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Thomas W. Joo

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Comment: Corporate Governance and the "D-Word"

Thomas W. Joo[†*]

Abstract

Shareholders' legal rights to participate in corporate governance are often said to constitute "corporate democracy." But the core values of corporate governance are undemocratic in two ways. First, corporate governance allocates power among shareholders based on the dollars they have invested, not on their status as persons. Second, and moreover, it disenfranchises other stakeholders—such as employees, neighbors, and customers—unless they have the means and inclination to buy shares.

There are of course many economic reasons for allocating corporate control in this way. The "undemocratic" nature of corporate governance does not necessarily make the existing governance regime illegitimate. But it does show that "corporate democracy" is a misleading metaphor. While economic efficiency and property-rights arguments may provide justifications for the corporate governance regime, democratic theories do not.

After some seventy years, most corporate law academics have come to agree with Berle and Means' famous descriptive argument that corporate decisionmaking power is denied to shareholders and is instead heavily concentrated in the board of directors and upper management.[1] As with most

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† This comment responds to the draft version of the Article as presented at the Symposium. The final version of the Article, as revised, appears in this volume at 63 WASH. & LEE L. REV. 1503 (2006).

* Professor, University of California, Davis, School of Law (Dr. Martin Luther King, Jr., Hall). This paper was prepared for and presented at the "Understanding Corporate Law Through History" conference held at Washington and Lee University School of Law in March 2006. I thank Dalia Tsuk Mitchell, Lyman Johnson, David Millon, and all the participants in the conference for a stimulating discussion. I would also like to thank U.C. Davis School of Law and Dean Rex Perschbacher for research support.

1. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4–5 (1932); *see also, e.g.*, Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005) ("A central and well-settled principle

issues in corporate law academia, the normative discourse about this concentration of power consists mainly of debating whether this arrangement is "economically efficient." That is, "corporate democracy" is both descriptively inaccurate and normatively marginalized. Outside the ivory tower, however, the law continues to use the concept both descriptively and normatively. The Delaware Supreme Court, for example, has invoked the term in a number of prominent cases.[2] The United States Supreme Court has treated some corporate political spending as protected political speech on the theory that such spending is the product of "the procedures of corporate democracy."[3] Many reformers who disagree with this rosy descriptive view call for increased shareholder power in order to make corporate governance more "democratic."[4]

Dalia Tsuk Mitchell's contribution to this Symposium, *Shareholders as Proxies: The Contours of Shareholder Democracy*,[5] is an intellectual history of the changing views of regulators, reformers and scholars as to the meaning of "corporate democracy." Tsuk Mitchell identifies three theories that reformers have invoked to justify increased shareholder participation in corporate governance. These theories make varying assumptions about the relationship

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of U.S. corporate law is that all major corporate decisions must be initiated by the board."); Stephen A. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L REV. 1735, 1735 (2006) ("I do not quibble with Bebchuk's exposition of shareholder weakness; to the contrary, I welcome it as further evidence that my director primacy model accurately describes how corporations work.").

2. *See, e.g.*, Williams v. Geier, 671 A.2d 1368, 1381 (Del. 1996) ("[T]he stockholders control their own destiny through informed voting. This is the highest and best form of corporate democracy."); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) ("The machinery of corporate democracy and the derivative suit are potent tools to redress the conduct of a torpid or unfaithful management."); Unocal Corp. v. Mesa Petroleum, 493 A.2d 946, 959 (Del. 1985) ("If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.").

3. First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 794 (1978).

4. For example, after unsuccessful attempts to place shareholder proposals on corporate proxies, AFSCME released a white paper on proxy reform titled *Shareholder Access to the Proxy: Increasing Democracy and Accountability in Corporate Governance*, http://www.sri advocacy.org/reports/proxy_access.pdf (on file with the Washington and Lee Law Review). The SEC took no action on the corporations' exclusions of the proposals but announced it would consider reforming proxy regulation "to improve corporate democracy." SEC Press Release, Apr. 13, 2003, http://www.sec.gov/news/press/2003-46.htm (on file with the Washington and Lee Law Review). This led to a proposal, ultimately rejected, to allow shareholders to place their nominees for the board on the corporate proxy. *See* Thomas W. Joo, *Corporate Hierarchy and Racial Justice*, 79 ST. JOHN'S L. REV. 955, 961 (2005).

5. Dalia Tsuk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, at 1 [hereinafter Tsuk Mitchell, Symposium Draft Version] (Symposium: Understanding Corporate Law Through History, Draft Version, 2006) (on file with the Washington and Lee Law Review).

between corporations' role in society (in Tsuk Mitchell's terminology, "corporate power") and the allocation of control rights between shareholders and management ("corporate hierarchy"). First, Tsuk Mitchell argues, Progressive Era reformers believed that reforming hierarchy to increase shareholder participation would enable shareholders to tame corporate power for the benefit of society.[6] Second, Tsuk Mitchell contends that the primary concern, from the New Deal Era through the 1970s, was protecting the rights of the individual shareholder against potential abuses of power by management.[7] Third, neoclassical economists since the 1970s have argued that shareholder participation empowers shareholders to "shape their own economic (and political) destinies."[8] In sum, she argues, the focus of analysis has shifted from corporate power in society to internal corporate hierarchies to the market.[9]

Although I have a different view of the Progressives' approach, I otherwise agree with Tsuk Mitchell's insightful intellectual history. In this Comment, I would like to expand upon the normative implications of her account. After the Progressive Era, as Tsuk Mitchell argues, the corporate problem was redefined as corporate hierarchy rather than corporate power.[10] The focus on this problem, and the ostensible solutions to it, played an important role in legitimating corporate power by portraying it as the result of a "democratic" process. Today, the neoclassical economic model assumes that all outcomes are the voluntary result of market mechanisms. I agree with Tsuk Mitchell's conclusion that the law has come to see the market as "democracy's sustaining and legitimating force."[11] Most corporate law academics, however, have been relatively frank about their narrow focus on "efficiency" and their lack of interest in "democracy" as a normative value. To the extent that the nonacademic discourse about corporations remains interested in democracy, academics' efficiency-minded analyses of corporate governance have limited relevance. Policymakers and corporate reformers must resist the temptation to conflate "democracy" with either that old favorite, shareholder power, or the current academic darling, the market.

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6. *See id.* at 5 ("Progressives were concerned about potential abuses of corporate power and how the rapid separation of ownership from control augmented these potential abuses.").

7. *See id.* at 6 ("[C]oncerns about corporate power in society . . . were replaced by concerns about the relationship between management and individual shareholders.").

8. *Id.*

9. *See id.* at 39 (noting the change in the analysis over time).

10. *See* Tsuk Mitchell, Symposium Draft Version, *supra* note 5, at 31–33 (contrasting the theories of Douglas with those of Ripley and Berle).

11. *Id.* at 55.

In the late 1800s and early 1900s, the "corporations problem" was the emerging potential of large businesses to affect social conditions such as prices and wages, primarily through the formation of trusts. Tsuk Mitchell argues that the Progressives sought to enlist shareholders to restrain management and controlling shareholders from using corporate power in this way.[12] According to Tsuk Mitchell, the Progressives "assumed that by imposing mandatory disclosure rules on corporations . . . they would protect not only the market *but also the shareholders* as a group from the threat of monopoly . . . ."[13]

This is my only point of descriptive disagreement with Professor Tsuk Mitchell. I do not believe that "disclosure" in the Progressive era was intended to empower shareholders to exercise participatory powers of voting or selling, whether for their own protection or for the benefit of society. In fact, the Progressives seem to have viewed shareholders as part of the problem of excessive corporate power, not the solution. While information asymmetries and power conflicts within the firm were acknowledged, of course, they were not the central theoretical or policy concern at that time.[14] Progressives wanted disclosure because they believed it would create accountability, not to shareholders, but to "the public." That is, the information was for consumption *outside* the firm, not within it. It was intended to inform regulators, deter legal violations, and warn would-be public investors of bad investments. Rather than the "management vs. shareholder" trope we are familiar with today, the fundamental dichotomy of the day was "corporation vs. society." "Corporation" included management as well as financiers and shareholders, and "society" included the government, consumers and the relatively new phenomenon of the middle-class individual who was considering investing his money in securities.[15]

12. *See id.* at 5 ("[T]he 1920s reformers emphasized the role that minority shareholders as a group could play in preventing the control group from dominating the corporate decision-making process.")

13. *Id.* at 10 (emphasis added).

14. It is true that *Dodge v. Ford*, for example, recognized internal power conflicts when it famously opined that management's duty is to the shareholder. Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919). But *Dodge*'s real import is its statement of business-judgment-rule deference: The strong presumption that fiduciary principles and management expertise align management actions with shareholder interests. *Id.* at 681–82. That is, upon recognizing the hierarchy issue, the court resolved it by assuming it away.

15. Contemporary economic theory sees little difference between the two. But, as will be argued, the Progressives focused specifically on the investor as "outside" the corporation. While purist adherents of the "nexus of contracts" model of the firm may argue that the firm has no "outside" or "inside," that theory was not available until the 1970s. *See* William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 407–10 (1989) (discussing the history of the "nexus of contracts" theory).

The primary examples of "mandatory disclosure" Tsuk Mitchell cites are the Bureau of Corporations, established by President Theodore Roosevelt to gather information on trust activity,[16] and Louis Brandeis's argument for increased disclosures in *Other People's Money*.[17] Modern disclosure philosophy aims to enable individuals to express their preferences (whatever they may be) through market mechanisms. The stated purpose of "disclosure" under the Bureau of Corporations scheme, however, was to further a specific, government-determined macroeconomic policy: curtailing anticompetitive activity. As Robert Rabin has argued, Roosevelt believed in active federal regulation of big business for the benefit of society, which necessitated "*governmental* monitoring of large-scale enterprise . . . ."[18] According to Rabin, "[t]he embodiment of Roosevelt's regulatory philosophy was the Bureau of Corporations, established in 1903 for the purpose of collecting industrial data and investigating corporate trade practices *as a deterrent against illicit corporate activities*."[19] That is, the Bureau required a corporation's "disclosure" not to empower or protect that corporation's shareholders, but to discourage the corporation from anticompetitive activity—activity that could have enriched its shareholders. It was *society* (broadly defined), not shareholders, that needed protection from corporations and their actions.

In *Other People's Money*, Brandeis's notion of "disclosure" explicitly meant providing information to investors.[20] But Brandeis's view of investors in the market *vis à vis* corporate issuers was like Theodore Roosevelt's view of the public *vis à vis* trusts: as consumers in danger of exploitation by corporations. His concern was the collusion of issuers and investment banks in selling overvalued stock to the public.[21] Thus, Brandeis wanted investment banks to disclose their underwriting profits. He argued that if prospective investors knew the extent to which the offering price was inflated by the underwriters'

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16. *See infra* note 23 and accompanying text (describing the purpose and function of the Bureau of Corporations).

17. *See* LOUIS BRANDEIS, OTHER PEOPLE'S MONEY: AND HOW THE BANKERS USE IT 62–73 (Richard M. Abrams ed., Harper Torchbooks 1967) (1914) (positing increased publicity as a remedy to corporate malfeasance).

18. Robert L. Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189, 1218 (1986) (emphasis added).

19. *Id.* at 1219 (emphasis added).

20. *See* BRANDEIS, *supra* note 17, at 69–73 (arguing for disclosure as a solution to corporate problems).

21. *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 41–42 (3d ed. 2003) ("Brandeis . . . viewed the need to reform securities sales procedures primarily as stemming from the self-interest of investment bankers.").

markup, they could make better investment decisions.[22] As with the Bureau of Corporations, the proposed method did not involve *shareholder* empowerment. Indeed, as with the Bureau, corporate disclosure would give the power of information to nonshareholders, potentially at the expense of the corporation and its shareholders: Brandeis noted with approval that when British investors believed underwriting markups had gotten out of hand, they engaged in a "capital strike" and refused to purchase new corporate bonds.[23]

As Tsuk Mitchell observes, the "corporations problem" was conceived differently by the 1930s.[24] Theorists and policymakers began a formal analytical dissection of the corporation as an institution.[25] Corporate theory was, and remains, profoundly affected by this "disaggregation" approach. The immediate question was no longer the role of the corporation as a component of society, but the roles of shareholders and management as components of the corporation. In the decades that followed, reforms of corporate hierarchy tinkered with the balance between shareholder participation and managerial prerogative.

How did the new understanding of the disaggregated, conflicted corporation affect the old question of corporate power? The "corporate hierarchy" issue soon came to overshadow the larger "corporate power" issue. In the Progressive era, the government had been the regulator of corporations. Thus the fundamental American notions of a democratically legitimate government played a key role in legitimating the role of corporations in society. But even as giant corporations amassed more state-like powers, the government backed further and further away from attempting to control them. Although the New Deal is often caricatured as statist, it is probably better understood as embodying "corporate liberalism": cooperation among government, business, and other institutions as constitutive units of liberal society.[26] The Securities

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22. *See* BRANDEIS, *supra* note 17, at 69–73 (arguing for disclosure as a solution to corporate problems).

23. *Id.* at 68–69.

24. For an analysis of changing views of corporations during the 1930s, see Tsuk Mitchell, Symposium Draft Version, *supra* note 5, at 25–34.

25. *See, e.g.*, BERLE & MEANS, *supra* note 1, at 4 (describing the "separation of ownership and control").

26. Ellis W. Hawley, *The Discovery and Study of a "Corporate Liberalism,"* 52 BUS. HIST. REV. 309, 311–14 (1978). While elements of corporate liberalism survive, Tsuk Mitchell has elsewhere convincingly argued that due to libertarian ideological developments and the failure of the National Recovery Administration (NRA), corporate liberalism gave way to today's even more individualistic view of corporations and their shareholders. Dalia Tsuk, *From Pluralism to Individualism: Berle and Means and 20th Century American Legal Thought*, 30 LAW & SOC. INQUIRY 179, 189–94 (2005).

Exchange Act, for example, recognized the stock exchanges as "self-regulatory organizations" collaborating with the SEC to make economic policy.[27]

This shift from an adversarial to a cooperative relationship with corporations likely resulted not just from the political muscle of business, but also from deeper anti-totalitarian and anti-communist ideological concerns. But as corporations became more self-regulating, the legitimacy of government could no longer suffice to explain the legitimacy of the corporate role. Corporations themselves needed legitimation. Berle and Means had robbed libertarian property theory of some of its ability to justify corporate power: They argued that corporations were not controlled by their "owners" and were thus fundamentally different from private property.[28] Moreover, a justification of corporate power based solely on private-property grounds might sound uncomfortably like an apology for plutocracy—a potential liability for capitalism as global ideological battles heated up. The Cold War also limited the appeal of a technocratic explanation (i.e., the business acumen of professional managers), as its inherent elitism failed to distinguish capitalism from totalitarianism.[29] Corporate power, then, came to require not merely a justification, but a *democratic* justification.

The SEC rule requiring corporations to include shareholder proposals in proxy solicitations, now known as Rule 14a-8, symbolically addresses this need. Tsuk Mitchell is ambivalent, and rightly so, about the rule's actual value in empowering shareholders.[30] But her dramatic telling of the contraction of the Rule's scope implicitly overstates the original Rule's impact on shareholder participation. Since 1943, the Rule has applied only to proposals that involve "a proper subject for action by the security holders."[31] As Tsuk Mitchell notes, the SEC has vacillated as to whether this includes proposals relating to "'political, racial, religious, social or similar causes.'"[32] But whatever the

27. Securities Exchange Act of 1934, 15 U.S.C. §78(c) (2000).

28. BERLE & MEANS, *supra* note 1, at 69–118.

29. *Cf.* Tsuk, *supra* note 26, at 182 ("[I]ncreasing apprehension about the politically contagious European totalitarianism turned scholarly attention to individual rights.").

30. *See* Tsuk Mitchell, Symposium Draft Version, *supra* note 5, at 48 ("[T]he SEC amended the rule 14A-8 to open the door, albeit not widely, for social purpose shareholder proposals.").

31. SEC Rule X-14-A-7, Duty of Management to Set Forth Stockholder's Proposals, Securities Act Release No. 2887, Exchange Act Release No. 3347, Investment Company Act Release No. 417, 1942 WL 34864 (Dec. 18, 1942). The SEC had required corporations to include shareholder proposals on the proxy since 1938, but the "proper subject" limitation did not go into effect until 1943. David C. Bayne, *The Basic Rationale of* Proper Subject, 34 U. DET. MERCY L. REV. 575, 590–92 (1957). The current version of the Rule is SEC Rule 14a-8(i)(1), 17 C.F.R. § 240.14a-8(i)(1).

32. Tsuk Mitchell, Symposium Draft Version, *supra* note 5, at 48 (quoting Phillip A.

substantive content of proposals, the "proper subject" provision has long been limited primarily to *nonbinding* shareholder proposals, on the theory that state law does not empower shareholders to manage the corporation directly.[33]

Focusing on the Rule's failure to empower shareholders also understates the impact of 14a-8 on the *legitimation* of corporate conduct.[34] "Shareholder democracy" is "mythical" in two senses. First, it is a falsehood. Second, and more importantly, it is a comforting tale that, despite its falsity, appeals to our preexisting beliefs and ideologies to help us to rationalize the status quo.[35] Shareholder voting bears a superficial resemblance to political elections, the civic rituals that symbolize our political democracy. While the term "shareholder democracy" can be used narrowly to refer to this surface similarity, the usage cannot be severed from its deeper connotations. Furthermore, rhetorical emphasis on the importance of shareholder voting implicitly equates it with political voting. Thus the institution of shareholder voting and the rhetoric of "corporate democracy" or "shareholder democracy" feed upon all our beliefs about democracy as the legitimator of our political system.[36] These legitimating connotations were of course very potent during the Cold War Era, and have renewed resonance in post-9/11 America.

Nicholas, Jr., *The Securities and Exchange Commission and the Shareholder Proposal Rule: Agency, Administration, Corporate Influence, and Shareholder Power, 1942–1988*, at 67–81 (2002) (unpublished Ph.D. Dissertation, State University of New York at Albany) (on file with the Washington and Lee Law Review)).

33. LOUIS LOSS, 2 SECURITIES REGULATION 906–08 (2d ed. 1961). The current rule is followed by a "Note" advising shareholders that the SEC is more likely to approve proposals that are "cast as recommendations or requests that the board of directors take specified action." 17 C.F.R. 240.14a-8, Note to Paragraph (i)(1) (2006). Similar language has appeared in the rule since 1976. LOUIS LOSS & JOEL SELIGMAN, 4 SECURITIES REGULATION 2006 (3d ed. 1990). As Loss and Seligman observe, the extent to which state law prohibits binding shareholder proposals is not entirely clear. *Id.* at 2007–11. In any case, shareholder power to affect governance through proposals is limited, whether that limitation is imposed by state or federal law.

34. *Cf.* LOSS, 2 SECURITIES REGULATION, *supra* note 33, at 911 ("[O]ne should not underestimate [the rule's] symbolic significance in an area in which no alternative philosophy has yet been developed for the classic theory of managerial responsibility to the owners for the business.").

35. *Cf.* Donald Langevoort, *Rereading Cady Roberts*, 99 COLUM. L. REV. 1319, 1328–29 (1999) (arguing that insider trading regulation is legitimated by the myth that it increases investor confidence in the securities markets). This sense of "myth" is famously articulated in ROLAND BARTHES, *Myth Today*, *in* MYTHOLOGIES (Annette Lavers trans., 1972).

36. *Cf.* Thomas W. Joo, *Contract, Property, and the Role of Metaphor in Corporations Law*, 35 U.C. DAVIS L. REV. 779, 789–804 (2002) (arguing that the contract metaphor for corporations, although based on the economic idea of contracts as market transactions, also feeds upon the legal meaning of "contract" as an enforceable obligation). As for whether our beliefs about our political "democracy" are themselves myths, I leave that for another day.

The legitimating power of "shareholder democracy" is undeserved. Adjustments in the balance of power between shareholders and management seek to bring corporate governance into conformity with its own professed aspirations about governance. But those aspirations are hardly "democratic." Our political "democracy" purports to be "government of the people, by the people, for the people,"[37] and gains legitimacy from that description. Of course significant debate exists over the precise meaning of "democracy"—for example, whether it requires only procedural equality of opportunity to participate or some degree of substantive equality of outcome as well. The vague and contested nature of the term underscores the fact that the term "democracy" in the corporate context is more useful as a legitimating myth than as an illuminating description.

But whatever the precise meaning of the term, "shareholder democracy" aspires only to corporate decisionmaking by shareholders and not to the control of society by its people. This narrow aspiration is clear from its internal allocation of control rights and, moreover, from its external denial of control rights. As Colleen Dunlavy's contribution to this Symposium points out, modern shareholder voting is allocated on the basis of shares owned.[38] Corporate governance in the age of the public corporation does not even *aspire* to the democratic ideal of "one person, one vote." The highest aspiration of contemporary reform is "one share, one vote." At best, this only *metaphorically* resembles "one person, one vote," under a metaphor that substitutes a share—an economic commodity—for a person. As Dunlavy points out, one-vote-per-*shareholder* voting regimes once were common in the United States.[39] While the one-vote-per-share principle is property-based, or, to use Dunlavy's term, "plutocratic," a per-capita voting allocation would not necessarily transform corporate governance into a democratic institution. Because shareholder voting power is limited in scope and weak in practice, reallocating votes on a per-capita basis would not by itself give shareholders as individuals control over corporations.

Moreover, the one-vote-per-share principle is "plutocratic" not only because of *how* it allocates (limited) participation rights among shareholders but because it allocates participation rights *only* among shareholders. Shareholder voting, whether allocated per share or per capita, disenfranchises those who do not own shares, particularly those who lack the money to invest.

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37. President Abraham Lincoln, The Gettysburg Address (Nov. 19, 1863).

38. Colleen A. Dunlavy, *Social Conceptions of the Corporation Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1347, 1348–49 (2007).

39. *Id.* at 1354–55.

Thus shareholder control gives shareholders power to make decisions that affect the corporation's nonshareholder constituents (workers, consumers, society broadly) while denying those constituents *any* participatory role.[40] Since shareholders have financial interests in the corporation that the other constituents do not, shareholders have incentive to use their voting power to enrich themselves at the expense of other constituents.

Tsuk Mitchell retells the dramatic story of James Peck, co-founder of the Congress of Racial Equality.[41] As a shareholder of Greyhound Corporation, Peck attempted to use the federal shareholder proposal rule to advance a resolution against segregated bus seating. The SEC advised Greyhound in 1951 that it need not allow shareholders to use the proposal rule for "political" issues and codified this position in a 1952 amendment to the rule. Tsuk Mitchell criticizes the SEC for choosing management over shareholders in this internal dispute and, moreover, for framing the Greyhound issue as one of corporate hierarchy instead of corporate power. "The alternative of focusing on corporate power," she argues, "would have required Greyhound to include Peck's proposal in its proxy solicitation."[42] But requiring Greyhound to include the proposal would have expressed no position as to whether segregation was an abuse of corporate power. Such a requirement would have merely regulated the procedure by which the shareholders and management determined whether African Americans deserved an equal place in society. Would "democracy" have been satisfied, and corporate power addressed, if the desegregation proposal had gone before the shareholders and they had voted it down? The real "undemocratic" problem with the Greyhound affair was hardly the privileging of management over shareholders; it was the privileging of corporate self-governance over black civil rights.[43] This was a problem that could not be solved, or even addressed, by empowering shareholders, a class that was (and is) primarily wealthy and white.

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40. Consider past versions of "democracy" that we now see as having been inadequate: "one man, one vote;" one propertied free white man, one vote; one *white person* one vote. Referring to one-vote-per-share as "democracy" evidences a similar failure of imagination and lack of respect for the individual.

41. Tsuk Mitchell, Symposium Draft Version, *supra* note 5, at 40.

42. *Id.*

43. Actually ordering the desegregation of buses would, of course, have been beyond the power of the SEC but not beyond the power of Congress (although that was admittedly a contentious issue at the time). The SEC's limited mandate suggests that its authority only touches a corporation's hierarchy and can do *nothing* significant about a corporation's power. In any event, the question is whether the government's response to Greyhound's segregation would address power or merely hierarchy, not whether it would have been within the government's constitutional power at the time.

My purpose here is not to quarrel with Tsuk Mitchell, who herself has argued elsewhere that shareholder-centrism allows corporate power to grow without social accountability.[44] The point, rather, is to underscore the misleading nature of "democracy" rhetoric in the corporate governance context. Both the internal allocation of votes and the external denial of votes grant status based on wealth, not personhood. The cognitive failure lies in thinking of the corporation as a miniature polity, of which only shareholders are members with the moral right to vote. But "democracy" is not satisfied by parochial self-determination of institutions that affect society if they are free from democratic accountability to society.

I am not advocating the nationalization of industry. My point is that the uncritical equation of shareholder voting with "democracy" ignores the obvious and fundamental tension between communitarian and libertarian values in a capitalist democracy. Shareholder control has plenty of reasonable justifications, such as categorical property rights theories, or consequentialist theories about incentivizing the efficient generation of wealth. Appealing as these values may be though, they are *not* necessarily the same as "democracy." It is often argued that private property rights and free markets are prerequisites to democracy. But property and markets are normative values distinct from democracy. Even if these values are prerequisites, it is far from settled how far they reach and how inviolable they should be. In short, the "democratic" legitimacy of corporate governance does not follow directly from shareholder voting rights, however extensive. Such a conclusion depends upon contested assumptions about the nature of democracy and its relationship to property rights and markets.

As the Greyhound example shows, the inward and proceduralist focus of corporate governance threatened to obscure the issue of corporate power. The neoclassical economic theory of the firm, also known as the "contractarian," or "nexus of contracts," model, took corporate disaggregation to its extreme, turning it back upon itself to reunify the hierarchy and power inquiries. While Progressivism and corporate liberalism had relied on elitist technocrats to coordinate activity for the maximization of welfare, Neoclassicism relied upon the "natural" force of the Market. Under this view, it is not management's superior skill, knowledge or honor that binds it to shareholders. Rather, it is the naked self-interest of management that forces it to serve the naked self-interest of shareholders. These anti-elitist views accorded nicely with the loss of faith in government and democratic institutions in post-Watergate, post-Vietnam America. Technocratic centralization has been replaced by the neoclassical

44. For this argument, see Tsuk, *supra* note 26, at 184–85.

belief that social welfare is best optimized by maximizing aggregate individual utility, as measured by idiosyncratic individual preferences that are "exogenous" and immune to normative analysis.

Thus, as Tsuk Mitchell argues, corporate governance has come to focus on "freeing" shareholders to engage in self-determination.[45] A nice irony is that under this model, as in the Progressive conception, the shareholder and the corporation are once again teamed up against the state. Social welfare, however, no longer depends upon the state taming the corporation and its greedy shareholders, but on the corporation and its shareholders taming the smothering state.

The neoclassical approach adopts a totalizing marketism: Corporations and other institutions are not distinct from the market; they are nothing but rhetorical shorthand for sets of market transactions. This addresses the "externality" problem discussed above, for if there is no firm, no one is outside the firm. Everyone is "inside" the market: Control rights are allocated among all potential claimants by market principles. The participatory rights of shareholders reflect their bargained-for balance between power and low share prices. The limited participatory rights of workers reflect their tradeoff between power and high wages and benefits. Nonshareholder constituencies have chosen not to become participatory shareholders and, further, have failed in the political marketplace to obtain government regulation. Furthermore, marketism holds that self-interested bargains among individuals result by definition in the optimal allocation of resources across society. Thus the neoclassical model unifies the hierarchy and power inquiries: The allocation of corporate control rights, by its very nature as a market outcome, maximizes social welfare.

On the one hand, this model may appear to answer the "antidemocratic" accusations raised above. To the extent that managers enjoy control, they have not seized it. Corporate constituents (and not just shareholders) have bargained it away. But even assuming for the moment that market transactions are not coercive and that they are equally—or more—economically efficient than participatory, deliberative decisionmaking,[46] that does not make a transaction-based regime "democratic." Vote-selling, for example, is generally considered counter to democratic values. Some political values may be categorically immune to commodification. Moreover, even if the neoclassical model is correct in its predictions about economic efficiency, the outcome of market procedures is not necessarily the same as the outcome of a democratic process.

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45. Tsuk Mitchell, Symposium Draft Version, *supra* note 5, at 33, 55.

46. For this assumption, see *id.*, at 46, quoting Henry G. Manne, *Some Theoretical Aspects of Shareholder Voting*, 64 COLUM. L. REV. 1427, 1444 (1964).

That is, deliberation and participation may change opinions and yield different results than commodification and market transactions would. Finally, by defining market outcomes as fair outcomes, the neoclassical model conflates "liberty" (that is, economic deregulation) with "democracy." That conflation allows it to avoid the fundamental question of whether "democracy" requires some measure of substantive equality in addition to procedural equality.

Now of course, none of the foregoing critique by itself establishes that the corporate governance regime is "illegitimate." Most corporate law academics of the law-and-economics stripe (that is, most corporate law academics) do not claim that corporate legitimacy rests on "democratic" values. They may debate whether control rights should vest in management or shareholders, but frankly commit to use the consequentialist yardstick of "efficiency," expressed in terms of high share prices, to evaluate corporate governance.[47] As noted above, however, corporate doctrine, as expounded by the courts, regularly invokes "democracy" as a legitimating myth. As Tsuk Mitchell notes, the Delaware Supreme Court has stated that shareholder voting is a special institution because it is crucial to legitimating the corporate governance system—*even if* it is merely an empty, "unimportant formalism."[48] This startlingly frank assessment seems to imply that the law must protect the safeguard of the legitimacy of management power over shareholders (and by extension management's choices about the use of corporate power in society) by whatever means necessary, including manipulating the legitimating power of "democratic" myths.

I beg to differ. Corporate legitimacy may be based on many alternative foundations, and public discourse should be more frank and explicit about what those bases are. If shareholder voting, proposals, and other trappings of "shareholder democracy" amount to nothing but "unimportant formalism," eliminating them makes more sense than continuing to exploit their legitimating power. Director elections and shareholder proposals only rarely enable

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47. For example, Lucian Bebchuk and Stephen Bainbridge disagree over whether increased shareholder power will increase firm value but agree that firm value is the relevant metric. *Compare* Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005), *with* Stephen A. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006). Bainbridge subscribes to Kenneth Arrow's view that large businesses cannot be run efficiently without centralized "authoritative control." *Id.* at 1749. Bebchuk argues that shareholder power will make corporations more efficient at wealth creation. Bebchuk, *supra*, at 842 ("I do not view increasing shareholder power as an end in and of itself.").

48. *See* Tsuk Mitchell, Symposium Draft Version, *supra* note 5, at 55 (noting how this formalism serves a legitimating purpose) (quoting Blasius Indust., Inc. v. Atlas Corp., 564 A.2d 651, 659 (1988)).

shareholders to affect corporate policy. Their far greater significance lies in the false "democratic" aura they give to all exercises of "corporate" power—a power that is in fact almost always wielded unilaterally by management. Eliminating nominally "participatory" rituals would squelch the confounding myth of corporate democracy and show that modern corporate power, if it is legitimate at all, must legitimate itself on the basis of its social utility. The discourse about the extent of corporate regulation could then explicitly weigh the material benefits (and costs) of the modern corporation against categorical "democratic" values like accountability and public participation. A frank focus on efficiency justifications might also facilitate a more serious critical assessment of Neoclassicism's often unquestioned claims about corporate efficiency.[49]

I doubt my immodest proposal will get very far. Like the courts, many nonacademic shareholder activists wave the flag of "corporate democracy." But they should be aware that, in exchange for incremental control rights, they are indirectly participating in the mythmaking that legitimates both corporate hierarchy and corporate power. At the very least, courts and reformers should be wary of the careless application—and deliberate manipulation—of the forms and terminology of "corporate democracy" and "shareholder democracy."

49. The neoclassical market model, like "corporate democracy," can itself be seen as a myth that legitimates corporate hierarchy and power. Patrick J. Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy*, 23 GA. L. REV. 97, 104–05 (1988–89).