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## CONCEPTS OF POWER: MAJORITY CONTROL AND ACCOUNTABILITY IN PRIVATE LEGAL ORGANIZATIONS

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### ABSTRACT

This Article offers an innovative, cross-field analysis of how control over decisionmaking is established and regulated within private legal organizations, focusing on business corporations, residential community associations, and labor unions. While diverging in their historical origins, stakeholders’ composition, and specific norms of internal governance, these organizations share an underlying set of challenges regarding both the bottom-up formation of credible coordination to solve collective action problems and the top-down ordering of their legal power and authority. This common ground calls for a unified theoretical analysis that does not merely fall back on simplistic attempts to classify these organizations as either purely-private or quasi-public enterprises.

While private legal organizations implicate various axes of stakeholders’ relations, this Article focuses on modes of control and accountability among “direct members”—that is, shareholders in the business corporation, homeowners in the residential community, and labor union members.

The Article argues that U.S. law works with different sets of assumptions and modes of intervention in regulating majority-minority relations in each of the three organizations. In business corporations, the law recognizes, and to some extent legitimizes, potential stratification and power imbalance among different classes of shareholders, while imposing special duties on controlling stockholders. As for labor unions, lawmakers are well aware of power dynamics and the lack of markets for union control, but work to flatten internal hierarchies so as to formally eradicate class division. In residential communities, enabling legislation views homeowners as inherently equal in organizational power and remains silent on organized block voting.

Beyond examining the integrity of the law's work across private legal organizations—that is, whether the current differential legal treatment of these organizations holds true—the Article sets the ground for studying how a consolidated theoretical framework for these organizations corresponds with broader social and cultural concepts of power, hierarchy, and accountability in the United States and across other societies.

## I. INTRODUCTION

**P**PRIVATE legal organizations occupy a key position in modern societies. Various forms of collective action entities, enabled and regulated by law, feature prominently across countries and economies. One can hardly imagine the working of contemporary society without bodies such as business corporations, partnerships, charitable organizations, merchant associations, labor unions, and residential community associations. Such organizations have received considerable attention in social science literature, which has sought to identify the structure and governance modes that enable such collective entities to function effectively in producing goods and benefits. New Institutional Economics (“NIE”), instituted by Nobel Prize Laureates Ronald Coase, Douglas North, and Oliver Williamson, has played a dominant role in conceptualizing such organizations.

In contrast, legal theory remains relatively dormant in its study of such organizations, examining each type of organization separately but lacking a comprehensive view of how these organizations work and what role the law should play in regulating their governance structures. This Article breaks new ground by offering a cross-field analysis of the ways in which control over decisionmaking is established and regulated within private legal organizations, focusing on business corporations, residential community associations, and labor unions.

The Article argues that while these organizations diverge in their historical origins, stakeholders' composition, and specific norms of internal governance, they share an underlying set of challenges regarding both the bottom-up formation of credible coordination to solve collective action problems and the top-down ordering of their legal power and authority.

Accordingly, understanding these various private legal organizations requires a unified theoretical analysis. Such an analysis should not merely fall back on simplistic attempts to classify organizations as either purely-private or quasi-public bodies through doctrines such as “state action.” These collective entities differ inherently from government, on the one hand, and individual action or arms-length contracts, on the other. Instead, such entities feature an

organizational nexus that entails both vertical and horizontal governance typified by credible elements of authority, agency, and “sticky” control.

In constructing a theory of private legal organizations, the Article focuses on the ways in which power and control are established, maintained, and enforced across such organizations. The Article studies the complex interplay between “organizational power”—the set of internal practices guiding relations among actors given the alleged self-enforcing structure and dynamics of such organizations—and “legal power,” the state-enforced mandate for designing and directing legally binding relations in these entities while controlling excessive organizational power.

Focusing on modes of control and accountability among direct members—shareholders in the business corporation, homeowners in the residential community, and labor union members—the Article argues that the U.S. legal regime applies different sets of preliminary assumptions and modes of intervention in regulating majority-minority relations in each of the three organizations.

In business corporations, the law recognizes the potential stratification and power imbalance among different classes of shareholders. It generally validates a controlling block’s ability to direct the corporation and enjoy a control premium for its shares, while subjecting it to heavy fiduciary duties to the minority, such as the “entire fairness” standard in conflicted transactions.<sup>1</sup> As for labor unions, lawmakers are well aware of power dynamics and the lack of markets for union control, but work to flatten internal hierarchies so as to formally eradicate class division, viewing majority decisions as a practical necessity while levying on the majority a “duty of fair representation.”<sup>2</sup> In residential community associations, enabling legislation starts with a different assumption, one of pure horizontal governance. Viewing homeowners as inherently equal in their organizational power, the law regards majority-based decisions as formed on an ad hoc, topic-specific basis and grants these decisions broader latitude, subjecting them to lenient tests such as “unreasonableness.”<sup>3</sup>

The Article inquires whether the differential set of assumptions and consequent legal treatment of each organization hold true, or whether the cross-field analysis offered in this Article reorients at least some of the current doctrines on majority-minority relations. Are minorities in business

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<sup>1</sup> See *infra* Part IV.A.

<sup>2</sup> See *infra* Part IV.C.

<sup>3</sup> See *infra* Part IV.B.

corporations indeed more fragile and prone to opportunism by the majority compared to their counterparts in residential community associations? Is the law justified in refusing to recognize class-based structures in labor unions, unlike its approach to corporations? Is there indeed no block voting in residential communities?

Beyond examining the integrity of the law's work across private legal organizations, the theoretical framework developed in this Article seeks to tie the study of such organizations to broader social and cultural concepts of power, accountability, and legitimacy in the United States and across other societies, offering a research agenda for a novel cross-country analysis of private legal organizations in a cultural context.

The Article is structured as follows. Part II identifies the multi-directional structure of private legal organizations, analyzing both vertical and horizontal governance. It starts by reexamining NIE's concept of vertical integration in view of the currently dominant "nexus of contracts" view of firms, and demonstrates how property and unified ownership nevertheless play a key role as an organizing principle that directs both organizational and legal power down the organization's production process. Part II then examines horizontal governance in organizations, identifying three key features of credible collective action: transfer of assets, delegation to agents, and governance by majority.

Part III studies the interplay between organizational power and legal power, and explains why legislatures and courts must play an active role in guarding against excessive organizational power, with the exact form and scope of such intervention depending on the inherent power relations that can be identified for each type of organization. Part IV addresses the different concepts of power that typify majority-minority relations and the balances designed by law for each of the three organizations. Offering a detailed account for corporations, residential associations, and unions, Part IV questions the extent to which the underlying assumptions of legal policy genuinely reflect the ways in which organizational power practically works across these organizations.

Part V makes the claim that the scope of legal intervention cannot be based on trying to define organizations as either "private" or "public" entities. Instead, legal policy should focus on the functional attributes of power relations within a certain type of organization and on how such relations should be regulated through the distribution of legal powers. The type of analysis that looks beyond the public-private dichotomy to study the forms of order, collective action, and power allocation is also instrumental in understanding the overall implications that such organizations have for

broader-based sociopolitical structures. This insight should set the ground for an innovative, cross-country study of the relations between private legal organizations and cultural perceptions of governance, power, and accountability across various nations and societies.

## II. THE MULTI-DIRECTIONAL STRUCTURE OF PRIVATE LEGAL ORGANIZATIONS

The study of institutions and organizations has been occupying a central role in the social sciences over the past few decades. Pursuing various historical, empirical, and theoretical methodologies, numerous writers have sought to explain how different forms of human interaction and coordination, both formal and informal, correspond to key features of societies and economies.<sup>4</sup> Currently dominated by NIE, this research agenda broadly assumes that “institutions matter and are susceptible to analysis”<sup>5</sup> and that institutional change “shapes the way societies evolve through time.”<sup>6</sup>

North distinguishes between “institutions” and “organizations.” The former include “any form of constraint that human beings devise to shape human interaction.”<sup>7</sup> Institutions can be informal, such as social conventions and codes of behavior, or formal, such as “statute law, and common law, and contracts between individuals” or any other rules formally enforced.<sup>8</sup>

If institutions are the rules, organizations are the players, such that while “the purpose of the rules is to define the way the game is played ... the objective of the team within that set of rules is to win the game.”<sup>9</sup> Organizations include political, economic, social, and educational bodies, and can be seen as “groups of individuals bound by some common purpose to achieve objectives.”<sup>10</sup>

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<sup>4</sup> Part of this research has aimed at reaching broad-based conclusions as to “why some countries are rich and others poor, why some enjoy a welfare-enhancing political order and others do not.” AVNER GREIF, INSTITUTIONS AND THE PATH TO THE MODERN ECONOMY: LESSONS FROM MEDIEVAL TRADE 3–4 (2006) [hereinafter Greif].

<sup>5</sup> Oliver E. Williamson, *The Economics of Governance*, 95 AM. ECON. REV. 1, 15 (2005) [hereinafter Williamson, *Governance*].

<sup>6</sup> DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 3, 3 (1990) [hereinafter North].

<sup>7</sup> *Id.* at 4.

<sup>8</sup> *Id.* at 6.

<sup>9</sup> *Id.* at 4–5.

<sup>10</sup> *Id.* at 5.

North's concept of organizations appears to resonate with definitions suggested by earlier generations of organizational theorists, such as Chester Bernard, who in 1938 offered a pragmatic view of organizations as "that kind of cooperation among men that is conscious, deliberate, purposeful."<sup>11</sup> But the current approach entails a thick set of analytical and normative assumptions that have been gradually built into the literature and that now guide its study of organizations. This part analyzes the current approach by examining the two dimensions of governance: vertical and horizontal.

### A. Vertical Integration and Hierarchy within Organizations

How is order created along the production process in organizations? The conventional starting point for contemporary study is Coase's analysis of transaction costs in *The Nature of the Firm*.<sup>12</sup> Noting that a specialized exchange economy relying on contracts and the price mechanism entails potential costs that do not always allow for a smooth process of economic production, Coase suggested that firms emerge as an alternative mode of operation to markets, whereby an organization is formed to allow some authority (the "entrepreneur") to direct resources within the organization rather than having to rely on external market transactions. Firms thus serve as "islands of conscious power in this ocean of unconscious co-operation."<sup>13</sup>

Transaction costs may explain why hierarchical structures emerge. Beyond the costs of identifying what the relevant prices are when relying on the price mechanism, Coase argued that whenever longer-term contracts (such as in the case of labor) are generally more effective for production, the parties incur substantial costs in trying to specify up-front the stream of services or goods and the prices paid for them.<sup>14</sup> The resulting uncertainty and mutual dependency over the long run may tilt a business toward controlling the factors of production by internal organization, paying less for such factors and saving on other transaction costs that the firm would have incurred in the marketplace. Coase also suggested initial principles for studying the optimal size of the firm, that is, which types of economic activity are done through internal organization and which would continue to rely on

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<sup>11</sup> CHESTER I. BARNARD, *THE FUNCTIONS OF THE EXECUTIVE* 3, 4 (1938).

<sup>12</sup> Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937).

<sup>13</sup> *Id.* at 388 (citing D.H. ROBERTSON, *THE CONTROL OF INDUSTRY* 85 (1923)).

<sup>14</sup> *Id.* at 391–92.

market transactions, considering also the marginal costs of organizing an additional activity under each option.<sup>15</sup>

These core insights have been extensively developed. In exploring the concept of vertical integration—which refers to the mechanism of nonmarket resource allocation by organizational fiat—Kenneth Arrow suggested that “an incentive for vertical integration is replacement of the costs of buying and selling on the market by the costs of intra-firm transfers.”<sup>16</sup>

In a restatement of this theory, Oliver Williamson views the challenge for organizational theory as determining the “efficiency logic for managing transactions by alternative modes of governance—principally spot markets, various long-term contracts (hybrids), and hierarchies.”<sup>17</sup> Arguing that the transaction cost approach to the study of economic organization regards the transaction as the “basic unit of analysis,”<sup>18</sup> Williamson—like his NIE peers—seems driven by an analytical and normative approach that is otherwise committed to a decentralized market system, one in which contract and consent serve as the economy’s building blocks. But as a pragmatic matter, transaction costs may often hinder market economic performance, requiring actors to resort to organizations based on internal hierarchy and authority.

Focusing, as did Coase, on “ongoing contractual relations for which continuity of the relationship is a source of value,”<sup>19</sup> Williamson looks at asset-specificity, uncertainty, and frequency as the relevant dimensions for typifying transactions, paying particular attention to the ways in which asset-specific investment and production could lead to bilateral dependency. Consequent “disturbances” to the contract implementation could be the result of opportunistic behavior by one of the parties, genuine dispute due to the contract’s incompleteness, or changes that require a broader-based sequential adaptation. At least in some instances, autonomous adaptations accomplished in the market will be less effective than “consciously coordinated adaptations accomplished through the use of management within the firm.”<sup>20</sup> Vertical integration allows for adaptive, sequential decisionmaking

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<sup>15</sup> *Id.* at 394–96.

<sup>16</sup> Kenneth J. Arrow, *The Organization of Economic Activity: Issues Pertinent to the Choice of Market versus Non-market Allocations*, in PUBLIC EXPENDITURE AND POLICY ANALYSIS 67, 68 (R.H. Havenman and J. Margolis eds., 1970).

<sup>17</sup> Williamson, *Governance*, *supra* note 5, at 1.

<sup>18</sup> Oliver E. Williamson, *The Economics of Organizations: The Transaction Cost Approach*, 87 AM. J. SOCIO. 548, 548 (1981).

<sup>19</sup> Williamson, *Governance*, *supra* note 5, at 2.

<sup>20</sup> *Id.* at 4.

without the need to “consult, complete, or revise inter-firm agreements.”<sup>21</sup> According to Williamson, “where a single ownership entity spans both sides of the transaction, a presumption of joint profit maximization is warranted.”<sup>22</sup>

This literature does not assume that intra-organizational costs are negligible. As North notes, “the agency issue is ubiquitous in hierarchical organizations.”<sup>23</sup> Considering the employer-employee axis, the employer (the “principal”) must constantly engage in “monitoring and metering the various attributes that constitute performance of agents.”<sup>24</sup> Monitoring and policing is a costly process that goes beyond guarding against obvious shirking or other straightforward instances in which the principals’ maximizing attempts are “frustrated by agents whose objectives do not coincide with their own.”<sup>25</sup> As Yoram Barzel shows, measuring the employee’s inputs by time, performance, or contribution to output proves a major challenge, since often there is no clear proportionality between these parameters. Unlike the case of the self-employed person, in which one assumes true unity of interests and effective direction of labor inputs, hiring labor means “renting labor services from the owners of the capital good ‘labor,’”<sup>26</sup> thus potentially undermining the assumptions of vertical integration as a self-enforcing organizational feature.

Barzel’s analysis brings back labor and other types of intra-firm production processes to the contractual context. In so doing, his analysis seems to follow a course similar to the “nexus of contracts” theory of the firm, which questions the hierarchical view of organizations.

In an influential 1972 article, Armen Alchian and Harold Demsetz depicted the Coasean view of the firm as a “delusion.”<sup>27</sup> The firm “has no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting between any two people.”<sup>28</sup> Since “neither the employer nor the employee is bound by any contractual

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<sup>21</sup> OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* 56, 78 (1985) [hereinafter Williamson, *Capitalism*].

<sup>22</sup> *Id.*

<sup>23</sup> North, *supra* note 6, at 32.

<sup>24</sup> *Id.*

<sup>25</sup> YORAM BARZEL, *ECONOMIC ANALYSIS OF PROPERTY RIGHTS* 14 (James E. Alt & Douglass C. 2d ed. 1997).

<sup>26</sup> *Id.* at 69.

<sup>27</sup> Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 *AM. ECON. REV.* 777, 777 (1972).

<sup>28</sup> *Id.*

obligations to continue their relationship,”<sup>29</sup> the employer is continuously involved in renegotiation of contracts with its workers on terms that must be acceptable to both parties. The only difference between the firm and the market lies “in a *team* use of inputs and a centralized position of some party in the contractual arrangements of *all* other inputs. It is the *centralized contractual agent in a team productive process*—not some superior authoritarian directive or disciplinary power.”<sup>30</sup>

In their 1976 work, Michael Jensen and William Meckling voiced sympathy to Alchian and Demsetz’s analysis but argued that the focus on joint input production is “too narrow and therefore misleading.”<sup>31</sup> This is so because “contractual relations are the essence of the firm, not only with employees but with suppliers, customers, creditors, and so on.” The corporation, like other forms of private organizations, is merely a legal fiction that serves as a nexus of contractual relationships. Viewed this way, they argue, “it makes little or no sense to try and distinguish those things that are ‘inside’ the firm... from those things that are ‘outside’ of it.”<sup>32</sup>

The nexus of contracts approach has since become dominant in analyzing the nature of the firm and similar private organizations. But over the past few years, it has faced growing criticism for apparent analytical and normative flaws. I have discussed these shortcomings elsewhere by offering a competing model of the firm as a “nexus of property.”<sup>33</sup> In the present context, I address only the way in which decisionmaking and direction of resources in the production process is governed not chiefly by contract, but rather by the property status of the organization’s assets.

Recall Williamson’s statement about the “presumption of joint profit maximization” in the case of vertical integration that puts the organization’s productive assets under single ownership.<sup>34</sup> Single ownership can be that of a natural person or a corporate body with a separate legal entity. The question of ownership over the organization’s assets implicates multiple facets touching on the relations among direct members, such as stockholders;

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<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 778.

<sup>31</sup> Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 310 (1976).

<sup>32</sup> *Id.* at 311.

<sup>33</sup> AMNON LEHAVI, *THE CONSTRUCTION OF PROPERTY: NORMS, INSTITUTIONS, CHALLENGES* 179–213 (2013) [hereinafter Lehavi].

<sup>34</sup> Williamson, *Capitalism*, *supra* note 21.

between members and other stakeholders, including creditors, suppliers, and employees; and within such groups of non-member stakeholders.

Many of the legal relations within this nexus, or the “property microcosm” of the organization, implicate parties who have no contractual privity among them. Nevertheless, the law has to establish a set of legal powers and priorities to the organization’s assets, with potential contests among otherwise distant parties being particularly acute in cases such as “conflicting transactions”<sup>35</sup> or insolvency. The property structure of these organizations thus plays a crucial role in ordering the powers of decisionmaking regarding the direction of resources and priorities, bearing in mind also that such organizations inherently delegate much of their decisionmaking powers to management and other agents, rather than retaining such powers solely for direct members.

Notwithstanding these complexities, the concept of ownership still retains a powerful role, at least in the everyday life of the organization down the production chain and in other internal dealings. This role goes beyond the ways in which ownership breaks down into a set of “legal powers,” those state-enforced mandates granted to owners through formal lawmaking to unilaterally affect changes in legal relations with others. Even prior to that, ownership supports a strong sense of “organizational power,” one that is reflected in the set of internal practices that guides relations among actors, given the structure and dynamics of such organizations. As Part III will show, organizational power refers not only to social norms or similar self-enforcing norms that are based on a shared sense of mission, repeat-play settings, or preeminent cultural attributes,<sup>36</sup> but also is concerned more broadly with how organizational mechanisms are constructed to self-referee, through authority and ownership, potential frictions in everyday matters. Williamson refers to this as “forbearance” by courts, meaning that courts have the “good sense” to refuse to hear most types of internal disputes in the production process,

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<sup>35</sup> The term “conflicting transactions” refers to a category of cases in which a party commits to simultaneous transactions with (at least) two other parties, promising each of them to provide or transfer the same or similar type of right to an asset (e.g., to transfer ownership in a certain piece of land) in a manner that creates conflicting claims among the two otherwise remote promisees. Such situations pose a challenge for property law in crafting priority rules among such distant parties, especially when the promisor is insolvent or cannot otherwise be made to remedy his wrongdoing. See Menachem Mautner, *“The Eternal Triangles of the Law”*: Toward a Theory of Priorities in Conflicts Involving Remote Parties, 90 MICH. L. REV. 95, 134–46 (1991).

<sup>36</sup> Greif, *supra* note 4, at 167–70.

leaving the organization to resolve internal frictions.<sup>37</sup> This means that “the firm becomes its own court of ultimate appeal,” and such forbearance “authenticates hierarchy by supporting its main purpose, namely, timely responsiveness to consequential disturbances for which coordinated adaptations are needed.”<sup>38</sup>

The self-enforcing nature of such complex multi-actor forms of private ordering relies in turn on the general idea of unified ownership as an organizing principle within these entities. Economist Oliver Hart has noted that “ownership is a source of power when contracts are incomplete.”<sup>39</sup> Hart does not seem to merely focus on the potential doctrinal results of external dispute resolution. He also points to the broad-based signals that the idea of ownership regularly entails for such organizations, understood by the different participants along or down the production chain as granting owners and authorized agents residual control over the direction of resources, without constantly having to spell out particular rights or legal powers.<sup>40</sup>

Williamson notes that the “organization, like the law, has a life of its own.”<sup>41</sup> In the present context, it seems that the idea of vertical integration reflects a set of organizational norms relying on the concept of ownership as a general principle that facilitates the underlying structure of hierarchy and authority in organizations. Had courts embraced a “no-forbearance” approach—namely, one of viewing organizations as nothing more than a cluster of contracts, with each such dealing being subjected to formal litigation and full-fledged contracts jurisprudence—then private legal organizations would have been denied the streamlining benefits of vertical integration.

## B. The Credible Nature of Horizontal Collective Action

Alongside vertical integration and hierarchy, the governance of private legal organizations also entails a key horizontal ordering component. Business corporations, residential community associations, labor unions, and other types of organizations are premised on devising enduring governance mechanisms to facilitate multi-member credible collective action.

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<sup>37</sup> Williamson, *Governance*, *supra* note 5, at 9.

<sup>38</sup> *Id.* at 9–10.

<sup>39</sup> OLIVER HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE 29 (1995).

<sup>40</sup> *Id.* at 30.

<sup>41</sup> Williamson, *Governance*, *supra* note 5, at 14.

Private legal organizations must first devise modes of effective rulemaking and governance to overcome potential “tragedy of the commons” scenarios featuring inter-member externalities of overuse and underinvestment in common-pool resources.<sup>42</sup> At the same time, in delineating a set of rights and duties for members to control such externalities, a dynamic private ordering organization must also overcome potential “anticommons” settings,<sup>43</sup> that is, scenarios of over-fragmentation of vested private rights and veto powers that could hamper the kind of adaptive, sequential decisionmaking that is essential in the life of the organization. Governance by majority voting, studied in detail in Part IV, serves as a clear example of a collective action mechanism that prevents individual members from vetoing otherwise efficient organizational adjustments, while ensuring that such governance mechanisms do not serve to abuse minorities.

More generally, for such collective action mechanisms to function well over time, members must make certain *credible commitments* while enjoying correlative *credible benefits*. I suggest that members in these legal organizations typically make at least three types of horizontal credible commitments, meaning that regularly, these commitments cannot be unilaterally reneged on so as to undermine the collective action. This is done in exchange for correlative benefits vested in the members. I now present these key types of horizontal credible commitments.

**Transfer of Assets.** First, members undertake to move certain privately owned assets or property rights to the organization, or to otherwise contribute to establishing resources governed by the collective entity. As Section C shows below, in the business corporation, members contribute capital to establish assets owned and managed by the corporation as a separate legal entity in return for non-fixed claims in the form of shares. While tradable shares grant members rights to dividends when they are issued and allow for liquidity and exit through sale of the shares, members cannot simply pull back their respective portion of the assets now owned by the firm or otherwise unilaterally liquidate the company’s assets. In residential community associations, homeowners set up common assets and are

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<sup>42</sup> Garrett Hardin, *The Tragedy of the Commons*, 162 SCI. 1243 (1968).

<sup>43</sup> Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621 (1998). See LEE ANNE FENNELL: THE UNBOUNDED HOME: PROPERTY VALUES BEYOND PROPERTY LINES 45–64 (2009) for the complex interplay between commons and anticommons problems [hereinafter Fennell].

committed to contributing to the upkeep of these assets. They also agree to place equitable servitudes on their privately owned homes to ensure compliance with their contribution commitments and with additional limits that may be placed on their use of privately owned homes. In return, homeowners enjoy reciprocity in the sense that all other homeowners are subjected to the same commitments, preventing others from defecting. Members thus own a reciprocal power or “amenity right” against other homeowners.<sup>44</sup> In the labor union, members transfer their bargaining power and rights arising out of personal employment contracts to create a bargaining unit and entrust it with the collective bargaining power. This transfer of rights or the granting of effective dominion over supply-side labor is practically irrevocable, since decertifying the union is generally impractical and individual exit—resignation from the workplace—is costly. At the same time, this credible commitment is backed by reciprocity of other members, thus safeguarding collective action.

**Delegation to Agents.** Second, members in these organizations delegate a key part of their decisionmaking authority to a representative or professional body: the board of directors and executive management in business corporations; directors and officers of the association in residential communities; and union officials in the labor context. Unlike the conventional case of principal and agent in private law, the principal cannot simply take back the reins by terminating the agency relations or otherwise preempting, at least prospectively, decisions made by the agent. In the business corporation, while shareholders must ratify certain decisions such as mergers and charter amendments, they lack the power to initiate them. Moreover, in the U.S. legal system—considered relatively “board-centric” as compared with other jurisdictions—shareholders do not have the general power to overrule any matter that is within the board’s competence.<sup>45</sup> The scope of “shareholder democracy”<sup>46</sup> thus is often reduced to representative-based governance.<sup>47</sup> In residential associations, enabling legislation or the

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<sup>44</sup> Fennell, *supra* note 43, at 45.

<sup>45</sup> Luca Enriques et al., *The Basic Governance Structure: The Interests of Shareholders as a Class*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 55, 72–75 (Reinier Kraakman et al. eds., 2d ed. 2009) [hereinafter Enriques et al., *Governance*].

<sup>46</sup> Prominent in this context is Lucian Bebchuk, who has advocated the empowering of shareholders vis-à-vis directors in an influential series of works. See, e.g., Lucian Arye Bebchuk, *The Case against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002).

<sup>47</sup> Grant Hayden & Matthew T. Bodie, *Shareholder Democracy and the Curious Turn toward Board Primacy*, 51 WM. & MARY L. REV. 2071 (2010) (presenting, and criticizing, contemporary

community's governing documents typically require direct approval by members for limited types of decisions, such as amendment of the governing documents or authorization of special assessments; the board is otherwise considered to have all powers not expressly reserved for members.<sup>48</sup> Labor unions probably feature the most extensive credible delegation of decisionmaking power to the agents, here the union's officers. Governed by federal legislation, members are ensured equal rights when taking part in membership meetings, elections, and referendums, but federal law does not in itself require that certain matters be reserved for the direct decision of members, with the exception of general elections and "rates of dues and initiation fees."<sup>49</sup> This leaves the allocation of decisionmaking powers between union officers and members to the organization's constitution or bylaws, with the practical result being extensive delegation of power. Unlike firms, labor unions are not even required by law to hold general membership meetings on a regular basis.<sup>50</sup>

This credible commitment to delegation of decisionmaking power is embedded in well-established organizational principles of effective governance and professionalism, but it is implicated by various concerns over agency problems. To protect the organization's members as a class against such potential misalignments of interests, all of these organizations maintain the right of members to elect and re-elect officers and managers, while imposing, to varying degrees, certain procedural and substantive duties on these agents toward members.<sup>51</sup>

**Governance by Majority.** Third, in matters reserved for direct decisionmaking by members, private legal organizations facilitate collective action by governance through majority vote. As I show in Part IV, each individual member consents to be placed under a regime in which she may

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board-centric theories that seek to justify prevailing doctrine, one that allegedly promotes a less responsive but more deliberative decisionmaking).

<sup>48</sup> Restatement (Third) of Property: Servitudes § 6.16 (2000) [hereinafter Restatement, Servitudes].

<sup>49</sup> 29 U.S.C. §§ 401, 411(a)(3) (2006).

<sup>50</sup> *Grant v. Chicago Truck Drivers, Helpers & Warehouse Workers Union*, 806 F.2d 114, 117–18 (7th Cir. 1986).

<sup>51</sup> For such rules in the context of the business corporation, see Enriques et al., *Governance*, *supra* note 5, at 78–81. For RCAs, see Restatement, Servitudes, *supra* note 48, at § 6.14 and in Part IV.B. below. For the labor union, see, e.g. *Goulet v. Carpenters Dist. Council of Boston and Vicinity*, 884 F. Supp. 17, 23–24 (D. Mass. 1994) and more in Part IV.C. below.

contribute to, or otherwise advance, certain organizational activities to which she has objected. In most cases, simple majority voting is sufficient. In a small set of cases, a special majority or a “majority of the minority” is required.<sup>52</sup> In addition, certain procedural and substantive duties are imposed on the organization as a whole, and in corporations also on the controlling subclass, in order to protect the minority against potential abuses of the system of majority rule.<sup>53</sup>

The following section explains in more detail, for each of the three types of private legal organizations, the origins of the demand for credible horizontal collective action and the general structure that these organizations take to meet this demand. This analysis serves to conceptualize, at the close of this part, private legal organizations as multi-directional entities, which go beyond contracts to include strong features of agency, authority, and “sticky” control.

### C. Horizontal Collective Action across Private Legal Organizations

#### 1. *Collective Capitalism*

In their seminal study of the modern corporation, Adolf Berle and Gardiner Means portrayed the evolution of the Boston Manufacturing Company, established in 1813, and the way in which stockownership became increasingly dispersed while direction of the industrial activity was concentrated in the hands of managers who held only a fraction of the stocks.<sup>54</sup> By selling stocks broadly to the public, the original organizers “freed themselves and a large part of their capital from the fortunes of their first investment and were enabled to go on to organize further similar corporate units.”<sup>55</sup> Analyzing the 200 largest non-banking corporations in the United States over a century later, in the early 1930s, Berle and Means concluded that this form of “collective capitalism” had come to dominate the American economy, carrying dramatic financial and legal implications.<sup>56</sup>

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<sup>52</sup> See *infra* text accompanying note 142.

<sup>53</sup> See *infra* Part IV.A.

<sup>54</sup> ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION & PRIVATE PROPERTY 11–12 (rev'd ed. 1991, with a new introduction by Murray Weidenbaum & Mark Jensen) [hereinafter Berle & Means].

<sup>55</sup> *Id.* at 11.

<sup>56</sup> *Id.* at 44. For their conclusions as to quasi-public features of such widely-held shares, see *infra* Part V.A.

Business corporations have since continued to grow in scope and dominance, taking various shapes and offering sophisticated innovations, but remaining with a set of basic organizational and structural dilemmas—such as whether to remain closely-held corporations or to go to public securities markets, and whether to finance investments through debt (loans) or equity (shares).<sup>57</sup>

Accordingly, equity shareholding illustrates one way that dispersed individuals and institutions (equity investors) cultivate financial and legal interests through their association with a private legal organization (the corporation). The shareholder commits to contributing capital to the collective enterprise while giving up control over such funds and the power to unilaterally block corporate actions. This commitment is made in exchange for the power to alienate the pro rata non-fixed stake in the form of tradable shares; the financial stake in dividends and asset distribution in case of dissolution (subject to priority of other stakeholders); power as a member of the shareholders' class to indirectly control the corporation by electing directors and ratifying certain decisions; and assurance of procedural and substantive protections for the shareholder as a class member and as an individual who may find herself in a minority position.<sup>58</sup>

The business corporation's separate legal entity plays a key role in solidifying and ensuring the credibility of the commitment by each individual equity shareholder to transfer direct control over the now-collectively-governed assets. As Henry Hansmann and Reinier Kraakman argue, for the business corporation to effectively engage in contractual relations with actors outside of the firm, it must have the ability to bond its contracts credibly, that is, to assure other parties that it will perform its contractual obligations. Such bonding usually requires that there exist "a pool of assets that the firm's managers can offer as satisfaction for the firm's obligations."<sup>59</sup>

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<sup>57</sup> See, e.g., Armen Hovakimian et al., *The Debt-Equity Choice*, 36 J. FINANCIAL & QUANTITATIVE ANALYSIS 1, 22–23 (2001) (arguing the firms' target debt ratio changes over time as the firm's profitability and stock prices change); Paul Marsh, *The Choice between Equity and Debt: An Empirical Study*, 37 J. OF FINANCE 121, 142 (2012) (pointing to market conditions and past history of stock prices, alongside company size, bankruptcy risk, and asset composition).

<sup>58</sup> For the various strategies employed by corporate law to protect the interests of shareholders as a class, see Enriques et al., *Governance*, *supra* note 45.

<sup>59</sup> Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 392 (2000).

Hansmann and Kraakman view “asset partitioning” as the “core defining characteristic of a legal entity” and as the essential role of organizational law.<sup>60</sup> Asset partitioning has two components. The first is designating a separated pool of assets that are associated with the firm and are distinct from the personal assets of the firm’s owners and managers. The second is assigning creditors with priorities in the distinct pools of assets that result from the formation of the legal entity. The assignment of such priorities can take two forms. One form is “affirmative” asset partitioning, which assigns to the firm’s creditors a claim on the firm’s assets that is categorically prior to the claims of the personal creditors of the firm’s owners. The other form is “defensive” asset partitioning, which does the opposite: “granting to the owners’ personal creditors a claim on the owners’ separate personal assets that is prior to the claim of the firm’s creditors.”<sup>61</sup> The latter is regularly achieved, in its strongest fashion, through the limited liability in corporations.

The essence of organizational law lies, according to Hansmann and Kraakman, in affirmative asset partitioning.<sup>62</sup> This partitioning could not be effectively achieved only by contract or even through a standard application of the proprietary mechanism of secured transactions. This is so because given the default rules of obligations law—by which all creditors have an equal-priority claim to the entire pool of assets in case of default—an entrepreneur would be practically unwilling and unable to credibly promise to business creditors a priority over the business assets.

This problem is exacerbated when the enterprise is made up of multiple owners, and particularly so in the case of the publicly traded corporation, which is the focus of this study. To ensure their priority, business creditors would have had to constantly assess and reassess the personal creditworthiness of each one of the owners, undermining the basis of collective action.<sup>63</sup>

It is here that the mechanism of establishing a separate legal entity comes into play. Permitting the firm itself to be the owner of assets “provides a simple means for identifying which assets are to be considered personal assets as opposed to business assets.”<sup>64</sup> Through affirmative asset partitioning, which grants this discernible group of creditors a categorical priority with regard to a discernible group of resources, business corporations allow for credible

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<sup>60</sup> *Id.* at 393.

<sup>61</sup> *Id.* at 393–94.

<sup>62</sup> *Id.* at 398.

<sup>63</sup> *Id.* at 401–03.

<sup>64</sup> *Id.* at 408.

horizontal collective action by shareholders. The separate legal entity prevents moral hazard and other defection tactics by shareholders that might have been exercised if the firm's assets had been available for collection or liquidation by the shareholders' personal creditors. Together with the credible delegation of decisionmaking by the shareholders' class to the corporation's agents and the yielding by each shareholder to governance by majority member vote, the concentration of assets with the corporate entity solidifies the credible horizontal collective action of shareholders.<sup>65</sup>

## *2. Provision of Neighborhood Goods*

With more than 323,000 residential community associations (RCAs) housing 63.4 million residents in the United States as of 2012, real estate developments governed by such private legal organizations have come to dominate much of the residential landscape.<sup>66</sup>

The core of the horizontal collective action among homeowners lies in the association's governing documents, typically comprised of "declarations" containing a set of conditions, covenants, and restrictions (CC&Rs), which are recorded with the land registrar. These provisions regularly concern "membership and voting rights in the owners association, maintenance responsibilities, procedures for calculating and collecting assessments, accounting and insurance requirements, architectural and/or design control, and enforcement of the declaration."<sup>67</sup>

Though regularly viewed as based in contract, the governing documents and subsequent amendments, rules, and regulations adopted by the association go well beyond conventional contractual provisions, awarding them a more credible and reciprocal nature. This is so because under enabling legislation, individually owned lots or units are "burdened by a servitude that imposes an obligation that cannot be avoided by nonuse or withdrawal."<sup>68</sup> Under such statutes, the CC&Rs and subsequent association rulemaking are

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<sup>65</sup> For a fuller analysis of the implications of asset portioning for the conceptualization of the firm as a nexus of property, see Lehavi, *supra* note 33, at 179–213.

<sup>66</sup> See Community Associations Institution, 'Data on U.S. Associations' (2012), available at [www.caionline.org/about/facts.cfm](http://www.caionline.org/about/facts.cfm).

<sup>67</sup> *Pinnacle Museum Tower Ass'n v. Pinnacle Market Development*, 145 Cal.Rptr.3d 514, 523–24 (2012).

<sup>68</sup> Restatement, Servitudes, *supra* note 48, at § 6.2.

considered “enforceable equitable servitudes, unless unreasonable.”<sup>69</sup> Such provisions do not require actual notice once registered and apply to subsequent purchasers, even if these provisions would not have otherwise fulfilled the “common law requirements for creation of an equitable servitude or a restrictive covenant.”<sup>70</sup>

As the California Supreme Court reasoned in its 2012 *Pinnacle* decision, having a single set of recorded covenants and restrictions that applies to an entire residential association “protects the intent, expectations, and wishes of those buying into the development and the community as a whole by ensuring that promises concerning the character and operation of the development are kept.”<sup>71</sup> The fact that such provisions are enforced as servitudes and not as common law contractual provisions—which might otherwise allow an infringing homeowner to avoid specific performance and instead pay compensatory damages—amplifies the credibility of reciprocal commitments made by members and thus secures the endurance of collective action.

What are the kinds of collective action problems that neighbors typically face in residential neighborhoods, and how is the RCA as a private legal organization engineered to address them? I roughly divide the realms of horizontal collective action into (1) establishment and management of common neighborhood amenities, such as streets, parks, and sport facilities, and (2) control of intra-neighborhood externalities resulting from the use of privately owned housing units.<sup>72</sup>

As for the commonly owned assets, the collective action challenge consists of two phases. The first phase is the efficient creation of the amenities. For some of these assets, such as inner streets, which more genuinely possess the economic traits of public goods—non-excludability and non-rivalry—the existence of reciprocal duties of contribution solves the inherent market failure that usually necessitates governmental production and financing through imposition of taxes.<sup>73</sup> For “club goods” such as sport

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<sup>69</sup> CAL. CIV. CODE § 1354(a). Other state statutes may define the standard of enforcement of such servitudes somewhat differently. See Restatement, Servitudes, *supra* note 48, at § 6.8, Statutory Note.

<sup>70</sup> *Pinnacle*, 145 Cal.Rptr., at 525.

<sup>71</sup> *Id.* at 524.

<sup>72</sup> For a fuller analysis of these realms of collective action, see Fennell, *supra* note 43, at 67–95; Lehavi, *supra* note 33, at Ch. 3.

<sup>73</sup> Non-excludability means that there is no feasible way to prevent people from enjoying the good even if they refuse to pay for it. Non-rivalry means that the marginal cost of an

facilities, which can usually be provided by the market in ordinary residential settings, the internal group provision of such amenities is a significant cost-cutting device for RCA members.<sup>74</sup> The second phase concerns the ongoing maintenance, protection, and improvement of these assets. The servitude-backed contribution commitments and the association's governance powers guard against underinvestment and overuse.<sup>75</sup>

Beyond the control over commonly-owned assets, RCAs also employ extensive collective governance regarding the use of private housing units. This form of private ordering comes in addition to, and not in lieu of, public regulation such as land use controls or nuisance rules. The community provisions may include aesthetic controls of the external shape, design, and color of the housing units; limits or flat prohibitions on the possession of pets; restrictions on outside storage of certain items such as unused cars; and limits on other types of activities not regularly prohibited by law. One recent front seems to be bans on smoking within RCA housing units.<sup>76</sup>

These restrictions are designed to constrain certain potential adverse spillover effects that do not conform to the community members' tastes or preferences, preventing individual members from exercising the effective privilege of use they would otherwise have enjoyed as owners of the privately held units. Such an organizational design transfers to the group decisionmaking powers that go substantially beyond the sphere of public intervention in private property.

This additional layer of horizontal credible commitment is designed as a reciprocal mechanism, one that arguably makes every member of the group better off. Such community-wide norms and regulations may be seen as granting a "property rule" protection against restricted private uses in favor of the community, or more exactly, in favor of the number of residents whose aggregate votes are needed in the association's or the general meeting's decisionmaking process in order to abolish the restriction or make an exception to it.<sup>77</sup>

It should be noted, however, that this property rule protection may be problematic from an efficiency viewpoint whenever the value that a certain

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additional consumer is zero or close to it. See RICHARD CORNES & TODD SANDLER, *THE THEORY OF EXTERNALITIES, PUBLIC GOODS, AND CLUB GOODS* 8–10 (2d ed. 1996).

<sup>74</sup> *Id.* at 347–56.

<sup>75</sup> Fennell, *supra* note 43, at 45–64.

<sup>76</sup> Vivian S. Toy, *Upper West Side Condo Votes to Ban Smoking*, *New York Times*, May 12, 2011, A1.

<sup>77</sup> Restatement, Servitudes, *supra* note 48 at § 6.10.

resident attributes to the enjoined use (e.g., painting the exterior of her house pink in an all-white-paint RCA) outweighs the harm expected to other community members. Should the resident try to collect the consent needed to overturn the restriction, she is likely to face an anticommons scenario, in view of the fact that the power to overturn is dispersed among various members. The resulting “one-directional stickiness in the fragmentation process” creates substantial transaction and strategic costs, which may hamper consensual correction of an inefficient baseline.<sup>78</sup> Although, as mentioned, the governance structure of the RCA does not normally require unanimous consent to allow such extraordinary use, the process of consent assembly is nevertheless complicated, given also the conservative bias that seems to characterize RCA members for undoing restrictions imposed on private uses.<sup>79</sup>

### 3. Organized Labor

The demand for collective action of workers through collective bargaining and other forms of organized labor originates in the imbalances that are reported to have existed in labor markets with the growing dominance of industrialism and market economies. As Matthew Finkin notes, while in colonial America workmen could not have been dismissed without cause, by the latter part of the nineteenth century the law had changed so that the employer was free to discharge an employee for arbitrary reason and without notice, or to reduce wage rates and other terms of employment, with the employee assumed to have assented to such contractual changes upon continuing the employment.<sup>80</sup> Trade unions began to emerge with the purpose of correcting for the imbalances in bargaining power. As Clyde Summers shows, at the turn of the twentieth century, trade unionism had received substantial tailwind not only from scholars and social activists, but more importantly from the work of formal bodies such as the United States Industrial Commission, set up in 1898 to study industrial life in the United

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<sup>78</sup> See Francesco Parisi et al., *Duality in Property: Commons and Anticommons*, 25 INT'L REV. L. & ECON. 578, 585–86 (2005).

<sup>79</sup> Suggested solutions to such an anticommons scenario, based also on a switch to a “liability rule” protection (i.e. compensation determined by a third party) have proven to be far from simple. See Fennell, *supra* note 43 at 96–119 (offering a reciprocal option mechanism between the homeowner and the community, based on a periodic self-assessment made by the homeowner of the use’s value).

<sup>80</sup> Matthew W. Finkin, *The Limits of Majority Rule in Collective Bargaining*, 64 MINN. L. REV. 183, 185–86 (1980) [hereinafter Finkin].

States, including working conditions and labor relations.<sup>81</sup> In its 1902 final report, the Commission stated that since the individual worker had “felt himself under the control of powers upon whose conduct he has been able to exercise no direct influence,” the organization of labor had become necessary to allow workers to “take part in determining the conditions under which they work.”<sup>82</sup>

“Industrial democracy,” the term that had been coined during that era, was viewed as reflecting the stance that organized labor should do more than just improve economic working conditions. The reference to “democracy” has also sought to promote the idea of giving workers more voice and enabling them to share in the control of workplaces so as to promote self-standing values of individual worth and dignity.<sup>83</sup> Goals of “developing self-control, expressing personal creativity, and experiencing the happiness of goal attainment” through active involvement in the workplace were advanced by early institutional theorists such as Richard Ely, Sidney and Beatrice Webb, and John Commons.<sup>84</sup> The conflation of such intrinsic values with economic motives for improving employment conditions can also be, however, a source of confusion in identifying the types of horizontal collective action that trade unions promote or in designing legal policy pertaining to the status of trade unions.

To better understand how these two sets of goals interact but are not necessarily aligned, consider first the dramatic change in the organizational and legal powers of trade unions brought about by the 1935 National Labor Relations Act (“NLRA”).<sup>85</sup> Prior to the NLRA, “courts conceived of the relationship between employee and union as a wholly consensual agency relationship,” so that the terms of a “trade agreement” bound the parties, including the employer, only if the court established that “the employee consented to be bound, as for example, by belonging to the union or by ratifying the collective agreement.”<sup>86</sup> Accordingly, this previous system

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<sup>81</sup> Clyde W. Summers, *From Industrial Democracy to Union Democracy*, 21 J. LAB. RES. 3, 3–7 (2000) [hereinafter Summers].

<sup>82</sup> Final Report of the Industrial Commission, H.R. Doc. No. 57–380, at 804–05 (1902).

<sup>83</sup> Summers, *supra* note 81, at 5.

<sup>84</sup> See Bruce E. Kaufman, *The Early Industrialists on Industrial Democracy and Union Democracy*, 21 J. LABOR. RES. 189, 189–95 (2000) [hereinafter Kaufman].

<sup>85</sup> National Relations Labor Act, ch. 372, 49 Stat. 449 (1935) (codified at 29 U.S.C. §§ 151–69 (2006)), as amended at the Labor Management Relations Act, ch. 120, 61 Stat. 136 (1947) (codified as amended at 29 U.S.C. §§ 141–97 (2006)).

<sup>86</sup> Finkin, *supra* note 80, at 186.

involved a weak commitment by employees, one that correspondingly limited the potential of collective action.

In stark contrast, under Section 9(a) of the NLRA, the union elected by the “majority of the employees in a unit appropriate for such purposes” is the exclusive representative of all of the employees in the bargaining unit.<sup>87</sup> The “bargaining unit” is determined by the National Labor Relations Board (“NLRB” or “the Board”), established by the NLRA. The Board considers whether the proposed unit is appropriate and if the employees in it can be seen as constituting a “community of interest.”<sup>88</sup>

Employees within the bargaining unit are fully bound by the authority of the trade union to negotiate all employment terms; indeed, “the very purpose” of giving the union such bargaining power “is to supersede the terms of separate agreements of employees with terms which reflect the strength and bargaining power and serve the welfare of the group.”<sup>89</sup> This is the case not only with union members who object to the representatives’ policies or to decisions made by the union, but also with employees who decide not to become union members. Such nonmembers are still bound by collective bargaining and are also required to pay dues under the union security agreement negotiated between the union and the employer.

These federal statutory provisions are viewed by the U.S. Supreme Court as promoting a compelling interest in securing “industrial peace along the arteries of commerce.”<sup>90</sup> The dues required from nonmembers are particularly justified “to prevent nonmembers from free-riding on the union’s efforts, sharing the employment benefits obtained by the union’s collective bargaining without sharing the costs incurred.”<sup>91</sup> Although the force of the federal legislation is somewhat undermined by the recently increasing wave of state-level “right to work” legislation—which releases employees from being forced to contribute dues to unions to gain employment or prohibits employers from dismissing workers if they do not contribute such funds<sup>92</sup>—the Court’s support for such collective obligations remains valid at the federal level.

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<sup>87</sup> Codified at 29 U.S.C. § 159(a) (2006).

<sup>88</sup> See Douglas L. Leslie, *Labor Bargaining Units*, 70 VA. L. REV. 353, 380–82 (1984) [hereinafter Leslie].

<sup>89</sup> *J.I. Case Co. v. Nat’l Labor Relations Bd.*, 321 U.S. 332, 338 (1944).

<sup>90</sup> *Railway Emp. Dep’t v. Hanson*, 351 U.S. 225, 233 (1956).

<sup>91</sup> *Knox v. Serv. Emp. Int’l Union, Local 1000*, 132 S. Ct. 2277, 2289 (2012).

<sup>92</sup> The mandate for states to pass such legislation that would make union security agreements unenforceable derives from the 1947 Taft-Harley Amendments to NLRA, *supra* note 85, at § 164(b). For a critical analysis of this history of state-level “right-to-work” laws as of the 1940s to date, see Kenneth Glenn Dau-Schmidt & Winston Lin, *The*

What exactly are the collective benefits shared by employees and how is the trade union—as a private legal organization authorized by federal legislation and building on the credible commitments made by employees acting through majority vote—positioned to achieve them?

As Bruce Kaufman shows, the early industrialists—who defined the economic purpose of unions as wealth distribution and advancement of wages, hours, and conditions of labor—favorably viewed collective bargaining as creating a cartel-like mechanism on the supply side of labor. For them, both government regulation and trade unionism were essential to “correct the imbalances and imperfections of the labor market by redistributing and redefining property rights” and by placing a uniform floor under labor conditions (such as minimum wage) so that employers and workers would compete “on a plane that is both higher and more level.”<sup>93</sup>

These earlier arguments were at odds with the underlying assumptions of liberal and neo-liberal economics. Unlike business corporations and residential community associations, labor unions are not formed to address particular market failures resulting from collective action problems, but rather to tackle an inherent distortion of the free market, or at least of the labor market. The trade union is not complementary to the free market, but an adversary mechanism.

Later versions of arguments in favor of collective bargaining have sought, however, to justify the benefits of trade unions on a more market-compatible basis. Douglas Leslie articulates a collective goods model of labor unions, one that is closer to the conventional analysis of collective action problems against the backdrop of market contracts.<sup>94</sup> Reviewing goods such as wage systems, seniority rosters for promotions and layoffs, “just cause” disciplinary protection, grievance arbitration, and plant safety, Leslie argues that since many of these goods are non-excludable in nature, “individual workers will spend little to secure collective goods at the workplace” because the individual effort may be costly, the prospects of success uncertain, and other

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*Great Recession, The Resulting Budget Shortfalls, The 2010 Elections and the Attack on the Public Sector Collective Bargaining in the United States*, 29 HOFSTRA LAB. & EMP. L.J. 407, 428–31 (2012). As of the end of 2012, twenty-four states have enacted some version of such a “right to work” law or constitutional provision, with Michigan and Indiana, two heavily unionized Midwest, enacting such statutes in 2012. See William J. Bennett, *A Victory for Right-to-Work Laws*, CNN NEWS, Dec. 13, 2012, available at <http://edition.cnn.com/2012/12/12/opinion/bennett-michigan-unions/index.html>.

<sup>93</sup> See Kaufman, *supra* note 84, at 194–95.

<sup>94</sup> Leslie, *supra* note 88, at 354–60.

workers would attempt to free-ride on these efforts.<sup>95</sup> In contrast, a union can secure such results. It does so not only by requiring all employees to pay union fees, but also by possessing information or taking measures not available to individual employees: strikes, picketing, and boycotting; speaking with a collective voice; securing collective goods in exchange for ensuring employee cooperation and productivity; and “purchasing” a collective good from the employer by trading off another benefit of lesser value to the union members.<sup>96</sup>

But are the goods generated through union activity necessarily collective ones, promoting the interests of the group as a whole? Is the collective action credibly committed to by union members reciprocated with benefits vested in them? These questions have been particularly challenging in view of the rich evidence that “unions share with other bureaucratic organizations a tendency towards oligarchy”<sup>97</sup> and, moreover, that some unions are prone to union corruption and labor racketeering.<sup>98</sup> While corruption or blunt oppression seem to be clear abuses of the trade union system—abuses that served as a major incentive for enacting the 1959 Labor-Management Reporting and Disclosure Act (“LMRDA”)<sup>99</sup>—the increasing calls to further democratize the internal institutions of labor unions cannot be entirely separated from identifying the chief goals that labor unions should promote. When economic collective goods are at stake, is broad-based democracy necessarily superior to hierarchy or centralism?

Proposals to democratize the labor union for intrinsic reasons rely on viewing the workplace as an “industrial government” and the trade union as a mini-government committed to individual rights and liberties alongside the promotion of collective action.<sup>100</sup> Internal democracy also has been argued to have instrumental value in securing the efficient production of collective goods. Robert Bruno argues that by instituting democratic decisionmaking practices and procedures, unions elicit “valuable membership input which subsequently increases the capacity of the institution to represent its

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<sup>95</sup> *Id.* at 355–56.

<sup>96</sup> *Id.* at 356–57.

<sup>97</sup> Richard W. Hurd, *Professional Employees and Union Democracy: From Control to Chaos*, 21 J. LABOR RES. 103, 103 (2000) [hereinafter Hurd].

<sup>98</sup> Michael J. Goldberg, *An Overview and Assessment of the Law Regulating Internal Union Affairs*, 21 J. LABOR RES. 15, 16–17 (2000).

<sup>99</sup> 29 U.S.C. §§ 401, 411(a)(3) (2006).

<sup>100</sup> Kaufman, *supra* note 84, at 195–98.

members' interest."<sup>101</sup> George Strauss, too, emphasizes the importance of internal democracy for ensuring responsiveness to members' concerns while admitting that it may come at the expense of short-term efficiency.<sup>102</sup> Yet, others have been hesitant on this point, suggesting that "the question of whether democratic unions are more effective than oligarchic ones has no straightforward answer."<sup>103</sup>

This "democracy dilemma" is influenced by the unique features of the labor union and the particular forms that the agency problem takes in this context. Samuel Estreicher examines the lack of viable "exit" options for employees; the apathy of the overwhelming majority of union members in exercising their right for "voice"; the incentive structure of union officers that leads them to maximize expenditures on office buildings or sinecures for relatives and friends; and the lack of a market for union control.<sup>104</sup> In this regard, apathy often is not a sign of satisfaction with centralist decisionmaking in unions but rather a sign of discontent—one that also may explain the decline of nationwide union representation of workers in the private sector from 30 percent in 1945 to around 10 percent today.<sup>105</sup>

Thus, unlike the business corporation and the residential community association that have been enjoying ongoing institutional success,<sup>106</sup> the labor union is more challenged in having to demonstrate appropriate benefits in return for credible horizontal commitments. At the same time, since decertification of already-existing labor representation is impractical under

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<sup>101</sup> Robert Bruno, *Democratic Goods: Teamster Reform and Collective Bargaining Outcomes*, 21 J. LABOR RES. 83, 84 (2000) [hereinafter Bruno].

<sup>102</sup> George Strauss, *What's Happening inside U.S. Unions: Democracy and Union Politics*, 21 J. LABOR RES. 211, 211–12 (2000).

<sup>103</sup> Hurd, *supra* note 97, at 106.

<sup>104</sup> Samuel Estreicher, *Deregulating Union Democracy*, 21 J. LABOR RES. 247, 248–55 (2000) [hereinafter Estreicher].

<sup>105</sup> Summers, *supra* note 81, at 6; Estreicher, *supra* note 104, at 252. The weakening of labor unions in the private sector is also attributed to the currently increasing state-level "right to work" legislation, discussed in *supra* note 92.

<sup>106</sup> The number of residents living in RCAs has grown rapidly over the past few decades from 2.1 million in 1970 to 63.4 million in 2012. See *supra* note 66. Corporations have been the most prominent form of business association over the course of the twentieth century and to date. As of 2008, based on tax return data, there were 5.84 million corporations in the United States, as compared with a total of 1.63 million other business entities, including limited liability companies, general partnerships, and limited partnerships. LARRY E. RIBSTEIN, *THE RISE OF THE UNINCORPORATION* 2–3 (2010). While new forms of non-corporate business associations have gained currency since the 1980s, the corporation still retains a key role in economic organization at least for large firms. *Id.* at 237–38.

current federal legislation and industrial practices,<sup>107</sup> there is a continuous interest in designing the optimal organizational and legal regime governing the collective action of represented workers.

#### D. The Organizational Nexus: Agency, Authority, Stickiness

The multi-directional analysis of private legal organizations suggested above sets the ground for conceptualizing the “organizational nexus” that typifies each one of these collective entities.

Recall Williamson’s statement that the “organization, like the law, has a life of its own.”<sup>108</sup> The mechanisms of vertical integration and credible horizontal collective action align the direction of resources with the decisionmaking power and organizational authority of majority or controlling members or of agents entrusted with a long-term, multi-faceted capability to act. While these powers and authorities are not unconstrained as an organizational matter, and especially as a legal principle—as Parts III-IV show in detail—these organizations are nevertheless governed by self-enforcing norms that rely on the mechanisms of private ordering and that go far beyond the formal phrasing of the underlying contractual terms of incorporation.

The power and authority of those who lead the organization down the production chain, among members, and within the complex array of members and other stakeholders are thus not defined only by specific contractual terms. None of these organizations—the business corporation, the RCA, or the labor union—is simply a nexus of contracts. All of these organizations harness “sticky”<sup>109</sup> or “lumpy”<sup>110</sup> powers and priorities with respect to the direction of resources and other types of decisions. Controlling or majority members, alongside authorized agents, retain residual control over decisions and otherwise enjoy an often irrevocable authority over indefinite types and numbers of uses and actions as part of the adaptive, sequential decisionmaking dynamics of the organization. The fact that the life of these organizations is generally designed to be perpetual or otherwise largely irrevocable—corporations do not die and the same is generally true of

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<sup>107</sup> Estreicher, *supra* note 104, at 250.

<sup>108</sup> Williamson, *Governance*, *supra* note 5, at 14.

<sup>109</sup> See Melvin A. Eisenberg, *The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 827–28 (1999).

<sup>110</sup> THOMAS W. MERRILL & HENRY E. SMITH, THE OXFORD INTRODUCTIONS TO U.S. LAW: PROPERTY 7 (Dennis Patterson ed., 2010); Lee Anne Fennell, *Lumpy Property*, 160 U. PENN. L. REV. 1955, 1957–64 (2012).

residential associations, given the indeterminate life of buildings, and of labor unions unless decertified—only adds to the demand for and the consequent supply of lumpy and self-enforcing decisionmaking powers.

### III. FROM ORGANIZATIONAL POWER TO LEGAL POWER

Part II has identified how power over decisionmaking and direction of resources is practically established across private legal organizations. The design mechanisms of vertical integration, transfer of assets, delegation to agents, and governance by majority entrust majority members and top agents with “organizational power.” Such power goes far beyond particular contractual provisions in the founding documents to constitute a dynamic, lumpy set of internal governance practices building on the self-enforcing structure of these organizations.

But organizational power is far from synonymous with “legal power.” By legal power, I refer to the state-enforced mandate for designing and directing legally-binding relations within these entities, or in Wesley Hohfeld’s terminology, the legal ability to affect a “particular change of legal relations” vis-à-vis other parties who face a correlative “legal liability.”<sup>111</sup> In the context of private legal organizations, legal power translates to the legally-enshrined mandate of majority members or executive agents to transact with third parties while binding the entire organization or to otherwise make collective decisions and run the affairs of the organization. While in some cases, legal power is designed and enforced through enabling legislation and judicial decisions to facilitate self-enforcing practices, in many other cases legal power constrains organizational power. Such constraining rules may include ultra vires doctrines, duty of care and duty of good faith in running the organization, limits on conflicted transactions, and restrictions on decisions that amount to abuse of minorities. Legal power thus looks to monitor against the tendency of organizational power to be excessive. Opportunism, rent-seeking, and other phenomena that have initially justified the setting-up of the organization may reemerge, albeit in different forms, as byproducts of too much organizational power. This means that law must always be present in the life of private legal organizations, from the point when it enables and facilitates the creation of these various entities to the ex post monitoring of their practices of organizational power.

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<sup>111</sup> Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16, 24, 44–54 (1913).

But how does the legal system identify excess or illegitimate organizational power? Where should the law draw the line between forbearance, which facilitates the organization's self-enforcing mechanisms of governance in view of the "inherent limits of legal centralism,"<sup>112</sup> and legal intervention, which constrains the organization's practices?

The answer should lie in our foundational normative premises about such organizations. One question that regularly comes up is whether such organizations should be implicated to some extent by public law norms, even though they are formally incorporated as private legal entities. Berle and Means have famously viewed the widely-held corporation as a quasi-public entity, arguing that the commercial corporation is not merely a technical vehicle for production but rather an essential socioeconomic institution, a modern way of organizing social and political life, one that "bids fair to be as all-embracing as was the feudal system in its time."<sup>113</sup> In the context of residential community associations or labor unions, several authors have labeled decisions made by such organizations as implicating "state action."<sup>114</sup> I address this issue in detail in Part V, and argue that the conceptualization of organizations cannot be based merely on simplistic attempts to classify such organizations as either "private" or "public."

I suggest instead that the law pertaining to such organizations should, at minimum, ensure that those who take part in the collective action would be governed by ongoing norms that reasonably could be construed as those which members would initially have bought into, whether holding a majority or minority position in the organization.

I do not suggest a Rawlsian-like model of norms consented to "behind the veil of ignorance."<sup>115</sup> Quite the contrary: rules should be conscious of power relations that are typical of each one of these organizations, with actors often knowing in advance whether they enter an organization that is regularly dispersed in nature or rather one that is prone to consistent control by a certain subgroup. For example, when a private corporation goes public and offers twenty percent of its equity stock to the public, purchasers of those stocks know that they will be minority or non-controlling shareholders. As such, they have certain expectations about the benefits they will receive in return for their capital investment and the legal liabilities they are likely to face

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<sup>112</sup> Williamson, *Governance*, *supra* note 5, at 2.

<sup>113</sup> Berle & Means, *supra* note 54, at 9.

<sup>114</sup> See *infra* text accompanying notes 204–213.

<sup>115</sup> JOHN RAWLS, A THEORY OF JUSTICE 15–19 (rev'd ed. 1999).

in view of decisionmaking power entrusted to agents or controlling shareholders. They may also consider the different underlying legal regime, organizational dynamics, and power structures that may implicate majority and minority shareholders in a publicly traded corporation rather than in a closely-held one. At any rate, an artificial attempt to flatten power relations that could be reasonably expected when entering the organization is both impractical and normatively inadequate. It disregards the attractive features of private ordering and self-enforcing mechanisms, on the one hand, and the minimal protections that persons view as necessary to engage in credible collective action, on the other. Different organizations may require different rules because of inherent differences in concepts of power and nature of relations among members and vis-à-vis agents.

It is clear enough that market discipline is not enough to provide protections to members against excess organizational power. A frequent argument in business corporations is that controlling shareholders will be careful not to abuse minorities because this would result in lower priced shares and make it more difficult for firms to further raise capital in the stock market.<sup>116</sup> Such arguments are contestable, however, even in competitive stock markets that also feature a market for corporate control,<sup>117</sup> and they are even more problematic for trade unions or residential community associations. In the latter organizations, liquidity is substantially lower, there is no active market for control, and many members join the organization after its rules of incorporation have already been established (e.g., workers who join the workplace after certification of the trade union or subsequent purchasers of homes in residential associations).<sup>118</sup>

Law must, therefore, play an active role in guarding against excessive organizational power. The exact form and scope that this intervention should take depends on the inherent power relations that can be identified for each type of organization given the self-enforcing operation of the organization's mechanisms and, in the context of intra-organizational relations, the particular perils that minority members face vis-à-vis the majority (alongside those faced

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<sup>116</sup> See Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131, 1139–46 (1997) (analyzing data for forty-nine countries and arguing that countries that offer better legal protection for minority shareholders enjoy better access to external finance through debt or equity and have higher-valued and broader capital markets).

<sup>117</sup> See, e.g., Ronald J. Gilson & Alan Schwartz, *Contracting about Private Benefits of Control* 2–3 (2012) (Working Paper), available at <http://ssrn.com/abstract=2182781>.

<sup>118</sup> See Stewart J. Schwab, *Union Raids, Union Democracy, and the Market for Corporate Control*, 1992 U. ILL. L. REV. 367, 389–405 (1992) [hereinafter Schwab].

by the entire class of members vis-à-vis managers). The normative criteria for such legal intervention should therefore take into account both the bottom-up initial incentives for collective action while guarding against potential intra-organizational abuses of such mechanisms, alongside top-down normative considerations regarding the efficacy and fairness of these various private legal organizations given their overall impact on both members and other stakeholders.

The next part more specifically addresses the different concepts of power that typify majority-minority relations and the consequent balances designed by law for each one of these organizations. Part V then draws the broader outline of the functional approach to legal policy beyond the public-private dichotomy.

#### IV. MAJORITY RULE AND MINORITY PROTECTION IN PRIVATE LEGAL ORGANIZATIONS

##### A. Business Corporations: Controlling Stock and “Entire Fairness”

How are power and control allocated and monitored among shareholders in corporations? Berle and Means famously argued that the American modern corporation is largely typified by dispersed shareholding, such that “there are no dominant owners, and control is maintained in large measure apart from ownership.”<sup>119</sup> This has led to their focus on one aspect of the agency problem, namely that all shareholders as a class should guard against excessive managerial power.

Berle and Means’s empirical observation about the lack of controlling shareholders has been reconsidered and often contested by numerous studies. In his 2008 work, Clifford Holderness sampled 375 corporations traded on the U.S. capital markets, concluding that 360 of them had a block-holder owning at least five percent of the shares.<sup>120</sup> The overall picture that emerges from current literature is that U.S. public corporations are far from being monolithic.<sup>121</sup> It is clear that, on average, shareholding in the United States and the United Kingdom is less concentrated than in other developed economies, including in continental Europe and East Asia. One also needs to

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<sup>119</sup> Berle & Means, *supra* note 54, at 110–11.

<sup>120</sup> Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377, 1382 (2008).

<sup>121</sup> Brian Cheffins & Steven Bank, *Is Berle and Means Really a Myth?* 83 BUS. HIST. REV. 443, 466–67 (2009).

account for the fact that many block-holders are institutional investors who do not seek control.<sup>122</sup> However, controlled corporations are far from being a negligible phenomenon in U.S. public corporations as a matter of both organizational reality and formalized legal concept.<sup>123</sup>

Generally, a shareholder is considered to be in control of the corporation when it holds greater than fifty percent of the equity interest or voting rights, thus being a “majority holder.” Control, however, could be established and legally recognized for a shareholder that holds a smaller block but who, as demonstrated through case-specific inquiry, has the actual “power to control the affairs” of the corporation.<sup>124</sup> Once this determination has been made, the legal status of the blockholder is equated with that of a face-value majority shareholder.<sup>125</sup> Accordingly, I use the terms “majority” and “controlling” interchangeably with regard to such shareholders.

What motivates shareholders to control corporations and how is such control translated into financial terms? In discussing the potential private benefits of control, that is, those benefits that are not shared with non-controlling shareholders, some commentators have pointed to a psychic value that shareholders may attribute simply to being in control.<sup>126</sup> A more pragmatic approach taken by courts and authors has looked at the potential economic advantages in the form of perquisites enjoyed by top executives, who can be controlling shareholders themselves, or of other corporate transfers that cannot be easily monitored or verified by minority

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<sup>122</sup> See Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence from CalPERS*, 51 J. FIN. 227, 227, 232–35 (1996) (studying the rise of institutional holding in correspondence with the decline of the market for corporate control, and the role of institutional investors as monitors of corporate governance).

<sup>123</sup> See Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy* 119 HARV. L. REV. 1641, 1645, 1663–65 (2006) (surveying the literature on such differences, and arguing that the taxonomy is more complicated given also the implications of legal regimes and nonpecuniary benefits of control).

<sup>124</sup> *Weinstein Enterprises, Inc. v. Orloff*, 870 A. 2d 499, 508 (Del. 2005). It should be noted, however, that the five percent threshold used in Holderness’s study refers to the general duty of disclosure of shareholders’ identity and to the application of particular duties, such as when a five-percent blockholder has a “material interest” in a corporate transaction but this does not in itself establish a stockholder’s control. See Luca Enriques et al., *Related Party Transactions*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 153, 156 (Reinier Kraakman et al. eds., 2d ed. 2009) (hereinafter Enriques et al., *Related*).

<sup>125</sup> 870 A. 2d at 506–08. See also CORPUS JURIS SECUNDUM, CORPORATIONS § 378 Dominant, Controlling, or Majority Stockholders (updated through 2013).

<sup>126</sup> Philippe Aghion & Patrick Bolton, *An Incomplete Contract Approach to Financial Contracting* 59 REV. ECON. STU. 473, 473–75 (1992).

shareholders.<sup>127</sup> A more radical version looks at the potential for abuse of control to loot the firm or otherwise “exploit vulnerable others.”<sup>128</sup> On a more positive note, it has been suggested that control allows the majority shareholder to make efficient changes to the corporation.<sup>129</sup> Control may also result from the fact that some shareholders may have more optimistic projections than others about the subject stock’s future value.<sup>130</sup> Accordingly, there is no clear-cut conclusion about whether a controlling block is a socially-undesirable phenomenon typical of less developed financial markets,<sup>131</sup> or whether it can also entail benefits such as providing an effective self-enforcing mechanism to control agency problems vis-à-vis managers.<sup>132</sup>

How is the value of control quantified? One method seeks to measure the price difference between two classes of stocks that have similar or identical dividend rights but different voting rights.<sup>133</sup> While a system of dual-class shares is not forbidden under U.S. state law, it is subject to several legal limits and is relatively uncommon among publicly traded U.S. corporations,<sup>134</sup> and would thus receive less attention here. The second method looks at whether an additional price is paid for a share that is part of a control block that changes hands by comparing the price paid by the acquirer with the price quoted on the stock market. In a leading study measuring this “control premium” across thirty-nine countries, Alexander Dyck and Luigi Zingales find that in the United States, the mean value of the block premium as a percent of firm equity is about one percent, much lower than the cross-country average of fourteen percent, but nevertheless positive.<sup>135</sup> This

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<sup>127</sup> Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison* 59 J. FIN. 537, 540–41 (2004) [hereinafter Dyck & Zingales].

<sup>128</sup> *Mendel v. Carroll*, 651 A.2d 297, 305 (Del. Ch. 1994).

<sup>129</sup> FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 112–13 (1991).

<sup>130</sup> *Mendel*, 651 A.2d at 305.

<sup>131</sup> See Rafael La Porta et al., *Law and Finance*, 58 J. POL. ECON. 1113, 1145–51 (1998) (finding strong negative correlation between concentration of ownership and the quality of legal protection of investors and broader-based financial performance) (hereinafter La Porta, et al., *Law and Finance*).

<sup>132</sup> See Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms Versus Ex Post Transaction Review* 4 (2012) (Working Paper), available at <http://ssrn.com/abstract=2129502>.

<sup>133</sup> Dyck & Zingales, *supra* note 127, at 542.

<sup>134</sup> Edward Rock et al., *Fundamental Changes*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 183, 191–92 (Reinier Kraakman et al. eds., 2d ed. 2009).

<sup>135</sup> Dyck & Zingales, *supra* note 127, at 550–53. Out of the thirty-nine countries studied, Japan was the only country to feature a negative mean block premium (minus four

relatively low figure is attributed, in part, to the fact that accounting requirements, minority shareholders' protection, and law enforcement standards are relatively strict in the U.S. legal system.<sup>136</sup>

U.S. courts have held that the majority shareholder's power to control the corporation is not a corporate asset and that the value of this aspect of ownership need not be shared with other shareholders.<sup>137</sup> Accordingly, "the law has acknowledged, albeit in a guarded and complex way, the legitimacy of the acceptance by controlling shareholders of a control premium."<sup>138</sup> This is so unless the seller has reason to suspect that the acquirer will loot the corporation or that some part of the premium is paid in consideration of a business opportunity that belongs to the firm.<sup>139</sup>

Although the Delaware Court of Chancery outlined in its 2012 *Synthes* decision an approach that "encourage[s] majority stockholders to use their negotiating power in a way that gives the minority stockholders the opportunity to share in the benefits the majority stockholder obtains for itself," it stopped short of undermining the legal legitimacy of a control premium.<sup>140</sup> U.S. law thus validates the added value that the market regularly attributes to controlling shares.<sup>141</sup>

How is the power of controlling shareholders monitored? While most decisions in the corporation are governed by a simple majority rule, including appointment rights of the board—cumulative voting rules ensuring minority

percent), with Hong Kong and Taiwan each having a mean block premium equal to zero. *Id.* at 551.

<sup>136</sup> This is so in addition to the work of extra-legal institutions such as public opinion, measured by newspaper diffusion in the country. *Id.* at 576–87.

<sup>137</sup> 12B WILLIAM MEADE FLETCHER ET AL., *Fletcher Encyclopedia of the Law of Corporations* § 5805.10 (perm. ed., rev. vol. 20122009 & Supp. 2012) [hereinafter *Fletcher et al.*].

<sup>138</sup> *Mendel v. Carroll*, 651 A.2d 297, 305 (Del. Ch. 1994).

<sup>139</sup> 18A Am. Jur. 2d *Corporations* § 672 (2d ed. 2004).

<sup>140</sup> *In re Synthes, Inc. S'holder Litig.*, 50 A.3d 1022, 1039–40 (Del. Ch. 2012). *See also* *In re Delphi Fin. Grp S'holder Litig.* No. 7144–VCG, 2012 Del. Ch. LEXIS 45, at \*53 (Del. Ch. Mar. 6, 2012) (reiterating the traditional approach by which "a controlling stockholder is, with limited exceptions, entitled under Delaware law to negotiate a control premium for its shares").

<sup>141</sup> There is much debate in the literature about whether such a "market rule," under which minority shareholders enjoy no rights in connection with a transaction for the sale of control, is more or less socially efficient than an alternative "equal opportunity rule," which entitles minority shareholders to participate in the transaction on the same terms as the control seller. *See* Lucian Arye Bebchuck, *Efficient and Inefficient Sales of Corporate Control*, 109 Q. J. ECON. 957, 959–60 (1994) (arguing that this question depends on several conditions pertaining mostly to the "distribution of managerial ability and private benefits of control among existing and new shareholders").

representation on the board are a rarity in the U.S.<sup>142</sup>—a special majority is required for certain types of decisions entailing fundamental changes. Charter amendments require shareholders’ ratification by a majority of the outstanding stock, which practically translates into a supermajority requirement, the scope of which is determined by the percentage of the votes that are actually cast.<sup>143</sup> The same principle applies to the ratification of mergers, consolidations, and other fundamental organizational changes.<sup>144</sup> Moreover, many U.S. jurisdictions, Delaware being a key example, promote “majority of the minority” approval as the most reliable guarantee for screening conflicted transactions with controlling shareholders.<sup>145</sup>

In some cases, these decision rights are accompanied by substantive rights addressed specifically to minority shareholders. In charter amendments, dissenting shareholders may be awarded appraisal rights—a mandatory buyout option—if the amendments materially affect their rights, such as by limiting existing voting rights.<sup>146</sup> Appraisal rights are also awarded to minority shareholders following certain types of restructurings, in particular “freeze-out mergers” in which the controlling shareholder owns more than ninety percent of the target company’s shares.<sup>147</sup>

But since most corporate decisions are made by the board or the shareholders’ meeting through simple majority voting, and are not accompanied by mandatory opt-out rights in favor of dissenting shareholders, the mainstay of minority protection lies in imposing procedural and substantive duties on the controlling shareholder by virtue of its dominant status in the firm.

While controlling shareholders do not occupy a full-fledged trust relation toward the other shareholders,<sup>148</sup> and are not under a duty “to engage in self-sacrifice for the benefit of minority shareholders,”<sup>149</sup> they are fiduciaries with

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<sup>142</sup> Enriques et al., *Governance*, *supra* note 45, at 90–91.

<sup>143</sup> Rock et al., *supra* note 134, at 186, 198.

<sup>144</sup> *Id.* at 198.

<sup>145</sup> See Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 678 (2005); *In re John Q. Hammons Hotels Inc. S’holder Litig.*, No. 758–CC, 2009 WL 3165613, at \*12 (Del. Ch. Oct. 2, 2009) (“requiring approval of the majority of all the minority stockholders assures that a majority of the minority stockholders truly support the transaction, and that there is not actually ‘passive dissent’ of a majority of the minority stockholders”).

<sup>146</sup> Rock et al., *supra* note 134, at 191.

<sup>147</sup> *Id.* at 202–05.

<sup>148</sup> Fletcher et al., *supra* note 137, § 5811.

<sup>149</sup> *In re Synthes, Inc. S’holder Litig.*, 50 A.3d 1022, 1040 (Del. Ch. 2012).

respect to both the corporation and the minority shareholders as a subclass. Generally speaking, this fiduciary obligation prohibits the controlling shareholders from using their power to promote personal interests at the expense of corporate interest, and requires them to protect the entire “community of interests” in the corporation while exercising “complete loyalty, honesty, and good faith.”<sup>150</sup>

Such legal duties do not always lend themselves to clear-cut operative rules listed in advance in legislative provisions. The prevention of usurpation or opportunism by controlling shareholders would often require a “legal standards” approach, one which would fill general fiduciary duties with content over time, based on a review of relevant facts in particular cases.<sup>151</sup> Since self-dealing by controlling shareholders can take so many subtle and covert forms, no single set of procedural or substantive crystalized rules could serve as an efficient catch-all regime.<sup>152</sup> The heightened standard that has emerged with respect to transactions or other corporate dealings that may be typically prone to self-dealing is that of “entire fairness” in Delaware and of “utmost good faith and loyalty” in some other states, even when such conflicted dealings have been preapproved by the corporation’s independent directors.<sup>153</sup>

Beyond broad-based disclosure requirements,<sup>154</sup> the content of the entire fairness standard requires that the related-party transaction would exhibit both “fair dealing”—by looking at the timing of the transaction and how it was initiated, structured, and negotiated—and “fair value,” generally requiring market value that is otherwise typical of arms-length transactions.<sup>155</sup> In the context of mergers and similar transactions that feature the controlling shareholders on both sides of the transaction, the entire fairness standard would generally require not only “complete candor” in disclosing all of the facts, but also proof of an independent legitimate business reason that benefits the entire corporation, alongside fair dealing and fair price to minority shareholders.<sup>156</sup>

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<sup>150</sup> Secundum 18 C.J.S. Corporations § 378 (2007). *See also* Weinstein Enters., Inc. v. Orloff, 870 A.2d 499, 512 (Del. 2010).

<sup>151</sup> *See generally*, Amnon Lehari, *The Dynamic Law of Property: Theorizing the Role of Legal Standards*, 42 RUTGERS L.J. 81, 90–94, 125–27 (2010).

<sup>152</sup> *See* Enriques et al., *Related*, *supra* note 124, at 169–78.

<sup>153</sup> *Id.* at 175.

<sup>154</sup> *Id.* at 155–61.

<sup>155</sup> *See, e.g.*, Olson v. Floit, 219 F.3d 655, 657 (7th Cir. 2000) (noting that “Illinois defines ‘fair’ as market value”).

<sup>156</sup> *See generally* Am. Jur. 2d Corporations §§ 2198–2202 (current through 2012).

What are the broader lessons that emerge from this survey of U.S. doctrine on the relations among majority and minority shareholders in corporations? The legal system recognizes the potential stratification and power imbalances that exist among different classes of shareholders. It does not seek to entirely abolish or severely cripple the ability of a shareholder to gain such a controlling or otherwise dominant status, and goes further in recognizing the legitimacy of the control premium as an economic expression of the controlling shareholder's superior decisionmaking status. But this power imbalance is counterbalanced by imposing certain one-directional procedural and substantive duties on the controlling shareholder vis-à-vis minority shareholders.

Hierarchy and class division in the corporation exist, therefore, not only along the vertically-integrated production axis, but also along the shareholders' allegedly horizontal axis. The law both envisions and tolerates such stratification, but subjects it to relatively strict fiduciary obligations. The corporation, otherwise operating against the backdrop of a market economy in a liberal democracy, allows for class-based allocation of power and control. Accordingly, "fairness" is not always about strict equality. It seeks to ensure a socially- and economically-adequate division of powers and liabilities that facilitates this particular form of collective action.

#### **B. Residential Associations: Ad Hoc Majority and "Unreasonableness"**

A very different set of assumptions seems to guide legislatures and courts with regard to the ordering of majority-minority relations within residential community associations. While not entirely oblivious to the possibility that a certain individual or small minority would be disenfranchised, the law governing such associations implicitly views the organizational power of members as basically equal, with majorities being formed in disputed matters on an ad hoc, context-specific basis, but with no block voting or control exercised by a pre-organized majority.

Prior to addressing direct decisionmaking by members, it should be noted that the elected directors and officers of the association have broad authority to "exercise all the powers of the community except those reserved to the members."<sup>157</sup> This authority also regularly includes the power to adopt "reasonable" rules that govern the use of the common property and the use of individually-owned property when this is required to protect the common

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<sup>157</sup> Restatement, Servitudes, *supra* note 48, at § 6.16.

property.<sup>158</sup> Managers owe several duties to members, including ones of acting in good faith, exercising ordinary care and prudence, treating members fairly, acting reasonably in exercising discretionary powers, and providing access to information.<sup>159</sup> In reviewing the association's actions, courts regularly adopt either a "reasonableness rule" or corporate law's "business judgment rule"—both bearing a similar content of general deference. In contrast, courts scrutinize decisions that are either taken by interested directors, made in bad faith, or are otherwise "arbitrary, capricious, or discriminatory."<sup>160</sup>

But most of these duties do not apply to members in their relations with other members, either as individuals or as part of a notional subgroup when opinions and votes are divided. In principle, unless expressly limited by statute or the association's declarations, simple majority is effective to amend the declarations or to otherwise adopt rules, such as to "make administrative changes reasonably necessary for management of the common property" or to "prohibit or materially restrict uses of individually owned lots or units that threaten to harm or unreasonably interfere with the reasonable use and enjoyment of other property in the community."<sup>161</sup>

In contrast, unanimous consent is required for those prohibitions or material restrictions of individual uses that cannot be grounded in common interest or for changes made to the basis for allocating voting rights or assessments among community members. Also, when an amendment does not apply uniformly to similar lots, it must be approved by the members whose distinct interests would be adversely affected by it.<sup>162</sup>

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<sup>158</sup> *Id.* at § 6.7.

<sup>159</sup> *Id.* at §§ 6.13–6.14.

<sup>160</sup> *Id.* at § 6.13. A leading case applying the business judgment rule is *Levandusky v. One Fifth Ave. Corp.*, 553 N.E. 2d 1317 (1990). In the case of *40 West 67th Street v. Pullman*, 790 N.E.2d 1174 (2003), the New York Court of Appeal reiterated its general ruling in *Levandusky*, but emphasized that while the court will not inquire board actions that are taken in legitimate furtherance of corporate purposes, there must be a "legitimate relationship between the Board's action and the welfare of the cooperative" and not all objectives will necessarily be considered lawful or legitimate. *Id.* at 1181. For a case applying the reasonableness test for board decisions, see, e.g., *Chateau Village North Condominium Ass'n v. Jordan*, 643 P.2d 791 (Colo. Ct. App. 1982) (holding that the board acted unreasonably in adopting a flat prohibition on pets rather than acting reasonably and in good faith in exercising its discretion under the bylaws as to whether or not to allow a specific permit).

<sup>161</sup> Restatement, Servitudes, *supra* note 48, at § 6.10.

<sup>162</sup> *Id.*

In practice, however, courts tend to broadly construe enabling legislation and declarations so as to settle for simple majority to amend the declaration or to promulgate new rules in nearly all instances. Consider the ruling in *Villa De Las Palmas Homeowners Association v. Terifaj*,<sup>163</sup> in which the California Supreme Court upheld a majority-approved amendment to the condominium's declarations imposing a no-pet restriction, by viewing such a use restriction as "crucial to the stable, planned environment of any shared ownership arrangement" and holding that all homeowners, including those who purchased their units prior to the amendment, are bound by it.<sup>164</sup> The court read Section 1355(b) of California's Civil Code on declaration amendments as settling for simple majority, reasoning that it is designed to prevent a "small number of holdouts from blocking changes regarded by the majority to be necessary to adapt to changing circumstances and thereby permit the community to retain its vitality over time."<sup>165</sup>

Reviewing the substance of the amendment, the court ruled that the provision of Section 1354(a) of the Code, by which the "covenants and restrictions in the declaration shall be enforceable equitable servitudes, unless unreasonable," applies also to subsequently promulgated and recorded use restrictions.<sup>166</sup> This means that amendments made by a simple majority vote, even when applying to homeowners who purchased their individual interest prior to the amendment, enjoy a presumption of reasonableness. This shifts the burden to the party challenging the use restriction, who must show that these restrictions are "wholly arbitrary, violate a fundamental public policy, or impose a burden on the use of affected land that far outweighs any benefit."<sup>167</sup>

While in a limited number of instances, the courts exhibit a more interventionist approach—scrutiny of sweeping restrictions on individual political speech within the community being a notable example<sup>168</sup>—majority voting by members regularly enjoys broad deference from courts. Unlike business corporations, a majority of voters promulgating a certain rule or amending the declarations is not considered as constituting a distinct group that "controls" the association or that otherwise exercises systematic power over other members. In legitimizing simple majority voting as the only

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<sup>163</sup> 90 P.3d 1223 (Cal. 2004).

<sup>164</sup> *Id.* at 1228–29.

<sup>165</sup> *Id.* at 1228.

<sup>166</sup> *Id.* at 1229.

<sup>167</sup> *Id.* at 1231.

<sup>168</sup> See *infra* text accompanying notes 219–230.

practical way to facilitate the community's collective action, the law implicitly assumes that members are inherently equal in their ability to influence decisionmaking and that coalitions are formed on an ad hoc basis. Such majority-based decisions do not translate into control premiums or to any other systemic private benefits enjoyed by some but not by others.

One may question, however, whether this nearly unequivocal approach taken by legislatures and courts truly represents the power relations within residential community associations. There is no doubt that such associations foster a strong preference for homogeneity within the community. On the face of it, homogeneity makes perfect sense from both an organizational and economic perspective. The costs of collective action would be significantly lower when members share preferences about how to run the association, what common amenities to establish, which private uses to permit and which ones to restrict, and so forth. Borrowing from Charles Tiebout's famous depiction of local governments that offer a unique mixture of taxes and services and of resident-consumers "voting with their feet" to move to the locality that best accommodates their preferences,<sup>169</sup> one can argue that the logic of homogeneity seems even more self-evident for residential community associations.<sup>170</sup> In such associations, one should expect relatively few genuine disputes about preferences, and dissent can be regarded as a sign of mere opportunism or free-riding that should be stamped out through simple majority voting.

The reality of homogeneity and equally-dispersed control could nevertheless be more complex. As Lior Strahilevitz argues, certain preference-based design mechanisms in residential community associations, such as the construction of golf courses, could serve as covert mechanisms of exclusion targeting certain societal groups not only on a socioeconomic basis but also on a racial or ethnic one.<sup>171</sup> Moreover, during the life of the community, an amendment with retrospective application, such as the no-pet restriction in

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<sup>169</sup> Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956). For the economic argument in favor of at least some degree of homogeneity at the local government level, following Tiebout's work, see Wallace E. Oates, *On Local Finance and the Tiebout Model*, 71 AM. ECON. REV. 93, 96 (1981); Robert C. Ellickson, *Commentary*, in *THE TIEBOUT MODEL AT FIFTY: ESSAYS IN PUBLIC ECONOMICS IN HONOR OF WALLACE OATES* 199 (William A. Fischel ed., 2006).

<sup>170</sup> For a qualified support of homogeneity in RCAs being private organizations based on voluntary membership, see Robert C. Ellickson, *Cities and Homeowners Associations*, 130 U. PENN. L. REV. 1519, 1521–26 (1982).

<sup>171</sup> See Lior Jacob Strahilevitz, *Exclusionary Amenities in Residential Communities*, 92 VA. L. REV. 437 (2006).

the *Terifaj* case, may single out a certain group. In some cases, such measures could be justified to the extent that they promote overall welfare and monitor against excessive heterogeneity impeding collective action.

But other cases may raise doubts about whether a community becomes controlled by a certain pre-organized majority that takes steps to serve the interests of one group at the expense of others. Restrictions on pets, smoking, certain kinds of outdoor activities, and the like would not implicate “suspect classes” or otherwise raise constitutional-like issues (as is the case with free speech, discussed in Part V). But these types of decisions could create over the long run a relatively stable majority, which is at least somewhat coordinated in acting vis-à-vis dissenters. With RCAs becoming the default for housing across many metropolitan areas, the cost of exit for homeowners in the dissent becomes substantially higher,<sup>172</sup> and their voice in decisionmaking is subjected to majority control enjoying broad judicial deference for its decisions “unless unreasonable.”<sup>173</sup>

I do not argue here that majority-based decisionmaking is inappropriate for the residential community association or that courts should systematically change their approach in choosing their standard of review.<sup>174</sup> But this increasingly dominant type of organization may exhibit changing patterns in the ways that power and control are established and exercised over time, and this could consequently implicate the role of law in regulating inter-member relations. The law’s disregard for the possibility of systematic intra-organizational control or block voting in RCAs may prove generally inadequate.

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<sup>172</sup> This is not so much in the sense that the minority unit owner would have to sell it to a subsequent buyer for a price discount, but more importantly in view of the decrease of choices among residential forms that such residents may have if the majority conduct in one RCA is representative of other RCAs in the region.

<sup>173</sup> See *supra* note 69 and accompanying text.

<sup>174</sup> Numerous scholars have called for the scrutiny of decisions made by RCAs, concerned chiefly with their exclusionary practices vis-à-vis outsiders, but the thread of their arguments seems to apply to “internal” minorities. See, e.g., Sheryll D. Cashin, *Privatized Communities and the “Secession of the Successful”: Democracy and Fairness beyond the Gate*, 28 *FORDHAM URB. L.J.* 1675 (2001); Paula A. Franzese, *Privatization and its Discontents: Common Interest Communities and the Rise of the Government for “The Nice,”* 37 *URB. LAW.* 335 (2005). For a sophisticated analysis of potential majority-minority conflicts within RCAs, see Fennell, *supra* note 43, at 81–86.

### C. Labor Unions: One-Party Voting and the “Duty of Fair Representation”

As Part II has shown, the internal democracy in labor unions has several idiosyncratic features that distinguish it from democracy in the public arena, on the one hand, and the system of governance in other private organizations, such as firms or residential associations, on the other. These features carry intriguing implications for the legal ordering of majority-minority relations.

Clyde Summers’s conceptualization of the labor union, following the enactment of the LMRDA, as “democracy in a one-party state,”<sup>175</sup> captures the fact that while the LMRDA and subsequent case law seek to ensure that members are granted a real voice in union deliberation and decisionmaking, the institutional framework in which members operate is that of a single representative body that is solely authorized to speak on behalf of all members. This stems not only from the formal status that is awarded under the NLRA to the trade union once it is chosen as the exclusive agent in the bargaining unit, but more broadly, from the lack of a market for union representation.<sup>176</sup> Both the 1955 federative merger of the American Federation of Labor (AFL) and the Congress of Industrial Organizations (CIO)—with its internal no-raiding pact—and the general exemption of trade unions from antitrust laws practically rule out the possibility of competition among different trade unions during the initial stage of certification in the workplace or at a potential later stage of decertification and election of a new union.<sup>177</sup> Thus, unlike corporations, the representative trade union is not disciplined by the fear of a market takeover.

Moreover, the LMRDA and subsequent case law seem to be well aware that the trade union is not only a sole agent, but also that it is grounded and colored in very particular internal power relations that may, unless monitored, promote and over-represent the interests of certain identifiable subgroups of workers at the expense of others. This relates not only to extreme cases of corruption, labor racketeering, and outright discrimination, but also to more

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<sup>175</sup> Clyde Summers, *Democracy in a One-Party State: Perspectives from Landrum-Griffin*, 43 MD. L. REV. 93 (1984).

<sup>176</sup> See Schwab, *supra* note 118.

<sup>177</sup> Estreicher, *supra* note 4, at 254–55. In 2005, several leading unions seceded from AFL-CIO to form the Change to Win Coalition. It seems, however, that this coalition has not been able to this point to create a substantial market for union control across the American workforce. See Steven Greenhouse, *Politics has Dissidents Talking to A.F.L.-C.I.O.*, N.Y. TIMES, July 19, 2008.

conventional scenarios of dominance by certain types of workers, based on seniority, professional affiliation, political association, and the like, with such oligarchic tendencies having a self-perpetuating feature.<sup>178</sup> This means that unlike the community residential association, the law cannot intelligibly assume that majorities within the union would be formed on an ad hoc, subject-specific basis, but rather that labor unions would inherently tend toward dominance by predetermined, organized groups that control the union. Hierarchies exist among members and these tend to have a self-enforcing nature. The exclusive status awarded to a labor union under the NLRA, standing alone, only intensifies this state of affairs.

I suggest that the position taken by the LMRDA and subsequent case law is one of recognizing this tendency in fact, but at the same time seeking to control it by flattening existing hierarchies to a reasonable degree without formally recognizing the existence of separate subclasses within the union or awarding each class a separate set of rights and duties, as is the case with the controlled business corporation. This delicate balance is achieved primarily by broad adherence to simple majority rule and abstention from requiring supermajority or “majority of the minority” approvals, on the one hand, and the imposition of a “duty of fair representation” designed to prevent abuse against “invisible” or identifiable minorities, on the other.<sup>179</sup>

Consider, first, that the only issues required by the LMRDA to be brought to the direct approval of members are periodic elections for representatives<sup>180</sup> and the setting of rates and initiation fees payable by members, both of which require the consent of a simple majority vote.<sup>181</sup> Otherwise, while a labor union may decide to bring other matters to direct vote by members, it is not obligated to do so, nor is it even required to regularly hold general meetings.<sup>182</sup> Courts have gone further to suggest that “[a]n ability to make choices through representatives is important to effective democracy.”<sup>183</sup> In labor unions, “[d]ecisions may be complex, and persons in a large group who perceive that their votes are unlikely to alter the outcome

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<sup>178</sup> See, e.g., Bruno, *supra* note 101; Strauss, *supra* note 101; David Witwer, *The Different Meanings of Corruption in the Context of the Teamsters Union*, 21 J. LAB. RES. 287 (2000).

<sup>179</sup> See Finkin, *supra* note 80, at 199–200.

<sup>180</sup> See *Finnegan v. Leu*, 456 U.S. 431, 441 (1982) (“[T]he Act’s overriding objective was to ensure that unions would be democratically governed, and responsive to the will of the union membership as expressed in open, periodic elections.”).

<sup>181</sup> See 29 U.S.C. § 411(a)(3)(2006).

<sup>182</sup> *Grant v. Chicago Truck Drivers, Helpers & Warehouse Workers Union*, 806 F.2d 114, 117–18 (7th Cir. 1986).

<sup>183</sup> *Serpico v. Laborers’ Int’l Union of N. Am.*, 97 F.3d 995, 998 (7th Cir. 1996).

are unlikely to devote the time and energy necessary to vote intelligently.”<sup>184</sup> Therefore, “[i]t may then be best to entrust decisions to a smaller body of representatives, who have more time and better incentives to gather and act on information.”<sup>185</sup>

As for those matters reserved for direct member voting, courts have shown steady support for the efficacy of simple majority vote. As the U.S. Supreme Court stated in its *14 Penn Plaza LLC v. Pyett* decision, “[the] ‘principle of majority rule’ . . . is in fact the central premise of the NLRA.”<sup>186</sup> The Court further held that “[i]t was Congress’ verdict that the benefits of organized labor outweigh the sacrifice of individual liberty that this system necessarily demands.”<sup>187</sup> In reaching this holding, the Court echoed earlier cases that found that “[i]n establishing a regime of majority rule, Congress sought to secure to all members of the unit the benefits of their collective strength and bargaining power, in full awareness that the superior strength of some individuals or groups might be subordinated to the interest of the majority,”<sup>188</sup> and also declared that “[t]he complete satisfaction of all who are represented is hardly to be expected.”<sup>189</sup> While the Court’s ruling has been criticized by scholars who view it as undermining a longstanding commitment of labor unions to solidarity toward all members and vulnerable ones in particular,<sup>190</sup> the Court’s current stance focuses on a more instrumental approach, aggregating member preferences as the chief currency of facilitating collective action.

How does the law nevertheless control what it may consider as excessive majority power? While not expressly enacted as part of the LMRDA, the chief instrument applied is imposition of a “duty of fair representation,” which has been read by the Court into NLRA in the 1944 *Steele v. Louisville & Nashville Railroad* case,<sup>191</sup> and reaffirmed in numerous subsequent decisions.<sup>192</sup>

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<sup>184</sup> *Id.*

<sup>185</sup> *Id.*

<sup>186</sup> *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247, 270 (2009) (quoting *Emporium Capwell Co., v. Western Addition Cmty. Org.*, 420 U.S. 50, 62 (1975)).

<sup>187</sup> *Id.* at 271 (quoting *Emporium Capwell Co., v. Western Addition Cmty. Org.*, 420 U.S. 50, 62 (1975) (footnote omitted); *Ford Motor Co. v. Huffman*, 345 U.S. 330, 338 (1953)).

<sup>188</sup> *Id.* at 270–71 (quoting *Emporium Capwell Co.*, 420 U.S. at 338) (internal quotation marks omitted).

<sup>189</sup> *Id.* at 271 (quoting *Ford Motor Co. v. Huffman*, 345 U.S. 330, 338 (1953)) (internal quotation marks omitted).

<sup>190</sup> See Kenneth M. Casebeer, *Supreme Court without a Clue: 14 Penn Plaza LLC v. Pyett and the System of Collective Action and Collective Bargaining Established by the National Labor Relations Act*, 65 U. MIAMI L. REV. 1063, 1076–79 (2011).

<sup>191</sup> *Steele v. Louisville & Nashville R.R. Co.*, 323 U.S. 192, 202–04 (1944).

What does “fair representation” mean? The Court reads this duty as requiring the union “to serve the interests of all members without hostility or discrimination toward any, to exercise its discretion with complete good faith and honesty, and to avoid arbitrary conduct.”<sup>193</sup> The burden of showing that the union acted in a manner that is “arbitrary, discriminatory, or in bad faith” lies with the member, often requiring him to prove the union’s subjective motivation.<sup>194</sup>

While some courts have depicted the labor union as a fiduciary of all members,<sup>195</sup> they have attributed this duty only to the union’s officers and not to majority members in their individual capacity. Moreover, the fiduciary role of the union is viewed as somewhat unconventional, with one court equating the union to a “parent who must resolve a quarrel between brothers.”<sup>196</sup> While this depiction is somewhat odd, it does seem to reflect the sense in which courts are aware of the potential for power imbalances and organized majorities within unions, but nevertheless refrain from formally acknowledging a division among “controlling” and “controlled” members.

Accordingly, the duty of fair representation is not breached “simply by an action which is more favorable to one group than to another, and mere knowledge of the fact that one group may gain and another lose is not proof of a discriminatory motive.”<sup>197</sup> At the same time, differential treatment among groups must bear some rationally justified purpose. The distinction between full-time and part-time workers may be valid,<sup>198</sup> as is the case with benefits based on seniority, but the juggling of a seniority roster for no reason other than to advance one group of members over another or to punish a disfavored group would amount to unfair representation.<sup>199</sup>

Legislators and courts thus try to balance between the practical advantages of majority control and the fear of abuse when a minority is

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<sup>192</sup> See, e.g., *Ford Motor Co. v. Huffman*, 345 U.S. 330, 338–39 (1953); *Marquez v. Screen Actors Guild*, 525 U.S. 33, 44 (1998).

<sup>193</sup> *Marquez*, 525 U.S. at 299–300 (quoting *Vaca v. Sipes*, 386 U.S. 171, 177 (1967)).

<sup>194</sup> Plaintiff should also demonstrate that the damages suffered were caused by the union’s breach. *Thompson v. Aluminum Co. of America*, 276 F.3d 651 (4th Cir. 2002); *Thomas v. Little Flower for Rehabilitation & Nursing*, 793 F. Supp. 2d 544, 547 (E.D.N.Y. 2011).

<sup>195</sup> See, e.g., *Thompson v. Modernfold Industries*, 373 N.E.2d 916, 922 (Ind. Ct. App. 1978); *Smith v. Hussmann Refrigerator Co.*, 100 L.R.R.M. 2238, 2246 (8th Cir. 1979).

<sup>196</sup> *Waiters Union, Local 781 v. Hotel Ass’n*, 498 F.2d 998, 1000 (D.C. Cir. 1974).

<sup>197</sup> *Cooper v. TWA Airlines, LLC*, 274 F. Supp. 2d 231, 246 (E.D.N.Y. 2003).

<sup>198</sup> *Finkin*, *supra* note 80, at 223.

<sup>199</sup> *Ramey v. District 141, Intern. Ass’n of Machinists and Aerospace Workers*, 378 F.3d 269, 277 (2d Cir. 2004).

singled out by a pre-organized majority. Trying to flatten the hierarchies that inherently exist in labor unions may prove difficult when lawmakers and judges refuse to formally recognize, and somewhat legitimize, consistent stratification among union members, as is the case with controlled business corporations. But one cannot simply assume that majorities within unions will be established only as a result of issue-specific aggregation of member preferences, which is arguably typical of residential associations. The continuing effort to democratize labor unions against their tendency for oligarchy is commendable, but it is questionable whether the organizational and legal ordering of majority-minority relations in unions has reached an effective equilibrium of power allocation.

## V. PRIVATE LEGAL ORGANIZATIONS AND SOCIOPOLITICAL STRUCTURE

### A. Legal Organizations beyond the Private-Public Dichotomy

As discussed in Part II, a potential method to conceptualize the broad legal framework within which private organizations act is one of operationalizing the public-private distinction.

In this type of analysis, if a certain organization is viewed as located within the private sphere, then the transition from organizational power to legal power should rely on the general principles that are prevalent in private law jurisprudence. This could be manifested, for example, in adopting the legal policy pertaining to contracts, which defers extensively to the private ordering of the parties and intervenes only in extreme cases of unconscionability, coercion, and the like. In contrast, if the organization's activity is deemed as implicating "state action," this would trigger constitutional law norms that would intervene more extensively with private ordering.

Numerous scholars have sought to follow this approach. In the context of the business corporation, Berle and Means famously called to distinguish between the closely-held corporation and the widely-held one that relies on the "investing public" for raising capital, arguing that the latter type of corporation should be viewed as a quasi-public entity that would be governed, at least to some extent, by constitutional law norms.<sup>200</sup> Their analysis was far from being merely descriptive; rather, it was driven by a normative agenda.

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<sup>200</sup> BERLE & MEANS, *supra* note 54, at xxviii-xxix.

Reasoning that individual stockholders do not contribute effort, work, or risk to income generated, Berle and Means argued that the “[p]rivilege to have income and a fragment of wealth without a corresponding duty to work for it cannot be justified except on the ground that the community is better off—and not unless most members of the community share it.”<sup>201</sup> To meet this goal, they argued, the law should encourage a wider distribution of stocks, either through tax policy or some other device, so that the corporate system “can achieve whatever redistribution the American people want.”<sup>202</sup> The widely-held corporation was thus considered to be located well within the public realm.

In the context of majority-minority relations, Anupam Chander has argued that corporate law follows such a notion in that it recognizes minority status even more explicitly than does constitutional law.<sup>203</sup> Reviewing several doctrines, such as derivative suits, limits on control transactions, and appraisal rights, Chander claims to identify in the law a “commitment to minority protection and egalitarianism” and a “theory of power that underlies much of corporate law and that speaks to constitutional debates.”<sup>204</sup> Under this thesis, corporate law goes well beyond a contractual or other private law model to include broader societal values, serving also as a device to “ensure that minorities will be treated fairly, even without a showing that they would have bargained for contractual safeguards in the absence of transaction costs.”<sup>205</sup>

Others have been skeptical of this approach to corporate law. Stephen Bainbridge argues that corporate law not only lacks any significant layer of affirmative action in favor of minority shareholders, but that it may also favor controlling shareholders, including by the validation of control premiums and other forms of “selfish ownership.”<sup>206</sup> As is the case with the counter-thesis, Bainbridge’s view of the corporation and its location in the private sphere is not merely positive, but also normative. An advocate of the nexus of contracts approach, Bainbridge argues that the rights and duties of stakeholders are established by bargaining, even if through off-the-rack

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<sup>201</sup> *Id.* at xxxv.

<sup>202</sup> *Id.* at xxxvi.

<sup>203</sup> Anupam Chander, *Minorities, Shareholder and Otherwise*, 113 YALE L.J. 119 (2003).

<sup>204</sup> *Id.* at 124.

<sup>205</sup> *Id.*

<sup>206</sup> Stephen M. Bainbridge, *There Is No Affirmative Action for Minorities, Shareholder and Otherwise*, in *Corporate Law*, 118 YALE L. J. POCKET PART 71, 73 (Oct. 28, 2008).

default rules of corporate law. This contractarian account rests “on the presumption of validity a free market society accords voluntary contracts.”<sup>207</sup>

The public-private distinction has been also said to implicate other legal organizations. In the case of residential community associations, several authors have argued that the authority and power awarded to such associations through enabling legislation and case law could amount to “state action.”<sup>208</sup> David Kennedy suggests that while not all residential associations should be categorically treated as state actors, the evaluation of whether the association might be viewed as engaging in essentially public conduct should be “closely linked to the impact that it has upon the surrounding community,” so that gating vast expanses of public streets or otherwise excluding nonmembers would more likely amount to state action.<sup>209</sup> This approach has received a rather cool reception, even among courts that are otherwise conscious of exclusion dilemmas.<sup>210</sup>

The public-private distinction has also been debated in the context of labor unions. The U.S. Supreme Court has differentiated between private sector employees and public sector ones, so that a union’s exclusive bargaining power in the latter case may force individual workers to obey majority rule as a condition of government employment, thus potentially implicating constitutional concerns.<sup>211</sup> While it is clear that the Constitution

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<sup>207</sup> STEPHEN M. BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE* 32–33 (2008).

<sup>208</sup> See Lisa J. Chadderdon, *No Political Speech Allowed: Common Interest Developments, Homeowners Associations, and Restrictions on Free Speech*, 21 J. LAND USE & ENVTL. L. 233 (2006); David J. Kennedy, Note, *Residential Associations as State Actors: Regulating the Impact of Gated Communities on Nonmembers*, 105 YALE L.J. 761 (1995).

<sup>209</sup> *Id.* at 783–84.

<sup>210</sup> Consider *Mulligan v. Panther Valley Property Owners Ass’n*, 766 A.2d 1186 (N.J. Super. Ct. App. Div. 2001). A community association voted to prohibit individuals registered as Tier-3 sex offenders under New Jersey’s Megan’s Law from residing in the community. This decision was challenged by an association member, who argued that it violates public policy by infringing the constitutional rights of Tier-3 registrants and also by de facto deflecting such persons to neighborhoods that have no institutional exclusion mechanisms. The court did not explicitly consider whether the association could be considered as a state actor or is otherwise implicated by constitutional law, and opted instead for the “reasonableness” standard regularly applying to residential associations. The court reasoned that the question as to whether such provisions “make a large segment of the housing market unavailable” to such persons, or exposes those who live in the “remaining corridor to the greater risk of harm than they might otherwise have had to confront,” is largely empirical. Since the court held that the burden of proof lies with the plaintiff, who has established no such record, the court finally ruled in favor of the association.

<sup>211</sup> See, e.g., *Machinists v. Street*, 367 U.S. 740, 749 (1961).

serves as a limit on the public employer and it may accordingly control the terms of the collective agreement,<sup>212</sup> constitutional principles may also implicate the labor union's internal governance. In the 2012 *Knox* case,<sup>213</sup> the Court held that a public-sector union's decision to collect fees from members to finance political action is subject to stricter limits than is the case with private-sector unions in view of the different scope of First Amendment concerns,<sup>214</sup> an issue I discuss separately below.

Some authors have argued more broadly that both public- and private-sector labor unions implicate state action in view of the "exclusive bargaining representative" status granted to them by federal legislation.<sup>215</sup> Criticizing this claim, Benjamin Sachs argues that a government grant of monopoly status to an otherwise private economic actor is not sufficient to implicate state action, and that in any case, a labor union cannot be genuinely viewed as holding monopoly power as it only has the "authority to propose contractual provisions to management on behalf of all the employees in a bargaining unit" but not to impose them on any employee.<sup>216</sup>

I suggest that the focus on the public-private distinction may be somewhat superfluous in the context of private legal organizations. One need not embrace theories that have sought to entirely undermine the public-private distinction in order to conclude that the regulation of power should not follow a binary approach.<sup>217</sup> In particular, legal policy should study the functional attributes of power relations within a certain organizational context and the way in which they should be regulated through the distribution of legal powers among the relevant parties in the organization.

Consider, in this context, legal realism's discussion of the relations between power and reason. Morris Cohen famously depicted private property as the exercising of sovereignty over other persons with the endorsement of

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<sup>212</sup> Finkin, *supra* note 80, at 241–45.

<sup>213</sup> *Knox v. Service Employees Int'l Union, Local 1000*, 132 S. Ct. 2277 (2012).

<sup>214</sup> *Id.* at 2295–96.

<sup>215</sup> See David H. Topol, Note, *Union Shops, State Action, and the National Labor Relations Act*, 101 YALE L.J. 1135 (1992). See also Karl E. Klare, *The Public/Private Distinction in Labor Law*, 130 U. PA. L. REV. 1358, 1371–75 (1982) (criticizing the courts' inconsistent application of the public/private distinction to labor unions).

<sup>216</sup> Benjamin I. Sachs, *Unions, Corporations, and Political Opt-Out Rights after Citizens United*, 112 COLUM. L. REV. 800, 844–51 (2012) [hereinafter Sachs].

<sup>217</sup> For a concise history of the public-private distinction in law and its attack by some progressive and critical twentieth-century scholars, see Morton J. Horowitz, *The History of the Public/Private Distinction*, 130 U. PA. L. REV. 1423 (1982). This front is ever stormy. See Developments in the Law, *State Action and the Public/Private Distinction*, 123 HARV. L. REV. 1248 (2010).

the state.<sup>218</sup> But unlike Marxist or other critical theories, Cohen believed that the “recognition of private property as a form of sovereignty is not itself an argument against it.”<sup>219</sup> Nevertheless, it does require giving good justifications for property rights, ones that would at times justify placing limits on property rights. Accordingly, legal realism constantly seeks to identify the numerous ways in which power may implicate interpersonal relations, including in “so-called voluntary associations,” and the proper mode of reasoning that is required for regulating power through law.<sup>220</sup> But legal realism hardly suggests that the tension between power and reason reduces legal policy to pure politics or that it otherwise subjects all types of private relations to wholesale public law jurisprudence.<sup>221</sup>

Similarly, the identification and analysis of power relations within organizations that are based on horizontal governance and credible collective action need not yield to a single concept of power that is either “private” or “public” in nature. Law should identify the particular form of power relations that is typical of a certain organization in view of its self-enforcing nature—that is, organizational power—and accordingly design and allocate among stakeholders the set of legally-validated interests and priorities—that is, legal power.

While the various legal organizations diverge from one another in the modes of organizational power and should accordingly vary in the exact forms of legal power, my analysis thus far makes it clear that organizations cannot simply be attributed either to “state action” or to conventional arms-length contracts. As collective entities based in credible modes of hierarchy, authority, and “sticky” governance, such organizations require a self-standing analysis of the proper transition between organizational power and legal power, one that is not dictated by a simplistic binary approach of being either “public” or “private” in nature.

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<sup>218</sup> Morris R. Cohen, *Property and Sovereignty*, 13 CORNELL L.Q. 8 (1927).

<sup>219</sup> *Id.* at 9.

<sup>220</sup> See Louis L. Jaffe, *Law Making by Private Groups*, 51 HARV. L. REV. 210, 220 (1937) (arguing that “the great complexes of property and contract which constitute our modern industrial machine, the monopolistic associations of capital, labor, and the professions which operate it, exert under the forms and sanctions of law enormous powers of determining the substance of economic and social arrangement”).

<sup>221</sup> For an analysis of the interplay between power and reason in the private law jurisprudence of the legal realism school, see Hanoch Dagan, *Legal Realism and the Taxonomy of Private Law*, in *STRUCTURE AND JUSTIFICATION IN PRIVATE LAW: ESSAYS FOR PETER BIRKS* 147 (Charles Rickett & Ross Grantham eds., 2008).

The suggested analysis should not raise grave concerns about over-contextualizing the law. I have elsewhere discussed the delicate balance between the intuitive appeal of context-specific jurisprudence and the adverse effects of instability and unpredictability in law.<sup>222</sup> At least in the context of private legal organizations, whose general structure is based in enabling legislation tailored to each type of organization, such differentiation is less troublesome. The particular traits of credible collective action, inherently distinguishable from free market contracts, on the one hand, and government allocation of resources, on the other, have necessitated the validation of each of these organizational forms through specific legislation.

The functional approach to regulating power within such organizations and majority-minority power relations in particular, while rejecting a simplistic public-private dichotomy, has been demonstrated in a number of cases. This is so, for example, when majority rule is viewed as undermining the individual member's interest to engage in or to refrain from political speech.

The U.S. Supreme Court's 2010 decision in *Citizens United v. FEC*,<sup>223</sup> which held that Congress may not restrict political speech based on the speaker's identity, has direct implications for business corporations' internal governance and majority-minority relations, so that firms are no longer limited in spending corporate funds to promote a political agenda.<sup>224</sup> The *Citizens United* holding applies also to other types of organizations, including labor unions. But in the case of labor unions, minority members who object to funding political speech through union funds may opt out of contributing by being awarded a dues reduction or rebate in an amount proportional to the share of the union's overall budget that goes to fund political speech.<sup>225</sup> In the case of public-sector employees, the Court has gone further, requiring unions to ask members to opt *in* for contribution when a special assessment is made to fund political speech.<sup>226</sup>

This asymmetry between corporations and labor unions has been a source of controversy. But judicial policy on the matter has not revolved around identifying the business corporation or the labor union as engaging in "state action" or being a pure private entity. Rather, the Court has looked at whether the collective use of funds amounts to compulsion, and if so, whether such compulsion could be justified. In the context of labor unions,

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<sup>222</sup> Lehari, *supra* note 33, at 59–93.

<sup>223</sup> 130 S. Ct. 876 (2010).

<sup>224</sup> Sachs, *supra* note 216, at 810–11.

<sup>225</sup> *Id.* at 811–19.

<sup>226</sup> Knox, 132 S. Ct. at 2292–96.

the Court has reasoned that while some compulsion may be necessary to overcome free rider problems, this applies to economic functions related to collective bargaining and contract administration purposes, but not to political activity.<sup>227</sup> As for corporations, the Court has rejected the concept of compulsion by viewing shareholders' investments as voluntary in contrast to paying union dues as a condition of employment.<sup>228</sup> While this distinction has been criticized,<sup>229</sup> it is noteworthy that the focus on the legitimacy of group compulsion has not been grounded in the public-private debate, but in a functional analysis of the proper scope of collective action in such organizations.

In the context of residential associations, consider the 2012 *Kahn* case,<sup>230</sup> in which the New Jersey Supreme Court invalidated a ban on all non-for sale signs in an association's governing documents, following a petition by a resident who ran for town council and posted two signs at his private residence, one at the window and the other on his door. The court held that the free speech clause under the New Jersey Constitution is not conditioned on the showing of state action, and can be employed to protect against "unreasonably restrictive and oppressive conduct by private entities in certain situations."<sup>231</sup> Reviewing earlier cases dealing with political speech in private universities and shopping malls, the court reasoned that this case implicated not the interests of an "outsider" but rather those of a member who holds both free speech and property rights.<sup>232</sup>

Examining the extent to which an association may limit the use of privately-owned property, the court concluded that while the association has power to "adopt reasonable time, place, and manner restrictions to serve the community's interests,"<sup>233</sup> an outright ban unreasonably limits the resident's rights to property and free expression. In contrast, a window sign in support of a candidate is a "relatively minor interference" with the property interests of the association.<sup>234</sup> The court focused, therefore, not on the identification of

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<sup>227</sup> *Machinists*, 367 U.S. at 768–69.

<sup>228</sup> *See* *First National Bank of Boston v. Bellotti*, 435 U.S. 765, 794 (1978).

<sup>229</sup> *Sachs*, *supra* note 216, at 827–58 (discussing and rejecting the arguments for such asymmetry).

<sup>230</sup> *Mazdabrook Commons Homeowners' Association Ass'n v. Kahn*, 46 A. 3d 507 (N.J. 2012).

<sup>231</sup> *Id.* at 514 (quoting *N.J. Coalition Against War in the Middle East v. J.M.B. Realty Corp.*, 650 A.2d 757, 771 (N.J. 1994)).

<sup>232</sup> *Id.* at 516–517.

<sup>233</sup> *Id.* at 519.

<sup>234</sup> *Id.* at 520.

the organization as either a “public” or “private” entity, but rather on a functional analysis of the rationales for group compulsion to advance collective action and the balance of power between the group and minority members.

The focus on compulsion, therefore, seems to offer a more adequate normative platform for scrutinizing private legal organizations than is the case with the public-private dichotomy. It allows for a functional analysis of power relations within organizations that takes into account the initial motives for coordination; the ways in which organizational power plays out, and how, if at all, it can be constrained by counter- mechanisms such as exit and voice; and the forms of legal intervention that may adequately balance between organizational efficacy and the taming of excessive power.

## **B. Toward a Cross-Cultural Study of Organizations**

The type of analysis that looks beyond the public-private dichotomy to study the forms of order, collective action, and power allocation inherent in each such type of organization is also instrumental in understanding the broader implications that such organizations have for the cultural and political structure of societies and their underlying concepts of power.

Modern liberal democracies, which explicitly seek to shun certain forms of power and force in interpersonal relations that have been typical of traditional societies—slavery, feudalism, patrimonial family relations, and the like—and to embrace the all-too-familiar societal shift “from [s]tatus to [c]ontract,”<sup>235</sup> are nevertheless inclined to allow the formation of new power-based structures. This observation is valid even if we reject those critical theories that argue for the lingering presence of old-style power and domination in all of the social institutions that have been explicitly reformed to reflect contemporary values of equality, liberty, and democracy—from impersonal land markets to spousal relations.<sup>236</sup> Enabling legislation and subsequent case law for organizations such as business corporations, residential community associations, and labor unions validate various forms of power and control that cannot be reduced to arms-length contractual

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<sup>235</sup> HENRY JAMES SUMNER MAINE, *ANCIENT LAW: ITS CONNECTION WITH THE EARLY HISTORY OF SOCIETY, AND ITS RELATION TO MODERN IDEAS* 170 (1861).

<sup>236</sup> For one such seminal study of such theories, see TRENT SCHROYER, *THE CRITIQUE OF DOMINATION: THE ORIGINS AND DEVELOPMENT OF CRITICAL THEORY* (1973).

relations, on the one hand, or to state-versus-individual ordering, on the other.

Moreover, as this Article shows, not all such organizations follow the same blueprint in designing legally-legitimate forms of power and control, and this is due not merely to technical or purely instrumental reasons. Specifically, the different forms of majority-minority power balance across such organizations attest to the multiplicity of social and economic substructures within general society. Unlike the general tolerance that the modern state exhibits for other reasons to religious-based associations<sup>237</sup>—which according to some evidence make up nearly half of associational memberships in the United States<sup>238</sup>—the types of organizations studied in this Article feature the mainstay of modern liberal society in at least three key domains: financial markets, work, and housing. Each of them constitutes a distinctive societal microcosm of governance, power, and accountability. The demand for credible collective action and effective governance yields a variety of power-based interpersonal structures that offer key insights about contemporary society's fundamental values and underlying culture.

This analytical framework may also set the ground for a broader-based study of the complex relations between private legal organizations and underlying perceptions of governance, power, and accountability across various societies. The following paragraphs do not aim to suggest a concrete hypothesis about the interrelations between private legal organizations and local cultures in a cross-country perspective, but rather to outline a research agenda for future work.

The study of cultures and their cross-influences on informal and formal institutions of governance has enjoyed considerable attention in the literature, with a particular growing interest for cross-country studies that seek to quantify certain cultural measures with the purpose of correlating them with data on economic performance, protection of legal interests, and the like.

Probably best known is the series of works by Rafael La Porta et al., which aims to identify correlation and causality not only between legal traditions and certain measures of good governance, economic growth, and protection of investors and shareholders,<sup>239</sup> but also to attribute these findings

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<sup>237</sup> For a recent critical account of such policies, see BRIAN LEITER, *WHY TOLERATE RELIGION?* (2013).

<sup>238</sup> ROBERT D. PUTNAM, *BOWLING ALONE: THE COLLAPSE AND REVIVAL OF AMERICAN COMMUNITY* 66 (2000).

<sup>239</sup> See La Porta et al., *Law and Finance*, *supra* note 131 at 1113–16 (offering a cross-country study of national laws protecting corporate shareholders and creditors); Rafael La Porta et

to cultural features such as dominant religion. Thus, in *The Quality of Government*, La Porta et al. suggest that countries with high proportions of Catholics or Muslims exhibit inferior government performance as compared with Protestant-dominated countries.<sup>240</sup>

More broadly, an influx of current works looks at various angles of the interrelations between culture, economics, government, and law.<sup>241</sup> In their 2012 revised edition of *Riding the Waves of Culture*, Fons Trompenaars and Charles Hampden-Turner offer a series of indicators of cultural differences and the way this impacts business, identifying culture as “the way in which a group of people solves problems and reconciles dilemmas.”<sup>242</sup> As such, cultures may also strongly affect the shapes taken by private legal organizations, which are formally-established and legally-validated forms of interpersonal collective action.

A useful framework for identifying the interrelations between concepts of power in private legal organizations and cultural attributes across societies could be based on recent work, which tries to break down the term “culture” to a set of emphases on certain types of values and beliefs.

Amir Licht et al. offer a classification of culture that is based primarily on three dyads of value orientations: embeddedness vs. autonomy, hierarchy vs. egalitarianism, and mastery vs. harmony.<sup>243</sup> They study the ways in which these value emphases interact with key social institutions for regulating governance and power: rule of law, control of corruption, and democratic accountability.<sup>244</sup> Licht et al. argue that “[s]ocial norms of governance

al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3, 4–6 (2000) (focusing on similar questions with a broader view of corporate governance); Rafael La Porta et al., *The Economic Consequences of Legal Origins*, 46 J. ECON. LIT. 285, 286–87 (2008) (tying the historic origins of a country’s laws to the current content of its laws and to its economic performance).

<sup>240</sup> Rafael La Porta et al., *The Quality of Government*, 15 J. L. ECON. & ORG. 222, 224 (1999).

<sup>241</sup> For a concise discussion and a list of references on the topic, see Giuseppe Dari Mattiacci & Carmine Guerriero, *Law and Culture: A Theory of Comparative Variation* (2012) (Working Paper) (on file with author).

<sup>242</sup> FONTS TROMPENAARS & CHARLES HAMPDEN-TURNER, *RIDING THE WAVES OF CULTURE: UNDERSTANDING DIVERSITY IN GLOBAL BUSINESS* 8 (3d ed. 2012) (emphasis removed).

<sup>243</sup> Amir N. Licht, Chanan Goldschmidt & Shalom H. Schwartz, *Culture Rules: The Foundations of the Rule of Law and other Norms of Governance*, 35 J. COMP. ECON. 659, 661–62 (2007) [hereinafter Licht, et al., *Culture Rules*]. Their taxonomy is based largely on previous work of one of the co-authors, psychologist Shalom Schwartz. See, e.g., Shalom H. Schwartz, *A Theory of Cultural Values and Some Implications for Work*, 48. APPLIED. PSYCHOL. INT’L REV. 23 (1999).

<sup>244</sup> Licht et al., *Culture Rules*, *supra* note 243, at 660.

correlate strongly and systematically with culture value dimensions,<sup>245</sup> such that countries with high scores for the prevalence of rule of law, non-corruption, and accountability are also high on autonomy and egalitarianism. Moreover, such cultural orientations can be seen as the cause for the general characteristics of basic social institutions for governance and regulation of power.<sup>246</sup>

Taking this analysis one step further, one could make the argument that the same set of value emphases within a certain culture will feature dominantly not only in society-wide institutions such as rule of law, but also in smaller-scale organizations such as those studied in this Article. The ways in which collective action is established and decisionmaking power is allocated and managed over time within such organizations could be based dominantly on such cultural orientations, especially those dealing with how a society values either hierarchy or egalitarianism as a worthwhile moral value and organizing principle. The establishment of organizational power within such entities, based on such cultural orientations, could also point to the process of legitimacy and regulation undertaken by lawmaking institutions in designing legal powers. In a cross-country perspective, one may assume that different value emphases may lead to a distinctive organizational and legal design of otherwise-similar organizations—be they business corporations, residential associations, or labor unions—such that the allocation of power and majority control will follow country-specific cultural concepts of power.

Such a research agenda will have to rely on extensive empirical data. An initial cross-analysis of current databases does not necessarily point to a clear-cut connection. Thus, for example, a comparison of Dyck and Zingales's data on control premium as percent of firm equity across 39 countries with Jordan Siegel et al.'s ranking of 55 countries based on their relative emphasis of egalitarianism-versus-hierarchy does not establish a significant correlation.<sup>247</sup>

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<sup>245</sup> *Id.* at 669.

<sup>246</sup> *Id.* at 672–79. For a follow up study, tying these cultural orientations to the level of protection of private property, see Amnon Lehavi & Amir N. Licht, *BITs and Pieces of Property*, 36 *YALE J. INT'L L.* 115, 139–48 (2011).

<sup>247</sup> Compare Dyck & Zyngales, *supra* note 127, at 551, with Jordan I. Siegel, Amir N. Licht & Shalom H. Schwartz, *Egalitarianism and International Investment*, 102 *J. FIN. ECON.* 621, 625–26 (2011). Japan, the only country to demonstrate a negative control premium in Dyck and Zingales's study ranks relatively low in the egalitarianism score. In contrast, Brazil, which has the highest positive block premium percentage of firm equity, is one of the most egalitarianism-oriented cultures in Siegel et al.'s index, and the same is true of Austria, the third highest ranking country for block premiums, which is culturally egalitarian.

Whether this disparity points to an overall failure of the intuition about the correlation between power relations in private legal organizations and power-related cultural orientations, to a certain incompleteness of the datasets themselves, or to the need to control for many more variables prior to engaging in such an analysis, is a dilemma that must be left for another day.

Moreover, the argument made above, by which a certain society may be practically receptive to different alignments of power relations across various private legal organizations—rather than establishing a single model of organizational and legal power in each country<sup>248</sup>—suggests that the challenge of deciphering the cultural code of power relations in such organizations may prove to be a daunting task. Nevertheless, such an endeavor may be essential if we seek to fully realize the key role that private legal organizations play in the contemporary ordering of societies.

## VI. CODA

Private legal organizations call for a unified legal theory that identifies the need for collective action, the self-enforcing mechanisms that aim at meeting this basic demand, and the essential role of law in fostering this system of credible commitments and benefits, while guarding against its potential abuse. The cross-field study of business corporations, residential community associations, and labor unions provides a unique prism through which we could start to complement the rich economic study of organizations with a corresponding legal analysis—one that looks beyond current doctrines, prevailing taxonomies, and the public-private dichotomy to understand how members and other stakeholders could be better positioned to collaborate through legally-validated nexuses of private ordering. The complex interplay between economic organization, legal ordering, and the cultural setting against which interpersonal collective action comes to exercise various modes of power, authority, and accountability poses a major challenge that should occupy a central space in studying the spectrum of private legal organizations.

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<sup>248</sup> See *supra* text accompanying notes 235–236.