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Can Corporations Be Held to the Public Interest, or Even to the Law?

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Abstract
This article addresses our failing ability to hold business corporations to the public interest, or even to bare legality. It defends, in brief compass, the reasonableness of the expectation that corporations provide public benefits as consideration for their public privileges. But as succeeding sections recount, the traditional instrument for holding corporations to the public interest has gradually been undermined; and our standard, punitive tools for holding them even to bare legality, suffer from inherent limitations and fail adequately to deter corporate misconduct. A more adequate approach would be to supplement the current punitive regime with reform of corporate governance in directions that would decrease the temptation of managers to engage in misconduct in the first place. Several possibilities are considered, with the most promise found in allowing corporations to be owned by Danish-style "industrial foundations." Among its advantages, the reform is realizable and would reduce incentives to corporate misconduct without compromising on performance. Industrial foundations also customarily direct a portion of corporate profits to charity, in effect reinstating the norm that for-profit corporations provide public benefits.

Keywords Corporation · Punishment · Governance

Introduction

The present article addresses our failing ability to hold business corporations to the public interest, or even to bare legality. From the first application of the corporate form to business enterprise, and for centuries thereafter, the reigning norm (if not in all instances the reality) was that business associates received the privilege of incorporation only on condition that their enterprise would generate public benefits. The essay's first section defends, in brief compass, the reasonableness of this expectation—that corporations provide public benefits as consideration for their public privileges. But this reasonableness confronts a stark reality. As succeeding sections recount, the traditional instrument for holding corporations to the public interest has gradually been undermined. What is more, as John Coffee Jr. ably argued a generation ago, corporations are so structured that our standard tools for holding them even to bare *legality*—for example, punishing the legal entity, or punishing the culpable individuals—suffer from inherent limitations and fail adequately to deter corporate misconduct. Nor, I argue, would deterrence be increased were we to follow the recent proposal of Christian List and Philip Pettit and punish the corporate group as a whole whenever it acts as a single "group agent."

From these considerations the essay draws the lesson that punishment, while necessary, will always be insufficient to hold corporations to the law, let alone to the public interest. A more adequate approach would be to supplement the current punitive regime with reform of corporate governance in directions that would decrease the temptation of managers to engage in misconduct in the first place. Among the many possibilities, three are singled out for consideration, each of which targets simultaneously the problem of corporate short-termism and the problem of corporate misconduct. One reform would be to change the way in which corporate executives are compensated, curbing pay in the form of stock and stock options so as to eliminate its perverse incentives. A second would be to institute some form of German-style "co-determination." A third would be to allow ownership of corporations by Danish-style "industrial foundations." The essay concludes that the last reform holds the most promise as the most realizable supplement for decreasing corporate misconduct. The reform adds two additional benefits. Foundation ownership is one of the few effective devices for

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institutionalizing progressive corporate governance over the long term; and industrial foundations customarily direct a portion of corporate dividends to charity, in effect reinstating the norm that for-profit corporations provide public benefits.

Public Privileges Justify an Expectation of Public Benefits

Historically, incorporation was recognized as a substantial privilege bestowed upon a group by the state. Incorporation gives the associates the advantage of operating as a single legal entity, with jurisdictional authority, centralized management, perpetual succession, asset lock-in, entity shielding, and (almost always today) limited liability.[1] To justify receipt of these advantages from the public, the norm long governing the chartering of corporations, including business corporations, was that the associates had to be committed to a purpose with exceptional public benefits—for example, building and maintaining a bridge or road, providing insurance, or opening trade to distant lands (Roy 1997, pp 41–55).

The case for holding corporations to a standard of public benefit remains strong. In the mid-twentieth century, law-and-economics scholars asserted, against the notion that corporations are indebted to the public and have corresponding obligations to the public, that corporations are but a "nexus of contracts" (Jensen and Meckling 1976), or that they can in principle be erected through private contract even if they currently are not (Easterbrook and Fischel 1989, p 1444). But recent scholarship has effectively dismantled this view.

For example, Ron Harris has shown that, as a matter of historical fact (and contrary to the impression conveyed by scholars such as Maitland and DuBois),[2] from the origins of the business corporation in the sixteenth century through to the Joint Stock Companies Act of 1844, which made incorporation readily available, English business associates who were denied a corporate charter were unable to cobble together a package of legal rules—drawing from English partnership law, contract law, trust law, and agency law—that even remotely approximated the legal advantages of the corporate form (Harris 2000, pp 137–167). There is perhaps no better evidence of the inadequacy of the unincorporated forms of business in their eyes, than their rush to incorporate once the Act of 1844 was passed (Harris 2000, p 288).

Meanwhile, Henry Hansmann and Reiner Kraakman have demonstrated, in more analytical terms, the impossibility of using contracts to generate the crucial corporate privilege of "entity shielding." Entity shielding may be thought of as the inverse of limited liability. While limited liability protects the stockholders from the debts of the corporation, entity shielding protects the corporation from the debts of the stockholders. In other words, the private creditors of the stockholders cannot levy against the assets of the corporation to settle what they are owed. Nor, for that matter, can the stockholders themselves pull out corporate assets. The assets of the firm are "locked in" and can be safely specialized to the production process, increasing the firm's productivity (Ciepley 2013, pp. 143–5). This lock-in also enhances the creditworthiness of the firm, because it guarantees that the assets will remain with the firm to secure its loans (Hansmann et al. 2006).

Could the economic advantages of entity shielding be secured through private contract? As Hansmann and Kraakman point out, this would require every stockholder to secure from every one of her personal creditors (Mortgage Company, grocer, babysitter) a contract or pledge to the effect that, in the case of the stockholder's personal insolvency, the creditor will refrain from levying against the assets of the corporation in which she holds shares. Not only would the transaction costs of doing this be prohibitive, but also every stockholder would have an incentive *not* to secure these pledges. Specifically, it would vastly increase her borrowing limit and creditworthiness if, instead of securing these pledges, the assets of the corporation were left to backstop her borrowing. And because every stockholder would have the same incentive to cheat, each would need to monitor all the others to ensure all are securing these pledges from their creditors—an impossible task both practically and legally (as it would likely involve a massive violation of privacy rights). Entity shielding simply cannot be secured through private contract. It requires the legal fiat of the state (Hansmann et al. 2006).

In sum, many of the privileges that come with incorporation are simply unavailable to natural persons operating under the general rules of property and contract. Nor are there conceivable alterations to the rules of property and contract as applied to natural persons that would change this fact (Ciepley 2013, p 145). (For example, if natural persons in general were exempted from liability for their debts, it would no longer be a "privilege" of those invested in corporations and a few other legal forms of business; but it would also subvert our entire system of credit and economy.) Nor does incorporation cease to be a state-granted privilege once it is made available to all qualified applicants—any more than a state-run old age pension program ceases to be a state program because it is made available to all seniors. Business incorporation too is a state program. It is a state program for economic growth, and has, for example, been a central strategy of the American developmental state since Hamilton's Society for the Establishment of Useful

[1] On the economic advantages of this latter triumvirate, see Hansmann et al. (2006) and Ciepley (2013).

[2] Maitland (2003) and DuBois (1938), p 216; see also references in Harris (2000), p 138.

Manufactures (although the globalization of corporate firms in recent decades has brought into question the coherence of the strategy).

The chartering of corporations thus contradicts the liberal market principle of government non-intervention in the economy. This is a point that classical liberals well understood. Given the dependence of corporations on public intervention, classical liberals (along with all their contemporaries) held corporations to a standard of public benefit above that of genuinely private business associations (Smith 1776, vol II, pp 246–247). And this seems reasonable. At the least, it exactly parallels traditional "police powers" doctrine, according to which the public welfare is the only acceptable legal basis for the state to intervene in the realm of private property and contract more generally. While we may wish all business entities to provide public benefits, the public is justified in holding corporations to this standard more strictly, in light of the privileges it has granted them.[3]

Our Declining Ability to Hold Corporations to the Public Interest

The case for corporate social responsibility—or, as I prefer to frame it, public responsibility—is strong. The question is, how are public benefits to be secured from corporations? Here, the public's right runs into the reality of failing means.

As already noted, the norm long governing the incorporation of business enterprise was that doing so would provide noteworthy public benefits. However, a point that merits emphasis in all discussion of corporate responsibility, is that the chartering of corporations was originally done in such a way that the corporation's supply of public benefits did not depend upon any personal commitment on the part of the business associates to benefit the public. It was certainly possible for business associates then, and now, to desire to benefit the public. But relying on such altruistic motives would have been considered foolhardy. Most associates, and certainly most outside investors, would, it was assumed, be driven primarily, perhaps solely, by private interest. Instead, the object of the enterprise itself was to be such as to benefit the public—for example, infrastructure construction. As Henry Carter Adams summarized in his 1896 presidential address to the American Economic Association, "A corporation … may be defined in the light of history as a body created by law for the purpose of attaining public ends through an appeal to private interests" (Adams 1897, p 16).

The device that was intended to ensure these public benefits was the corporate charter. The beneficial purpose of the enterprise was written into the charter, as the purpose of the corporation to which management must stick. When corporate law placed the board under a fiduciary duty to "the corporation," this entailed a duty to the authorized purpose of the corporation. If the corporation failed to fulfill this purpose, it was dissolved by the state in a *quo warranto* proceeding (Angell and Ames 1832, p 510). Meanwhile, activities unrelated to this purpose (or outside of any other bounds set in the charter) were subject to being struck down by the courts as *ultra vires*, "beyond powers" of the corporation.

From the beginning, however, the regime for enforcing the charters of business corporations was weak—weaker than that of almost any other kind of corporation. Church corporations (monasteries, confraternities, cathedral chapters, and suchlike) were, unless operating under special exemption from the pope or other hierarch, subject to regular "visitation" by their ordinary—an ecclesiastical superior who enforced discipline, good order, and faithful discharge of the corporate purpose. Eleemosynary corporations were likewise subject to visitation, often by their donors. Business corporations, however, fell into a different class—that of civil corporations, such as towns. These, too, technically speaking, had a visitor. Their visitor was the king. But the king certainly did not show up in person to inspect the business corporations he had chartered, and by the eighteenth century, he and his agents were expressly forbidden to do so (Blackstone 1893, vol I, pp 300–301). In fact, no one showed up. The king's right of visitation was by law exercised in the court of King's Bench, where a corporation was "visited" when it appeared before the king's judges in legal suit (ibid.). In the United States today, the institutional descendent of the king, holding the visitatorial power, is the attorney general of the state in which the corporation is chartered. But as in England, it is in practice the judges of the state court who "visit" from the bench (Pound 1936). This institution is not trivial. It is the legal basis of the state's inquisitorial power over corporations, and this is a power worth remembering in the face of new corporate claims to "privacy" even against state investigations (for an example, Clements and Coats 2017). But as a device to keep business corporations in faithful pursuit of their authorized purpose, this manner of visitation left much to be desired.

The real collapse of this regulatory regime, however, has followed from the gradual expansion, or one might say dilution, of corporate purposes. Initially, corporations were chartered for some purpose, which purpose brought clear public benefits. The 19th and early twentieth centuries witnessed a

[3] It may be countered that the government regularly provides "privileges" to persons, such as old age pensions (Social Security), without expecting a reciprocal public benefit from them. However, in this example, keeping the elderly off of the streets is itself the public benefit achieved, and furthermore, old age pensions are universal in their application, whereas incorporation, although in principle available to all qualified applicants, in practice applies only to those operating under this specific business form (as opposed to other business forms, or not operating a business at all).

dramatic expansion of allowed corporate purposes, driven by three factors.

First, the concept of "public benefit" was thinned out to encompass manufacturing and other quotidian lines of business (Seavoy 1982).

Second, as general incorporation laws and contractualist ideology spread, business corporations came to be regarded as ever more "private," rather than quasi-public (Horwitz 1992). As a result, they were allowed into still more lines of business, of decreasingly clear public benefit, until the list of allowed activities became co-extensive with that allowed to any other business enterprise.

Third, competition among the states for incorporation and franchise fees unleashed a "race to the bottom" in charter leniency. One expression of this was that incorporators were allowed to expand the purpose clause of their charter to include multiple purposes—multiple lines of business into which the enterprise might move. This process continued apace until the second half of the twentieth century, when, as culmination, American states began to allow incorporators to declare the purpose of the corporation to be "any legal purpose" (Schaeftler 1984, pp 482–484). Once this happened, the very idea of fiduciary duty to a purpose lost its sense (as did *ultra vires* suits and *quo warranto* suits for nonfeasance). Into this fiduciary vacuum, the stockholders have been thrown—in legal and economic ideology, if not always in actual law. The Board's duty, it is said, is to them alone (Strine 2015; for critique, Ciepley forthcoming). Management, which state legislatures intended to grant greater latitude, now must operate, or believes it must operate, in the straightjacket of "shareholder primacy," with all the dysfunctions of "short-termism" that follow from it, including a hobbling of the corporation's ability to provide public benefits (Stout 2012; Ciepley 2013; Lazonick 2014; Mayer 2015).

One longstanding proposal in the United States that aims to end the race to the bottom and revive meaningful charter regulation of corporate activity is to replace state (provincial) chartering with federal (national) chartering (Simons 1934, p 19; Nader et. al. 1976; Nader 2013). However, trade agreements such as the WTO establish rules of comity that allow the corporations of any signatory state to operate within all other signatory states on the same terms as their domestic corporations. Even a small corporation can now choose to charter in whichever national jurisdiction it finds most accommodating and do business almost anywhere. In other words, the race to the bottom is now international in scope. This undermines even national chartering as a tool for securing public benefits. And because there is no realistic prospect of establishing a single world chartering agency which could halt this race to the bottom, this spells the end of the charter as a regulatory tool.

With the end of the charter as a constraint on the activity of corporations, it is left to the control group to provide public benefits as an *intention*. Yet as noted at the outset of this section, the corporation was never programmed to operate this way. It can certainly happen, and the development of the "benefit corporation" as a distinct legal form is meant to facilitate it. But given the current nature of recruitment for corporate leadership, and the pressures of market competition, and the pressure of short-term institutional investors, it is not to be expected that such commitments will often be maintained, at least as a driving objective, for the publicly traded corporation—and certainly not when it is structured so as to be dominated by stockholder interests. Indeed, the track record of progressively managed corporations retaining their progressivism across generations is abysmal (O'Toole forthcoming).

The Difficulty of Holding Corporations to the Law

Our prospects have dimmed for guaranteeing public benefits from corporations. But what of a more minimalist standard for corporations—not the active supply of public benefits, but merely the avoidance of harm, or, even more narrowly, avoidance of illegal conduct. What are the prospects simply of holding business corporations to the law?

The usual manner of holding corporations to the law is, naturally enough, through punishment. However, as has been long recognized, corporations are so structured that they are difficult to punish in a way that will deter misconduct.

Throughout the 18th and most of the nineteenth centuries, it was held that corporations could not commit torts or crimes. Corporations were chartered only for legal activities; therefore, torts and crimes were by definition *ultra vires* ("beyond powers") of the corporation and had to be laid at the feet of the natural persons who pretended to be acting in its name.[4] But as corporations grew in size and reach after the American Civil War, pressure mounted to find corporate entities themselves liable and tap their treasuries to recompense the mounting harms they could do (Hager 1988–1989, pp 592–598, 595; Laufer 2006, pp 3–43). By 1879, the U.S. Supreme Court announced sweeping liability of corporations for the torts committed by their employees while acting for the business.[5] The question of a corporation's criminal liability gave greater pause, on account of a corporation's lack of *mens rea* ("guilty mind"). But as theoreticians wrangled over the coherence of attributing criminal intent to corporations, legislatures and judges simply side-stepped the

[4] Anonymous Case (No. 935), 88 Eng. Rep. 1518, 1518 (K.B. 1701); *State v. Great Works Milling & Manufacturing Corp*., 20 Me. 41, 44 (1841).

[5] *First Nat'l Bank of Carlisle v. Graham*, 100 U.S. 699, 702 (1879).

theoretical question and, on purely policy grounds, began to hold corporations criminally liable for the acts of their officers, agents, and employees, applying the same doctrine and conditions that made them liable under tort law: *respondeat superior*.[6]

Consequently, courts now have two main tools for holding corporations to account for violation of the law. On the one hand, there are civil and criminal convictions with fines for the corporate entity, and on the other, civil and criminal convictions with fines and/or incarceration for its agents.

Targeting the Juridical Person

In the "economic," or "cost-minimization," approach to corporate crime associated with Gary Becker and Richard Posner, it is the legal person of the corporation, rather than natural persons, that is the focus of punishment. The corporation may have no body to jail, no soul to damn, and no pride to shame. But if the financial penalty is high enough, management, it is reasoned, will institute internal controls to prevent misconduct on the part of the corporation's employees and other agents for which the corporation is legally liable. In other words, deterrence will succeed if the expected punishment (the monetary penalty, discounted by the probability of being successfully detected and prosecuted) exceeds the expected gain (Becker 1968; Posner 1977, pp 165–167; Coffee 1981, pp 389–390; Coffee 1979–1980, pp 419–421).

Unfortunately, such a focus on the corporation alone is subject to serious limitations and drawbacks. Unlike the victims of personal crimes, such as robbery, who are well aware they have been victimized, the victims of corporate crimes often do not realize they have been victimized (say, by a carcinogenic product, or by the bribe a competitor passed to secure a lucrative contract). This makes such crimes hard to detect. The apprehension rates are therefore low, and the financial penalty must be set correspondingly higher to deter. If the probability of detection is 10%, and the expected gain is $10 million, then the penalty must be set above $100 million before management will have incentive to clamp down. The problem is, this can easily be above the cash resources of the firm. As John Coffee, Jr. notes, "the maximum meaningful fine that can be levied against any corporate offender is necessarily bounded by its wealth" (Coffee 1981, p 390). If the penalty needed to deter the misconduct is greater than the corporation's ability to pay, then the conduct is undeterrable. Any penalty applied would either be too small to deter, or would bankrupt the company, which judges are loath to do given the many innocents this harms—employees, stockholders, bondholders, suppliers, and consumers.[7]

This points to a further problem. Even short of bankruptcy, fines levied on the corporate entity have consequences that are primarily borne by those without culpability. Layoffs may occur and wages may be frozen or cut; the stock price will drop; the value of corporate bonds will sink; and consumer prices may rise.

In earlier eras, the harm to stockholders could be rationalized on grounds that stockholders had enjoyed the gains in stock price and dividends that flowed from the misconduct. A drop in stock price was just setting this aright. But given that shares of stock today are held on average for only 4 months before being resold (Stout 2012, p 66), while misconduct generally takes a while to detect and legal cases take a while to move through the courts, most of the price drop will be borne by those who did not benefit and who may even have been lured into the stock based on the fraudulent boost in performance. As for employees, job losses will fall disproportionately on those who will have seen no benefit from the misconduct—the lower-level and newer employees. As Coffee summarizes, this approach "[shows] mercy to the corporate executive (who is saved from the possibility of incarceration by the recommendation of a corporate focus), but it imposes a harsh penalty on the less privileged classes (such as employees, consumers, and others dependent on the corporation) who bear the indirect burden of corporate penalties" (Coffee 1981, p 408).

Finally, an underlying weakness of the Becker–Posner approach is its simplifying and unrealistic assumption that managers always act so as to maximize the corporation's value. If we open up the black box of the corporate firm, we instead find managers who keep at least one eye on their personal welfare, which may not align with the welfare of the firm. This makes the nut of misconduct even harder to crack, as consideration of the possible harm to the corporation may be outweighed by a likely benefit to themselves.

For example, corporate executives—especially those compensated heavily in stock options, which is now the norm (Lazonick 2014)—may take high-risk actions that, if successful, allow them to reap a sizeable portion of the upside (through bonuses, stock price increases, and dividend payments), but that if unsuccessful, generate significant tort damages that will be borne by the corporate entity and its spillovers (the employees, stockholders, bondholders, and

[6] See *New York Central Hudson River Railroad v. United States* (1909). For discussion, Hager (1988–1989), pp 585–611, Laufer (2006), pp 3–43 and Alshuler (2009), pp 1363–1364.

[7] Coffee also points out that high authorized penalties encourage meritless, extortionary lawsuits against corporations (Coffee 1981, pp 402–405). For example, it would be rational for a corporation slapped with a $20 million lawsuit, albeit with only a 5% chance of success, to settle for up to $1 million; and it may need to settle simply to maintain its access to the credit markets, which shy away from companies with big lawsuits hanging over their heads.

customers), of which the executive only bears a portion. This is one example of how the "financialization" of the corporation has increased the incentive to corporate misconduct. While it might be thought that boards would punish executives whose actions have brought large fines upon the corporation, this seldom happens, even when the conduct is criminal.[8]

The case of the middle manager throws up even more difficulties. Most corporate misconduct, by far, is not directed from the top, but originates with mid-level managers under pressure to get results pleasing to their superiors. For example, the time- and resource-constrained middle manager may falsify environmental or safety data, to pass off as a success the work of his team (Coffee 1981, p 397). The recent VW scandal is a typical case in this regard, involving two German managing-engineers who implemented an illegal "defeat device" as the best way, in the absence of feasible engineering solutions, to satisfy the intense pressure from the top to meet American particulate emissions standards (McElrath 2015). If the entity is fined for the misconduct, the middle manager bears even less of the cost than the executive considered above, who at least has stock value to lose. So such fines have little chance of directly deterring him. More relevant is the likelihood of his getting *fired* for the fraud. This is the most severe internal penalty executives can impose. Yet it still may not deter the crime. When a manager weighs the possibility of detection and dismissal against the likelihood of punishment and possible dismissal for failure to meet the performance target, the scale easily tips to the latter. This suggests that the Becker–Posner approach significantly underestimates the difficulty of establishing effective internal controls on employee misconduct. Only highly invasive (and resented) surveillance could rebalance the middle manager's calculation. What is more, if the fine falls only on the corporation, executives might not even wish to root out such fraud. They are its biggest beneficiaries, and they only bear diluted, mediated losses if it is detected and prosecuted.

In short, penalties levied against the corporate entity alone cannot deter conduct undertaken in disregard of the interests of this entity. In such instances, fines on the entity will fail to deter even when not above the firm's wealth boundary.

Targeting Natural Persons

The obvious alternative to punishing the legal entity is to punish the actual perpetrators, the responsible individuals. This dissolves the main problems associated with a focus on the legal entity. The wealth limitation on deterrence evaporates, as incarceration becomes an option. Spillover effects are largely eliminated. And the disjunction between personal interest and firm interest becomes irrelevant.

Unfortunately, this approach suffers from limitations of its own, beginning with the well-known difficulty of assigning blame (morally culpable causal responsibility) within organizational settings. The institutional pressures on the individual, combined with the joint nature of much decision-making, leave it genuinely unclear in many cases where blame should be placed.

In one kind of case, an order is issued from the top to perpetrate a tort or crime.[9] This is the least confounding kind of case, because there is no question that the person at the top issuing the order is culpable. The organizational setting may raise difficulties in determining the culpability of those below, who were "just following orders." But from the perspective of deterrence, this difficulty is of minor importance. The possibility of jail time for the person at the top is by itself a significant deterrent to the issuing of the order, regardless of whether the order's faithful executioners face conviction.

However, in practice, even this "easy" case is difficult to deter. For example, it is now standard practice for corporate funds to be used to indemnify executives and directors for costs they incur fighting legal suits, even when found guilty (McKeown 1968; Alschuler 2009, p 1371; Szeto and Washburn 2004), weakening the deterrent effect of legal suits. What is more, the executive or director frequently avoids the penalty itself. If the penalty is monetary, the board is likely to indemnify him. And even in cases of criminality that would normally elicit jail time, the executive is likely never to be placed in jeopardy. Prosecuting agencies such as the SEC often seek to reach a settlement, lacking the resources to pursue trials in more than a minority of the cases they bring. Typically, in exchange for a large monetary settlement, the perpetrator is not required to admit guilt as part of the settlement. Therefore, no jail time. And without a finding of guilt, the corporation may be legally *obligated* by its by-laws, or even by statute, to indemnify the executive for the monetary settlement. "Most defendants can obtain full indemnification from their corporations and escape full

[8] Coffee cites studies documenting that top executives are seldom penalized by their boards for illegal conduct (Coffee 1981, pp 408–409). The relative dearth of managerial dismissals for the financial scandals of the Great Recession suggests this remains true. Derivative suits by stockholders also face significant obstacles. This means that, as things stand, there is little internal sanction to constrain executive misconduct when external sanctions fail.

[9] An order may also be issued that leads to an unintentional tort. It is obviously difficult to deter something that was unintentional. I therefore focus on the case of intentional torts and crimes.

financial responsibility for settlements" (Szeto and Washburn 2004).

Yet as noted above, most malfeasance comes not from top management, but middle management. This pushing of malfeasance downward is a direct consequence of the "financialization" of the corporation in the pre-neoliberal sense. In the standard organizational structure of today's multi-divisional public corporation, a central office takes responsibility for strategic planning and budgeting decisions, while leaving operational control at the divisional level. Operating like an ersatz capital market, the central office sets profit targets for the divisions, and establishes accountability to these targets with rewards and punishments in the form of adjustments in salary, benefits, staff, and budget, and through promotion, or demotion, or dismissal. Managing by the numbers, headquarters leaves it to the division to figure out how to meet the targets, often with no forum to contest the reasonableness of the demands. As Coffee notes,

> Properly applied, such pressure establishes and enforces accountability without sacrificing the flexibility and adaptiveness that are the virtues of decentralization. However, this structure also permits the central headquarters to insulate itself from responsibility for operational decisions while simultaneously pressuring for quick solutions to often intractable problems (p 398).

These are the hard cases. Do we place the blame squarely on the shoulders of the middle manager, ignoring the perhaps impossible demands made upon him from above, under threat of dismissal? Or do we blame instead central management, for having applied this pressure, despite it being part of what has become normal managerial practice, and despite management's genuine lack of knowledge of the illegal conduct? Or do we apportion blame between them? And how?

Not only is the assignment of blame problematic, but so are the consequences of prosecution. Suppose one goes after the middle manager, who perpetrates the act. Unlike the case in which the entity was the target of punishment, this time around the middle manager faces a direct fine or even imprisonment. The latter is clearly worse than mere loss of employment. Unfortunately, it still may not deter him. The manager makes a new calculation, weighing the possibility of detection and jail time against the likely punishment for failure to meet his target. The possibility of incarceration certainly adds weight against misconduct. But it still might not outweigh the likelihood of internal punishment. And the possibility of jail may appear remote, while the likelihood of internal punishment is immediate (Coffee 1981, pp 409–410).

A second shortcoming of the approach is that it fails to acknowledge the portion of blame that should be accorded to the institutional pressure the manager was put under. Unjustly, it allows the manager to be made the fall guy. This points to a third problem.

Perverse organizational incentives can easily follow from a policy of prosecuting individuals. For example, a focus on prosecuting the actual perpetrator may encourage top management to distance itself even further from the operational side of the firm, since the exercise of oversight can have the consequence of passing legal responsibility upwards. Thus, if the hope of the Becker–Posner approach is to incentivize a system of internal control by punishing the entity, the opposite may be incentivized by a focus on the perpetrator. Top management may view it as safer to abandon oversight altogether, even if doing so increases the likelihood of misconduct by middle managers down the line. "Here is the result I want, and I don't want to hear how you get it." Ironically, therefore, prosecuting the perpetrator could increase the rate of misconduct, rather than deter it.

An alternative approach, which short-circuits this kind of responsibility-shifting, would be to hold those at the top accountable regardless of whether they initiated or even knew of the violation. This might capture the blame that is due for having created the institutional pressures under which the violation occurs. But it could easily go too far. No one would want to serve in an executive capacity if exposed to incarceration for actions one did not take, did not know about, and perhaps could not have controlled. Under such a legal regime, top management might double down on its strategy of responsibility-shifting and, to protect itself, spin off its operating units as separate corporations, which existing management would loosely coordinate as a holding company—exacerbating the very problem of responsibility-shifting-without-oversight that the focus on top executives was meant to solve.

Or, organizational reform might swing to the opposite extreme, with executives asserting command and control management so as to minimize the discretion that leads to violations. In most industries, this would surely be a suboptimal management style. And it would spell the end of the multi-divisional corporation, with its functional differentiation and flexibility, which since Alfred Sloan pioneered it at General Motors, has been the preferred organizational structure of the large corporation. Either way, prosecuting individuals can encourage suboptimal reorganization from a business perspective, with some reorganizations actually *increasing* corporate misconduct.

Last, but certainly not least among the limitations of the focus on perpetrators, is that the pockets of the perpetrators will seldom be deep enough to compensate the victims of the corporate harm. The entity simply must be fined if victims are to be properly compensated.

Likely, the best enforcement regime is thus some combination of all of the above—fines for entities (to generate compensation funds), and prosecution of both perpetrators

and senior executives (hopefully establishing an equipoise between the opposed managerial motives of distancing and micromanaging). But a little thought shows this is not straightforward alchemy. The best balance will be difficult to determine, and will vary from case to case, even as spillover effects, and the problem of effectively deterring middle managers, substantially remain.[10]

Targeting the Group as a Whole

Another logically possible option for holding corporations to account—although it has no presence in current law—is to hold, not the legal entity, nor specific individuals, nor even all the business associates severally, but the *group* (supervening on, but distinct from, the individuals who comprise it) to be responsible for all corporate acts and a proper object of punishment. In this approach, the associating individuals are treated as a single responsible group agent.

The idea of group agency is most closely associated with Otto von Gierke, who held the corporate association to be "no collective name for individuals, but a living organism and a real person, with body and members and a will of its own" (quoted in Maitland 1900, p xxvi).

Gierkean arguments fell out of favor in the mid-twentieth century as being objectionably "emergentist" and, when applied to the state, dangerously fascistic (although the latter charge is surely unfair) (List and Pettit 2011, pp 73–74). However, a magisterial and ingenious volume by Christian List and Philip Pettit defending, on new grounds, the reality of group agents (List and Pettit 2011), has generated renewed interest, especially among political theorists and philosophers, in the implications of treating both corporations and states as responsible group agents. Doing so, List and Pettit suggest, promises not only to provide a more realistic account of the social world we inhabit, but to improve it. Assigning responsibility to a group agent avoids the deficit of responsibility that results when no member of the group, as an individual, is culpable enough to merit punishment. It vindicates our sense that sometimes "the system" is as much to blame as any specific individuals, and thus better achieves justice (pp 166–167). Additionally, it can have a "developmental rationale," in that assigning responsibility to the group that can "responsibilize" it. That is, blaming and penalizing it can encourage organizational reform—for example, incentivize stockholders to place a check on management—making the group even more fit to be held responsible (pp 168–169).

The following section overviews List and Pettit's defense of the possibility of group agents. Sections thereafter evaluate whether business corporations are well described as group agents and, if so, whether punishing the group agent can effectively deter corporate misconduct.

Agents and Group Agents

As defined by List and Pettit, an "agent" is any system (be it a human, a robot, or anything else) that has (a) representations states ("beliefs" about how things are in its environment), (b) motivational states ("desires" about, or "intentions" toward, its environment), and (c) a processing capability that leads it to intervene suitably in its environment whenever its environment fails to match a motivating specification (i.e., does not conform to how it wants its environment to be) (p 20, p 26).

A group of individuals, List and Pettit argue, can also be an agent, and qualifies as one if it has the above three features (p 32). Of course, a group agent does not acquire its beliefs and desires in the same way as a natural person or robot. Its beliefs and desires derive entirely from its individual members. They are the "eyes and ears" of the group, and the source of its intentions (p 36). To function as an agent, the group must find an organizational form that aggregates these individual beliefs, and these individual desires, and acts on the resultants, all with "at least a modicum of rationality" (p 36)—meaning that there is at least rough accuracy in its representations of its environment, and consistency in both its representations and motivations, so that it does not undertake contradictory and self-thwarting actions (which would put in question its agency) (pp 24–25).[11]

Furthermore, although it is not a requirement for agency, it is nonetheless immensely helpful for any agent that aspires to more than a "modicum" of rational agency, to be capable also of "reasoning," so as to improve its rational performance. Reasoning so understood is distinct from rationality, although an aid to it. An agent reasons when it critically reviews its own performance, then checks its lower-level processing for sources of error and makes adjustments (for example, to its criteria for what qualifies as good evidence) so as to improve its future performance (pp 30–31). In other words, a reasoning agent attempts to self-correct when it fails to perform rationally (p 31, p 63, p 178).

It is important to note that such reasoning requires the agent to have "feedback" on its performance. List and Pettit do not explicitly state this, but they come close, and it is nicely illustrated by their discussion of the use of a "straw vote procedure" to endow a group agent with capacity for

[10] Other, more creative punishment proposals exist, from "equity fines" to corporate community service, that might further increase deterrence; but all have their limitations and their critics (Schlegel 1990, pp 30–38).

[11] It will be noted that this is a wholly instrumental, and not a substantive, conception of rationality.

reasoning. A straw vote is taken to test the prospective result of, say, an attitude aggregation, thereby allowing individual members to adjust their votes so that the official poll will meet some standard of rationality, such as consistency (pp 62–63). What List and Pettit say of this straw vote procedure is true of group reasoning more generally: it "requires 'feedback' from the group-level attitudes that are being formed [or, we may add, the group-level actions that are being taken] to the individual members involved in forming them" (p 62). Unambiguous feedback is an essential ingredient of effective self-correction.

Are Corporate Firms Group Agents?

List and Pettit see the theory of group agency as highly germane to understanding business corporations. "Shaped in an environment of commercial competition, corporations are paradigm examples of instrumentally rational group agents" (p 40).

It is a question whether this is really so. A group agent, as presented by List and Pettit, is authorized by its members (pp 35–36), with beliefs and desires—and thus goals—aggregated from the beliefs and desires of its members. This may be an apt description of business partnerships run by their partners. But it contrasts sharply with the business corporation. Authorization of the latter comes not from "members," but from the charter issued by the state, which, in addition to creating the legal entity that owns the assets of the firm, institutes a board, and authorizes the board to control these assets, hire employees, issue shares, and manage the firm in pursuit of purposes spelled out in the charter.[12] Nor does the board arrive at its beliefs and desires by aggregating the beliefs and desires of the stockholders (customarily, if awkwardly, identified as the "members" of the business corporation). Nor, for that matter, does it arrive at them by aggregating those of the employees (nor does the typical CEO, to whom the board generally delegates its operational authority). Subordinates may, at the discretion of management, participate in decisions about means, but the strategic planning of the firm is almost always top down.

Considering its autocratic structure, the corporate firm would seem to approximate what List and Pettit describe as a "degenerate" form of group agent—the dictatorship—which "can be seen as just an extension of that individual's agency rather than as a group agent proper" (p 59). Meanwhile, in its authorization, the corporate firm seems not to approximate any form of group agent.[13] However, for the sake of the argument, I set aside the issue of authorization and furthermore assume a highly participatory corporate firm.

Holding Group Agents Accountable

With respect to corporate conduct, the key question is whether it makes sense to hold the group agent responsible for corporate misconduct, separate from the responsibility that individuals might bear—such as the responsibility of the members severally in contributing to the group decision, or the responsibility of the person who performs on behalf of the group (the "enactor"), or that of the system's designers, or of the legal entity.

The present inquiry need not proceed as far as the question of whether a group agent can rightfully be held responsible, meaning *blameworthy*, for the actions of a corporate group (on which, see List and Pettit 2011, pp 153–169). We need only inquire into the merits of holding the group agent responsible, meaning *accountable* (through punishment), so as to deter misconduct.

Individuals are often held accountable, even when not culpable or blameworthy. Parents are held accountable for the actions of their children, and the "responsible head" of an organization is, at least sometimes, held accountable for the actions of subordinates, despite not being personally culpable or blameworthy, because that is where the buck stops (p 154). *Respondeat superior*. List and Pettit defend the propriety of holding the *group agent* accountable (p 155)—in effect putting it in the place of the "responsible head" of the organization. In practice, the punishment meted out to the group agent—a monetary fine or perhaps even incarceration (p 157)—will pass through to the members, since it is they who comprise the group agent (pp 163–164).[14] Nonetheless, this is logically distinct from holding these individuals accountable severally. And it may at times yield a different practical result, as the group agent may be held accountable and punished even if no individual member acts in a manner rising to the level of culpability and therefore would not otherwise receive punishment (p 165).[15]

In evaluating the merits of holding group agents accountable, there are two cases to consider: the case in which the group agent is autonomous from its individual members, and the case in which it is not.

[12] For critique of the myth that the board is authorized by its stockholders, see Ciepley (2013).

[13] It could perhaps be described as a hybrid: a charter-constrained, degenerate, state-and-group agent. But such a conceptual monster is best shot, and buried in a footnote.

[14] How the penalties are to be distributed is a difficult detail the authors leave to one side, although it would be important to the issue of deterrence.

[15] List and Pettit expressly set to the side the practical question of the best sanctions to impose upon group agents so as to regulate their conduct. But they argue that imposing sanctions can be justified and effective (p 157, pp 165–169).

The Case of Autonomous Group Agents The idea of a group agent gaining autonomy from the individuals who comprise it sounds spooky—like a Gierkean ghost in the machine. But List and Pettit offer an "unmysterious" account of this autonomy—one that is not "ontological," but "epistemological" (p 59).

"A group agent is autonomous in the relevant sense to the extent that the features that make it an agent—particularly its attitudes—are not readily reducible to the features of the individual members: again, crucially, their attitudes" (pp 76–77). In other words, a group agent is properly regarded as autonomous if its aggregation process is so complex that it becomes too difficult to trace group beliefs and desires (or "attitudes") back to the individual inputs that generated them. Indeed, as their example of a typically complex aggregating mechanism makes clear, the reduction will often be too difficult to make even for the participating members themselves (pp 77–78). This complexity leaves us no choice but to lift our gaze from the individuals to the group agent itself in order to understand it. "The agency of the group relates in such a complex way to the agency of individuals that we have little chance of tracking the dispositions of the group agent ... and to predict how it is likely to perform and what we can do to affect it, if we keep our gaze fixed at the level of individuals" (p 76). The group agent is autonomous, therefore, in that we are forced to understand its attitudes and actions without reference to the individuals who comprise it.[16]

It is at this point that misfortune strikes the theory. There appears to be a direct contradiction between a group agent's autonomy and its ability to reason.

Recall that reasoning, which aims at self-correction and improved rationality, relies upon clear feedback from group-level attitudes and actions to the individuals involved in forming them. These individuals need to know how their own inputs contribute to the group outcome, or there can be no reasoned self-correction. Yet this knowledge is precisely what they are denied when the aggregation process reaches a level of complexity and opacity that qualifies the group agent as autonomous. Feedback is lost in the organizational hairball. The reduction from group effect to individual cause cannot be made. It thus appears that a group cannot be autonomous and self-correcting at the same time. An autonomous group agent simply gets stuck at its current level of rationality and suffers the same failures over and over.[17]

This also means that punishment cannot deter an autonomous group agent. Even if it wished to correct itself going forward, it would be unable to, but would chronically generate the misconduct in question.

Additionally, although we have set to one side the question of whether group agents can be blameworthy, an inability to self-correct would seem to cast doubt on the idea. Blameworthiness presupposes that one did know, or should have known, the consequences of one's action and could have adjusted one's action so as to avoid those consequences. Both conditions are absent where the causal link between individual actions and group actions has become opaque.

Furthermore, even could an autonomous group agent be blamed, the reforming impact that blame can have, even without the sanction of punishment, is blocked when directed at an autonomous group agent, because blame will also be unable to trigger reasoned self-correction. There is no "responsibilizing" the autonomous group agent.

The above considerations do not eliminate autonomous group agents as candidates for *retribution*. But whenever their aggregation mechanisms reach a level of complexity that creates opacity, they cease to be agents that punishment can deter.

The Case of Non-autonomous Group Agents This leaves the case of the non-autonomous group agent. If group acts can be traced back to the specific inputs of individuals, such that the group can self-correct, then punishment of the group might deter. Unfortunately, this case raises a different problem. Namely, if group acts can be traced back to specific individuals, then it is unclear why one would punish the group agent rather than the specific individuals whose input made a difference, as only their input needs to change.

It might be contended that doing so is acceptable as part of "responsibilizing" the group, just as we find it acceptable to hold an organizational head accountable for the actions of subordinates. But the cases are not parallel. The organizational head has a high degree of control over the group and can be incentivized by the punishment to institute reforms. This is not true of lower-level participants. About all they can change is their individual input. And if their input is not in need of change, because it played no part in generating the misconduct, then punishing them, by punishing the entire group agent, seems gratuitous. There thus seems little advantage, and a fair amount of injustice, in meting out punishment to the non-autonomous group agent, given that it redounds to all members.

If this is so, then the better way to punish so as to deter is to punish the individuals whose input made a difference, rather than the group agent. The case of the non-autonomous group agent thus reverts to that of punishing individuals, discussed above, with the limitations already there noted. Namely, it may well have some deterrent effect, but, if an

[16] One oddity of this approach is that it would appear to make the autonomy of the group agent depend upon the perspicuity of the analyst.

[17] At best, the members could embark on a long and unhappy period of more or less blind trial and error, hoping to strike upon a patterning of inputs that leads to better outcomes. This is an aspiration to rationality, but it is not reasoning, and any improvement in performance would not be from reasoned self-correction.

individual's input produces self-serving results, then the punishment will often fall short of effective deterrence, since the expected sanction from the organization (whether award or avoided penalty) will often outweigh the remote legal consequences of misconduct.

In sum, the List and Pettit theory of group agents, and the proposal to hold the group agent accountable, appears not to offer help in deterring corporate misconduct. Either the group will not be able to self-correct, or, if it can, it will be better to focus on punishing the jointly responsible individuals (or both these individuals and the legal entity), as imperfect as this is.

Reforming Corporate Governance

The conclusion I draw from the above analysis is that we will never secure satisfactory deterrence of corporate misconduct by focusing on external regulation and punishment alone. An important supplemental approach is to reform the *governance* of the corporate firm. In other words, since it is so difficult to punish corporate misconduct effectively, we should try to reform the corporate control structure or the corporate culture so that actors are less tempted to illegality in the first place.

The Existing Approach

In a limited sense, this is already being attempted, and has been for some time. In the U.S., the creation of the Environmental Protection Agency and passage of the Foreign Corrupt Practices Act in the 1970s led some management teams to create some of the first internal corporate compliance programs, to keep their firms from falling afoul of applicable laws, rules, and regulations. Corporate compliance entered a new phase in the wake of the Enron and Arthur Anderson scandal of 2001, with a 2005 survey finding that over 50% of all ethics and compliance programs had been created since 2000. In parallel, state and federal prosecutors shifted their preferred law enforcement strategy, from prosecuting corporate entities and their human agents, to tackling malignant corporate cultures through non-prosecution and deferred prosecution agreements that establish compliance programs with external monitors (MacKessey 2010; Larkin 2013, pp 17–18).

The philosophical shift underlying the turn to compliance programs appears to me to move us in the right direction (although one might wish as a matter of enforcement strategy that compliance programs more frequently serve as a supplement to, rather than alternative to, a more traditional punitive approach). Unfortunately, however, studies find that these programs, whether voluntary or court-ordered, have had questionable impact (Baer 2009). Alschuler (2009), for example, summarizes the scholarly evaluations of "conduct codes, internal compliance structures, and training programs intended to reduce sexual harassment and increase diversity." Notably, "none of the three large-scale studies that purported to test the effectiveness of the compliance programs favored by the Federal Sentencing Guidelines indicated that these programs had reduced illegal conduct" (1386). But one need to look no further than the breadth and depth of skullduggery that led to the 2008 Financial Crisis—despite much professed dedication within the financial services industry to "compliance risk management" (MacKessey 2010)—to appreciate the limited effectiveness of the standard compliance approaches.

One much-discussed problem with such programs is that their implementation can perversely *heighten* the legal risks faced by the corporation and its employees, rather than mitigate them. In particular, legal infractions documented by a corporation's compliance officers can, through subpoena, become evidence of wrongdoing in the hands of adverse litigants (Murphy 2000). This gives management an incentive to implement compliance programs cosmetically.

But a deeper source of the limited effectiveness of these programs may be that they leave untouched the basic governance structure and compensation practices of the firm. Instead of genuinely reforming corporate governance—changing the existing incentive structure and culture—they simply attach a monitoring system thereto. Everything is left as is, but a policeman is added to walk the beat. This does nothing to change how employees would prefer to conduct themselves but for the presence of the policeman. Not surprisingly, therefore, these monitors are generally resented and, if possible, eluded. In contrast, more substantive reform of corporate governance could actually leave less internal resistance than simple monitoring, by changing the situation, and thus motivation, of corporate actors, especially of those who control.

More Aggressive Approaches

Given the apparently undiminished incidence of corporate malfeasance under existing monitoring approaches, more aggressive approaches to corporate governance reform bear consideration. There is actually no shortage of reform ideas worthy of exploration. I focus on three, all of which in some way also address the problem of corporate short-termism, which has become a drag on corporate productivity (Stout 2012). Thus, all three show promise of improving corporate conduct without adversely affecting, and perhaps improving, business performance. Aside from these specific proposals, the broader hope is to stimulate fresh interest in tackling this question of "corporate constitutionalism."

To reiterate, these proposals should not be seen as substitutes but as supplements to a punitive approach that

combines fines on the entity with the punishment of responsible individuals. None of these approaches are sufficient alone to deter corporate misconduct, and indeed they a re not sufficient even in combination, but all are part of the equation in reducing the level of corporate misconduct and the harm it imposes.

Reforming Executive Pay

The first reform idea is the most straightforward—although not politically easy to enact. It is to constrain, or ban, managerial compensation in stock and stock options, or their equivalent.

Roughly 80% of the pay of the CEOs of Fortune 500 companies now comes in the form of stock and stock options (Hopkins and Lazonick 2016, p. 45). The explosive growth of this mode of compensation, under the influence of Chicago law-and-economics and its inaccurate "principal–agent" model of the corporation (the corporation as a simple partnership of stockholder-owners), has, by design, reoriented corporate management to stock price.

The critical scholarly discussion of this development has centered on its *economic* downside: that it focuses CEOs too much on boosting short-term stock price rather than sustained growth. For example, it encourages "disgorging free cash flow" to stockholders (including the executives themselves), whether directly in the form of dividends or indirectly in the form of stock repurchasing programs. Over the past 15 years, S&P 500 companies have paid out on average over 80% of their earnings in buybacks and dividends. In the first half of 2016, it was 112%—a rate that invites comparisons with cannibalism.[18] This boosts stock price, but it is money unavailable for expansion, or for research and development and worker training, which have a longer payoff period.

But beyond this, stock compensation also incentivizes top executives to act with greater disregard for the law than when simply salaried. First, the holder of stock options, especially, reaps much of the upside but little of the downside of illegal corporate activity. If the activity elevates the stock price and goes undetected, she gains. If detected and stock price drops back down, she simply lets her options expire. So long as the illegal activity is not so egregious as to trigger dismissal or jail time, then, as discussed above, the only penalty for it will be a fine that, even if levied against the executive, will likely be paid by the corporate treasury, not by the executive.

Second, pressure for uninterrupted positive quarterly financial statements, so as to maintain the stock price, adds to the likelihood of misconduct, both on the part of the executive and the middle managers. Often the quickest and easiest way to reach a target is to cut a legal corner, or simply falsify the data one reports. The more targets to be met, the more likely a corner will be cut.

From the perspective of corporate responsibility, moving away from stock compensation aims simply to eliminate the incentives toward misconduct and public harm that stock compensation has introduced.

Co-determination

A model of corporate governance that has been garnering renewed attention from political theorists and political philosophers is "co-determination." Best known as practiced in Germany, it is also the rule in Austria and, in more modest form, across Scandinavia. Co-determination involves a dual board structure, with a managing board that is appointed and overseen by a supervisory board, fully half of whose members, in the German case, must be worker representatives.

The principal attraction of co-determination for contemporary political theorists and philosophers is that it allows for a degree of worker self-government and is security against worker domination. For those with more economic interests, its attraction is that, at least in theory, the presence of workers on the board should check the short-termism of the stockholders, because workers have a countervailing interest in the long-term viability and growth of the firm. To the extent that this is so, it should create a more hospitable environment for mutual commitments and productivity-enhancing firm-specific investments.

In this latter connection, one can at least say that few scholars of the German co-determination system have detected any compromise of economic performance compared to similarly situated firms with stockholder-dominated governance (although apples-to-apples comparison is difficult for lack of a proper control group). On the other hand, no clear and systematic improvement in economic performance has been demonstrated either (Jackson 2016, slide 33).

These consequences for worker non-domination and for industrial and political stability are worth placing in the balance in evaluating co-determination. But what I would emphasize in the present context are the "pro-social" consequences of co-determination, which are now coming to light thanks especially to the work of Gregory Jackson and his students. For example, co-determination systems have not experienced the same sharp divergence over time between average CEO pay and worker pay (Jackson 2016, slide 35), and CEO pay is more sensitive to actual performance (Jackson 2016, slide 36). Also, co-determination systems show somewhat higher corporate responsibility on the "social index," especially in areas of human rights violations and

[18] Keating (2016), citing a study by Aswath Damodaran, Stern School of Business.

leadership diversity, such as inclusion of women on boards (slide 37). These data suggest that co-determined firms do a better job of advancing the public interest in jobs and pro-social behavior than do stockholder-dominated firms. Whether they also do a better job of observing the law is an open question. The mixed composition of their supervisory boards can be expected to check the uniform pressure for stock price improvements, which, similar to the change in executive compensation, should reduce this particular source of pressure for law-breaking.[19] To my knowledge the question is unstudied, but could be a fruitful line of research.

The major caveat against holding up co-determination as a general model, however, is the dim prospect of successfully exporting it (to the Anglo-American world, for example), absent major social upheaval. Politically powerful boards and executives would fiercely oppose the loss of autonomy and customary prerogatives that it would entail. And the success and political sustainability of co-determination may depend upon its placement within a broader "coordinated economy" (for example, where wages are negotiated on an industry-wide basis, vocational training is integrated into the educational system, and national political-economic policy is relatively stable due to the dynamics of proportional representation), as characteristic of the Germanic and Scandinavian countries (Gourevitch and Shinn 2005).

Industrial Foundations

Were I to choose but one, the reform I would propose is the very simple one of allowing a majority of the voting stock of a corporation to be held by a non-profit corporation, or "industrial foundation." Such industrial foundations are especially common in Denmark, where they control 60% of the corporations listed on the main Danish stock exchange, although each foundation controls only one or a few corporations and performs best when restricted to this small number (Hansmann and Thomsen 2013, 4, 13, 38). Danish corporations under foundation control include such well-known companies as Carlsberg Beer (since 1882) and Novo Nordisk. Industrial foundations are typically established at the retirement of a company founder whose children are incapable of or uninterested in continuing the business. The foundation is established, in a sense, to perpetuate the founder's company and vision, as a personal legacy beyond the founder's lifespan. Such foundations are normally chartered for combined business and charitable purposes, although Danish law does not require a charitable component, and foundations are not mandated by law, nor normally by charter, to distribute any specific percentage of their earnings to charities, but leaves this to the discretion of the board (ibid., 4).

The result is, in effect, a dual board structure, with the foundation board, usually composed of six members, appointing and overseeing the operating board of the corporation or corporations whose voting stock it controls. The foundation board itself is usually self-elected, although it is not uncommon for a charter to require that one or more directors be chosen from among descendants of the founder, or by an independent outside organization (ibid., 5).

In Denmark, industrial foundations are lightly regulated by two government offices that police only for legality and adherence to the foundation's charter (a form of "visitation"), although with authority to replace the board in cases of gross violation of the law (p 6). By the Danish law governing non-profits, the board cannot distribute the earnings it receives to its own members. Instead, they are reinvested in the operating company or disbursed to the foundation's charitable causes. Board members receive a fixed compensation, without stock, stock options, or other incentive pay (p 6).

Reigning assumptions about managerial motivation would predict that the corporations controlled by such foundations would suffer from high "agency costs," for lack of disciplining mechanisms to focus board members on stockholder returns. The board members of industrial foundations are insulated from the market for corporate control, and from control by outside stockholders, and receive compensation insensitive to stockholder returns. Yet such agency costs are hard to detect in the empirical evidence. Foundation-controlled corporations perform as well as, or slightly better than, their more conventionally governed peers by all standard economic measures, such as return on assets and return on equity (p 6, and literature cited there). Under the above institutional specifications, the fiduciary duty of the board to the foundation's purpose appears sufficient to motivate the board members to oversee the businesses in their charge as if they personally were their owners.

I find the industrial foundation governance model especially promising for a variety of reasons. First, as Colin Mayer emphasizes in his own praise of industrial foundations, it is a device that insulates control of the corporation from the baleful influence of short-term stockholders. It allows corporations to function as they were intended—as "commitment vehicles" allowing for the long-term commitment of resources to the corporation's purpose and long-term commitment to the people who advance that purpose (employees, suppliers, investors, consumers, and so forth) (Mayer 2015). Indeed, it is likely more than coincidence that firms under foundation control are more concentrated in industries with high research and development

[19] But other pressures, unreasonably applied, can have the same result. In the case of VW, a new CEO wanted to increase sales (a more pro-worker objective than maximizing profits) to become the Number One auto manufacturer in the world, and to this end pushed engineers to meet U.S. emissions standards (McElrath 2015).

costs, such as pharmaceuticals and medical devices, as their insulation from stockholder pressure allows them to sustain such long-term investments. Additionally, foundation boards would be in a good position to discontinue the inclusion of stock and stock options in executive compensation packages, releasing hired managers, too, from stock price fixation. Unlike stockholders, foundation board members have no personal interest in bribing executives to pursue "shareholder value" when such pursuit proves to be counter-productive.

Second, as Mayer also notes, industrial foundations could mitigate the problem of rising inequality. The foundation, and not private persons, holds the majority of shares, as well as their dividends, which must either be reinvested to build the business or sent out to charity (and not spent on political ambitions, vanity projects, or controversial social engineering).

Third, the insulation of the foundation-controlled firm from short-term stockholder pressure might be expected to decrease the incidence of corporate misconduct, as discussed above. Although I have found no study of the question, one would expect less misconduct from foundation-controlled corporations if, for example, it means that operating managers are released from unforgiving quarterly performance pressures, or if the compensation packages of executives are shifted away from stock and stock options. A research study of this question might yield noteworthy results.

Fourth, industrial foundations can dampen the race to the bottom among competing jurisdictions. Management of the controlled business corporation cannot recharter or redomicile the firm simply for the reason that it would be to the management team's personal advantage. The directors of the foundation would have no interest in allowing such a move. If it would increase the overall profitability or growth of the firm, then it might be allowed. If it would simply strengthen the hand and compensation of management, then no.

Fifth, the charitable contributions that these foundations make with corporate proceeds would help restore the public benefit dimension of the corporation.

Sixth, non-profit foundation control is the one governance form that has proven capable of preserving progressive corporate governance practice across generations. Many firms over the decades have experimented, successfully, with progressive management practices with respect to workers and other stakeholders. But the record of their ability to maintain these arrangements in the face of stockholder pressure, and across changes in management and acquisition, is depressingly poor. In the mid-1980s, James O'Toole identified 23 American firms—some large, others smaller—with impressive records of socially responsible, ethical, and environmentally conscious behavior (O'Toole 1985). By the end of the 1990s, only three had fully maintained their admirable practices (O'Toole forthcoming). But it is worth noting that these three were the ones under the control of an industrial foundation or equivalent governance structure.

Finally, changing the law to accommodate industrial foundations should be politically easy. It would garner widespread support among entrepreneurs, with no clear interest groups in opposition. And the governance form should be widely exportable. Indeed, industrial foundations were once common in the U.S., until 1969, when the U.S. Congress passed tax legislation that effectively prohibited a non-profit foundation from owning more than 20% of the voting shares in a corporation, thus ending the industrial foundation in the U.S. (Hansmann and Thomsen 2013, p 5). Yet even today, a few examples survive in the U.S., including the Hershey Company (controlled by the Milton Hershey School Trust, which survived the law for idiosyncratic reasons) and an increasing number of hospitals, controlled by a non-profit foundation as part of a holding company structure unaffected by the law (pp 5–6). The industrial foundation is a successful chapter of American business history that was thoughtlessly discarded and has been almost entirely forgotten. The 20% rule is a restriction that would be well worth lifting, perhaps with other incentives added to encourage the use of the form.

Conclusion

Business corporations were never designed to pursue the public good as a matter of managerial commitment. The public was to be benefited because the service or good the business associates were privileged to provide corporately was itself of benefit to the public, and originally had to be of exceptional benefit. However, with the expansion of allowable corporate pursuits to include any legal activity, it should no longer be expected that all corporations will benefit the public in a sustained and consistent manner. Indeed, it is exceedingly difficult even to keep corporations to the law. The threat of prosecution, whether civil or criminal, and whether of the corporation or of its agents, will in many cases be insufficient. Nor would the practice of prosecuting the "group agent" improve matters.

The conclusion to which we are driven, therefore, is that punishment, while indispensable, is insufficient to keep corporate misconduct to acceptable levels. We must also look to reform corporate governance to lower the incentives to misconduct in the first place. The one step that has been taken in this direction—of encouraging or mandating corporate compliance programs—has unfortunately not appreciably lowered the incidence of corporate misconduct. This may be because it does not actually reform the corporation's governance, but just aims to monitor it. More substantive reform of corporate governance should therefore be considered.

This article weighs the relative benefits and feasibility of three possible reforms, each of which aims to address the

problem of corporate short-termism as well as the problem of corporate law-breaking: (1) the curtailment of stock-based pay for corporate executives, (2) the mandating of German-style co-determination, and (3) the making available of Danish-style industrial foundations. The three are not mutually contradictory, but of the three, the turn to Danish-style industrial foundations holds the most promise. It is politically feasible; it offers at least some promise of reducing corporate malfeasance by reducing pressure for quarterly stock price and earnings gains; and it has the greatest prospect of reviving the corporation's tie to the provision of public benefits, in that it revives the corporation's commitment to a specific purpose, can institutionalize pro-social management as part of this purpose, and introduces an ancillary commitment to provide financial support for a designated charitable cause.

Compliance with Ethical Standards

Conflict of interest The author declares that he has no conflict of interest.

Research Involving Human and Animal Participants There were no human participants in this study, nor were animals involved. For this type of study, formal consent is not required.

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