Klein and the Contradictions of Corporations Law

Stewart Macaulay

Follow this and additional works at: http://scholarship.law.berkeley.edu/bblj

Recommended Citation
Available at: http://scholarship.law.berkeley.edu/bblj/vol2/iss1/11

Link to publisher version (DOI)
http://dx.doi.org/https://doi.org/10.15779/Z38XG5Q

This Article is brought to you for free and open access by the Law Journals and Related Materials at Berkeley Law Scholarship Repository. It has been accepted for inclusion in Berkeley Business Law Journal by an authorized administrator of Berkeley Law Scholarship Repository. For more information, please contact jcer@law.berkeley.edu.
Klein and the Contradictions of Corporations Law

Stewart Macaulay†

In the early 1950s, the Rockefeller Foundation made a major grant to the University of Wisconsin Law School. Willard Hurst won the grant in a contest with Harvard’s Lon Fuller.1 Hurst and his colleague Jacob Beuscher used these resources to develop a different kind of law faculty at their school. Some of the people they persuaded their colleagues to hire came out of government where they had served during World War II until the end of the Truman Administration. They brought practical experience with federal agencies. Others had relatively little experience, and Hurst and Beuscher hoped to influence them as they learned to be scholars. Hurst and Beuscher pushed them to break out of the conventional patterns for law professors. A film clip often run by the ESPN cable network exemplified their Wisconsin approach. The clip shows Vince Lombardi, as coach of the Green Bay Packers, yelling at his team on the field: “What the hell is going on out there?”

Professor Bill Klein and I were two of Willard’s and Jake’s young recruits to Madison.2 Sadly for me, during my forty-seven years at Wisconsin, I have watched far too many good people, including Bill, export themselves to other law schools after Wisconsin had stirred up their eccentricity.3 I am delighted to have the chance to honor Bill. First, I admire his work tremendously. Second, thinking about Bill involves memories of the eclectic group at Wisconsin when the world was new and we were all much younger.4

Bill has uncovered about thirty goals that business associations law might

† Malcolm Pitman Sharp Hilldale Professor of the University of Wisconsin-Madison and Walter T. Brazeau Bascom Professor of Law.

1. See Bryant G. Garth, James Willard Hurst as Entrepreneur for the Field of Law and Social Science, 18 LAW & HIST. REV. 37, 40-41 (2000). Garth reports a debate in the early 1950s before a committee of the Rockefeller Foundation between Fuller and Hurst. Fuller wanted to support thought about philosophy and law. Hurst, arguing against such an approach, said: “I would like to see more people dealing with the more grubby fields of law. I would like to see people come to this field not for its own sake but because they are exasperated with the tools that they have in, say, contracts.” Id. at 55. To state the obvious, I owe a great deal to Willard Hurst’s mentoring when I was a beginning law teacher not long after his debate with Lon Fuller. I got to spend some of the money the Rockefeller Foundation granted to Willard. Indeed, I was “exasperated with the tools that . . . [I had] in [the grubby field of] contracts.” I also had a wife, the late Jacqueline Macaulay, who was well into her graduate studies in social psychology and who edited my papers.

2. Bill was at Wisconsin from 1961 to 1969. I began there in 1957, and I have not had sense enough to retire or leave yet.

3. At Wisconsin, we refer to them as the “University of Wisconsin Law School Faculty in Exile,” but we do exile them to very nice places.

4. Bill and I even watched Vince Lombardi’s Green Bay Packers on television together.
seek. When asked to speak at occasions such as this, I often remember an old Duke Ellington tune: "What Am I Here For?" If I could have some background music, the band would be playing it right now. I am not entirely sure what a contracts teacher can offer here: I took a corporations course in law school, and I may have written a question dealing with it on the California bar exam in March of 1955. All I remember about that exam is my fear of failing it. I did accidentally teach a business associations course in the summer of 1958. Let me explain: given the modest salaries paid to assistant professors then, I jumped at the chance to earn a quarter of my pay for summer teaching. I thought that I would teach contracts, but at the last minute, I was assigned business associations. All I had were vague memories of such a course in the first year at Stanford. Henry Manne was also an assistant professor at Wisconsin at that time. Business associations was his thing, and he offered his notes which I accepted gratefully. Most of the time, they saved the day. One evening, however, I turned to the Manne notes and discovered they said only: “Discuss the fallacy of Berle and Means.” Needless to say, the next day I improvised wildly. I have repressed the details about that class. But that is it as far as it goes for today’s topic. All I know about corporations today is what I read in the newspapers about Enron, Martha Stewart, and Elliot Spitzer, and I did pick the brains of my colleagues at Wisconsin who teach the subject.

But I notice that I am not the only contracts teacher on the list of people invited. Maybe I will have to revise Ellington’s title to “What are WE here for?” I played detective and turned up a few clues. Bill Klein and Mitu Gulati have published a fine paper about the process of building a medical facility that shows how far it was from a traditional law school model of contract. I have heard that they think that corporations law is related to contract ideas. Indeed, I found a sentence in a recent article that said: “Professors G. Mitu Gulati, William A. Klein, and Eric M. Zolt have proposed a firm model that views

5. Some of my friends tell me that they think that Stewart Macaulay playing a part in a script by Henry Manne is an amusing idea. However, I learned much from him. Others think that the idea of Henry Manne on the University of Wisconsin Law School Faculty itself is also amusing. I know, however, that Willard Hurst enjoyed his debates with Henry. My late wife, Jackie, claimed that she was the only person who ever had won an argument with Henry, but they were the best of friends when we all were beginners at Wisconsin. Henry introduced the Macaulays to Lawrence and Leah Friedman, and so he played a large role in my career and friendship networks.

6. Henry later published his ideas in a well-known landmark article. See generally Henry G. Manne, Some Theoretical Aspects of Share Voting: An Essay in Honor of Adolf A. Berle, 64 COLUM. L. REV. 1427 (1964). However, this article came about six years too late to help me that summer when I discovered the entry in Henry’s notes.

7. I must thank Gordon Smith and John Ohnesorge. In this case, the usual caveat applies with great force. I am responsible for all mistakes. I may have misunderstood them or perhaps I just did not get it.

8. William A. Klein & Mitu Gulati, Economic Organization in the Construction Industry: A Case Study of Collaborative Production under High Uncertainty, 1 BERKELEY BUS. L.J. 137 (2004). Even before we received reprints, my colleague William Whitford had this article photocopied and distributed to all of us at our school interested in contracts.
Klein and the Contradictions of Corporations Law

collaborative economic activity as connected bargains with regard to risk, control, return and duration, and rejects the concept of "ownership" and of a centralizing nexus." Maybe this is the reason that a few contracts teachers were invited to the party. I can offer some of my approach to contracts policies and ask whether it might suggest analogies as we look at Bill Klein’s thirty or so goals reflected in business associations law.

Long ago, I tried to make sense out of the conflicts in the policy goals behind contract law. When I first arrived in Madison in 1957, I found that I had been sentenced to teach a required course in restitution. I did not even know that such a field existed. I struggled to put together the matter I was teaching in contracts with the anti-matter that I found in restitution. I used Kessler and Sharp’s casebook in contracts. It stressed the contradictions of contract law with topic headings such as "rule and counterrule: over-generalizations and over-corrections." At Willard Hurst’s suggestion, I also was reading Max Weber and understanding some small part of the master. Weber distinguished substantive from formal rationality, and he thought that capitalism needed formal rationality to minimize risk. I accepted Weber’s distinction and added what I had learned from Kessler and Sharp to organize the material that I found challenging.

I first offered my schema in a book review of a casebook, drew on it to write a critical appraisal of Justice Roger Traynor’s contracts decisions, and finally used it to think about the results of an empirical study of credit cards’ fine print matched against the duty to read and understand. It reflects the


10. See GRANT GILMORE, THE DEATH OF CONTRACT 61 (1974) ("We have become accustomed to the idea, without in the least understanding it, that the universe includes both matter and anti-matter. Perhaps what we have here is Restatement and anti-Restatement or Contract and anti-Contract.").


13. David Trubek, Reconstructing Max Weber’s Sociology of Law, 37 STAN. L. REV. 919 (1985) tells us that Weber thought only a formal system of law can be predictable. Law seeking substantive ends leads to particularistic decisions. Such decisions make it impossible for business people to know in advance the right answers to legal questions. Formal justice, Weber argues, enhances individual opportunities, promotes self-determination, and helps assure individual freedom. Trubek notes that Weber also argues, perhaps paradoxically, that formal thought in law may actually defeat the intent of transacting parties and benefit those with power and wealth. In fact, Weber suggested that completely formal thought may be impossible.


16. Stewart Macaulay, Private Legislation and the Duty to Read—Business by IBM Machine, the
contradictions of American contract law. This body of law inconsistently rests on policies that both promote the market and those that attempt to blunt it. Whatever the virtues of clear and certain rules, the American economy has developed and prospered with a large amount of contradictory rules often expressed in uncertain qualitative terms. Here is the diagram:

The Contradictions of Contract Law

| Protect, Effectuate | Supplement, Limit, |
| Enforce the Market | Replace, Correct the |
| to Achieve Efficiency | Market to Achieve |
| Other Goals |

Emphasis on: ____________________________

Goals:
- Market Functioning
- Social Planning
- General Rules
  - Decide cases by General Rules that Facilitate Efficient Operation of the Market
- Transactional
  - Look at real deal to Carry Out Intent of These Parties
- Relief of Hardship
  - Intervene to Prevent an Unacceptable Result in This Case
  - "Right" Result

- Individual Maximizing, Self-reliance, Choice: "A Deal's a Deal, but What Was the Deal?"
- Altruism, Paternalism, "Fiduciary Society"

My attorney-daughter said that her eyes glazed over when she first looked at my four boxes in this diagram. Let me offer a few illustrations for those

---

17. My colleague Marc Galanter edited the original version as he was teaching from Stewart Macaulay et al., Contracts: Law in Action (1994), and the diagram in the text reflects this. He added the descriptive material in the margins around the chart. Duncan Kennedy, Form and Substance in Private Law Adjudication, 89 Harv. L. Rev. 1685, 1686 (1976), very kindly acknowledges my approach as one of the sources of ideas in his great article.
18. I want to thank my daughter, Laura Macaulay, Senior Corporate Counsel, Ask Jeeves, Inc., for
trying to make sense of my chart. Most of those who have been to law school will recognize the market-oriented goals. The market functioning policy is beloved by corporate lawyers. They want "safe harbors." Just tell them what language will get them where they want to go. Clear, certain, and simple rules minimize transaction costs. Guard written contracts with a strict Willistonian parol evidence rule. Offer few, if any, excuses for failure to perform. Require clear-cut formation of contracts and refuse to protect reliance on a relationship created during the process that should have produced a formal bargain. The primary goal of contract law should be to fashion clear default rules so that those drafting contracts will not have to invest energy in writing particular provisions. This will minimize transaction costs.

The transactional policy runs through much of Article Two of the Uniform Commercial Code. Under this policy, courts should seek the real deal behind the paper deal. They should accept people, even highly paid business people, as they are rather than hold them to how they should be. For example, Article Two says: "[a] contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract." And "[a]greement means the bargain of the parties in fact as found in their language or by implication from other circumstances . . ." Transactional rules turn on the decision maker's judgments and intuitions informed by what she or he knows of commercial practice. All contracts are subject to a duty of good faith. This is, for merchants, "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." We excuse performance when it is made "impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made." Justice Traynor's California parol evidence rule and his approach to construing language also focus on seeking the real allocation of risk rather than a literal formal approach.

---


22. UCC § 1-201(3) (emphasis added).

23. UCC § 1-203.

24. UCC § 2-103(b).

25. UCC § 2-615(a).

Some think that the anti-market goals of contract law should not be mentioned in polite company. These goals seek to blunt that perfect institution, the market. Nonetheless, there is much regulation lurking in contract law, and this has long been true. **Social planning policy** is reflected in some fairly clear rules designed to protect people or the society from bad bargains that they might make. For example, a person under eighteen can disaffirm any contract unless it was made for those few things that the law calls "necessaries." In California, "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."  

It is not as easy to offer examples of **relief of hardship** policy. Because our national ideology tells us that a deal is a deal, we find that in our contract law there are more discretionary limited-to-the-facts-of-this-case approaches to bail out people. Courts can just misconstrue the language of a written document to reach fair results. The classic example is Portia's reading of the Shylock-Antonio contract as authorizing a pound of flesh but not a drop of blood. A more modern version involves construing contracts most strongly against the drafter. Conditions can always be implied. Waiver and estoppel are always at hand. Article Two of the Uniform Commercial Code allows a court to refuse to enforce a contract or a clause in a contract if it finds either to be "unconscionable." The statute does not define this term. The standard citation found in the Official Comment sends us to Judge Herbert Goodrich telling us intuitively that Campbell Soup's lengthy one-sided form contract with its suppliers of vegetables was just "carrying a good joke too far."

---

27. For example, Judge Richard Posner is highly skilled in transforming what some of us see as altruistic approaches into market-supporting theories. See Market Street Assocs. Ltd. P'ship v. Frey, 941 F.2d 588, 595 (7th Cir. 1991) ("The contractual duty of good faith is thus not some newfangled bit of welfare-state paternalism or (pace Duncan Kennedy, Form and Substance in Private Law Adjudication, 89 HARV. L. REV. 1685, 1721 (1976)) the sediment of an altruistic strain in contract law...").  
28. See, e.g., Halbman v. Lemke, 99 Wis. 2d 241, 244-45 (1980).  
29. CAL. BUS. & PROF. CODE § 16600 (2001). Most states, of course, have a case-by-case relief-of-hardship rule, enforcing employee-restrictive covenants only if they are reasonable as to area and duration. See, e.g., Philip G. Johnson & Co. v. Salmen, 211 Neb. 123, 128-29 (1982), which lists ten factors to balance in reviewing the reasonableness of such employee-restrictive covenants.  
30. In *The Merchant of Venice*, Shakespeare had Portia find a way to deny Shylock his pound of flesh. In form, she just enforced Antonio's promise. In substance, she denied Shylock legal enforcement of his actual expectations. As a result, *Shylock v. Antonio* may have deterred others from claiming a pound of flesh as their remedy for breach of contract. (Some rational maximizers, of course, might provide in their contract that they could take all necessary blood as well as a pound of flesh.) Shakespeare, however, never tells us whether Portia's sophisticated or sophist treatment of Shylock's contract undermined the economy of Venice. Somehow, I suspect that it did not.  
32. Campbell Soup Co. v. Wentz, 172 F.2d 80, 83 (3d Cir. 1948) ("This is the kind of provision..."
Friedman, another noted law professor who was one in our group in Madison but who also left for California, tells us: "Case-by-case decision, another alternative to legalism, is inefficient; but it flourishes in areas of law where human values are perceived as all-important."  

Obviously, these four polar approaches to contract law do not fit together neatly. Duncan Kennedy has pointed out that law professors tend to rationalize the common law as consisting of hard core rules surrounded by a soft periphery of exceptions. For example, consideration is countered by promissory estoppel. Usually, there is no rule telling us when the core and when the periphery applies or such a rule is but a vague abstraction such as Restatement section 90's phrase "if injustice can be avoided only by enforcement of the promise." Change in the balance between core and periphery comes as our legal culture shifts over time. Roger Traynor is not sitting on today's Supreme Court of California, and Frank Easterbrook is fashioning the contract law of Wisconsin from his position on the United States Court of Appeals for the Seventh Circuit. Karl Llewellyn's legal realism is not unquestionably accepted today. 

Ronen Shamir has examined Max Weber's arguments about formally rational and substantively rational styles of law in United States history. He sees a never-ending series of cycles:

[T]he interplay between ideally formal and ideally substantive law corresponds to the interplay between periods of stability and reform in the political arena.... Autonomous law is discarded when its internal tensions and inconsistencies can no longer be sustained. But in order to institutionalize and permanently root desired reforms, a reawakening of formal rationality, as a means of ensuring stability, security and predictability, is again called for. In the sphere of the economic market, this means that the same old capitalists may dominate again after such 'radical' changes as, say, the Wagner Labor Relations Act. In the legal sphere, this means
that legalistic orientations and strict formal procedures regain their power, albeit under new conditions. It is by invoking Weber's analysis that we may grasp the cycle of formal rationality—internal contradictions—substantive rationality—substantive rationality—routinization—formal rationality. Social change and progress appear, when they do, in the form of a spiral ascent: important and radical changes are introduced through substantive rationality; once in place, formal rationality, albeit on a new 'progressive' level, reappears.3

One reason for the instability and cyclic movement from formal to substantive rationality and then back again, is the way that we rationalize contract law. Despite almost a century of celebrating an objective theory and hundreds, if not thousands, of cases talking about a duty to read, contract still is supposed to rest on choice. Academic writers can brush aside the phrase "the meeting of the minds," but courts still mention it constantly because it does express an important rationalization widely accepted in society for contractual liability.

Not all contract situations are the same. When larger organizations deal with smaller ones or with consumers, they use "contract documents" that are, in substance, the statutes of private governments. Often it would be irrational to attempt to read these documents.38 Usually people ignore them and rely on norms present in relational contracts.39 These private governments raise the text of the printed form contract only when trouble arises and when means more

37. Id. at 63-65.
38. It is not just those in smaller organizations or consumers who find it irrational to read contractual documents. One of my favorite discoveries was as follows:
Kirk Kerkorian, the billionaire casino magnate, said he had only 'browsed' the papers before signing over his 13.7 per cent stake in Chrysler in support of the deal. . . . Hilmar Kopper, chairman of Daimler-Benz, DaimlerChrysler and Deutsche Bank, its biggest shareholder, said he did not look at a word of the document. . . . Jürgen Schrempp, the chief executive of Daimler and the merged group, said he relied on experts to tell him the important parts of the agreement. Bob Eaton, the chairman and chief executive officer of Chrysler, said he reviewed drafts more than once but: 'Did I read every single page and make sure that every single thing was included in every possible place it could be referred to? No, sir, I didn't.' James Mackintosh & James Politi, Car Chiefs Did Not Read Merger Papers, FIN. TIMES, Dec. 17, 2003, at 1; see also James Politi, Billionaires Need to Read the Small Print: Casino Magnate Kerkorian "Browsed" Merger Document Before Voting for Daimler/Chrysler Deal, FIN. TIMES, Dec. 8, 2003, at 18. This all came to light when Kerkorian sued Daimler-Benz for fraud based on what was said rather than what was in the printed agreement.
39. Macneil observes: "[N]o one can honestly say that consumers ought to read long documents of this kind. The many courts which over the years have casually or not so casually said that ignore the fact that if consumers actually did such a foolish thing the modern economy would come to a screeching halt." Ian R. Macneil, Bureaucracy and Contracts of Adhesion, 22 OSGODEE HALL L.J. 5, 5-6 (1984). Macneil argues that you cannot legitimate holding people to such contracts by either choice or fault. Rather, the legitimacy must come from holding people to be bureaucrats in organizations performing consumer functions such as the Ford Motor Company. This way the justification is the same as holding us to many relationships which we enter not knowing the details of what we will be called on to do, such as military service, working for a law firm, and marriage. Professor Whitford similarly distinguishes a predictive from a normative model of behavior. It is one thing to say that people ought to read contracts; it is another to suggest that many do this. He also asserts: "Sellers have long known that it is precisely in the . . . [written document called the contract] that information consumers are not supposed to notice is to be put." William Whitford, The Functions of Disclosure Regulation in Consumer Transactions, 1973 WIS. L. REV. 400, 425-26 (1973).
Klein and the Contradictions of Corporations Law

appropriate to relationships have failed. Whatever the efficiency claims for treating the document as if it had been freely agreed to, often the element of choice is just too attenuated for the comfort of a judge writing an opinion. Sometimes, we can suspect, second-class choice is accompanied by a contract clause that, as applied to the particular case, just does not seem completely, intuitively fair. Many of us will not worry about whether the expectations of a lawyer who tried to draft a license for salespeople to lie will be defeated if a court seeks the real expectations of the one tricked.

Usually we talk as if we think that there is a single thing called contract law. We talk as if it were pure abstraction independent of the type of case and parties. However, Harold Havighurst's 1934 casebook recognized that context is all important—real estate is different than employment, sales of hardware is different than contracts for services, and so on. The rule may be stated the same way in one context as another, but Havighurst argued that usually it was applied very differently. One interesting question is whether, when we get a rule applied in, say, insurance, it will spill over into other areas.

Whatever the contradictions of contract that we find at the policy level, we also must remember both "the living law" and the "law in action." Ehrlich and Malinowski helped me make sense of what I found in interviewing business people and their lawyers about contract. Long-term, continuing relations generate norms and sanctions quite apart from contract law. Ian Macneil has a rich body of, in my view, under-appreciated writing about relational contract. Moreover, the law in action makes clear that it makes

---

40. See Lawrence M. Friedman, Contract Law in America: A Social and Economic Case Study (1965).
45. See The Relational Theory of Contract: Selected Works of Ian Macneil (David Campbell ed., 2001); see also David Campbell, Ian Macneil and the Relational Theory of Contract, in id. at 3. I reviewed relational contract theory and devoted particular emphasis to Ian Macneil’s work, in
sense to sue for breach of contract only in a limited subset of all contracts disputes. Most disputes are settled. Sometimes the parties bargain in the shadow of the law, but sometimes they abandon contract rights and attempt to deal with the problem as it stands when they face it. All of the steps in litigation may be no more than part of a larger settlement process. There are all kinds of alternative dispute resolution institutions, and the richer the parties, the more options they have. Whatever policy goals law professors and judges adopt, they must recognize that they will be implemented more or less through the law in action. Indeed, the living law may push official law to one side, turning it into little more than a potential influence at best. It is just possible that substantive rationality, resting on general and uncertain terms applied intuitively by judges, may promote the best settlements as parties seek to avoid the risk that the legal system will get it wrong.

How, if at all, do the policies that I charted in my attempts to make sense of the law of contract and restitution relate to those that Bill Klein dredges up out of years of study of the law of corporations? Klein does not emphasize the Weberian conflict between formal and substantive rationality that is so much of debate about contract law. Once we accept, however, a particular policy goal, we must consider how to get to where we are going. Do we have formal predictable rules or do we grant a legal official power to apply qualitative standards seeking justice in this case? Klein includes this idea under his “Criteria Concerned with Fairness,” but I think that it will be involved in deciding whether to seek every goal on his list. For example, we can want, in good fuzzy liberal fashion, what he terms “protection of the weak.” But do we set up firm and clear rules so that those who form corporations, finance them, and run their activities can take them into account with a fair degree of certainty? Do we grant discretion to judges and regulators to upset transactions and impose sanctions when the powerful have “carried a good joke too far?” If, say, the Delaware courts deal with the responsibilities of directors and corporate officers with a concept such as fiduciary duty, are there at least working rules or does every case turn on its facts? Does the approach change over time in response to changes in the legal culture? Do we solve problems or see cycles spiraling onward?


When we look at Klein’s set of criteria, it is more complex than my simple market versus nonmarket contract goals. Corporations have long triggered more negative reactions than ordinary contracts. Michael Moore’s Roger and Me and Dilbert cartoons reflect an old and enduring part of American social culture. Corporations potentially affect more people and more interests than even a long-term continuing relationship between, say, a supplier and a customer or even employers and employees. As I read Klein, he sorts the policy goals into those that affect people who organize corporations and those who buy stock, those that seek efficiency and the minimization of transaction costs, and those that react to the economic and political power great aggregations of capital can have. The first two are something such as my market versus other-than-market goals that are found in contracts. Indeed, some of the writers who would have us treat corporation law as just a variety of contract doctrine seem to be using one of the ideological views of my subject. However, these anarchists forget how much regulation lurks in contract law—a subject too often seen as Dick and Jane simple.

Klein mentions in many places that his thirty or so goals can conflict. Part of the reason for spelling out a checklist of this sort is the urge to harmonize matters. I am skeptical, and Bill does not say that this can be done. Just as Shamir, whom I quoted above, sees the Weberian goals of substantive and formal rationality prompting cycles or an endless spiral in my field, I would expect this to be a general phenomenon. Corporation is a term that can refer to my undercapitalized start-up that makes things in my garage, or to General Motors or IBM. It matters which kinds of cases come to the courts and provoke published appellate opinions. Certain types of cases may push judges into undercutting formalism or standing fast behind the hard rules.

Of course, we all know that regulation imposes transaction costs. Regulation means government, and government means politics. We see the urge to deregulate in order to cut transaction costs and to foster competition in


50. See Richard Bernstein, “Roger and Me”: Documentary? Satire? Or Both?, N.Y. Times, Feb. 1, 1990, at C20, col. 3.; Dan Roberts, US Chief Executives Stem Increases in Their Salaries to Avoid Embarrassment, Fin. Times, Dec. 13, 2004, at 1, reports: “CEO pay is now more than 500 times that of the average American worker . . . .” Our skepticism about whether anyone is worth current executive salaries feeds a long-standing strain in American legal culture. Dilbert’s subversive messages are taped and pinned up in many business offices as a way of commenting on the absurdity of work in the 1990s and 2000s. In Dilbert those who know things are powerless; those who know nothing run corporations. From time to time Scott Adams, who draws Dilbert, deals with matters of interest to contracts teachers. One of my favorites involves contracts created by the magic of tearing the shrink-wrap on packages of computer software. In a cartoon dated Jan. 14, 1997, Dilbert is talking to Dogbert. He says: “I didn’t read all of the shrink-wrap license agreement on my new software until after I opened it.” He continues in the next panel: “Apparently I agreed to spend the rest of my life as a towel boy in Bill Gates’ new mansion.” Dogbert says: “Call your lawyer.” In the next panel, Dilbert says: “Too late. He opened software yesterday. Now he’s Bill’s laundry boy.” Dilbert cartoons are copyrighted by the United Features Syndicate.
the market. Sometimes we repeal statutes and regulations. Sometimes we just starve the enforcement agencies and appoint those with a business point of view as enforcement officials. Corporations can even dangle good jobs in the future for government officials who are reasonable. Almost inevitably, after we deregulate we get an Enron, a Martha Stewart, and a Boeing influencing government contracts to its benefit.\textsuperscript{51} And my friends who teach legal history insist that this has been true almost as long as we have had governments and corporations. Populist representatives and social action groups try to score points by exposing corporate wrongdoing. Add a muck-raking press seeking a nice scandal to entertain the audience, and we can expect almost predictable cycles of regulation, concern about costs, business lobbying,\textsuperscript{52} deregulation, scandals, exposés, crusading legislators or attorneys general of New York,\textsuperscript{53} and then new regulation.\textsuperscript{54} Sometimes the ends and means may be connected rationally, and the regulatory scheme may make sense. Often, however, the urge is symbolic, and those advocating it are grandstanding.

One can expect a law professor from Wisconsin to sneak the phrase "law in action" into his or her talk at least now and then. As I read Klein's thirty criteria, I started thinking about how the American legal system tries to implement them and what the law in action might look like. Suppose a situation where a court might decide a case involving a dispute that raises issues of corporation law. Armies of well-paid lawyers try to avoid such disputes or put language in the documents that they hope will insure that if a court gets such a case, their client will win. If the dispute comes up, corporations bargain in the shadow of the law.\textsuperscript{55} Often the costs of litigation and appeals are a major

\begin{itemize}
\item \textsuperscript{51} See Leslie Wayne, \textit{Air Force at Unease in the Capital: Questions About the Boeing Scandal Just Won't Go Away}, N.Y. TIMES, Dec. 16, 2004, at C1 ("At the heart of the scandal is a relationship between the Air Force and its main supplier, the Boeing Company, that had grown increasingly cozy.").
\item \textsuperscript{52} The Wall Street Journal reported that business groups had launched a campaign to get President Bush to replace Securities and Exchange Commission Chairman William Donaldson. Donaldson was appointed after the SEC performed poorly during the corporate accounting scandals. Donaldson has pushed for stronger regulation and enforcement. See Alan Murray, \textit{Business Groups are Seeking Ouster of SEC's Donaldson}, WALL ST. J., Dec. 14, 2004, at A4.
\item \textsuperscript{53} Compare Henry Manne's criticism of New York Attorney General Elliot Spitzer's plea bargaining approach to what he sees as the transgressions of major businesses. Henry G. Manne, \textit{Regulation "In Terrorem,"} WALL ST. J., Nov. 22, 2004, at A14 ("In an era of general acceptance of deregulation and privatization, Mr. Spitzer has introduced the world to yet a new form of regulation, the use of the criminal law as an in terrorem weapon to force acceptance of industry-wide regulations.").
\item Christopher Caldwell, \textit{An Investing Class Warrior}, FIN. TIMES, Dec. 12, 2004, at 7, examines the arguments for and against Spitzer's approach. He concludes: "Spitzer knows that, in an age when half of Americans own stock, restoring the confidence of investors is a potent electoral tool."
\item \textsuperscript{54} Andrei Postelnicu, FIN. TIMES, Dec. 15, 2004, at 21 ("Almost twice as many companies were the target of shareholder litigation in the third quarter of this year as a year ago, according to data set to be released by PwC today. The consultancy said the number of cases filed during this quarter has been the highest since it began gathering the data and puts this year on course to match 1998 and 2002 in terms of total shareholder litigation cases filed.").
deterrent to asserting rights and standing fast. The function of trials is to deter other trials. Corporations usually do not go far down the litigation path when they have a dispute with other corporations or regulators who have some teeth. They do not sue those with whom they have some relationship, and they hesitate to invite bad publicity. Over 800 of the largest corporations have taken the CPR pledge. They have agreed that if they have a dispute with another large corporation that has signed the pledge, they will attempt to mediate before they begin litigation. CPR will offer Distinguished Neutrals who can help top executives find a forward-looking solution that avoids focusing on legal rights.

Of course, there are some cases that are filed and tried. However, even when a case has gone through all of the rituals of pretrial, has been tried, then appealed, and then reversed and remanded for further proceedings, matters are likely to be settled. Even when an appeal affirms a judgment supporting a big award of damages for one side, we are often likely to see a settlement. In some cases, the bankruptcy court offers one more bargaining arena, and even the implicit threat of a trip down this road may affect a willingness to accept what seems to be the best deal going. Moreover, courts can only deal with the cases brought before them, and this is not a random process. Attempting to carry out any policy by creating individual or corporate rights and duties is too close to trying to empty Lake Mendota in Madison with a spoon. (I should tell those whose experience is limited to the right or the left coast, that Mendota is a very large lake). Even administrative agencies may be limited in their ability to be proactive and to anticipate problems. Under-funding and overload keeps most agencies from looking for trouble.

What happens to the best balance of Klein’s mutually consistent overlapping or contradictory policies when it is put through the meat grinder of the legal process in context? The policy conflict usually means that all sides will have a plausible argument, and often all sides will have a very good argument as judged by the precedents and statutory standards. Obviously, bargaining power in the dispute resolution game involves far more than just

---


plausible legal arguments based on some blend of Klein’s thirty criteria.

Moreover, as I have suggested, in the American legal system, regulation—whether attempted by courts or administrative agencies—often is far from rational social engineering. Wolf Heydebrand argues that we have moved more and more from Weber’s formal and substantive rationality to something Heydebrand calls “process rationality.”† This is a mode of governance based on the “logic of informal, negotiated processes within social and sociolegal networks.”§ These networks are not accountable to elected or appointed officials. Selective and partial enforcement means that the legislative policy underlying the regulation will be carried out only partially and unpredictably. Instead of planned social change, enforcement practice yields evasion, coping, adaptation, and some unknown degree of compliance. We may assume that problems are being solved when they are only being papered over. Process rationality tolerates diversity and indeterminacy, and it does not yield transparent, highly predictable law. We lose constitutional safeguards, and we lose both substantive and procedural rights. Moreover, some individuals and interests will be able to play the game of informal, negotiated processes better than others. Rather than imposing some restraint on power, this form of governance often amplifies the benefits of holding power. It is highly attractive to the interests of corporate and transnational governance.¶

Of course, I do not want to go too far. My late colleague and mentor Willard Hurst always warned me about pushing my skepticism into cynicism. He insisted that we notice that regulation often works. Effective regulation means that we can drink the water and the milk. Highways are planned, built, and repaired. We can rely on systems for providing telephones, water, electricity, and natural gas. Airlines and automobiles are safer than they once were. While we do not get 100%, we seldom get 0% compliance. Even when we might like more effective regulation, regulation matters to business, and business must cope with it. When courts or regulators select some mix of Klein’s thirty policies, some of it will get through and impact behavior.

What are we to conclude? The law on the books never matches the law-in-action, and the living law usually trumps formal law. Professor Klein has

58. Heydebrand, supra note 58.
59. Id. at 326.
60. Cf. Stewart Macaulay, Business Adaptation to Regulation: What Do We Know and What Do We Need to Know? 15 LAW & POL’Y 259 (1993). See also Albert Alschuler, Mediation With a Mugger: The Shortage of Adjudicative Services and the Need for a Two-Tier Trial System in Civil Cases, 99 HARV. L. REV. 1808 (1986), where Alschuler deals most critically with the situation that Heydebrand calls “process rationality.” Compare Owen Fiss, Against Settlement, 93 YALE L.J. 1073 (1984) (arguing that “[s]ettlement is a capitulation to the conditions of mass society and should be neither encouraged nor praised”), with Jane E. Larson, Informality, Illegality, and Inequality, 20 YALE L. & POL’Y REV. 137, 181 (2002) (“Viewed from the perspectives of legality and equality, the subject of informality is a minefield. Even so, lawyers and legal scholars must take the lead in formulating policy responses to informality.”).
Klein and the Contradictions of Corporations Law

performed a useful service for those who worry about the many goals the law does and might pursue in corporation law. Just providing a list suggests the overlap and conflict. Moreover, the coauthor of *Economic Organization in the Construction Industry: A Case Study of Collaborative Production under High Uncertainty* is certainly aware of the law-in-action and the living law. Nonetheless, I think it is important that law professors keep Heydebrand’s “process rationality”61 front and center as they think about corporate law as a means to attain the ends reflected in Klein’s thirty policies. In America, we promise due process or social engineering, but typically, instead we give people a deal. And the nature of bargaining means that some people will get better deals than others.

Moreover, we should not fool ourselves into thinking that we can solve problems once and for all with law-school-office-analysis. Our legal culture goes through cycles, but I predict that Americans will not soon lose their skepticism about major business corporations. American law always is messy, but we should expect this because Americans do want to have their cake and eat it too.
