SHORTCOMINGS OF THE ARGUMENTS AGAINST MODERNIZING CORPORATE LAW

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Various kinds of arguments have been made against proposals to modernize corporate law, including the ALI Project. One argument consists of offering up the adage, "If it ain't broke, don't fix it." It is hard to know what is meant by the adage in this context. It seems to mean, don't make any changes in a legal rule, even by way of modernization, unless the relevant portion of the legal system has broken down. If that is the meaning, the argument reflects great imprudence. The adage is a caution that is well to keep in mind. There is, however, another concept of caution that is also well to keep in mind: If it isn't well maintained, it will break.

Interestingly, many of the same people who put forward the adage simultaneously urge that the Williams Act be dropped, and all tender-offer defensive tactics be precluded, although there is no indication that the market for corporate control has broken down.

A second argument sometimes made against proposals to modernize corporate law is that the need for modernization has not been empirically demonstrated. The meaning of this argument is also elusive. It seems to mean that the need for a given proposal is not empirically demonstrated unless the evidence supporting the proposal consists of quantitative economic data that is significant at the 95% level of confidence. If that is the meaning of the argument, it is wrong. With very few exceptions, those areas of life governed by law are much too complex to be adequately captured by quantitative data that is significant at the 95% level of confidence. To the extent this argument means that a law is not justified unless it is supported by such data, it would require wiping off the books almost every law that has ever been adopted.

Interestingly, many of the people who make this argument simultaneously press for abolition of the Williams Act, although there is no quantitative evidence that is significant at the 95% level of confidence to show that corporate efficiency has been reduced by that Act.

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(626)
A variant of this second argument is that the only support given for a proposal to modernize corporate law is "anecdotal evidence." People who make this argument are seriously distorting the language, by characterizing all empirical evidence, except quantitative data that is significant at the 95% level of confidence, as "anecdotal." That is nice political rhetoric but bad English. Virtually all the empirical evidence for law, including corporate law, consists of data and experience that does not rise to the 95% level of confidence, but is much more than "anecdotal."

A third argument sometimes made against proposals to modernize corporate law is that such proposals are inspired by Berle and Means, who are said to claim the managers want to line their own pockets. This is a serious mischaracterization. Most managers, like most other people, try to do their moral best, and most proposals for modernizing corporate law, including the proposals in the Corporate Governance Project, are based on that premise. (Of course, this does not mean that attention need not be paid to conflict-of-interest situations when they do arise.)

Interestingly, many of the people who make this third argument simultaneously advocate the so-called "agency theory," which does claim that managers want to line their own pockets and will do so unless repressed by some sort of formal institution.

Still another argument sometimes made against proposals to modernize corporate law is that the markets take care of most corporate law problems. It is foolish to think that the market will take care of, for example, conflict-of-interest transactions, because usually too little money is involved. If a corporation has $50 million in earnings, and somebody engages in a conflict transaction that at most is going to line his pockets with $50,000, there will be no market effect. Of course, if a corporation is operating exclusively in product markets that meet the classical requirements for perfect competition, then unfair self-dealing would theoretically result in insolvency, because there would be no margin for any inefficiency. However, few publicly held corporations conduct all of their operations in such markets. Similarly, the argument, sometimes made, that there is a market in corporate charters that has desirable effects, is not supported by reliable evidence.

Interestingly, many of those who argue that markets work perfectly, or at least very well, simultaneously argue that the Williams Act needs to be amended or dropped, and that defensive tactics need to be curtailed or eliminated, because the Act and such tactics seriously in-
terfere with the workings of the market. If the Williams Act and defensive tactics seriously interfere with the workings of the market, then the market isn’t working very well. If they don’t seriously interfere with the working of the market, why drop them?

Another argument sometimes made against proposals to modernize corporate law is the ad hominem argument that people who want to modernize corporate law are antibusiness. Like most ad hominem arguments, this one is both intellectually improverished and factually wrong. Modernization of corporate law, as embodied in the Corporate Governance Project, is intended to preserve the corporate system. In the long run, if you want to preserve that system, which the Reporters do, you’ve got to keep its legal aspects up-to-date and in good repair. That’s what the Corporate Governance Project is about.