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Abstract

David Yosifon's first book, Corporate Friction: How Corporate Law Impedes American Progress and What To Do About It, provides a unique perspective on the corporate purpose debate. The corporate purpose debate can be summarized as a search for the answer to a seemingly rudimentary question: "For Whom is the Corporation Managed"? Yosifon presents a well-researched argument that U.S. corporations should be managed for the best interest of stakeholders, opposed to shareholders. This distinction is known as the shareholder-stakeholder best-interest trade-of. Yosifon supports his argument with a refned analysis of the assumptions and norms that have led to a shareholder-centric model of corporate governance in the United States and its impact on "American progress."

Book Review

Corporate Friction: How Corporate Law Impedes American Progress and What To Do About It by David Yosifon[1]

CAMERON TESCHUK[2]

DAVID YOSIFON'S FIRST BOOK, *Corporate Friction: How Corporate Law Impedes American Progress and What To Do About It*, provides a unique perspective on the corporate purpose debate. The corporate purpose debate can be summarized as a search for the answer to a seemingly rudimentary question: "For Whom is the Corporation Managed"?[3] Yosifon presents a well-researched argument that U.S. corporations should be managed for the best interest of *stakeholders*, opposed to *shareholders*. This distinction is known as the shareholder-stakeholder best-interest trade-off. Yosifon supports his argument with a refined analysis of the assumptions and norms that have led to a shareholder-centric model of corporate governance in the United States and its impact on "American progress."

Yosifon's focus on "American progress" is simultaneously too restrictive and too vague for the subject matter it covers. Yosifon's discussion of America's shareholder-primacy model of corporate governance is in no way restricted in its application to the American debate surrounding the shareholder-stakeholder

1. (Cambridge University Press, 2018) [*Corporate Friction*].
2. B.Comm (Hons) (2017), University of Manitoba; JD Candidate (2021), Osgoode Hall Law School; MBA Candidate (2021), Schulich School of Business.
3. See Tom Vos, "The Corporate Purpose Debate(s) under the Spotlight" *European Corporate Governance Institute* (23 September 2020), online: <ecgi.global/news/corporate-purpose-debates-under-spotlight> (summarizing different perspectives in the corporate purpose debate).

best-interest trade-off in corporate legal theory. Save for an extended discussion of American patriotism and the odd baseball reference, Yosifon's overview of the academic and jurisprudential history of the corporate purpose dilemma and his recommended changes are equally relevant for any student, politician, practitioner, or corporate legal scholar, regardless of where their personal opinion falls along the shareholder-stakeholder primacy spectrum.

Where Yosifon's work leaves more to be desired, however, is in its definition and discussion of *progress*. Progress, in the context of corporate regulation, can encapsulate a wide array of objectives, ranging from social, environmental, psychological, and political, to economic. Despite Yosifon's early assertion that he would provide a theoretical case for the American shareholder-primacy model, which as he notes, is predominantly driven by economic objectives, that is "so fairly presented, the reader may be convinced," his theoretical case for abandoning America's shareholder-primacy model includes minimal discussion of economic objectives.[4] Instead, Yosifon's definition of *progress* is restricted to social, environmental, and political progress, with minimal discussion of potential negative impacts on economic progress.

This assertion is, in no way, meant to minimize the contribution that Yosifon's work makes to corporate legal theory. Yosifon utilizes a wide array of political and sociological theory, ranging from Adam Smith[5] to Sigmund Freud,[6] to develop a strong picture of the ideologies and normative realities that make up the infrastructure and issues of America's shareholder-centric corporate governance system. In fact, many of Yosifon's ideas were seemingly adopted by the Business Roundtable following the publication of Yosifon's book.[7] In a highly publicized statement in 2019, a group of 181 CEOs from leading U.S. companies publicly committed to move away from a shareholder-primacy model of corporate governance and instead "lead their companies for the benefit of all stakeholders."[8] This is not, however, the end of the debate. A distinction has to be made between Yosifon's work and the Business Roundtable Statement.

4. See Yosifon, *supra* note 1 at 5.
5. *Ibid* at 14, 23, 30.
6. *Ibid* at 105.
7. The Business Roundtable is an association of business leaders from America's leading corporations. See Business Roundtable, "About Us" (last visited 19 November 2020), online: <www.businessroundtable.org/about-us>.
8. Business Roundtable, "Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy That Serves All Americans" (19 August 2019), online: <www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>.

Yosifon is not just arguing that corporations *should* act in the best interest of all stakeholders, but that directors should have a *legal duty* to act in the best interest of stakeholders.[9]

A jump from a discussion of the problems with the current system to a recommendation that America should adopt a stakeholder-primacy legal system of governance, as Yosifon argues,[10] requires a more significant discussion of the economic-sociological trade-off than is present in *Corporate Friction*. Accordingly, Yosifon's work reads more as a well-researched counter-piece to the predominantly shareholder- and economic-centric literature in American corporate legal theory than as a stand-alone piece that can convince a reader (or regulator) that the United States should abandon its shareholder-centric model of corporate governance in favour of a regulatory framework that promotes the interest of all stakeholders.

My tendency to emphasize the limitations of Yosifon's argument, which stem from a lack of economic analysis, may reflect my own personal bias as to the appropriate balance of effectively weighing economic and social trade-offs in the corporate governance debate. On this point, I would like to borrow a sentiment from Yosifon directly, that the highest form of flattery in academia is not imitation, but rather critique.[11] Yosifon's stakeholder-primacy solution presented in *Corporate Friction* and his criticism of the shareholder-centric approach present a strong argument in support of the need for changes in America's corporate governance framework. I hope that my own criticism of Yosifon's proposed solution is read, not as an assertion that his stakeholder-primacy model is unachievable, but rather that it is insufficiently supported based solely on the arguments presented in *Corporate Friction*.

Yosifon's primary argument is that "the law presently requires directors to work 'hard and honestly' on behalf of shareholders."[12] We should say instead, he continues, that directors should "work hard and honestly on behalf of all corporate stakeholders."[13] The definition of other "stakeholders," which Yosifon purposefully does not restrict, includes, in addition to shareholders: employees, consumers, the environment, and the nation.[14] Yosifon's argument that corporate directors should have a legal duty to act in the best interest of all stakeholders,

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9. Yosifon, *supra* note 1 at 175-76.
10. *Ibid* at 175-78.
11. *Ibid* at 71.
12. *Ibid* at 175.
13. *Ibid* at 175-76.
14. *Ibid* at 180.

as opposed to just shareholders, is on its face, relatively straightforward, and not particularly novel amongst left-leaning corporate legal scholars.[15] The predominant debate surrounding corporate governance scholarship, and the central focus of Yosifon's work, instead lies in the establishment of the underlying premises and assumptions that support this claim.

The standard logic of any argument to expand the breadth of corporate director duties to consider the best interest of stakeholders other than shareholders can be simplified as follows. The initial premise is that the current law requires directors to focus only on shareholders' wealth-maximization.[16] Taking this as a starting point, it must then be established that the model creates negative externalities as corporations create additional costs that are not borne by shareholders.[17] The strongest aspects of *Corporate Friction* are Yosifon's establishment of each of these premises, and the disputes with scholarly attempts to undermine them. The more challenging assertion to establish is that these negative externalities should be mitigated by imposing a *legal duty* on directors to equally weigh the interests of external stakeholders. This raises the question of whether a legal duty, enforced via director liability, is the best method of mitigating the negative externalities borne by external stakeholders.

To support this conclusion, two key assumptions need to be proven. First, it must be shown that the reduction of negative externalities to external stakeholders are not offset by equal or greater negative economic externalities, such as reduced job creation, higher costs of capital, or increased litigation under the stakeholder-primacy model. Second, it must be established that there are no alternative mechanisms to reduce the negative externalities that may result in fewer negative economic externalities than shifting to a stakeholder-centric model. Perhaps the biggest strength of *Corporate Friction* is Yosifon's discussion of the latter, while its glaring weakness is minimal discussion of the former. The remainder of this review discusses in more detail the strengths and weaknesses of Yosifon's take on the four primary assumptions that underline the argument for a shift from a shareholder-centric to stakeholder-centric model of corporate governance.

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15. See *e.g.* Frederick Post, "The Social Responsibility of Management: A Critique of the Shareholder Paradigm and Defence of Stakeholder Primacy" (2003) 18 Mid-Am J Bus 57.
16. This premise is not universally accepted in the scholarship. Yosifon dedicates a significant portion of his book to developing an argument for why this is the case. See generally Yosifon, *supra* note 1 at 61-95.
17. "Negative externalities" refers to external costs that are borne by third parties opposed to the cost creator.

Yosifon's first assertion, that American corporate governance law requires directors to solely consider shareholder interests,[18] is not a given in corporate legal theory. Many critics of the stakeholder-primacy argument assert that U.S. law, as it stands, already permits directors to consider other stakeholders.[19] This is supported in cases where courts have upheld directors' decisions to make considerable charitable donations without violating their fiduciary duties.[20] Yosifon effectively rebuts these assertions by exploring the case law wherein the legality of these actions is affirmed by courts. Yosifon notes that each of the affirmations are prefaced by acknowledgment that the charitable or political actions were performed with the purpose of increasing shareholder value through improved relationships with stakeholders.[21] In doing so, Yosifon distinguishes between *actions* and *purposes* of corporate directors. Yosifon's argument is rooted in this distinction between actions and purpose. The American corporate governance regime permits *actions* that promote stakeholder best-interests, but only if they are done with the *purpose* of promoting shareholder best interests (*i.e.*, profits).[22] In order to achieve the desired social progress associated with a shift to a stakeholder-primacy model of corporate governance, Yosifon asserts that the law must be extended to require directors to put stakeholder interests first, or at least on equal footing with shareholders in certain situations where the proposed actions may not be in the best interest of shareholders.[23] This represents a change in the *purpose* of director decision-making, as opposed to just extending the allowable actions available to directors.

The above distinction, between scenarios where stakeholders and shareholders are aligned and those where they are conflicted, represents the second premise of Yosifon's argument: the shareholder-primacy model creates negative externalities for external stakeholders when stakeholder and shareholder goals are distinct.[24] One of the common arguments in support of the current shareholder-primacy model is that directors will necessarily consider other stakeholders (*e.g.*,

18. Yosifon, *supra* note 1 at 17.
19. See *e.g.* Lymna Johnson & David Millon, "Corporate Law After Hobby Law" (2014) 70 Bus Lawyer 1; David Millon, "Two Models of Corporate Social Responsibility" (2011) 46 Wake Forest L Rev 523; Christopher M Bruner, "Corporate Governance in a Time of Crisis" (2011) 36 J Corp L 309; Andrew S Gold, "Theories of the Firm and Judicial Uncertainty" (2012) 35 Seattle UL Rev 1087. Yosifon specifically references and rebukes these critics in the fourth chapter of his book. See Yosifon, *supra* note 1 at 72-74, 80-82.
20. See *e.g. Theodora Holding Corp v Henderson*, A (2d) 398 (Del Ch 1969).
21. Yosifon, *supra* note 1 at 85-87, 91-92.
22. *Ibid* at 61-95.
23. *Ibid* at 177-78.
24. *Ibid* at 18-19, 138-39.

employees, the environment, and consumers) when acting in the best interest of shareholders, as positive long-term stakeholder relationships will drive long-term profits for shareholders.[25] Yosifon acknowledges that this is often the scenario in the shareholder-primacy model, but makes it clear that his work is focused on eliminating the exceptions where this is not the case.[26] He uses events such as the 2008 Global Financial Crisis, the Volkswagen Emissions Scandal,[27] and the decision to close domestic factories in favour of outsourcing production to jurisdictions with weaker labour standards, as examples of times where external stakeholders bore, and continue to bear, the cost of corporate director decisions to prioritize short term profits.[28] You would be hard-pressed to find a corporate governance scholar, even those stoutly in favour of shareholder-primacy, that does not believe these negative externalities exist in a shareholder-primacy corporate governance system. The ongoing debate concerns the extent to which negative externalities can be eliminated with changes to the shareholder-primacy corporate governance framework, and whether a shift to a stakeholder-centric model may reduce some of the positive externalities created by the shareholder-centric model.

Critics of the stakeholder-primacy model that Yosifon defends argue that there are alternative methods to effectively minimize negative externalities without removing the economic benefits of shareholder-centric corporate governance regimes.[29] Perhaps Yosifon's strongest contribution to corporate governance legal theory is his strong refutation of each of these claims. One of the most commonly supported alternative mechanisms is the use of non-corporate regulations, such as labour laws and environmental laws, to control corporate behaviour.[30] The argument is that the purpose of corporate law is to promote efficiency and effectiveness of business entities, and any resulting negative externalities that outweigh the benefits should be individually dealt with using legislation external to corporate charter regulation. Yosifon argues, however, that different stakeholders are not on equal footing with corporations to lobby for changes to

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25. Yosifon refers to this as the "Pareto fallacy of corporate profitability" and discusses it at length in chapter 2. *Ibid* at 18, citing Richard A Posner, *Economic Analysis of Law*, 5th ed, (Wolters Kluwer Law & Business, 2007).
26. Yosifon, *supra* note 1 at 18-19.
27. The Volkswagen Emissions Scandal refers to Volkswagen's use of vehicle software to evade environmental emissions standards. See Russell Hotten, "Volkswagen: The Scandal explained" (10 December 2015), online: *BBC News* <www.bbc.com/news/business-34324772>.
28. Yosifon, *supra* note 1 at 17, 146-47, 154.
29. *Ibid* at 30-31.
30. *Ibid.*

legislation.[31] The legal benefits granted to corporations via corporate law place them in a superior position to accumulate wealth, compared with individuals. Based on the U.S. Supreme Court's ruling in *Citizens United* protecting corporate political advertisements under free speech rights,[32] corporations, according to Yosifon, are in a superior position to accumulate wealth and use it to lobby for legislation that will promote corporate (shareholder) interests.[33] Yosifon does not, however, argue that *Citizens United* should be overruled and that the United States should adopt legislation similar to that of comparable foreign jurisdictions which limit corporate political speech. He argues that free speech, including corporate political speech, is paramount to the functioning of liberal democracies.[34] He proposes that the most effective way to resolve this dilemma is to change corporate law so as to require that corporations use their political lobbying power to promote the interests of all stakeholders.[35]

The second common alternative to stakeholder-primacy regimes that advocates of shareholder rights allude to, is the ability of markets, particularly labour and consumer markets, to monitor corporate behaviour and punish corporations that sacrifice stakeholder interests in favour of shareholder profits.[36] Based on this theory, firms that put shareholder profits ahead of their employees or customers will lose talented employees and future sales, thereby reducing corporate profits. Accordingly, the ability of labour and consumer markets to utilize their market power to control corporate behaviour will align the best-interests of shareholders with those of other stakeholders. To rebut this argument, Yosifon cleverly draws on similar logic that has traditionally been used to support a shareholder-primacy corporate governance model. He argues that the ability of consumer and labour markets to control corporate behaviour requires the complete dissemination of information between all parties.[37] The same agency argument, which cites information asymmetry between shareholders and managers as the driving force behind shareholder-centric regimes, is extended to external consumers and employees to support a stakeholder-centric regime. Yosifon argues that there is an inherent agency problem that impacts the ability of workers and consumers to assert their market power, based on the control of

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31. *Ibid* at 32.
32. *Citizens United v Federal Elections Commission*, 130 S Ct 876 (2010) [*Citizens United*].
33. Yosifon, *supra* note 1 at 42-44.
34. *Ibid* at 41-44.
35. *Ibid* at 38-39, 56.
36. *Ibid* at 26-28.
37. *Ibid* at 22.

corporations over the information that they provide to external stakeholders.[38] Under the stakeholder-primacy regime put forth in *Corporate Friction,* a corporate director's fiduciary duty should be extended to external stakeholders in order to overcome the agency problem associated with asymmetric information between corporations and their external stakeholders.[39]

As noted above, there are two key assumptions required to support a transition from a shareholder-centric to stakeholder-centric model of corporate governance. The first is that the negative externalities eliminated by the shift to a stakeholder-primacy approach are not offset by reduced positive externalities associated with shareholder-primacy governance models. Second, there are no alternative methods that more effectively balance these competing interests.

Yosifon convincingly discusses why alternative theoretical models of corporate accountability are ineffective at reducing the negative externalities associated with shareholder-primacy.[40] Upon doing so, however, he errs in his inference that this is sufficient to support the conclusion that a stakeholder-centric model should be implemented without considering the stand-alone merits of his recommendation. This is not coherent. Even if a reader accepts his argument that a stakeholder-primacy model is the best way to reduce the negative externalities associated with shareholder-centric corporate governance regimes, this does not entail the conclusion that it is necessary to adopt such a model. Advocates of the current shareholder-primacy model do not necessarily assert that there are no external costs to the system, but rather that the positive externalities of the system that promote job creation, lower cost of capital, and increased tax revenue outweigh the external costs.[41] Supporters of external (non-corporate law) solutions to corporate law's negative externalities do not view them as preferential solely because they are more effective at reducing negative externalities than stakeholder-primacy models, but because they can more effectively address the concerns without eliminating the positive externalities associated with shareholder-centric corporate governance regimes.[42]

The argument that the United States should abandon its shareholder primacy model in favour of a stakeholder-centric model requires an attempt to quantify the net benefits and costs (economically and socially) of shifting

38. *Ibid* at 129-30.
39. *Ibid* at 177-78.
40. See generally, *ibid*, c 1-2.
41. See *e.g.* Henry Hansmann & Reinier Kraakman, "The End of History for Corporate Law" (2001) 89 Geo LJ 439.
42. *Ibid*.

corporate governance regimes. This discussion, particularly regarding economic effects, is missing from *Corporate Friction.* While Yosifon acknowledges the potential for a reduction in positive economic benefits, his primary response is that foreign capital markets have adopted a more stakeholder-centric approach to corporate governance and still maintain strong capital and labour markets and even report stable foreign investment from U.S. investors.[43] In his discussion of foreign markets, Yosifon acknowledges the different normative cultural regimes, historically developed in each jurisdiction, that place them in a unique position to adopt a multi-stakeholder approach to corporate governance.[44] In his discussion of how foreign multi-stakeholder regimes can be used as evidence that a similar regime can be successfully implemented in the United States, however, Yosifon fails to discuss how specific U.S. cultural differences may influence the extent to which a shift in corporate governance law will have a differing impact on U.S. economic progress compared to foreign jurisdictions.[45]

In addition to possible differences in economic effects, entrenched corporate legal and cultural norms may inhibit the ability of U.S. corporations to effectively implement a multi-stakeholder corporate governance regime in a manner that reduces the negative externalities that Yosifon is targeting in his recommended corporate governance system. To account for cultural differences, the United States would likely need a customized stakeholder-centric corporate governance regime that is integrated with the existing legal system and different from comparable foreign alternatives. Yosifon proposes a system whereby directors are required to equally weigh the interests of shareholders and other stakeholders, with a strong deference accorded to the business judgment of directors in court challenges.[46] While simple in theory, the application is complex. Yosifon's proposed system of stakeholder-primacy paired with director deference creates an inherent risk that directors with engrained opinions on the importance of shareholder primacy, whose decisions will be protected under the business judgment rule, will continue to prioritize shareholder interests. It may also have the effect of magnifying the problem if shareholders use their voting power to elect directors with a pro-shareholder mindset. Under a worst-case scenario, this may result in a corporate legal regime whereby the de jure corporate governance laws increase the

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43. Yosifon, *supra* note 1 at 185, 197.
44. *Ibid* at 148, 166.
45. For example, as noted by Yosifon, U.S. corporate shares are more likely to be widely held and the concept of shareholder-primacy has been entrenched in U.S. market culture. *Ibid* at 165-67.
46. *Ibid* at 178.

shareholder agency problem and deter investment, but the de facto application of directors' business judgment will still prioritize shareholder interests and create negative externalities for external stakeholders. This could result in a governance model where litigation and legal costs increase, but no substantive changes are made in favour of external stakeholders.

My introduction of the worst-case results of Yosifon's recommendation is not meant to assert that Yosifon's ideas on corporate governance are incorrect. I am unwilling to go so far as to say that a multi-stakeholder approach to corporate governance would result in more harm than good. Instead, my assertion is that any argument recommending that the United States abandon its longstanding position that shareholder-primacy is the ideal model of corporate governance in favour of a multi-stakeholder approach, must be supported by a full cost-benefit analysis that considers both economic and social objectives in the context of the unique U.S. economic and cultural history. *Corporate Friction* offers a well-thought-out critique of the shareholder-primacy model of corporate governance, but its limited economic analysis prevents it from acting as a stand-alone argument that supports rejecting the current shareholder-centric regime in favour of a stakeholder-primacy legal governance model, as Yosifon intends. The net result is that *Corporate Friction* presents a valuable contribution to the current debate on the role of corporate law in promoting societal progress, but it should be read as one element of this debate—not as the final answer.