopt measures to drive up immediate financial returns and seek to bend the regulatory system instead of attending to the risks that the system is intended to address.[35]

But the most substantial costs are borne by human beings in their full economic and human portfolios (think, for example, of their need for quality jobs, a healthy environment, and their obligation to pay taxes to cover externalized corporate harms) and thus society as a whole and are reflected in diminished returns for diversified investors with broad portfolios. Given the huge costs that climate change has already imposed, and the gigantic costs it will impose in the near future, it is not credible to claim that this corporate behavior represented a win-win between these companies' investors and society.

In fact, for diversified investors, the gains made by these companies by delaying a transformation of their industries will be swamped by the negative costs to all companies and society.[36] The

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34 *See, e.g.*, *United States v. Philip Morris USA, Inc.*, 449 F. Supp. 2d 1, 28 (D.D.C. 2006), *vacated in part and aff'd in part*, 566 F.3d 1095 (D.C. Cir. 2009) ("[The tobacco industry] survives, and profits, from selling a highly addictive product which causes diseases that lead to a staggering number of deaths per year, an immeasurable amount of human suffering and economic loss, and a profound burden on our national health care system. Defendants have known many of these facts for at least 50 years or more. Despite that knowledge, they have consistently, repeatedly, and with enormous skill and sophistication, denied these facts to the public, to the Government, and to the public health community.").

35 *See, e.g.*, Leo E. Strine, Jr., *Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending*, 97 WASH. U. L. REV. 1007, 1035–37 (2020) ("Logically, one would infer that there is a high correlation between public corporations that engage in problematic behavior and those that engage in spending to influence the political process. Even from the narrow perspective of an investor in an actively traded mutual fund with a smaller portfolio of stocks, there is strong reason to be concerned that corporate political spending is a warning signal for investors."); John C. Coates, IV, *Corporate Politics, Governance, and Value Before and After* Citizens United, 9 J. EMPIRICAL STUD. 657, 658 (2012) (finding that corporate "political activity . . . correlates negatively with . . . shareholder value"). For one deadly example of a corporation pursuing immediate shareholder profits, working the regulators, and facing a catastrophe as a result, see PETER ROBISON, FLYING BLIND: THE 737 MAX TRAGEDY AND THE FALL OF BOEING (2021) (discussing Boeing's development of the 737 Max, a defective plane that caused numerous deadly high-profile crashes).

36 *E.g.*, John C. Coffee, Jr., *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk*, 2021 COLUM. BUS. L. REV. 602; Madison Condon, *Externalities and the*

same can be said of the misuse by pharmaceutical companies of their marketing techniques to pump up sales of opioids, in an irresponsible, life- and community-destroying way.[37]

And this raises another flaw in Easterbrook and Fischel's reasoning. Most investors are not long one company or one industry. They are long the whole economy.

Most of them depend more on their job for their wealth than their stock. Most of their portfolios track the whole economy, and also contain substantial amounts of debt securities.[38] And these diversified human investors also pay taxes, consume products, and live in the environment.

A system of corporate governance that focuses each company on maximizing the immediate wealth of the company's specific stockholders does not even maximize the overall economic welfare of equity investors. Rather, by pushing companies to manage to the market and only consider their equity investors, it moves all corporate managers closer to the edge of irresponsibility, in which shortcuts that harm workers, creditors, consumers, communities, and the environment are tempting ways to satisfy their powerful stockholders' demands. Instead of recognizing the reality that

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Common Owner, 95 WASH. L. REV. 1 (2020). Concentrated shareholders can also suffer as a result of measures adopted to drive up immediate financial returns.

37 For an account of the pharmaceutical industry's marketing of opioids, its effect on society, and its effect on the financial fortunes of one group of concentrated shareholders, see PATRICK RADDEN KEEFE, EMPIRE OF PAIN: THE SECRET HISTORY OF THE SACKLER DYNASTY (2021). Although the infamous Purdue Pharma was a privately held company, public companies also participated in the mass marketing of these dangerously addictive drugs. *See, e.g.*, Jan Hoffman, *Drug Distributors and J&J Reach $26 Billion Deal to End Opioid Lawsuits*, N.Y. TIMES (July 21, 2021), https://perma.cc/T4VR-M4N3 (describing $26 billion settlement with Johnson & Johnson, Cardinal Health, AmerisourceBergen, and McKesson for opioid misconduct).

38 Like many others, Easterbrook and Fischel overestimate the extent to which agency costs only exist in a form that harms stockholders. Most diversified investors hold corporate debt securities as a substantial part of their portfolio, but the level of stewardship they receive by the institutional investors who run debt funds is far less than exists on the equity side, and underwriting standards have eroded as debt has been securitized. Just as is the case with workers, stockholders can and do gain at the expense of creditors. A good deal of evidence exists that increases in stock prices as a result of activism often result in value transfers from debt holders to equity holders. *E.g.*, Strine, *Who Bleeds When Wolves Bite?*, *supra* note 20, at 1940 (noting that "some scholars have found that rather than creating additional firm value, hedge fund activism engaged in by equity investors has the effect of shifting wealth from debt capital to equity capital" and collecting sources); John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 588 (2016) (citing evidence that in activist engagements "there is a wealth transferred [sic] from bondholders to shareholders"); *cf.* John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 68 (1986) ("Anecdotal evidence is now abundant that bondholders have recently been adversely affected by highly leveraged takeovers.").

American corporate law has always given priority to stockholders, Easterbrook and Fischel instead push for it to limit the space managers have to create wealth in ways that are respectful of other stakeholders and thus create far greater incentives to harm stakeholders and society, and diversified investors themselves.

To the extent that the vision of shareholders as true residual claimants was true in the middle of the twentieth century, one wonders what made it so. What made it impossible for businesses to succeed unless they treated labor with respect and did not externalize other costs to society? It was certainly not some natural force of economics. Economic history suggests that it is quite possible for equity owners to profit off the backs of others.[39] Instead, it was an appropriate regulatory environment. Most of what the New Deal and European Social Democratic reforms were about was a recognition of that reality, and creating a structure within which businesses were more likely to make money in a way that required that they have at least some minimal regard for workers, consumers, the environment, and society as a whole. But, as discussed below, Easterbrook and Fischel are among the school of thinkers who say stakeholders should rely on external legal protections outside of corporate law, without favoring those protections and while generally supporting their erosion or repeal.[40] The Easterbrook and Fischel position is a specific application of Milton Friedman, and all share the Friedman-Reagan view that

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[39] This is not a new phenomenon. As President Lincoln recognized, economic exploitation was a major part of the moral abomination of slavery. *See* Abraham Lincoln, Second Inaugural Address (Mar. 4, 1865) ("It may seem strange that [the Confederacy] should dare ask a just God's assistance in wringing their bread from the sweat of other men's faces; but let us judge not that we be not judged."). This fact was not lost on former slaves. ERIC FONER, RECONSTRUCTION: AMERICA'S UNFINISHED REVOLUTION, 1863–1877, at 102 (rev. ed. 2014) ("Blacks brought out of slavery a conception of themselves as a 'Working Class of People' who had been unjustly deprived of the fruits of their labor."). It was not lost on the architects of Reconstruction, who sought to remake the southern economy on lines that would promote economic freedom. *Id.* at 392. And it was not lost on the violent opponents of Reconstruction, who sought to restore conditions of economic exploitation rapidly upon assuming power. *See id.* at 588 ("[Southern Redeemers] shared . . . a commitment to dismantling the Reconstruction state, reducing the political power of blacks, and reshaping the South's legal system in the interests of labor control and racial subordination."). Feudal systems persisted well into the twentieth century in various forms. *E.g.*, Nikolas Bowie, *Antidemocracy*, 135 HARV. L. REV. 160, 160–61 (2021) (tracing through-line of antidemocratic oppression of workers from slavery through the redemption period to twentieth century efforts to suppress agricultural labor organizing). And so-called laissez-faire, when it evolved, often involved markets that in reality provided no power to workers in comparison to those with inherited wealth and who were part of the powerful classes. In all of these eras, and even today, profit could be reaped by a few at the expense of the many.

[40] *See infra* Part IV.B.

stakeholder protections should largely be dispensed with and the Powell view that corporations should use their influence to make that happen. Indeed, Friedman opposed the National Labor Relations Act, minimum wage laws, and the Civil Rights Act of 1964, and he considered racial equality concerns and environmental considerations to be newly emerging "catchwords of the contemporary crop of reformers" that businesses should ignore.[41] In his worldview, effective external protections for workers, the environment, consumers and society actually would not exist, and one senses that Easterbrook and Fischel are closer to his position, and that of Reagan, than is stated in the work that is the subject of this retrospective. In sum, Easterbrook and Fischel cannot be characterized as supporters of those external safeguards, and their opposition to allowing corporations to be other-regarding toward workers, other stakeholders, and society must be understood in the context of a worldview that generally prefers that the New Deal not have occurred and the EPA not have existed.

B. Declining External Protections for Other Corporate Stakeholders

As Easterbrook and Fischel acknowledge, government regulation is required to force firms to internalize the costs of their behavior:

> We do not make the Panglossian claim that profit and social welfare are perfectly aligned. When costs fall on third parties—pollution is the common example—firms do injury because harm does not come back to them as private cost. Dumping offal may impose costs on downstream users exceeding the gains to the stockholders. . . . The task is to establish property rights so that the firm treats the social costs as private ones, and so that its reactions, as managers try to maximize profits given these new costs, duplicate what all of the parties (downstream users and customers alike) would have agreed to were bargaining among all possible without cost.[42]

If the government fails to impose "new costs" on firms to force them to internalize the consequences of their conduct, firms will engage in socially destructive behavior.

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[41] Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG. 32 (Sep. 13, 1970), https://perma.cc/ZHX7-Z8LZ.

[42] EASTERBROOK & FISCHEL, *supra* note 1, at 39.

The problem, of course, for this argument is that Easterbrook and Fischel would not call themselves vigorous supporters of external protections for stakeholders.[43] And more certainly, fellow adherents to their worldview, like Milton Friedman who opposed unions, the civil rights and environmental laws,[44] are oddly positioned to say, "leave the protection of other stakeholders to positive law," when they oppose that positive law, and advocated for policies, like those of the Reagan Administration, to erode the effectiveness of key laws protecting workers, consumers, minorities and women, and the environment.

Since 1980, many of the key protections for corporate stakeholders have declined in strength, and that decline was encouraged by the Reagan-Friedman school. The laws that protect workers' right to organize have been undercut, and so has the real value of the minimum wage.[45] Antitrust's larger historical purpose was abandoned in favor of a blinkered focus solely on short-term consumer welfare.[46] Environmental agencies and laws were systematically attacked, and the same has been true of consumer protection laws.[47] And, governmental attempts to remediate four hundred years of racial oppression of black people and to protect women and other minorities have been hampered by hostility from this same school.[48] Indeed, when in power, Reagan-

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43 Frank H. Easterbrook, *When Does Competition Improve Regulation?*, 52 EMORY L.J. 1297, 1299 (2003) ("Regulation is a means by which a segment of the populace enriches itself at the expense of the general welfare.").

44 *E.g.*, MILTON FRIEDMAN, CAPITALISM AND FREEDOM (1962). Easterbrook and Fischel's work does not suggest a decisive break with Friedman's views. For example, Easterbrook depicted important civil rights statutes as regulation resulting from messy interest group wrangling and cautioned against using them to achieve broad remedial goals. *E.g.*, Frank H. Easterbrook, *The Court and the Economic System*, 98 HARV. L. REV. 4, 55–56 (1984); Frank H. Easterbrook, *The Absence of Method in Statutory Interpretation*, 84 U. CHI. L. REV. 81, 93–95 (2017). Fischel seemed somewhat indifferent to the deep-seated effects of long-standing discrimination in his analysis of labor markets, despite the fact that the practice of discrimination seriously challenges his premises about labor market competition. Daniel R. Fischel, *Labor Markets and Labor Law Compared with Capital Markets and Corporate Law*, 51 U. CHI. L. REV. 1061, 1067 & n.15 (1984) (implying that labor markets were "surprisingly competitive" notwithstanding Jim Crow and discrimination).

45 *E.g.*, David Cooper, Elise Gould, & Ben Zipperer, *Low-Wage Workers Are Suffering from a Decline in the Real Value of the Federal Minimum Wage*, ECON. POL'Y INST. (Aug. 27, 2019), https://perma.cc/F923-XLJG ("The real value of the federal minimum wage has dropped . . . 31% since 1968.").

46 *E.g.*, Sanjukta Paul, *Recovering the Moral Economy Foundations of the Sherman Act*, 131 YALE L.J. 175 (2021).

47 *E.g.*, David M. Uhlmann, *Back to the Future: Creating a Bipartisan Environmental Movement for the 21st Century*, 50 ENV'T. L. REP. 10800, 10802 (2020).

48 *See* ADAM WINKLER, WE THE CORPORATIONS: HOW AMERICAN BUSINESSES WON THEIR CIVIL RIGHTS 278 (2018) (noting Lewis Powell's role in subjecting racial affirmative

Friedman adhering administrations have often governed agencies charged with protecting stakeholders in a manner contrary to the obvious statutory purpose for their existence.[49]

These moves to undermine the external protections for stakeholders have been supported and accelerated by corporate political and lobbying expenditures, which have gone predominantly to one political party, and have swamped our political system with funds for candidates and causes opposing worker rights, environmental protection (including addressing climate change), voting rights for minorities, and regulation to protect consumers.[50] The result is a vicious cycle in which corporations gain wealth and economic power, translate that wealth and economic power into political power for themselves and the wealthier segment of society, and use that political power to gain further wealth and economic power.

The government has thus not been effective in compensating for the enormous growth in stockholder power, and for predictable reasons. Constituencies other than shareholders often struggle to make their voices heard in the political process due to resource constraints, collective action problems, and unrepresentative structures in our government.[51] By contrast, corporations have perfected the art of exerting political influence. Put simply, capital is capital, and in a money-dominated regulatory environment, the haves tend to win out.

The Easterbrook response to this power imbalance in the legislative process is to deny that it exists. Easterbrook has claimed that corporations face serious collective action problems that make it difficult for them to protect themselves through the

action programs to strict scrutiny and his overall successful effort in encouraging business to go to war on the New Deal/Great Society regulatory state).

[49] *See* Uhlmann, *supra* note 47 (describing Reagan's appointment of Gorsuch to the EPA and Watt to the Department of the Interior). More recent examples include President Trump's appointment of Eugene Scalia to the Department of Labor.

[50] *E.g.*, CTR. FOR POL. ACCOUNTABILITY, CONFLICTED CONSEQUENCES (2021) https://perma.cc/56FR-PXZA (showing that corporations have used opaque 527 organizations as vehicles to channel money to political causes that conflict with their stated values, with the bulk of spending going to benefit the Republican Party); Eric Lipton, Mike McIntire, & Don Van Natta Jr., *Top Corporations Aid U.S. Chamber of Commerce Campaign*, N.Y. TIMES (Oct. 21, 2010), https://perma.cc/NW4M-WGPY (describing corporate support for the U.S. Chamber of Commerce, and the Chamber's support for Republican causes); Chris Frates, *Koch Bros.-Backed Group Gave Millions to Small Business Lobby*, CNN (Nov. 21, 2013), https://perma.cc/FZ3P-9E52 (describing corporate support for the National Federation of Independent Business).

[51] *Cf.* Kate Andrias & Benjamin I. Sachs, *Constructing Countervailing Power: Law and Organizing in an Era of Political Inequality*, 130 YALE L.J. 546 (2021).

political process.[52] This is implausible on its face: corporations and institutional investors have formed interest groups and sophisticated lobbying operations. And corporations have a shared interest in enfeebling labor and other social interests.

Ultimately, the dispute can only be resolved by looking to evidence and experience. Consider Easterbrook's chosen evidence:

> If you doubt this perspective on corporate influence, ask yourself: why is there a corporate income tax? Not because corporations are wealthy; corporations are just place-holders, collective names for aggregates of investments. The corporate tax is attractive to politicians because it is invisible. No natural person pays the bill. Investors are so scattered and diversified that they cannot resist it, cannot even tell who pays it. . . . Corporations do not hold political power in America: they are too large, and their investors too many.[53]

To which we might respond, ask yourself: *is* there an effective corporate income tax? Not for the many major corporations, including Nike and FedEx, that reportedly paid no taxes for 2020.[54] And not until recently for one of America's largest corporations, Amazon, which seems to have avoided paying federal income taxes as recently as 2018.[55] A recent tax cut bill gave most of its benefits—in a period of huge and growing inequality—to corporations and the wealthy, on the supposed promise that the cuts would result in job-creating and improving investments in the US. The cuts came to pass; the investments not so much.[56] And the share of taxes paid by corporations in the United States is a third of what it was in prior generations.[57]

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52 Frank H. Easterbrook, *The Race for the Bottom in Corporate Governance*, 95 VA. L. REV. 685, 700–01 (2009) ("And since 'everyone knows' that big corporations are effective lobbyists, this should protect investors fully. Unfortunately, what 'everyone knows' about the power of corporate lobbying is wrong."); Easterbrook, *supra* note 43, at 1300 ("Corporations do not vote and are forbidden by law from making political contributions."). Others have picked up this torch, though generally in less extreme ways. *Cf.* Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 665–66 (2006) (arguing that managers are more effective players in the political process than shareholders).

53 Easterbrook, *supra* note 52, at 701–02.

54 *E.g.*, Chris Isidore, *Jeff Bezos Endorsed Higher Corporate Tax Rates. But It Won't Cost Him Much*, CNN BUS. (Apr. 10, 2021), https://perma.cc/9PT6-VTHS.

55 *E.g.*, Richard Rubin, *Does Amazon Really Pay No Taxes? Here's the Complicated Answer*, WALL ST. J. (June 14, 2019), https://perma.cc/294P-GMKA.

56 *See* Blair, *supra* note 32 ("investment has cratered" in the months after the Trump tax cuts).

57 *See* Hungerford, *supra* note 32.

These problems are not limited to the political branches. Like Lewis F. Powell, Jr., himself, the architect of corporate America's successful strategy for winning the war of ideas who ultimately ascended to the Supreme Court,[58] the problems made the leap to the judiciary. Conservative judicial decisions have exacerbated defects in the political process by systematically strengthening the political power of corporations while systematically weakening the political power of organized labor and racial minorities.[59] These decisions have frequently involved the invalidation of legislation approved overwhelmingly by Congress, and the use of *Lochner*-era reasoning that is selectively applied.[60]

Even if Easterbrook and Fischel earnestly supported stakeholder-protective legislation, it is unlikely that the political system could meet that need. Given the onslaught of corporate lobbying and political donations, it has become increasingly difficult for stakeholder-protective legislation to pass in the first place. But, even when regulatory statutes somehow survive this gauntlet, they are then undermined, invalidated, or misinterpreted by an activist, right wing judiciary with an arid approach to statutes and a desire to repeal the New Deal and return to *Lochner*. [61] As

[58] WINKLER, *supra* note 48, at 278–89 (describing memorandum by Lewis Powell urging businesses to cultivate and use political power to counter labor unions, civil rights groups, and public interest law firms).

[59] Compare the incompatible logic of *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010), which insisted that corporations must be allowed to play at politics despite concerns that some shareholders might disapprove of the message, and *Janus v. American Federation of State, County, & Municipal Employees, Council 31*, 138 S. Ct. 2448 (2018), which hobbled union participation in politics over concerns about dissenting workers. *See* Jonathan Macey & Leo E. Strine, Jr., Citizens United *as Bad Corporate Law*, 2019 WIS. L. REV. 451, 506–14 (2019).

[60] In *National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012), Chief Justice Roberts held two Justices hostage to get his vote on an obvious question of law—which is whether Congress had the authority to enact the individual mandate within the ACA if it did not call that mandate a tax—in exchange for invalidating an expansion of Medicaid to cover everyone within 133% of the federal poverty line. When Congress adopted Medicaid, it reserved the right to expand coverage, and the federal government was covering most of the costs of expansion. But, according to Chief Justice Roberts, the states objecting to this expansion had a sovereign right to continue to participate in Medicaid—because they found it so valuable and useful—and to not have that participation conditioned on paying their fair share of the expansion. In other words, the states were like perpetual children who could not be expected to give up the subsidies they received if they did not wish to contribute to the household's needs. This remarkable ruling is often lost sight of due to the tax ruling, but it resulted in serious harm to consumers of health care and to the nation's ability to effectively address the pandemic, and to protect the health of struggling American families and their children.

[61] *See supra* notes 59–60; Leo E. Strine, Jr., Aneil Kovvali, & Oluwatomi O. Williams, *Lifting Labor's Voice: A Principled Path Toward Greater Worker Voice and Power Within American Corporate Governance*, 106 MINN. L. REV. 1327, 1330–31 n.8 (2022) (describing the phenomenon and collecting examples).

a result, rules adopted to protect *stakeholders* are generally interpreted and applied in a stingy and grudging manner. By contrast, the fundamental rules that protect *shareholders* are interpreted and applied by Delaware jurists who take a practical and equitable approach.

C. The Particular Case of Declining Protections for Workers and the Fairness of Labor Markets

From a societal standpoint, the most important stakeholder is the worker: corporate workers must be treated respectfully, have safe working conditions, and quality wages. Workers are the many who make a capitalist system work. Unless the wealth they create is fairly shared with them, then there will be social instability and less overall wealth in the way that matters.[62]

In recognition of this reality, and also of the dangers that nativist ideologues would use growing inequality and insecurity to appeal to struggling workers, the New Deal sought to create a framework within which businesses would compete, while ensuring that they did not do so unfairly at the expense of workers. Just as the Great Depression taught policymakers that stock markets required vigorous regulation to avoid abuses,[63] the experience of history taught policymakers that labor markets required vigorous regulation to generate reasonable outcomes. Breaking sharply with the laissez-faire model of capitalism that had dominated the nineteenth and early twentieth centuries, Congress enacted minimum wage and collective bargaining provisions in the National Industrial Recovery Act of 1933,[64] created a framework for labor organizing in the National Labor Relations Act of 1935,[65] and banned child labor and set minimum wage and overtime pay requirements in the Fair Labor Standards Act of 1938.[66] Relatedly, Congress set up a program—Social Security—to provide

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62 More wealth in the hands of billionaires may benefit them, but it has little to do with overall prosperity, at least in a positive way that is associated with communal well-being.

63 *See, e.g.*, MICHAEL PERINO, THE HELLHOUND OF WALL STREET: HOW FERDINAND PECORA'S INVESTIGATION OF THE GREAT CRASH FOREVER CHANGED AMERICAN FINANCE (2011).

64 *See A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935) (describing minimum wage and collective bargaining provisions of the National Industrial Recovery Act before finding the act unconstitutional).

65 *See* 29 U.S.C. § 157 ("Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection . . . .").

66 *See* 29 U.S.C. §§ 206, 212.

minimum economic support for retired workers, and to provide economic support to the disabled.

The New Deal revolution was not complete, and its failure to safeguard the rights of Black Americans, command full respect from Southern states, or address the effect of trade with nations that had not adopted similar regulations would ultimately limit its effectiveness.[67] But there was a remarkably broad and durable consensus on the idea that the government had a responsibility to protect workers. By setting boundaries on markets, these regulations facilitated better dynamics within markets: workers were empowered to bargain collectively for better wages and conditions, and companies had less reason to resist concessions because there were few competitive advantages to be gained by squeezing workers.

An intellectual and political counterrevolution radically altered the direction of American policymaking. From Milton Friedman's various broadsides against government regulation[68] and ethical approaches to business,[69] to Lewis Powell's memorandum,[70] there was a concerted effort to weaken protections for workers. These efforts culminated in (but did not begin with)[71] the Reagan revolution, which proceeded from the premise that "government is the problem."[72] The new tone was vividly demonstrated by President Reagan's busting of the Professional Air Traffic Controllers Organization,[73] and by his gutting of OSHA regulations.[74] Much like Easterbrook and Fischel, the proponents of these changes urged that these changes would be a win-win, as the increased efficiency and output would ultimately benefit workers:

> The new review standard ordered for a number of Occupational Safety and Health Administration regulations, with an eye to relaxing them, could affect such rules as how much lead, asbestos, cotton dust or benzene will be in the air

[67] *See* Leo E. Strine, Jr., *Development on a Cracked Foundation: How the Incomplete Nature of New Deal Labor Reform Presaged Its Ultimate Decline: A Response to Cueller, Levi, and Weingast*, 57 HARV. J. ON LEG. 67 (2020) [hereinafter Strine, *Cracked Foundation*].

[68] *E.g.*, FRIEDMAN, *supra* note 44.

[69] *E.g.*, Friedman, *supra* note 41.

[70] *See* WINKLER, *supra* note 48, at 278–89.

[71] Strine, *supra* note 67, at 84.

[72] Ronald Reagan, Inaugural Address (Jan. 20, 1981), https://perma.cc/JZ87-B6XH.

[73] *E.g.*, William Serrin, *Reagan Stance on PATCO Causes Unions Anxiety*, N.Y. TIMES (Oct. 21, 1981), https://perma.cc/4KBG-JTYH.

[74] Sandra Evans Teeley, *OSHA Under Siege*, WASH. POST (Apr. 12, 1981), https://perma.cc/3U4R-RL9K.

> workers breathe. "Some workers will be less protected," concedes James C. Miller III, regulatory affairs administrator at the Office of Management and Budget and director of the president's task force on regulatory relief. But he also argues that worker health and protection overall will improve because industry will be better able to allocate its resources to health priorities. "I am absolutely sure of that," Miller says.[75]

The Economic Structure of Corporate Law, and the articles on which it is based, can only be understood as part of this transformation. Their influential work advocated a decisive rejection of the model of labor relations present elsewhere in the OECD, where workers have voice within large corporations through works councils and board representation, and government buttresses and facilitates their efforts with effective regulations.[76]

The government's abdication of its responsibility to ensure reasonable outcomes for workers has had predictable consequences: as we have already discussed, workers have not received a fair share of corporate wealth.[77] Indeed, corporations have succeeded in delivering value to shareholders largely by perfecting their oppression of workers: one study found that a whopping 44 percent of the equity wealth generated by corporations from 1989 to 2017 came at the expense of other corporate constituencies, primarily workers.[78] Actual economic growth—as opposed to squeezing workers and financial market developments—represented just 25 percent.[79] The Easterbrook and Fischel model—have corporations focus exclusively on shareholder wealth, while the government and workers tend to other interests—thus appears profoundly broken in the labor space.

Easterbrook and Fischel's other scholarship stands as an obstacle to remedying this failure. Consider labor law. In one striking analysis, Fischel provides a forceful rejection of collective bargaining by workers:

> Most economists are hostile to unions because they view them as attempts by workers to act in concert for the purpose of charging monopoly prices for their labor. Only the labor

75 *Id.*

76 *See* Strine, Kovvali, & Williams, *supra* note 61.

77 *See supra* Part II; Stansbury & Summers, *supra* note 16; Greenwald, Lettau & Ludwigson, *supra* note 15; *cf.* Aneil Kovvali, *Countercyclical Corporate Governance*, 101 N.C. L. REV. (forthcoming) (arguing that labor markets do not facilitate all value-generating deals with workers during a recession).

78 Greenwald, Lettau, & Ludvigson, *supra* note 15.

79 *Id.*

> exemption to the antitrust laws, it is widely believed, enables workers to act collectively without violating the antitrust laws. Under this standard monopoly view, unions reduce the value of the firm.[80]

Fischel acknowledges the possibility that unions create value by facilitating monitoring and more efficient deals between labor and capital. But he rejects the possibility *on the ground that managers do not like dealing with them*:

> One method of distinguishing between the union as an attempted solution to the free-rider problem and the union as a monopoly is to analyze the behavior of firms. If unions were solely a rational response to the free-rider problem, firms would voluntarily deal with them. . . . Perhaps some firms do deal with unions voluntarily . . . [b]ut casual empiricism suggests that firms frequently oppose organization drives by unions. . . . Attempted appropriation of monopoly rents created by imperfections in the product market is a likely alternative explanation.[81]

It's a classic unworldly law and economics analysis: clever, provocative, and utterly disconnected from real history and the real world in which we live.

To begin, unions might be understood as a collective effort on the part of workers to dictate the price of labor. But by parity of reasoning, a business firm can be understood as a similar collective effort on the part of shareholders to dictate prices in labor and product markets. As Sanjukta Paul has emphasized, courts invented a "firm exemption" to antitrust law to permit shareholders to engage in this type of economic coordination within firms.[82] This exemption for capital is far less justified as a matter of law or logic than the "exemption" that allows working people to freely associate in an effort to better their lot.

Shareholders also benefit from coordination across firms. Sometimes the coordination is explicit: for example, antitrust authorities were briefly jolted from complacency by the revelation that legally-sophisticated Silicon Valley firms like Apple and Google had reached no-poaching agreements that clearly violated

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[80] Fischel, *supra* note 44, at 1061 (citation omitted).

[81] *Id.* at 1072–73.

[82] *See* Sanjukta Paul, *The Case for Repealing the Firm Exemption to Antitrust (A Modest Proposal; or, a Response to Professor Epstein)*, *in* THE CAMBRIDGE HANDBOOK OF U.S. LABOR LAW FOR THE TWENTY-FIRST CENTURY 88 (Richard Bales & Charlotte Garden eds., 2019).

the Sherman Act.[83] Sometimes the coordination is the result of a convergence in practices. A broad set of firms use non-compete agreements to limit the ability of employees to seek alternative jobs. Firms are thus spared the need to compete for worker time.

Coordination across firms to suppress wages can also come about through capital markets, particularly when important institutional investors are in thrall to the Easterbrook and Fischel model of corporate governance. By pushing corporate managers at all firms to be responsive to the short-term whims of shareholders, their one-size-fits-all approach to corporate governance may suppress investment in real world projects, leaving slack in the labor market and depressing wages.[84]

There is a glimmer of a response to these points in Fischel's suggestion that:

> [There is] a greater risk of monopolization in the labor area since there are better substitutes for capital than for labor. Because of the availability of alternative sources of funds (including retained earnings), it is inconceivable, for example, that an indenture trustee could negotiate a monopoly return for capital. Unions have a somewhat greater ability to obtain monopoly wages, particularly if they have the ability to prevent the hiring of substitutes by force or intimidation.[85]

This clearly is not a realistic analysis today, if it ever was. In part due to systematic suppression of investment and hiring in favor of delivering value to shareholders,[86] the American economy has long been characterized by slack: a large number of workers are unemployed or underemployed, and are therefore available to replace or substitute for any employee who dares to demand better wages or working conditions.

American workers have also found themselves under constant threat of replacement by workers abroad and by workers at other firms. Employers have learned to use fissuring and offshoring to break up worker power, and drive gains for shareholders. Although shareholder money can always flow someplace more

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83 Suresh Naidu, Eric A. Posner, & Glen Weyl, *Antitrust Remedies for Labor Market Power*, 132 HARV. L. REV. 536, 544 (2018).

84 Zohar Goshen & Doron Levit, *Common Ownership and the Decline of the American Worker* (Eur. Corp. Governance Inst., Law Working Paper No. 584/2021, 2021), https://perma.cc/6R27-4JCZ.

85 Fischel, *supra* note 44, at 1072. In fairness, Professor Fischel acknowledges some limits on these claims, but does not appear to recognize the extent of their departure from practical reality.

86 *See* Goshen & Levit, *supra* note 84.

congenial—whether within the United States or abroad—workers often cannot move without substantial sacrifices.[87] This fundamental imbalance of power suggests the need to support workers in their battle with shareholders, but Easterbrook and Fischel's analysis has largely tended in the opposite direction.[88]

D. Bailouts for the Haves, Bupkis for the Many

The residual claimant theory rests on the notion that unless other stakeholders receive their full returns, then stockholders cannot gain. That notion, however, acts as if there was a, say, generational summing up, and where stockholders who have held for 20 years can only get paid, if there is a determination that workers' pensions have been funded and promises to them fully honored, that all corporate taxes have been paid to communities of operation, that all creditors have been satisfied, and that consumers and the environment have either not been harmed or have received full compensation. But that is not how the world works.

Stockholders take—claim—all the time, and often in advance of other stakeholders. The rules against distributions without adequate capital are far too lax to protect stakeholders from this risk, and there is no serious argument that stockholders are really residual claimants except insofar as in occasional cases, those holding the remaining equity in a bankruptcy are supposedly last

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87 Easterbrook, *supra* note 52, at 698 ("Capital is highly mobile, as are governance structures, even when physical assets and labor are immobile."); *cf.* Easterbrook, *supra* note 43, at 1301 ("As it is easy to move funds across national borders in a world of floating exchange rates—and easy to protect against exchange-rate risk in a world of currency-futures contracts—no one country can impose costs on investors. Any attempt to do so will cause firms and investors to transfer funds elsewhere."). The mobility of capital does not simply weaken workers directly. It also weakens institutions that seek to defend them and other stakeholders. Governments struggle to impose regulations or appropriate taxes because corporations can pursue regulatory or tax arbitrage strategies to shift operations or accounting profits abroad. *See, e.g.*, Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 789–90 (2015) (describing tax arbitrage strategy of inversions). And unions will struggle to persuade an employer to make concessions if it is powerless to impose similar concessions on the employer's competitors, as will generally be the case for competitors in states hostile to labor rights. *See, e.g.*, Samuel Estreicher, *Labor Law Reform in a World of Competitive Product Markets*, 69 CHI.-KENT L. REV. 3, 13–14, 13 n.33 (1993).

88 Fischel, *supra* note 44, at 1061 ("While some differences between labor and capital markets do exist, I argue that they do not justify the differences between labor and corporate law. In particular, the tendency of firms to reach efficient contractual arrangements, and to economize on transaction costs by choosing to be governed by a particular set of standard-form contractual terms embodied in state law, is relevant to both labor and capital markets.").

in line. That does not mean that in the run up to insolvency that was the case.[89]

In fact, bankruptcies have often resulted from transactions where gains were extracted by stockholders at the expense of workers and creditors, and a good company went insolvent, not because it could not make profits, but it could not make profits sufficient for the leverage put on it in a private equity takeout or from too much debt incurred in buying another company.[90] And, of course, companies exist now and pay dividends to stockholders that have shirked their duties to pensioners, communities, and creditors.[91]

And when risk-taking led by investors goes wrong, the investor class has been the beneficiary of huge government subsidies, even while others suffering harm (such as homeowners during the financial crisis) received far less government wealth. The United States government has bailed out the financial sector repeatedly, with support varying from cash infusions to liquidity supplied by the Federal Reserve. Recent history includes the Savings and Loan Crisis of the late 1980s and early 1990s, through the market meltdown in 1987, to the Financial Crisis in 2009. And even during the pandemic, the predominant amount of bail-out funds and Federal Reserve liquidity went to big business itself. These bailouts understate the support the federal government has given to equity investors, because the Federal Reserve has continuously acted to prop up the stock market through interest rate changes and open market operations.

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[89] *See* Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 CAL. L. REV. 745 (2020) (describing rise of tactics by managers of distressed firms to secure value for shareholders at the expense of creditors). The bankruptcy process can also undermine protections for other stakeholders, as bankruptcy judges eager to ensure a successful corporate reorganization undermine laws and regulations intended to protect stakeholders. *E.g.*, Jonathan Randles, *Judge Throws Out Purdue Pharma's Deal to Shield Sacklers from Opioid Lawsuits*, WALL ST. J. (Dec. 16, 2021), https://perma.cc/3BQV-PVQN (describing district judge's ruling rejecting bankruptcy court order that would have shielded Sackler family from liability for Purdue's involvement in the opioid crisis); Joshua Macey & Jackson Salovaara, *Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879 (2019) (documenting coal companies' use of bankruptcy process to evade environmental and worker protections).

[90] *E.g.*, Danielle D'Onfro, *Companies as Commodities*, 48 FLA. ST. U. L. REV. 1 (2020) (collecting examples of private equity and other investors increasing leverage at businesses in an effort to improve immediate financial returns). For a summary intended for a popular audience, see Emily Stewart, *What Is Private Equity, and Why Is It Killing Everything You Love?*, VOX (Jan. 6, 2020), https://perma.cc/U3KB-S5W6 (describing failures at Toys R Us and other companies after private equity firms saddled them with debt).

[91] *E.g.*, Leo E. Strine, Jr., *Corporate Power Is Corporate Purpose I: Evidence from My Hometown*, 33 OXFORD REV. ECON. POL'Y 176 (2017) (describing conduct of DuPont).

A core assumption of Easterbrook and Fischel is that the market generally prices risk well, and that is a reason to trust it, and to allow its forces to act on corporations. But this history of bailouts demonstrate that financial markets are not an adequate protection for corporate stakeholders and society against the dangers of speculation and overreaching. The efficient capital markets hypothesis ("ECMH") is not a promise that that the market is right at any time, only a theory that says that it is extremely difficult to build a portfolio that will durably outperform a market driven by the collective estimates of current values of all trading investors. The current stock market is not right in some fundamental sense, and markets have proven themselves capable of blinding themselves to obvious risks, and of operating on the "greater fool theory" until that no longer works.

The pressures that these trading markets create—such as their demands that companies not have adequate reserves and to source materials on the cheapest, but not most reliable and resilient basis—often come to bear later. The companies are then blamed by the same investors for lacking the cash and resiliency to weather a period of adversity, with the investors of course acknowledging no responsibility for a state of affairs their own desires encouraged. The pandemic illustrates exactly that sort of behavior, and also illustrates that institutional investors—whose own interests in short-term returns is different from that of their investors in durable returns—pose stakeholder and societal risks of their own that demand a regulatory response.

We favor vibrant stock markets. We favor vibrant competition. But history has shown that depending on powerful economic interests to act in a manner that is socially responsible, that does not externalize their costs of business to others, and that creates shared prosperity is naïve. A philosophy of corporate law that simultaneously exalts stockholder interests and subordinates the interests of other stakeholders, and sits aside a desire to return to an era when there were no environmental laws, no minimum wage laws, no maximum hour laws, no worker safety laws, and no protections against invidious discrimination is not a recipe for a win-win. It is a recipe for a return to a benighted past, a torn social fabric, and the destruction of our planet.

V. CONCLUSION

This is not the place for us to suggest a complete program for reversing what we see as two generations of erosion in our nation's social fabric. In other work, each of us has done so.[92]

But we do venture this. The idea that making societally-important corporations govern more to the whims of the stock market would be a win-win for investors, other corporate stakeholders, and our society as a whole has emerged, as an empirical matter, to be implausible. Easterbrook and Fischel, at bottom, failed to contend with the real-world realities that allow investors—especially intermediaries like institutional investors who are agents for others—to profit by shifting distributions to themselves and costs to workers, creditors, consumers, and taxpayers.

Not only that, although they said other stakeholders should look to other bodies of law for protection, the intellectual and political movement they helped lead systematically rolled back those protections and undermined the institutions, such as the NLRB and EPA, that enforced them. And their arguments ignored the reality that corporations had been encouraged to, and have, used their entrusted capital to erode those protections, and to influence elected officials toward views adverse to the interests of workers, consumers, and the environment. Finally, they did not anticipate that the globalization of their economic views that favored equity capital over other stakeholders, without corresponding protections for other stakeholders, would accelerate a reversal of the equalizing effects of the New Deal/European social democratic approach.[93]

To be sure, the implementation of the Friedman-Reagan vision, of which Easterbrook and Fischel's corporate law is a subsidiary but important part, has created winners. But those winners are a sliver of society, and a great deal of their gains have come from taking the share of the pie that the New Deal/European social democratic approach had ensured would be shared with the stakeholders most responsible for our economy's productivity: American workers. And the costs to taxpayers and societies of other externalities—such as bailouts, unemployment caused by burst financial bubbles, and climate change caused by corporate

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[92] *E.g.*, Strine, Kovvali, & Williams, *supra* note 61; Kovvali, *supra* note 21; Leo E. Strine, Jr., *Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy – A Reply to Professor Rock*, 76 BUS. LAW. 397 (2021); Strine, *supra* note 31; Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism*, ROOSEVELT INST. (Aug. 13, 2020), https://perma.cc/X767-3MXK; Kovvali, *supra* note 77.

[93] *E.g.*, Strine, *Cracked Foundation*, supra note 67.

concealment of the risks of carbon—have been enormous and continue to grow. No win-win, but a triumph of certain haves, particularly financial engineers, over the bulk of society.[94]

Those genuinely committed to a market economy and democracy should heed the lessons of history and the need for guarantees of fairness and efficiency, which ensure that corporations are encouraged to make money the right way, by producing products and services that create sustainable value, net of externalities, and through the respectful treatment of all their stakeholders. Realizing that does not require a revolution; it simply requires a restoration and commitment to the hard work of extending the shared values that worked to create widespread prosperity in the U.S. and our market allies to a globalizing world economy.

A global new deal, not a benighted return to the nineteenth century, is what is needed, and that includes giving corporations space to create wealth the right way, and to resist stock market pressures to divert from that mission to increase short-term stock prices, at the expense of other stakeholders. That is what would help us return to a win-win economy.

Unless we want London to be foggy again, and to risk democracy and social stability, then it is important not to repeat the mistakes of history. The kind of harm to workers and the environment and the kind of inequality that so called laissez-faire produced cannot be survived. There are billions of us now, and the planet and social harmony cannot survive an economic system that rewards only a narrow class with prosperity and denies the vast bulk of people responsible for societal wealth a fair chance for a dignified living and a better future. The way forward depends on sustainable wealth creation that is based on more than forcing costs onto third parties.

Although government regulation is an essential part of the solution, giving corporate boards room to tend to groups other than shareholders can also play a useful role. Given the failings of regulation, labor markets, product markets, and capital markets, corporations that strive only to maximize their stock price will predictably engage in socially destructive behavior. It is only by considering the needs of other constituencies that corporate boards can find and help implement true win-wins for our nation and the world.

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94 *E.g.*, RANA FOROOHAR, MAKERS AND TAKERS: THE RISE OF FINANCE AND THE FALL OF AMERICAN BUSINESS (2016).