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Workers, Information, and Corporate Combinations: The Case for Nonbinding Employee Referenda in Transformative Transactions

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WORKERS, INFORMATION, AND CORPORATE COMBINATIONS: THE CASE FOR NONBINDING EMPLOYEE REFERENDA IN TRANSFORMATIVE TRANSACTIONS

MATTHEW T. BODIE*

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INTRODUCTION

> How can I convey to you the disgust which your name awakens in me? The merger with Warner was a catastrophe. But the hitherto unimagined stupidity, the blind arrogance of your deal with Case simply beggars description. How can you face yourself knowing how much history, value and savings you have thrown away on your mad, ignorant attempt to merge with a wretched dial-up ISP? I don't know what advice you have to offer, but I have some for you. Buy some rope, go out the back, find a tree and hang yourself. If you had any honor you would.
>
> *—e-mail from Robert Hughes, Time magazine art critic, to Gerald Levin, AOL Time Warner CEO, 2002*[1]

Employees present a curious puzzle for corporate law. On the one hand, employees are central to every business. The success of a corporation depends on its employees, from the chief executive officer down to the front-line production or service worker. But, for the most part, corporate law relegates employees to the sidelines. The players in corporate-law dramas are management, directors, and shareholders. The tension between shareholders and management is the focal point of corporate scholarship.[2] Employees have no role in corporate governance.

1. KARA SWISHER, THERE MUST BE A PONY IN HERE SOMEWHERE: THE AOL TIME WARNER DEBACLE AND THE QUEST FOR A DIGITAL FUTURE 200 (2003).

2. *See, e.g.*, ADOLF A. BERLE, JR. & GARDINER C. MEANS, MODERN CORPORATION AND PRIVATE PROPERTY (1932); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) ("We focus in this Article on the behavioral implications of the property rights specified in the contracts between the owners and managers of the firm."); David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1374 (1993) ("Managerial accountability to shareholders is corporate law's central problem."). *Cf.* Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1624 (2001) ("It was as if everyone already knew (from Berle and Means) that the master problem of corporate law was agency costs, and along came an economic model and a vocabulary to elaborate that view.").

Perhaps nowhere is this contrast as dramatic as in the realm of mergers, acquisitions, and other transformative transactions. Such transactions are generally negotiated at the highest levels of management, approved by the board, and then announced to great fanfare.[3] Shareholders have the power to vote on most large-scale combinations and therefore hold veto power over their ultimate consummation.[4] In contrast, employees have no say. Even unionized employees do not have the right to bargain over these transactions; at most, they can merely bargain about their effects.[5]

However, as the e-mail in this article's epigraph vividly demonstrates, employees do have opinions about mergers, acquisitions, and other such transformative corporate transactions. Some of these opinions may be fairly predictable: for example, employees will be fearful of a merger that promises to eliminate huge swaths of the company's workforce. But employees also have more nuanced opinions about their work environment—opinions based on much more intimate knowledge about the company than shareholders typically have. These opinions may be overlooked in the post-announcement excitement, especially since management has an interest in hearing only positive news about the forthcoming combination.

This Article proposes that employees be given the right to vote on mergers, sales of substantially all assets, and the other corporate combinations for which shareholders can vote. Unlike shareholders' ballots, the employees' choices would not be binding on the company. Referenda would be held before the required shareholders' elections so that shareholders could know about the results before they cast their votes. Although it might be possible to implement the referendum through federal law, states could also insert the referendum into their systems for corporate governance.

Why require corporations to conduct nonbinding employee referenda? First, the referenda would improve the information flow surrounding corporate combinations and would lead to more efficient transactions.

3. In this description, I refer only to transactions in which two companies combine; I do not include hostile tender offers. Such offers may lead to shareholders' selling their shares over the objections of the target company's board.

4. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251 (2007); MODEL BUS. CORP. ACT § 11.03 (2002).

5. Employers need not bargain over issues that are within the "core of entrepreneurial control." First Nat'l Maint. Corp. v. Nat'l Labor Relations Bd., 452 U.S. 666, 686 (1981) (no duty to bargain over decision to shut down part of business purely for economic reasons); Int'l Union, United Auto Workers v. Nat'l Labor Relations Bd., 470 F.2d 422, 425 (D.C. Cir. 1972) (no duty to bargain regarding "sale" of manufacturer-owned and operated retail outlets to franchisers). However, employers must bargain over the effects such actions have on terms and conditions of employment. First Nat'l Maint. Corp., 452 U.S. at 676.

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Mergers and acquisitions are generally negotiated under a heavy shroud of secrecy by the very top levels of management.[6] After the initial agreement is announced, management has a strong incentive to see that the merger is approved, weakening any incentive for a robust debate on the merits of the plan.[7] An employee vote would provide concrete data about workers' opinions on the merger. Although the vote would not have any legal effect, directors, management, and shareholders may find the expression of collective employee wisdom to be useful in making their own determinations about the wisdom of the proposed combination. Moreover, the vote would offer employees and shareholders the opportunity to work together in furtherance of their mutual interest: curtailing managerial rent-seeking.

Second, the vote would make employees feel more a part of the company by giving them a voice in the process. Current corporate law doctrine treats employees as a purchased input, no different than raw materials or property expenses.[8] A referendum would give employees a chance to express their opinion on the combination. Social psychology research has shown that employee voice leads to improved productivity and job satisfaction, as well as greater corporate compliance.[9] Allowing employees to participate in the process creates a greater likelihood that employees will buy into the merger and thus work for its success. In addition, the process of collective deliberation has the potential to create social capital that will come into play in other societal moments of democracy.

Finally, the proposed referenda would impose relatively small costs on companies. With improved technology, it is much easier and less expensive to conduct a companywide election than it once was.[10] Rather than mailing proxy materials to employees, employers will be able to use interoffice mail, e-mail, and internet web pages to distribute the necessary materials and conduct the final tally. The referendum presents an ideal

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6. *See* DAVID A. BROADWIN, NEGOTIATING AND DOCUMENTING BUSINESS ACQUISITIONS 1–2 (1997) (discussing the importance of confidentiality agreements to merger negotiations); J. Robert Brown, Jr., *Corporate Secrecy, the Federal Securities Laws, and the Disclosure of Ongoing Negotiations*, 36 CATH. U. L. REV. 93, 93 (1986) ("Most major arms length agreements are preceded by a period of negotiations that typically take place behind a veil of secrecy.").

7. *See infra* Part II.B.

8. *Cf.* KENT GREENFIELD, THE FAILURE OF CORPORATE LAW 60–66 (2006) (comparing the presence of corporate law protections for shareholders with the absence of such protections for employees).

9. *See infra* Part III.

10. *See infra* Part IV.

opportunity for state experimentation—the "genius" of American corporate law.[11]

The barriers between corporate and labor law have too long stymied efforts to provide employees with more involvement in their work life. Recent studies have made clear that workers want some form of meaningful participation in their place of employment.[12] Traditional approaches such as employee ownership, employee stock option plans, labor unions, and work councils have failed thus far to provide such opportunities to a large percentage of the workforce.[13] The implementation of employee referenda would finally give workers a voice on issues of corporate transformation, where their input would benefit managers, directors, and shareholders as well.

I. THE PROPOSAL

In the United States, corporations are creatures of state law.[14] The delegation of such a critical legal regime to a collection of fifty independent governmental regimes has drawn both praise and criticism.[15] What is perhaps more remarkable, however, is the relative uniformity of corporate law despite its many creators. In these different regimes, the central locus of authority within the corporation is the board of directors.[16] The board has the authority to hire the officers of the corporation and to terminate the officers according to contractual provisions. Although we generally think of the chief executive officer (CEO) as the head of the

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11. *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 151 (1993).

12. RICHARD B. FREEMAN & JOEL ROGERS, WHAT WORKERS WANT 68–71 (1999).

13. About eight percent of the private work force is represented by a union. Economic News Release, U.S. Dep't of Labor, Bureau of Labor Statistics, Union Members in 2007, Table 3: Union Affiliation of Employed Wage and Salary Workers by Occupation and Industry (Jan. 25, 2008), *available at* http://www.bls.gov/news.release/union2.t03.htm. The National Center for Employee Ownership estimates that 10.5 million workers participate in ESOPs, stock bonus plans, and profit sharing plans primarily invested in employer stock, and that 10 million employees participate in stock option plans. National Center for Employee Ownership (NCEO), A Statistical Profile of Employee Ownership (updated May 2007), http://www.nceo.org/library/eo_stat.html. *See also* Robert Hockett, *What Kind of Stock Ownership Plans Should There Be? Of ESOPs, Other SOPs, and "Ownership Societies*,*"* 92 CORNELL L. REV. 865, 874 (2007) (discussing the low level of stock ownership among average employees).

14. JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS 31 (2d ed. 2003).

15. *See, e.g.*, ROMANO, *supra* note 11, at 148–51 (praising the system); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 706 (1974) (criticizing it).

16. *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 550 (2003) (discussing how boards of directors control corporations). For an example of the statutory provisions giving directors control, see DEL. CODE ANN. tit. 8, § 141 (2007).

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corporation, the board has the authority to remove the CEO from office.[17] In turn, the shareholders have the authority to elect the board.[18] This power structure has led to the conception that shareholders are the ultimate "owners" of the corporation.[19] However, directors have the right to run the corporation largely as they wish and need not follow the dictates of a majority of shareholders on any particular issue.[20] They are thus akin to Burkean representatives: the elected representatives of their constituencies who may govern largely according to their personal conscience.[21]

For certain fundamental corporate acts, however, directors need the approval of a majority of shareholders. Amendments to the corporation's charter or articles of incorporation must generally be approved by the board and by the shareholders.[22] Shareholders must consent to the voluntary dissolution of the corporation.[23] In addition, states generally have required shareholder approval for transactions that transform the institutional structure of the corporation through a combination with another corporation. The standard method of combination is the statutory merger.[24] However, corporations also de facto combine when one corporation buys the assets of the other corporation or when a corporation buys another corporation's shares through a tender offer. However, not all corporate combinations require shareholder approval. Mergers generally require shareholder approval from the shareholders of both companies.[25]

17. COX & HAZEN, *supra* note 14, at 136.

18. *Id*. at 328.

19. Current corporate scholars largely consider this notion to be a misconception. *See, e.g.*, Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 604 (2006) (calling this view "deeply erroneous"); Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1192 (2002) ("From both a legal and an economic perspective, the claim that shareholders own the public corporation simply is empirically incorrect.").

20. For an early expounding of this principle, see Automatic Self-Cleansing Filter Syndicate Co. v. Cuninghame, [1906] 2 Ch. 34 (Eng. C.A.).

21. *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 102–03 (2004) (describing directors as "vested with wide powers to exercise their discretion by fiat"). Burke is famous for his advocacy of a representative's use of his or her own judgment in representing constituents. *See* Edmund Burke, Speech to the Electors of Bristol § 4.1.22, Nov. 3, 1774, *available at* http://www.econlib.org/Library/LFBooks/Burke/brkSWv4c1.html ("Your Representative owes you, not his industry only, but his judgement; and he betrays, instead of serving you, if he sacrifices it to your opinion.").

22. *See, e.g.*, DEL. CODE ANN. tit. 8, § 242(b) (2007); MODEL BUS. CORP. ACT § 10.03 (2002).

23. *See, e.g.*, DEL. CODE ANN. tit. 8, § 275(b) (2007); MODEL BUS. CORP. ACT § 14.01 (2002).

24. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251 (2007); MODEL BUS. CORP. ACT § 11.03 (2002).

25. *See* COX & HAZEN, *supra* note 14, at 609 ("Most states now provide for majority approval by the shares entitled to vote . . . ."). Cox and Hazen note, however, that Massachusetts requires the approval of two-thirds of the shareholders, and New York requires a two-thirds vote for corporations created before 1989. *See id.* at 609 n.4 and accompanying text (citing MASS. ANN. LAWS ch. 156, § 46B(5) (Law. Co-op 2000) & N.Y. BUS. CORP. LAW § 903 (McKinney 1986 & Supp. 2002)).

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In Delaware, the state of incorporation for roughly fifty percent of the nation's public companies,[26] mergers require approval from the shareholders of both companies unless the company's charter would remain unchanged postmerger and less than twenty percent of the company's outstanding common stock would be involved in the merger.[27] Shareholders must also approve a corporation's sale of "substantially all" of its assets.[28] This language, which is found in every jurisdiction, has been interpreted with some variation, but it generally means the sale of a significant portion of the corporation's assets in a transaction outside the corporation's regular course of business.[29]

Why are shareholders given the right to veto these transforming transactions? According to one commentator, the basic idea is that "sudden, deliberate (that is, manager-initiated), major or 'organic' corporate changes that affect shareholder interests ought to be approved or consented to by some majority of the shareholders."[30] There seem to be two primary concerns here: first, a concern about the drastic nature of the change, and second, a concern that this change is initiated and controlled by management. With respect to the nature of the change, corporate law aims to give shareholders the right to vote down a proposal that would significantly alter the nature of the holdings in the company. As residual claimants, shareholders are considered the most "vulnerable" of the corporation's stakeholders to management agency costs.[31] Severe changes in the nature and scope of the enterprise will have more of a direct effect on their rights than the rights of bondholders or employees. In fact, mergers often force shareholders to exchange their stock for stock in another company or in a newly formed company.[32] Given the changes in their contractual rights, shareholders have a strong interest in having some

26. The web site for Delaware's Division of Corporations states that "[m]ore than 800,000 business entities have their legal home in Delaware including more than 50% of all U.S. publicly-traded companies and 60% of the Fortune 500." Del. Dep't of State, Division of Corporations, http://www.corp.delaware.gov/default.shtml.

27. DEL. CODE ANN. tit. 8, § 251(c), (f) (2007).

28. *Id.* § 271(a).

29. COX & HAZEN, *supra* note 14, at 594–96.

30. ROBERT C. CLARK, CORPORATE LAW § 10.2.4 at 414 (1986).

31. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 1–39 (1991).

32. For example, in its merger with Alcatel, Lucent Technologies was absorbed into an Alcatel subsidiary and ceased to exist. Former Lucent shareholders were given shares in the Alcatel subsidiary. *See* Lucent Technologies Form 8-K, Filing 061260746, Dec. 6, 2006 (Item 8.01), *available at* http://www.sec.gov/edgar/searchedgar/companysearch.html (search "CIK" for "1006240"; follow link for Form "8-K," Filing Date "2006-12-06"). For a description of the process, see Jeffrey L. Kwall, *What is a Merger? The Case for Taxing Cash Mergers Like Stock Sales*, 32 J. CORP. L. 1, 2–3 (2006).

control over the transformation of their company's internal corporate structure.[33]

There is also a concern that transformative transactions offer an opportunity for management to protect its own interests at the expense of the shareholders.[34] Corporate combinations offer executives an opportunity to receive a one-time monetary, stock, or stock-option bonus based on the fulfillment of the merger. When one company's management will be replaced or subordinated as a result of the transaction, the deal will often arrange for a large payout to those managers as compensation for their loss of position.[35] Conversely, executives of the newly formed company may give themselves bonuses for having successfully carried out the combination.[36] Having the right to veto a transaction gives shareholders power to vote down a transaction that would reward management at the expense of the shareholders.[37]

This Article proposes a small change to the merger approval process: an employee referendum for transformative transactions which would piggyback on top of the existing system of shareholder voting rights. Employees at a company involved in a combination would be entitled to vote in a nonbinding referendum on the combination whenever shareholders also had the right to vote on the combination. All employees would be entitled to cast a ballot. The referendum would be held prior to the shareholders' vote, with enough time for the results of the referendum to be communicated to shareholders prior to their vote.[38] Since the referendum would not be binding on the corporation, the directors, or the shareholders, victory or defeat would have no legal effect on the proposed transaction. The percentage of employee votes for and against would be

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33. More generally, former Delaware Chancellor Allen has described the shareholder franchise as "the ideological underpinning upon which the legitimacy of directorial power rests." Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988).

34. The field of corporate law has largely centered around the general problem of management opportunism. *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 31; OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE 171 (1996).

35. For example, James Kilts, the former CEO of Gillette Company, received a package worth an estimated $165 million as part of the merger of Gillette with Procter & Gamble. Gretchen Morgenson, *What Are Mergers Good For?*, N.Y. TIMES, June 5, 2005 (Magazine), at 56, 58.

36. *See* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 127–30 (2004) (discussing bonuses paid for acquisitions).

37. Morgenson, *supra* note 35, at 58 (discussing how MONY shareholders threatened to vote against a merger with AXA because of the high compensation to MONY executives).

38. Delaware requires notice to shareholders about the merger vote at least twenty days prior to the meeting date. *See* DEL. CODE ANN. tit. 8, § 251(c) (2007). The employee referendum would need to be held early enough so that the shareholder proxy materials could include the results of the referendum.

the critical information communicated to the shareholders and, by extension, the general public.

Further specifics are, of course, in order. The statute would need to define the corporation's "employees" for purposes of the vote. The statute would have to describe the timing and scope of the required disclosure that would be made to shareholders about the employees' vote. The statute could also set forth the necessary procedures for the referendum, as well as whether there were any remedies for improper procedures. These details, and their effect on the proposal, are discussed further in Part IV of the Article. As a reference for what such a statute might look like, I have included an extremely simplified proposed amendment to Delaware law in the Appendix.

The lack of any legal effect to an employee referendum may prompt an initial concern that such a vote would be "meaningless." The vote would, in fact, have no legal effect on the outcome of the proposed transaction; employees could vote overwhelmingly to reject a proposed merger only to see it enacted through director and shareholder approval. Given the lack of legal power behind the employee vote, what would be the point? The point is not to create a regime of employee participation in governance, along the lines of the German system of codetermination.[39] Such a system would require real power sharing, whether through board participation, expanded union powers, or some form of binding referenda.[40] But this proposal is not a piece of that endeavor. In fact, the objective of this proposal is to reap a portion of the benefits of employee participation without some of the drawbacks and complications codetermination engenders. With this in mind, I now turn to the reasons in support of the proposed system of nonbinding employee referenda: more information, greater voice, and the low costs of experimentation.

II. REFERENDUM AS INFORMATION

As a nonbinding resolution, the results of the employee referenda would have no inherent legal power of their own. What the referenda would provide, however, is information—information about whether the company's employees support or object to the corporate combination

39. For one discussion of German codetermination, see Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, *in* EMPLOYEES AND CORPORATE GOVERNANCE 163 (Margaret M. Blair & Mark J. Roe eds., 1999).

40. For a recent proposal that employees should participate in the direct election of the chief executive officer, see Lawrence E. Mitchell, *On the Direct Election of CEOs*, 32 OHIO N.U. L. REV. 261, 281–82 (2006).

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proposed by management. As discussed below, this information would be useful to those groups who have power over the transactions: shareholders and boards of directors. This information would increase the likelihood that shareholders and directors would reject inefficient transactions. As a result, management would do a better job in carrying out these transactions from the start.

In order to understand what this information would convey and how it would affect corporate decision making, it is helpful to begin with a brief description of both the purposes and the processes of mergers and acquisitions.

A. The Purpose of Corporate Combinations

It may seem like overkill to spend time considering the purpose of a corporate combination. Combining two companies is one of many possible business decisions and thus should share the same rationale as the decision to borrow money, hire employees, or purchase raw materials; like any of these decisions, the decision to combine with another company should rest on the same principles behind the corporation itself. As is well known, however, the purpose of the corporation itself has been the subject of prolonged, sustained debate among corporate-law scholars.[41] Proceeding without considering this debate risks a failure to establish first principles and, thereby, a failure to establish the criteria upon which the employee referenda proposal is to be judged.[42]

Corporate-law scholars generally employ a utilitarian approach, seeking to maximize the overall gains to society through the corporate form. In pursuing this end, the majority of corporate scholars ascribe to the notion of "shareholder primacy," or "shareholder wealth maximization."[43] The theory of shareholder wealth maximization posits that by maximizing the returns to shareholders above all other corporate goals, the corporation

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41. *See, e.g.*, William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1067 (2002) ("The past two decades have witnessed a rigorous continuation of the long-standing debate about the proper role of the corporation in our society.").

42. William Klein has recently criticized the failure of corporate law academics to establish such first principles clearly. *See* William Klein, *Criteria for Good Laws of Business Association*, 2 BERKELEY BUS. L.J. 13, 15 (2005) ("Academics debating various aspects of the law of business associations are often like ships passing in the night. One reason for their inability to join issue may be a failure to identify goals or objectives—the failure to weigh proposals against explicitly stated criteria and to engage in effective cost-benefit analysis.").

43. Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 798 (2002) ("Today, most corporate law scholars embrace some variant of shareholder primacy.").

will also maximize its contribution to societal efficiency. This conception rests on the shareholders' role as the sole "residual claimants" within the corporation. According to the theory, other actors within the corporation—creditors, employees, customers, suppliers—have a relationship to the corporation that is fairly well defined through contract.[44] However, shareholders' returns are residual; they are not payable until the other contractual participants have been fully satisfied.[45] In order to maximize social wealth, the corporation's organizing principle should be the maximization of the residual returns payable to shareholders. In this way, all other claimants receive their contractual entitlements, and the shareholders' remainder has been maximized.

On the other side of this debate stand those who argue for a stakeholder-oriented conception of the corporation.[46] According to stakeholder theorists, the corporation's purpose should focus on serving all of the corporation's stakeholders. In addition to shareholders, those with a stake in the corporation include management, employees, creditors, suppliers, customers, and even the broader community in which the corporation is situated.[47] Stakeholder theorists argue that a corporation and its directors should focus on maximizing returns to all of these stakeholders. Although commentators differ as to the means, most agree that directors should have a significant degree of discretion in carrying out their duties so as to serve all of these interests.[48]

Much of recent corporate-law scholarship has taken up this debate about the proper purpose of the corporation. Scholars disagree whether existing corporate law is more oriented toward shareholder primacy or stakeholder theory.[49] There is also sharp divergence on normative grounds.

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44. EASTERBROOK & FISCHEL, *supra* note 31, at 67–68.

45. *Id.* at 36–37. This perspective assumes that all other claimants have rigidly set contractual entitlements, such that paying them more would be akin to a gift.

46. *See* Stout, *supra* note 19, at 1190 (citing William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264–66 (1992)).

47. *Id.*

48. *See, e.g.*, LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY 118–19 (2001) (arguing that boards of directors should be self-perpetuating); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 280–81 (1999) (arguing for the notion of directors as "mediating hierarchs" for the different constituencies at the firm).

49. *Compare* Henry Hansmann & Reiner Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001) ("[A]s a consequence of both logic and experience, there is convergence on a consensus that the best means to this end (that is, the pursuit of aggregate social welfare) is to make corporate managers strongly accountable to shareholder interests and, at least in direct terms, only to those interests."), *with* Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 650 (2006) ("Although corporate law mandates managerial fidelity to shareholder interests both through shareholder election rights and through fiduciary principles, existing law does not actually require officers and directors to make operational decisions with the sole

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In 2001, one set of pro-shareholder-primacy commentators stated that "[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value,"[50] while a stakeholder theorist argued that the notion of stock price maximization is "as destructive as it is simple."[51] However, it is possible to make too much of this distinction. In the long term, stock price maximization will depend on keeping the other constituencies happy as well; cheating customers, employees, or creditors will surely harm the company and, by extension, its stock price. And stakeholder theorists have acknowledged that some focus on share price can be a useful tool for constraining the discretion of management.[52] Courts, as a whole, have not spent too much time on the debate themselves, preferring to stick to the more practical concerns of fiduciary duties and conflicts of interest.[53]

In this Article, I sidestep this debate, instead arguing that nonbinding employee referenda would be beneficial under both shareholder primacy theory and stakeholder theory. In other words, these referenda would improve overall societal efficiency regardless of whether the best route to such efficiency is shareholder wealth maximization or some version of stakeholder interests maximization. As discussed further below, this dual approach rests primarily on the role of the referenda in informing directors and shareholders,[54] the role of the referenda in restraining management,[55] and the role of the referenda in improving employee morale, productivity, and efficiency.[56] All of these benefits would lead to better results according to shareholder primacy as well as stakeholder theory.[57] Thus, the purpose of corporate combinations need only be the same purpose as the corporate form—namely, increasing societal efficiency by maximizing returns to shareholders or maximizing returns to all of the stakeholders in the company. Moreover, there are reasons for concern that corporate

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objective of shareholder wealth maximization.").

50. Hansmann & Kraakman, *supra* note 49, at 439.

51. MITCHELL, *supra* note 48, at 4.

52. Stout, *supra* note 19, at 1200.

53. *See* D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 280, 284–88 (1998) (discussing how the concept of shareholder primacy has limited relevance to corporate law in practice).

54. *See infra* Part II.C.

55. *See infra* Part II.C.3.

56. *See infra* Part III.

57. What shareholder primary and stakeholder theory do not support is a strong notion of managerial primacy. Concern about agency costs has largely driven managerial primacy from the debate. *See* Bainbridge, *supra* note 16, at 549 (noting that managerial primacy "no longer has much traction in the legal academy").

combinations, as currently constructed, are failing along both of these measures.

B. Problems with Corporate Combinations

The initial challenge raised to employee referenda may be that their absence under current law is a result of properly made market decisions. If the reform really increased firm efficiency, the argument goes, the market would have already developed it.[58] However, there are reasons to think the market may be in need of some tweaking here. Corporate combinations have been the subject of extensive study in both law and finance literature, and there are grounds for believing that certain kinds of combinations decrease firm value. These substantive concerns coincide with procedural concerns about incentives on the part of executives, directors, and consultants to act inefficiently in their own self-interest.

1. Substantive Problem: Poor Results

Corporate combinations can often be scenes of shipwreck-level destruction for the companies involved. Although some potential for failure is inherent in any enterprise, there is evidence that corporate combinations may be generally value-reducing for the participating firms. The effects of corporate combinations on firm value and on stock price are much-studied phenomena in the financial literature. The results have been different for targets (smaller companies that will be taken over) as compared with acquiring companies. There is general consensus that in the very short term, when the corporate combination is announced, there are large positive abnormal returns to companies that are the targets of a proposed merger or acquisition.[59] While there is conflicting evidence on acquirers, the evidence is sufficiently mixed that "the null hypothesis of zero abnormal performance to acquirers should not be rejected."[60] These results are attributable to the general process whereby the acquirer offers to pay a premium over and above the current market price for the target's

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58. *See, e.g.*, Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1736–44 (2006) (criticizing Lucian Bebchuk's programme of shareholder empowerment because it has not already appeared in the marketplace). *But see* Michael D. Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 793–96 (2006) (discussing how learning and network externalities may impair efficient corporate innovations).

59. Anup Agrawal & Jeffery E. Jaffe, *The Post-Merger Performance Puzzle*, in ADVANCES IN MERGERS AND ACQUISITIONS 7, 7 (Cary Cooper & Alan Gregory eds., 2000).

60. *Id.* at 8 (citing Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59 J. BUS. 197 (1986)).

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shares. Indeed, offers that are at or are minimally above the current market price are generally rejected as nonserious.[61] Thus, in the short term, gains from a merger announcement are often zero sum, as the short-term boost to the target is offset by the loss to the acquirer.

Over the long term, moreover, there are indications that corporate combinations do not increase overall societal efficiency. Studies on long-term returns for corporate acquisitions have generally shown "strong evidence of abnormal under-performance following mergers."[62] There is empirical evidence on both sides, and academics continue to refine and debate the best methods for determining long-term performance.[63] However, the overall pattern has been one of value-reduction in the long term. Numerous academic, financial, and media commentators have noted the failure of corporate combinations to bring long-term gains.[64]

Furthermore, corporate combinations are more likely to fail in situations where the employee referendum would take place—namely, where a vote of the shareholders is required to execute the combination. As noted earlier, shareholders must vote to approve most mergers, as well as the sale of substantially all of their company's assets.[65] However, this

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61. For example, Oracle was widely denounced for its initial bid to purchase PeopleSoft, which offered little to no premium over market price. As one analyst stated, "If [Oracle is] serious, they're going to have to up their bid by a significant premium." Andrew Ross Sorkin & Laurie Flynn, *Oracle Takes $5 Billion Jab at PeopleSoft*, N.Y. TIMES, June 7, 2003, at C1, C2. *See also* Robin Sidel & David Bank, *PeopleSoft Bid by Oracle Corp. Busts Tradition*, WALL ST. J., June 10, 2003, at C1, C5 (noting that the Oracle bid "broke two longstanding traditions of deal making: make an offer that carries a hefty premium to the target's stock price and first approach the target privately with a friendly bid").

62. Agrawal & Jaffe, *supra* note 59, at 37.

63. *See, e.g.*, John D. Lyon et al., *Improved Methods for Tests of Long-Run Abnormal Stock Returns*, 52 J. FIN. 165, 165–67 (1999).

64. *See, e.g.*, ROBERT F. BRUNER, DEALS FROM HELL: M&A LESSONS THAT RISE ABOVE THE ASHES 14 (2005) ("The popular view is that M&A is a loser's game."); Robert G. Eccles, Kersten L. Lanes & Thomas C. Wilson, *Are You Paying Too Much for That Acquisition?*, HARV. BUS. REV. July–Aug. 1999, at 136, 136 (noting "30 years of evidence demonstrating that most acquisitions don't create value for the acquiring company's shareholders"); James A. Fanto, *Braking the Merger Momentum: Reforming Corporate Law Governing Mega-Mergers*, 49 BUFF. L. REV. 249, 280 (2001) ("Evidence from past merger waves shows that public companies engaging in mergers underperform their peer companies that have not followed similar acquisition strategies."); Sara Moeller, Frederik P. Schlingemann & René M. Stulz, *Firm Size and the Gains from Acquisition*, 73 J. FIN. ECON. 201, 202 (2004) (finding that in a study of large corporate acquisitions between 1980 and 2001, acquiring firms lost $303 billion in shareholder wealth); Morgenson, *supra* note 35, at 56 ("Academic research suggests that few mergers add up to significantly more prosperous or successful companies . . . ."); Gregory Zuckerman, *Ahead of the Tape*, WALL ST. J., Dec. 30, 2002, at C1 ("Most just mergers don't work. A mountain of academic research shows most acquisitions end up costing shareholders . . . ."); *A Business Week Analysis Shows that Sixty-One Percent of Buyers Destroyed Shareholder Wealth*, BUS. WK., Oct. 14, 2002, at 60 (looking at 302 large mergers of public companies from 1995 to 2001).

65. *See supra* Part I.

leaves large swaths of corporate combinations uncovered. Most notably, shareholders do not vote when the acquisition is through means of a tender offer. Instead, shareholders "vote" for a tender offer by tendering their shares to the acquirer, and the acquirer treats the purchase as a normal business transaction. This contrasts with mergers between two companies in which the companies trade stock to create a new corporation. Studies have demonstrated that companies involved in stock-for-stock mergers fare more poorly than companies involved in cash transactions in which one company purchases the other.[66]

The information technology boom of the late 1990s is replete with examples of failed corporate combinations. Perhaps the most notorious of all corporate combinations is the merger between AOL and Time Warner. Known as "the worst deal in history,"[67] the combination laid waste to the market value of the new company and led to the departure of almost all of the executives responsible for the union.[68] Three years after the completion of the merger, shareholders in AOL Time Warner had lost over $200 billion in equity value.[69] Although the company has stabilized under current leadership, its stock price remains mired in place, and it recently was the subject of an aborted proxy battle.[70] The AOL–Time Warner merger has become the paradigmatic example of a failed corporate combination.[71]

Other high-profile deals have been less spectacularly unsuccessful, but unsuccessful nonetheless. In 2002, Hewlett-Packard (HP) CEO Carly Fiorina pushed through a merger with Compaq despite a proxy challenge from company director Walter Hewlett, son of one of HP's founders. The media heralded the merger as a real victory for Fiorina, who succeeded despite litigation by Walter Hewlett alleging proxy improprieties.[72] However, the merger failed to revitalize HP, instead leading to Fiorina's

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66. *See, e.g.*, Agrawal & Jaffe, *supra* note 59, at 46 (noting that "abnormal performance is worse for acquirers using stock-financing than for acquirers avoiding stock"); Carlos P. Maquierira, William L. Megginson & Lance Nail, *Wealth Creation Versus Wealth Redistributions in Pure Stock-for-Stock Mergers*, 48 J. FIN. ECON. 3, 8 (1998) (noting that "research indicates that stock-for-stock mergers have systematically lower offer premiums for target firm stockholders, significantly negative abnormal returns for acquiring firm stockholders, and lower net synergistic gains created").

67. SWISHER, *supra* note 1, at 9.

68. BRUNER, *supra* note 64, at 275–78.

69. NINA MUNK, FOOLS RUSH IN: STEVE CASE, JERRY LEVIN, AND THE UNMAKING OF AOL TIME WARNER 277 (2004).

70. *See, e.g.*, Ken Auletta, *The Raid*, NEW YORKER, Mar. 20, 2006, at 132.

71. For a discussion of the AOL–Time Warner merger as an example of the dangers of the shareholder primacy ethos, see Matthew T. Bodie, *AOL Time Warner and the False God of Shareholder Primacy*, 31 J. CORP. L. 975 (2006).

72. *See* Hewlett v. Hewlett-Packard Co., 2002 WL 818091 (Apr. 30, 2002).

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ouster in 2005.[73] The merger's difficulties came despite a complex plan, lauded in the press, that was designed to avoid the mistakes of past mergers.[74] Other flawed combinations include the mergers of Mattel and The Learning Company (in which TLC became a division of Mattel),[75] CUC International and HFS (forming Cendant),[76] and BankAmerica and NationsBank (forming Bank of America).[77] Even those who question whether corporate combinations have generally poor results concede that a significant number of them have spectacularly poor results.[78]

Having found a strange pool of inefficiency in otherwise efficient markets, scholars have sought out the reasons why. They have identified the following flaws in the process as potential reasons for the poor results.

2. Process Problem: Limited Information

The process of carrying out a corporate combination generally follows a prescribed pattern. Initially, officers at the highest levels of each corporation talk over the feasibility and desirability of a combination. If the top officers agree to a deal, then the companies must secretly and expeditiously conduct due diligence using high-level management and outside consultants. If this hastily conducted due diligence uncovers no problems, the boards approve the combination and announce the deal to the public and shareholders. The shareholders generally have a few months to digest the proxy materials and media reports before they vote to approve or quash the merger. If the combination receives shareholder and regulatory approval, the combination ultimately goes into effect.

There are strategic reasons for the structure of this process. Executives begin in secrecy because news of negotiations can send stock prices up.[79] Competitors may also jump into the process if word gets out, making the negotiations more complicated and costly.[80] Failed merger negotiations can damage both companies' reputations, or make one company seem

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73. Paul R. La Monica, *Carly Fiorina Forced Out at HP*, CNNMONEY.COM, Feb. 10, 2005, http://money.cnn.com/2005/02/09/technology/hp_fiorina/index.htm?cnn=yes.

74. Pui-Wing Tam, *An Elaborate Plan Forces H-P Union to Stay on Target*, WALL. ST. J., Apr. 28, 2003, at A1.

75. *See* BRUNER, *supra* note 64, at 246–64.

76. *See* Fanto, *supra* note 64, at 272–73.

77. *See id.* at 274.

78. *See* BRUNER, *supra* note 64, at 95–340 (discussing particularly poor performers).

79. *See, e.g.*, Basic, Inc. v. Levinson, 485 U.S. 224, 234–35 (1988) (discussing the importance of keeping merger negotiations secret).

80. *See* Brown, *supra* note 6, at 93 ("Corporate officials fear that premature disclosure may result in a competitive disadvantage or may jeopardize continuation of the negotiations.").

weak and ripe for the taking.[81] The ramifications of such negotiations are so far-reaching that executives do their best to keep the discussions under tight wraps. The talks may be so secretive that only a handful of the company's top executives even know about them.[82]

While this secrecy serves a purpose, it also narrowly restricts both the information and the perspectives that can be brought to bear. The decision to actually carry out the merger is generally made at the very highest levels before any due diligence. For example, in the AOL–Time Warner merger, AOL CEO Steve Case and Time Warner CEO Gerald Levin made the decision to merge the two companies over dinner in a private room at the Rihga Royal Hotel.[83] For the next two months, small groups of executives and advisors on both sides haggled over the final details—including the number of board seats each side would have in the new company and the values of shares given to each side's shareholders.[84] The negotiations were intense, and the transaction was called off at various points. Ultimately, Levin and Case made the final agreement over dinner with just two other executives present.[85] Only four executives at Time Warner knew about the possibility of a merger before the agreement had been reached.[86]

While Levin may have been unusually secretive with his upper-level cohorts, the general rule for merger negotiations is a shroud of secrecy maintained by a small number of executives and advisors.[87] As a result,

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81. *See, e.g.*, Dale Oesterle, *Hard Lessons for Harvey Electronics*, Business Law Prof Blog, http://lawprofessors.typepad.com/business_law/2007/12/hard-lesson-for.html (Dec. 29, 2007) (noting that "a failed merger negotiation, once publicly announced and far along, can have heavy, heavy costs for a company").

82. *See* MUNK, *supra* note 69, at 141–43 (discussing how AOL CEO Steve Case and Time Warner CEO Gerald Levin met in secrecy at hotels and homes to carry out their talks).

83. *See* MUNK, *supra* note 69, at 143 ("By the end of the evening, Levin and Case were of one mind. Together they could create the world's most powerful and respected Internet-driven media and entertainment company.").

84. *Id.* at 145–56.

85. Also present were Kenneth Novack, AOL's vice chairman, and Richard Bressler, the head of Time Warner Digital Media. *Id.* at 156.

86. *Id.* at 158 (noting that only Bressler, Rob Marcus (who worked under Bressler), then-president Richard Parsons, and deputy general counsel Chris Bogart had heard of the negotiations). The chief financial officer and the general counsel had no knowledge of the negotiations. *Id.* at 159–60.

87. *See, e.g.*, BILL VLASIC & BRADLEY A. STERTZ, TAKEN FOR A RIDE: HOW DAIMLER-BENZ DROVE OFF WITH CHRYSLER 227 (2000) ("Only ten executives in Chrysler knew of the pending deal, and only a few more than that at Daimler."); Press Release, Walter Hewlett Responds to Statement from Hewlett-Packard (Feb. 19, 2002) *available at* http://www.sec.gov/edgar/searchedgar/companysearch.html (search "CIK" for "47217"; search "Prior to" for "2002–02–19"; follow link for File No "02553516") ("According to [Hewlett-Packard] management's own earlier claims, the Compaq merger [with Hewlett-Packard] is the culmination of a surprise telephone conversation

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corporate combinations are extremely top-down affairs. The critical decision to combine is made at the very top, often by the CEO alone. Only after the decision to combine has been made are larger circles of executives and advisors included in the planning.

Consequently, the board and the shareholders are often handed something of a *fait accompli*. Presumably the board has the benefit of due diligence conducted by investment banks, which is designed to draw out any potential flaws in the merger.[88] But those conducting the due diligence know the end result they are supposed to reach: allow the combination to proceed. Due diligence is generally conducted by the same investment banks who have been working with the firms' principals; these banks stand to earn fees if the combination proceeds.[89] Moreover, they are often given incredibly short periods of time in which to conduct the diligence. For the AOL–Time Warner merger—the largest combination in history—the banks had a three-day weekend to prepare their fairness reports for the companies' boards.[90]

The board has the final approval of the deal before it is announced to the media. As the situs of corporate power,[91] the board might be considered the driver behind any corporate combination. However, boards may find themselves in a poor position to provide effective review. Much has been written about the role of the board in the modern corporation, and recent corporate governance reforms have focused on strengthening the board's ability to monitor management.[92] But boards are made up of top

between [Hewlett-Packard CEO] Carly Fiorina and [Compaq CEO] Michael Capellas which occurred only a few short months before the merger was announced.").

88. *See, e.g.*, Goldman Sachs, Investment Banking, http://www2.goldmansachs.com/client_services/investment_banking/index.html; Robert J. Giuffra, Jr., Note, *Investment Bankers' Fairness Opinions in Corporate Control Transactions*, 96 YALE L.J. 119, 121–25 (1986). For a narrative example of the role of financial advisors in a merger, see Emerald Partners v. Berlin, 2003 WL 21003437, at *8–*12 (Del. Ch. 2003).

89. MUNK, *supra* note 69, at 166 (noting that the two investment banking firms involved in the AOL–Time Warner merger each received a fee of $60 million); Giuffra, *supra* note 88, at 127–28 (noting that "investment banks face strong incentives to provide opinions that serve management's interests").

90. MUNK, *supra* note 69, at 161–62. As one of the bankers involved in the opinions noted, "[i]f you do a deal over a weekend, you take shortcuts. . . . In hindsight, it was sloppy." *Id.* at 163.

91. *See* Bainbridge, *Director Primacy*, *supra* note 16.

92. Commentary on the board's role in monitoring management has been voluminous. The discussion stems from the focus placed on managerial agency costs. *See* Jensen & Meckling, *supra* note 2. Many commentators have seen the board's primary role as reducing these costs through monitoring. *See* MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 205–09 (1976) (discussing board structure to maximize monitoring). The failures of the boards to detect massive or blatant wrongdoing at such companies as Enron and WorldCom have led to a reexamination of the board as monitor. *See, e.g.*, Arnoud W.A. Boot & Jonathan R. Macey, *Monitoring Corporate Performance: The Role of Objectivity, Proximity, and Adaptability in*

management or part-timers. The part-timers may or may not be independent, and even so-called independent directors often have powerful ties or obligations to management.[93] In any event, they are part-timers, generally with significant responsibilities of their own to other firms.[94] As a result, their other responsibilities limit the time in which to carry out their monitoring functions.

The condensed timeframe for the board's decision exacerbates the limitations of part-time status. The need for secrecy may lead management to inform board members about the potential deal at the last minute.[95] Directors get much of their information about the deal from the bank's fairness opinion, which may have been drafted with the purpose of convincing the board to do the deal.[96] Generally, the board then has an extremely limited amount of time to decide on whether to do the deal. Critics contend that the process is not designed to provide board members with a true informational picture of the combination; rather, it is designed to get the board's approval at the last minute, as a prelude to the formal announcement.[97]

The announcement itself shows the front-loaded nature of the process. When the principals call a press conference to announce the combination,

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Corporate Governance, 89 CORNELL L. REV. 356 (2004).

93. *See, e.g.*, *In re* Oracle Derivative Litigation, 824 A.2d 917 (Del. Ch. 2003) (holding that directors, who were professors at Stanford University, lacked independence as to defendant executives, who had promised substantial charitable gifts to the university). For recent work on the function of independent directors, see Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007); Usha Rodrigues, *The Fetishization of Independence* (Univ. of Ga. Sch. of Law, Research Paper Series, Paper No. 07-007, 2007), *available at* http://ssrn.com/abstract=968513.

94. *See* BEBCHUK & FRIED, *supra* note 36, at 31–37.

95. The need to keep merger negotiations secret was at the heart of *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). The Court ruled that executives were not free to lie about their negotiations, despite the need for secrecy. *Id.* at 236. The Court reasoned that a consistent "no-comment" policy would protect the secrecy of the negotiations without misleading investors. *Id.* at 239 n.17. *But see* Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059, 1069–71 (1990) (arguing that secrecy is critical to the M&A market and that lying should be permitted in that context).

96. *See* Lucien Ayre Bebchuk & Marcel Kahan, *Fairness Opinions: How Fair Are They and What Can Be Done About It?*, 1989 DUKE L.J. 27, 37 ("Bankers are thus likely to use their discretion to render opinions that serve the interests of managers."); Steven M. Davidoff, *Fairness Opinions*, 55 AM. U. L. REV. 1557, 1562 (2006) (discussing how fairness opinions are "deeply flawed" because of their subjectivity, flawed methodologies, and conflicts of interest); Andrew Ross Sorkin, *They're All No. 1, But Are They Worth It?*, N.Y. TIMES, Aug. 5, 2007 (Business), at 1 (discussing the banks' incentive to "make the deal happen").

97. *See, e.g.*, MUNK, *supra* note 69, at 170–74 (discussing the Time Warner board's approval of the merger with AOL); Bebchuk & Kahan, *supra* note 96, at 37–43 (discussing the conflicts of interest that might lead to such a result); Davidoff, *supra* note 96, at 1587 (noting that some contracts provide that the bank will only be paid, or will be paid more handsomely, if the transaction is approved).

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the deal appears complete to the public.[98] The announcement is not framed as one step in a process of approval but rather as the announcement of the actual deal, pending a few technicalities. The announcement has the air of a celebration, and the media often joins in on the fun.[99]

In contrast to the board, shareholders are given significantly more time to make their decision concerning the merger and can look to the required proxy disclosure about the merger. Depending on the size of the merger, the media may also be a source of information. But again, the process is designed not to give shareholders an active role in the combination, but rather to secure their "yes" vote with as little controversy as possible. State law and federal securities regulations require substantial disclosure when public companies solicit proxies.[100] The materials tend to be quite lengthy.[101] While the required disclosure is designed to provide shareholders with critical information, firms and their counsel generally design such disclosure in order to minimize risk of after-the-fact liability

98. For a recent example of premature closure, see *Whole Foods Is Buying Wild Oats*, ASSOC. PRESS, Feb. 21, 2007 ("Whole Foods Market Inc. said Wednesday it will pay $565 million for Wild Oats Markets Inc., a chain of natural and organic food markets in the United States and Canada."); Andrew Martin, *Whole Foods Buys Smaller Rival*, N.Y. TIMES, Feb. 22, 2007 (web version). The *N.Y. Times* changed the title in time for the print version. Andrew Martin, *Whole Foods Makes Offer for a Smaller Rival*, N.Y. TIMES, Feb. 22, 2007, at C1.

99. *See* Fanto, *supra* note 64, at 298 ("[T]he media has celebrated [mega-merger] transactions and lionized the CEOs proposing them . . . .").

100. State law generally requires that corporations have a duty to disclose the facts material to their stockholders' decisions to vote on a merger. *See, e.g.*, Arnold v. Society for Savings Bancorp., Inc., 650 A.2d 1270, 1277 (Del. 1994). The test is generally stated as follows: "[A]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Zirn v. VLI Corp., 621 A.2d 773, 778–79 (Del. 1993) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)). In Delaware, two recent cases by Vice Chancellor Leo Strine, Jr. have highlighted the company's disclosure obligation to shareholders. The vice chancellor enjoined a shareholders' vote in *In re* Lear Corp. Shareholders Litigation, 926 A.2d 94 (Del. Ch. 2007), because the company had failed to disclose the CEO's financial situation that made a buyout personally favorable to him. *See id.* at 98 (concluding that shareholders were "entitled to know that the CEO harbored material economic motivations that differed from their own that could have influenced his negotiating posture"). In *In re* Topps Co. Shareholders Litigation, 926 A.2d 58 (Del. Ch. 2007), Vice Chancellor Strine held that the company had failed to disclose several critical factors to shareholders about its proposed merger, such as the willingness of the acquirer to retain current management and the seriousness of a competing bid. In both cases, the shareholders' vote was enjoined until shareholders received the appropriate disclosures.

Federal securities regulations provide for more uniform disclosure through § 14 of the 1934 Securities Exchange Act. 15 U.S.C. § 78n (2000). Specific disclosures are provided for in the regulations. *See* 17 C.F.R. §§ 240.14a–3, –101 (2007) (Schedule 14A).

101. For example, the proxy solicitation materials regarding the proposed Lucent-Alcatel merger are 175 pages plus 75 pages of appendices. *See* Lucent-Alcatel Merger Proxy Statement (Aug. 4, 2006), *available at* http://www.sec.gov/edgar/searchedgar/companysearch.html (search "CIK" for "1006240"; follow link for Form "DEFA14A," Filing Date "2006-08-07").

for improper disclosure.[102] As a result, the disclosure tends to be a static, lump-sum document written primarily to advance the proposal while meeting legal requirements.

In some circumstances (particularly for larger combinations), the media does play a role in investigating the proposal and serving as a check against management. However, business journalists generally need some sort of hook in order to generate interesting coverage. Most shareholder votes are dull affairs for the media, with the proposal receiving the overwhelming majority of votes.[103] The only recent shareholder vote on a corporate combination that drew any press was the vote for the HP-Compaq merger. That vote drew attention because of Walter Hewlett's battle against the merger and subsequent litigation over the proxy contest.[104] Even those combinations that draw a significant amount of attention may not receive appropriate journalistic scrutiny; the press has been largely adulatory of the CEOs who can bring off a high-stakes merger.[105]

Thus, from start to finish, the typical corporate combination is hampered by the absence of critical information. At the beginning, the CEO and her trusted coterie must labor in secret in developing the basic decision on whether or not to combine. Once the CEO has decided to go forward, the board generally approves the combination under hurried conditions with information provided by those who are already invested in the deal—the CEO, her advisors, and an investment bank that stands to earn hefty fees if the deal goes through. Then, shareholders vote after receiving a thoroughly vetted, lengthy disclosure document and perhaps hearing some media scrutiny. By that point, however, the company itself has committed to the combination. Given this process, there is real reason

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102. Larry E. Ribstein, *Fraud on a Noisy Market*, 10 LEWIS & CLARK L. REV. 137, 146 (2006) (noting that companies base disclosure decisions on liability concerns).

103. Shawn Tully, *Taking the Guesswork out of Proxy Voting*, CNNMONEY.COM, Dec. 21, 2006, http://money.cnn.com/magazines/fortune/fortune_archive/2006/12/25/8396763/index.htm ("[M]ost of the deals win shareholder approval by an overwhelming margin . . . .").

104. *See, e.g.*, Dawn Kawamoto, *Walter Hewlett Speaks Out*, CNET News, http://news.com.com/2100-1001-858499.html. Hewlett hired consulting firms, made numerous presentations, and took out several ads all with the purpose of persuading shareholders to vote no. It is estimated that both sides combined spent over $100 million in their efforts to persuade shareholders. Steve Lohr & Michael Brick, *Hewlett-Packard Claims a Victory in Hewlett-Compaq Proxy Battle*, N.Y. TIMES, Mar. 20, 2002, at A1.

105. *See* Fanto, *supra* note 64, at 298–304. Even proxy advisors such as Institutional Shareholder Services (ISS) have been strangely acquiescent toward many of the ill-founded mergers of recent past. *See* Tully, *supra* note 103 ("M&A is ISS's weak point. It has a long record of recommending deals that were doomed from conception, and it has consistently endorsed mergers in which the buyer agreed to vastly overpay.").

to question whether the information used in making the decision is optimal.

3. Process Problem: Managerial Overconfidence

Limited information is not the only obstacle to efficiently negotiated corporate combinations. Within the negotiations themselves, commentators have long been concerned that top executives may not be negotiating with economic rationality. Instead, there is a concern that CEOs may be acting with hubris—an inflated sense of their own abilities and the transactions they seek to effectuate.[106] This hubris may be a product of two types of systematic irrationalities known as heuristics—the optimism bias and the commitment bias. These two heuristics form what one commentator has labeled the "optimism-commitment 'whipsaw.'"[107]

Scholars have keyed in on the effects of the optimism or overconfidence bias on high-level corporate decision makers.[108] The optimism bias is one of the most well-chronicled and intuitively resonant biases.[109] The bias refers to people's irrational beliefs that they are smarter, more successful, and more talented than they actually are. The quintessential optimism bias study concerns questions about whether one's ability in a certain area is "above average." Subjects on average believe that their talents are above average.[110] Relatedly, evidence also suggests

106. Richard Roll has argued that corporate takeovers were generally a value-neutral proposition, and therefore, rational executives would not seek them out. Roll, *supra* note 60, at 198 ("It will be argued here that takeover gains may have been overestimated if they exist at all."). In order to explain the frequency of combinations, Roll relied not on rational market theory but rather managerial hubris. *Id.* at 200. Relying on the empirical evidence that individual decision making is not always rational, Roll noted that takeovers were an apt subject for such research, as takeovers reflect individual decisions. *Id.* at 199. Given that the data, in his view, did not show added value from takeovers to the acquiring firm, Roll hypothesized that managerial hubris—namely, the notion that a manager's (higher) valuation of the target was better than the market's (lower) valuation—was responsible for takeover activity. *Id.*

107. Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)*, 146 U. PA. L. REV. 101, 147 (1997).

108. *See, e.g.*, MAX H. BAZERMAN, JUDGMENT IN MANAGERIAL DECISION MAKING 37–39 (3d ed. 1994) (discussing overconfidence among managers).

109. *See, e.g.*, Werner F.M. De Bondt & Richard H. Thaler, *Financial Decision-Making in Markets and Firms: A Behavioral Perspective*, in 9 HANDBOOKS IN OPERATIONS RESEARCH AND MANAGEMENT SCIENCE: FINANCE 385–410 (R.A. Jarrow et al. eds., 1995) ("Perhaps the most robust finding in the psychology of judgment is that people are overconfident.").

110. *See* David Dunning, Judith A. Meyerowitz & Amy D. Holzberg, *Ambiguity and Self-Evaluation: The Role of Idiosyncratic Trait Definitions in Self-Serving Assessments of Ability*, *in* HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT 324, 324 (Thomas Gilovich et al. eds., 2002) (finding that seventy percent of high school students in one study rated themselves above average in leadership skills, while only two percent ranked themselves below average on that dimension); Ola Svenson, *Are We All Less Risky and More Skillful than Our Fellow Drivers?*, 47

that individuals underestimate others' abilities, especially those of their competitors.[111] Optimism bias also leads individuals to believe that good things are more likely to happen to them, and bad things are less likely to happen to them, than they are to other people.[112] Another component of the optimism bias is the so-called "illusion of control." This irrationality means that "people not only think that they are better than average when skill or ability is relevant to outcomes, they sometimes believe that they have more control over outcomes than they do."[113]

Although the optimism bias creates an irrational perspective, social psychologists believe the bias may be rationally adaptive.[114] A bias towards optimism gives the individual a reason to strive to overcome difficulties. It may inspire others to similarly persist. The illusion of control may lead individuals to try harder to succeed, since they have the "illusion" that success is within their grasp. In fact, many believe that corporate executives are well served by these very traits.[115] The

ACTA PSYCHOLOGICA 143, 146 (1981) (finding that most drivers believe they are above-average drivers); D. Walton, *Examining the Self-Enhancement Bias: Professional Truck Drivers' Perceptions of Speed, Safety, Skill and Consideration*, 2 TRANSP. RES. Part F 91, 99 (1999) (finding that nearly eighty percent of truck drivers believe they are safer drivers than the average truck driver); E. W. Zuckerman & John T. Jost, *What Makes You Think You're So Popular? Self Evaluation Maintenance and the Subjective Side of the "Friendship Paradox*,*"* 64 SOC. PSYCH. Q. 207 (2001). This tendency is sometimes called the "Lake Wobegon Effect." *See* Joseph Bankman & Ronald J. Gilson, *Why Start-Ups?*, 51 STAN. L. REV. 289, 291 n.3 (1999).

111. A recent example of such behavior is the case of "Rahodeb," the online user name for Whole Foods CEO John Mackey. Mackey used his anonymous online account to praise Whole Foods and pillory competitor Wild Oats. David Kesmodel & John R. Wilke, *Whole Foods Is Hot, Wild Oats a Dud—So Said "Rahodeb*,*"* WALL ST. J., July 12, 2007, at A1.

112. Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1524 (1998) ("A common feature of human behavior is overoptimism: People tend to think that bad events are far less likely to happen to them than to others."); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051, 1091 (2000) (describing the overconfidence bias as "the belief that good things are more likely than average to happen to us and bad things are less likely than average to happen to us").

113. Russell Korobkin, *Psychological Impediments to Mediation Success: Theory and Practice*, 21 OHIO ST. J. ON DISP. RESOL. 281, 288 (2001). *See generally* Ellen J. Langer, *The Illusion of Control*, 32 J. PERSONALITY & SOC. PSYCHOL. 311 (1975).

114. *See, e.g.*, Pamela C. Regan, Mark Snyder & Saul M. Kassin, *Unrealistic Optimism: Self-Enhancement or Person Positivity?*, 21 PERSONALITY & SOC. PSYCHOL. BULL. 1073, 1079–80 (1995) (finding that unrealistic optimism resulted in a greater chance of experiencing positive future life outcomes); Shelley E. Taylor & Peter M. Gollwitzer, *Effects of Mindset on Positive Illusions*, 69 J. PERSONALITY & SOC. PSYCHOL. 213, 224–25 (1995) (demonstrating that people tend to use positive thinking when implementing goals).

115. Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals About Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285, 288 (2004) (noting that "over-optimism, an inflated sense of self-efficacy and a deep capacity for ethical self-deception are *favored* in corporate promotion tournaments, so that people who possess them are disproportionately represented in executive suites").

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tournaments which drive the market for managerial talent reinforce optimism and the illusion of control by giving those with such biases a greater likelihood of success.[116]

However, those same irrationalities that allow CEOs to climb the corporate ladder successfully also may work against the company's fortunes when applied to business decisions. In fact, research has shown that executive overconfidence has demonstrated effects on corporate decision making. According to this research, executive overconfidence leads to excessive entry into unfamiliar markets,[117] overpaying in the context of auctions,[118] overreliance on the executive's personal information and perspective,[119] and undue faith that the market is undervaluing the executive's own company.[120] As a result, executive overconfidence may lead to a consistent pattern of market irrationality, resulting in inefficiencies.

Furthermore, overconfidence can combine with another behavioral heuristic to do even more damage to corporate decision making. Social psychologists have identified a human tendency to stay with a project or endeavor past when it remains profitable or beneficial to do so.[121] This reluctance to abandon prior sunk costs is known as the commitment bias.[122] Studies have demonstrated this bias within the corporate world.[123] When commitment bias teams up with the optimism bias, executives will

116. *See, e.g.*, Donald C. Langevoort, *The Organizational Psychology of Hyper-Competition: Corporate Irresponsibility and the Lessons of Enron*, 70 GEO. WASH. L. REV. 968 (2002); Troy A. Paredes, *Too Much Pay, Too Much Deference: Behavioral Corporate Finance, CEOs, and Corporate Governance*, 32 FLA. ST. U. L. REV. 673 (2005); Anand Mohan Goel & Anjan V. Thakor, *Rationality, Overconfidence and Leadership* (Univ. of Mich. Bus. Sch., Working Paper No. 00–022, 2006), *available at* http://ssrn.com/abstract=244999. For a brief overview of the tournament for managerial talent, see Iman Anabtawi, *Explaining Pay Without Performance: The Tournament Alternative*, 54 EMORY L.J. 1557, 1586–87 (2005).

117. *See, e.g.*, Colin Camerer & Dan Lovallo, *Overconfidence and Excess Entry: An Experimental Approach*, 89 AM. ECON. REV. 306 (1999).

118. *See, e.g.*, RICHARD H. THALER, THE WINNER'S CURSE: PARADOXES AND ANOMALIES OF ECONOMIC LIFE (1992).

119. *See, e.g.*, Antonio Bernardo & Ivo Welch, *On the Evolution of Overconfidence and Entrepreneurs*, 10 J. ECON. & MGMT. STRATEGY 301 (2001).

120. *See, e.g.*, J.B. Heaton, *Managerial Optimism and Corporate Finance*, 31 FIN. MGMT. 33 (2002); Ulrike Malmendier & Geoffrey Tate, *CEO Overconfidence and Corporate Investment*, 60 J. FIN. 2661 (2005).

121. *See* Langevoort, *supra* note 107.

122. *See, e.g.*, Lawrence E. Cunningham, *Behavioral Finance and Investor Governance*, 59 WASH. & LEE L. REV. 767, 783 (2002) (discussing commitment bias).

123. *See, e.g.*, Barry M. Staw, *Rationality and Justification in Organizational* Life, in 2 RESEARCH IN ORGANIZATIONAL BEHAVIOR 45 (Barry M. Staw & L.L. Cummings eds., 1980); Charles R. Schwenk, *Information, Cognitive Biases, and Commitment to a Course of Action*, 11 ACAD. MGMT. REV. 298 (1986).

not only make overly optimistic choices, but they will also stay with those choices long after the evidence demonstrates the error—the aforementioned optimism-commitment whipsaw.[124] The exacerbated effects of these irrationalities may lead to unethical behavior, as executives realize too late how bad the situation is and desperately try to get themselves out of it.[125]

It is easy to see how these biases can lead to poor decision making in the context of corporate combinations. At the beginning of negotiations, the CEO and just a few trusted advisors are put in the position of determining whether the combination makes sense, and on what terms.[126] The success of the combination, in the eyes of the CEO, may largely depend on his or her own finesse and ability in making the transaction work. The overconfidence bias is thus likely to make the CEO more inclined to believe that he or she can make the combination a success. Once the two sides agree to the transaction, the commitment bias takes over. Even though only the CEO and a small group of executives have decided on the combination, in their minds the commitment has been made. Thus, they are prone to push hard for the deal and genuinely (if even irrationally) believe that the deal will make the corporation better off. The commitment bias then will affect the board's judgment once it decides in favor of the transaction. These players are thus more likely to stick with their decision even if further evidence changes the cost-benefit analysis that a bias-free actor would make.

As noted earlier, scholars have particularly noted the presence of managerial overconfidence and hubris in the market for corporate control.[127] Unlike other areas of corporate conduct, the finance literature has made a place for behavioral irrationalities such as overconfidence in large-scale mergers and acquisitions. These irrationalities place a further burden on the combination process.

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124. *See supra* note 107 and accompanying text.

125. *Id.*

126. *See* BRUNER, *supra* note 64, at 347 ("Overoptimism (also called 'hubris') is pervasive at the start of most of these failed deals.").

127. In his article on CEO overconfidence, Troy Paredes turns repeatedly to corporate combinations for examples of overconfidence at work. *See* Paredes, *supra* note 116, at 674–75 (discussing Comcast's bid to acquire Disney); *id.* at 692 (discussing VeriSign's acquisition of Network Solutions); *id.* at 745 (discussing a remedy against overconfidence in the context of "big-ticket items, such as significant mergers [and] acquisitions"). Another recent study found evidence of behavioral heuristics and biases in the context of required disclosure documents for the thirty biggest stock-for-stock mergers over a three-year period. *See* James A. Fanto, *Quasi-Rationality in Action: A Study of Psychological Factors in Merger Decision-Making*, 62 OHIO ST. L.J. 1333, 1354–74 (2001).

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4. Process Problem: Managerial Financial Incentives

In addition to irrational biases in favor of the combination, managers and directors will often have quite rational biases in favor of executing the deal. Because combinations are a time of upheaval and reorganization, they are also a time to revisit the positions and compensations of the executives and directors who run each company. It should not be surprising that companies often make large payouts at these times—payouts that may not be justified under an arms-length system of compensation negotiation.

The payments come on all sides and for all different reasons. When a small company is being merged into a bigger company, the so-called "target" company will often pay its departing executives a sizeable sum.[128] This payment is justified as compensation for a loss or downgrade of position, and it may be necessary to move a profitable combination forward. But it also means that these managers and directors can exact a price for their acquiescence to the plan—a premium unavailable to most employees. That premium may be excessive and against shareholder interests. Sometimes this payment is made by the target company itself, while in other cases the acquiring company pays the sum. In both cases, there is concern that the executive will become too attached to the payout and will fail to follow shareholder interests.[129]

Companies also give executive bonuses when they are on the acquiring end of the deal. According to one study, the acquiring company's CEO received a gratuitous multimillion-dollar bonus in about forty percent of acquisitions.[130] The bonuses are often given as cash for work that falls within the overall job expectations of a chief executive officer. Acquisition bonuses are a critical example of the "managerial power" thesis: these bonuses are not the result of compensation negotiations but rather the CEO's power over the board.[131] In addition, they provide a powerful incentive for executives to pursue acquisitions. Another recent study has found that executives' decisions to expand company size are associated

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128. These may be referred to as "golden parachutes," since they insure the executives a soft landing after they have been jettisoned by the company.

129. BEBCHUK & FRIED, *supra* note 36, at 91 (relating the story of a $170 million "retention pool" for MCI executives promised by British Telecommunication in a proposed merger; the executives then continued to support the merger even after BT reduced its offer by twenty percent).

130. Yaniv Grinstein & Paul Hribar, *CEO Compensation and Incentives—Evidence from M&A Bonuses*, 73 J. FIN ECON. 119 (2004).

131. BEBCHUK & FRIED, *supra* note 36, at 127–29.

with increases in subsequent pay.[132] There is a real concern that "the promise—or even the expectation—of an acquisition bonus could exacerbate managers' excessive acquisition tendencies."[133]

In addition, shareholders may not know ahead of time whether the board will view the merger and its implementation as a justification for a substantial bonus after the merger has been approved. In his campaign against the HP merger with Compaq, renegade director Walter Hewlett raised this issue explicitly. In a report distributed as part of his campaign, Hewlett accused the company of "hiding the ball" with respect to postmerger compensation.[134] Because he believed that management was not forthcoming, he leaked board discussions that had contemplated compensation packages totaling more than $115 million.[135] It is, of course, highly unusual to have a dissident board member leak such information; shareholders are generally not privy to such understandings or discussions.

Given the propensity for managers to use combinations as a reason for higher pay, it is no wonder corporate combinations themselves have come under greater scrutiny.[136] Even if such bonuses are based on desert, they still can provide a powerful incentive to initiate or continue with deals that should not be done.

5. *Process Problem: Deal-Protection Provisions*

In addition to the information and behavioral problems that can lead to bad corporate combinations, many firms find themselves locked into a decision not only by commitment bias but also by contractual provisions. Deal-protection provisions include: agreements to sell certain assets to the bidding company at a reduced price if the transaction does not go through; agreements to submit the transaction to the shareholders, even if the board changes its mind; termination fees if the transaction does not occur; and side agreements with key shareholders as to their votes. Such provisions

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132. Lucien A. Bebchuk & Yaniv Grinstein, *Firm Expansion and CEO Pay* (Harvard Univ. Olin Ctr. for Law, Econ. & Bus., Discussion Paper No. 533, 2005), *available at* http://ssrn.com/abstract=838245.

133. BEBCHUK & FRIED, *supra* note 36, at 128.

134. Walter B. Hewlett, Edwin E. Van Bronkhorst & William R. Hewlett Revocable Trust, Proxy Materials, Report on Executive Compensation (Feb. 26, 2002), *available at* http://www.sec.gov/edgar/searchedgar/companysearch.html (search "CIK" for "1136512"; follow link for Form "DFAN14A," Filing Date "2002-02-26," Acc. No. "0000891618-02-000921").

135. *Id.*

136. Gretchen Morgenson answered the title of her article *What Are Mergers Good For?* with: "Not much, unless you're one of the bankers or executives whose compensation goes up with every deal you do." Morgenson, *supra* note 35, at 56.

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have been the subject of considerable judicial consideration and academic discussion for their role in discouraging hostile takeovers.[137]

There is substantial literature in support of deal-protection provisions: such provisions protect the initial bidder and may increase the likelihood that bidders will enter into combination agreements in the first place.[138] However, such provisions also extract a price: they make it much more difficult for boards and shareholders to get out of a deal after the fact. In fact, deal-protection provisions are often written to provide protection to the disappointed firm even if the shareholders reject the proposed combination.[139] Certainly deal-protection provisions offer an opportunity for managers and directors to make it more painful for shareholders to reject a proposed merger. The costs of such proposals have led some commentators to recommend more judicial skepticism of such provisions.[140]

C. The Employee Referendum as Information Generator

An overview of the corporate combination process reveals problematic tendencies toward inefficient behavior. The combination begins with discussions between a small group of executives at the highest level, who are by necessity acting on limited information. However, they soon become locked into the deal, and the other participants in the process—namely, the directors and the shareholders—often play a purely

137. *See, e.g.*, Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 939 (2003) (holding certain deal-protection provisions invalid); *In re* Toys "R" Us Shareholder Litigation, 2005 WL 5756357 (Del. Ch. 2005) (upholding deal-protection provisions); Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-Ups in Negotiated Acquisitions*, 75 MINN. L. REV. 239 (1990); John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory and Evidence*, 53 STAN. L. REV. 307 (2000); Marcel Kahan & Michael Klausner, *Lockups and the Market for Corporate Control*, 48 STAN. L. REV. 1539 (1996).

138. *See, e.g.*, Sean J. Griffith, *The Costs and Benefits of Precommitment: An Appraisal of Omnicare v. NCS Healthcare*, 29 J. CORP. L. 569, 595–615 (2003) (arguing that restriction on deal-protection devices may reduce shareholder welfare by decreasing a target board's options in the midst of competing deals); E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1461 (2005) ("I think most objective observers believe that the majority decision [in *Omnicare*] was simply wrong.").

139. *See, e.g.*, Lucent-Alcatel Merger Proxy Statement, *supra* note 101, at 8 ("A fee of $250 million, which is referred to as the initial termination fee, will be payable by one party to the other party if: (a) either party terminates the merger agreement because the paying party's shareholders failed to approve the merger . . . and prior to the paying party's shareholders meeting, a competing acquisition proposal was made known to the paying party").

140. Coates & Subramanian, *supra* note 137, at 389 ("[L]ockups can in fact protect deals from third-party higher-value bidders, thereby reducing allocational efficiency in the market for corporate control.").

reactionary role. When the participants fail to obtain and evaluate the necessary information, they make bad decisions. The efficiency of corporate combinations would improve with more information, particularly information from players who are not tied into the success of the combination.

Employees are a natural fit for this role. In the 1980s and 1990s, both academic and popular business literature discussed the ways in which firms could take better advantage of the information held by employees.[141] The success of Japanese businesses led many to investigate ways in which Japanese firms sought to work with employees to better design the business.[142] Groups such as "quality circles" and "quality improvement teams" were heralded as a way of getting workers to contribute their knowledge to the corporation.[143] Such methods stood in opposition to hierarchical management structures and the Taylorist method of production, which held that managers generated the information and disseminated down the ladder.[144]

The employee referendum would be one way of tapping into this employee knowledge base.[145] The referendum would ask employees whether they thought the proposed merger should go through. The employees would be given some time to consider their vote and to talk amongst themselves. However, the vote would need to be taken soon enough so that the shareholders would have the results of the referendum

141. For a sampling of the legal academic literature—much of it involving employee ownership—see MARGARET M. BLAIR, OWNERSHIP AND CONTROL (1995); THE NEW RELATIONSHIP: HUMAN CAPITAL IN THE AMERICAN CORPORATION (Margaret M. Blair & Thomas A. Kochan eds., 2000); JOSEPH R. BLASI, EMPLOYEE OWNERSHIP: REVOLUTION OR RIPOFF? (1988); HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 66–119 (1996); SAUL A. RUBENSTEIN & THOMAS A. KOCHAN, LEARNING FROM SATURN: POSSIBILITIES FOR CORPORATE GOVERNANCE AND EMPLOYEE RELATIONS (2001); PAUL WEILER, GOVERNING THE WORKPLACE (1990); Alan Hyde, *In Defense of Employee Ownership*, 67 CHI.-KENT L. REV. 159, 160 (1991).

142. *See, e.g.*, ROBERT E. COLE, WORK, MOBILITY, AND PARTICIPATION: A COMPARATIVE STUDY OF AMERICAN AND JAPANESE INDUSTRY (1980). Enthusiasm for Japanese production methods continues today. *See* Jon Gertner, *From 0 to 60 to World Domination*, N.Y. TIMES, Feb. 18, 2007 (Magazine), at 34.

143. *See, e.g.*, JOSEPH M. JURAN, QUALITY BY DESIGN (1992); DAVID I. LEVINE, REINVENTING THE WORKPLACE: HOW BUSINESS AND EMPLOYEES CAN BOTH WIN (1995); PAUL LILLRANK & NORIAKI KANO, CONTINUOUS IMPROVEMENT: QUALITY CONTROL CIRCLES IN JAPANESE INDUSTRY (1989). For a more recent example, see Erin White, *How a Company Made Everyone a Team Player*, WALL ST. J., Aug. 13, 2007, at B1.

144. *See* Katherine V.W. Stone, *Labor and the Corporate Structure: Changing Conceptions and Emerging Possibilities*, 55 U. CHI. L. REV. 73, 143–46 (1988) (discussing Taylorism in the workplace).

145. *See, e.g.*, Stephen M. Bainbridge, *Participatory Management Within a Theory of the Firm*, 21 J. CORP. L. 657, 680–90 (1996) (discussing how participatory management improves the flow of information between management and employees).

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for their own vote on the merger.[146] The results of the referendum itself—the percentage voting for, the percentage voting against—would be useful information. Beyond that, however, those results would in turn lead to efforts to explain the results. These explanatory efforts would generate more information about the merger and its wisdom.

At first glance, the results of the referendum itself may not seem all that important. After all, it is a nonbinding referendum that simply says whether the employees believe the merger is a worthwhile endeavor. Much of this information, it could be argued, is accessible simply by asking the employees. However, although managers may be able to get a general sense of employee sentiment through internal channels, that anecdotal information is not the same as a referendum. Anecdotal information may be insightful, but it may also vary wildly from the actual reality. Managers cannot be expected to contact every employee about his or her thoughts on the combination.[147] Given the lack of unionization among private sector employees,[148] most companies do not have union representatives that they can turn to as barometers of employee sentiment. In addition, managers would be primed to read employee sentiment as supporting the merger, since they have already bought into it. Psychological biases would lead managers to overvalue employee support and undervalue employee criticism.[149] In addition, employees would be more likely to publicly support the combination, whatever their own views, if they thought managers were looking for positive feedback.[150] Employees might be fearful that failure to support the combination would be punished. Finally, even if managers could get a realistic read on employee sentiment, they would in all likelihood keep that information to themselves. They are unlikely to share the information with directors, the

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146. As discussed in Part IV, it may make sense to provide a mandatory set of disclosures to employees so that their vote is more well informed. To make the process less costly, it may be easiest to simply provide to employees the same information that is provided to shareholders. However, a state might opt not to impose any disclosure requirement, and simply let management decide how much information it wishes to share with employees. *See infra* Part IV.

147. *Cf.* JAMES SUROWIECKI, THE WISDOM OF CROWDS: WHY THE MANY ARE SMARTER THAN THE FEW AND HOW COLLECTIVE WISDOM SHAPES BUSINESS, ECONOMICS, SOCIETIES, AND NATIONS 205 (2004) (noting that "with so many layers separating the men in the executive suite from workers in the field, it was hard for top executives to know if the picture they had of their own corporation resembled reality" (citing THOMAS J. PETERS & ROBERT H. WATERMAN, IN SEARCH OF EXCELLENCE: LESSONS FROM AMERICA'S BEST-RUN COMPANIES 17–19 (1982))).

148. Union members account for only 7.5% of the private sector workforce. Economic News Release, *supra* note 13.

149. *See supra* Part II.B.3 (discussing the optimism bias).

150. *Cf.* FREEMAN & ROGERS, *supra* note 12, at 141–42 (citing research that shows that employees want joint participation with management on worker organizations).

shareholders, or the public, particularly if employees are generally unfavorable about the transaction.

The difficulties in determining employee sentiment without a referendum were highlighted in the recent proxy battle over the HP merger with Compaq. Both sides in that battle claimed that employees agreed with their position. In fact, HP shareholder and merger opponent David W. Packard commissioned independent polls of employees on the merger.[151] The polls were conducted by surveying residents in three towns that were known to have high concentrations of HP employees.[152] The results showed that employees surveyed (which included retirees) were against the merger by a two-to-one ratio.[153] However, HP claimed that it had internal survey data demonstrating that more than sixty percent of employees were in favor of the merger.[154] Both sides attacked the other's data.[155] In both cases, however, the results reflected surveys of small portions of employees—not comprehensive efforts to determine what employees thought as a whole.

In addition to providing a definitive, quantitative account of employee sentiment, the referendum would then generate a second level of information: reporting on the referendum's results and the reasons behind those results. Once the votes were counted, the results would trigger a discussion about the meaning behind the numbers. They would provide for a more grounded dialogue among employees, managers, directors, and shareholders. Moreover, instead of merely relying on anecdotal accounts from individual employees, members of the press would have a concrete figure to discuss and dissect. They could then look to the company, employees, and analysts for explanations of the result. Much of this information would still be anecdotal, but it would be in response to a firm-wide survey of employees. It would be grounded in a more scientific slice of reality.[156] This second level of information generation would add an important layer of context to the raw numbers.

151. David W. Packard, Advertisement, *The Case for the H-P Way*, WALL ST. J., Mar. 14, 2002, at C17, *available at* http://www.crn.com/it-channel/18837628.

152. *Id.*

153. *Id.*

154. Peter Burrows, *What Price Victory at Hewlett-Packard?*, BUS. WK., Apr. 1, 2002, at 36–37.

155. HP CEO Carly Fiorina referred to the Packard-commissioned polls as "employee surveys in a small town in Oregon with 500 employees and half of them are retirees." *Fiorina Says Pay No Heed to Hewlett*, ZDNET (Feb. 28, 2002), http://www.zdnet.co.uk/misc/print/0,1000000169,210520139001084c,00.htm. David Packard attacked the company's surveys as biased, directed at certain employees, and nonconfidential. Packard, *supra* note 151.

156. For example, stories about employee discontent will be more meaningful than simply the traditional handful-of-disgruntled-employees accounts. *See, e.g.*, Alorie Gilbert, *PeopleSoft*

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Having identified the type of information that the referendum would generate, we are still left with determining the usefulness of this information. Specifically, what does a vote for or against the combination say about that combination? What are the reasons behind it?

An employee's vote can likely be explained by three different general areas of concerns: business-judgment concerns, employee-related concerns, and managerial-opportunism concerns. Some employees may vote based solely on one of these reasons, while others may cast their vote based on all three. Each category would have different benefits and uses for management, directors, and shareholders. But this is the type of information that would likely bubble up in the referendum's wake.

1. Business-Judgment Concerns

Business-judgment concerns reflect a judgment on the part of employees about the business sense of the combination. This judgment may be reflected in majority support for the combination (signaling agreement with the managers' business judgment), or it may be reflected in majority disapproval of the combination (signaling disagreement with the managers' judgment). Employees may agree or disagree with managers on a variety of business-related judgments: the culture of the other firm, the value of the other firm's business or technology, or the need for a combination to expand the business or enter new markets. A vote that centered on these concerns would generate further information about these business-related issues.

Information generated in this category is obviously useful to all three groups of decision makers: managers, directors, and shareholders. Managers would benefit by getting feedback on their planned combination. They might choose to abandon the plan if employees raise significant enough concerns. By contrast, employee support may bolster their confidence in the plan. Even if they disagreed with the employees' judgment, knowing those concerns would make it easier for management to adapt the plan so that, down the road, employees could buy into the new arrangement. Employees must participate in and adapt to the combination to achieve a successful new company.[157]

Customers, Employees Weigh Deal, CNET NEWS.COM (Dec. 14, 2004) ("Several employees interviewed at the firm's Pleasanton campus on Monday, each of whom requested anonymity, expressed concerns about the deal.").

157. David B. Jemison & Sim B Sitkin, *Corporate Acquisitions: A Process Perspective*, 11 ACAD. MGMT. REV. 145, 147 (1986).

Directors would benefit from the information in their role as stewards of the transaction and the firm. Although directors would have approved the merger before the referendum, they would maintain the ability to withdraw the combination from consideration by the shareholders or to recommend a "no" vote to the shareholders. Many merger agreements contain a "fiduciary out" clause, which gives the board the right to withdraw from the agreement if their fiduciary duties as directors require the deal to be nixed.[158] If employee referenda were implemented, perhaps directors would stipulate that employee disapproval gives a board the discretion to terminate the agreement.[159] An employee vote disapproving the deal, together with the information supporting that vote, may be sufficient to change a board's mind about the wisdom of the transaction.

Finally, shareholders might also look to the employees' business judgment in casting their votes about the proposed combination. For reasons discussed above, management and directors might not give the proper weight to negative information generated by the employee referendum about the deal's business impact.[160] Executives and the board would have already formulated and executed the deal and then would be looking for shareholders to go along with the plan. Their buy-in, combined with behavioral heuristics, may lead them to irrationally ignore or discount business-judgment concerns generated from employees. Shareholders, however, would not be subject to these irrationalities and, thus, could vote against the plan based on the employees' business-judgment concerns.

Indeed, in the most hotly contested merger proxy contest in recent memory, both sides looked to employees to bolster their claims about the

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158. *See, e.g.*, William T. Allen, *Understanding Fiduciary Outs: The What and the Why of an Anomalous Concept*, 55 BUS. LAW. 653, 654 (2000) ("A fiduciary out typically provides that if some triggering event occurs (often the receipt of a defined 'Superior Offer' and sometimes the receipt from the corporation's outside lawyers of an opinion to the effect that the board must *as a matter of fiduciary duty* do an act that the contract forbids or must not do an act the contract requires), then the doing of that act (or the refraining from doing a required act) will not constitute a breach."); Michael A. Stanchfield, *Fiduciary Duties in Negotiated Acquisitions: Questioning the Legal Requirement for "Outs*,*"* 27 WM. MITCHELL L. REV. 2261, 2263–66 (2001) (discussing the prevalence and varieties of such "outs"). There is some suggestion that a "fiduciary out" is necessary under Delaware law. *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 938 (Del. 2003) ("The fiduciary duties of a director are unremitting and must be effectively discharged in the specific context of the actions that are required with regard to the corporation or its stockholders as circumstances change."); Edward D. Herlihy, *Takeover Law and Practice* 2005, 1528 PLI/CORP. 341, 394, Jan. 25, 2006 ("*Omnicare*'s emphasis on the 'unremitting' nature of the board's duties to obtain the best price, and its flat per se rule that replaces previous factual, case-by-case analysis, may suggest that contracts will require some form of fiduciary out to pass muster in the future.").

159. Of course, canceling the deal would likely result in a termination fee, but agreements generally require such fees even if shareholders vote down the proposed combination.

160. *See supra* Part II.B.

wisdom of the proposed transaction. In the battle over the HP-Compaq merger, both management and the dissident group argued that employees agreed with their position.[161] In presentations and advertising, Walter Hewlett emphasized that HP employees were against the merger; one advertisement stated, "If employees are opposed to the Compaq merger at a rate of almost 2 to 1, what hope is there for the Compaq merger?"[162] In addition, both the dissident group and David Packard quoted employee responses discussing the merits of the merger proposal.[163]

Even if these scenarios are possible, one might question whether employees would actually have the business judgment necessary to detect and then vote against a proposed deal based simply on the merits. Firms generally do not call upon the combined judgment of employees in making business decisions; instead, executives are hired to make these big-picture decisions using their access to both public and confidential sources of information along with their intelligence and experience. The likelihood is slim to none (it might be argued) that employees, as a whole, would actually exercise better business judgment on a deal than management and the cadre of professionals who advise them.

However, this conventional wisdom about employees' judgment may be overstated and, in fact, misplaced. As discussed earlier, firms are now using methods to draw more and more information from their employees.[164] Much of this activity is focused on the lower level, such as the shop floor.[165] However, employees may also have collective wisdom on big-picture items as well. In *The Wisdom of Crowds*, James Surowiecki argues that firms should tap employees not only for bottom-level productivity concerns but also for top-level problems of cognition.[166]

> These are the problems that define corporate strategy and tactics. They include everything from deciding among potential new products to building new factories to forecasting demand to setting

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161. *See supra* note 155.

162. Walter B. Hewlett, *Do Not Trade HP's Crown Jewel Imaging & Printing for Compaq's Low-Margin Commodity Computing Business*, Advertisement (appearing in various newspapers on Feb. 26, 2002 and Feb. 27, 2002), *available at* http://www.sec.gov/edgar/searchedgar/companysearch.html (search "CIK" for "1136512"; follow link for Form "DFAN14A," Filing Date "2002-02-28", Acc. No. "0000891618-02-000966").

163. *Id.*; Packard, *supra* note 151.

164. *See supra* Part II.C.

165. *See, e.g.*, MICHAEL J. PIORE & CHARLES F. SABEL, THE SECOND INDUSTRIAL DIVIDE: POSSIBILITIES FOR PROSPERITY 231–36 (1984) (discussing the practice of "flexible specialization" on the shop floor). *See also* MIKE ROSE, THE MIND AT WORK: VALUING THE INTELLIGENCE OF THE AMERICAN WORKER xxxiv (2004) (discussing the various intelligences of different types of workers).

166. SUROWIECKI, *supra* note 147, at 215–16.

> prices to contemplating mergers. Today, in most corporations, the answers to these problems are ultimately decided by one man: the CEO. Yet they are the problems that . . . are probably most amenable to collective decision making, even if the collective is a relatively small group.[167]

Surowiecki goes on to promote the use of "methods of aggregating collective wisdom" in making strategic decisions.[168] In an age which saw the sharp rise and swifter fall of Enron—the allegedly "smartest guys in the room"[169]—the luster of professional expertise in strategic decision making has lost some of its shine.[170] In its place, the use of collective intelligence, through such mechanisms as organizational structure, referenda, and information markets, has enjoyed a recent surge in interest and popularity.[171] Similarly, the wisdom of the average employee has been heralded (again) in popular business literature.[172]

Of course, employees may be wrong. But, if a majority of employees vote "no" based on business-judgment concerns, then at least management has an awareness of the problem and the opportunity to respond to those concerns. A more vigorous debate of the wisdom of the merger increases the likelihood that the eventual decision will be the most efficient one.

2. Employee-Related Concerns

The vote might also reflect concerns about the proposed transaction that pertain primarily to employee interests. For example, employees might vote for a merger because the merger would offer greater

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167. *Id.* at 216.

168. *Id.* at 220–21. Surowiecki specifically discusses the uses of trading markets drawing a diverse mix of employees as methods of assessing projected sales and regulatory decisions. *Id.* at 221–22.

169. BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2003).

170. *See, e.g.*, Malcolm Gladwell, *The Talent Myth: Are Smart People Overrated?*, NEW YORKER, July 22, 2002, at 28 (arguing for organizational structure—not individual intelligence—as the way to institutional success, and criticizing the "McKinsey" approach to employee hiring).

171. *See, e.g.*, Michael Abramowicz, *Information Markets, Administrative Decisionmaking, and Predictive Cost-Benefit Analysis*, 71 U. CHI. L. REV. 933 (2004); Michael Abramowicz, *Predictive Decisionmaking*, 92 VA. L. REV. 69 (2006); Michael Abramowicz & M. Todd Henderson, *Prediction Markets for Corporate Governance*, 82 NOTRE DAME L. REV. 1343 (2007); Miriam A. Cherry & Robert L. Rogers, *Tiresias and the Justices: Using Information Markets to Predict Supreme Court Decisions*, 100 NW. U. L. REV. 1141 (2006).

172. *See, e.g.*, ORI BRAFMAN & ROD A. BECKSTROM, THE STARFISH AND THE SPIDER: THE UNSTOPPABLE POWER OF LEADERLESS ORGANIZATIONS 181–91 (2006); ADRIAN GOSTICK & CHESTER ELTON, THE INVISIBLE EMPLOYEE: REALIZING THE HIDDEN POTENTIAL IN EVERYONE (2006).

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opportunities for employees to move up in the organization. Conversely, employees might vote against a combination because of proposed layoffs or closings that the combination would engender. Unlike business-judgment concerns, employee-specific concerns specifically relate to the employee's interests and may be counter to the interests of managers, shareholders, and other stakeholders in the firm.

A "no" vote from a majority of employees may signal specific employee-related concerns about the proposed transaction. Most obviously, employees may be concerned about layoffs or terminations that would result from postcombination redundancies. In fact, the very reason for the deal may be the cost savings from a reduced payroll. Employee rejection of such a deal would be unsurprising and perhaps not all that illuminating to decision makers within the firm.

However, for those who believe in a stakeholder or "mediating hierarchy" theory of board governance, an employee referendum offers a way to quantify the breadth of employee sentiment for and against a proposed transaction. As discussed earlier, stakeholder theorists believe that the role of the board is to balance among the concerns of the various stakeholders in the firm.[173] Unlike shareholder primacists, who believe that directors must maximize residual returns to shareholders,[174] stakeholder theorists argue that boards must generally maximize returns across all of the stakeholders to the firm.

One clear example of stakeholder theory in action is the state corporate constituency statute. Over half of the states have a provision allowing directors to make certain decisions based on the needs of all corporate constituencies.[175] New York, for example, provides that when considering a change or potential change in the control of the corporation, a director "shall be entitled to consider" the effects that the corporation's actions may have upon the corporation's various stakeholders, including current employees, retired employees, customers, creditors, and the communities in which it does business.[176] The purpose of the statute is to give directors the freedom to consider the impact of a control transaction[177] on

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173. *See supra* Part II.A.

174. *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 31, at 37–39.

175. *See* Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REG. 209, 215 tbl.1 (2006) (finding that thirty-one states have constituency statutes).

176. N.Y. BUS. CORP. LAW § 717(b) (McKinney 2003).

177. The statute states that "[f]or purposes of this paragraph, 'control' shall mean the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the corporation, whether through the ownership of voting stock, by contract, or otherwise." *Id.*

stakeholders other than shareholders. Constituency statutes have generated a voluminous literature both in favor and against such statutes.[178]

The most generally recognized weakness of the constituency statute is lack of accountability for its use. Directors are only given authorization to consider the needs of other constituencies; they are not obligated to do so.[179] Directors are not legally accountable to any of the stakeholders for failure to consider their needs.[180] Thus, critics fear that constituency statutes will be used as a "fig leaf" by boards to act in their own interests rather than in stakeholders' interests.[181] Despite numerous proposals to beef up constituency statutes,[182] they remain in their largely hortatory form.

Employee referenda are a way of putting more substance into constituency statutes. In their current form, directors could cite to vague or anecdotal employee concerns in order to approve, nix, or counter a proposed corporate combination. With an employee referendum in place, directors would have a concrete representation of employee sentiment upon which to base their actions, at least for that constituency. The information generated in response to the referendum would also be useful to directors in formulating their constituency-balancing strategy. By providing quantitative evidence about employee views, the referendum

178. For a recent summary of the arguments for and against constituency statutes, see Brett H. McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1227, 1232–36 (2004).

179. *See, e.g.*, Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 579 (1992).

180. For example, New York's statute states: "Nothing in this paragraph shall create any duties owed by any director to any person or entity to consider or afford any particular weight to any of the foregoing or abrogate any duty of the directors, either statutory or recognized by common law or court decisions." N.Y. BUS. CORP. LAW § 717(b) (McKinney 2003).

181. Letter from Joseph Grundfest, Commissioner, Securities Exchange Commission, to Mario Cuomo, Governor for New York (June 6, 1989), *cited in* Mitchell, *supra* note 179, at 580 & 580 n.4. *See also id.* at 581 ("The principal criticism of rejecting this traditional relationship is that authorizing the board to consider constituencies that have no monitoring or enforcement powers would leave the board accountable to nobody."); Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001) ("[A] stakeholder measure of managerial accountability could leave managers so much discretion that managers could easily pursue their own agenda, one that might maximize neither shareholder, employee, consumer, nor national wealth, but only their own."). Even constituency statute proponents have deep concerns about this problem. *See* David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, *in* PROGRESSIVE CORPORATE LAW 1, 30 (Lawrence E. Mitchell ed., 1995) ("However attractive [the constituency] model might be in theory, communitarian scholars have yet to show persuasively that it could function effectively in practice."); Katherine Van Wezel Stone, *Employees as Stakeholders Under State Nonshareholder Constituency Statutes*, 21 STETSON L. REV. 45, 70 (1991) (noting that constituency statutes provide "very little" actual protection to employees and other constituents).

182. *See, e.g.*, Mitchell, *supra* note 179.

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would provide a better foundation for director decisions based on the stakeholder framework.

More generally, the employee referendum supports the stakeholder model by looking for input from stakeholders other than shareholders on critical decisions of corporate strategy. Employees would have the opportunity to voice their own, potentially self-interested concerns, and directors could take those concerns into account. The referendum invigorates the stakeholder model by offering a concrete way for employees to reach the board with their input. Under stakeholder theory, directors are obliged to take this input seriously; directors could even incorporate the referendum into the process of the transaction itself.[183] Thus, even where employees simply vote based on their own interests, the employee referendum would be useful to corporate decision makers.[184]

3. Managerial-Opportunism Concerns

Thirdly, a vote might reflect employee concerns related to management and managerial opportunism. Even if the combination makes sense from a business-judgment perspective, employees might still vote against the merger if they believe management has used the transaction as an opportunity to extract unnecessary rents from the firm.

As discussed earlier, corporate combinations offer management the opportunity to extract particularized rents.[185] Because the combination requires some degree of reshuffling, both of the corporate structure and of the managerial hierarchy, the combination would generally require changes in managerial positions as well as compensation. The combination is often an opportunity for management to give itself bonuses for pulling off the merger. If the new corporation must offer new stock,

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183. For example, as noted earlier, the transaction agreement could allow the board to terminate the merger based on stakeholder concerns, such as those expressed in the referendum. *See supra* notes 157–59 and accompanying text. But, since the board would not be compelled to do anything based on the referendum, it would still satisfy those scholars who believe that directors must have unfettered discretion to implement policy. *See, e.g.*, Blair & Stout, *supra* note 48, at 254 ("Where progressives have argued that corporate law ought to be reformed to make directors more accountable to stakeholders, the mediating hierarchy approach suggests that directors should not be under direct control of either shareholders *or* other stakeholders.").

184. The information would also be useful for outside unions and other employee activists who would advocate against the change based on employee preferences. Katherine Stone's "citizen union" covering employee concerns in a certain region might find the information particularly useful. *See* KATHERINE V.W. STONE, FROM WIDGETS TO DIGITS: EMPLOYMENT REGULATION FOR THE CHANGING WORKPLACE 229 (2004) ("Citizen unions could act at the local and regional level to pressure corporations to become good corporate citizens.").

185. *See supra* Part II.B.4.

performance-related pay packages would be restructured to accommodate the new system.[186] These new packages often would provide benefits to managers, such as accelerated vesting of stock options, new options packages, or new grants of stock or restricted stock.[187] Even base pay may be changed to reflect the new corporate culture of the combined entity.

While directors may be expected to police instances of excessive compensation, there are a variety of reasons to doubt their effectiveness. First, the directors themselves may be in on the deal. Just as managerial reshuffling can lead to payouts, so too can directorial reshuffling. The firm may decide to award bonuses to directors as well as managers.[188] Second, directors may already feel beholden to managers. Top-level executives have significant power over the board nomination and reelection process[189] as well as the directorial compensation process.[190] Personal ties help cement the feelings of loyalty and friendship.[191] Third, the merger process is so complicated and hurried that directors may focus on the big picture and neglect to work through the complicated compensation details. As discussed, managers generally turn to the board for approval of these transactions at the last minute.[192] As they generally do, boards may trust that investment bankers, compensation consultants, and other advisors have dealt with the compensation issue sufficiently.[193]

In the context of a merger or acquisition, shareholders are empowered to protect against such compensation themselves by vetoing the proposed combination. However, shareholders have to know about the problem in

186. *See, e.g.*, SWISHER, *supra* note 1, at 178–79 (discussing change from Time Warner to AOL).

187. For an extreme example, see Scott Thurm, *The 'I Must Do a Merger' Bonus*, WALL ST. J., Apr. 6, 2004, at C1 (discussing a CEO bonus that was dependent on the company's "entry into new businesses by means of acquisitions").

188. *See* Lewis v. Vogelstein, 699 A.2d 327, 331–33 (Del. Ch. 1997) (discussing the issues surrounding a stock option grant to directors).

189. BEBCHUK & FRIED, *supra* note 36, at 25–27.

190. *Id.* at 27–31 (discussing how top-level managers can financially reward directors).

191. Brian G.M. Main, Charles A. O'Reilly III & James Wade, *The CEO, the Board of Directors, and Executive Compensation: Economic and Psychological Perspectives*, 4 INDUS. & CORP CHANGE 292 (1995).

192. *See supra* Part II.B.5.

193. *See* BEBCHUK & FRIED, *supra* note 36, at 37–39. *See also In re* Walt Disney Shareholders' Litigation, 907 A.2d 693, 704–11 (Del. Ch. 2005), *aff'd* 906 A.2d 27 (Del. 2006) (discussing the process through which Michael Ovitz was hired by Walt Disney in 1995). Although Chancellor Chandler ultimately found no breach of the duties of care and good faith in the Ovitz hiring, he acknowledged that "the compensation committee met *for one hour*" to discuss the terms of Michael Ovitz's compensation along with the compensation packages for various Disney employees, 121 stock option grants, top-level executive Robert Iger's employment agreement, and compensation committee chair Irwin Russell's $250,000 reward for negotiating the Ovitz deal. *Id.* at 708 (emphasis in the original).

order to police it. Increasingly, shareholder service providers are taking steps to police management and inform large institutional shareholders about problems or corruption,[194] but such services are not complete. We are still far from a world in which shareholders are completely informed about their firms and have the power and incentives to act on that information.[195]

Employees are ideally situated to ally with shareholders in an effort to police management. Indeed, this already appears to be taking place. Labor unions, for example, have become much more involved in traditional corporate governance activism.[196] In the 1980s, unions were generally antagonistic to shareholder concerns and supported anti-takeover tactics such as constituency statutes.[197] However, unions have increasingly joined the side of shareholders in pushing through shareholder-friendly corporate governance measures.[198] Unions and union-affiliated pension funds have promoted anti-takeover measures through shareholder proposals under SEC Rule 14a-8.[199] "The amazing thing about these union-sponsored shareholder proposals," notes one set of commentators, "is how ordinary they are, from the perspective of any institutional investor."[200]

These measures suggest a new role for union activism: an alliance with shareholders in an effort to maximize long-term growth for shareholders and other stakeholders.[201] In particular, unions can use their "monitoring advantages to take actions to increase firm value by policing management shirking and reducing the agency costs of equity."[202] In addition, unions have a greater incentive to monitor management, because "[w]orkers are locked into the firm with firm-specific human-capital investments."[203] If unions can monitor and credibly relay their information to other

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194. *See, e.g.*, Institutional Shareholder Services, http://www.issproxy.com/index.jsp (last visited Feb. 4, 2008).

195. Lucien A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 880 (2005) ("Unlike management, shareholders do not have access to inside, private information."); Larry Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1467 (2006) ("[E]ven institutional shareholders face obstacles in managing details of each firm in their portfolios.").

196. See Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018 (1998).

197. *Id.* at 1036.

198. *Id.*

199. Examples include efforts to remove poison pills and repeal classified boards. *See id.* at 1045–46.

200. *Id.* at 1045.

201. *Id.* at 1090.

202. *Id.* As Schwab and Thomas note, unions have "special monitoring abilities" given their closeness to the firm and their access to employee information. *Id.* at 1036.

203. *Id.* at 1037.

shareholders, their role in current corporate governance processes will only expand.[204]

However, the overwhelming majority of employees do not have union representation.[205] For them, there is no institution to play the role that unions play in receiving and channeling employee information. The referendum would provide employees with the opportunity to express themselves collectively on an issue of corporate governance. The referendum results, along with the information generated by those results, would inform shareholders and board members about collective employee concerns. Employees would have the incentive and the ability to express concerns about managerial overreaching.

The referenda thus offer the opportunity for employees to join with shareholders in policing management opportunism. Unlike directors, employees do not have the complications that can often muffle complaints about executive overreaching.[206] And, unlike shareholders, employees are immersed in the firm and are more likely to know about managerial misconduct. Employees could vote against a transaction on the grounds that the compensation packages for managers were too rich and undeserved.[207] Although this signal would have no binding ramifications, it would highlight a problem that shareholders could address in their binding vote on the matter.

In addition, employees themselves may have ownership interests in the company. An employee may be invested in her company in a variety of forms. The employee might buy stock independently. A more common scenario involves employee purchases of company stock through a 401(k) plan. Recent reports suggest that thirty to forty percent of the assets of 401(k) plans that offer an employer stock fund are invested in that fund.[208] In fact, lower-wage workers are more likely to be heavily invested in their company's stock.[209] But employees may also have ownership interests that

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204. *Id.*

205. *See supra* note 148 and accompanying text.

206. Schwab & Thomas, *supra* note 196, at 1038 ("[O]utside directors who are CEOs of another corporation may be unwilling to raise serious questions about executive compensation for fear of having the spotlight turned on their own pay one day.").

207. Employees may need required disclosure of this information in order to monitor it. However, it is also possible that this information might leak out, even without mandatory disclosure.

208. Susan J. Stabile, *I Believed My Employer and Didn't Sell My Company Stock: Is There an ERISA (or '34 Act) Remedy for Me?*, 36 CONN. L. REV. 385, 385 (2004). Stabile has criticized this underdiversification and has suggested efforts to remedy it. *See id.*; Susan J. Stabile, *Freedom to Choose Unwisely: Congress' Misguided Decision to Leave 401(k) Plan Participants to Their Own Devices*, 11 CORNELL J.L. & PUB. POL'Y 361 (2002).

209. Susan J. Stabile, *Another Look at 401(k) Plan Investments in Employer Securities*, 35 J. MARSHALL L. REV. 539, 543 (2002). Employers may also match employee contributions with their

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do not provide the traditional shareholders' rights. Stock options provide another way for employees to have ownership in the company but do not provide a right to vote. The purpose of the stock option is to encourage employees to think like owners.[210] Millions of employees receive stock options, and thus have similar incentives to shareholders, but do not have a vote on corporate combinations.[211]

The employee referendum thus gives more power to the shareholders by increasing the odds that they can use their vote as an effective curb against managerial opportunism. Shareholder proponents have lamented the weakness of shareholder protections.[212] A nonbinding employee referendum gives shareholders the benefits of employee information with essentially no strings attached. Shareholders may accept or reject employees' judgments depending on their own independent analysis, but they will benefit from the additional set of monitors that the referendum puts in place when it comes to corporate combinations. These monitors will have an incentive to work with shareholders, since they have no power acting on their own. And they have common ground: the desire to prevent managerial overreaching. Indeed, this concern may explain why firms have not voluntarily conducted referenda in the past; managers may have been afraid of precisely this result.

If employees vote against a merger because of a particular concern about management, managers have the opportunity to correct this problem before shareholders vote on the transaction. This happens, from time to time, without the referenda; for example, in the merger between the MONY Group and AXA Financial, MONY postponed a shareholder vote and cut $7.4 million out of executive pay packages in response to shareholder concerns about excessive compensation.[213] With employees on the scene who are able to express themselves, there is a greater chance that managerial opportunism would be caught and brought to the attention of shareholders. Knowing this, management would be more likely to curb opportunism, both *ex ante* (before the referendum) and *ex post* (between the referendum and the shareholders' vote).

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own contributions of company stock. Howell E. Jackson, *To What Extent Should Individual Investors Rely on the Mechanisms of Market Efficiency: A Preliminary Investigation of Dispersion in Investor Returns*, 28 J. CORP. L. 671, 680 n.16 (2003).

210. Matthew T. Bodie, *Aligning Incentives with Equity: Employee Stock Options and Rule 10b-5*, 88 IOWA L. REV. 539, 548 (2003).

211. *Id.* at 541.

212. *See, e.g.*, Bebchuk, *supra* note 195.

213. Jonathan Stempel, *MONY Delays AXA Merger Vote*, REUTERS (Feb. 23, 2004), *available at* http://www.washingtonpost.com/wp-dyn/articles/A64919-2004Feb23.html.

The employee referendum could be just one part of the new coalition between shareholders and employees to discipline top-level management. Regardless, the referendum provides shareholders with a way to tap into inside knowledge for their own benefit. This change will strengthen the use of the shareholder franchise.[214] For this reason, assuming the referenda costs are low,[215] shareholder primacists should welcome the addition of the nonbinding employee referendum to the corporate law framework.

III. REFERENDUM AS VOICE

The employee referendum is a way for employees to communicate their opinions about the wisdom of a proposed corporate combination. This communication is beneficial not merely for its instrumentality in increasing in the flow of information about the transaction. These referenda would also give employees a chance to voice their concerns in a systematic and public manner. The vote itself—the chance to be heard—has important benefits beyond the derivative information gains.

This Part discusses the benefits of giving employees a voice in the corporate transaction. It starts with the basic sense of satisfaction and utility that employees would derive from the vote itself. It then discusses the improvements in employee performance and compliance with institutional norms that come from the chance to participate. Finally, the Part discusses how improving the civic life of the firm may lead to improved civic life in society more generally.

A. *Employee Satisfaction*

In their landmark study of the state of employee perceptions, Richard Freeman and Joel Rogers undertook "the most extensive analysis of American worker attitudes toward workplace relationships and power in more than twenty years."[216] Using focus groups and telephone surveys of over 2400 employees, the Worker Representation and Participation Survey (WRPS) sought an unbiased look into the concerns of American

214. *Cf.* Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261, 263–64 (2001) (discussing the importance of shareholder self-governance in the overall structure of the corporation).

215. *See infra* Part IV.

216. FREEMAN & ROGERS, *supra* note 12, at 3.

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workers.[217] The stakes were sufficiently high that management and labor groups fought over the framing of the study and its results.[218]

According to the WRPS, workers have one primary concern at the workplace: a desire for more voice. As Freeman and Rogers summarized, "American workers want more of a say/influence/representation/participation/voice (call it what you will) at the workplace than they now have."[219] The study found that employees wanted greater participation because of the improvement to their own working lives as well as the improvement to the productivity and success of their company.[220] They wanted not only voice individually but collectively as well—particularly on issues that affected the workers as a group.[221] Workers wanted their participation to be cooperative with management and believed that management resistance was the primary reason they did not have more voice within the firm.[222]

Although the WRPS focused on workers' involvement in employee-related issues, it found evidence that workers wanted a voice in higher-level company concerns as well. The study found that over half of the workers surveyed worked at a company that had a program for employee involvement, and thirty-one percent of employees participated in these programs.[223] A substantial number of these employees reported that their employee-involvement committees discussed issues of corporate direction.[224] Overall, however, eighty-two percent of employees who participated in employee-involvement programs believed that giving employees a greater say in these programs would make the programs more effective.[225] This is consistent with the WRPS's findings that workers want more of a voice.

The notion that employees want more of a voice is consistent with a growing number of findings relating to overall satisfaction in a variety of circumstances. These findings show that humans want more than simply a satisfactory outcome; they also place great importance on a satisfactory process. The "procedural justice" school of social psychology has

217. *Id.* at 3, 17–38.
218. *Id.* at 25–27.
219. *Id.* at 4.
220. *Id.*
221. *Id.* at 4–5.
222. *Id.* at 5.
223. *Id.* at 92.
224. *Id.* at 102 (noting that twenty-four percent of employees who participated in long-term committees discussed issues of corporate direction).
225. *Id.* at 113.

http://openscholarship.wustl.edu/law_lawreview/vol85/iss4/4

emphasized the importance of process to individual satisfaction and utility.[226] According to research, individuals look to a number of factors in determining whether a decision making process is procedurally just.[227] The decision maker's impartiality, honesty, and integrity are critical components, as are the opportunity to appeal and the quality of the decision. But another critical component is voice: more specifically, having some representation within the decision making process. Indeed, the importance of voice is evidenced by "one of the most reliable findings in research on procedural justice: that people react more favorably to procedures that give them considerable freedom in communicating their views and arguments."[228]

The employee referendum is an opportunity for employees to participate in the process of corporate combinations. As constructed, the current process affords no room for employee voice. The ball passes from top-level management to the board to the shareholders without any formal method for employees to express their opinions. At best, employees may voice their opinions to each other, to their supervisors, or to the media. Such opportunities are interstitial, sporadic, and uncertain. Moreover, they offer no collective opportunity for employees to exercise judgment on the proposed transaction. By denying employees a voice in the process, corporations and corporate law reduce employee satisfaction with the outcome, regardless of its distributive favorability.[229]

Early procedural justice theorists argued that voice and representation were important for the effect these had on the ultimate outcome of the

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226. Economics and its "rational actor" model of human behavior have tended to focus on the utility of actual outcomes in determining overall human satisfaction. Procedural justice theorists, on the other hand, believe that the process whereby that outcome was reached is also critical in determining satisfaction with that outcome. One example of this phenomenon is dissatisfaction with dispute resolution procedures even when the dispute is resolved in one's favor. In one study, those who challenged parking tickets were found to be upset with the court's procedures, even though their cases were dismissed. E. ALLAN LIND & TOM R. TYLER, THE SOCIAL PSYCHOLOGY OF PROCEDURAL JUSTICE 2 (1988) (discussing an earlier study). Procedural justice research has focused generally on the influence of such concerns on processes of dispute resolution. *See* Rebecca Hollander-Blumoff & Matthew T. Bodie, *The Effects of Jury Ignorance About Damage Caps: The Case of the 1991 Civil Rights Act*, 90 IOWA L. REV. 1361, 1389–90 (2005) ("Procedural justice effects have been found in a variety of legal contexts, including with juries, police, mediators, and other government authorities."). However, procedural justice is an issue whenever groups or organizations must make decisions.

227. *See* Tom R. Tyler, *What Is Procedural Justice? Criteria Used By Citizens to Assess the Fairness of Legal Procedures*, 22 LAW & SOC'Y REV. 103, 128–31 (1988).

228. LIND & TYLER, *supra* note 226, at 9. *But see* Bainbridge, *supra* note 145, at 702–04 (arguing that employees have widely varying tastes for participation).

229. For an earlier discussion of the importance of procedural justice to the workplace, see Marleen A. O'Connor, *A Socio-Economic Approach to the Japanese Corporate Governance Structure*, 50 WASH. & LEE L. REV. 1529, 1546–56 (1993).

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procedures.[230] Participation in the process was not important in and of itself, but rather for its instrumental effects. This theory, known as the "control model," had significant effects on the development of procedural justice scholarship.[231] However, a growing body of literature suggests that voice is not solely important for its effect on the process. Rather, voice is a noninstrumental value. This alternative approach, known as the "group-value" model, argues that expression of one's view is important without reference to the impact on the outcome.[232] Instead, "[t]he opportunity to present one's views enhances procedural justice judgments in and of itself."[233] These findings confirm what is probably intuitive: we appreciate the opportunity to make ourselves heard during decision making processes simply for that opportunity.

These findings have important ramifications for the notion of a nonbinding employee referendum. One criticism of the proposal would be that employees would not care about the opportunity simply to express themselves. Because management and shareholders are free to ignore the employees' vote, the vote may seem meaningless and trivial. But procedural justice findings indicate that the vote would have value just as an opportunity for employees to express their views. Communicating their views and arguments is itself a benefit.[234]

In researching the reasons why voice is a noninstrumental value, social psychologists have found that the opportunity to participate has important ramifications for a group's self-valuation. This model, known as the relational model of authority, finds that "people are concerned with those aspects of procedures that convey information to them about their status in their group."[235] A just process communicates to those involved that they have importance and worth to the decision makers. In a study of 404 employees from a variety of employment settings,[236] Tom Tyler and Steven Blader found strong support for the relational model of authority. Overall, the study found that employees' concerns about procedural justice

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230. *See, e.g.* JOHN THIBAUT & LAURENS WALKER, PROCEDURAL JUSTICE: A PSYCHOLOGICAL ANALYSIS (1975); TOM R. TYLER & STEVEN L. BLADER, COOPERATION IN GROUPS: PROCEDURAL JUSTICE, SOCIAL IDENTITY, AND BEHAVIORAL ENGAGEMENT 90–91 (2000) (discussing the control model).

231. TYLER & BLADER, *supra* note 230, at 91.

232. *Id.* at 91.

233. *See* LIND & TYLER, *supra* note 226, at 215.

234. *Id.*

235. TYLER & BLADER, *supra* note 230, at 91–92 (citing Tom R. Tyler & E. Allan Lind, *A Relational Model of Authority in Groups*, 25 ADV. IN EXPERIMENTAL SOCIAL PSYCH. 115, 175–76 (1992)).

236. *Id.* at 18.

exceeded their concerns about distributive justice and outcome favorability.[237] Looking at what employees found most important in assessing the fairness of their workplaces, Tyler and Blader found that concerns relating to status recognition and neutrality were significantly more important than employees' ability to exercise control over their workplace or the likelihood of favorable outcomes.[238] To the employees in the study, conceptions of fairness were based more on the relational norms evidenced by certain procedures, and less on their power to take part in the actual decision making.

These findings suggest that the employee referendum would provide employees greater satisfaction by providing employees with a higher level of recognition and status. Giving employees a formalized role in the process would demonstrate that they are valued members of the community entitled to participate. Even if they had no control over the process, and even if the end result were a disadvantageous combination to workers, having a role in the process would provide employees with a greater sense of fairness and greater satisfaction with their workplace. Combined with the informational benefits that the referenda would provide to shareholders and directors, the referenda proposal is a win-win-win for all three of the primary groups involved.

Of course, it may seem unsettling that employees could be satisfied with a largely symbolic role, rather than actual decision making power. In fact, the larger notion that people care more about looking important than being important suggests the possibility for manipulation or fraud. Procedural justice theorists have described this phenomenon as the "false consciousness problem."[239] In one study, for example, an opportunity to voice one's opinion about a decision maker's verdict led to an increase in the perception of fairness even when there was no chance of even influencing the decision.[240] The authors noted that this could lead people to believe that the process was fair "even though, by objective criteria, it

237. *Id.* at 83 ("Thus, we have strong empirical evidence that people's concern with the fairness of group processes exceeds their concerns about what they garner via their group membership . . . .").

238. *Id.* at 92–96 & tbls. 8-1, 8-2 & 8-3.

239. LIND & TYLER, *supra* note 226, at 4; *see also* Robert J. MacCoun, *Voice, Control and Belonging: The Double-Edged Sword of Procedural Fairness* 24 (Cntr. for the Study of Law & Soc'y Faculty Working Papers, Paper 30, 2005), *available at* http://repositories.cdlib.org/csls/fwp/30 (discussing how procedural justice theorists need to spend more time on the "dark side" of procedural justice).

240. *See* E. Allan Lind, Ruth Kanfer & P. Christopher Earley, *Voice, Control and Procedural Justice: Instrumental and Noninstrumental Concerns in Fairness Judgments*, 59 J. PERSONALITY & SOC. PSYCHOL. 952 (1990).

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[was] patently unfair."[241] An employee referendum could fool employees into thinking that their votes mattered when, in actuality, they did not. Given employees' propensity to overestimate the power of their legal rights,[242] the referendum may be a tool of keeping employees in the dark while extracting valuable information and postcombination acquiescence.

This is an overreaction. Employees should know full well that the vote is not binding on the company, and it would not be in management's interest to encourage such a belief. After all, if the referendum defeated the combination but went through anyway, the legal reality would hit home. To the extent that management pretended to be interested in the referendum but did not really care, that expression of concern might be valuable in and of itself to employees. Even if merely symbolic, an expression of employees' importance to the firm is useful and meaningful. Ultimately, a symbolic expression not only has its own meaning, but over time it can deepen into a stronger current between management and employees. By establishing a mandatory procedure, the referendum proposal provides employees with a voice in the process that upgrades their status within the group. This increase in the procedural justice of the workplace not only improves the lot of workers, but more importantly has further benefits for the firm and society.

B. Employee Performance and Compliance

Providing employees a voice in the corporate combination process would give them a greater sense of fairness and procedural justice with regard to that process. In addition, however, workers who perceive that their workplaces are more procedurally just are more likely to work cooperatively, follow the firm's leadership, and comply with ethical guidelines.

Getting employees to work cooperatively—that is, to work together for the good of the company—is an essential component to successful business. As self-interested actors, individuals generally place their own needs above the needs of others. However, in working for a firm, individuals are asked to engage in joint productive activity, in which the

241. *Id.* at 955.

242. *See, e.g.*, Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105, 155 (1997) (offering evidence that "workers systematically overestimate their legal protections against arbitrary and unjust discharge"); Pauline T. Kim, *Norms, Learning, and Law: Exploring the Influences on Workers' Legal Knowledge*, 1999 U. ILL. L. REV. 447, 448 (1999) (concluding that workers "do not really distinguish between informal norms and enforceable legal rights").

gains may not be easily partitionable between members. The notion that firm members must provide individualized investments in exchange for uncertain and nonseparable returns has been referred to as the "team production" problem.[243] Although corporate law scholars have focused on agency-cost theory in discussing the purpose of the firm, some theorists consider the puzzle of team production to be more important in explaining the law's function.[244]

Recent scholarship has focused more specifically on the role of law in fostering or impeding the development of cooperative relationships within the firm. The need to develop cooperative behavior through trust may explain such corporate-law doctrines as the duty of care in the face of the business judgment rule, the mandatory nature of the duty of loyalty, and problems with closely held corporations.[245] Yet trust may be highly dependent on the social context.[246] Certain seemingly irrelevant provisions, such as the duty of care, can have important representational and relational power in fostering trust amongst members of the corporation. Scholars have argued that failure to take trust into account can have deleterious consequences to a firm or to society as whole.[247] Such observations are backed up by extensive social science findings about the importance of group cooperation.[248]

Perceptions that a process or institution is procedurally just have been shown to lead to increased cooperative behavior.[249] In their study of employees, Tyler and Blader found that procedural justice assessments were more likely to predict discretionary cooperative group behavior—such as complying with work rules and norms, exerting full effort to get the job done, deferring to organizational authority, and going beyond job responsibilities to help others at the job—than were the employees'

243. Blair & Stout, *supra* note 48.

244. *See, e.g.*, *id.* at 249–50, 271.

245. Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1737–45 (2001).

246. *Id.* at 1768–77.

247. *Id.* at 1807–10; *see also* Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899, 954–57 (1993) (discussing the importance and fragility of trust in the workplace and proposing methods to sustain it).

248. *See, e.g.*, TYLER & BLADER, *supra* note 230, at 23 ("It would be hard to overemphasize the importance of the level and type of cooperative behavior engaged in by group members in shaping the extent to which groups can function efficiently, effectively, and ultimately, successfully.").

249. *See* Dennis W. Organ & Katherine Ryan, *A Meta-Analytic Review of Attitudinal and Dispositional Predictors of Organizational Citizenship Behavior*, 48 PERSONNEL PSYCH. 775, 791–95 (1995) (showing a robust correlation between job satisfaction, perceptions of firm fairness, and organizational citizenship behavior).

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perceptions of distributive justice or outcome favorability.[250] Research has also linked perceptions of procedural justice with other attitudes and behavior that are supportive and beneficial to the firm as a whole. Individuals are less likely to leave a group and are more committed to their group or organization when they perceive the group to be procedurally just.[251] They are more likely to perceive the institution as acting legitimately.[252] Ultimately, a whole host of behaviors beneficial to the firm correspond to the procedural justice of the firm. As Tyler and Blader note:

> These results suggest that we know a considerable amount about how to encourage the types of cooperative behavior that are central to the effectiveness of groups. We can do so by creating structures that enact decision-making processes in ways that group members will experience as fair.[253]

Happiness with the fairness of the process leads to happiness with the outcome itself, which leads to greater acceptance of the outcome. One of the most robust findings about procedural justice is that individuals are more likely to comply with those outcomes (both in experimental and in real-world settings) that they perceive as procedurally just.[254] Procedural justice judgments have been found particularly important to adherence to an agreement over time.[255] Much of this research has focused on responses to judicial or other dispute resolution procedures, but it applies as well in the context of group decision making.

This research supports a common sense notion: workers are likely to do a better job if they believe their workplace treats them fairly and wants their input.[256] As discussed above, these results do not ride in ultimate

250. TYLER & BLADER, *supra* note 230, at 33, 80–85 & tbl.3-1.

251. *Id.* at 79 (citing ten different studies).

252. *Id.* (citing four studies).

253. *Id.* at 87.

254. LIND & TYLER, *supra* note 226, at 81–82 (discussing experimental support); ROBERT J. MACCOUN ET AL., ALTERNATIVE ADJUDICATION: AN EVALUATION OF THE NEW JERSEY AUTOMOBILE ARBITRATION PROGRAM 62 (1988), *available at* http://www.rand.org/pubs/reports/2007/R3676.pdf (same); Katherine M. Kitzmann & Robert E. Emery, *Procedural Justice and Parents' Satisfaction in a Field Study of Child Custody Dispute Resolution*, 17 LAW & HUM. BEHAV. 553, 564 (1993) (discussing results from field study); E. Allan Lind, Jerald Greenberg, Kimberly S. Scott & Thomas D. Welchans, *The Winding Road from Employee to Complainant: Situational and Psychological Determinants of Wrongful Termination Claims*, 45 ADMIN. SCI. Q. 557, 575–76, 580–81 (2000) (same); E. Allan Lind et al., *Individual and Corporate Dispute Resolution: Using Procedural Fairness as a Decision Heuristic*, 38 ADMIN. SCIENCE Q. 224, 235–36, 240–41, 243 (1993) (same).

255. Dean G. Pruitt et al., *Long-Term Success in Mediation*, 17 LAW & HUMAN BEHAV. 313, 324–25 (1993); Dean G. Pruitt et al., *Goal Achievement, Procedural Justice, and the Success of Mediation*, 1 INT'L J. CONFLICT MGMT. 33, 42 (1990).

256. *See* SUROWIECKI, *supra* note 147, at 213 ("Similar results from both experimental and

control over the actual outcomes or even the value of those outcomes. An employee referendum would provide employees with a way of participating in the transforming transaction. As a result, it would lead to better cooperation and compliance within the workplace.[257]

C. Social Capital

In her recent book *Working Together*, Cynthia Estlund discusses the importance of workplace interaction to democratic life in a civil society.[258] In her view, "[t]he workplace is the single most important site of both cooperative interaction and sociability among adult citizens outside the family."[259] The focus of Estlund's book is the workplace's role in creating bonds between individuals from different racial, ethnic, and religious groups as well as between men and women. However, her insights on the role of the workplace as an institution for civic life have important ramifications for this Article's referendum proposal.

Estlund argues that the workplace is a critical institution for the reinvigoration of civic life. Citing the recent literature on "social capital,"[260] Estlund demonstrates that social capital is "linked to an array of social goods, including greater prosperity, health and well-being, safe neighborhoods, and better government."[261] She argues, however, that social capital theorists have lamented the decline of civic institutions while overlooking the role of the workplace in fostering greater social capital. In

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empirical studies show that allowing people to make decisions about their own working conditions often makes a material difference in how they perform.").

257. A sense of procedural justice gives employees more than a greater *esprit de corps* within the institution. Social science research suggests that employees are also more likely to follow the law and external ethical norms if they believe their workplace follows fair procedures. *See* Tom R. Tyler, *Promoting Employee Policy Adherence and Rule Following in Work Settings: The Value of Self-Regulatory Approaches*, 70 BROOK. L. REV. 1287, 1308 (2005) (finding that "people will comply with and, more strikingly, voluntarily defer to rules when they feel that their organization's rule-making authorities are following fair procedures when they exercise their authority and make managerial decisions").

258. CYNTHIA ESTLUND, WORKING TOGETHER: HOW WORKPLACE BONDS STRENGTHEN A DIVERSE DEMOCRACY vii (2003).

259. *Id.* at 7.

260. *See id.* at 114 (defining social capital as "'connections among individuals—social networks and the norms of reciprocity and trustworthiness that arise from them' and that help people to accomplish things together" (quoting ROBERT D. PUTNAM, BOWLING ALONE: THE COLLAPSE AND REVIVAL OF AMERICAN COMMUNITY 19 (2000))). *See also* Deborah A. DeMott, *Trust and Tension Within Corporations*, 81 CORNELL L. REV. 1308, 1309 (1996) (discussing the role of law in creating circumstances that "tend to facilitate or discourage productive association among people").

261. ESTLUND, *supra* note 258, at 115 (citing PUTNAM, *supra* note 260).

Estlund's view, "the workplace [is] a central site of social capital building in contemporary society."[262]

If Estlund is correct, then the employee referendum could be an important way of encouraging and developing social capital amongst employees. As discussed above, employee referenda would foster a climate of greater procedural justice, leading to greater cooperation and trust within the firm.[263] In essence, greater procedural justice has been shown to lead to greater social capital within the firm. In addition, part of social capital is so-called "'civic skills'—skills of communication, compromise, and collective decisionmaking, and a sense of political efficacy."[264] As an exercise in corporate democracy, the referendum would facilitate the development of these skills. Estlund makes an eloquent plea for the importance of workplace discussions to the realm of public discourse.[265] Arguing that the workplace is "a leading site of public discourse," Estlund describes how at the workplace, employees practice their deliberation skills, discuss topics of national importance, and reach across family and neighborhood boundaries.[266] The employee referendum would facilitate all of these, in a forum that allows for direct participation on an issue of importance to the entire workforce.

Moreover, the employee referendum would mitigate some of the concerns that social theorists have about the workplace as an institution of civic life. For example, theorists are concerned with the instrumental and hierarchical context in which managers can rule the workplace.[267] Estlund herself recognizes that "[t]o the extent that the workplace is a major site for the formation of social capital, it contributes very unequal portions of those assets to individuals and groups at different rungs of the socioeconomic ladder."[268] She counters that "[t]hese concerns are mitigated but not dissolved by trend towards greater collaboration and less rigid hierarchies in the workplace."[269] The referendum is an opportunity for collaboration and equality: all get to vote, and each vote has the same weight. It would thus mirror the democratic institutions that social theorists are hoping to nurture.

262. *Id.* at 116.

263. *See supra* Part III.B.

264. ESTLUND, *supra* note 258, at 116.

265. *Id.* at 118–23.

266. *Id.* at 118–19.

267. *Id.* at 117. *See also* Mark Barenberg, *Democracy and Domination in the Law of Workplace Cooperation: From Bureaucratic to Flexible Production*, 94 COLUM. L. REV. 753, 764–65 (1994).

268. ESTLUND, *supra* note 258, at 117.

269. *Id.*

http://openscholarship.wustl.edu/law_lawreview/vol85/iss4/4

There is another way in which benefits from employee referenda may spill out beyond the firm and into the public at large. These referenda may serve to reinvigorate the discussion about possible new channels for employee-firm relations across society.[270] In the late 1980s and early 1990s, when states were passing corporate "constituency" statutes, some believed that the statutes were important simply for their symbolic value.[271] As one commentator argued:

> [T]he fact that half of the states have enacted legislation that recognizes that employees are stakeholders in their firms is an important event, if only for its symbolic value. The very enactment of such statutes suggests that employees' interests are beginning to receive serious attention in the public mind. It therefore suggests the possibility that effective means of protecting them can be developed in the future.[272]

As I have argued above, I believe that employee referenda would have substantial informational and participatory benefits to employees. But they would also have a symbolic meaning to the public at large: employees matter. The referendum is not intended to be a "camel's nose under the tent" leading to a binding employee referendum down the road. It is instead one piece of a new approach to employer-employee relations that will recast those relations for a new century. The referendum proposal may stimulate other ways in which relations between managers, directors, shareholders, and employees can be restructured for the greater fairness and efficiency of corporate law and society as a whole.

IV. IMPLEMENTATION

Parts II and III of this Article discussed the benefits in implementing a system of nonbinding employee referenda for corporate combinations. This Part concerns the costs of implementation. There are a myriad of ways of setting up a system of referenda, but such a system will inevitably impose some costs on businesses. Employees must register their votes, and then the firm must tabulate and announce the results. These processes use employee time and firm resources. These costs must be weighed against the benefits in deciding the wisdom of implementing the plan. Below are

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270. *Cf.* Cynthia L. Estlund, *The Ossification of American Labor Law*, 102 COLUM. L. REV. 1527 (2002).

271. *See, e.g.*, Stone, *supra* note 181.

272. *Id.* at 71.

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some initial thoughts on how the referenda could be constructed to keep costs as low as possible while still retaining the key elements.

A. Bright-Line Rules

In order to keep the process as straightforward as possible, the legislation should be crafted to match up with bright-line rules that firms could easily follow in holding the referenda. First, the definition of "employee" is a source of some controversy, as temporary employees, employees of subcontractors, and independent contractors all may be considered "employees" depending on the statute or state common law in question.[273] In order to ease administration, firms could count as employees those workers whom they count as employees for tax purposes.[274] Both the company and the IRS are likely to keep accurate and up-to-date records of a company's employees. Introducing a different standard is likely to cause further confusion and delay.

In addition, states should set a flexible but easy-to-calculate timeline for holding the vote. There must be enough time after the announcement for employees to process and share information about the transaction, but it must provide enough time before the shareholder vote to allow for shareholders and directors to respond to the results.[275] Perhaps the proposal could require that the referendum not be held less than thirty days after the announcement, but the referendum's results must be announced at least thirty days prior to the shareholder's vote. If the latter requirement were not followed, shareholders would have the right to petition a court for a delay in the vote in order to meet the thirty-day period.[276]

Finally, states may wish to require that corporations disclose certain material facts to employees prior to the vote. Under state and federal law, shareholders are already entitled to significant disclosures prior to their proxy vote.[277] In order to simplify this process, states could mandate that

273. *Compare* Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 323–24 (1992) (discussing the common-law control test for employee status), *with* Sec'y of Labor v. Lauritzen, 835 F.2d 1529, 1534–35 (1987) (discussing the "economic realities" test under the Fair Labor Standards Act). *See* STONE, *supra* note 184, at 67–86 (discussing the changing nature of employment).

274. See, e.g., I.R.C. §§ 3306, 3121, 3401–04 (2006) (defining employees for purposes of federal taxes).

275. *Cf.* DEL. CODE ANN. tit. 8, § 251(c) (2007) (providing that shareholders must receive proxy materials at least twenty days before the vote).

276. The right would be akin to shareholders' rights to call an election if the corporation has failed to hold one. *See id.* § 211(c).

277. *See, e.g.*, 15 U.S.C. § 78n (2000) (federal disclosure requirements); 17 C.F.R. §§ 240.14a–3, –101 (Schedule 14A) (2007) (same); Arnold v. Soc'y for Sav. Bancorp., Inc., 650 A.2d 1270, 1277

employees receive the same set of disclosures as shareholders. If the corporation were permitted to make the same set of materials available to employees electronically, the additional disclosure requirements would impose few additional costs on the company.

B. Distribution and Election Costs

Beyond these bright-line rules, companies should have considerable flexibility in establishing the process through which employees would vote. This flexibility would enable companies to experiment with the process and develop the most cost-effective means of processing the votes.

The cost of running an employee referendum might initially seem comparable with the costs of conducting elections over shareholder proposals, which have been estimated at $87,000 per proposal.[278] However, $37,000 of that is estimated as expense for deciding whether to include the proposal or not.[279] As for the $50,000 in printing, distribution, and tabulation costs, the total would be substantially smaller for an employee referendum. Because the company has a direct connection to its employees, it can use interoffice means to distribute the materials. Electronic distribution could provide even greater savings. Similarly, the vote need not be conducted at polling stations with paper ballots during work hours; instead, the company could use a website to collect and tally the votes. As internet access continues to grow and expand across the population, the ability to coordinate the distribution of information together with the actual voting will mean fairly low costs for conducting the employee referendum online.[280]

(Del. 1994) (state disclosure requirements); Zirn v. VLI Corp., 621 A.2d 773, 778–79 (Del. 1993) (same).

278. Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018, 67 SEC Docket 373, 388 (June 15, 1998) (describing eighty firms reporting on proposal inclusion determination costs and sixty-seven reporting on printing and other direct costs). Robert Romano has thus argued that limiting or eliminating shareholder proposals could save companies over a billion dollars. Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174, 248 (2001) ("The savings to firms from eliminating the subsidy for shareholder proposals that fail to receive at least 40% of the votes ranges, across the differing historical capitalization rates, from $1.9 billion to $293 million.").

279. Amendments to Rules on Shareholder Proposals, *supra* note 278.

280. SUROWIECKI, *supra* note 147, at 207 (noting that "dramatic improvements in information technology have made the diffusion of information to large numbers of employees feasible and cost-effective").

Ideally, the technology would balance the need for a secure ballot with an effort to make sure than the firm could not check to see how individual employees voted. This technology has already been implemented for employee shareholders, who often receive their proxy materials electronically. *See* D. Craig Norlund, *Electronic Dissemination of Disclosure Documents*, Practising Law Institute,

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C. State Law Enactment

Much has been written about the advantages and disadvantages of our state, as opposed to federal, system of corporate law.[281] Because mergers and acquisitions are controlled by state law, the employee referendum makes sense as a creature of state law. It is designed to work within that system and be a part of the corporate combination process. Although it may, perhaps, be possible to impose such a requirement through federal law,[282] it would be an overlay on top of a distinct legal regime. And it would be subject to criticism as a federal intrusion upon state practices of corporate governance.

Implementing the referenda process through state law has functional advantages as well. Since the referendum has not been tried anywhere, it is by its very nature an experimental project. In Justice Brandeis's memorable phrase, states serve as "laborator[ies]" of democracy and "try novel social and economic experiments without risk to the rest of the country."[283] This notion has come to life in corporate law.[284] States could implement the referenda in a variety of ways and determine, by looking at others, which practices work best.[285]

Corporate Law and Practice Course Handbook Series, PLI Order No. B0-006E, Jan.–Feb. 1999, at *77 ("The fastest growing audience for electronic proxy material and annual report distribution is employee stockholders."). Such materials must allow for employee shareholders to vote confidentially so as to avoid retaliation for their votes.

281. For a recent summary of the literature on corporate law federalism, see Brett H. McDonnell, *Two Cheers for Corporate Law Federalism*, 30 J. CORP. L. 99, 103–09 (2004).

282. It may be necessary to enact such referenda through federal law if they would otherwise be preempted by federal law. The most likely candidate for preemption would be the National Labor Relations Act (NLRA). The NLRA protects collective activity on the part of workers. *See* 29 U.S.C. §§ 157, 158(a)(1) (2000). If a state were to provide its own remedies for employees who had been fired or otherwise discriminated against because of their vote, such remedies might conflict with the NLRA's remedies and thus be subject to preemption. *See* San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236, 246 (1959) (holding that states cannot regulate conduct that is at least arguably protected or prohibited by the NLRA). However, states have traditionally been given great deference in establishing their own systems of corporate governance. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477–80 (1977). Given that the vote would be part of the state's corporate law scheme, state corporate law interests should outweigh any potential overlap the referendum has with NLRB processes.

283. New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

284. Romano, *supra* note 175, at 210.

285. *Cf.* David Zaring, *Best Practices*, 81 N.Y.U. L. REV. 294 (2006). Moreover, as corporations are governed by their state of incorporation, the experiment's subjects are free to leave if they wish to opt out—the "genius" of American law. ROMANO, *supra* note 11. This flexibility may ameliorate the concerns of those who object to legislative changes to the traditional schema of corporate law. *See, e.g.*, Bainbridge, *supra* note 145, at 704–09 (objecting to a "one-size-fits-all" approach to participatory management).

CONCLUSION

In closing, let us revisit the opening quote from the email by Robert Hughes to Gerald Levin. In retrospect, the e-mail may be spiteful and vindictive, but it is also well founded. The merger with AOL was indeed disastrous.[286] But the e-mail was written not in January 2000, or even 2001, but in 2002, well after the initial hopes of the merger had proven unfounded. With the benefit of hindsight, Hughes can declaim against the combination with effective bitterness. What did he think in 2000?

This "what if" demonstrates the possibilities for the employee referendum. If employees, along with the shareholders, had overwhelmingly approved the merger, then it would have been much harder for Hughes and those like him to center their anger on the CEO. Instead of feeling justifiably vengeful, Hughes might have to look inward, first, to see how he and his fellow employees voted. Given the apparent stock price boost that the merger seemed to have in store for Time Warner shareholders, employees might have voted for the merger to support their 401(k) and stock-option plans. Having bought into the merger from the beginning, perhaps they would have given less resistance to it, which would have made the transition smoother and ultimately more successful.

Or, perhaps employees would have voted against the merger. After-the-fact accounts bristle with Time Warner employees who were horrified at the merger and never thought it would work.[287] If they truly were against the merger from the start, employees could have put a splash of cold water on a process that was all heat and light. Directors, shareholders, and the media would have asked why, and would have found business-judgment concerns, employee-centered concerns, or managerial-opportunism concerns—or all three. These doubts might have led to more questions about whether the proposed combination was as good an idea as was touted. Even if the merger had gone through, perhaps the company, its shareholders, and the media would not have been so optimistic about the immediate future, and the subsequent downturn would have been less crushing. Moreover, having been given a say in the process, employees

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286. It is interesting to note that the two principals behind the merger (Time Warner CEO Gerald Levin and AOL CEO Stephen Case) are not only no longer with the company, but have removed themselves to the edges of corporate America. *See* Lillian Ross, *Spa Man*, NEW YORKER, July 9, 2007, at 38 (reporting that Case owns a spa in Arizona called Miraval); Seth Stephenson, *The Believer*, N.Y. MAG., July 16, 2007, at 24, 26 (reporting that Levin is presiding director of Moonview Sanctuary, a "holistic healing institute" with a full-time staff of fewer than twenty people).

287. *See, e.g.*, MUNK, *supra* note 69, at 233–34; SWISHER, *supra* note 1, at 149–50, 178–80.

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may have been more receptive to the combination and may have worked to make it more successful.

This is speculation. Nonetheless, behind the speculation about this particularly ill-conceived merger lies the possibility for a different future. Economic, psychological, and corporate law research suggests that employees may have the information and the interest in participating formally in their company's decision to combine with another. The employee referendum would be a straightforward and meaningful way of bringing them into the conversation.

APPENDIX

Proposed changes to Delaware Law
(Changes to existing statute in **bold**)

DEL. CODE ANN.

TITLE 8

§ 251. Merger or consolidation of domestic corporations and limited liability company

. . .

(new c) At least 30 days after the adoption of the agreement, the corporation shall hold a nonbinding referendum in which all employees [as defined by state tax law] shall vote on the agreement. The results of this referendum must be announced publicly at least 30 days prior to the holding of the special stockholders meeting in subsection (d).

(c) **(new d)** The agreement required by subsection (b) of this section shall be submitted to the stockholders of each constituent corporation at an annual or special meeting for the purpose of acting on the agreement. Due notice of the time, place and purpose of the meeting shall be mailed to each holder of stock, whether voting or nonvoting, of the corporation at the stockholder's address as it appears on the records of the corporation, at least 20 days prior to the date of the meeting. The notice shall contain a copy of the agreement or a brief summary thereof, as the directors shall deem advisable. **The notice shall include the results of the employee referendum in subsection (c).** At the meeting, the agreement shall be considered and a vote taken for its adoption or rejection. If a majority of the outstanding stock of the corporation entitled to vote thereon shall be voted for the adoption of the agreement, that fact shall be certified on the agreement by the secretary or assistant secretary of the corporation. If the agreement shall be so adopted and certified by each constituent corporation, it shall then be filed and shall become effective, in accordance with § 103 of this title.

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