7

Antitrust by Interior Means

Ramsi A. Woodcock

7.1 INTRODUCTION

Monopoly is fundamentally a problem of imbalance of power among a firm's counterparties: the suppliers, workers, managers, shareholders, and consumers who do business with the firm.[1] The archetypical monopoly oppresses a particular counterparty – consumers – by charging them high prices for the products they buy from the monopoly.[2] In this case, consumers suffer, and one or more of the firm's other counterparties benefits: shareholders if the additional profits are paid to them as dividends; workers if the additional profits are paid to them as higher wages; suppliers if the additional profits are paid to them as higher supply prices; and managers if the additional profits are paid to them as higher executive compensation. But a firm can monopolize any of the markets in which the firm does business, not just the consumer-facing markets into which the firm sells its products.[3] The firm can monopolize – technically, monopsonize[4] – supply markets,

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1 A synonym for 'counterparties,' as the term is used in this chapter, is the term 'patrons' employed by Henry Hansmann in his work. See H Hansmann, *The Ownership of Enterprise* (The Belknap Press of Harvard University Press 1996) 12. The category of firm 'stakeholders' is somewhat broader because it includes victims of a firm, such as community members affected by pollution, who do not voluntarily do business with the firm. See R Edward Freeman and others, *Stakeholder Theory: The State of the Art* (Cambridge University Press 2010) 40–42. Through damages awards, courts effectively set the price at which such 'involuntary' counterparties do business with the firm. Because courts can set the price fairly, the governance alternative to antitrust described in this chapter is not needed to address problems of monopoly pricing in such involuntary markets. See R Woodcock, 'The Antitrust Duty to Charge Low Prices' (2018) 39 Cardozo L Rev 1741, 1764–66.

2 See H Varian, *Intermediate Microeconomics: A Modern Approach* (7th edn, WW Norton & Company 2006) 423–24.

3 See *ibid*. at 471–77.

4 For the sake of brevity, the term 'monopoly' and its derivatives will be used here to refer to market power whether exercised on the sell-side or the buy side. In the case of exercise of buyside power, the proper term is, technically, 'monopsony'.

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labour markets, management markets, and even the market for investments in which shareholders compete (though that is unlikely because capital markets are so large).[5]

Every market monopolized by a firm is an opportunity for the firm to oppress the particular counterparty that stands on the other side of the market from the firm by charging the counterparty monopoly prices. In the extreme case in which the firm monopolizes all of the markets in which the firm does business – supply markets, labour markets, management markets, investment markets, and product markets – the firm has the ability to oppress all of its counterparties. Which counterparties will the firm actually oppress or, more to the point, which counterparty will the firm not oppress and will thereby benefit from the oppression of the other counterparties? Some party must benefit, as the firm is just the sum of its counterparties, a nexus of contracts, and cannot oppress for its own independent benefit.

The counterparty that the firm will favour is the counterparty that dominates the governance of the firm. That controlling counterparty will be able to induce the firm to charge monopoly prices to other counterparties but not to itself, and indeed will induce the firm to transfer the firm's monopoly profits to it. Therefore, not one but two sorts of power determine whether a firm will exercise monopoly power. First, the firm must actually have monopoly power in some market (with monopoly power defined as the ability profitably to manipulate the prices charged to the counterparty in that market).[6] Second, some other counterparty of the firm must have sufficient power over the governance of the firm to then induce the firm to exploit its ability to charge monopoly prices by actually charging them and then turning the resulting profits over to the controlling counterparty. In the classic case, the firm that charges consumers high prices does so only because (1) the firm has a monopoly position in the market in which the firm sells its products and (2) shareholders of the firm – counterparties in the market for financing in which the firm also participates – use their control over the governance of the firm to insist that the firm charge consumers the highest possible prices and turn the resulting profits over to shareholders in the form of dividends or share buybacks.

The law, therefore, has not one but two possible ways of dealing with the problem of monopoly. The first is to prevent firms from acquiring monopoly power in

[5] See Hansmann (n 2) 54 (observing that '[t]he capital market today is so large relative to the size of any individual firm that no firm has market power as a borrower of capital.'). A firm can nevertheless always interact with shareholders as would a monopolist because shareholders cannot withdraw their funds from the firm – they have no general right to return of capital and so are locked into the firm. See *ibid* at 71–72. Selling their shares is no alternative, for they can obtain their investment from a share buyer only if the buyer can expect the firm to pay out the same amount or more on the shares in future in the form of dividends or buybacks.

[6] See J Kirkwood, 'Market Power and Antitrust Enforcement' (2018) 98 BU L Rev 1169, 1172.

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markets. That is the traditional role of antitrust law. But antitrust is an imperfect fix because often monopoly power results from superior performance, rather than anticompetitive conduct, and, in such cases, antitrust cannot intervene to eliminate monopoly power without running the risk of slowing economic growth.[7] The second way of dealing with the problem of monopoly is to prevent any one counterparty of the firm from acquiring so much power over the governance of the firm as to be able to direct the firm to charge monopoly prices to counterparties in markets in which the firm has monopoly power. The great advantage of this second, governance-based solution is that, unlike antitrust laws, it can be used to stop monopoly pricing even when the firm has acquired its monopoly position through superior performance and the elimination of that position would therefore be destructive.

But how to prevent any one counterparty from taking control over firm governance? None of the familiar approaches to governance fits the bill. Shareholder-run firms give shareholders control.[8] Employee-run firms give employees control.[9] Consumer cooperatives give consumers control.[10] Supplier-run firms give suppliers control.[11] Management-dominated firms give managers control. The solution proposed here is to give each major category of counterparty apart from managers – workers, shareholders, consumers, and suppliers – an equal vote in the election of the corporate board that manages the firm. Thus, management will be checked by the other counterparties, and the other counterparties will check each other. This approach will tend to leave managers with a lot of discretion, because oversight will be dispersed among firm counterparties rather than concentrated in one. But it will also provide a democratic check on any attempt by one counterparty to exploit the firm's monopoly power to oppress the others, one that does not exist when only one counterparty dominates firm governance. The benefit of less exercise of monopoly power may outweigh the cost of less oversight over management.

The fact that the exploitation of monopoly power divides counterparties by enabling some to take from others, combined with the fact that monopoly can strike any market, making all counterparties potential victims of the exploitation of monopoly power by the firm, means that counterparties as a group have an interest in working together to block the exploitation of monopoly power in relation to any one counterparty, much the way a country's citizens have the incentive to oppose the oppression of any one group of citizens by any other because all are potentially vulnerable to abuse. Counterparties can express this common interest, however, only if they all have a voice in firm governance.

[7] See *United States v Aluminum Co of America* 148 F 2d 416, 429–30 (2d Cir 1945); R, 'The Obsolescence of Advertising in the Information Age' (2018) 127 Yale LJ 2270, 2309–14; R Woodcock, 'Digital Monopoly without Regret' [2020] (1) Concurrences 53, 54–55.

[8] See Hansmann (n 2) 53–66.

[9] See *ibid*. at 66–120.

[10] See *ibid*. at 149–68.

[11] See *ibid*. at 120–49.

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7.2 USING CORPORATE GOVERNANCE TO PREVENT THE EXPLOITATION OF MONOPOLY POWER

7.2.1 *The Exploitation of Monopoly Power by Firms as a Function of the Governance Power of Counterparties*

To see why corporate governance determines whether a firm will exploit monopoly power, consider how wealth is distributed between the counterparties of a firm.

All transactions create surplus understood as the difference between the value the buyer places on the goods and the necessarily lower value the seller places on them.[12] Price divides the surplus between buyer and seller.[13] Netting the firm's cash inflows and outflows gives the overall amount of surplus kept by the firm through all of its transactions in all of the markets in which the firm does business. The rest of the surplus goes to each of the firm's counterparties. Thus, the worker who would work for $7 but is paid $12 by the firm takes $5 in surplus. The consumer who would pay $20 but is charged $18 by the firm takes $2 in surplus, the supplier who would sell for $1 but is paid $2 by the firm takes $1 in surplus, and so on. This calculus applies even to the firm's suppliers of cash qua commodity, the shareholders.[14] The shareholder who would invest $10 for a 10% return of $1 but receives the equivalent of a 20% return in the form of $2 in dividends takes 10% – $1 – as surplus.

In competitive markets, the surplus taken by counterparties of the firm through the markets in which they transact with the firm is fixed because the firm has no power to vary the prices the firm charges in competitive markets.[15] The competitive price guarantees counterparties a certain level of surplus that the firm cannot eliminate.[16] If $12 is the competitive wage, the firm cannot pay $11, because then workers would go to work for the firm's competitors instead. If the competitive product price is $18, then the firm cannot raise the price to $19, because then consumers would buy from competitors instead. If the competitive supply price is $2, then the firm cannot pay $1 because then suppliers would supply to the firm's competitors instead. If the competitive rate of return is 20%, then the firm cannot pay a 10% return to shareholders, because then investors will not buy any new shares that the firm wishes to sell and will invest in competitors instead.

[12] See R Woodcock, 'The Antitrust Case for Consumer Primacy in Corporate Governance' (2020) 10 UC Irvine L Rev 1395, 1403–09.

[13] This follows immediately from the basic definitions of consumer and producer surplus in partial equilibrium. See H Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice* (6th edn, West Academic Publishing 2016) 6.

[14] See D Greenwood, 'The Dividend Puzzle: Are Shares Entitled to the Residual?' (2006) 32 J Corp L 103, 117 ('[T]he stockholders [are] a factor of production that has sold capital to the firm[.]').

[15] See Varian (n 3) 289.

[16] See *ibid.* at 410–12.

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The competitive price also guarantees the firm a certain level of surplus – the profit that the firm makes in competitive markets.[17] As a surplus, this profit is technically not necessary to make the firm function.[18] It represents the excess of receipts over the payments the firm must make to counterparties in order to operate. But, despite representing an excess in receipts over the amount needed by the firm to function, this profit is not due to monopoly – not a monopoly profit – because it is earned in competitive markets. Instead, this profit is due to scarcity, the fact that the firm's other counterparties are more productive than those with which the firm's competitors contract. The profit the firm earns in competitive markets is therefore properly called scarcity rent.[19]

The counterparty that dominates the governance of the firm takes this scarcity rent. In an investor-owned firm, that counterparty is the shareholder, whose right to the firm's share of the surplus – the firm's profits – is known as the shareholder's right to the 'residual' earnings of the firm.[20] Thus, the investor of $10 who would be perfectly happy with a competitive $2 return on this investment nevertheless takes an additional $4, $20, or $100 – whatever the amount of the scarcity rents generated by the firm may be. Corporate governance and tax scholars debate what should be done with those scarcity rents.[21] Putting workers in control of the firm would ensure that workers take them. Putting consumers in control of the firm would ensure that consumers take them. Allowing managers to manage without supervision from other counterparties would ensure that managers take them. A properly designed corporate tax would ensure that the government takes them.[22] And so on.

But we are not concerned in this chapter with the distribution of the surplus generated by the firm in competitive markets. Monopoly interests us. Suppose, therefore, that the firm monopolizes at least one of its markets. Monopoly power is the power to dictate price, and so it is the power to extract more surplus from a counterparty than the firm would be able to extract in a competitive market. The firm can now pay the worker $7, charge the consumer $20, pay the supplier $1, or pay the shareholder a 10% return, for example, depending on which market the firm monopolizes. But will the firm actually exercise its monopoly power and extract

[17] See *ibid.* at 412–14.

[18] See Woodcock, 'The Antitrust Case for Consumer Primacy in Corporate Governance' (n 14) 1413–15. The seller necessarily places a lower value on the goods, otherwise the buyers would not be willing to pay a price that the seller would accept.

[19] See D Teece and M Coleman, 'The Meaning of Monopoly: Antitrust Analysis in High-Technology Industries' (1998) 43 Antitrust Bull 801, 819–20; R Woodcock, 'Antimonopolism as a Symptom of American Political Dysfunction' (2021) Social Science Research Network Working Paper No. 3864585 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3864585 accessed 7 July 2021.

[20] See Hansmann (n 2) 11.

[21] See generally L Kaplow, *The Theory of Taxation and Public Economics* (Princeton University Press 2011); Hansmann (n 2).

[22] See Kaplow (n 23) 236–38.

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extra surplus from the counterparty in the market that the firm monopolizes? This is where corporate governance meets antitrust. If the counterparty in the market monopolized by the firm has control over the governance of the firm, then the answer is no. The firm will not exploit its monopoly power to extract additional surplus from the counterparty. If the firm monopolizes capital markets (to pick an unlikely example), and shareholders are willing to accept a minimum of a 10% return, then the firm could insist on paying only that 10% return, rather than the 20% that the firm would pay in a competitive capital market. But if the shareholders are in control of the firm, that will not happen. Instead, shareholders will continue to pay themselves the 20% competitive return, plus any scarcity rents generated by the firm in other markets. Similarly, if a firm is dominated by labour, the firm will not exploit any monopoly power the firm may have in labour markets to pay $7 to the worker who would receive $12 in a competitive labour market. Instead, the firm will pay $12 – the competitive wage rate – despite having the power to pay less. And the firm will pay out to workers, as bonuses at the end of the year, any scarcity rents that the firm earns in other markets.

If, however, governance of the firm is dominated by a counterparty other than the one operating in the market that is monopolized by the firm, then the firm will exploit its monopoly power to charge prices that extract additional surplus from the monopolized market. The governance-dominating counterparty will then arrange to appropriate that additional surplus from the firm. The shareholder-dominated firm will, for example, pay $7 to the worker if the firm monopolizes the labour market or $20 to consumers if the firm monopolizes the product market. The shareholders will pay the additional surplus extracted thereby – $5 more from the worker or $2 more from the consumer – to themselves in the form of higher dividends or share buybacks. The additional surplus extracted by the firm due to the exercise of its monopoly power is monopoly rent.[23] When a governance-dominating counterparty induces a monopolist to exercise its monopoly power, the counterparty extracts from other counterparties not only the scarcity rents that the governance-dominating counterparty would enjoy were the firm to operate in competitive markets but also additional monopoly rents.[24]

This is possible, however, only if the firm has a governance-dominating counterparty. If instead, no counterparty dominates governance of the firm, then the firm will not exploit its monopoly power, and the firm will instead behave as if it were operating in competitive markets even when the firm is in fact monopolizing the markets in which the firm does business. Imagine a firm in which workers, suppliers, shareholders (suppliers of cash subject to no absolute repayment obligation), and consumers were each collectively to have one vote for each member of the board that manages the firm. Management – understood to mean both the board

[23] See Teece and Coleman (n 21) 822.

[24] See *ibid*.

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and the managers responsible for day-to-day operations – would, as under current shareholder-dominated business forms, have no vote, but management's day-to-day control over the firm would presumably give management equal power to defend its own interests, which power would, as under current forms, be checked by those voting on the membership of the board. Under this new structure, each counterparty would insist upon competitive pricing for other counterparties in exchange for others' insistence upon competitive pricing for itself. For each counterparty would fear that, absent others' support, the firm might one day seek to charge the counterparty monopoly prices. Thus, each counterparty would vote for board members who insist upon competitive pricing in all markets in which the firm does business, notwithstanding any power the firm may have to charge monopoly prices.

One might reasonably ask why counterparties with equal governance power might not instead seek to demand prices that equalise the division of surplus between the counterparties. In every market in which a firm does business, the firm stands on one side of the transaction, either taking money in or paying money out. After deducting outflows from inflows, the firm divides any resulting profits (such as, in competitive markets, scarcity rents) among counterparties by making cash payments to them (e.g., to the shareholders in a shareholder-dominated firm). One can imagine a firm choosing prices in every market in which the firm does business to ensure that the surplus enjoyed by each counterparty, after accounting both for the value the counterparty derives from market transactions with the firm and for the share of firm profits paid to the counterparty by the firm, is equal.

For example, imagine that a worker, supplier, shareholder, and manager were each to place a value of $8 on what they supply to the firm, the firm were to pay $8 to each, a consumer were to place a value of $42 on the firm's product, and the firm were to charge $40 to the consumer. In that case, the firm could pay its profit of $8 ($40 less the $32 total cost of buying from the other counterparties) in equal parts of $2 each to the worker, supplier, shareholder, and manager, equalising the surplus enjoyed by each counterparty. The consumer, who would receive no transfer of profits from the firm, would nevertheless retain $2 of surplus in the product market thanks to having purchased a product the consumer values at $42 for a price of $40. There is no reason why the prices required to achieve this equal distribution of surplus – prices of $8 in each buyside market and a price of $40 to the consumer – should be competitive prices. If counterparties with equal governance power were to seek to equalise the surpluses they enjoy, then they would likely not compel the firm to charge competitive prices.

Counterparties having equal governance power would not seek to equalise their surpluses, however, because in order for counterparties to equalise their surpluses, they must reveal private information to each other regarding the value they place on what they supply or buy from the firm. To be able to equalise the surpluses in the example above, the firm must know that the worker, supplier, shareholder, and manager place an $8 value each on what they supply and that the consumer places

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a $42 value on the firm's product. To obtain a larger share of firm profit payouts, each has an incentive to lie about this value. The competitive price is, by contrast, one that the firm can find, at least in principle, in an objectively verifiable fashion, even in monopolized markets, by making bids or offers until supply is maximised in sell-side markets or until demand is maximised in buy-side markets. Because the competitive price is an externally determined benchmark, each counterparty can be certain that, in defending the competitive prices enjoyed by others, the counterparty is not falling victim to fraud.

We can, then, state the following theorem: *In order for the firm to exploit a position of domination in relation to one counterparty, that counterparty must itself occupy a position of subordination in relation to another counterparty – a counterparty that dominates governance of the firm. Absent that subordination of one counterparty to another, a firm will behave as if it were operating in competitive markets even when the firm is in fact a monopoly.*

7.2.2 A Democratic Check on Management

None of the business forms in use today suffices to ensure that no counterparty dominates; they all allow one counterparty or another to dominate governance. The most common type, the investor-owned firm, puts shareholders in control.[25] Consumer cooperatives put consumers in control.[26] Supplier cooperatives put suppliers in control.[27] Employee-owned firms put employees in control.[28] Non-profits tend to put managers in control thanks to tunnelling.[29] And so on. To the extent that the favoured counterparty in each of these business organisations actually succeeds at using its power to overcome management – something that is often debatable – these business forms shift the locus of domination away from managers but do not eliminate it.[30] Shareholder-run businesses will oppress all counterparties but shareholders. Consumer-run businesses will oppress all counterparties but consumers. Worker-run businesses will oppress all counterparties but workers. Supplier-run businesses will oppress all counterparties but suppliers.

One solution would be to expand the corporate board to enable each category of counterparty to choose an equal number of seats, effectively diffusing control over management among all counterparties in a bid to balance power between them.[31] But that would make the board vulnerable to deadlock, as the interests of the firm's

[25] See Hansmann (n 2) 53–66.
[26] See *ibid.* at 149–68.
[27] See *ibid.* at 120–49.
[28] See *ibid.* at 66–120.
[29] See *ibid.* at 238–40.
[30] See Greenwood (n 16) 152–53.
[31] See R Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017) 95.

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various counterparties are heterogeneous.[32] A better solution is to grant each category of counterparty the right to vote for all board seats: one vote each for shareholders collectively, workers collectively, other suppliers collectively, and consumers collectively. This would ensure that individual board members would not be beholden to any particular counterparty and so the board, once elected, would be able to act decisively as a unit. Indeed, the effect would be to strengthen management because there would be no possibility of total subordination to a controlling shareholder or other single counterparty. But this stronger management would still be subject to a check: the ability of the firm's counterparties as a group to vote the board out of office at the next election.[33] That would ensure that collective control does not result in paralysis, while still giving counterparties the power to restrain management if management undertakes actions that threaten all other counterparties as a group. Managers, control over the day-to-day administration of the firm would permit them to protect their own interests as counterparties. Indeed, the challenge will be to prevent managers from oppressing the other counterparties rather than to save managers from oppression.

A majority of counterparties would vote to replace the board in two circumstances. First, a majority would vote against the board when mismanagement threatens the fortunes of the firm generally. An underperforming firm both has less scarcity rent to divide among counterparties and generates less surplus for counterparties through market transactions with them. If a high-performing firm introduces an advanced product, for example, consumer demand goes up, increasing the surplus enjoyed by consumers, and the firm's profits go up, allowing the firm to write consumers a check for still more value in the form of consumers' share of the firm's profits. (In a firm governed by a board elected by all counterparties, as proposed here, counterparties would insist that the firm distribute profits to all counterparties, not just shareholders, as in the traditional shareholder-dominated firm.) The increase in demand also increases the firm's own demand for labour, investment dollars, and supplies, and that in turn enables counterparties in those markets to increase their own profits – meaning to increase the surplus they take from their market interactions with the firm – in addition to receiving larger payouts of the firm's profits. Thus, a firm creates a 'residual' through high performance that each counterparty captures in part through distributions by the firm to the counterparty and in part directly through doing business with the firm. As a result, all of the firm's counterparties have an interest in checking management when mismanagement threatens that broadly defined residual.

High performance by a firm sometimes creates winners and losers among the firm's counterparties, but that is unlikely to prevent the firm from performing at a high level.

[32] See R Clark, *Corporate Law* (Little, Brown 1986) 781. German law, which gives workers the right to elect half of board seats, handles this problem by giving the chairman of the board, who is elected by shareholders, the right to cast a tie-breaking vote. See Kraakman and others (n 33) 90–91. That means, however, that ultimately shareholders remain in control of German firms. In a board controlled by all counterparties, there would be no equivalent method of forcing a decision in the face of deadlock.

[33] See Hansmann (n 2) 58–59.

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A firm's decision to adopt a transformative technology might benefit consumers and shareholders but shift business away from current suppliers and workers, who would then oppose the board.[34] Or adoption of new technology might benefit a minority of workers but harm a majority of them, causing workers as a group to oppose the board. But so long as the new technology were to increase demand, meaning that it were to expand the pie, counterparties would in aggregate gain enough to compensate the losers for their losses while still forging ahead with the project. Dealmaking between counterparties should, therefore, permit profitable projects to proceed.

Second, a majority of counterparties would vote against the board if management were to attempt to wield the firm's monopoly power to oppress any one counterparty. All counterparties are vulnerable to oppression, and so each has an interest in maintaining a norm that prohibits oppression for all. A firm has some amount of power to dictate prices in all markets in which the firm operates because every firm is differentiated to some extent from every others firm. Every firm offers a unique set of employment conditions, if only because employment locations differ. Every firm purchases supplies in a unique fashion, at different locations, with differing levels of reliability. Every firm offers a unique investment opportunity to shareholders, and sells a differentiated product to consumers.[35] The counterparties that do business with a firm therefore prefer the firm to other firms, otherwise, they counterparties would take their business elsewhere. They are, therefore, to the extent of this preference, at the mercy of the firm with respect to the terms the firm dictates to them.[36] It follows that each counterparty stands to benefit if the firm pursues a policy of competitive pricing instead of exercising its power. Management, or other counterparties working with management, might try to oppress some counterparties and reward others with the proceeds of that oppression, so dividing counterparties against each other that they cannot effectively check the oppression. This is unlikely to work, however, because counterparties cannot safely assume that a counterparty coalition that rewards them one day will not turn against them the next. As a result, all counterparties have the incentive to defend each other against attempts to exploit monopoly power, lest they, too, one day find themselves victimised by other counterparties. Political democracies run on the same general principle: no one knows who will be next, so it is in everyone's interest to censure bad behaviour, regardless of whom the target happens to be.[37] This is true even for investors, who, despite

[34] cf. Hansmann (n 2) 138–39 (giving an example of conflict of interest between suppliers in a supply cooperative).

[35] See E Chamberlin, *The Theory of Monopolistic Competition: A Re-orientation of the Theory of Value* (7th edn, Harvard University Press 1956) 71–74.

[36] See *ibid*.

[37] See A Vermeule, 'Veil of Ignorance Rules in Constitutional Law Essay' (2001) 111 Yale LJ 399, 399 ('A veil of ignorance rule … is a rule that suppresses self-interested behavior on the part of decisionmakers; it does so by subjecting the decisionmakers to uncertainty about the distribution of benefits and burdens that will result from a decision.').

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doing business in highly competitive capital markets, are locked into the firm by their investment, and therefore relate to the firm as they would to a monopolist.[38]

The same principle applies to explain why counterparties that operate in markets in which the firm has less monopoly power are likely to vote to protect those that operate in markets in which the firm has more monopoly power: a counterparty never knows when markets will shift and the firm will acquire more monopoly power in the markets in which the counterparty operates. Competition, after all, is more fragile than monopoly, which is why there are antitrust laws.[39] No counterparty can rely on competition to protect it from the firm in the long run. So every counterparty has the incentive to vote against the exploitation of monopoly power regardless of the identity of the current victim. Consumers enjoying competitive prices today, for example, will want to vote to prevent the firm from using its monopoly power in labour markets to pay below-market wages because tomorrow the firm may monopolize its product markets and try to charge consumers supracompetitive prices. Consumers will then need workers to come to their aid.[40]

To enable counterparties to vote for each board seat, corporate law must extend to all counterparties the organisational support that the law currently affords only to shareholders.[41] The law must provide workers, consumers, and suppliers, all of whom are often numerous and disorganised, with the same voting rights, majority decision rules, and proxy options as shareholders currently enjoy in electing board members.[42] But now each member of a counterparty class (i.e. each worker, supplier, shareholder, or consumer) would vote to determine how the counterparty class of which he is a member will vote for each board seat, rather than vote directly for each seat. Workers will vote to determine the board members for which the worker class casts its single vote. Suppliers will vote to determine the board members for which the supplier class casts its single vote. And so on. Thus, corporate law must work to overcome the barriers to collective action that each counterparty class faces

[38] See Hansmann (n 2) 55–56. While holders of shares in publicly traded companies can always sell their shares, the price the shares fetch is determined by expectations regarding future dividends or buybacks. So current shareholders are always at the mercy of firm decisionmaking regarding how much cash to pay to shareholders.

[39] See R Atkinson and M Lind, *Big Is Beautiful: Debunking the Myth of Small Business* (MIT Press 2019) 19–26; J Foster and others, 'Monopoly and Competition in Twenty-First Century Capitalism' (2011) 62 *Monthly Review* 1, 3 ('Monopoly … is the logical result of competition, and should be expected. It is in the DNA of capitalism.').

[40] Might all of the counterparties gang up on the firm and each insist on receiving better-than-competitive prices? The answer is no, because the firm is just the sum of its counterparties, and so in taking from the firm counterparties take from each other. See Hansmann (n 2) 18–20. It follows that attempts to obtain better-than-competitive terms from the firm will pit counterparties against each other, and counterparties will therefore vote to prevent such conduct for the same reasons that they will vote to prevent attempts by management to divide them or to oppress one but not another: they never know when other counterparties will choose to gang up on them.

[41] See Kraakman and others (n 33) 59–62 (discussing 'the extent to which the law seeks to assist dispersed shareholders in overcoming their collective action problems').

[42] See *ibid*.

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and indeed that workers, suppliers, and consumers in particular face to a greater extent than shareholders.[43]

7.2.3 *But Is Not Shareholder Control Efficient?*

Giving each category of counterparty the right to vote for board members violates the tenet of modern corporate governance theory that efficiency requires that shareholders alone control management.[44] The principal ground for this tenet is collective action.[45] In most firms, workers have heterogeneous interests (they work different jobs and receive different levels of pay), consumers have heterogeneous interests (they buy some of a firm's products but not others, at different times, and for different purposes), and suppliers have heterogeneous interests (they supply different goods). But shareholders all want one thing: the highest possible cash return on their investment.[46] It follows, the argument goes, that if you put workers, consumers, or suppliers in charge of the firm, their members will fight among themselves and so fail to control management.

Putting all types of counterparties in control of the firm will lead to even more gridlock and indecision than if any one category of counterparty were to control the firm independently. With oversight paralyzed, management would have even more power than it would have under other corporate governance forms, including shareholder control. But the harm to firm performance associated with inadequate oversight of management must be offset by the benefit associated with the democratic check on the exercise of monopoly power that nevertheless would remain, however weak that check might be. It is not clear that the harm outweighs the benefit.

Indeed, my proposal to give a measure of control to all counterparties addresses a glaring defect in another key tenet of modern corporate governance theory. Theorists argue that the group that is entitled to the residual profits of the firm – the shareholders in a shareholder-owned firm – should have exclusive control over governance. Maximising the residual is efficient and, the theorists argue, the group that is entitled to the residual will act to maximise the residual.[47] This view of how to achieve efficiency in corporate governance is correct, but only so long as firms make their profits in competitive markets. If instead firms profit by charging monopoly prices, then maximising the residual, which residual includes monopoly rents as well as scarcity rents, ceases to be efficient, and indeed magnifies inefficiency the more effectively it is undertaken. The more that a monopolist's prices are pushed

[43] See Hansmann (n 2) 4–5.

[44] See H Hansmann and R Kraakman, 'The End of History for Corporate Law' (2000) 89 Geo LJ 439, 440–41.

[45] See H Hansmann, 'All Firms Are Cooperatives – and so Are Governments' (2014) 2 JEOD 1, 4–5.

[46] See Hansmann (n 2) 62–64.

[47] See M Jensen and W Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 J Financ Econ 305, 320–23.

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beyond the competitive level in order to maximise the residual, the greater the deadweight loss that the monopoly creates.[48]

Corporate governance theorists have traditionally left it to the antitrust laws to solve this problem by ensuring that markets are competitive.[49] But antitrust is an imperfect tool. Some firms have monopoly power because they have made their own products better than those of competitors, not because they have taken steps to degrade competitors' products.[50] Antitrust rightly does not condemn monopoly based on product improvement, and so these firms can charge monopoly prices without fear of antitrust sanction, at least in the United States.[51] That does not mean, however, that a product-improving monopolist's monopoly prices cannot create deadweight loss. They do. It follows that corporate governance cannot fob the problem of monopoly off on antitrust, but must address the problem itself.[52]

[48] See Woodcock, 'The Antitrust Duty to Charge Low Prices' (n 2) 1751–52; M Jensen, 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function' (2010) 22 J Appl Corp Finance 32, 35 n7.

[49] See Hansmann and Kraakman (n 46) 442; Jensen (n 49) 39.

[50] See Teece and Coleman (n 21) 820–22.

[51] See F Scherer and D Ross, *Industrial Market Structure and Economic Performance* (3rd edn, Houghton Mifflin 1990) 613–60; R Woodcock, 'How Antitrust Really Works: A Theory of Input Control and Discriminatory Supply' (2021) Social Science Research Network Working Paper No. 3794816 https://papers.ssrn.com/abstract=3794816 accessed 7 July 2021.

[52] See Woodcock (n 14) 1403–08, 1433–35. Is corporate governance really capable of filling in the gaps that antitrust cannot address? Suppose that a firm that uses research to produce innovative products needs to be able to charge high prices for the products, pay low wages to workers, or pay low prices to suppliers in order to cover the costs of the research. Using antitrust to break the firm up would lead to competitive pricing that fails to cover those costs, and therefore to a reduction in research and innovation. See R Woodcock, 'Inconsistency in Antitrust' (2013) 68 U Miami L Rev 105, 126–36. But so too would the firm's unilateral resort to competitive pricing as a result of governance pressure exerted by counterparties. This suggests that governance-based restrictions on the exercise of monopoly power might be just as destructive as antitrust remedies such as the breakup of large firms.

The nice thing about a governance-based solution to the problem of monopoly, however, is that counterparties will not, in fact, impose competitive pricing on a monopolist when doing that would make the firm unable to cover costs, because making the firm unable to cover costs would harm all counterparties. A firm's costs are what the firm pays to counterparties. If the firm cannot cover costs and exits the market, counterparties end up with nothing. Thus, in cases in which competitive pricing would not cover costs, and would therefore be inefficient, counterparties can be expected not to act to check attempts by management to charge supracompetitive prices. But Counterparties will still act to check attempts by management to charge prices that more than cover costs, because such prices would represent an attempt to redistribute surplus, and therefore to oppress some counterparties for the benefit of others. Antitrust cannot police such a fine distinction between competitive pricing, fixed-cost-covering pricing, and monopoly pricing, because antitrust does not regulate prices directly and therefore can act only to achieve competitive pricing through remedies that promote competition. See H Hovenkamp, *Federal Antitrust Policy, the Law of Competition and Its Practice* (6th edn, West Academic Publishing 2020) 356–58. But a governance-based solution can police such a distinction because it acts directly on the administration of the firm. Indeed, the governance approach leads to a regime that more closely resembles public utility regulation than antitrust, for managers choosing pricing that covers fixed costs would need to identify an allocation of fixed costs across counterparties that does not cause a majority of counterparties to revolt, much as rate regulators today strive to allocate utility costs among different categories of consumers without triggering a political backlash. See W Viscusi and others, *Economics of Regulation and Antitrust* (5th edn, MIT Press 2018) 528–30.

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Embracing my proposed democratic check on management would address the problem of monopoly by ensuring that firms strive to maximise only that part of the residual that is due to scarcity rents rather than the entire residual consisting of both scarcity rent and monopoly rent. That is because, as described earlier, when the governance power of all counterparties is in balance, as it would be under my proposed governance form, the firm will not seek to exploit any monopoly power that the firm may acquire.[53] The firm will charge competitive prices and earn only scarcity rents. Because of the equality of governance power among all counterparties, the firm will likely distribute the scarcity rent equally to all counterparties, giving each counterparty an incentive to push for maximisation of that rent. Thus, the firm will strive to operate at a lower cost than competitors or to produce better products than competitors, in pursuit of scarcity rent. But the firm will not strive to exploit any monopoly power the firm may acquire along the way. Under my proposed governance form, all counterparties would *own* the firm, in the sense that all would take some of the residual, and all would, collectively, *control* the firm, through their democratic check on the board. But because no one counterparty would dominate governance, the firm's counterparties would take only the healthful, efficient part of the residual – the scarcity rent – and not the unhealthful, inefficient part – the monopoly rent. The unity of ownership and control that is another name for the rule that the taker of the residual should control the firm would be preserved but the profit motive of the owners would be fundamentally altered, due to the equal distribution of power among them, to encompass only maximisation of scarcity rent and not of monopoly rent.

7.3 MANAGERIALISM AS A GUIDE

The mid-twentieth century American experience with managerialism hints at what a democratic check on management might accomplish.[54] Large shareholders dominated firms in the nineteenth and early twentieth centuries.[55] But management instead came to dominate firms during the long period of economic growth that followed World War II. Small shareholders, who could not muster the majorities required to impose shareholder interests on management, replaced controlling shareholders.[56] Adolf Berle and Gardiner Means famously fretted during this period that unaccountable managers would exploit their newly democratised shareholders.[57] They failed to appreciate that other forces worked during this period to

[53] See above Section 7.2.1

[54] See G Davis, *Managed by the Markets: How Finance Reshaped America* (Oxford University Press 2011) 32–33.

[55] See J Coffee, Jr., 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 Yale LJ 1, 24–25.

[56] *Ibid.* at 70–71.

[57] See A Berle and G Means, *The Modern Corporation and Private Property* (Transaction Publishers 1932) 46, 313; L Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (Berrett-Koehler Publishers 2012) 17–18; Davis (n 56) 71–72.

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constrain managers. Unions gave labour bargaining power in labour markets that prevented managers from exploiting the firm's monopoly power to depress wages.[58] And the public sentiment in favour of the regulation of big business made regulation or antitrust breakup an ever-present threat if firms failed to satisfy consumers, who were also voters.[59] The result was a management that was powerful but nevertheless checked by its counterparties. Subject to this balance of power, managers shrank from the price discrimination that so troubled nineteenth-century consumers, favouring instead uniform and even average cost pricing.[60] And firms offered workers stable employment, competitive wages, and defined-benefit pension plans.[61] AT&T, for example, was a pioneer in progressive labour practices in the post-war period. The company also strove for two generations to ensure that the price of a month of local calling would not exceed the price of a medium pizza with two toppings, bundling directory services into the deal.[62]

The success of this mid-twentieth century managerialism reflects the crucial role the balance of power between counterparties plays in restraining the exercise of monopoly power.[63] Shareholders were the dominant counterparty in the nineteenth century because they tended to own controlling stakes in firms.[64] Power shifted to managers in the mid-twentieth century because the legal trigger for shareholder power – a majority stake – was no longer pulled, as shareholdings democratised.[65] This in turn devolved power to managers because corporate governance rules give

[58] See M Goldfield, *The Decline of Organized Labor in the United States* (University of Chicago Press 1989) 12.

[59] See M Pertschuk, *Revolt against Regulation: The Rise and Pause of the Consumer Movement* (University of California Press 1982) 5–45. The dynamic between antitrust regulation and corporate good behavior is nicely illustrated by commitments made by AT&T in 1913 and again in 1956 to avoid antitrust action by the Justice Department pursuant to which the company agreed not to expand out of the telephone industry into adjacent businesses, such as telegraph or television. See R Vietor, *Contrived Competition: Regulation and Deregulation in America* (Harvard University Press 1996) 172–73, 185. The agreements followed a pioneering public relations campaign by AT&T in which the company sold itself to the public as a mom and pop owned operation dedicated to providing "universal service" to all Americans. See Davis (n 56) 70–71; R John, *Network Nation: Inventing American Telecommunications* (Harvard University Press 2015) 385–95. The company in effect negotiated the right to dominate telephone service in exchange for a promise of good behavior that the company mostly honored.

[60] See H Hovenkamp, 'Regulatory Conflict in the Gilded Age: Federalism and the Railroad Problem' (1988) 97 Yale LJ 1017, 1044–58 (discussing the controversy over 'unjust discrimination' by railroads); T McCraw, *Prophets of Regulation: Charles Francis Adams, Louis D. Brandeis, James M. Landis, Alfred E. Kahn* (Harvard University Press 1984) 239–43.

[61] See Davis (n 56) 87–91.

[62] See John (n 61) 408; McCraw (n 62) 256–59; Davis (n 56) 78–79.

[63] For more on managerialism, see generally H Wells, 'Corporation Law Is Dead: Heroic Managerialism, Legal Change, and the Puzzle of Corporation Law at the Height of the American Century' (2012) 15 U Pa J Bus L 305.

[64] See D Smith, 'The Shareholder Primacy Norm' (1998) 23 J Corp L 277, 291–305; Coffee, Jr (n 64) 24–25.

[65] See Kraakman and others (n 33) 79–80; L Bebchuk, 'The Case for Increasing Shareholder Power' (2005) 118 Harv L Rev 833, 24–25.

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managers free reign when shareholders lack the votes to replace them.[66] But managers could not exploit their power because other counterparties, namely workers and consumers, obtained countervailing power during this period.[67] Unlike what would happen under my proposed democratic check, however, neither workers nor consumers obtained power through corporate governance rules, which remained largely static.[68] Instead, workers obtained power out in labour markets through unionisation.[69] And consumers obtained power in the sense that antitrust enforcers, rate regulators, and Congress used threats of enforcement and regulation effectively to cow firms into making concessions to consumers.[70] But though workers and consumers obtained power by ad hoc means, they nevertheless succeeded at checking managers when necessary. As a result, monopolies such as AT&T shared the wealth despite being under the complete control, as a formal matter, of unaccountable managers.[71] At the same time, these monopolies were free to leverage their size to achieve economies of scale – something that they could not have done had antitrust enforcers broken them up.

In typical American fashion, a felicitous outcome had been achieved not through reform of the rules that directly bear on the balance of power inside the firm – the rules of corporate law – but instead through a hodgepodge of private solutions (unionisation) and government intervention (antitrust and economic regulation).[72] Democratising the election of the board, as I propose here, would broaden and institutionalise within corporate law itself the balance of power so haphazardly constructed in the heyday of managerialism.

The collapse of managerialism starting in the late 1970s shows just how important institutionalising the balance of power within the firm really is.[73] Scholars sometimes suggest that corporate raiders killed managerialism by reconstituting the old controlling ownership stakes in firms or otherwise shifting the balance of power back in favor of shareholders.[74] But corporate raiding and the cult of shareholder value maximisation it instilled in managers is more likely a symptom of the collapse

[66] See Kraakman and others (n 33) 12.
[67] See the text accompanying n 68–69.
[68] See Smith (n 66) 323 (observing that shareholder primacy became a 'fixture' of corporate law).
[69] See Goldfield (n 60) 12.
[70] See the text of n 69.
[71] See Kraakman and others (n 33) 12; John (n 61) 408.
[72] See R Skidelsky, *John Maynard Keynes: Fighting for Freedom, 1937–1946* (Viking 1986).
[73] See Davis (n 56) 81–87.
[74] See *ibid.* at 85. The argument here is not that as a result of takeovers every American corporation has come to have a controlling shareholder, although the sharp decline in the number of publicly-traded corporations in the United States in recent decades suggests that the economy is moving in that direction (due more to a preference on the part of startups for private financing than to going-private transactions, however). See C Doidge and others, 'Eclipse of the Public Corporation or Eclipse of the Public Markets?' (2018) 30 *Journal of Applied Corporate Finance* 8, 11–13, 15. Instead, the argument is that the *threat* of takeover, which is meaningful only if a raider that acquires a controlling stake is able to use it to dominate management, has forced managers to act in shareholder interests, even when the firm has no controlling shareholder. This change in the locus of governance power within firms from

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of the balance of power that underpinned managerialism, rather than a cause. After all, if workers and consumers had continued to enjoy countervailing power, it is not clear why that power would have been less effective in checking a corporate raider or other powerful shareholder than it was in checking powerful management.

The real cause of the collapse of managerialism was the demise of the balance of power upon which it depended. That balance required both the persistence of unions and of public sentiment in favour of the regulation of business, neither of which lasted.[75] Public support for the regulation of business collapsed in the 1970s, giving rise to deregulation and a drastic weakening of antitrust enforcement in the late 1970s and 1980s.[76] Because government was no longer willing to provide consumers with bargaining power, management – or anyone in control of management – now could extract surplus from consumers and give that surplus to itself. That in turn meant that there were now rewards associated with buying a controlling stake in the firm and dominating management that had not existed for decades. Those rewards created the figure of the corporate raider. They also enabled managers, acting on behalf of shareholders – or indeed themselves – to finance attacks on the last powerful counterparty of the old order – unions – which went into decline. Profits derived from lower wages and canceled pensions rewarded the attacks.[77]

The part that managers themselves played in the demise of managerialism highlights the role of the balance of power in this story. Managers themselves often raided their own firms.[78] Perceiving that the government was no longer willing to protect counterparties, managers sought to use their controlling position in corporate governance to take as much of the value that now could be extracted from counterparties as possible. The easiest way for managers to do that was to become controlling shareholders themselves because corporate governance orthodoxy continued to give shareholders the legal right to extract all excess value from the firm.[79]

7.4 CONCLUSION

In an age characterised by weak antitrust enforcement, it is tempting to respond with a full-throated call for across-the-board promotion of competition.[80] This temptation

managers to shareholders is reflected in the cult of shareholder value maximization among managers that arose in the wake of the 1980s takeover wave. See Stout (n 59) 2–4. The shareholder value maximization ideal was a major departure from managerialism, for which maximizing shareholder value was a secondary concern. See Davis (n 56) 74.

75 See Goldfield (n 60) 12; Pertschuk (n 61) 69–119.

76 See Davis (n 56) 84; J Baker, 'Taking the Error Out of Error Cost Analysis: What's Wrong with Antitrust's Right' (2015) 80 Antitrust L J 1, 506–09; Pertschuk (n 61) 69–119.

77 See Goldfield (n 60) 19–20.

78 See L Lowenstein, 'Management Buyouts' (1985) 85 Colum L Rev 730, 730.

79 See Kraakman and others (n 33) 13.

80 See Zephyr Teachout, *Break' Em Up: Recovering Our Freedom from Big Ag, Big Tech, and Big Money* (All Points Books 2020); T Wu, *The Curse of Bigness: Antitrust in the New Gilded Age* (Columbia Global Reports 2018).

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must be resisted, because sometimes bigger really is better.[81] A wiser approach is to recognise that a firm is just the sum of its counterparties, and so the firm will not exercise monopoly power against one counterparty unless some other counterparty of the firm has sufficient control over firm governance to cause the firm to engage in such oppressive behaviour. This suggests that by altering corporate governance rules to prevent firms from coming under the control of any one counterparty and instead leaving firms in the hands of a management subject to a democratic check from firm counterparties, the law can defang monopolists without depriving the economy of the virtues of size. But to do that, antitrust – or rather the antitrust spirit, operating through the law of corporate governance – must strike at the interior of firms, rather than at the markets that surround them.[82]

[81] See Atkinson and Lind (n 41) 63–81; A Hirschman, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations and States* (Harvard University Press 1970) 55 (arguing that 'if exit is ineffective as a recuperation mechanism, but does succeed at draining from the firm or organization its more quality-conscious, alert, and potentially activist customers or members' then 'a tight monopoly is preferable … to a looser arrangement in which competition is present').

[82] For the argument that existing antitrust rules compel a reinterpretation of prevailing corporate governance rules, albeit in favor of consumer dominance rather than a balance of power, see Woodcock (n 14) 1396–403.

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