Santa Clara Law
Santa Clara Law Digital Commons

Faculty Publications | Faculty Scholarship

1-1-2011

# Towards a Firm-Based Theory of Consumption

David Yosifon
*Santa Clara University School of Law*, Dyosifon@scu.edu

Follow this and additional works at: http://digitalcommons.law.scu.edu/facpubs

Part of the Law Commons

Automated Citation
David Yosifon, *Towards a Firm-Based Theory of Consumption* (2011),
Available at: http://digitalcommons.law.scu.edu/facpubs/125

This Article is brought to you for free and open access by the Faculty Scholarship at Santa Clara Law Digital Commons. It has been accepted for inclusion in Faculty Publications by an authorized administrator of Santa Clara Law Digital Commons. For more information, please contact sculawlibrarian@gmail.com.

Santa Clara University

# Santa Clara University School of Law

Legal Studies Research Papers Series

Accepted Paper No. 20-11, September 2011

*Towards a Firm-Based Theory of Consumption*,
46 Wake Forest Law Review 447 (2011)

David G. Yosifon
Assistant Professor of Law
Santa Clara University School of Law

This paper can be downloaded without charge from the
Social Science Research Electronic Paper Collection:
http://ssrn.com/abstract=1933844

Electronic copy available at: http://ssrn.com/abstract=1933844

# TOWARDS A FIRM-BASED THEORY OF CONSUMPTION

*David G. Yosifon*∗

ABSTRACT

Corporate theory typically construes consumption activity as involving a series of arms-length, atomistic transactions in which consumers exchange money for discrete corporate goods or services. Canonical accounts expect satisfied consumers to engage in repeat transactions, but the transactions themselves are (implicitly or explicitly) assumed to be isolated, fully contained dealings with the firm. Such a view of consumption supports the inference that consumers can readily manage their own interests in corporate operations through serial decisions to "take it," "leave it," repeat, or refuse to repeat patronization of a firm. This assessment plays an important part in justifying American corporate governance law, which charges corporate directors with fiduciary obligations only to shareholders, not consumers or other stakeholders. In this Article, I begin to explore some ways in which consumer associations with the corporate "nexus of contracts" are more relational and indeterminate, and less atomistic, than mainstream corporate theory typically presumes. I draw on and extend Ronald Coase's transactional theory of the firm by exploring ways in which some important consumption decisions are made "in-house" by firm managers rather than "in the market" by individual consumers. This positive theory of "firm-based consumption" poses a challenge to the view that corporate governance law should require directors to manage firms exclusively on behalf of shareholders.

## INTRODUCTION

Consumption is a fundamental part of life. We must consume air, water, and food to stay alive. More than mere survival, consumption is an important technique through which we make our lives fully human. We express ourselves and forge group

∗ Assistant Professor, Santa Clara University School of Law. I would like to express my sincere thanks to Alan Palmiter, Kent Greenfield, and the editors of the *Wake Forest Law Review's* Symposium, "The Sustainable Corporation," for their invitation to participate in this symposium. My thanks to Marx Sexton for her help in obtaining research materials.



Electronic copy available at: http://ssrn.com/abstract=1933844

associations, in part, through our consumption patterns.[1] Influential economic and political theories hold that our social prosperity is dependent upon extensive and deepening patterns of consumption.[2] Consumption activity is creeping ever more pervasively into the lives of people already living in consumer-based societies, and more and more societies the world over are becoming consumer based.[3] *How* we consume is in part a function of our social, economic, and legal institutions. In this Article, I explore some undertheorized aspects of the corporate organization of consumption.[4] In particular, by drawing on and extending Ronald Coase's work on the theory of the firm,[5] I explore ways in which some consumption decisions are made "in-house" by corporate managers, rather than "in the market" by individual consumers.[6] I then argue that this analysis of "firm-based consumption" presents a new challenge to prevailing justifications of the view (presently dominant in corporate theory and corporate law) that corporate directors should manage firms exclusively on behalf of shareholders.

## I. CONSUMERS IN THE CORPORATE NEXUS

The corporation is a "nexus of contracts" comprised of all those

1. *See* Albert C. Lin, *Virtual Consumption: A Second Life for Earth*, 2008 BYU L. REV. 47, 62 ("Consumption often involves an attempt to satisfy *nonmaterial* needs—such as affection, participation, relationship, and understanding—through *material* means.") (emphasis added) (citing Tim Jackson, *Live Better by Consuming Less?*, 9 J. INDUS. ECOLOGY 19, 25 (2005)). *See also id.* at 64 ("[C]onsumption choices can also serve as a means of liberation from the constraining norms of closed communities.").

2. *See* Martha T. McCluskey, *Efficiency and Social Citizenship: Challenging the Neoliberal Attack on the Welfare State*, 78 IND. L.J. 783, 802–07 (2003) (attributing these ideas to the influence of economist John Maynard Keynes).

3. *See* Lin, *supra* note 1 (reviewing the rapid expansion of consumption across the globe, emphasizing the adverse environmental impact of such consumption, and exploring the possibility that "virtual" consumption may offer a solution to adverse environmental impact of this pattern, but concluding that such a solution is not very promising).

4. This work builds on my recent scholarship, which has endeavored to flesh out a more robust conception of the consumer interest in the corporation than is otherwise available in corporate law scholarship. *See generally* David G. Yosifon, *The Consumer Interest in Corporate Law*, 43 U.C. DAVIS L. REV. 253 (2009) [hereinafter *Consumer Interest*]; David G. Yosifon, *The Public Choice Problem in Corporate Law: Corporate Social Responsibility after* Citizens United, 89 N.C. L. REV. 1197 (2011) [hereinafter *Public Choice Problem*]; David G. Yosifon, *Discourse Norms as Default Rules: Structuring Corporate Speech to Multiple Stakeholders*, 21 HEALTH MATRIX 189 (2011) [hereinafter *Discourse Norms*].

5. *See* Ronald Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

6. As this Article has been developed for a symposium on the "sustainable corporation," the focus here will be on the ways in which consumer preferences for sustainable consumption are sometimes managed "in-house," within the firm, rather than through individual consumer transactions in the market.

Electronic copy available at: http://ssrn.com/abstract=1933844

with a stake in the firm's operations, including shareholders, workers, consumers, and the broader social and political community.[7] Under the prevailing view, shareholders are the exclusive beneficiaries of fiduciary obligations from corporate directors *not* because shareholders "own" the corporation, but because shareholders have a unique need for fiduciary ties in firm governance that other stakeholders can do without.[8]

Once shareholders invest their capital in corporate enterprise, they have little ability to control or monitor its use.[9] After they turn over their money, shareholders are entitled only to whatever "residual" profits directors decide to pay in dividends after all other corporate obligations have been satisfied (e.g., payments to creditors, wages for workers, taxes to the state, etc.).[10] The inability of dispersed shareholders to control corporate operations, combined with rank indeterminacy in what they are owed, leaves shareholders with little confidence that turning capital over to the firm would be a good idea. One of corporate law's basic solutions to this problem of shareholder vulnerability is to make directors fiduciaries, *exclusively*, of shareholders.[11] Directors are charged with managing firm operations on behalf of shareholders without, at the end of the day, any formal regard for themselves or non-shareholding

---

7. Commentators employing "nexus of contracts" models of the corporation usually presuppose, typically without elaboration, that consumers are part of the "nexus," along with investors, workers, and communities. *See* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 6 (2004) ("[A] firm fundamentally serves as a nexus of contracts: a single contracting party that coordinates the activities of suppliers of inputs and of consumers of products and services."); Michael C. Jensen & William H. Meckling, *Theory of the Firm*, 3 J. FIN. ECON. 305, 307 (1976) (describing the corporation as being "in a very real sense only a multitude of complex relationships (i.e., contracts) between the legal fiction (the firm) and the owners of labor, material and capital inputs and the consumers of output").

8. For authoritative justifications of modern corporate theory and doctrine, see generally STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE (2008); FRANK H. EASTERBOOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

9. My focus here is on large, publicly traded corporations. Closely held firms present unique analytic challenges, which I do not address here. *See* STEPHEN BAINBRIDGE, CORPORATION LAW AND ECONOMICS 797–842 (2002) (summarizing governance issues unique to close corporations).

10. Once shareholders turn over their capital to a corporation, they cannot demand that the firm cash them out by buying back their shares. This exacerbates shareholder agency problems. Shareholders can alienate their shares on secondary markets, but only at a price that is discounted by whatever corporate problems (managerial or otherwise) are motivating the sale. *See* LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 71–72 (2010); *infra* note 27.

11. *See* BAINBRIDGE, *supra* note 8, at 28–30.

stakeholders, "however hard the abnegation."[12]

Nonshareholding corporate stakeholders must rely on nonfiduciary mechanisms to guard their interests. According to the standard account, workers are intimately involved in firm operations (physically, at the plant, or through electronic communications) and can therefore monitor their interests and negotiate their interest in corporate operations with firm managers either individually or collectively through unions. Moreover, workers' fundamental stake in the firm is wages, which unlike "residual" profits, can be contractually specified, ex ante, with precision. They therefore do not need fiduciary attention in firm governance.[13]

Critical corporate scholars have repudiated this view, arguing that workers, like shareholders, also have unfixed, indeterminate interests in corporate operations.[14] After all, workers want not only wages, but also job security, raises, promotions, and safe working conditions. Once they invest their human capital (learning and becoming expert at firm-specific tasks) it becomes more and more difficult for laborers to "exit" a particular corporate nexus by quitting and getting work at a different firm. Without a credible threat of exit, it becomes easier for directors to deal sharply with workers as one way of satisfying corporate law's central command that directors pursue profits for shareholders.[15] Further, some important elements of employment are difficult for workers to monitor on their own. It is at least as hard for workers to spot asbestos hiding in construction materials, or carpel-tunnel syndrome lurking in repetitive key strokes, as it is for shareholders to see the frailty of investments in bundled subprime mortgages. Because of the irreducibly *relational* nature of corporate employment, critical corporate scholars have sometimes argued that corporate boards should be required to serve as fiduciaries of workers in addition to shareholders.[16]

Fewer scholars have critically examined the nature of the consumer interest in corporate operations.[17] Neither theorists nor the law have thought it necessary to afford consumers fiduciary protections in firm governance. Corporations, the standard account goes, must already serve consumer interests if they hope to stay in

12. Meinhard v. Salmon, 164 N.E. 545, 548 (N.Y. 1928) (describing fundamental requirements of fiduciary obligation); *see also* Bainbridge, *supra* note 8, at 53 ("[T]he shareholder wealth maximization norm . . . indisputably is the law in the United States.").

13. *See* KENT GREENFIELD, THE FAILURE OF CORPORATE LAW 57–60 (2007).

14. *See id.* at 41–71 (synthesizing and extending corporate law scholarship critical of shareholder primacy, largely from the labor perspective).

15. *Id.* at 52–53.

16. *Id.* at 60–71.

17. *See Consumer Interest*, *supra* note 4, at 261–63.

business at all—neither taxes nor wages, creditors *nor* shareholders, can be paid unless consumers are satisfied and patronize the firm.[18] Moreover, consumers can look after their own interests by inspecting corporate goods and services before making any purchases. While consumers rarely negotiate the terms of their deals with corporate operatives, the decision to "take" or "leave" what firms offer is thought to be a sufficient contract-based safeguard to protect consumer interests.[19] Of course, consumers will sometimes find it hard to evaluate important aspects of goods. It is difficult, for example, for most consumers to inspect or understand the relevance of nicotine levels in cigarettes, trans fats in french fries, or escalating interest rates in home mortgages. Nevertheless, mainstream corporate theory and extant law ascribe a protective role in such circumstances not to corporate decision makers, but to external government regulators who are charged with insulating consumers from the pernicious effects of misleading advertising or hazards that are difficult to observe.[20]

In previous work, I have challenged these fundamental justifications for keeping consumer interests out of corporate boards' formal responsibilities.[21] First, wedded as it is to unreconstructed "rational actor" and "common sense" conceptions of the sources of individual behavior, corporate theory has failed to adequately address what social science tells us about the ease with which consumer perceptions of risk and other product attributes can be manipulated by corporations through advertising and marketing activity.[22] Corporations may be serving shareholder interests not by discerning and satisfying consumer preferences, but by inducing preferences and manipulating perceptions.[23] Second, corporate theorists have failed to attend to the substantial public choice problems that preclude the development of the external regulatory structures that the canonical view claims should protect consumers where individual judgment is inadequate or exploited.[24] After all, firms charged with maximizing shareholder profits will be motivated to work within the political sphere to stunt the

18. *See id.* at 259–60.

19. *See id.*

20. This reliance on external government regulations, rather than internal firm governance, is also prescribed to protect workers from health and safety concerns that they cannot effectively protect themselves from through contract. *See* GREENFIELD, *supra* note 13, at 60–66.

21. *See supra* note 4.

22. *See Consumer Interest*, *supra* note 4, at 261–70; *see also* Jon Hanson & David Yosifon, *The Situational Character: A Critical Realist Perspective on the Human Animal*, 93 GEO. L.J. 1, 169–70 (2004) (reviewing social science emphasizing the general failure of human intuition to appreciate the magnitude of situational influence over human behavior).

23. *See Consumer Interest*, *supra* note 4, at 169–71.

24. *See Public Choice Problem*, *supra* note 4, at 1198.

development of such regulatory regimes in service to their shareholders. After the Supreme Court held in *Citizens United v. Federal Elections Commission*[25] that the First Amendment forbids government from stifling corporate political speech, corporate interference in regulatory development will prove to be an even more significant hitch in shareholder primacy theory.[26] In light of these problems, I have argued that it may be prudent for corporate law to vindicate a voice for consumers not only at cash registers and in the halls of government, but also in corporate board rooms, by making directors actively attend to the interests of consumers at the level of firm governance.

Here, I want to bracket my analysis of corporate manipulation of consumer preferences and political processes and focus instead on more deeply situating consumption activity within the general theory of the firm. The positive assessment of the corporate organization of consumption that I begin to sketch here will provide a more complete foundation for my normative claim that corporate boards, or some corporate boards, should be required to attend to consumer interests at the level of firm governance.[27]

## II. FIRM-BASED CONSUMPTION

While equity and (sometimes) labor are viewed as having extended, unfixed relationships with the corporate nexus, corporate theorists typically construe consumption activity as involving arms-length, atomistic transactions in which consumers exchange money for discrete corporate goods or services.[28] Under the canonical account, consumers might be expected to engage in repeat transactions,[29] but the transactions themselves are seen as isolated, finite, fully contained dealings with the firm. The presumption that consumers have simple, fixed, and determinate claims on the

25. 558 U.S. 50 (2010).

26. *See Public Choice Problem*, *supra* note 4, at 1199.

27. As the "Toward" in my title implies, this Article is the first step in what will be an ongoing research project. I continue this analysis in a forthcoming article, *Locked-In: Shareholders, Consumers, and the Theory of the Firm* [hereinafter *Locked-In*] (draft on file with author), which explores ways in which consumers can find themselves "locked-in" to consumption relationships with particular firms. The problem of consumer "lock-in" presents a challenge to prevailing views of corporate governance, which typically considers "lock-in" to be a problem that only needs to be solved for shareholders.

28. *See Consumer Interest*, *supra* note 4, at 261–62.

29. Indeed, the imperative of *encouraging* repeat transactions in order to keep the firm going is among the justifications that proponents of shareholder primacy in firm governance give for why consumers do not need fiduciary duties. *See e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 4 (1991) (asserting that firms succeed by promising *and delivering* what people value); *see also id.* at 38 ("The more appealing the goods to consumers, the more profit.").

corporation is an important basis for the conclusion that consumers can take care of their own interests and do not need fiduciary attention in corporate governance. I believe that this presumption oversimplifies contemporary consumption patterns, which are far more *relational* in nature than is appreciated in mainstream corporate theory.

### *A. Consumption and Corporate Philanthropy*

Recently I made my weekly trip to Whole Foods Market, Inc. (a publicly traded company). Thrilled with my chosen lot of fresh fruit, vegetables, breads, and prepared (but purportedly healthy) delectables I had chosen, I paid for the goods and left the store. As I pushed the grocery cart to my car I saw a notice printed on the sides of the brown paper grocery bags announcing that on September 22, Whole Foods would be giving 5% of its sales to something called the California Coastal Cleanup Day. I thought to myself, is this a promise or a threat? I wondered, why would Whole Foods give 5% of the price it charges me for groceries to this cleanup project, instead of reducing its prices by 5% such that I could then have a little extra to spend on cancer prevention, the search for extra-terrestrial life, prisoner rights advocacy, my still-festering law school loans, or, if I wanted, coastal cleanup? Why would I be better off with Whole Foods deciding how to spend this money than I would be if I made the decision myself? Whole Foods might as well fill up my grocery cart for me, and I could just meet them at the checkout. The mystery deepens when you consider that if I donated to the Coastal Cleanup with cash savings from reduced prices I could take a tax deduction on the donation. At least with respect to the prepared food I purchased, I had to *pay* sales tax on the purchase price (which was inflated by the cost of the coastal cleanup contribution) *and* I get no personal tax deduction for the money Whole Foods donates to the Coastal Cleanup.[30]

For a moment I thought that maybe it really was a kind of warning and that if I wanted no part of the cleanup I could just avoid patronizing Whole Foods on September 22. But then I realized that I had, obviously, already paid for part of the beach cleanup through the prices on the purchases I had just made (before I even learned about the Coastal Cleanup); indeed, I had paid for it in the purchases I had made the previous week too, and the week before that. The money that Whole Foods was going to use to pay for the cleanup could have been used instead to lower prices

30. Corporations can deduct charitable contributions from their federal income taxes (up to ten percent of their taxable income). *See* IRS Publication 526 (2010), Charitable Contributions, *available at* http://www.irs.gov/publications/p526/index.html. This corporate tax savings may to some extent be reflected in discounted prices to the consumer, but the discount would be less than the possible savings available from foregoing coastal cleanup altogether.

throughout the year. Or was Whole Foods trying to make me think that the 5% for coastal cleanup would be coming only out of "residual" profits, and thus coming from shareholders' pockets, rather than coming out of the gains-to-trade that all stakeholders in the corporate enterprise, including workers and consumers, must split?[31]

Perhaps Whole Foods is able to accomplish an economy of scale by drawing consumers to its stores with promises of coastal cleanups, economies that reduce the overall cost of produce to the consumer.[32] Indeed, one of the justifications that scholars and courts propound for why corporations are permitted to make charitable donations is that consumers like it and are more likely to patronize firms that do it, thereby making such conduct profitable for shareholders.[33] But this just begs the question, why do promises of coastal cleanups, rather than promises of greater cash savings, attract consumers and produce this economy of scale? Upon further inquiry (i.e., by Googling it), I learned that the California Coastal Cleanup is also supported by contributions from, among others, Oracle, Inc., Kohls, Inc., Delta, Inc., KPMG, Inc., Fairmont Hotels & Resorts, Inc., and See's Candies, Inc.[34] It turns out that one's consumption of computer services, household goods, travel, name, but then they lose such collateral benefits. They could make ld make the donation conditional on the recianups and other environmental ventures, and am happy to help pay for them. What begs explicit analysis, however, is the realization that I am paying for them not just through direct contributions, or through tax-and-transfer programs, but as part of my day-to-day consumption activity. Of course, the California Coastal Cleanup is just one of many charitable ventures supported by corporations. In 2009,

31. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 290–92 (1999) (emphasizing the role of the board of directors in divvying up gains-to-trade among all stakeholders in corporate enterprise).

32. Whole Foods' corporate ethos generally expresses a commitment to sound environmental practices. But a number of journalistic inquiries have drawn attention to elements of Whole Foods' business practices that may be misleading in this regard. *See, e.g.,* Field Maloney, *Is Whole Foods Wholesome?*, SLATE, Mar. 17, 2006, http://www.slate.com/id/2138176/ (arguing that Whole Foods misleads consumers about the amount of organic food it supplies from small, family-owned farms and claiming that Whole Foods' promotions "artfully mislead customers about what they're paying premium prices for").

33. *See, e.g.,* Victor Brudney & Allen Ferrell, *Corporate Charitable Giving*, 69 U. CHI. L. REV. 1191, 1192–94 (2002); Geoffrey Miller, *Narrative and Truth in Judicial Opinions: Corporate Charitable Giving Cases*, 2009 MICH. ST. L. REV. 831, 842–43.

34. *See* Press Release, Cal. Coastal Comm'n, California Coastal Commission Announces the 26th Annual California Coastal Cleanup Day (Aug. 31, 2010), *available at* http://www.coastal.ca.gov/publiced/ccd/8.31.10.MediaAdvisory.pdf.

American corporations made an estimated $14.4 billion in charitable donations.[35]

In the penultimate section of this Article, I will turn to the issue of consumers' desire for goods that are produced and disseminated in an environmentally sustainable fashion (rather than products that are bundled with charitable contributions).[36] I hold that issue in abeyance in this Part in order to first square up the analytic issues involved in "firm-based" consumption through two further examples that I think introduce the issue in a more direct, graspable fashion.

### *B. Loyal Consumption*

My highly organized wife is a proponent of cultivating and using "points" or "miles" by participating in retail and credit card company loyalty and reward programs. By staying as often as possible at Marriott International, Inc. hotels, we generate "points" which can be used for a "free" (ahem) hotel stay in the future.[37] By using an American Express, Inc. credit card to pay for all manner of consumption, we can receive "free" (ahem) hotel rooms, baseball tickets, household electronics, or gift cards for retailers, such as Home Depot, Inc., or Linens 'n Things, Inc.[38] Consumer loyalty

35. *See Charitable Giving Statistics*, NAT'L PHILANTHROPIC TRUST, http://www.npt.org/philanthropy/philanthropy_stats.asp (last visited Aug. 30, 2011). It is possible to analyze this as a "tying" problem under anti-trust laws which prohibit firms with monopolistic power in one consumer market from requiring consumers who want to purchase their product to also purchase a distinct or "tied" product. *See generally* Einer Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, 123 HARV. L. REV. 397 (2009); Alan J. Meese, *Tying Meets the New Institutional Economics*, 146 U. PA. L. REV. 1 (1997). Commentators appear to sometimes use the term "bundle" to refer to benign or competitive "tying" arrangements. A stricter usage refers to "bundles" as the discounted, grouped sale of two or more items that are otherwise sold separately, and "ties" as sales of two or more items that a firm will only sell together. *See* Daniel A. Crane, *Mixed Bundling, Profit Sacrifice, and Consumer Welfare*, 55 EMORY L. J. 423, 433 n. 38 (2006). Using these terms, the coastal cleanup example appears to be a benign tie, because the markets that I am describing, grocery stores (even health food stores), clothing retailers, insurance, and candy are all quintessentially *competitive* markets. The coastal cleanup is not, strictly speaking, bundled with these firms' goods, since the firms will not sell you soy milk, insurance, candy, etc. without the slice of beach cleanup (i.e., will not reimburse your pro-rata share of the contribution if you want to refuse to be a part of it). So again, the question is why are these firms competing with ties (or more loosely, bundles) that involve their own products and largely distinct sustainability initiatives, rather than on price?

36. *See infra* text accompanying notes 80–93.

37. *See Marriott Rewards*, MARRIOTT, http://www.marriott.com/rewards/rewards-program.mi (last visited Aug. 30, 2011).

38. *See Get the Card*, AMERICAN EXPRESS, http://getthecard.americanexpress.com/home (last visited Aug. 31, 2011).

programs have a long and quirky history, but the modern practice can be traced to the introduction of "frequent flyer" miles by American Airlines, Inc. in 1981.[39] The success of that program spurred imitators not just in the airline industry, but throughout retail markets.[40] Analysts have found that the average American consumer belongs to fourteen different rewards programs, and is actively engaged in six of them.[41] So why would a consumer prefer to receive "points" that she can put towards future consumption of a limited range of goods that American Express or some other business offers through its rewards program, rather than receiving a present cash discount (equal to whatever it costs the business to run the rewards program), which she could then spend on anything at all? This pattern is especially mysterious given robust evidence from social psychology that consumers usually behave as "hyperbolic discounters."[42] That is, consumers are generally thought to strongly prefer more present consumption over the possibility of higher levels of consumption in the future.[43] Why do firms compete on the basis of offering better "miles" or rewards programs, rather than on price?[44]

39. *See generally* FREDERICK F. REICHHELD, LOYALTY RULES! (2001).

40. *See id.*

41. Tim Donnelly, *How to Start a Customer Rewards Program*, INC.COM (Aug. 17, 2010), http://www.inc.com/guides/2010/08/how-to-start-a-customer-rewards-program.html.

42. *See* Hanson & Yosifon, *supra* note 22, at 44–46 (reviewing studies on hyberbolic discounting); Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 40 STAN. L. REV. 1471, 1539–42 (1998) (exploring policy implications of hyberbolic discounting).

43. *See* Hanson & Yosifon, *supra* note 22, at 44–46.

44. Commentators have provided idiosyncratic explanations for specific programs. For example, airline "miles" programs have been explained as a method of (open) secret compensation for employees, who are reimbursed for corporate (or law school) related travel by employers, but keep the accumulated miles in their personal rewards account for future personal travel. Moreover, this compensation has typically evaded taxation. *See* Abhijit Banerjee & Lawrence Summers, *On Frequent Flyer Programs and Other Loyalty-Inducing Economic Arrangements*, Harvard Institute of Economic Research, Discussion Paper Number 1337 (1987), *available at* http://econ-www.mit.edu/files/501 (last visited Aug. 21, 2011). Lawrence Ausebel has argued that credit card companies compete on the basis of rewards programs rather than on interest rates because most consumers (mistakenly) predict that they will use credit cards merely for convenience and will not use the credit; they therefore do not distinguish between interest rates when deciding which cards to patronize. Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 50, 70–76 (1991). Others argue that rewards programs are the bounty of transfers from the relatively poor, who cannot qualify for credit cards with rewards programs, to relatively wealthy consumers who do use them, since credit card interchange fees are impounded into the price of commodities by retailers who do not offer discounts for cash payments (retailers are forbidden by credit card companies from offering such discounts). *See, e.g.*, Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55

*C. Employee Consumption of Benefits*

I am principally concerned here with analyzing the nature of consumer associations with corporate enterprise. This task will be aided by briefly considering an important employee-specific form of firm-based consumption: employee benefits, or "in kind" employee compensation programs. Such benefits most prominently include health insurance, but also include maternity, paternity, and other family leave programs, fitness and recreational programs, meals and entertainment (group or individual tickets to baseball games, etc.), and reduced costs for company products and services.[45] A 2002 study by the U.S. Chamber of Commerce found that benefits programs comprised a (surprisingly high) 42.3% of total employee compensation for American workers.[46]

Why would a worker prefer to receive specific goods or services as compensation rather than higher wages that the worker could use to buy anything she wanted, including health insurance, opera tickets, or coastal cleanups? Analysts give two fundamental explanations, only the second of which is directly relevant to the present inquiry. First, unlike ordinary wages, some in-kind benefits are not taxed as income under the United State Tax Code.[47] These include big-ticket, obvious items like health insurance, but also less-obvious, less-tractable items like "free" air conditioning in the office.[48] The tax explanation is important, but it is not complete, as many benefits *do* count as income under the tax code.[49] In fact, the default rule is that benefits are taxed as income, although, as stated, there are important exceptions.[50] Examples of nonexcludable

U.C.L.A. L. REV. 1321 (2008). These interesting arguments undoubtedly go some distance in explaining specific programs, but the ubiquity of rewards programs in consumer markets suggests that something more general may help explain their use. *See* Banerjee and Summers, *supra*, at 2. Moreover, these accounts do not explain why airlines or credit cards attract consumers with rewards offering a limited universe of consumption, rather than cash, which consumers could put to any privately preferred use. I explore a "firm-based consumption" explanation *infra*, text accompanying notes Part II.B.

45. Anthony M. Marino & Jan Zabojnik, *A Rent Extraction View of Employee Discounts and Benefits* (Oct. 16, 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=608041.

46. *Id.*

47. 26 U.S.C. § 132 (2006).

48. *See generally Taxable Fringe Benefits Guide*, INTERNAL REVENUE SERVICE (2011), http://www.irs.gov/pub/irs-tege/fringe_benefit_fslg.pdf (examining various benefits exempt from taxation under the Internal Revenue Code).

49. Moreover, without some other explanation for benefits programs, we might expect that many employees would still prefer to have cash, even if they had to pay taxes on it, rather than taking a limited set of in-kind goods tax-free.

50. *See Taxable Fringe Benefits Guide*, *supra* note 48, at 7 ("In general, taxable fringe benefits are reported when received by the employee and are included in employee wages in the year the benefit is received.") (citing 26

benefits include routine snacks and meals, athletic club memberships, gift certificates to department stores, and the like. The second, nontax explanation for why firms give employees benefits instead of higher wages is that firms sometimes have a cost advantage in procuring the in-kind item and can make it available more cheaply than their employees could acquire it in the open market.[51] The cost advantage can be split between the firm and the worker, making both better off than they would be if the firm paid the worker enough cash to purchase the benefit outside of the firm. As one scholar succinctly puts it: "When the firm can buy a benefit for a lower cost than the employee could buy it on their own, the firm is essentially acting as a buying agent for the worker."[52]

## III. A COASIAN APPROACH TO A FIRM-BASED THEORY OF CONSUMPTION

A firm that wants to sell pencils might go into the open market and contract with a woodchopper for the chopping of wood, then make a deal with a graphite miner for the mining of graphite, then contract with a designer for the pencil's design, then make a deal with a factory to compile all these elements into a pencil, which the firm would then sell. Alternatively, a pencil business might organize these production components "in-house" by employing and deploying its own woodchoppers, miners, designers, and manufacturers. How do firms decide how to organize pencil production?

In his groundbreaking 1937 essay *The Nature of the Firm*, Ronald Coase explained why production (pencil and otherwise) is sometimes accomplished through a series of arms-length contractual exchanges "in the market," and at other times is organized by command and control "in the firm."[53] Coase famously argued that

U.S.C. §451(a) (2006)).

51. *See* Marino & Zabojnik, *supra* note 45, at 1.

52. Darren Lubotsky, *The Economics of Employee Benefits*, *in* EMPLOYEE BENEFITS: A PRIMER FOR HUMAN RESOURCE PROFESSIONALS 34 (Joseph Martoccio ed., 2004). A third interesting (though not directly relevant to the present inquiry) explanation for the prevalence of benefits in lieu of more cash is that it provides employers a cheap mechanism through which to distinguish more desirable from less desirable job applicants. *See* Marino & Zabojnik, *supra* note 45, at 10. For example, if firm managers believe that employees who exercise regularly are likely to be more productive than workers who do not exercise, then firms might find it useful to offer a mix of cash and gym memberships rather than all cash as compensation. Workers who are likely to use the gym membership will value it and be attracted to the compensation package, while workers who do not value gym memberships will be less likely to apply for the job. The compensation structure is a more reliable sorting mechanism than would be simply asking applicants whether or not they enjoy exercising, which might seem both rude and legally risky. *See id.*

53. *See* Coase, *supra* note 5. *The Nature of the Firm* was Coase's first article. He published it at the age of twenty-seven, reportedly based on a

"[t]he main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism. The most obvious cost of 'organizing' production through the price mechanism is that of discovering what the relevant prices are."[54] The high cost of discovering—Coase includes the cost of "negotiating" in this notion of discovery—prices for various inputs, such as raw materials and labor, can sometimes make it cheaper to just vertically integrate production components within one firm, where the combination and use of such components is determined by the day-to-day fiat of firm managers, rather than continually negotiated with outsiders.[55]

Coase's "transactional" theory of the firm has had tremendous influence in economics generally and in corporate law scholarship in particular.[56] Coase's insights, however, have not been deployed to make sense of consumption activity. Coase himself touched only very briefly on the issue of consumption in his article. His one statement on the matter comes in an obscure footnote to a famous rhetorical question: "[W]hy, if by organizing one can eliminate certain costs and in fact reduce the cost of production, are there any market transactions at all?"[57] The Coasian answer to the rhetorical question is, of course, that in some circumstances transaction costs in the market are lower than organizing (and monitoring) costs in the firm.[58] But in the footnote to his rhetorical question Coase stumbles (well, Coase never stumbles, he jaunts) into consumption:

> There are certain marketing costs which could only be eliminated by the abolition of 'consumers' choice' and these are the costs of retailing. It is conceivable that these costs might be so high that people would be willing to accept rations because the extra product obtained was worth the loss of their choice.[59]

I argue that this is not just conceivable, but is in fact

lecture he first developed at the age of twenty-one. *See* Donald N. McCloskey, *The Lawlerly Rhetoric of Coase's* The Nature of the Firm, 18 J. CORP. L. 425, 426 n.79 (1993).

54. *Id.* at 390.

55. *Id.* at 388 ("Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-co-ordinator, who directs production.").

56. *See* Jason Scott Johnston, *The Influence of* The Nature of the Firm *on the Theory of Corporate Law*, 18 J. CORP. L. 213, 214 (1993).

57. Coase, *supra* note 5, at 394.

58. *Id.* at 395 ("[A] firm will tend to expand until the costs of organizing an extra transaction within the firm become equal to the costs of carrying out the same transaction by means of an exchange on the open market or the costs of organizing in another firm.").

59. *Id.* at 394 n.2.

widespread in the contemporary corporate organization of consumption. Where price information and other transaction costs are relatively cheap, consumers prefer to make their own consumption decisions through spot transactions "in the market." But where information and other transaction costs are high, consumers fare better turning consumption decisions over to be made "in-house" through firm governance.[60] Just as the worker sometimes gets higher wages by turning discretion over the use of her labor to corporate managers, rather than bargaining for its use in individual projects in the marketplace, and capital sometimes receives higher returns by relinquishing to firm managers discretion over how its money will be invested, so also does the consumer sometimes do better turning over discretion regarding what exactly will be consumed to firm managers. The consumer sometimes finds it more efficient to eat what is "rationed" to her on "islands of conscious power" rather than go casting her own net about in the open sea.[61]

The consumer who purchases groceries, candy, insurance, hotel stays, or computer software all with a side of coastal cleanup[62] of course is free to patronize a different set of firms not tying their wares to beach cleanup, buy groceries, insurance and candy at a slightly cheaper price, and then separately make her own donations to the charities of her choice. It is difficult to tell exactly what amount of beach cleanup one would be getting with a purchase of groceries, candy, or software, just as it is difficult to tell how much beach cleanup one can get with a direct donation. That is to say, it is difficult for the consumer in these areas to determine prices. The quantum of the individual consumer's portion of the corporate donation with each purchase is so small that the opportunity costs involved in seeking out and executing atomistic purchases and donations would far outweigh any efficiency loss in just leaving the decision making up to an otherwise trusted firm and taking the corporate bundle.[63] The firm-based decisions will not exactly accord with the consumers' private preferences, but the consumer has no better preference-maximizing option in serial spot markets, which are very costly to negotiate.[64] These are precisely the conditions that Coase explained would cause activity to be brought in-house

60. *See id.*

61. *See* D.H. ROBERTSON, THE CONTROL OF INDUSTRY 85 (1930) (describing business corporations as "islands of conscious power in this ocean of unconscious co-operation [i.e., the price mechanism in the market] like lumps of butter coagulating in a pail of buttermilk.").

62. *See supra* Part II.A.

63. *See* M. Todd Henderson & Anup Malani, *Corporate Philanthropy and the Market for Altruism*, 109 COLUM. L. REV. 571, 576–77 (2009).

64. *See* Coase, *supra* note 5, at 114–19.

and managed by fiat, rather than left to the market.[65]

A similar analysis helps to explain the phenomena of consumer

65. My analysis here bears some resemblance to Henry N. Butler and Fred S. McChesney's assessment of corporate charitable giving from the shareholder perspective in *Why They Give at the Office: Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation*, 84 CORNELL L. REV. 1195 (1999). Butler and McChesney take as their point of departure the idea that some corporate philanthropy benefits shareholders because it creates goodwill for the firm in dealing with workers, consumers, and communities, leading to more profit opportunities (their example is General Motors sponsoring a Ken Burns documentary). *Id.* It is conceivable, Butler and McChesney argue, that rather than firms giving directly, shareholders could make donations in their individual capacity, contingent on the recipient noting their support from "shareholders of GM." *Id.* at 1203. This might achieve the same kind of goodwill for GM, but at a much higher cost. "[I]t is not hard to see why in fact shareholders wold prefer to give at the office . . . . [T]he firm already has the earnings (current or past) necessary for the philanthropy. Distributing the earnings as dividends which [shareholders] can contribute individually simply imposes an additional transaction cost . . . . Each shareholder must send in his [or her] own check; write a letter explaining that the gift is made in the firm's name . . . ." *Id.* at 1203. Consumers benefit from charitable giving in a similar fashion. To the extent that such giving creates goodwill for the firm it may more easily attract shareholders, reducing the cost of capital, or workers, reducing the cost of labor, all of which will reduce the prices that consumers have to pay for the firm's goods and services. Individual consumers could donate to the coastal cleanup in their own name, but then they lose such collateral benefits. They could make the donation conditional on the recipient noting support from "consumers of GM," but in doing so they take on unnecessary transaction costs. Further, as Butler and McChesney note, if individual shareholders were to make donations *qua* GM shareholders, then nondonating shareholders would free ride on those who make donations (making would-be donors less likely to contribute, since they anticipate the free riding). Firm-based philanthropy helps shareholders and consumers alike overcome this free-riding problem. Butler and McChesney acknowledge that firm managers may sometimes exploit the firm by donating to charities they privately prefer rather than charities that would benefit the firm, but such costs have to be balanced against the gains that are otherwise available through corporate charitable giving. *Id.* at 1205.

I am taking the argument a step further to suggest that corporate charitable giving may serve the private interests of individual consumers irrespective of the benefits to the firm, in that firms may enjoy transaction cost advantages over individuals in making charitable donations, even without considering the impact of such donations on corporate reputation. Large firms can make it somebody's entire job to study and manage the organization's philanthropic activity. There is some evidence that firms are beginning to make use of sophisticated metrics to evaluate the utility of their philanthropic activity, something that is well beyond the capacity of most individuals or families. See, for example, materials collected at www.corporatephilanthropy.org, the website for an international organization of corporate CEOs called the Committee Encouraging Corporate Philanthropy, which collects research on best practices in corporate philanthropy. *See also* Henderson & Malani, *supra* note 63 (arguing that business corporations sometimes have a competitive advantage in the supply of "altruism" over nonprofit and government entities, and urging tax reforms that treat nonprofits and for-profits more equally).

loyalty and rewards programs. Rather than holding onto more cash with which they could buy a greater range of future goods, consumers in such programs turn over a quantum of future consumption decisions to the firm and take whatever "ration[s]" the firm later provides. The consumer is willing to turn these decisions over to the firm because the opportunity and transaction costs of open-market activity would leave the consumer with less than she receives in the end by just taking what firms she knows she already likes and trusts decide by fiat to give her. This kind of firm-based consumption corresponds in a sense to economists' explanation of the service that conglomerates (firms that own companies in numerous distinct industries, but not every industry) provide for capital investors. The conglomerate accomplishes for investors "a breadth-for-dept tradeoff . . . as the firm selectively internalizes functions ordinarily associated with the capital market."[66] Consumers similarly trade breadth-for-depth by relying on the firm's capacities and expertise to select a limited set of consumption goods, in exchange for the full breadth of options that are available in spot markets. This trade-off makes sense because the opportunity and transaction costs of open market activity would leave the consumer with less than if she simply took what the firm decides to give her.[67]

## IV. Reforming Corporate Law to Account for Firm-Based Consumption

The ubiquity of corporate charitable giving and consumer rewards programs makes implausible the view that what consumers want (or get) from their corporate associations is merely a product or service on offer, and nothing more, with no relational strings attached. Consumers rely in ongoing fashion on the fiat of firm-based decision making. This positive assessment can contribute to the normative case for making firm directors fiduciaries of their consumers.[68] The shareholder primacy norm relies in part on the

66. Oliver Williamson, *The Modern Corporation: Origins, Attributes, Evolution*, 19 J. Economic Lit. 1537, 1546 (1981).

67. Of course, an alternative explanation is that consumers do not benefit at all from charitable-giving ties or loyalty programs, but rather that such programs succeed only by manipulating consumer perceptions in the service of corporate managers or shareholders. Such an alternative explanation is plausible and would support arguments I have otherwise made for requiring firms to treat consumers in a fiduciary, rather than an arms-length, fashion. *See Consumer Interest*, *supra* note 4. However, as noted, here I am trying to (at least temporarily) leave the question of manipulation to the side and am trying to ground justifications for consumer-oriented firm governance in a more general theory of firm-based consumption.

68. Note that Coasian analysis of the contours or "nature" of the firm provides no deductively applicable answers regarding what rights or duties should run to those stakeholders determined to be inside or outside the firm.

presumption that consumers manage their interests in corporate enterprise through serial, arms-length, fully-determined transactions (with government regulators as a backstop).[69] In fact, the consumer's dealings with the firm can be far more relational than the conventional depiction would lead us to believe. Firm-based consumption decisions can only reliably be in the consumer's interest if firm managers are taking consumer interests into account when making them. If firm managers are charged only with pursuing shareholder interests then there is reason to doubt that consumer deference to the firm's consumption decisions is reliably well placed.

Moreover, firm-based consumption may put consumer interests in more direct conflict with shareholder interests than is anticipated by canonical justifications for the shareholder primacy regime. Consider the case of rewards programs. The consumer who participates in such a program pays a premium on earlier transactions (rather than taking a cash discount) in order to receive discounts or perks in connection with future consumption. The consumer now has a stake in the long-term viability of the firm with which she has a loyalty association and wants that firm to be managed in a conservative, risk-averse fashion. Shareholders are generally thought to be relatively more risk preferring as to the operations of any individual firm with which they are invested, given that most shareholders are highly diversified, enjoy limited liability for firm losses, and receive unlimited upsides from very profitable firms.[70] This conflict bears not only on the survival of individual firms, but also on business decisions while the firm is a going concern. Directors of a corporation with many retail outlets might consider it profitable to close a number of stores, or an airline might decide it can make more money by shutting down some routes. While shareholders may benefit from such a move, consumers in loyalty programs may find that their points, miles, or discounts are worth less than when they were earned.[71] Bringing

*See* Oliver Hart, *An Economist's Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757, 1764 (1989) (arguing that the intellectual turn in the second half of the twentieth century from entity to nexus-of-contract theories of the firm merely "shift[s] the terms of the debate" from a focus on distinctions between entities and markets to an assessment of "why particular 'standard forms' [or terms within standard forms] are chosen").

69. *Id.* at 258–61.

70. *See* BAINBRIDGE, *supra* note 8, at 114–20 (explaining risk preferences of diversified shareholders).

71. Some firms' reward programs purport to reserve the right to unilaterally change the terms of their programs at any time, at their discretion, even as to already accumulated "points" or "miles." *See* Peter A. Alces & Michael M. Greenfield, *They Can Do That? Limitations on the Use of Change-of-Terms Clauses*, 26 GA. ST. U. L. REV. 1099, 1103–04 (2010) (citing examples from JetBlue, Inc., and Orbitz.com, Inc.). Some economists argue that loyalty

this analysis together with concerns about the incentive (and ability) that shareholder-primacy corporations have to manipulate consumer risk perceptions and external regulations, the case for requiring corporate directors to manage their firms with fiduciary attention to consumers, in addition to shareholders, begins to look stronger.

Such an extension of the board's fiduciary obligations may seem like a radical proposal at first, but this impression surely fades when one considers how little is actually required of corporate directors before corporate law will say their fiduciary duties are satisfied. Corporate law does not permit courts or law professors to review the substance of the business judgments that corporate boards make. Absent fraud or self dealing, courts will not second-guess the business judgment of corporate boards.[72] This "business judgment rule" in corporate law ensures that it is the board, with its particular institutional expertise, that ultimately has authority over corporate operations, rather than some other less qualified institution.[73] While corporate law abstains from substantive evaluation, it nevertheless does impose *process* obligations on the firm's decision makers. To satisfy fiduciary obligations to shareholders, corporate law requires directors to deliberate in an informed and sincere fashion about what course of action will be in the shareholders' best interests.[74] Imposing such obligations on the board with respect to consumers would help to ensure that decisions consumers turn over to corporate boards are made at least with consumer interests explicitly on the table. Despite the ease with which these fiduciary obligations may be satisfied, canonical corporate theory holds that the process obligations do presently substantially benefit shareholders.[75] This mechanism can also pay dividends to the consumer interest.[76]

More dramatic approaches to multi-stakeholder corporate governance are also cognizable. One such possibility would be to provide consumers with an active voice in corporate governance, by extending to them the corporate suffrage that shareholders now exclusively enjoy. Instead of getting soy milk with a side of coastal cleanup, consumers might get soy milk with a side of coastal

programs "artificially" inflate consumers' cost of switching from one seller to another, resulting in higher prices. *See* Gianluca Faella, *The Antitrust Assessment of Loyalty Discounts and Rebates*, 4 J. COMPETITION L. & ECON. 375, 402–03 & n.96 (2008) (noting the issue and citing literature). I explore the problem of "switching-costs" in *Locked-In*, *supra* note 27.

72. *See* BAINBRIDGE, *supra* note 8, at 106–26 (reviewing doctrine of and justifications for the business judgment rule).

73. *Id.*

74. *See Discourse Norms*, *supra* note 4, at 1236.

75. *See* BAINBRIDGE, *supra* note 8, at 77–100.

76. *See Discourse Norms*, *supra* note 4, at 1236.

cleanup and a fraction of a vote in the next corporate election.[77] Consumers could be given access to the corporate proxy mechanism, allowing them to author and vote on "stakeholder proposals" through a process similar to the Securities and Exchange Commission's Rule 14-a mechanism, which allows shareholders to author and vote on "proposals" broadly relating to firm operations.[78] Mainstream corporate theorists consider such mechanisms presently to be only a weak kind of "backup" safeguard even for shareholder interests,[79] but they do provide a bit of backup protection, which might at least serve as a credible threat against directors by encouraging them to work hard and honest on behalf of their consumer stakeholders.

## V. COLLECTIVE CONSUMER PREFERENCES FOR SUSTAINABILITY

As this Article was developed for a symposium on the subject of the "sustainable corporation," I want to briefly examine some implications of firm-based consumption and multi-stakeholder corporate governance for spurring corporate "sustainability" in the sense of corporate operations that are environmentally sound.[80] This issue is distinct from corporate charitable contributions to environmental projects unrelated to the firm's business, and is arguably a much more important issue when it comes to environmental protection generally. Some corporations tout sustainable production as an attribute of the product they are selling. As I write these words I am sipping on a cup of coffee from Starbucks, Inc. On the side of the cup it reads: "You. Bought 228 Million Pounds of Responsibly Grown, Ethically Traded Coffee Last Year. Everything We Do, You Do." The cup has many slogans on it, but the one that best encapsulates the point under analysis here is this: "You and Starbucks. It's bigger than coffee." While many product attributes are difficult for consumers to inspect and verify on their own,[81] the environmental consequences of a good's production and distribution dynamics are almost always unverifiable through individual consumer evaluation.[82] Starbucks is assuring me that the coffee I am drinking has been responsibly grown—but is this "mere" puffery, or can I take Starbucks' word for it?[83] Douglas Kysar has argued that even as consumers have in the

77. The loyalty and rewards programs that many firms have in place suggest that the technological means to track consumer purchases, and apportion consumers votes in corporate elections, is already available.

78. *See Consumer Interest*, *supra* note 4, at 311–12.

79. *See* BAINBRIDGE, *supra* note 8, at 201–19.

80. *See generally* Jeff Civins & Mary Mendoza, *Corporate Sustainability and Social Responsibility: A Legal Perspective*, 71 TEX. B.J. 368, 369 (2008).

81. *See supra* text accompanying notes 18–19.

82. *See supra* text accompanying notes 18–19.

83. "Responsibly" is obviously a less tractable concept than is a label

last several decades developed a "preference for processes" (i.e., a desire for products made and disseminated with sound environmental practices), consumer protection laws have been stunted in their continued focus on advertising relating to the attributes of end products, failing to require firms to provide information about the processes through which products are created.[84]

If consumers desire sustainable business practices, then firms charged with attending to consumer interests at the level of firm governance might adhere to such practices more sincerely than firms charged merely with pursuing profits for shareholders. Moreover, addressing consumer preferences for processes at the level of firm governance might help consumers overcome what I call "the consumer collective action problem."[85] In surveys, consumers routinely *say* that they prefer products that are made in an environmentally responsible fashion; however, they do not always put their money where their mouth is: "[t]here appears to be a significant gap between consumers' explicit attitudes toward sustainable products and their consumption behavior. . . . [O]ne study suggests that though 40% of consumers report that they are willing to buy 'green products,' only 4% actually do so."[86] From the perspective of revealed preference theory, it might seem that consumers are not sincere when they tell researchers they prefer sustainability, given that they are unwilling to actually pay for it.[87] But the seeming contradiction between asserted and revealed

---

specifying the amount of caffeine or sugar in the drink (which, come to think of it, my beverage is lacking). When I speak of taking the firm's "word" for it when it says the coffee it sells is responsibly grown, I am asking if I can trust that the firm means by "responsible" what I reasonably mean by the word, what workers involved in the coffee production reasonably mean by the word, and what the law and ethics generally mean by the word. *See Discourse Norms*, *supra* note 4, at 104 (applying Michael Jensen's work on integrity to an exploration of the viability of multi-stakeholder corporate governance).

84. *See* Douglas A. Kysar, *Preference for Processes: The Process/Product Distinction and the Regulation of Consumer Choice*, 118 HARV. L. REV. 525, 641 (2004) ("[The] process/product distinction has been invoked to question the authority of an importing nation to ban or label products that are developed using processes deemed objectionable by its citizens; to rationalize ignoring overwhelming consumer support for mandatory labeling of food products that contain genetically engineered ingredients; and to narrow the constitutional conditions under which states may force manufacturers to disclose process information or to face legal challenges for disclosing false or misleading process information.").

85. *See Consumer Interest*, *supra* note 4, at 283–85.

86. Michael G. Luchs, et al., *The Sustainability Liability: Potential Negative Effects of Ethicality on Product Preference*, J. MARKETING, Sept. 2010, at 18, 18. *See also* Kysar, *supra* note 84.

87. Economists typically treat preferences as being "revealed" by conduct. Paul A. Samuelson, *A Note on the Pure Theory of Consumer's Behaviour*, 5 ECONOMICA 61, 62 (1938).

preferences may instead be evidence of a collective action problem. Any one consumer knows that, because of the very marginal impact of any one product on environmental sustainability, the environment will only be sustained if *other* consumers, and not her alone, are also willing to purchase sustainable products.[88] If a consumer assumes that others will be too selfish to purchase a (higher priced) sustainably produced good, then she is throwing good money after bad if she purchases the sustainably produced good: it costs her more, and the environment will not be sustained anyway. Somewhat more deviously, if she assumes that other consumers *will* pay the premium for the sustainable product, then she may free ride and purchase the cheaper, unsustainable product, thinking she will still enjoy a sustained environment because of everyone else's consumption habits. Since all consumers are prone to this logical assessment, nobody ends up paying extra for the environmentally sustainable products, even though everyone is willing to—and indeed, would prefer to—but only if they could be assured everyone else was going to do so as well.

Charging corporate boards with attending to consumer interests at the level of firm governance provides one way of overcoming this consumer collective-action problem. If firm directors explicitly strive to attend to consumer interests and to produce their products in a way that furthers those interests, they may choose to produce only sustainable products in a given product category, thus helping consumers to overcome their collective action problem. This would be another invocation of the "rationing" program that Coase identified may sometimes be in the consumer interest.[89]

This argument is a specific application of the general principle that government action can help overcome collective-action problems that otherwise stymie solutions to enduring social problems (like building roads or providing for national defense).[90] It may be wise, however, to have some kinds of governance decisions made at the level of individual firms, rather than in state or federal governments or administrative agencies, none of which can exercise the kind of informed, specific, and localized "business judgment" that corporate boards can in their own area of expertise.[91]

88. This assumes that consumers do not have a fetishistic desire for products produced with sound processes, in the sense that what they really desire is to possess products with such transcendent qualities. Rather, what they want is both to have the basic product *and* to have environmental sustainability. *See* Margot J. Pollans, *Bundling Public and Private Goods: The Market for Sustainable Organics*, 85 N.Y.U. L. REV. 621, 637–38 (2010).

89. *See supra* text accompanying notes 53–59.

90. *See* MANCUR OLSON JR., THE LOGIC OF COLLECTIVE ACTION 12–16 (1965).

91. *Cf.* STEPHEN M. BAINBRIDGE, CATHOLIC SOCIAL THOUGHT AND THE CORPORATION (2003), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=461100 (describing and applying the principle of subsidiarity—the idea that other things equal decisions should be made at the most local level

Of course, consumers and other stakeholders do not necessarily want sustainability. Some consumers, or consumers at some times, may be indifferent to future environmental conditions.[92] To the extent that this is true, then corporate law may have to find a way of making some other stakeholders' interests, beyond shareholders and consumers (e.g., the community at large or even future generations) a part of corporate governance concerns.

## CONCLUSION

Integrating consumption into theories of the firm, and considering ways in which corporate law can make firms more responsive to consumer interests, may contribute to corporate "sustainability" in more than just the environmental sense. Corporations are highly useful mechanisms for gathering, organizing, and deploying resources in socially useful ways. To sustain the availability of the corporate instrument, we must safeguard the institution against its own worst inclinations that might otherwise lead to its untimely demise. Public opinion and popular political movements on both the right and the left seem to be fed up with corporations and appear to be galled in particular by the selfish, myopic nature of corporate operations.[93] Among the reasons for such animosity is undoubtedly widespread dissatisfaction with the narrow, shareholder-focused agenda of corporate governance, which has been the driving force behind pollution of not just the natural environment, but our political landscape as well.[94] This Article has argued that consumers, just like shareholders, already rely on the authoritative decision making structure of the firm. Corporate governance reforms, which put directors into the business of talking about and working for not just shareholders, but workers, consumers, and other stakeholders, might contribute significantly to the long-term sustainability of not just the environment, but also the corporation in our society.

possible, rather than at a distance by hierarchical decision-makers—to corporate law concerns, although concluding that corporate governance should have no role other than pursuing shareholder value).

92. *See* Luchs et al., *supra* note 86.

93. *See* EVAN OSBORNE, THE RISE OF THE ANTI-CORPORATE MOVEMENT: CORPORATIONS AND THE PEOPLE WHO HATE THEM 41–70 (2009).

94. *See id.*