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Cover Page Footnote

Associate Professor of Law, The University of Toledo College of Law. B.A., 1985, Amherst College; J.D., 1988, Harvard Law School. The author wishes to thank his colleagues Llew Gibbons, Ken Kilbert and Kara Bruce, as well as Sydney Knell for their invaluable assistance and comments.

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IT'S TIME FOR A GOOD HARD LOOK IN THE MIRROR: THE CORPORATE LAW EXAMPLE

John A. Barrett, Jr.

IT'S TIME FOR A GOOD HARD LOOK IN THE MIRROR: THE CORPORATE LAW EXAMPLE

John A. Barrett, Jr.[*]

ABSTRACT

This Article asserts that the move from the industrial age to the information age represents a fundamental change to our society on such a widespread basis that the legal order must reexamine the premises about how our society functions, assessing whether foundational elements of U.S. Common Law remain valid. This Article first confronts briefly the continuing acceptance of certain foundational premises in contract and intellectual property law, illustrating that such premises are no longer supported by the realities of modern society. With fundamental change challenging multiple areas of law in the information age, this problem is worthy of widespread inquiry by legal scholars in various fields. This Article then turns to a detailed analysis of the premises supporting shareholder primacy in corporate law, demonstrating that the historic justifications for allocations of ownership, control and duties no longer support these premises. Based on the relative needs of today's businesses vis-à-vis the contributions of various other constituencies, this Article asserts that employees should also have certain duties owed to them. This Article concludes with a novel model for creating such a stake in the form of a springing right to profit sharing.

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[*] Associate Professor of Law, The University of Toledo College of Law. B.A., 1985, Amherst College; J.D., 1988, Harvard Law School. The author wishes to thank his colleagues Llew Gibbons, Ken Kilbert and Kara Bruce, as well as Sydney Knell for their invaluable assistance and comments.

INTRODUCTION

Everyone knows how much the world has changed in the last two hundred years. Some changes have been incremental, like moving from horse drawn carriages to automobiles as a basic means of transportation. Others have been quantum, such as moving from an industrial age to an information age. The fundamental question for the legal community is whether the law has adequately changed to keep pace with societal change.

This Article asserts that we have reached such a reflection point in the development of the common law**;** that the move from the local merchant, isolationist and industrial age to the mass market, globally intertwined, information age[1] represents such a fundamental change to our society, that the legal order must step back and reexamine the underlying premises about how our society functions and what is reasonable in each area of U.S. law in order to assess whether those premises remain valid.[2] Some areas of law may hardly be affected, as

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1. JOHN NAISBITT & PATRICIA ABURDENE, MEGATRENDS 11 (1982); TONY MURPHY, ACHIEVING BUSINESS VALUE FROM TECHNOLOGY (2002).

2. THOMAS L. FRIEDMAN, THE WORLD IS FLAT: A BRIEF HISTORY OF THE TWENTY-FIRST CENTURY 204-05 (2005). Commentators have asserted this claim with respect to individual areas of law already, but as fundamental shifts to the information age have become even clearer, the need for a wholesale undertaking has become apparent. *See* Susan J. Drucker, *The Tenets of Jurisdiction: Lost in Cyberspace,* 69-

their premises remain valid, whereas other areas may need a radical restructuring to reflect current realities.

This Article will briefly examine the continuing validity of certain foundational premises in contract and intellectual property law merely to illustrate that such premises are no longer supported by the realities of modern society. With fundamental change confronting multiple areas of law in the information age, this is indeed a problem worthy of widespread inquiry by legal scholars in various fields.

The Article will then turn to a detailed analysis of the continuing validity of the premises supporting shareholder primacy,[3] looking at the historic justifications for allocating ownership, control and duties to determine whether the premises upon which said structure is founded remain true today. This examination will demonstrate that these premises are no longer valid and that, based on the current relative needs of the business and contributions by various constituencies, employees should have certain duties owed to them as well. This Article concludes with a proposed model for such a stake.

I. THE NEED TO REEXAMINE FOUNDATIONAL PREMISES

A. THE HISTORICAL NEED FOR CHANGE

Law, by its very nature, is designed to help instill order and give predictability to human interactions and undertakings.[4] To do this, for

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DEC N.Y. ST. B.J. 30, 34 (1997) (arguing for the need to look back to first principles in jurisdictional law). *But see* Joseph H. Sommer, *Against Cyberlaw*, 15 BERKELEY TECH. L.J. 1145 (2000) (arguing that the cyber revolution does not require the creation of a new body of cyberlaw and that for various areas of law no radical change has occurred).

3. The term “Shareholder Primacy” is used to describe the view that all rights and duties in a corporation ultimately flow to the shareholders. The use of the term “corporation” in this Paper refers to any for-profit artificial business entity with multiple owners, regardless of actual form. It is used merely for ease of reference. Nevertheless, as will be described in more detail, differences in whether an entity is closely or publicly held, and whether it has solely active investors who run the business or a mixture of active and passive owners, will have a bearing on the relative needs of the enterprise and contributions of potential stakeholders.

4. JAMES WILLARD HURST, LAW AND SOCIAL ORDER IN THE UNITED STATES 48 (2000); ROSLYN WEISS, SOCRATES DISSATISFIED: AN ANALYSIS OF PLATO’S CRITO 125 (1998); HANS KELSEN, GENERAL THEORY OF LAW AND STATE 172 (Anders Wedberg trans., 2007).

any given endeavor, the law must validate either the way people customarily behave in similar circumstances or it must develop a model norm of behavior for people to follow. The United States, as a common law nation, has done precisely this historically. To settle disputes that came before the courts, judges would either look to what were the customary norms of behavior for such activities or would otherwise ask what a "reasonably prudent person" would do in similar circumstances.[5] In each area of law, these customary norms and reasonable person standards are presumed baselines of proper conduct—the premises upon which the legal system is based.

Over time, a complex legal order emerged in common law countries based on precedent, a system using previously decided cases to determine the outcome in similar situations.[6] While this is both efficient[7] and promotes the important societal goals of consistency and predictability,[8] it fails to consider the possibility that society itself may have radically changed, either due to evolving societal values or technological innovation. If radical change has occurred, the stagnant law created by adherence to precedent may become out of touch with the realities of the society it is governing. As such, it will become ill-suited to the purported basis for the very law being applied: to have legal rules that are reasonable to the circumstances of the situation.

In modern common law societies, this disconnect between the law as it has developed and society as it has evolved may be resolved by piecemeal legislative reform or by judges deviating from precedent. The judge may do this either by distinguishing precedent from the conflict presented on a factual basis or by using his equitable powers.[9] However,

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5. 15A AM. JUR. 2D *Common Law* § 1 (2011); C. E. F. RICKETT & THOMAS G. W. TELFER, INTERNATIONAL PERSPECTIVES ON CONSUMERS' ACCESS TO JUSTICE 342 (2003). *See generally* CHARLES W. BACON & FRANKYLN S. MORSE, THE REASONABLENESS OF THE LAW (2000); GEORGE F. COLE & CHRISTOPHER E. SMITH, THE AMERICAN SYSTEM OF CRIMINAL JUSTICE 106 (2006); MERRIAM-WEBSTER'S DICTIONARY OF LAW 88 (1996).

6. *See generally* BACON ET AL., *supra* note 5; COLE ET AL., *supra* note 5, at 106.

7. *See generally* Paul H. Ruben, *Micro and Macro Legal Efficiency: Supply & Demand*, 13 S. CT. ECON. L. REV. 19 (2005).

8. Robert G. Boliek, Jr., *Appellate Practice and Procedure*, 59 MERCER L. REV. 1075, 1092 (2008).

9. RICKETT & TELFER, *supra* note 5, at 342; JEFFREY F. BEATTY & SUSAN S. SAMUELSON, LEGAL ENVIRONMENT 10 (2010). Note, however, that judges are often

this is a haphazard solution to the problem. If society has changed dramatically, such an approach will result in numerous rules remaining valid that are based on a societal structure that no longer exists. In such situations, the better approach is for the legal system to take a step back from the legal order it has grown comfortable with and to ask whether the underlying premises remain valid. If the premises remain valid, the legal system can continue forward with minor adjustments as necessary, but once the premises are no longer supported by reality, it is time to discard those premises and replace them with a new set that is in sync with society.

Historically, such radical restructuring is not unfamiliar to the common law system. At the time of the Norman Conquest, English law rested in the County or Hundred Courts, which applied local custom.[10] Over time, these courts were replaced by various feudal courts that continued to apply local custom, as well as by the introduction of the *curia regis* (the king's dispensing of justice; later to become the Royal Courts).[11] By the thirteenth century, the Royal Court had become an institution unto itself and was no longer strictly tied to the king. Over time, the courts' jurisdiction grew, in part because of the courts' desire to obtain fees, but more importantly because of the perception by the people that such courts rendered better judgments.[12] By the end of the middle ages, the Royal Courts handled almost all matters, applying the "Common Law."[13] In order to appear before the court, the average person had to obtain a writ. Once the list of basic writs was established, it was little modified for hundreds of years.[14] Unfortunately, the writ system became mired in procedural technicality, which led it to focus less on finding justice and more on merely resolving disputes.[15] By the 15th century, dissatisfaction with the Royal Courts led to the creation of courts of equity, empowered to make decisions based on the equity of

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reluctant to invoke equity when faced with precedent. *See* RENE DAVID & JOHN E. C. BRIERLEY, MAJOR LEGAL SYSTEMS OF THE WORLD TODAY 304-305 (2d ed. 1978).

10. DAVID & BRIERLEY, *supra* note 9, at 290.

11. There were also Ecclesiastical Courts applying Cannon Law. *Id.*

12. *Id.* at 291.

13. *Id.* at 292.

14. *Id.* The first compilation of writs listed 56 and was compiled in 1227. By 1832, only 20 more writs had been added. However, writs could issue for similar instances not strictly covered by the terms of the writ as well. *See id.* at 292-93.

15. *Id.* at 295.

the case.[16] Ultimately, the Common Law (Royal) Courts, which generally relied upon precedent to decide cases, were also empowered with rules of equity, leading to the demise of separate courts of equity.[17] However, over time, even these rules of equity have become largely fixed and today's judges are unlikely to use equity to depart fundamentally from the holdings of precedent.[18] With the establishment of the United States, the common law was adopted from Britain. However, British common law was modified as necessary to reflect the needs and values of early U.S. society.[19]

This brief and highly simplified history of the development of the common law shows a recurring theme. Legal systems were put in place to support the society of the era, but each of them ceased to serve the needs of society as society changed over time. Once the legal order ceased to meet societal needs, it had to be replaced by a new set of rules or institutions. Although legislative action and equity powers help keep the modern system from imploding, the fundamental truth remains that without periodic overhauls, a precedent based system will eventually get out of step with an ever-changing society. When this happens, the law ceases to adequately and accurately order its citizens. The move from the industrial age to the information age presents a radical and ubiquitous change in the very manner in which society functions. As such, it is imperative that the legal system reexamine its foundational premises in a wholesale manner.[20]

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16. *Id.* at 300-03.
17. *Id.* at 307.
18. *Id.* at 305.
19. PAUL SAMUEL REINSCH, ENGLISH COMMON LAW IN THE EARLY AMERICAN COLONIES 8 (2005).
20. This claim has been made with respect to certain individual areas of law already. *See* Drucker, *supra* note 2.

B. THE CONTRACTS EXAMPLE[21]

There is perhaps no area of law with a more obvious disconnect between fundamental premises and modern reality than contracts.[22] One of the most basic ideas in contract law is the notion of freedom of contract—parties may, with minimal limitations, enter into contracts with one another on such terms as they see fit.[23] Of course the corollary to this freedom is that if one party does not like the deal being offered, that party is free to walk away and look for a better set of terms elsewhere. Based upon the premise that one has freedom of contract, U.S. courts have consistently held that almost all validly executed contracts are enforceable, regardless of how one-sided or egregious their terms.[24] The only significant exceptions are when contract terms are so outrageous that if one party had been aware of them, he or she would not have entered into the deal or when a term is facially unconscionable.[25]

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21. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981). This example is well understood by the academic community and numerous scholars have written on one or more aspects of the problem described in this Article. *See, e.g.*, W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 529 (1971); Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1188-89 (1983); Robert W. Gomulkiewicz, *Getting Serious About User-Friendly Mass Market Licensing for Software*, 12 GEO. MASON L. REV. 687, 687 (2004) (stating that over 100 articles have been written on the enforceability of end user licenses); Robert L. Oakley, *Fairness in Electronic Contracting: Minimum Standards for Non-Negotiated Contracts*, 42 HOUS. L. REV 1041 (2005). Taken together, it is clear that this rule of law continues to be adhered to even after its foundational premise is well understood to no longer be the case (although the justification for such continued adherence has been forced to shift to other grounds). Oakley, *supra* note 21, at 1048.

22. It is important to recognize that any description of "modern reality" is by its nature a generalization and not applicable to all circumstances. However, when crafting the default rules for an area of law, it seems appropriate to look to the most common occurrences and then create exceptions as necessary.

23. Edward A. Dauer, *Contracts of Adhesion in Light of the Bargain Hypothesis: An Introduction*, 5 AKRON L. REV. 1, 1 (1972); *see* E. ALLEN FARNSWORTH, 1 FARNSWORTH § 4.26, at 478-79 (2d ed. 1990).

24. Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 7 N.Y.U. L. REV. 429, 455 (2002); ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996); *see generally* Oakley, *supra* note 24.

25. *See* Oakley, *supra* note 21, at 1046; U.C.C. § 2-302 cmt. 1 (2005); Craig Horowitz, *Reviving the Law of Substantive Unconscionability: Applying the Implied*

Stepping back to the time of its adoption, one can see that this premise made sense in the context of commercial interactions as recently as 75 years ago or so. Historically, most contracts were between customers and small businesses, where the customer could actually negotiate the terms of the contract with the business because they were on relatively equal economic footing.[26] Additionally, the terms of the contract were relatively simple and straightforward (possibly even a handshake deal), with little in the way of "fine print" or "boilerplate" provisions, so the customer could understand what he was bargaining for. Equally important, information was not as easily transmitted as it is today, so there was at least a reasonable likelihood that going to another business could achieve a deal on different terms.

Looking at the world in 2012, we can see that each of these facts is no longer the case. The overwhelming majority of contracts entered into today are between mass-market providers and customers;[27] and mass-market businesses do not negotiate the terms of their contracts.[28]

Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts, 33 UCLA L. REV. 940, 946-47 (1986). It has been suggested that the number of cases where this has occurred is in the "tens or hundreds." James R. Maxeiner, *Standard-Terms Contracting in the Global Electronic Age: European Alternatives*, 28 YALE J. INT'L L. 109, 121 (2003).

26. Relatively equal economic standing appears to be the controlling factor in whether freedom of contract truly exists. *See* Farnsworth, *supra* note 23, § 4.26, at 479; ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 5.59, at 436. If the smaller party is conducting a significant amount of business, the larger party, even if not normally willing to negotiate contract terms, usually will do so. For example, if an individual wishes to rent a car from Avis for a weekend, the car will be offered on Avis' standard terms, but if a party (be it an individual or a business) wishes to rent 50 cars for a year, Avis would likely be willing to deviate from some of its standard terms. Given that the size of the transaction necessary to induce the merchant to negotiate increases as the merchant's size increases, the ability of the consumer to negotiate with merchants has diminished as most transactions have shifted away from smaller local businesses to mass merchants.

27. As early as 1983, one scholar asserted that standard form contracts comprise over ninety-nine percent of all contracts—an observation that came before mass consumer purchasing of computer software and the creation of the internet. *See* Slawson, *supra* note 21, at 529; *see generally* Oakley, *supra* note 21, at 1047-48.

28. Admittedly, there are still negotiated contracts between businesses of adequate size, but these comprise a mere fraction of the total contracts entered into in the U.S. *See* Slawson, *supra* note 21, at 529; Farnsworth, *supra* note 23, § 4.26, at 479; CORBIN,

Everyone has to look only at his own life to know the truth of this assertion. In what percentage of the purchases that you make on a daily basis could you have changed the terms of the deal? Just try negotiating the fine print at Best Buy, McDonalds, Hertz, Delta, Amazon.com, American Express, BP or Apple: the terms of these contracts are strictly "take it or leave it."[29] Nowhere has the "take it or leave it" nature of contracts become more glaringly evident than in the case of shopping on the web. One can click to see the terms of the deal, but it is not possible to alter the terms of the merchant's offer.[30] Similarly, many items are now sold with warranty and other terms inside the box (the "shrink-wrap license"), where the customer cannot even see the terms of the contract until after the purchase has been completed.[31] These types of transactions further underscore the pervasiveness of contracts where one side has no actual ability to negotiate the terms.

The inability to negotiate the terms of a contract might be tolerable if different merchants offered substantially different terms, but lawyers frequently borrow well-drafted clauses so that any clause that one attorney develops to benefit a client in a particular industry will soon find its way into the contracts of all companies in that industry. Not only is a customer left to "take it or leave it" regarding the legal terms of his deal with a merchant, but if he leaves it, he is unlikely to find better terms elsewhere.[32]

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supra note 26, § 5.59C, at 436. There are also a large number of "immediate exchange contracts" (e.g., restaurants and grocery stores, where a customer pays for goods/services and immediately receives them), and a significant, but ever-diminishing number of these are with small, local businesses that might be willing to negotiate terms. These numbers are diminishing because mass market providers are driving local providers out of business. Nevertheless, the very nature of these transactions virtually eliminates the need for spelling out the terms of the contract—the goods or services are received by the customer concurrently with the merchant receiving payment, so there is little need for detail and a relatively low likelihood of a dispute arising that would require a contract to clarify the terms of the transaction. Furthermore, many of these immediate exchanges are with large businesses and are actually standard form contracts. *See* Slawson, *supra* note 21, at 529.

29. Farnsworth, *supra* note 23, § 4.26, at 479; *see* Standard Oil Co. of Cal. v. Perkins, 347 F.2d 379, 383 n.5 (9th Cir. 1965).

30. Oakley, *supra* note 21, at 1048.

31. *Id.* at 1050.

32. *See generally* GERRIT DE GEEST, CONTRACT LAW AND ECONOMICS 117 (2011).

Finally, with convoluted drafting, legal terms of art and the sheer volume of boilerplate clauses involved in the average contract, it is unlikely that a consumer will bother to read the terms of the contract, much less understand the ramifications of the various clauses.[33]

Given that the underlying reality that historically supported the presumption that there is freedom of contract no longer exists, is it not time to drop the presumption in favor of a legal order that helps ensure individual consumers receive fair terms in the contracts they enter into but cannot negotiate? Germany and the European Union have done exactly this by invoking minimum standards in standard form consumer contracts,[34] while the United States continues to pretend that freedom of contract exists for consumers in most transactions.

C. THE INTELLECTUAL PROPERTY EXAMPLE[35]

One of the basic tenets of intellectual property law is that inventors need an economic incentive to create.[36] This incentive is structured as a limited time monopoly over the production and distribution of the creation.[37] More often than not, this monopoly right is transferred to the manufacturer or distributor of the product, who then bears the cost and risk for producing and distributing the product in return for the bulk of the reward for a successful creation.[38] Meanwhile, the inventor typically

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33. Hillman & Rachlinski, *supra* note 24, at 436-37.

34. *See* Council Directive 93/13, 1993 O.J. (L95); Burgerliches Gesetzbuch [BGB] [Civil Code] Jan. 1, 2002 Recht der Schuldverhaltnisse [Schubert] Buch 2; *see also* Oakley, *supra* note 21; Maxeiner, *supra* note 25.

35. There has been some speculation that a fundamental change in the concept of intellectual property ownership is needed in the information age. *See* FRIEDMAN, *supra* note 2, at 217-19.

36. Diamond v. Chakrabarty, 447 U.S. 303, 307 (1980); *see generally* Mark A. Lemley, *Ex Ante Versus Ex Post Justification for Intellectual Property,* 71 U. CHI. L. REV. 129, 132-35 (2004).

37. *Id.*

38. Theoretically, in very limited circumstances, a business might acquire an invention that could hurt its business by paying the inventor for all rights to his creation. Such an acquisition serves the purpose of burying the invention in the hopes that by the time the monopoly right has ended, the market conditions will have changed to the point that the invention is no longer a threat to the business. However, an

has a residual interest in the creation that takes the form of a royalty—a payment from the manufacturer/distributor based on its sales. While the need to incentivize and reward creativity does not appear to have changed, the realities of the marketplace have undergone a fundamental change.[39]

When patent and copyright laws were in their infancy, a very different market existed for inventions and creations. Until recently, the primary products seeking copyright protection were books, records and movies shown in theatres. Production and distribution costs for such products were relatively high and the size of the consumer market relatively small, so the publisher of such material was undertaking a significant risk in producing the material, including a meaningful risk that the product might prove to be unprofitable.[40] With patented goods, monopoly protection of 17+ years made sense when it could take over a decade to have significant national market penetration, and many products had a useful market life of decades.[41]

Today's market paints a different picture. Thanks to the internet and ever-decreasing communications costs,[42] there is a global

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economist will point out the folly of such a proposition. *See* Dwight R. Lee*, Opportunity Cost and Hidden Inventions,* FEE.ORG*,* http://www.fee.org/the_freeman/ detail/opportunity-cost-and-hidden-inventions/ (last visited Nov. 23, 2012). Some nations have chosen to deal with this potential course of action by requiring that patents be worked within a specific time period or else face forfeiture of the monopoly right. *See generally PCT Patents and Other International Patents*, BITLAW.COM, http://www.bitlaw.com/patent/international.html (last visited Nov. 23, 2012).

39. *See generally* Dan L. Burk & Mark A. Lemley, *Policy Levers in Patent Law,* 89 VA. L. REV. 1575 (2003) (discussing patent rights as incentives in specific industries).

40. The adoption of just-in time logistics has dramatically reduced inventory costs. *See* Presentation, Inventory on Demand in the Digital Age: Breakthroughs in Publisher Creation Through New Models in Publishing and Inventory Practices Presentation (Feb. 16, 2011), http://www.toccon.com/toc2011/public/schedule/detail/18086.

41. The fact that patentees are increasingly failing to pay maintenance fees can be seen as a sign that the useful lives of patents are decreasing. *See* Dennis Crouch & Jason Rantanen, *Paying Maintenance Fees*, PATENTLYO (Mar. 25, 2011), http://www. patentlyo.com/patent/2011/03/paying-maintenance-fees.html. As one indication of the historic lifespan of most physical products, it is worth noting the physical infrastructure of U.S. cities in 1990 was based on inventions over 100 years old. *See* JOHN NAISBITT & PATRICIA ABURDENE, MEGATRENDS 2000 305 (1990).

42. Deloitte Center for the Edge, The 2010 Shift Index, 56-7, 71-3 (2010) *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/TM

marketplace.[43] A new invention can obtain worldwide market penetration in just a few years,[44] but its lifespan has been equally reduced.[45] We live in a disposable society where everyone wants the latest mobile phone, laptop, tablet and/or iPad. Living in an information age, an increasingly large percentage of the U.S economy is in copyrightable materials (music, movies, digital books, for-pay television), producing a never-ceasing tsunami of products that are consumed and forgotten in favor of the next wave.[46]

For the manufacturer/distributor, the amount of risk being taken has decreased as well.[47] For one thing, the market is much larger—with over

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T_us_tmt/Shift%20Index%202010/us_tmt_si_shift%20Index2010_110310.pdf [hereinafter Deloitte Center for the Edge].

43. Freedman, *supra* note 2, at 150-159, 230; NAISBITT & ABURDENE, *supra* note 41, at 19-77, 299-300; Deloitte Center for the Edge, *supra* note 42, at 118.

44. *See* BRETT KING, BANK 2.0: HOW CUSTOMER BEHAVIOR AND TECHNOLOGY WILL CHANGE THE FUTURE OF FINANCIAL SERVICES 33 (2010); Chris Herbert, *Chart: Global Smartphone Penetration by Region 2009-2014*, B2B SPECIALIST (June 20, 2010), http://b2bspecialistPosterous.com/chart-global-smartphone-penetration-by-region; Apple had over one billion worldwide application downloads in its first nine months. Press Release, Apple Inc., Apple's Revolutionary App Store Downloads Top One Billion in Just Nine Months (Apr. 24, 2009), http://www.apple.com/pr/library/2009/04/24appstore.html; Fifteen million iPads were sold in the first year alone. Darrell Etherington, *The Unlikely Story of the iPad, One Year In,* GIGAOM (Jan. 27, 2011, 11:30 AM), http://gigaom.com/apple45/the-unlikely-story-of-the-ipad-one-year-in.

45. *See generally* Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899, 912 (1993). For example, cell phones in the U.S. are replaced roughly every 22 months. *See Americans replace their cell phones every 2 years, Finns – every six, a study claims*, PHONEARENA.COM (July 11, 2011, 10:50 PM), http://www.phonearena.com/news/Americans-replace-their-cell-phones-every-2-years-Finns—every-six-a-study-claims_id20255.

46. Consumers spent over $550 million for ringtones in 2007. *BMI Forecasts Ringtone Market Down 8% in 2007*, ALL ACCESS MUSIC GROUP (Mar. 27, 2007, 11:47 PM), http://www.allaccess.com/net-news/archive/story/22940/bmi-forecasts-ringtone-market-down-8-in-2007. Over 140 new apps are added daily to Facebook alone. Adam Singer, *Social Media, Web 2.0 and Internet Stats*, THE FUTURE BUZZ (Jan. 12, 2009), http://thefuturebuzz.com/2009/01/12/social-media-web-20-Internet-numbers-stats.

47. This is clearly not true for all products and industries. For example, pharmaceuticals require massive expenditures to develop, test and market. They may require an intellectual property protection regime similar to what currently exists. *See* Burk & Lemley, *supra* note 39, at 1616-17.

300 million people in the U.S, and a potential global market of just under 7 billion.[48] Of course not every product will be a roaring success, but that does not mean it will not be profitable. One need only look at the huge proliferation in television stations and magazines to see that the population is large enough to support a staggering number of niche interests and tastes.[49] It is equally important to note that production and distribution costs for many "information age" products have continued to decrease. When CD**s** and DVDs—single pressed pieces of plastic—were introduced, they were far cheaper to produce than cassette and VHS tapes, magnetically coated tapes that must be spooled and enclosed in a plastic shell with various moving parts. Now that music, movies and books have become digital, a single computer can potentially distribute the product to everyone on the planet.

In such a society, do long-term (20+ year) monopolies continue to make sense? Long-term monopolies have led to an ongoing, glaring market defect that harms the consumer. In a properly functioning market, the price of a product should move towards its production costs, with competing businesses battling for market share by lowering their prices to attract consumers.[50] However, with information age products, this has not occurred—CDs and DVDs had higher price points than cassette and VHS tapes for the same product during the period when both were being sold even though the latter were more expensive to

48. U.S. & World Population Clocks, CENUS.GOV, http://www.census.gov/main/www/popclock.html (last visited Oct. 20. 2012).

49. *See* AL LIEBERMAN & PATRICIA ESGATE, THE ENTERTAINMENT MARKETING REVOLUTION 111 (2002). In fact, the modern media's ability to cater to niche markets and to disaggregate consumers for marketing purposes makes smaller target markets more valuable. The consistent reutilization of existing content, while attractive to a small audience of aficionados, would be obsolete to a broader consumer audience. The average home receives almost 120 television channels. Nielsen, *US Homes Receive a Record 118.6 TV Channels on Average*, MARKETING CHARTS (June 13, 2008), http://www.marketingcharts.com/television/us-homes-receive-a-record-1186-tv-channels-on-average-4929/. There are over 20,000 magazines sold in North America alone. The Ass'n of Magazine Media, *1988 – 2010 Number of Magazine Titles by Bureaus*, MAGAZINE.ORG, http://www.magazine.org/insights-resources/research-publications/trends-data/ magazine-industry-facts-data/1988-2010-number (last visited Nov. 28, 2012).

50. PAUL J. J. WELFENS, INNOVATIONS IN MACROECONOMICS 342 (2008).

produce.[51] Today, the digital download is often the same price as a DVD or CD even though it has virtually no distribution costs.[52] Why does a product that is cheaper to produce and distribute cost more? It costs more because each product is a mini-monopoly.[53] If a consumer wants the newest pop phenom's CD/Download, there is only one company with rights to that product and rival music companies do not have a product the consumer can substitute for it. As such, the monopoly holder can price each format solely according to what consumers are willing to pay. Since the newer technology is seen as superior, consumers are willing to pay more, so the company charges more for the product despite it being cheaper to produce.[54]

For such information age products, would society not be better served by requiring dual licensing when an inventor/creator decides to license his creation?[55] If a band had to license its new album to two music companies, there would be no monopoly for it, and so the companies, through the forces of market competition, would be forced

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51. *See* Andrew D. Smith, *Now Blu-ray disc prices must fall*, DALLASNEWS.COM (Dec. 1, 2008, 1:03 PM), http://techblog.dallasnews.com/archives/2008/12/; Amy Harmon, *MUSIC; What Price Music?*, N.Y. TIMES, Oct. 12, 2003, *available at* http://www.nytimes.com/2003/10/12/arts/music-what-pricemusic.html?pagewanted=all&src=pm; Johnnie L. Roberts, *The Disc That Saved Hollywood*, NEWSWEEK, Aug. 19, 2001, *available at* http://www.thedailybeast.com/newsweek/2001/08/19/the-disc-that-saved-hollywood.html.

52. Dan Rayburn, This Is Just Stupid: Digital HD Downloads *Still Cost More than DVDs*, STREAMING MEDIA BLOG (Mar. 20, 2009, 12:01 AM), http://blog.streamingmedia.com/the_business_of_online_vi/2009/03/this-is-just-stupid-digital-hd-downloads-still-cost-more-than-dvds.html.

53. Welfens, *supra* note 50, at 342.

54. In fact, through licensing or digital rights management, newer technologies present the opportunity for significant price discrimination, as well as frustrating traditional doctrines such as first sale.

55. *See* Lemley, *supra* note 36, at 137-38 ("Insofar as the new ex post incentive theory suggests that control by a single firm is necessary to induce efficient distribution, therefore, it is theoretically flawed and empirically unsound."). *Cf.* 17 U.S.C. § 115 (2006) (compulsory music license for cover songs). One can also imagine various permutations on this to account for a primary licensor that has undertaken additional investment (and risk) in discovering, recording and promoting the band versus a secondary licensor who has not. To offset free rider issues and to maintain incentives for promoter/distributors, a two-tiered royalty system could be developed with lower rates for the primary licensor.

to price their products in line with their production costs, leading to lower prices for consumers.[56]

II. CORPORATE LAW IN THE INFORMATION AGE

The rights of potential stakeholders and the duties owed to them by corporations are built upon four premises, each of which were true during the industrial age, but none of which remain (or need remain) entirely true in the information-based economy.[57] These four premises are:

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56. Of course the ease of copying and distributing digital information may ultimately make this a moot point. If companies price their products too high, people may choose to steal them rather than buy them. In turn this is leading to subscription services providing access to a broad range of music/entertainment products for a set fee. *See* FRIEDMAN, *supra* note 2, at 217 (on theft risk); Sasha McCune, *Subscription Music Services*, MASHABLE (Sep. 7, 2011), http://visual.ly/digital-music-subscription-service-compared.

57. While these premises would have been well-known to an economist or businessman throughout much of the industrial age, other criteria have been used to justify having all corporate duties flow only to shareholders in the modern era. For example, with the growth of the law and economics movement in the second half of the twentieth century, corporations have been viewed as essentially a nexus of contracts in which corporate duties and powers flow only to shareholders, thereby maximizing efficiency and wealth. *See generally* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 14, 38 (1991); Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283, 311 (1998). This position has not been without its critics. *See, e.g.*, Brett H. McDonnell, *Employee Primacy, or Economics Meets Civic Republicanism at Work*, 13 STAN. J. L. BUS. & FIN. 334 (2008); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); O'Connor, *supra* note 45, at 905. In the Easterbrook model, other constituencies may have claims, but only to what they bargain for. EASTERBROOK & FISCHEL, *supra* note 57, at 37. This begs the question, why are some contract terms freely negotiable while others are fixed by law? *Greenfield*, *supra* note 57, at 312. However, much of the "negotiating" by various constituencies is not really bargaining at all, but rather relies upon the underlying system enshrined in the legal order. EASTERBROOK & FISCHEL, *supra* note 57, at 34. For commentary on the limitations of a contractual analysis for employees, see Katherine Van Wezel Stone, *Employees as Stakeholders Under State Nonshareholder Constituency Statutes*, 21 STETSON L. REV. 45, 54-69 (1991); *see generally Greenfield*, *supra* note 57; O'Connor, *supra* note 45. As such, an examination of the original economic assumptions that gave rise to the corporate structure, rather than a latter era's justification, merits examination.

1. Capital is scarce;[58]
2. Businesses need large amounts of capital;[59]
3. Labor is plentiful;[60] and
4. Investors of capital take all the risk and labor takes no risk.[61]

Based upon these premises, courts have concluded[62] that fundamentally the investors (shareholders) are the sole owners of the corporation; that corporations exist to maximize profits for their owners, the investors; and that no duties are owed to other potential stakeholders, such as the employees or the communities in which these corporations

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58. HOWARD ROTHMAN BOWEN, TOWARD A SOCIAL ECONOMY (1948); MICHAEL R. LISSACK & HUGH P GUNZ, MANAGING COMPLEXITY IN ORGANIZATIONS: A VIEW IN MANY DIRECTIONS 39 (2005); NAISBITT & ABURDENE, *supra* note 1, at 15; Greenfield, *supra* note 57.

59. *See generally* LIONEL D. LYLES, ESSIE THIBODEAUX LYLES, HISTORICAL DEVELOPMENT OF CAPITALISM IN THE UNITED STATES AND ITS AFFECTS ON THE AMERICAN FAMILY: FROM COLONIAL TIMES TO 1920 Vol. 1 (2003).

60. Historians have noted that in the first half of the 19th century the U.S. had various labor shortages requiring investments in technology and other labor saving devices. OTTO NEWMAN & RICHARD DE ZOYSA, THE AMERICAN DREAM IN THE INFORMATION AGE 15 (editors ed. 1999); H.J. HABAKKUK, AMERICAN AND BRITISH TECHNOLOGY IN THE NINETEENTH CENTURY (1962). Nonetheless, generally labor has been seen as a more readily available factor of production than capital. *Id.* As America established itself, waves of immigration made labor plentiful in the U.S. as well. JEREMY THORNTON, NEW INDUSTRIES, NEW JOBS: BRITISH IMMIGRANTS COME TO AMERICA, 1830S-1890S (2003); C. FRED BERGSTEN, THE UNITED STATES AND THE WORLD ECONOMY: FOREIGN ECONOMIC POLICY FOR THE NEXT DECADE 344 (2005); NEWMAN & DE YOYSA, *supra* note 60, at 16.

61. This premise can also be reformulated. Workers are entitled to compensation for their time whereas investors are not so entitled for their money. These various permutations are discussed in Part II.D. *See infra* notes 118-124 and accompanying text; EASTERBOOK & FISCHEL, *supra* note 57, at 36 (risk takers get residual claim to profit); *see* Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23 (1991).

62. In the modern era, most of these conclusions are also stated in the statutory provisions by which states allow corporations to be formed. Regardless of their source, however, the validity of these premises remains in question. If these premises are not correct, the philosophical basis for these conclusions is destroyed and alternative concepts of ownership and duty should be considered.

exist.[63] A corporation's managers, its board of directors, can choose to do many things that may benefit such other constituencies (e.g., bonuses and profit sharing plans for employees), but these actions must be justified as ultimately maximizing shareholder profits (e.g., creating incentives to reduce worker turnover thereby reducing training costs or making workers more productive). A board taking actions solely to benefit non-shareholder constituencies, or proclaiming a duty being owed to such groups, is anathema to U.S. corporate law, and would constitute a breach of the directors' fiduciary duties.[64]

A. CAPITAL IS SCARCE

Historically, a relatively small group of people has supplied the large amounts of capital needed to fund corporations.[65] There were several reasons for this. First, the vast majority of workers did not have the means (or did not perceive themselves as having the means) to invest in the stock market, so it was left to smaller numbers of wealthy individuals to invest.[66] Second, most people did not have the

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63. *See* Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del 1986); Blasius Indus. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988); EASTERBROOK & FISCHEL, *supra* note 57, at 36-38; Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 573 (2003); Macey, *supra* note 61, at 23; Greenfield, *supra* note 57, at 288-94.

64. However, in the late 1980s, a number of states modified their corporation statutes to allow the directors to consider the interests of other constituencies. Such language was not included in the subsequent revision to the Model Business Corporation Act. Macey, *supra* note 61, at 1; O'Connor, *supra* note 45, at 951-52; Van Wezel Stone, *supra* note 57, at 45. Additionally, a handful of states have recently created new types of entities, L3Cs and benefit corporations, which are expressly required to pursue goals for the benefit of society in addition to making a profit. *See generally* Anne Field, *Benefit Corporations, L3Cs and All the Rest: Making Sense of Those Confusing Choices*, FORBES (May 25, 2012, 9:58 AM), http://www.forbes.com/sites/annefield/2012/05/25/benefit-corporations-l3cs-and-all-the-rest-making-sense-of-those-confusing-choices/.

65. Prior to the Great Depression only 2% of Americans owned stock. *Great Depression*, OHIO HISTORY CENTRAL, http://www.ohiohistorycentral.org/entry.php?rec=500 (last visited Oct. 21, 2012).

66. See generally *Historical Income Tables*, CENSUS.GOV, http://www.census.gov/hhes/www/income/data/historical/household/index.html, for household income adjusted to current dollars since 1967.

sophistication to invest. Rather, the average person was afraid of putting his money in the stock market.[67] Third, the transaction costs in dealing with shareholders were relatively high since any increase in the number of shareholders in a company increased bookkeeping and communication costs. It therefore made sense for corporations to focus their energy on a smaller number of investors who contributed larger amounts.[68]

In the information age, capital need not be scarce.[69] As a practical matter, over the last century the U.S. stock market has seen a shift towards the majority of Americans being members of the investor class.[70] Most of this investment has come through pension and retirement funds.[71] These funds, generally bundled together for all employees of a company or even larger units, have provided the same benefits to the company as large individual investors because from the company's perspective, it was dealing with a single entity.[72] Furthermore, employers often bring in investment counselors to help employees choose their investments, and these counselors have educated several generations regarding the fact that over time, money in the stock market produces significantly better returns than money invested as a

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67. The Great Depression further reinforced this belief. D. H. POST, THE FEAR BASED LIFE 28 (2010).

68. *See infra* text accompanying notes 78-81.

69. One sign that capital has become less scarce is the fact that the cost of capital has steadily decreased over time. Deloitte Center for the Edge, *supra* note 42, at 13.

70. *Percentage of Americans with Stock Hits Eleven-Year Low, Gallup Says*, HUFFINGTON POST (June 21, 2011, 06:12 AM), http://www.huffingtonpost.com/2011/04/21/stock-market-us-real-estate-gallup_n_851786.html; Helen Huntley, *More Americans Investing in Stock: While the Market Rises in Popularity, the Value of Holdings is Relatively Low*, ST. PETERSBURG TIMES (Sep. 27, 2002), *available at* http://www.sptimes.com/2002/09/27/Business/More_Americans_invest.shtml. *See generally* NEWMAN & DE ZOYSA, *supra* note 60, at 169.

71. *See* Huntley, *supra* note 70.

72. INVESTOR'S BUS. DAILY, INVESTOR'S BUSINESS DAILY GUIDE TO THE MARKETS 48 (1996); STEPHEN J. ZACCARO & RICHARD J. KLIMOSKI, THE NATURE OF ORGANIZATIONAL LEADERSHIP: UNDERSTANDING THE PERFORMANCE IMPERATIVES CONFRONTING TODAY'S LEADERS 163, 163 (2001); *see generally* JAMES P. HAWLEY & ANDREW T. WILLIAMS, THE RISE OF FIDUCIARY CAPITALISM: HOW INSTITUTIONAL INVESTORS CAN MAKE CORPORATE AMERICA MORE DEMOCRATIC (2000).

creditor (i.e., treasury notes, certificates of deposit, bank accounts).[73] The combination of education and having one's retirement funds thrust into the market has increased the sophistication of the average American and removed much of the fear of stock market investments.

Although this historic trend is noteworthy and helps show that capital is not as scarce as it once was, it only scratches the surface in terms of the capital available in the information age. Indeed, it would appear that most Americans can afford \$5-\$100 to invest periodically in the market. In 2008, Americans spent over \$60 billion on lottery tickets[74] and over \$10.4 billion at Starbucks, a single coffee chain.[75] As a society, we do not really think about spending \$5, \$10 or even \$20, but we have not reorganized the capital markets to take advantage of this reality.[76] On the other hand, politicians have figured it out. President Barack Obama raised over \$650,000,000 in donations from individuals through a grass roots internet campaign,[77] exhibiting the ability to raise vast sums of capital in very small increments. This is the ultimate power among over 300 million Americans and almost 7 billion people worldwide—the ability to raise vast sums of capital in very small increments.

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73. *Stocks, Bonds, Bills and Inflation and Gold-Asset Class Performance*, INVESTORSFRIEND.COM, http://www.investorsfriend.com/asset_performance.htm (last visited Oct. 21, 2012); Aswath Damodaran, *Annual Returns on Stock, T.Bonds and T.Bills*: *1928 – Current* (Jan. 5, 2012), http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histret.html.

74. Brad Tuttle, *Q&A with The Lottery Wars Author Matthew Sweeney*, TIME MONEYLAND (June 16, 2009), http://moneyland.time.com/2009/06/16/qa-with-the-lottery-wars-author-matthew-sweeney/; *see generally* Keith Matheny, *Lottery Ticket Sales Increase Across Country*, U.S.A. TODAY MONEY (Sep. 1, 2011), http://www.usatoday.com/money/economy/story/2011-09-01/Lottery-ticket-sales-increase-across-country/50222366/1.

75. Starbucks Corp., Annual Report (Form 10-K), http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTExNzN8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1 (last visited Nov. 24, 2008).

76. Although it is beyond the scope of this article, this societal trend has important implications. Capital would be more accessible to businesses if U.S. securities regulation were restructured to facilitate micro-investing. Current regulations allow companies to avoid registration if various conditions are met, but such stock is not readily transferable. *See* Jack A. Rosenbloom, *Direct Public Offerings on the Internet: A Viable Means of Obtaining Capital?*, 2000 COMPUTER L. REV. & TECH. J. 85 (2000).

77. CENTER FOR RESPONSIVE POLITICS, *Presidential Candidate Barack Obama* (July 30, 2009), http://www.opensecrets.org/pres08/summary.php?id=n00009638

Furthermore, historically, a company composed of many tiny shareholders faced a potential logistical nightmare where the money raised would almost immediately be consumed in shareholder communication and recordkeeping costs. Computers and the internet virtually removed this hurdle for businesses, however.[78] Recordkeeping can be handled by computers at a low-cost, with micro-investors keeping their information up to date by logging in.[79] Emails can replace letters, annual reports and proxy solicitations can be viewed online or downloaded, and dividends can be electronically transmitted to the bank accounts of millions of shareholders with the push of a button—all at virtually no cost to the company.[80] At least one company has utilized such options, even if the full realm of possibilities has not been fully developed or explored. When Travelzoo was just getting off the ground, it offered three free shares to everyone who set up an account.[81] Although this undertaking exposed the company to the possibility of additional administrative costs for tens of millions of shareholders without new capital being raised, these necessary communications could be processed at almost no expense through the use of the internet. What is more, this example lends support to the argument that capital need not be scarce in the information age, despite current securities regulations that make capital appear scarcer than it really is.

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78. Low-cost communications are afforded by the internet. *See* Deloitte Center for the Edge, *supra* note 42, at 54.

79. The overwhelming majority of Americans are already active internet users. *See id*. at 31, 43, 53, 74.

80. Legal restrictions on acceptable forms of communication do present certain costs to these businesses that could be significantly reduced through reform.

81. In actuality, 700,000 people became shareholders in this way. Daniel Jimenez, *Free Stock Is Priced Right*, BANKRATE.COM (Mar. 20, 1999), http://www.bankrate.com/brm/news/advice/19990320a.asp. In 2004, after the company registered its stock (and a split turned the three shares into six), this giveaway was worth over $600. *See* Joanna Glasner, *Few Step Up to Claim Free Shares*, WIRED.COM, Nov. 24, 2004, *available at* http://www.wired.com/techbiz/media/news/2004/11/65801; *Travel Zoo Election to Participate,* TRAVELZOO.COM, http://corporate.travelzoo.com/2002/Election_to_Participate.pdf (last visited Nov. 28, 2012); *Travelzoo Inc. (TZOO), Historical Prices,* YAHOO! FINANCE, http://finance.yahoo.com/q/hp?s=TZOO (search between 11/9/2004 and 11/17/2004) (last visited Nov. 28, 2012).

B. Businesses Need Large Amounts of Capital

In the industrial age, the path to business success had always started with a great idea (a great product, like Coca Cola, or a major production innovation like Ford Motor Company's assembly line) to attract investors.[82] Since businesses primarily produced manufactured products in the industrial age, a great idea was not enough unless it was backed by significant amounts of capital. Without a lot of money to build larger and greater numbers of factories, efficiencies of scale could not be obtained and the product could not reach consumers due to inadequate inventory.[83] Of course, the biggest need for capital has always been early in the lifecycle of a business, at its formation or a few years thereafter when the business proves itself on a small scale and is trying to expand in order to cover a significant market.[84] After the company reaches a critical size, it can continue to grow through retained earnings or by borrowing against itself.

Although this need for capital persists today in the case of physical products, the landscape has changed insofar as high labor costs and other factors have driven most factory jobs overseas where production costs are lower.[85] All projections point towards the continuation of this trend.[86] Thus, in the information age, the U.S. is primarily in the business of producing information-based goods (such as entertainment products like movies, music and television) and service products.[87]

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82. *See* FRIEDMAN, *supra* note 2, at 339-56.

83. CARLO M. CIPOLLA, BEFORE THE INDUSTRIAL REVOLUTION: EUROPEAN SOCIETY AND ECONOMY, 1000-1700 80 (3d ed. 1993); Deloitte Center for the Edge, *supra* note 42, at 22; *see generally* CHARLES MORE, UNDERSTANDING THE INDUSTRIAL REVOLUTION (2000).

84. JOSEPH W. BARTLETT & PETER ECONOMY, RAISING CAPITAL FOR DUMMIES, ch. 6 (2011).

85. NAISBITT & ABURDENE, *supra* note 1, at 17, 55-56, 61-62, 71-73; FRIEDMAN, *supra* note 2, at 114-127; NEWMAN & DE ZOYSA, *supra* note 60.

86. NAISBITT & ABURDENE, *supra* note 1, at 61-62; FRIEDMAN, *supra* note 2, at 114-127; NEWMAN & DE ZOYSA, *supra* note 60, at 27, 191; Deloitte Center for the Edge, *supra* note 42, at 11.

87. NAISBITT & ABURDENE, *supra* note 1, at 12-14, 21 (also stating that most service jobs are actually creating, processing or distributing information); NEWMAN & DE ZOYSA, *supra* note 60, at 27; Deloitte Center for the Edge, *supra* note 42, at 11.

Notably, none of these information-based goods requires significant amounts of capital for their success.[88]

In the case of service products, workers are necessary to provide the service, posing a significant expense. Nevertheless, many costly service products, such as customer service requiring live personnel, have been largely outsourced to countries with cheaper labor costs in the form of non-face-to-face communication.[89] The result is that services remaining in the U.S. are often those in which the service physically comes to the customer (e.g., repairmen, plumbers, etc.) or the customer physically goes to the service (e.g., barbershops, mechanics, etc.). These businesses, by and large, are relatively small and do not require a significant capital investment to get started.[90] Likewise, they expand only by hiring more workers as profits permit.[91]

Although information products have upfront production costs,[92] these are trivial when compared to traditional costs of manufacturing

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88. Deloitte Center for the Edge, *supra* note 42, at 11, 25, 98.

89. FRIEDMAN, *supra* note 2, at 103-113.

90. Deloitte Center for the Edge, *supra* note 42, at 98, 11, 25.

91. Some service companies have become quite large, but they have not followed a traditional capital intensive model to do so. Some have done so by merging with one another (law firms and accounting firms), and others have franchised their business models to others so that each individual franchisee takes on a comparatively small financial undertaking.

92. For a small percentage of products there may be relatively significant production costs, such as for some movies and television shows. Still, even here the sheer volume of products required has moved the television industry away from scripted shows toward quick, easy to produce, low-cost programming. In its heyday, *Friends* costs $6 million per episode in primary cast salaries alone, totaling $22 million for a season. Bill Carter, *'Friends' Deal Will Pay Each of its 6 Stars $22 Million*, N.Y. TIMES, Feb. 12, 2002, *available at*, http://www.nytimes.com/2002/02/12/business/friends-deal-will-pay-each-of-its-6-stars-22-million.html. Now, reality television accounts for 40% of prime time viewing options. With limited exceptions, an entire season can be paid for with a prize of as little as $100,000, an apartment rented for a few months and salaries paid to a handful of "B" or "C" list celebrities, amounting to well under a million dollars total. Indeed, this does not even account for the myriad other forms of low production cost programming and the volume of reality television outside of primetime. Aaron Barnhart, *How Reality TV Took Over Prime Time*, KANSAS CITY STAR, Dec. 06, 2010, http://www.kansascity.com/2010/12/04/2497484/how-reality-tv-took-over-prime.html; *see generally* REALITY TV: REMAKING TELEVISION CULTURE (Susan Murray & Laurie Ouellette eds. 2d ed. 2009).

and distributing tangible products. More importantly, traditional costs of producing physical goods and distributing them are irrelevant for information products in the digital age. Once a movie, television show, album, book or ringtone has been created and loaded onto a server, worldwide distribution can occur at essentially no cost.[93]

Thus, for a significant and ever-increasing percentage of U.S. businesses, large amounts of capital are no longer required for success.

C. LABOR IS PLENTIFUL

In one sense, labor is as plentiful as ever; there are over 138.5 million Americans of working age, by far the most in history.[94] But in another sense, labor has never been scarcer. In the industrial age, the demands of the workplace were minimal, requiring little education or training for a factory job, such that essentially everyone in society was potentially suitable for a business.[95] In contrast, the information age demands that an increasing percentage of companies have technologically savvy employees who can adapt to a rapidly changing world.[96] Skills and proper training are necessary for the workplace of the

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93. *See* Paul Starr, *The Electronic Commons*, THE AMERICAN PROSPECT, March 27-April 10, 2000, *available at* http://www.princeton.edu/~starr/articles/articles00/Starr-ElectronicCommons-3-00.htm ("Second, the Internet provides incentives for commercial producers of intellectual property to shift from exclusive, high-priced forms of distribution to more open, low-priced, or free distribution--in short, from proprietary channels of communication to what I'll call the "commercial public domain.")

94. Tim Kane, *The American Workforce: Strong Facts Trump Weak Myths*, THE HERITAGE FOUNDATION (Jan. 28, 2004), http://www.heritage.org/research/reports/2004/01/the-american-workforce-strong-facts-trump-weak-myths; Dep't of Labor, *Bureau of Labor Statistics: Employer Situation Summary* (Mar. 9, 2012), http://www.bls.gov/news.release/empsit.nr0.htm. The total number of workers, combined with the lack of coordination among them helps explain their continued relative weakness of bargaining position relative to the businesses that hire them. Van Wezel Stone, *supra* note 57, at 54-69; *see generally*, Greenfield, *supra* note 57; O'Connor, *supra* note 45.

95. *See generally* O'Connor, *supra* note 45, at 910-13.

96. As long ago as 1956, the number of white-collar workers surpassed the number of blue-collar workers. NAISBITT & ABURDENE, *supra* note 1, at 12. By 1982, 60% of the U.S. workforce was in information related jobs with only 13% in manufacturing operations. *Id*. at 14; *see also id.* at 22-23, 37; NEWMAN & DE YOYSA, *supra* note 60, at 123; Deloitte Center for the Edge, *supra* note 42, at 15, 16, 20, 98.

21st century.[97] Studies have shown that, in absolute terms, the U.S. suffers from a shortage of properly educated workers and the situation will likely get worse as the demands of industry continue to move towards better educated and technically skilled employees.[98] Thus, skilled labor is not plentiful.[99]

More importantly, a product's lifespan has been dramatically reduced.[100] Fifty years ago, a company could be successful just by having one or a small handful of quality products that it sold for decades or longer.[101] Today, companies must constantly recreate their product lines to maintain consumer interest and sales volume.[102] The examples are endless. The number of brands in grocery stores has increased three fold since 1991.[103] The Coca-Cola Company was founded in 1892[104] and had only one Coke branded product for ninety-seven years.[105] It now has over 3,500 beverages in its portfolio, including over twenty varieties of Coke, as well as other soft drinks, energy drinks, juices, juice drinks, sports drinks, teas, coffees and water.[106] Many of these have been

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97. NAISBITT & ABURDENE, *supra* note 41, at 47-48; FRIEDMAN, *supra* note 2, at 237-49.

98. Tessa Watanabe, *Shortage of Skilled Workers Looms in U.S.*, L.A. TIMES, Apr. 21, 2008, *available at* http://articles.latimes.com/2008/apr/21/local/me-immiglabor21; FRIEDMAN, *supra* note 2, at 251-255; NAISBITT & ABURDENE, *supra* note 1, at 31-33, 19.

99. NAISBITT & ABURDENE, *supra* note 41, at 48.

100. *See generally* O'Connor, *supra* note 45, at 912.

101. Deloitte Center for the Edge, *supra* note 42, at 115 (noting that leading companies lose ground faster than ever due to increases in competition).

102. Deloitte Center for the Edge, *supra* note 42, at 22, 31; NAISBITT & ABURDENE, *supra* note 41, at 63-66 (noting that the automobile industry's vulnerability is caused by its failure to diversify).

103. James Surowiecki, *The Decline of Brands*, WIRED (Nov. 2004), *available at* http://www.wired.com/wired/archive/12.11/brands.html.

104. *Coca Cola*, NNDB, http://www.nndb.com/company/371/000058197/ (last visited Oct. 21, 2012).

105. *See The Coca-Cola Company Heritage Timeline*, HERITAGE COCA-COLA, http://heritage.coca-cola.com/ (last visited Nov. 23, 2012) (1982-1989 Heritage Timeline).

106. *Product List*, THE COCA-COLA COMPANY, http://www.thecoca-colacompany.com/brands/brandlist.html (last visited Oct. 21, 2012).

introduced in the last twenty years.[107] In 1967, there were only four major television stations (CBS, NBC, ABC and PBS), with a handful of UHF stations in larger U.S. markets.[108] However, with the introduction of cable and satellite television, the average home can now receive almost 120 channels, all of which require new programming to fill airtime.[109] The fact that many of these stations are owned by only a handful of companies, underscores the Herculean task of producing a constant flow of this massive new programming.[110]

In addition, this modern necessity to react to decreasing product life spans with evolving product lines is further seen in the realm of internet and mobile services. Over 140 new applications are added every day to Facebook alone.[111] The average person replaces a cell phone every 22 months.[112] In 2007, Americans spent over $550 million on new ringtones—products with the sole function of meeting consumer demand for novelty.[113] What is more, items are often replaced not because the old product no longer works but rather because it has fewer features or lesser capabilities than the consumer desires. Everyone simply wants the latest and greatest product, and companies scramble to create the next must-have item.

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107. *See The Coca-Cola Company Heritage Timeline*, HERITAGE COCA-COLA, http://heritage.coca-cola.com/ (last visited Nov. 23, 2012) (1990-1999 Heritage Timeline).

108. Mitchell Stephens, *History of Television*, NYU.EDU http://www.nyu.edu/classes/stephens/History%20of%20Television%20page.htm (last visited Oct. 21, 2012).

109. Nielson, *US Homes Receive a Record 118.6 TV Channels on Average*, MARKETING CHARTS (June 13, 2008), http://www.marketingcharts.com/television/us-homes-receive-a-record-1186-tv-channels-on-average-4929/.

110. *See* Alex, *Who Owns What on Television*, NEATORAMA (July 7, 2008, 3:13AM), http://www.neatorama.com/2008/07/07/who-owns-what-on-television/. Media companies must also compete for the consumers' interest with free web products and new content providers. Deloitte Center for the Edge, *supra* note 42, at 77. Over 13 hours of new content is uploaded to YouTube every minute and over 100,000,000 videos were viewed per day as of 2006.

111. Adam Singer, *49 Amazing Social Media, Web 2.0 and Internet Stats.*, THE FUTURE BUZZ (Jan. 12, 2009), http://thefuturebuzz.com/2009/01/12/social-media-web-20-Internet-numbers-stats. On average, 900,000 blogs are posted daily. *Id*.

112. *See supra* text accompanying note 45. 90% of Americans own have a wireless subscription. Deloitte Center for the Edge, *supra* note 42, at 43.

113. *BMI Forecasts Ringtone Market Down 8% in 2007*, ALL ACCESS MUSIC GROUP (MAR. 27, 2007, 11:47 AM), http://www.allaccess.com/net-news/archive/story/22940/bmi-forecasts-ringtone-market-down-8-in-2007.

What has become clear is that a company's success is no longer tied to a single good idea or product that investors can back.[114] Rather, the success of a company is tied to its ability to innovate and produce new products.[115] This innovation stems from labor.[116] In the information age, all workers must be involved in product or production innovation and development.[117] Notwithstanding this reality, innovators have never been perceived as plentiful, and the expansion of this responsibility for innovation from company founders to entire workforces highlights a scarcity of labor in today's society.

D. INVESTORS OF CAPITAL TAKE ALL THE RISK AND LABOR TAKES NO RISK

This final premise can be formulated in several different ways, each of which ultimately boils down to the same conclusion: investors are the owners of a business and workers have no ownership stake.[118] Another way to describe this premise is to say that workers are compensated for their time and effort via salaries, whereas investors are not compensated for their money—an investor's only return is an interest in the company's equity. Therefore, investors are owners and workers are not. A variant formulation would be to state that investors buy interests in a company, whereas the company hires workers as employees.

At some level this premise, as put forth in the last of the formulations above, is true by definition. If one buys something (the investor purchases ownership in the form of stock), one owns it. This is arguably an inalterable maxim of property law: to deny that a purchaser owns what he purchased would destroy the very notion of private property. As true as this may be, for example in the case of purchasing a

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114. FRIEDMAN, *supra* note 2, at 339-356.

115. *See generally* Deloitte Center for the Edge, *supra* note 42, at 21.

116. O'Connor, *supra* note 45, at 901-02; Deloitte Center for the Edge, *supra* note 42, at 3, 4, 22, 106.

117. O'Connor, *supra* note 45, at 911-13; *see generally* Deloitte Center for the Edge, *supra* note 42; NAISBITT & ABURDENE, *supra* note 1, at 16.

118. The fallacy of describing a shareholder's interest in ownership terminology has been discussed at length by Greenfield, *supra* note 57, at 288-94; *see also* NICHOLAS WOLFSON, THE MODERN CORPORATION: FREE MARKETS VERSUS REGULATION 40 (1984).

car, a subtler examination is merited with regard to business entities. Individuals can "purchase" stakes in a business entity by contributing money, tangible or intangible property, or services.[119]

So why is an up-front "purchase" of ownership for services recognized whereas a lifetime of services to an entity as a worker entitles one to no rights or ownership stake? One might see this as a purely contractual matter—the investor chose to buy an ownership stake whereas the worker chose to enter into an employment relationship.[120] However, while this is no doubt true in some sense, the law often limits the freedom of contract when structuring business entity arrangements.[121] For example, although founders of a company often continue as its managers and could benefit personally from not owing fiduciary duties to the other investors, corporate law limits a corporation's ability to eliminate the fiduciary duties of its managers, particularly with regard to the duty of loyalty.[122]

Why then does the law not limit freedom of contract with respect to business entities so that workers have some sort of ownership stake or at least certain minimum duties owed to them? The answer to this is in part the law's historical perspective on the three premises previously discussed in this Article. If it is true that capital is scarce, businesses need large amounts of capital and labor is plentiful, why then should labor have any duties owed to it? Workers' contributions are seen as being dwarfed by those of capital, so the law has not seemed fit to protect workers based on such contributions.[123] The other part of the answer lies in the way I have chosen to describe the fourth premise: in

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119. Although corporate law has long prohibited unperformed services as consideration for stock, other business entities such as partnerships readily recognize services, as well as cash and property, as an acceptable basis upon which one can acquire an ownership interest. HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS §§ 21, 167 (3d ed., 1983).

120. For a discussion of the hurdles facing employees in this negotiation context, see Van Wezel Stone, *supra* note 57, at 54-69; *see generally* O'Connor, *supra* note 45; Greenfield, *supra* note 57.

121. EASTERBROOK & FISCHEL, *supra* note 57, at 3; Greenfield, *supra* note 57, at 312.

122. EASTERBROOK & FISCHEL, *supra* note 57, at 3; HENN & ALEXANDER, *supra* note 119, §§ 136, 137.

123. *See supra* notes 56-63 and accompanying text.

the taking of risk.[124] The investor puts something at risk, be it money, property or services, and there is the possibility that the investor will receive no return on that risk. Workers, on the other hand, are perceived to put nothing at risk. Workers do their jobs and are paid for their services, and hence they should not be entitled to any upside in the business when they are not taking any of the risk in the business.

Thus, I believe the best formulation of the fourth premise is not a tautologically true statement about ownership, but rather one that asserts that the duties to the shareholders derive from their taking of risk that workers do not take. Whether this premise has historically been true and whether it remains relevant today is a further inquiry worth examining.

1. Capital's Risk or Lack Thereof

There can be no doubt that investors take a risk when investing in a business. When an investor buys stock in a company, there is no guarantee that the investment will ever be repaid, much less that a profit will be obtained. Indeed, the chances for repayment or profits are very low given the significant number of businesses that are liquidated or go bankrupt every year. Unless investors have already received a return on their investments in the form of dividends (which seems highly unlikely for many businesses that go bankrupt), they will have lost most or all of the money they risked in buying the stock in such companies. The level of risk that each investor takes in making his investment, however, varies.

First, as has been previously discussed in section B, the nature of the types of businesses that remain in the U.S.—that is, the production of services and information goods—is not particularly capital intensive.[125] Since businesses need less capital to become operational, investors are collectively taking less risk on any given venture simply because less money is at stake if the business fails.

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124. EASTERBROOK & FISCHEL, *supra* note 57, at 36 (risk takers have a residual claim to profit); Greenfield, *supra* note 57, at 303; *see also* Macey, *supra* note 61.

125. NAISBITT & ABURDENE, *supra* note 1, at 12-14, 21 (also stating that most service jobs are actually creating, processing or distributing information); NEWMAN & DE ZOYSA, *supra* note 60, at 27; Deloitte Center for the Edge, *supra* note 42, at 11, 98, 25.

Second, as discussed above, the modern world is a huge market catering to extraordinarily broad tastes. One can find a magazine, television station or type of music that caters to almost any interest. Because the U.S. is primarily a producer of services and information goods, its businesses face less risk with their access to a national market of over 300 million people and a potential internet world market of almost seven billion people.[126] There is a viable market for almost anything today.[127]

More importantly, one must consider the comparative risks that investors take. When an investor buys stock in a newly formed business, one with no track record, he takes the highest risk.[128] There is no way to know for certain whether the company's product idea has a significant market. Even if it does, the company could still fail if the costs of production and distribution cannot be adequately contained so that the finished product can be delivered to the market at a reasonable price. Moreover, if the product does manage to have a reasonable cost, there still remains the question of whether the company has competent managers that will make good business decisions for the company.

There is still a meaningful risk, albeit a smaller one, in the alternative scenario where investors buy into the typical company making its initial public offering (IPO).[129] These companies have usually been around for some time and have a proven track record of at least moderate success, so investors know that there is a market for the company's product, that the company has been able to contain costs and that the company is at least reasonably well-managed. Generally, companies undertake an IPO to raise significantly more capital than they have had in the past so that production can be significantly expanded.[130]

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126. *See generally* Deloitte Center for the Edge, *supra* note 42.

127. It must be acknowledged, however, that the global marketplace presents new risks as well in the form of increased foreign competition and information products that are uniquely vulnerable to piracy/theft. However, these risks may refer more to the size of one's profits as opposed to whether one can make a profit. *See generally* Deloitte Center for the Edge, *supra* note 42, at 11.

128. EDWARD PAULSON, THE COMPLETE IDIOT'S GUIDE TO STARTING YOUR OWN BUSINESS 53-54 (2007); Deloitte Center for the Edge, *supra* note 42, at 12; BARTLETT & ECONOMY, *supra* note 84.

129. PAULSON, *supra* note 128, at 55-56.

130. Of course the owners of the closely held company undertaking an IPO are also frequently interested in the significant personal rewards that an IPO will bring to them by greatly increasing the value of their stock.

Accordingly, there are risks associated with such expansion: will the company grow too large too fast and kill itself through lack of cash flow and overspending?; are the managers up to the task of managing a significantly larger enterprise?; is there the additional market for such increased production? These questions reflect legitimate risks for investors; however, they are lower than those existing for start-ups with no history to examine.

Finally, investors buying stocks in publicly held companies through secondary trading markets take little risk.[131] History shows that over time there are few better ways to make money than to invest in the stock market.[132] Occasionally, publicly held companies go bankrupt, but that is a relative rarity when compared to start-ups and closely held companies.[133] In general, the larger the capitalization of a company, the lower the risk. Moreover, the risk in publicly held companies is further reduced by the fact that as registered and traded shares, these investments are readily transferable. If an investor concludes that the situation does not look favorable for the company he or she has invested in, it is possible to sell shares in a few minutes thereby eliminating the risk of any further loss.

Furthermore, a corporation may not withhold dividends in bad faith if an adequate corporate surplus exists.[134] In practical terms, this means the risk is greatest to investors when stock is first purchased, for this is the time when it is theoretically possible to lose all of one's investment. However, over time as dividends are paid, the risk to the investor is correspondingly reduced because one has already locked in a return on

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131. *See generally* PAULSON, *supra* note 128, at 53.

132. *Stocks, Bonds, Bills and Inflation and Gold-Asset Class Performance*, INVESTORSFRIEND.COM, http://www.investorsfriend.com/asset_performance.htm.

133. In 2009, 60,837 companies filed for bankruptcy, but only 207 were publicly traded. See Matt Krantz, *Back on stock market after bankruptcy protection*, USATODAY.COM (June 4, 2010, 10:30 AM), http://usatoday30.usatoday.com/money/economy/2010-06-01-backfrombrink01_ST_N.htm and *U.S. Bankruptcy Courts—Business and Nonbusiness Cases Commenced by Chapter of the Bankruptcy Code During the 12-Month Period Ending December 31, 2009*, USCOURTS.GOV, http://www.uscourts.gov/uscourts/Statistics/BankruptcySTatistics/BankruptcyFilings/2009/1209_f2.pdf.

134. Gottfried v. Gottfried, 73 N.Y.S.2d 692 (Sup. Ct. N.Y. County 1947); Dodge v. Ford, 170 N.W. 668 (Mich. 1919).

the investment equal to the total amount of dividends received.[135] At some point, the investor has received a return of all the money initially invested in the form of dividends, while continuing to own one's interest in the company so that any additional dividends and the amount eventually received for selling the stock amount to risk-free profit. Thus, the risk for capital decreases over time as dividends are paid.[136] Once again, this factor is not equal for all types of stock purchases. Comparatively, few large publicly traded companies do not pay dividends, whereas many smaller businesses either do not have the profits necessary to pay dividends or distribute profits to the owners (who are also employees) in the form of additional compensation so as to minimize corporate taxation.[137]

Although most of the risk associated with buying stock is in buying shares in start-up companies and companies making IPOs, investors overwhelmingly put their money elsewhere when purchasing stock. Total IPOs on the NASDAQ and New York Stock Exchange rose only 19.1 billion in 2010.[138] By comparison, 6.3 billion shares on average were traded every day on these exchanges as of May 2011.[139] Single day trading in July 2011 by a single brokerage house in stocks listed on the Dow Jones Industrial Average, S&P500 and NASDAQ averaged 23 billion.[140] Thus, the reality is that the overwhelming majority of passive

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135. There remains, however, an opportunity cost that continues to exist. By buying one stock, one forecloses, at least temporarily, the possibility of using that money to buy something that could generate a better return.

136. One commentator has noted that the Dow Jones Industrial Average would have been over 233,000, as compared to 10,000, in 2000 had the index included dividends in the measure of return to investors. John B. Shoven & Clemens Sialm, *The Dow Jones Industrial Average: The Impact of Fixing Its Flaws* (SIEPR Policy paper No. 99-16), *available at* http://www-siepr.stanford.edu/papers/pdf/99-16.pdf.

137. Shawn M. Forbes & John Hatem, *NYSE & AMEX Listed Firms That Pay No Dividend: A Recent History*, 11 J. FIN. & STRATEGIC DECISIONS 1 (1998); *see generally* EASTERBROOK & FISCHEL, *supra* note 57, at 13 (smaller, growing companies often do not pay dividends).

138. Lee Spears, *U.S. IPOs Raise Lowest Amount in Decade Versus Cash Aim*, BLOOMBERG (Sep. 23, 2010, 12:00 AM), http://www.bloomberg.com/news/2010-09-23/u-s-ipos-raise-lowest-amount-in-decade-compared-to-cash-sought.html.

139. Thomas Lauricella, *Traders Exit High-Speed Lane*, WSJ.COM, http://online.wsj.com/article/SB10001424052748704322804576303543741007746.html. It should be noted, however, that IPOs would be included in these totals.

140. Knight Capital Group, *Volume Statistics*, KNIGHT.COM, http://www.knight.com/ourfirm/volumestats.asp (last visited Nov. 19, 2010)

investors[141] in corporations are taking little risk in buying stock because of the types of stocks they are choosing to buy—those of established companies.

2. Labor's Risk or Lack Thereof

Turning to the other side of this premise, it is worth asking whether it can truly be said that labor takes no risk. Admittedly, workers take little risk of not being compensated for their contributions given their routine of showing up to work and being compensated for the time they put in.[142] Nevertheless, even the average worker risks more than has historically been acknowledged.[143]

An employee who goes to work for a company ties himself to the fate of that company; and there is an opportunity cost for the worker in selecting a given employer over others.[144] For instance, workers develop skills and expertise suitable to the business in which they work.[145] If an employee's company goes bankrupt, that worker may be unemployable, practically speaking, unless there is another comparable business nearby

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141. There is also a significant amount invested in closely held, small "family" businesses (based on the total number of such businesses, not the amount invested on a per business basis). However, these investors are also running the day-to-day operations. *See* William Patterson University, *The Economic Impact of Closely Held Businesses*, WPUNJ.edu, http://www.wpunj.edu/CloselyHeld/EconomicImpact.dot. Such businesses have not traditionally been the ones searching for large amounts of "scarce" capital, but rather have been capitalized by those running the business. *See* EASTERBROOK & FISCHEL, *supra* note 57, at 13 (stating that many small businesses have only debt, no outside equity). Furthermore, as active investors running day-to-day operations, they are in a sense a hybrid class of investor/worker risking both their time and their money in the hopes of creating a successful operation. Additionally, as the parties actually running the business, they have greater control over the risks the business chooses to make when compared to the traditional, passive investor.

142. A small percentage of workers will perform work for which they are not compensated because the business becomes insolvent before they are paid, but this represents an insignificant percentage of the overall labor performed in the U.S.

143. *See* Van Wezel Stone, *supra* note 57, at 47-53; Greenfield, *supra* note 57, at 303-309; O'Connor, *supra* note 45, at 907-08.

144. *See generally* Greenfield, *supra* note 57, at 307; O'Connor, *supra* note 45, at 907 § 1.

145. McDonnell, *supra* note 57, at 349-50; Van Wezel Stone, *supra* note 57, at 49-53; Greenfield, *supra* note 57, at 309; O'Connor, *supra* note 45, at 908, 910, 915.

where the worker can seek employment.[146] On a facially comparative basis, the risk taken by the worker is similar to that of the investor—for each there is an overall low likelihood of business failure. Nevertheless, if failure does occur, the investor loses capital and the worker loses his job and marketability, having developed skills and expertise that are potentially job-specific and not transferable.

Indeed, upon closer examination, it becomes clear that workers risk even more in absolute terms. Investors typically risk excess capital; people put extra money they have into the stock market, not the money they need for food and rent. Workers, on the other hand, risk their very means of existence when they tie their futures to a particular business. Unlike the risk taken by capital, which decreases over time as dividends are paid,[147] the risk to labor actually increases over time. A worker's marketability generally decreases with time, rendering the failure of a business all the more devastating to a fifty-year-old worker than to a twenty-five-year-old worker.[148] Furthermore, for publicly traded companies, a shareholder can easily sell his investment to cut off future risk. In contrast, an employee may have no real comparable job opportunities available—his fate essentially tied to his employer until retirement. Shareholders can also diversify their risk by investing in multiple corporations, whereas workers cannot.[149]

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146. Van Wezel Stone, *supra* note 57, at 51. Many workers, particularly as they get older, are as a practical matter unable to move. This may be simply because of a lack of funds to move to a new area in hopes of finding new employment, particularly when the worker has lost a job and the income that accompanies it. Even those with employment available and employers that are willing to cover moving expenses are often constrained by other factors such as a divorce (creating a difficult choice between abandoning one's children for a decent job or being under-employed to remain near to them), or by the inability to sell one's home for enough to cover the mortgage. Looking solely at the last of these factors, 23% of homeowners had mortgages exceeding the value of their homes in the third quarter of 2009. *See* Ruth Simon & James R. Hagerty, *One in Four Borrowers is Underwater*, WALL ST. J., Nov. 24, 2009, *available at* http://online.wsj.com/article/SB1
25903489722661849.html; *see also* O'Connor, *supra* note 45, at 910.

147. *See supra* notes 134-136 and accompanying text.

148. Van Wezel Stone, *supra* note 57, at 49-52; *see generally* O'Connor, *supra* note 45, at 907-10.

149. *See* McDonnell, *supra* note 57, at 350; Greenfield, *supra* note 57, at 309.

The risks faced by labor are even more acute if one considers that there are no fiduciary duties owed to workers by companies.[150] Under the traditional corporate system, corporate managers must maximize shareholder profits. Owing no fiduciary duties of any type to labor, it is not only permissible, but in essence mandated, that if a corporation can make greater profits by closing its factory doors in the U.S. and moving abroad where labor and other production costs are lower, it must do so.[151] This has become a commonplace occurrence in the U.S., and is more likely to occur than bankruptcy.[152] Moreover, although this corporate action has the potential to destroy the lives of workers left unemployed, it does not hurt investors. Rather it often provides them with additional profits.

Furthermore, even the basic tenet that workers are fully compensated for their services is less true than most imagine.[153] This is not only because of their firm specific investment in human capital. In the U.S. today, pension and retirement plans are common features of the compensation owed to a worker.[154] However, a staggering number of these plans are unfunded or under-funded, so there is a significant risk that the workers covered will not receive the compensation to which they are entitled.[155] Given this risk and the absence of fiduciary duties owed to labor, there is a growing trend toward eliminating such plans.[156]

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150. One can argue that some states now have such duties, but the statutory provision is permissive rather than mandatory, except in one state. *See supra* note 64. However, workers have no means to enforce such rights even when they do exist. *See* O'Connor, *supra* note 45, at 951-52; Macey, *supra* note 61, at 23; Van Wezel Stone, *supra* note 57.

151. This is no longer true in a number of states given that corporate boards in such states have been statutorily authorized to consider the interests of other constituencies. However, workers have no standing even in such states to contest a decision to move a factory offshore. O'Connor, *supra* note 45, at 951-52; Macey, *supra* note 61, at 1.

152. *See* NAISBITT & ABURDENE, *supra* note 1, at 17, 55-56, 61-62, 71-73; *see also* FRIEDMAN, *supra* note 2, at 114-127; NEWMAN & DE YOYSA, *supra* note 60, at 27, 191; Deloitte Center for the Edge, *supra* note 42, at 11.

153. For a discussion of employees as residual claimants, *see* Greenfield, *supra* note 57, at 303-309; O'Connor, *supra* note 45, at 907-08; Van Wezel Stone, *supra* note 57, at 47-53.

154. Greenfield, *supra* note 57, at 306-309.

155. David S. Hilzenrath, *Stock Losses Leave Pension Funds Underfunded*, WASH. POST, Jan. 8, 2009, *available at* http://www.washingtonpost.com/wp-dyn/content/article

In sum, although investors do indeed take risk, historical characterizations overstate the risk to capital and, at the same time, fail to consider the risks taken by labor.

E. FACTORS OVERLOOKED BY THE HISTORICAL MODEL

The four historical premises for the allocation of corporate duties discussed above have not only ceased to be true today, but also fail to consider two important new elements:

1. Labor Contributes More Than Capital Over Time
2. Capital Does Not Go Where It Is Most Needed

Each of these elements raises additional issues that should be addressed in creating a legal regime that properly balances the relative risks and contributions of labor and capital.

1. Labor Contributes More Than Capital Over Time

There can be no doubt that businesses need both labor and capital to succeed. However, labor contributes more to the success of a corporation than capital over time based on the very nature of its contributions.

A business receives a contribution from capital only once—when the shareholder first buys stock for cash. While that money is essential to the initial success of the entity, over time such contributions can become a drop in the bucket compared to retained earnings.[157] Moreover, only the initial issuance of stock benefits the corporation, whereas profits from all subsequent sales of the stock belong solely to the selling shareholders.[158]

/2009/01/07/AR2009010701387.html; *Underfunded Pension Plans: The Next Shoe to Drop?,* DIVIDENDS VALUE (May 5, 2009), http://dividendsvalue.com/2963/underfunded-pension-plans-the-next-shoe-to-drop/.

156. Geoffrey Colin, *The end of a dream,* CNN MONEY, *available at* http://money.cnn.com/2006/06/12/magazines/fortune/pension_retirementguide_fortune/index.htm.

157. *See supra* Part 2.D.1.

158. However, the potential profits to be made by selling stock are a crucial component to the investor's initial willingness to risk capital by purchasing stock. Therefore, a secondary market is an important factor in attracting investment.

Labor, on the other hand, makes ongoing contributions in the form of not only manual labor but also the continuous infusion of creativity and new ideas.[159] Historically, a company might have been able to survive or even thrive on a single good idea for decades or more, but in the information age, a company cannot survive without continually reinventing itself by introducing new products.[160]

While in the infancy of a business, capital and labor may both make significant contributions, labor makes a larger impact on the continuing success of the enterprise over time.

2. Capital Does Not Go Where It Is Most Needed

Capital need not be scarce in the information age, and yet corporations are not the primary beneficiaries of the vast sums of capital dedicated to the stock market.[161] As previously discussed, corporations benefit from capital only when stocks are first issued, yet ironically this is where capital is most scarce.[162] As a result, profits move back and forth in the secondary market where all the benefits of such trading go to individual investors as opposed to the corporations issuing such stock.

If scarcity of capital is indeed a concern, society should create a model that promotes such capital going to where it is needed most.

III. POSSIBLE SOLUTIONS

Given that the historical premises underlying the creation of current U.S. corporate duties and ownership concepts are no longer true and that these historical premises also fail to consider important additional factors, as discussed above, it is essential that a new structure of duties and ownership rights be developed to reflect current societal realities. Whereas traditional corporate law both overstates the need for,

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159. *See supra* Part 2C; Deloitte Center for the Edge, *supra* note 42, at 114, 23; O'Connor, *supra* note 45, at 901, 911-13.

160. *Id*.

161. Over six billion shares are traded every day on the NYSE and NASDAQ. *See* Lauricella, *supra* note 139. This does not include any of the other stock exchanges in the world.

162. *See supra* Part 2.D.1.

contribution of and risk taken by capital, and understates the contribution of and risk taken by labor, there must be a shift away from a system where the corporation exists with duties owed solely to its shareholders. A new paradigm must embrace the idea that some set of duties are owed to and possessed by labor, thereby moving away from a system that legitimizes the single-minded pursuit of maximizing shareholder profits.

In addition, establishing a new legal regime that incorporates duties to labor presents two other important considerations. First, substantial legal scholarship has focused on additional reasons why workers or other constituencies might be entitled to various rights or duties beyond those discussed in this Article. Arguments have been put forth, for example, in support of worker profit sharing, share ownership, voting rights, the power to sue derivatively, fiduciary duties for workers and (board) representation as a means to increase productivity/innovation, equality, democracy and responsible business decision-making.[163] These proposals, the merits of which are beyond the scope of this Article, are generally further supported by this Article's contention that the premises supporting the current corporate structure are no longer true. Moreover, to the degree these other considerations are relevant, they should be woven into the creation of a new paradigm of corporate duties and rights.

Second, although this Article has argued that certain premises of corporate law no longer hold entirely true, they are not completely false either. Specifically, this Article's assertions that each premise no longer applies are a reflection of trends in American business that do not necessarily apply to every U.S. corporation. For instance, there are some companies in the U.S. that require large sums of capital, as well as others that manage to survive with limited, relatively unchanging product lines. Moreover, the realities of small, closely held businesses have not changed nearly as dramatically as those of large publicly held corporations,[164] and just as not all companies look to their workers for

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163. *See* David Millon, 1990 DUKE L.J. 201; O'Connor, *supra* note 45, at 936-54, 902, 904; Robert B. Moberly, *New Directions in Worker Participation and Collective Bargaining*, 87 W. VA. L. REV. 765 (1985); Dana Muir, *Groundings of Voice in Employee Rights*, 36 VAND. J. TRANSNAT'L L. 485 (2003); McDonnell, *supra* note 57; Greenfield, *supra* note 57.

164. As has been noted, closely held businesses by and large do not require as much capital, and look to their operators as investors. As such, the scarcity of capital plays a

new ideas, not all workers contribute to the continual reinvention of business.[165] Thus, it is clear that any solution based on the realities of today must embrace both the predominant situation and possible exceptions. The resulting new paradigm must be adaptable to accommodate varying situations and may require shifting duties and rights depending upon the circumstances at hand.

Despite these difficulties, a nuanced approach to future rights and duties arises as a potential solution: a springing profit sharing right for workers.[166] This solution addresses the significant, but not total, erosion of the foundational premises, as well as the unconsidered failings of these premises, both of which are discussed in this Article.

As previously discussed, investors of capital take risks, but this risk diminishes over time as a business grows, dividends are paid, stock appreciates in value and a company becomes publicly traded. Labor on the other hand takes little risk initially since salaries are paid, but takes an increasing risk over time as expertise develops, pensions vest and other career opportunities are foreclosed. Similarly, investors make a major contribution early in the life of a corporation when it has no profits and no ability to borrow absent collateral or an operations history, however, they do not contribute to the corporation again after the stock issuance. In contrast, labor performs assigned tasks initially, but over time contributes more to the success of the business by helping it to develop new products and otherwise reinvent itself to meet rapidly changing demands in the modern market. In light of the opposing

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lesser role for these entities. *See supra* note141. Additionally, the owner-operators of these businesses risk both capital and labor, so discussions of comparative risk and contribution do not directly apply as easily to them. As such, the closely held family business may not need an adjustment in its duties unless it decides to expand by offering stock to the public or manages to grow beyond a certain number of employees.

165. However, recent data suggests that companies should look to all their workers for innovation to succeed in an ever more competitive world. Deloitte Center for the Edge, *supra* note 42, at 23, 114, 124-126.

166. This springing right could actually take other forms such voting rights or share ownership with appropriate adjustments, particularly if other factors beyond the scope of this Article are considered. *See supra* note 163 and accompanying text. However, this Article couches the right as an economic entitlement to a portion of the profits since the basis for arguing that change is necessary to the basic corporate duty paradigm has been made by focusing on economic concerns—relative risks taken by labor and capital, the need for capital, the scarcity of capital and the non-scarcity of labor.

trajectories taken by labor and capital with respect to relative risk and contribution, the duties owed and rights possessed by each should adjust correspondingly.

Early in the life of a corporation, its duties should be most focused on the shareholders—on minimizing their risk and returning their capital with a profit. However, once the shareholders have been amply repaid for their one-time contributions, the duties owed to them should diminish. As the company continues to operate, it will have to reinvent itself and its product lines to remain competitive, with the source of this renewal being its employees.

One model that would reallocate rights between investors and workers would be to give employees a mandatory right to profit sharing in a corporation once it has repaid investors the full amount of their initial contributions together with a reasonable profit[167]—a return on investment at a level that would preserve the incentive to put forth capital. Using a familiar model for comparison, corporations would essentially be treating their shareholders as owners of preferred stock, those owners who receive the first cut of the corporation's profits. This approach would not increase the risk of capital flight because investors

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167. Reasonable profit must be a market driven analysis and would need to be determined by considering likely returns from other forms of investment so that an adequate percentage profit could be determined. Under current economic conditions, such a return might be the initial investment plus 6-8% cumulative annual interest, but this is merely offered as a ballpark figure for illustration purposes. See Bankrate.com, *IRA Search Engine*, http://www.bankrate.com/brm/rate/today_avg_iradep.asp for current average bank certificate of deposit interest rates and U.S. Department of the Treasury, *Daily Treasury Yield Curve Rates,* http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield for current treasury bill interest rates. This market driven rate would be fixed at the time of the stock's issuance by reference to a federal index. Likewise, one could argue over the percentage of profits that should be allocated to labor. Given the relative risks and contributions of capital and labor, an equal split of profits to capital and labor (after capital investments plus reasonable profits have been returned) seems reasonable to the author, but this is merely a suggestion based on the author's perception of the current state of the premises underlying the historic model. Alternatively, the percentage could be adjusted to different industry types so that those with greater capital requirements (such as heavy manufacturing) allocate a lower percentage and those with higher employee contributions and lower production costs (such as digital products) receive a higher percentage. Furthermore, labor's right to profit sharing need not be an all or nothing proposition; the right could always exist at a relatively low percentage and as capital is repaid or other benchmarks are reached, this percentage could increase.

would be adequately rewarded for their risk before profit sharing would arise for workers.[168] Moreover, if profits were not to reach an adequate level, shareholders would get all of the earnings and the workers would get none. In fact, if a company had to return capital plus a market-driven cumulative return before employee profit sharing kicked in, many companies would never move into a profit sharing phase.[169] This model accurately accounts for and rewards the actual risks and contributions of labor and capital in two ways. First, until investors receive a reasonable profit, capital continues to be taking most of the risk. Second, the most successful companies are likely to be those in which the most innovation occurs as a result of labor's contributions.

Notably, a number of technical difficulties would need to be overcome to make such a system viable. Shareholders, who both elect managers and are likely to prefer to continue receiving all profits, might look for ways to avoid triggering the worker's profit sharing phase. For example, if only dividends are counted towards the capital return, companies would likely withhold dividends to keep the aggregate return below the profit sharing trigger. Thus, return would have to include both dividends received and appreciation in stock value.[170]

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168. However, once a company moves into the profit sharing phase, the value of the stock would be diminished as investors receive lower dividends since profits would have to be split between labor and capital. This should not be crippling, however, as the shareholders still retain the underlying equity interest in the company and it is only profits that are being divided. In other words, stock appreciation would slow but the underlying valuation should not be affected dramatically. There is also some risk of capital flight if investors feel this profit sharing regime diminishes the value of investing in a U.S. company too much compared to the advantages of investing elsewhere. This risk should not be overstated, however. The U.S. is currently the world's largest single capital market for a number of reasons. *See* Capital Flow Analysis, *The Big Picture,* http://www.capital-flow-analysis.com/investment-tutorial/picture.html (last visited Oct 21, 2012); EDWARD F. GREENE, U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES, Vol. 1, LXV (9th ed. 2005). In spite of massive shifts to manufacturing overseas, U.S. companies have remained incorporated in the U.S. Furthermore, many of the huge number of small businesses owned by U.S. citizens would be ill-suited to reincorporating and operating overseas. The risk seems most likely to have negative repercussions with regard to foreigners trying to decide where to incorporate.

169. *See generally* Deloitte Center for the Edge, *supra* note 42, at 115-18.

170. Including appreciation in value bolsters the argument that the model proposed should be applied exclusively to publicly traded companies. For one thing, determining

Alternatively, a company might avoid profit sharing for workers by avoiding the retention of labor altogether. For instance, a company might set up a parallel company that exists solely to lease employees to the first enterprise at the exact cost of such labor. Such an arrangement would allow the owners of the first company to keep all of the company's profits while the second company would have no profits to share. To combat such tactics, corporate law might recognize affiliated leasing and operating companies as one entity or could otherwise consider leased employees to be employees of the lessee for profit sharing purposes.

Moreover, a company might try to avoid triggering worker profit sharing by occasionally issuing additional tranches of stock so that it always has at least some shares that have not been repaid their capital investment. Regulation and oversight over such issuances might address this issue, but not without a significant impact on corporate governance and decision-making given the myriad legitimate reasons for issuing more stock. A better approach might be to lump repaid capital and labor into one category and more recently issued capital that has not been repaid into another. Once again, turning to the preferred stock model, newly issued stock would get a higher preferred distribution and repaid capital, labor and the new stock would all share in the remainder of any distribution. This treatment would be similar to that of participating preferred stock and common stock. Because the original shareholders would move into a secondary payment category under this scenario, this should provide incentives not to use additional stock issuances except for legitimate purposes and to be careful with regard to the rights and benefits given to the newly issued shares.

Finally, the effects of mandatory profit sharing for workers upon existing companies must be considered. Under the proposed model, most would either be exempt as closely held family businesses or would not have a sufficient return to trigger profit sharing.[171] Nevertheless, there are companies that have already been highly successful and repaid

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appreciation is far more difficult without an ongoing market price for the stock. More importantly, the investor in a closely held entity cannot readily liquidate the investment to access such return.

171. Determining the rate of return for already issued stock could be handled either by a somewhat arbitrary rate tied to recent historical market factors or rates could be set tied to the year of original stock issuance. Either choice presents a number of difficulties given that such stock may have exchanged hands multiple times.

their capital contributions, such as many on the Dow and the S&P500.[172] To force these companies to immediately share a significant percentage of their profits could have a detrimental impact on the market. As such, a phase-in for profit sharing in such companies, starting at a low percentage and working up over a number of years, would be prudent.[173]

In addition, mandatory profit sharing for companies that have succeeded in returning capital and a market driven profit to investors would have several ancillary benefits beyond addressing the inequities of continuing to follow a regime based on premises that are no longer valid. First, as has been noted by others arguing in favor of profit sharing for employees on other grounds, profit sharing creates incentives that increase worker productivity, decrease worker turnover (thereby lowering training costs) and increase worker morale.[174] Similarly, it provides additional funds to workers, thereby allowing them a chance to become investors in their own right.

More importantly, for investors looking for maximum returns on their investment, exchanging stocks in long-established companies through the secondary market will no longer provide the returns it once did. As profits are split between the investors and the workers, dividends will decrease, stock appreciation will decrease, or both will occur. To capture all the profits a company is making, an investor must invest in a company that is not in the profit sharing phase. In other words, there will be a much greater incentive to invest in startup ventures and IPOs. Given that capital has always been scarcest for these types of companies, this regime will help fund the development of the next

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172. *See* Shoven & Sialm, *supra* note 136.

173. A phase-in of this kind would also dilute any unfair affects from the move to worker profit sharing on recent secondary purchasers of stock. Overall, the impact of mandatory worker profit sharing may not be as large as it first appears given that about forty percent of companies already have profit sharing regimes in place (at much lower percentages than the author proposes). *See* Lee Ann Obringer, *How Employee Compensation Works,* HOWSTUFFWORKS.COM http://money.howstuffworks.com/benefits 7.htm (Oct. 21, 2012). These programs would almost certainly be eliminated were such a regime to be adopted, and the savings from the elimination of these programs would help offset the effects of mandatory profit sharing.

174. *See, e.g.*, Erik Poutsma & Willem de Nijs, *Financial Participation in the 1990s – Dissemination and Challenges*, 20 ECON. & INDUS. DEMOCRACY 163, 166 (1999).

generation of American businesses, fueling innovation and creating much needed jobs in the U.S.

CONCLUSION

The common law has always looked to society to resolve its disputes. Judges decide cases based on actual controversies by looking to what is customary or by asking what a reasonable person would do. This inquiry is used to create premises about how society works, and these premises are the foundation for our rules. Unfortunately, over time such premises become enshrined in precedent and are blindly parroted as the basis for legislation even though the world upon which they were based has faded into the past. Members of the legal profession have a duty to reexamine periodically the foundational principles of the legal order.

The move from the industrial age into the information age has caused such widespread and pervasive changes to the way we order our lives and conduct business that it is now time to undertake such a review. Our foundational premises are no longer valid in various areas of law, including contracts, intellectual property and corporate law.

In particular, corporate law has established that duties are owed solely to shareholders, based on four premises that collectively represent the idea that capital is the only contribution to a corporation important enough to merit a duty being owed to its contributors. The modern world shows us, however, that these four premises no longer hold true, and that today capital contributes less and labor contributes far more than was historically the case. As such, it is time to rethink the duties a corporation owes to its contributors of labor and capital and to recognize that certain duties should be owed to workers, as well as shareholders.

In restructuring such duties, it is important to consider that the contributions of capital are greatest early in the life of a corporation and that the contributions of labor increase over time. For this reason, a static model of duties owed may not be the best model for the modern world.