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# Larry from the Left: An Appreciation

Grant M. Hayden\* & Matthew T. Bodie\*\*

## I. Introduction

Scholars live on through ideas. And Larry Ribstein had ideas about law schools, firms, and markets that will live on long after him. He spoke to the work through “Ideoblog,” a blog whose motto was: “A blog about ideas. Ideas are not beliefs or opinions.”<sup>1</sup> It was a surprisingly esoteric motto for a writer not afraid to dole out harsh criticism. But it captured something special about Ribstein: his attraction to the power of ideas. He was not a sentimentalist, nor a yellow-dog Republican or Democrat. He followed his scholarly and ideological principles and advocated ceaselessly for their implications.

One might expect a progressive paper on Larry’s legacy to focus on the importance of responding to his work in developing a compelling critique of conservative law-and-economics scholarship. Something along the lines of: “Ribstein’s formidable development of the case for free-market libertarianism provides a useful whetting stone upon which to hone a new programme for economic equality.” But that is not our approach. Instead, our claim—a bolder one, but perhaps more tenuous—is that progressive corporate law scholars can and should find ideas for legal reform in Ribstein’s voluminous writings. And this endeavor does not involve cherry-picking a passage here or a footnote there. Many of Ribstein’s most important ideas—his attack on the “nexus of contract” theory for public corporations and his idealized vision of small-c capitalism and the competition it engenders—provide support for a world that is more egalitarian, less protective of elites, and more robust in the economic opportunities that it offers. His attacks on certain liberal tropes should lead not to

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\* Professor, Hofstra University School of Law.

\*\* Professor, Saint Louis University School of Law. A version of this paper was presented at the January 2013 annual meeting of the Association of American Law Schools (AALS). The authors thank Lyman Johnson for his commentary on the paper at AALS. Part II of this Essay is based on our discussion of Larry Ribstein’s book, “The Rise of the Uncorporation,” in Grant M. Hayden & Matthew T. Bodie, *The Uncorporation and the Unraveling of “Nexus of Contracts” Theory*, 109 MICH. L. REV. 1127 (2011).

<sup>1</sup> This header appeared at Ribstein’s “Ideoblog” website. Ideoblog, <http://busmovie.typepad.com/ideoblog>, which is no longer active. Ribstein later joined the Truth on the Market blog, and his posts from both that blog and his earlier Ideoblog are archived at that site. Truth on the Market, at: <http://truthonthemarket.com/author/larryyer/>.

an instinctual defense of those tropes, but rather a reexamination of their underlying premises. In many situations, progressive scholars may conclude that Larry was right—or, at least, had ideas that would make the world a better place.

## II. Larry as Corporation Critic

Because Larry Ribstein was an avowed contractarian, one would have expected him to agree with mainstream corporate law scholarship, which remains centered on the “nexus of contracts” approach. And in fact, much of Ribstein’s writings accord with the view that corporate law should be structured so as to allow the individual players to create economic relationships on their own terms. He hated the increasingly regulatory approach of corporate law, taking particularly aim at the two big federal acts that had come along in the past decade.<sup>2</sup> However, while many scholars thought that the federalization of corporate law was an unfortunate encrustation on the existing state-oriented approach, Ribstein seems to have begun to have doubts about the entire enterprise. In other words, he had begun to doubt that the core premises of corporate law still longer held true.

The “nexus of contracts” theory holds that the firm – and by extension the corporation – is merely a central hub for a series of contractual relationships.<sup>3</sup> In other words, the firm is a “legal fiction;” it is “*not an individual*” and has no real independent existence.<sup>4</sup> Instead of thinking of the corporation as an independent entity, “nexus of contract” theory breaks it down into its component parts.<sup>5</sup> These parts are the contractual relationships between the various parties involved with the firm: executives, directors, creditors, suppliers, customers, and employees. Thus, corporate law is an extension of contract law and should focus on

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<sup>2</sup> HENRY N. BUTLER & LARRY E. RIBSTEIN, THE SARBANES-OXLEY DEBACLE: WHAT WE’VE LEARNED; HOW TO FIX IT (2006); Larry E. Ribstein, *Financial Reform That Isn’t*, FORBES.COM, July 15, 2010, at: <http://www.forbes.com/2010/07/08/financial-reform-bill-hedge-funds-opinions-columnists-larry-e-ribstein.html>.

<sup>3</sup> Michael C. Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Capital Structure*, 3 J. FIN. ECON. 305 (1976).

<sup>4</sup> *Id.* at 310-11.

<sup>5</sup> See, e.g., William W. Bratton, Jr., *The “Nexus of Contracts” Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989) (defining the “nexus of contracts” approach as “the firm is a legal fiction that serves as a nexus for a set of contracting relations among individual factors of production”).

facilitating the interrelationships between contractual participants in the most efficient manner.<sup>6</sup>

The nexus of contracts theory has been extremely influential in shaping corporate law theory of the past three decades.<sup>7</sup> But despite its dominance, there is still confusion over whether the theory is a descriptive model, a normative prescription, or some combination of both.<sup>8</sup> Jensen and Meckling presented a positive theory of the corporation and its concomitant relationships.<sup>9</sup> That thread has been picked up in the legal literature, with Easterbrook and Fischel cementing the concept in place.<sup>10</sup> But even at the most basic of levels, the “corporation as contract” claim is simply incorrect. Corporations are not creatures of contract. One cannot contract to form a corporation.<sup>11</sup> The individuals involved must apply to a state for permission to create such an entity. The fact that this permission is readily granted (as long as fees and taxes are paid) does not change the fact that permission is required.<sup>12</sup> Moreover, the designation is legally meaningful. As discussed further below, putting a series of contractual relationships within a corporation changes those contractual relationships.

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<sup>6</sup> Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1444 (1989)

<sup>7</sup> Lewis A. Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel*, 89 COLUM. L. REV. 1449, 1449 (1989) (“Critics and advocates agree that a revolution, under the banner ‘nexus of contracts,’ has in the last decade swept the legal theory of the corporation.”); Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1, 9 (2002) (“The dominant model of the corporation in legal scholarship is the so-called nexus of contracts theory.”); Thomas S. Ulen, *The Coasean Firm in Law and Economics*, 18 J. CORP. L. 301, 303 (1993) (arguing that “the nexus-of-contracts view of the modern corporation and the principal-agent explanation of some important aspects of the firm . . . have had profound implications for some of the most important issues of corporation law”).

<sup>8</sup> Melvin Eisenberg, *The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 824 (1999) (“Unfortunately, it has proved easy to confuse the positive proposition that the corporation is a nexus of reciprocal arrangements with the normative proposition that the persons who constitute a corporation should be free to make whatever reciprocal arrangements they choose, without the constraints of any mandatory legal rules.”).

<sup>9</sup> Jensen & Meckling, *supra* note JM, at 310-11.

<sup>10</sup> Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 780 (2006) (describing Easterbrook and Fischel as “the primary expositors of the contractarian theory”).

<sup>11</sup> This fact is acknowledged by contractarian theorists. See Easterbrook & Fischel, *Corporate Contract*, *supra* note EF2, at 1444-45 (acknowledging that statutory corporate law is necessary to create a corporation).

<sup>12</sup> Cf. Bratton, *supra* note WB1, at 445 (“If the corporation really ‘is’ contract, as the new economic theory tells us, then the last doctrinal vestiges of state interference should have withered away by now . . . . But the sovereign presence persists.”).

The fallback position of contractarian scholars is that the nexus of contracts model is not a literal claim.<sup>13</sup> But it's often difficult to determine when the theory crosses the line from abstracting metaphor to description of reality.<sup>14</sup> To say that we should conceive of the firm as a nexus of contracts for certain purposes is different than saying that corporations actually are simply a nexus of contracts.<sup>15</sup> Yet both characterizations are used seemingly interchangeably.<sup>16</sup> Moreover, contractarians often seek to minimize the role of the state to such a degree that it becomes vestigial. Easterbrook and Fischel, for example, claim that when it comes to the corporation, "what is open to free choice is far more important to the daily operation of the firm, and investors' welfare, than is what the law prescribes."<sup>17</sup> Corporate law thus becomes a way of facilitating the other aspects of the corporation – the more important, contractually-based ones.<sup>18</sup>

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<sup>13</sup> Fred McChesney, for example, stated: "Admittedly, as a descriptive matter state corporation codes and other sources of law contain many mandatory terms that parties cannot contract around. . . . [T]o claim that contractarians would deny the existence of coercive legal rules is to accuse them of blindness or stupidity." Fred S. McChesney, *Economics, Law, and Science in the Corporate Field: A Comment on Eisenberg*, 89 COLUM. L. REV. 1530, 1530 (1989). But it is sometimes difficult to parse the language of the theory to determine what is actually being claimed. See Bainbridge, "Nexus," *supra* note SB1, at 11 ("I have come around to the view that the corporation is a nexus of contracts in a literal sense, albeit a very limited one."); Julian Velasco, *Shareholder Ownership and Primacy*, 2010 U. ILL. L. REV. 897, 919 ("[A]lthough it may be technically accurate to describe a corporation as a nexus of contracts, it is entirely inadequate.").

<sup>14</sup> It is difficult to measure the extent to which contractarians shift their metaphor into the realm of literal truth. Certainly, most contractarians will admit that a corporation cannot be formed through contract. However, the theory is often described in shorthand as a positive description. See, e.g., MACEY, *supra* note JM1, at 22 ("It has long been recognized . . . that the corporation . . . should be viewed as a 'nexus of contracts' or a set of implicit and explicit contracts."); Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 781 (2006) ("[I]t is commonplace and correct to say that the corporation is a nexus of contracts . . .").

<sup>15</sup> For a discussion of the uses and misuses of models in corporate law theory, see G. Mitu Gulati, William A. Klein & Eric M. Zolt, *Connected Contracts*, 47 UCLA L. REV. 887, 889-93, 945-48 (2000). See also Daniel J.H. Greenwood, *Introduction to the Metaphors of Corporate Law*, 4 SEATTLE J. FOR SOC. JUST. 273 (2005) (discussing the use of metaphors in corporate law).

<sup>16</sup> Bill Bratton has described how Easterbrook and Fischel moved over time from a strong version of the theory to a weaker one. William W. Bratton, *The Economic Structure of the Post-Contractual Corporation*, 87 NW. U. L. REV. 180, 184 (1992) ("Easterbrook and Fischel are so astute that they keep a safe distance from the assertion that the corporation is a nexus of contracts. The book delimits and subordinates this once foundational proposition.").

<sup>17</sup> Easterbrook & Fischel, *Corporate Contract*, *supra* note EF2, at 1418. They continue: "For debt investors and employees, everything (literally) is open to contract; for equity investors, almost everything is open to choice." Easterbrook and Fischel assumedly are only speaking of state corporate law here, as there are significant regulations placed on debt and employment contracts.

<sup>18</sup> As Easterbrook & Fischel state:

Thus, contractarians have two competing sets of positive claims, with two sets of normative takeaways.<sup>19</sup> First, they argue that the corporation is primarily contractual, and as such it represents terms that the parties have freely chosen amongst themselves. Since the terms have been freely chosen, we can presume they are efficient.<sup>20</sup> This claim leads to the normative perspective that since the corporation is merely an intersection of voluntary agreements, corporate law should eschew mandatory rules.<sup>21</sup> The second set of claims, however, suggests that corporate law does provide default or even mandatory terms in those situations where these terms are approximations of the will of the parties.<sup>22</sup> These mandatory terms trump contractual freedoms, but they are designed so that the parties may more efficiently go about the rest of their business. The concern for these mandatory terms is mitigated, because there is choice amongst the fifty states as to the laws of incorporation.<sup>23</sup>

Larry Ribstein was a contractarian. Prior to his book *The Rise of the Uncorporation*, his work largely demonstrated agreement with the descriptive and

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Why not just abolish corporate law and let people negotiate whatever contracts they please? The short but not entirely satisfactory answer is that corporate law is a set of terms available off-the-rack so that participants in corporate ventures can save the cost of contracting. There are lots of terms, such as rules for voting, establishing quorums and so on, that almost everyone will want to adopt. Corporate codes and existing judicial decisions supply these terms “for free” to every corporation, enabling the venturers to concentrate on matters specific to their undertaking.

*Id.* at 1444.

<sup>19</sup> Klausner, *supra* note MK1, at 783 (“Easterbrook and Fischel’s theory of corporate law is both normative and positive: that corporate law *should* take this form; and that it ‘almost always’ does.”).

<sup>20</sup> A more nuanced version of this would be: having the parties choose their terms is the system most likely to lead to an efficient result over time, as there is no other system likely to result in greater efficiency.

<sup>21</sup> Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856, 860 (1997) (“The nexus of contracts model has important implications for a range of corporate law topics, the most obvious of which is the debate over the proper role of mandatory legal rules.”); Lucian Arye Bebchuk, *Foreword: The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395, 1397 (1989) (noting that corporate law contractarians argue “that the contractual view of the corporation implies that the parties should be totally free to shape their contractual arrangements”).

<sup>22</sup> MACEY, *supra* note JM1, at 22 (“[B]usiness law, including corporate law, exists to economize on transaction costs by supplying sensible ‘off-the-rack’ rules that participants in a business can use to economize on the costs of contracting.”).

<sup>23</sup> See, e.g., ERIN E. O’HARA & LARRY E. RIBSTEIN, *THE LAW MARKET* (2009); ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* (1993).

the normative aspects of the nexus of contracts theory. His most direct discussion of the theory is “Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians,” an article he wrote with Henry Butler.<sup>24</sup> Butler and Ribstein define contractarian theory as: “the corporation is a set of contracts among the participants in the business, including shareholders, managers, creditors, employees and others.”<sup>25</sup> They argue that private ordering is the best way to arrange these relationships.<sup>26</sup> Like Easterbrook and Fischel, however, they view state corporation law as an extension of the contract.<sup>27</sup> And they are quick to move to the “policy implication” that “private parties to the corporate contract should be free to order their affairs in whatever manner they find appropriate.”<sup>28</sup>

“Opting Out” criticizes anticontractarians on both descriptive and normative grounds. The authors point to the “demise” of concession theory, based on the notion that “[t]hroughout the nineteenth century, under the onslaught of increasingly permissive general incorporation statutes, state creation gradually yielded to private formation of the corporation and private ordering of the corporate relationship.”<sup>29</sup> They concede that “modern corporate statutes do include many mandatory terms, including voting rules, fiduciary duties and legal capital rules.”<sup>30</sup> However, they argue that these mandatory terms are, in most cases, better characterized as some form of avoidable placeholder. Some seemingly mandatory rules may be strong default rules that can nevertheless be contracted around.<sup>31</sup> Other mandatory rules, such as shareholder voting on mergers, can be avoided by restructuring the underlying transaction.<sup>32</sup> Moreover, parties can avoid the mandatory rules from a particular state by incorporating in another state or choosing another organizational form.<sup>33</sup> They conclude:

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<sup>24</sup> Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990).

<sup>25</sup> *Id.* at 7.

<sup>26</sup> *Id.* (“The corporate contract also specifies the extent to which the parties rely on the competitive pressures from capital, product, and managerial labor markets as well as internal incentive structures such as corporate hierarchy, boards of directors and managerial compensation contracts, to force agents to act in their shareholders’ best interests.”). Their focus, like Jensen and Meckling, is on agency costs.

<sup>27</sup> *Id.* (“The terms of the agency contract include the provisions of state law, which are regarded as a standard form that can be accepted by the parties or rejected either by drafting around the provision or by incorporating in another state.”).

<sup>28</sup> *Id.* at 7-8.

<sup>29</sup> *Id.* at 9.

<sup>30</sup> *Id.* at 10.

<sup>31</sup> *Id.* (discussing the close-corporation buyout rules from *Donohue v. Rodd Electrotpe Co. of New England, Inc.*, 328 N.E.2d 505 (Mass. 1975)).

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 11.

In sum, truly “mandatory” provisions are the exception rather than the rule in the law of business associations. The most important mandatory provisions are the federal securities laws and state provisions that are imposed on existing investors in firms. While these provisions are not trivial, they do not establish the non-contractual nature of the corporation.<sup>34</sup>

Interestingly, Butler and Ribstein also criticize Easterbrook and Fischel for not being sufficiently committed to the contractual model. They argue that Easterbrook and Fischel use the concept of a “hypothetical bargain” to impose certain terms upon the corporate contract.<sup>35</sup> Calling this approach “inconsistent with the contract theory of the corporation,” Butler and Ribstein contend that “it is one thing to propound a default rule to cover situations not covered in the parties’ contract, and another thing to state a general rule applicable irrespective of contract.”<sup>36</sup> A true contractualist, in their view, would favor a default approach, one that allowed parties to contract in accord with their preferences.<sup>37</sup>

The debate between two sets of committed contractarians over the proper approach to the corporate rules is indicative of the nexus of contract theory’s unsettled state – drifting between reality and metaphor, description and normative judgment.<sup>38</sup> In *The Rise of the Uncorporation*, however, Ribstein makes clear that the descriptive claim is no longer true. The book tracks the developments of two broad types of business organization: the corporation (in both public and private forms) and the “uncorporation,” a collective term for a variety of partnership-like organizations, primarily partnerships and limited liability companies (LLCs).<sup>39</sup> Ribstein tracks the history of these forms as two inversely-related lines: unincorporations predominated up until the latter nineteenth century, at which point the corporation took off and achieved a century of dominance. Although the corporation remains the primary form of business organization, the unincorporation is catching up, constituting almost a third of all tax-reporting

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<sup>34</sup> *Id.* at 11-12.

<sup>35</sup> *Id.* at 16-17.

<sup>36</sup> *Id.* at 17.

<sup>37</sup> *Id.* They discuss the example of management responses to hostile corporate takeovers. Easterbrook and Fischel support rules requiring management passivity, while Butler and Ribstein would impose default rules.

<sup>38</sup> *Cf.* Eisenberg, *supra* note ME1, at 836 (finding that nexus of contract theory “can be understood in either a very weak or a very strong sense”).

<sup>39</sup> Ribstein, *Uncorporation*, at 1.



business entities.<sup>40</sup> As the title of the book suggests, the corporation is poised to plummet as the unincorporation begins its ascent.

*The Rise of the Unincorporation* is a refutation of the descriptive part of the nexus of contracts theory, at least as applied to the twenty-first century corporation. To be sure, Ribstein is committed to nexus of contract theory in its normative instantiation; he believes that individual participants in a business organization should be left free to construct that organization as they see fit. But the new organizational hero for contractarians, in Ribstein's telling, is the unincorporation. The unincorporation, unlike pretenders before it, is actually something close to the pure nexus of contracts. To make his case, Ribstein uses a foil, and that foil is the corporation.

On a fundamental level, corporations all share the same governance characteristics. The firm is controlled by a board of directors, who in turn select the officers who run the day-to-day business of the operation. This board is elected by shareholders. The shareholders share in the profits of the corporation through dividends and can sell their shares on the open market. This same basic structure – shareholders elect directors who appoint officers – can be found in every public corporation.<sup>41</sup>

Why is this tripartite power dynamic so uniform across corporations? Is it because corporate law requires this structure, or because this structure is the most efficient and therefore freely chosen? Contractarians would point to the default nature of corporate law statutes as evidence that this structure is optimal. For example, section 141 of Delaware General Corporation Law states: “The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.”<sup>42</sup> Thus the board—the central feature of corporate governance—appears to be merely a default rule. Similarly, the Model Business Corporation Act states that “[a]ll corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement

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<sup>40</sup> *Id.* at 3.

<sup>41</sup> The same is true of closely-held corporations, although the roles overlap to a great extent.

<sup>42</sup> Del. Code tit. 8 § 141(a) (2010).

authorized under section 7.32.”<sup>43</sup> Perhaps corporations could really be arranged in almost any possible fashion.<sup>44</sup>

However, this apparent flexibility is belied by the actual structure of most corporations and the presence of other mandatory requirements. In practice, for example, corporate charters are extremely homogenous.<sup>45</sup> The diversity that one might expect from a collection of firms with heterogeneous governance needs is nowhere apparent.<sup>46</sup> Moreover, the apparent flexibility of corporate law on paper is undercut by a more complex reality. The textual openness of § 141(a), for example, masks a fairly rigorous defense of managerial power. Shareholders’ power to amend the corporation’s bylaws under § 109(b) of the Code takes a back seat to the more free-ranging power of § 141(a).<sup>47</sup> In addition, many aspects of federal securities law, particularly SEC Rule 14a-8<sup>48</sup> and the Sarbanes-Oxley Act,<sup>49</sup> assume the existence of the certain governance mechanisms, such as the board and shareholder meetings, before adding additional requirements.<sup>50</sup>

Ribstein argues that centralized management is “[t]he feature that best characterizes the large-firm nature of the corporation,” and the board of directors is “one of the most distinctive features of the corporate form.”<sup>51</sup> He contends that “only a corporation *must* have a board of directors that is separate from the executives and appointed directly by the owners.”<sup>52</sup> Shareholder voting is part of the “legally mandated corporate governance structure;” it is so critical that it is

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<sup>43</sup> MBCA § 8.01(b).

<sup>44</sup> Lynn A. Stout, *The Shareholder as Ulysses: Some Empirical Evidence on Why Investors in Public Relations Tolerate Board Governance*, 152 U. PA. L. REV. 667, 669 (2003) (“Delaware law accordingly treats board governance as a default rule that can be ‘bargained around’ in the corporate charter.”). See generally Henry Hansmann, *Corporation and Contract*, 8 AM. L. & ECON. REV. 1, 2 (2006) (“Even more than is commonly realized, virtually all of corporate law today consists of default rules rather than mandatory rules.”).

<sup>45</sup> Klausner, *supra* note MK1, at 784, 786-91.

<sup>46</sup> *Id.* at 783.

<sup>47</sup> John C. Coates IV & Bradley C. Faris, *Second-Generation Shareholder Bylaws: Post-Quickturn Alternatives*, 56 BUS. LAW. 1323, 1353 (2001) (“A bylaw is impermissible if its primary purpose is to prevent or interfere with the board’s discretion under section 141(a) to manage the business and affairs of the corporation . . . .”); Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409, 428-44 (1998).

<sup>48</sup> 17 C.F.R. § 240.14a-8(i)(1) (2009).

<sup>49</sup> Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

<sup>50</sup> For example, Rule 14a-8 gives shareholders the authority to propose actions to the board at the annual meeting, and Sarbanes-Oxley puts independence requirements on audit committees, which are subcommittees of the board. Sarbanes-Oxley Act § 301, 15 U.S.C. § 78j-1 (Supp. III 2003).

<sup>51</sup> RIBSTEIN, *UNCORPORATION*, at 67.

<sup>52</sup> *Id.*

considered “sacred space.”<sup>53</sup> In addition, Ribstein points to transferable shares, fiduciary duties, and capital lock-in as other essential “governance” elements of the corporation.<sup>54</sup> Each of these is essentially required as part of the corporate form.<sup>55</sup>

Ribstein does not spend a great deal of time defending his characterization of these corporate characteristics as mandatory. This is a critical point, as some contractarians have depicted the modern corporation as the product of market forces rather than state law.<sup>56</sup> It is somewhat surprising to see this article of contractarian faith being dismissed so cavalierly by a contractarian. But the mandatory nature of these governance “requirements” is necessary for Ribstein to tell his political economy story. Each of these factors, to a greater or lesser degree, plays a critical role in the government’s regulation of and control over the modern corporation.

As Ribstein describes it, “[t]he corporate form represents a quid pro quo: big firms get corporate features, and government gets an opportunity to regulate governance.”<sup>57</sup> Thus, the board of directors is not just an efficient way of centralizing authority, as others have argued.<sup>58</sup> It also plays a “politically legitimizing role” and has the opportunity to “help constrain corporations to act consistently with the objectives of lawmakers rather than solely those of investors.”<sup>59</sup> The shareholder meeting is “not simply a way to ensure that managers are running the firm in the shareholders’ interests, but also a mechanism for admitting vox populi into the running of these powerful institutions.”<sup>60</sup> Given the power of large corporations for good and evil, Ribstein argues, lawmakers sought to introduce internal limitations on their governance.<sup>61</sup> Of course, tax was an issue as well. The corporate tax—characterized as “double taxation,” since dividends are taxed as well—was “in a sense a fee for incorporating.”<sup>62</sup> All of these restrictions on corporate freedom can be traced back to regulatory motives.

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<sup>53</sup> *Id.* at 69.

<sup>54</sup> *Id.* at 68-75.

<sup>55</sup> In an earlier piece, Ribstein (with Butler) argued that fiduciary duties were not outside of the realm of contract law and thus should not be counted as evidence of a noncontractarian approach. Butler & Ribstein, *supra* note BR1, at 28-32.

<sup>56</sup> *See, e.g.,* Hansmann, *supra* note HH1, at 1-2.

<sup>57</sup> RIBSTEIN, UNCORPORATION, at 66.

<sup>58</sup> Bainbridge, *supra* note SB1.

<sup>59</sup> RIBSTEIN, UNCORPORATION, at 68.

<sup>60</sup> *Id.* at 70.

<sup>61</sup> *Id.* at 86-87.

<sup>62</sup> *Id.* at 99.

Given the corporate tax, as well as the regulation of corporate governance, why did the great majority of businesses choose the corporation as their organizational form? Ribstein's answer is, largely, the promise of limited liability. The role of limited liability has long been a *bête noire* for contractarians, since it is clearly an aspect of the corporation that is not contractual. Its importance has been minimized, overlooked, or disputed. In *Rise*, however, Ribstein decisively argues that the corporation's monopoly on limited liability was the key to its organizational popularity.

Limited liability is the reason why the corporation succeeded where the partnership failed. Discussing the characteristics that are specific to corporations, Ribstein notes that "partnerships long have been able to contract for such corporate-type features, with one critical exception – limited liability."<sup>63</sup> As he makes clear, limited liability is distinctly non-contractarian: "Limited liability is particularly important because, unlike other corporate features discussed above, partnerships could not easily contract for it without lawmakers' cooperation as they have to include the creditors in these contracts."<sup>64</sup> Although he recognizes that there may have been (cumbersome) contractual methods for limiting liability for contractual claimants, it would have been "impossible" to secure limited liability against tort claimants without the government's help.<sup>65</sup> And limited liability is not window dressing. As Ribstein concedes: "This feature is basic because . . . it is the one that parties cannot replicate by private contract. [W]hether a statutory form provides for limited liability therefore will dominate parties' choice of form."<sup>66</sup>

Control over liability is what gave lawmakers the upper hand in directing organizational choice. It was the carrot that states used to get businesses into the corporate form.

The tradeoff between limited liability, on the one hand, and the tax and regulatory treatment of the corporation, on the other, is critical to Ribstein's political economy narrative: "As lawmakers could control access to limited liability, they could extract a quid pro quo for it by channeling limited liability firms into the corporate form and then taxing and regulating corporations."<sup>67</sup> The delay in the

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<sup>63</sup> *Id.* at 76.

<sup>64</sup> *Id.* at 79.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.* at 138.

<sup>67</sup> *Id.* at 79. Ribstein believes that the normative basis for the quid pro quo is unclear.

Limited liability could not be considered a subsidy to firms to the extent that creditors adjust their credit charges for the greater risk. Even to the extent that limited liability shifts risks to tort creditors who cannot demand compensation

development of the unincorporation stems from legislators' desire to maintain the limited availability of this quid pro quo. Ribstein contends: "Government has jealously guarded the prerogative of cresting limited liability and sought to channel limited liability into the regulated corporate form."<sup>68</sup>

The importance of limited liability is a theme Ribstein turns to over and over again in the book.<sup>69</sup> For example, the closely-held corporation makes no sense to Ribstein as an organizational form, as it imposes a structure on small firms that is much more suitable to larger companies.<sup>70</sup> In Ribstein's view, "[c]losely held firms' widespread use of the corporate form indicates that the benefits of limited liability outweighed firms' costs of having to accept the other aspects of the corporate form along with it."<sup>71</sup> This basic equation started to shift, however, as tax reform in the 1980s made the corporate tax more onerous. Businesses started to push for organizational forms that avoided the corporate tax without many of the drawbacks of partnership. For a time, the *Kintner* regulations<sup>72</sup> drew the line as to which firms would be taxed as corporations. Because firms with limited liability were considered corporations, "the tax classification rules effectively forced firms to pay a tax to the federal government for complete limited liability"<sup>73</sup> However, as businesses grew increasingly dissatisfied with the strictures of the corporate form, pressure grew for an alternative. The limited liability company, originally a modest vehicle for oil and gas companies, threaded the needle by getting classified as a partnership for tax purposes,<sup>74</sup> despite having limited liability.<sup>75</sup> This leak in the dam ultimately drove the IRS to adopt a "check the box" rule allowing firms to choose whether

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for the additional risk, society arguably gains because investors are attracted to socially productive ventures. However, it is not clear why limited liability firms should "pay" for this social benefit by being subjected to extra constraints on their operations.

*Id.* at 79-80.

<sup>68</sup> *Id.* at 139.

<sup>69</sup> *See id.* at 5, 8, 10-11, 25, 37, 43-44, 72, 79-85, 95-97, 99-101, 120-21, 127, 138-47, 153, 162, 164-65, 256.

<sup>70</sup> *Id.* at 95-96.

<sup>71</sup> *Id.* at 95.

<sup>72</sup> Treas. Reg. § 301.7701-2(a) (1996). The regulations were promulgated in the wake of *Kintner v. United States*, 216 F. 418 (9th Cir. 1954).

<sup>73</sup> RIBSTEIN, *UNCORPORATION*, at 100. The S corporation was an exception. *See* 26 U.S.C. §§ 1361-1379. Ribstein characterizes the S corporation as a "kind of political safety valve by which Congress hoped to head off both demands to eliminate the corporate tax and state efforts to provide for the partnership with limited liability . . ." RIBSTEIN, *UNCORPORATION*, at 113.

<sup>74</sup> IRS REV. RUL. 88-76, 1988-2 C.B. 360.

<sup>75</sup> RIBSTEIN, *UNCORPORATION*, at 120-21.

they wanted to be taxed as partnerships or corporations.<sup>76</sup> “Check the box” opened the door for the full flowering of the “uncorporation,” as limited liability was allowed to coexist with favorable tax treatment.

Ribstein tells a story of contractual desires ultimately breaking free of a regulatory scheme that sought to channel businesses into one particular form. Certainly one could tell a different story: the story of how the corporation carefully balanced costs and benefits amongst businesses and society until interest groups finally succeeded in cracking the tax code. This is not Ribstein’s narrative, but it is consistent with his version of events. More importantly, both stories emphasize the importance of the government and of organizational law to the choice of organizational form. The corporation is not simply a nexus of contracts. It is an organizational form with a set of state-given benefits (primarily limited liability) along with a set of taxes and mandatory governance rules. The state plays a much larger role in the story than contractarians have ever before allowed.

Ribstein’s uncorporation seems to be the undoing for the nexus of contracts theory, at least as a positive description. The corporation is not simply a point at which myriad contracts intersect. It is instead a governmentally-created organizational body that imposes specific constraints on participants. Conceiving of the corporation as a simple agglomeration of private agreements—even metaphorically—is deeply misleading. As the uncorporation demonstrates, the corporation has many specific features that could be considered either mandatory or quasi-mandatory. These features distinguish the corporation not only from the realm of contract but from the uncorporation as well.

A contractarian might, at this point, turn the diversity in organizational choice around on us and argue that the variety demonstrates a different kind of contractual freedom. After all, as Ribstein argues, having a multitude of organizational choices allows parties to pick and choose the organizational form that best suits their needs.<sup>77</sup> Businesses are no longer stuck with the corporation; they are now free to choose any of the variety of uncorporations instead. Because parties are still using the corporation, even in the midst of organizational plenitude, that must mean that parties prefer the corporation. It is the choice of the majority of businesses; it must therefore have advantages that other organizational forms do not. In other words, we can say that the corporation is like a nexus of contracts, in that it is freely chosen by the parties as the best

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<sup>76</sup> *Id.* at 121. See TREAS. REG. § 301.7701-1-3 (2004).

<sup>77</sup> RIBSTEIN, UNCORPORATION, at 178.

organizational delivery system for their relationships. Even if not literally a contractual nodule, it represents the parties' free choice.<sup>78</sup>

This is not the argument Ribstein makes in *Rise*. He argues instead that the unincorporation is a superior vehicle for addressing the problems of contemporary organizational structure.<sup>79</sup> Arguing that the corporation is “far from ideal” as a governance structure, Ribstein claims that “the unincorporation provides potentially more efficient ways to control the agency costs of centralized management.”<sup>80</sup> He argues that the traditional corporate tools for restraining managers—shareholder voting, boards of directors, fiduciary duties, and takeovers—have failed to provide the proper market discipline.<sup>81</sup> Instead, the unincorporation's combination of greater managerial freedom and stronger mandate for distributions provide a better approach, in his view, for reducing managerial costs.<sup>82</sup>

If the unincorporation is a superior organizational form, why is it only gaining popularity now? Ribstein provides only a brief direct answer, citing the increased salience of agency costs, greater financial complexity, and advances in organizational development.<sup>83</sup> His narrative, however, describes how the unincorporation has only recently been freed of its regulatory shackles, with “check the box” allowing unincorporations both favorable tax treatment and limited liability. It is state lawmakers and federal bureaucrats who created the LLC revolution. Political forces entrenched the corporation; now those forces have created an opening for the unincorporation.<sup>84</sup> To the extent the unincorporation does face challenges to its growing role, Ribstein sees those challenges largely coming from the government.<sup>85</sup> This is not a story of firms adapting to organizational demands through contract. It is a story of government facilitating growth (or not) through the organizational forms it provides:

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<sup>78</sup> See Butler & Ribstein, *supra* note BR1, at 11 (“[T]he parties to a firm can opt out of terms that are mandatory for all corporations simply by choosing among different investment and organizational forms. For example, the ‘mandatory’ requirement of at least majority shareholder voting on significant corporate transactions can be avoided by disincorporating into a limited partnership.”).

<sup>79</sup> RIBSTEIN, UNINCORPORATION, at 193.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* at 195-207.

<sup>82</sup> *Id.* at 207-13, 214-17. Unincorporations cannot rely on the market for control, as their governance rights are generally difficult to transfer (p. 218). Although the market for corporate control has long been a critical aspect of imposing economic discipline on corporations, Ribstein believes this market is not necessary for unincorporations. *Id.* at 218-19.

<sup>83</sup> *Id.* at 194.

<sup>84</sup> *Id.*

<sup>85</sup> *Id.* at 238-46.

The large unincorporation's story is still unfolding. Courts, regulators, and tax authorities may decide that large firms should be subject to corporate rules whatever business form they have chosen. On the other hand, policy makers may see that the crisis in the governance of large firms demands a fresh approach rather than just tinkering with an increasingly unsatisfactory model. Understanding the distinct mechanisms of unincorporations and giving them room to operate may be a key to this fresh approach.<sup>86</sup>

In other words, it is up to government to develop the organizational forms necessary for efficient private ordering.

It is hard to know, at this point in time, how controversial such a statement is. Law and economics scholars such as Henry Hansmann and Michael Klausner have moved away from the descriptive form of the nexus of contracts theory by suggesting that government does need to play a role in creating the corporate "contract."<sup>87</sup> Easterbrook and Fischel have touted a hypothetical bargain to be used contemporaneously with the actual bargain of the parties.<sup>88</sup> And, of course, noncontractarians have long believed in the importance of government regulation to the nature of the firm.<sup>89</sup> Ribstein's approach is in many ways unremarkable. But it signals that, to the extent there was a debate about the positive version of nexus of contracts theory, the debate is over.

### III. Larry as Economic Liberator

Of course, it is Ribstein's normative commitment to contractarianism that draws him to the unincorporation in the first place. The unincorporation offers the contractual flexibility that the corporation lacks. Indeed, "unincorporation" itself is merely a label put on a variety of different organizational forms that offer an assortment of organizational approaches. The flexibility represented by these forms, both internally and as a group, allows for greater specialization and even

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<sup>86</sup> *Id.* at 194-95.

<sup>87</sup> Hansmann, *supra* note HH1, at 10 (discussing the government's role in structuring long-term relational contracts); Klausner, *supra* note MK1, at 793-96 (blaming learning and network externalities for the dearth of contractual innovation at the corporate level).

<sup>88</sup> Easterbrook & Fischel, *supra* note EF2, at 1444-46.

<sup>89</sup> Bratton, *supra* note WB1 (Nexus), at 442 ("Freedom of contract is freedom to ask the sovereign to confer power constraining your freedom on another party."); *id.* at 445 (noting that "the sovereign presence persists" in corporate law); Eisenberg, *supra* note ME1, at 823-25 (discussing mandatory rules).



“idiosyncratic arrangements.”<sup>90</sup> For example, when it comes to fiduciary duties, Ribstein notes that Delaware corporate shareholders cannot waive the duties of loyalty and good faith, whereas that state offers much more flexibility on that score for limited partnerships and LLCs.<sup>91</sup> Some of this flexibility can be put to very specific use. Ribstein advocates that business association owners have stronger access to the firm’s cash on hand, through distributions or the power to demand liquidation or buyout.<sup>92</sup> This access, in his view, would provide much greater market discipline against the managerial agency costs that have plagued the public corporation in the last decade.<sup>93</sup>

However, Ribstein acknowledges that all is not completely contractual, not even in the unincorporate world. Uncorporations have adopted the partnership approach of restricting transferability of management rights.<sup>94</sup> Most LLCs statutes do not provide for a default right to disassociate, in order to accommodate tax law requirements about the liquidity of estate assets.<sup>95</sup> And although LLCs have more flexible governance requirements than corporations, most statutes provide only a “binary choice between manager- and member-management.”<sup>96</sup> In addition, standardization may be appropriate “to clarify the expectations of the many people with which the corporation deals.”<sup>97</sup> Despite his admiration for Delaware’s freedom to waive such duties, Ribstein acknowledges that “[a]s LLCs increasingly become the new default entity, many undoubtedly are being formed with plain-vanilla certificates and no detailed arrangements.”<sup>98</sup> As a result, restrictions on waivers in other states’ LLC statutes may make sense as long as Delaware remains an option for sophisticated LLCs. Ribstein argues: “This illustrates how distinctiveness can be as important among different statutory versions of the same business associations as it is among different types of business associations.”<sup>99</sup>

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<sup>90</sup> RIBSTEIN, UNINCORPORATION, at 157.

<sup>91</sup> *Id.* at 169-70, 175, 177-78.

<sup>92</sup> *Id.* at 139.

<sup>93</sup> *Id.* at 209-12.

<sup>94</sup> *Id.* at 182.

<sup>95</sup> *Id.* at 179-80. Ribstein argues that this has had “the perverse secondary effect of forcing lawmakers to provide a backup exit right” in the form of judicial dissolution. *Id.* at 180. However, Delaware does allow parties to contract out of this dissolution remedy. *See id.* at 181; *R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, No. 3803-CC, 2008 WL 3846318, at \*8 (Del. Ch. Aug. 19, 2008).

<sup>96</sup> RIBSTEIN, UNINCORPORATION, at 153.

<sup>97</sup> *Id.* at 149.

<sup>98</sup> *Id.* at 178.

<sup>99</sup> *Id.* Ribstein also notes the confusion surrounding whether interests in LLCs are securities. *Id.* at 186-89; *see also* *Robinson v. Glynn*, 349 F.3d 166, 174 (4th Cir. 2003) (holding that the determination must be made case by case, since “LLCs lack standardized membership rights or

Rather than minimizing the role of government in the unincorporation, Ribstein's analysis highlights it. *Rise* is rife with discussions of the inefficiencies of legislative drafting,<sup>100</sup> the importance of tax policies such as the *Kintner* factors and "check the box,"<sup>101</sup> and regulatory arbitrage.<sup>102</sup> One is constantly reminded of the heavy hand of the state in creating corporations and unincorporations, in all their permutations. This approach suits Ribstein's normative agenda, which is to identify and eliminate market impurities introduced by legislative meddling.<sup>103</sup> But in his criticism of government, he must not only acknowledge that they sometimes get it right (LLCs, check-the-box), but also that the state holds the cards and controls the game. Entities are state creations—a fact made abundantly clear.

At the end of the book, Ribstein cites the possibility of the un-business association – the "fully customized firm."<sup>104</sup> Although he doesn't frame it exactly this way, one gets the sense the un-business-association would be Ribstein's ideal when it comes to organizational forms. Of course, at least one non-contractual element would still be necessary. As Ribstein describes it, an un-business association statute would allow parties to "enter into a customized contract, but still have limited liability—a sort of 'contractual entity.'"<sup>105</sup> Is this organizational form our future? Or are we destined to have no organizational forms at all – only contracts?

At this moment, the long-term future of corporations seems potentially suspect. As Ribstein has well documented, the corporation is under siege by this plethora of new organizational structures. When the Treasury moved to "check-the-box" taxation for these new entities, they became viable alternatives to the corporation in a variety of different fields. The flexibility of the LLC form is in contrast to many of the requirements, state and federal, placed upon the

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organizational structures" and thus "can assume an almost unlimited variety of forms"). He notes that state lawmakers might consider offering clear management alternatives, rather than a spectrum of flexible management possibilities, in order to create more certainty when it comes to securities regulation. RIBSTEIN, UNINCORPORATION, at 189.

<sup>100</sup> *Id.* at 155-56.

<sup>101</sup> *Id.* at 100, 131-32.

<sup>102</sup> *Id.* at 184-86, 192

<sup>103</sup> *E.g., id.* at 185 ("[L]awmakers could minimize total social costs by designing tax and regulatory statutes that take into consideration business association coherence as well as other statutory objectives").

<sup>104</sup> *Id.* at 256.

<sup>105</sup> *Id.*

corporation.<sup>106</sup> It seems, perhaps, as if Jensen & Meckling's "nexus of contracts" model is coming to life in the LLC, and the corporation's failure to live up to their model is bringing it down.

The employment relation seems to be moving from firm to market as well. In the mid-twentieth century, labor economists identified internal labor markets as a deviation from neoclassical labor market theory.<sup>107</sup> These economists found that employees largely stayed within one firm for their lifetime of employment, and that firms generally used internal promotion to fill vacancies. These findings established an empirical basis for Coase's notion of the importance of the employment relation to the firm. Moreover, internal labor markets are an instantiation of the separateness of the firm from the market; they demonstrate that the firm is truly a different set of relationships. However, economists are finding that the importance of internal labor markets has been dwindling.

Beginning in the 1970s, firms began to hire more temporary and contingent workers.<sup>108</sup> This trend accelerated through the 1990s, and continues apace. Recent reports indicate that the 2008 recession has turned many employees into "permanent" temporary workers, with as much as 26 percent of the workforce now having "nonstandard" jobs.<sup>109</sup> And the effects go beyond low-skill and low-wage employment; executive officers, lawyers, and scientists are all among the temporarily employed.<sup>110</sup> Moreover, "outsourcing" – a word of relatively recent vintage – continues to break down relationships that were traditionally within the firm.<sup>111</sup> What Alan Hyde said in 1998 continues to be true

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<sup>106</sup> Moreover, when it comes to the public corporation, commentators have suggested that more firms are going private because of the regulatory requirements layered upon the public corporation. William J. Carney, *The Costs of Being Public after Sarbanes-Oxley: The Irony of "Going Private"*, 55 EMORY L. J. 141 (2006). Bartlett argues, however, that Sarbanes-Oxley is not to blame for the high-profile "going private" transactions of the last decade. Robert P. Bartlett III, *Going Private But Staying Public: Reexamining the Effect of Sarbanes-Oxley on Firms' Going-Private Decisions*, 76 U. CHI. L. REV. 7 (2009).

<sup>107</sup> KATHERINE V.S. STONE, FROM WIDGETS TO DIGITS: EMPLOYMENT REGULATION FOR THE CHANGING WORKPLACE (2004).

<sup>108</sup> *Id.*

<sup>109</sup> Michelle Conlin, Moira Herbst & Peter Coy, *The Disposable Worker*, BUSINESSWEEK, Jan. 7, 2010, at: [http://www.businessweek.com/magazine/content/10\\_03/b4163032935448.htm](http://www.businessweek.com/magazine/content/10_03/b4163032935448.htm).

<sup>110</sup> *Id.*; STEVEN GREENHOUSE, THE BIG SQUEEZE (2008).

<sup>111</sup> Margaret M. Blair & Erin O'Hara, *Outsourcing, Modularity and the Theory of the Firm*, Working Paper No. 09-19, Vanderbilt University Law School, Law & Economics Series, available at: <http://ssrn.com/abstract=1318263>; George S. Geis, *An Empirical Examination of Business Outsourcing Transactions*, 96 VA. L. REV. 241 (2010); George S. Geis, *The Space Between Markets and Hierarchies*, 95 VA. L. REV. 99 (2009).

today: “Increasingly, labor is hired through short-term, market-mediated arrangements that may not be ‘employment’ relations in any legal or technical sense of that word.”<sup>112</sup>

During this new millennium, commentators have further analyzed the dissolution of the traditional employment relationship.<sup>113</sup> The breakdown in internal labor markets has occurred mainly with respect to workers on either end of the skill spectrum. Low-skilled workers find themselves in at-will employment contracts, which leave them exposed to outsourcing or replacement by other temporary workers.<sup>114</sup> Highly skilled workers are also less likely to be captured by internal labor markets as they are able to leverage their skills in the marketplace to move from project to project, employer to employer.<sup>115</sup> Internal labor markets have continued to dissolve as medium-skilled workers acquire fewer firm-specific firms, move between firms more frequently, and do so with more portable benefits at their disposal (especially defined contribution plans like 401k’s).<sup>116</sup> As Kathy Stone has argued, “Work has become contingent, not merely in the sense that it is formally defined as short-term or episodic, but in the sense that the attachment between the firm and the worker has been weakened.”<sup>117</sup>

If the corporation is giving way to a more contractually-oriented form of business enterprise, and the employment relationship is dissolving back into the market, then perhaps corporations (or their successor organizational forms) will exist only to structure financial relationships and confer limited liability. What would corporate law look like? What would employment law look like? The possibility of a radically individualized future is not necessarily a nightmare for progressive thinkers.

As low- and highly-skilled workers move out of internal labor markets into external ones, one could imagine a variety of ways that they may come together for mutual benefit. In some cases, this may take place on a relatively small scale. For example, there is already some indication of a move to smaller, more localized production in agriculture, as well as specialty foods like craft beer,

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<sup>112</sup> Hyde, *supra* note AH1998, at 99.

<sup>113</sup> See STONE, *supra* note KVWS, at 67-86; Samuel Estreicher, *Employer Reputation at Work*, 27 HOFSTRA LAB. & EMP. L.J. 1 (2009).

<sup>114</sup> See *id.* at 4.

<sup>115</sup> See *id.* Estreicher argues that it is the workers who possess medium-level skills who continue to function within, and perpetuate, internal labor markets. See *id.* at 4-6.

<sup>116</sup> See *id.* at 5; Samuel Issacharoff & Erica Worth Harris, *Is Age Discrimination Really Age Discrimination?: The ADEA's Unnatural Solution*, 72 N.Y.U. L. REV. 780 (1997).

<sup>117</sup> STONE, *supra* note KVWS, at 70-71.

smoked meats, and artisanal cheese.<sup>118</sup> These small-bore firms promote greater attention to detail and provide broader consumer choice. They may also encourage greater freedom of movement within one's career. Smaller agglomerations of individual workers who move from project to project, rather than from firm to firm, may allow greater independence, and may provide workers with greater bargaining power. The death of the massive public corporation may engender a Jeffersonian-style renaissance of small producers and greater attention to quality.

Of course, greater worker participation in the management of business firms wouldn't necessarily have to be limited to small-scale ventures. Workers may, on a broad scale, enter into contracts that involve much more than the simple exchange of labor for wages. In employee cooperatives, for example, workers also have economic and managerial interests in the enterprise.<sup>119</sup> Each worker-member in such a cooperative has input into the day-to-day and long term decisionmaking of the firm on a one worker, one vote basis.<sup>120</sup> For larger cooperatives, this power is exercised in the ability to elect members of a governing board.<sup>121</sup> Worker-members share in both the decisionmaking and profits.<sup>122</sup>

Employee cooperatives of this sort have already been successfully established on large scales in agricultural settings. The plywood cooperatives in the Pacific Northwest are a well-studied example.<sup>123</sup> More recently, the Tata Group in India established a cooperative as part of a strategy of divesting itself of a subsidiary, the Tetley Tea Company, which it had acquired for \$450 million in 2000.<sup>124</sup> Instead of selling its agricultural plots to rich landowners or other corporations, Tata sold a majority of them to former employees of the company

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<sup>118</sup> See Benjamin Wallace, *The Tweek Party*, N.Y. Mag., April 15, 2012, at: <http://nymag.com/news/features/artisanal-brooklyn-2012-4/>.

<sup>119</sup> See Henry Hansmann, *Employee Ownership of Firms*, THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW (1998).

<sup>120</sup> See Peter Pitegoff, *Worker Ownership in Enron's Wake—Revisiting A Community Development Tactic*, 8 J. SMALL & EMERGING BUS. L. 239, 247 (2004); Sara Tonnesen, *Stronger Together: Worker Cooperatives as Community Economic Development Strategy*, 20 GEO. J. ON POVERTY L. & POL'Y 187, 188 (2012).

<sup>121</sup> See John Logue, *What is an Employee Cooperative? How does it work? An introduction for employee-members*, Ohio Employee Ownership Center, Kent State Univ. (Jan. 2006), available at <http://www.oockent.org/download/cooperatives/whatisacooperative-ncdfversion.pdf.pdf>.

<sup>122</sup> See Hansmann, *supra* note xx.

<sup>123</sup> See, e.g., JOHN PENCAVEL, *WORKER PARTICIPATION: LESSONS FROM THE WORKER CO-OPS OF THE PACIFIC NORTHWEST* (2002).

<sup>124</sup> See Ann Graham, *Too Good to Fail*, STRATEGY+BUSINESS, Feb. 23, 2010, available at <http://www.strategy-business.com/article/10106?gko=74e5d>.

and established a cooperative that was eventually known as the Kenan Devan Hills Plantation Company (KDHP).<sup>125</sup> The cooperative has place great emphasis on outreach activities that involve health and education programs for their workers and their communities.<sup>126</sup> KDHP now employs over 12,000 workers, most of whom are also shareholders, and has become the largest tea company in South India.<sup>127</sup>

Although employee cooperatives have traditionally been concentrated in agricultural or other rural industries, the rise of the internet may facilitate expansion of this particular business form.<sup>128</sup> As an initial matter, workers interested in such a venture may find information and guidance on this type of organizational structure more readily on the internet than otherwise possible. But, more directly, the internet may allow like-minded workers separated by great distances come together into a cooperative without the imposition of the type of physical facilities and middle-management superstructure usually associated with such ventures. And, more generally, the flexibility fostered by internet may facilitate all sorts of productive combinations of workers.

Thus, workers, freed from traditional contractual norms associated with internal labor markets, may thus come together in different ways, large and small. Employee cooperatives give workers a role in decisionmaking and a share of the profits. Other institutional structures offer variations on those themes. German-style codetermination, for example, gives workers some decisionmaking authority through its works councils, but no real access to the profits.<sup>129</sup> Employee stock ownership plans do the opposite—workers are entitled to a share of the firm's profits but have no real access to the decisionmaking process.<sup>130</sup> And though Ribstein didn't spend as much time contemplating the role of the worker in most of his work on unincorporations, access to these types of organizational structures are clearly within the individual orderings contemplated by his broad commitment to contractarianism.

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<sup>125</sup> See *id.*

<sup>126</sup> See *Corporate Social Responsibility*, KDHP, <http://www.kdhptea.com/Welfare.html>

<sup>127</sup> See *Company Profile*, KDHP, <http://www.kdhptea.com/CompanyProfile.html>

<sup>128</sup> See Meredith-Anne Kurz, *The Merits of Cooperative Corporate Governance in the Digital Age* (unpublished manuscript).

<sup>129</sup> See Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, in *EMPLOYEES AND CORPORATE GOVERNANCE* 163 (Margaret M. Blair & Mark J. Roe eds., 1999); Viet D. Dinh, *Codetermination and Corporate Governance in a Multinational Business Enterprise*, 24 J. CORP. L. 975, 990-91 (1999).

<sup>130</sup> See HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 105 (1996).

Although internal labor markets aren't expected to disappear anytime soon, they, too, may move in the direction of greater contractual diversity. There is already evidence that workers are engaging with external markets on a number of fronts. Greater labor mobility, fewer firm-specific skills, and portable benefits have already been mentioned. But there are a number of other ways in which the traditional parties to a corporation might move toward greater worker independence. While unions may continue to engage in their core functions of negotiating and monitoring compliance with collective bargaining agreements, workers may also contract with other union-like institutions that maintain varying degrees of independence from employers.<sup>131</sup> Some of those institutions may move closer to employers, and engage both managers and workers in a consultative role.<sup>132</sup> Others may function more in the capacity of service providers, completely disengaged from employers, and furnish workers with such things as legal advice or opportunities for professional development.<sup>133</sup> For example, the Freelancers' Union provides affordable health insurance and access to a health clinic with yoga classes and other services.<sup>134</sup> As the Union's founder has argued, "If Gompers were alive today, he'd be trying to figure out what the next models are for today's workers."<sup>135</sup> Labor, just like capital in Ribstein's vision of unincorporations, may begin to organize itself in a greater variety of contractual arrangements.

While some of these changes may be under the control of the parties, others may demand removal of some of the legal obstacles to free contracting. Traditional unions could be freed up to bargain on such things that are currently either illegal—such as hot cargo clauses<sup>136</sup>—or strongly discouraged—such as employee representation on corporate boards.<sup>137</sup> We could eliminate state "right to work" laws, which prohibit unions and employers from freely bargaining for

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<sup>131</sup> See Samuel Estreicher, *Freedom of Contract and Labor Law Reform: Opening Up the Possibilities for Value-Added Unionism*, 71 N.Y.U.L. REV. 827, 833-34 (1996).

<sup>132</sup> See *id.*

<sup>133</sup> See *id.*

<sup>134</sup> Steven Greenhouse, *Tackling the Concerns of Independent Workers*, N.Y. TIMES, March 23, 2013.

<sup>135</sup> *Id.* (quoting Sara Horowitz).

<sup>136</sup> These are clauses in collective bargaining agreements that prohibit an employer from conducting business with some other employer with whom the union has a dispute, or, more generally, has a non-union workforce. With a few exceptions, these clauses are illegal under federal law, see 29 U.S.C. § 158(e) (2006), as are strikes to obtain such clauses, see 29 U.S.C. § 158(b)(4)(A) (2006), and strikes to enforce them, see 29 U.S.C. § 158(b)(4)(C) (2006); *Local 1976, Etc. v. National Labor Relations Board (Sand Door Case)*, 357 U.S. 93 (1958).

<sup>137</sup> See Estreicher, *supra* note xx, at 844.

union security arrangements.<sup>138</sup> The creation of some of the quasi-union organizations may also require some legal changes, such as lifting the ban on prehire agreements<sup>139</sup> or relaxing the rules on employer support of such employee organizations.<sup>140</sup> These, and other changes set out in what Samuel Estreicher terms a “freedom of contract” agenda,<sup>141</sup> may increase the number of possible arrangements open to workers.

There may also be ways to enhance the contractual possibilities of those workers who remain in internal labor markets. Although such workers, by definition, move between firms relatively infrequently, those moves still occur (and are, perhaps, more significant given their rarity). These workers also move within firms as they are promoted, demoted, or transferred. At all of these junctures, workers are faced with new contractual opportunities, however limited, and would benefit from more information. One can imagine that organizations could arise to provide that information about things such as a potential new firm’s behavior in the past with respect to its workers; a current or new firm’s market position; and wage and benefit data for comparable positions in the industry. Armed with this kind of information, workers may be able to alter certain aspects of their new employment contracts or, even in take-it-or-leave-it situations, make better informed decisions.

Enhancing the contractual opportunities available to workers does have some distinct advantages. Workers with better information may be able to tailor contracts to better fit their personal situations. This may not only lead to better contracts, but the sense of control over one’s worklife which would itself contribute to a worker’s sense of well-being. And such positive engagement with the employer would be beneficial to all corporate constituents.

There may be other advantages of moving toward a more contractarian regime for workers. With more freedom to contract, one would expect workers to enter into an increasingly diverse set of agreements that detail their relationships with other constituents. This, in turn, may begin to break down the traditional

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<sup>138</sup> See 29 U.S.C. § 164(b) (2006) (allowing states to prohibit union security devices). Twenty-three states have exercised this power. See Kenneth Glenn Dau-Schmidt & Winston Lin, *The Great Recession, the Resulting Budget Shortfalls, the 2010 Elections and the Attack on Public Sector Collective Bargaining in the United States*, 29 HOFSTRA LAB. & EMP. L.J. 407, 428-31 (2012).

<sup>139</sup> For a discussion of this, see Estreicher, *supra* note xx, at 834-39.

<sup>140</sup> See, e.g., *Electromation, Inc.*, 309 N.L.R.B. 990 (1992) (holding that an employer in a nonunionized workplace violated section 8(a)(2) when it established a committee to deal with the employer concerning grievances, labor disputes, wages, hours, and conditions of work).

<sup>141</sup> See generally, Estreicher, *supra* note xx.



distinctions between owners, managers, and workers. This is certainly true, by definition, when it comes to the various forms of employee-owned or –managed enterprises discussed above. But a blurring of roles may also take place in more traditional corporations as workers, alone or in groups, begin to structure contracts that involve more of what are usually considered ownership or management rights.

Allowing workers to restructure their relationships with each other and with other corporate constituents is certainly consistent with Ribstein’s contractarian impulses and his development of the unincorporation. Workers, like other corporate constituents, should be able to move beyond their traditional roles and create contractual relationships that more fully satisfy their individual preferences. This could be accomplished by altering some of the existing legal structures governing their relationships with other firm constituents, much as unincorporations undo many of the legal strictures of corporations.

Changing the legal restrictions and defaults with respect to employees is one thing. But one wouldn’t have to go this far. Some good could come by merely having workers (and other firm participants) act in new capacities. Getting past the old categories would allow better expression of a full range of people’s preferences. Under existing norms, corporate constituents tend to act on preferences consistent with their roles in the corporation. At a very general level, people acting in market contexts tend to focus on bottom-line considerations to the exclusion of other preferences.<sup>142</sup> And, more specifically, shareholders attempt to maximize profit; consumers attend to focus on price and product quality.<sup>143</sup> Non-market values—things like the social values of the corporation, its treatment of workers, environmental impacts—fall by the wayside. Markets then, are hegemonic—people act for personal gain and other values are reflected in what they do with that gain.<sup>144</sup>

This is curious, however, because we know from a wide range of research that people possess and act upon other-regarding preferences in non-market contexts.<sup>145</sup> So what accounts for the apparent on-again, off-again nature of people’s preferences? As we’ve argued elsewhere, one possibility is that people do not consult their entire set of preferences when making decisions; instead, they

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<sup>142</sup> See Stephen E. Ellis, *Market Hegemony and Economic Theory*, 38 PHIL. SOC. SCI. 513 (2008); Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 497-98 (2008).

<sup>143</sup> See Ellis, *supra* note xx, at 515.

<sup>144</sup> See Ellis, *supra* note xx; Hayden & Bodie, *supra* note xx, at 497.

<sup>145</sup> See Hayden & Bodie, *supra* note xx, at 497.

rely upon a proper subset of their interests.<sup>146</sup> Different contexts (e.g., market versus non-market) and different roles may focus attention of different sets of preferences. “Just as looking at a glass of cold water may focus one’s attention on his thirst, staring at a prospectus may make one focus on a corporation’s profitability.”<sup>147</sup> Other preferences, even strongly held ones, may stay “offline” in such situations.

Thus, enhancing the contractual freedom of workers and other constituents may ultimately allow them to act in ways that maximize the full range of their preferences. Workers could begin to think more like owners, and vice versa. And such a state of affairs would complete the dream of any contractarian: to ensure that markets reflected people’s preferences rather than the other way around.

At least, we should not reject this possibility. Larry Ribstein’s world is one of greater economic freedom. Liberals have come to regard economic freedom reflexively as promoting a winner-take-all state in which the vast majority of workers are oppressed by capital. But it would not necessarily turn out that way. The communist state is less “progressive” than an unrestrained capitalist state would be, and economic freedom can promote personal freedom. Progressives should take Ribstein’s challenge of promoting greater economic flexibility as a way of promoting human flourishing. To the extent some people would flail and fail under such a system, progressive should envision social structures that would provide support. But these structures need not be a massive regulatory state. Small-bore structures – micro-lending, employee ownership, unions or trade groups that offer insurance and support – can help individuals achieve success without the bureaucratic structures of a massive welfare state. It may turn out that Ribstein’s world would look more like a 19<sup>th</sup>-Century English industrial town than it would the buzzing, whizzing world of dynamic contractual invention. But progressive should not assume such a scenario—not when there are possibilities to explore.

The tide may be turning back to a more employee-oriented workplace. Popular management literature emphasizes the importance of the employee.<sup>148</sup> Small startups, particularly in the tech industry, are once again blurring the line between entrepreneur and employee.<sup>149</sup> Academia is evolving, as well. Recent research into the theory of the firm has focused on the importance of knowledge-

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<sup>146</sup> See Hayden & Bodie, *supra* note xx, at 498; Stephen Ellis & Grant Hayden, *Law and Economics After Behavioral Economics*, 55 KAN. L. REV. 629 (2007).

<sup>147</sup> See Hayden & Bodie, *supra* note xx, at 498.

<sup>148</sup> See, e.g., TONY HSIEH, *DELIVERING HAPPINESS: A PATH TO PROFITS, PASSION, AND PURPOSE* (2010) (discussing Zappo’s approach to employee service).

<sup>149</sup> See, e.g., Doree Shafrir, *Tweet Tweet Boom Boom*, N.Y. MAG., April 26, 2010, at 34.

based assets and the distribution of access to those assets within the firm.<sup>150</sup> As we learn more about the importance of trust, norms, and procedural justice within the corporation, employees will grow even more in importance.<sup>151</sup>

It is possible to envision a radically individualized future, in which each worker is a “corporation” unto herself and firms are merely temporary agglomerations within the global market. It is also possible to envision a future in which employees participate at the highest levels of governance, and corporations are tools of team production rather than investor enrichment. Perhaps both of these futures are in store, to varying degrees within different industries. Ribstein has encouraged us to envision a decentralized, contractual future. Progressives should take him up on it.

#### IV. Conclusion: Living in Larry’s Future

Larry Ribstein envisions a world that is not for the faint-hearted or ignorant. It requires workers to look for the best use of their talents, and to enter economic relationships that match best with their preferences and opportunities. It is a world shorn of bureaucracy, but also shorn of standard forms. It eschews bailouts and cronyism.<sup>152</sup> It also asks us to keep on our toes, lest we fall behind or be taken advantage of.

Progressives will want to look to the losers under such a system, and ask about their fate. The safety net should be strong.<sup>153</sup> But at the same time, progressives do not want to find themselves defending the “crony” capitalists, the bureaucrats, the defenders of the status quo. A world of contractual freedom offers tremendous opportunity for individuals to pursue their talents without the encrustation of societal red tape or past practices to encumber them.

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<sup>150</sup> See Érica Gorga & Michael Halberstam, *Knowledge Inputs, Legal Institutions, and Firm Structure: Towards a Knowledge-Based Theory of the Firm*, 101 NW. U. L. REV. 1123 (2007); Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q.J. ECON. 387, 388 (1998).

<sup>151</sup> TOM R. TYLER & STEVEN L. BLADER, COOPERATION IN GROUPS: PROCEDURAL JUSTICE, SOCIAL IDENTITY, AND BEHAVIORAL ENGAGEMENT (2000), Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001).

<sup>152</sup> Luigi Zingales has advocated for a similar approach. LUIGI ZINGALES, *A CAPITALISM FOR THE PEOPLE* (2012).

<sup>153</sup> See *id.* at 147-48 (2012) (acknowledging the need for a safety net).

A lot is riding, though, on how those contracts are constructed. It is not surprising, then, that Ribstein's world has a significant and creative role for attorneys. In his article on legal education reform, Ribstein describes lawyers as collaborators, manufacturers, lawmakers, information engineers, and capitalists.<sup>154</sup> Constructing legal relationships in a variety of settings allows attorneys to be much more influential in unlocking value within the economy. In fact, the level of legal knowledge amongst all economic participants would need a significant boost for participants to take full advantage of their economic freedom. Lawyers and law schools could play an important role in this new economy—a role that legal education has really yet to explore.

This essay has taken an optimistic, perhaps even Panglossian perspective on the world of contractual freedom envisioned by Larry Ribstein. But we think it is appropriate to do so, if only to get us started. Sticking with the tried-and-true always seems safer. It was Larry's hope that he could push us off of that secure station, into an unknown but potentially limitless future.

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<sup>154</sup> Larry E. Ribstein, *Practicing Theory: Legal Education for the Twenty-First Century*, 96 IOWA L. REV. 1649, 1666-70 (2011).