Power and Purpose in the "Anglo-American" Corporation

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Article

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INTRODUCTION

Public corporations in the United States and the United Kingdom are—from the global perspective—so very similar that it has become a commonplace in the comparative corporate literature to treat them as if they were practically identical. Notably, large American and British corporations tend to finance their operations through public offerings of stock on well-developed capital markets to dispersed, passive investors, none of whom possess substantial voting power. By contrast, large corporations throughout the rest of the world tend to be financed and dominated by controlling families, banks, corporate groups, or governments.[1]

1. *See, e.g.*, Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999); *see also* John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1751 (2007); Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 133 (1999); Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L L.J. 129, 154 (2009); Geoffrey Miller, *Some Points of Contrast Between the United States and England*, 1998 COLUM. BUS. L. REV. 51, 51 (1998); Brian R. Cheffins, Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation in the United Kingdom 9–11 (Revised draft of a paper presented at the 1999 Tilburg Conference on Convergence and Diversity in Corporate Governance Regimes and Capital Markets, Feb. 2000), *available at* http://papers.ssrn.com/paper.taf?abstract_id=218655.

Measuring ownership concentration has presented a significant empirical challenge, and by various measures other countries appear to exhibit similar levels of dispersal, but there are sound reasons to treat the United States and the United Kingdom as the quintessential dispersed ownership systems. Peter Gourevitch and James Shinn, for example, find similarly low levels of control over listed companies (defined as twenty percent share ownership) in Japan, China, and the Netherlands. *See* PETER ALEXIS GOUREVITCH & JAMES J. SHINN, POLITICAL POWER AND CORPORATE CONTROL: THE NEW GLOBAL POLITICS OF CORPORATE GOVERNANCE 17–18 (2005). As they observe, however, de facto control is considerably more centralized in these countries due to the *keiretsu* system of cross-shareholding in Japan, substantial government control in China, and the separation of control from cash-flow rights in the Netherlands through the

Moreover, while corporate governance systems in other countries often aim explicitly to balance the competing claims of various "stakeholders" in the corporate enterprise, the U.S. and U.K. corporate governance systems tend to place greater emphasis on generating investment returns for public shareholders, leaving other stakeholders—such as employees and creditors—to bargain contractually for what they can. These traits reflect a shareholder-centric and market-oriented approach to corporate governance that may be fairly described as uniquely "Anglo-American."[2]

In their corporate governance systems,[3] financial structures, and business cultures more generally, the United States and the United Kingdom "arguably have more in common than any other pair of developed economies."[4] Striking as these broad similarities may appear, however, they tend to divert attention from the substantial differences between the U.S. and U.K. corporate governance systems—differences of great practical and theoretical significance. Though described in some detail below,[5] the fundamental point of divergence can be simply stated: Shareholders in the United Kingdom are, in fact, far more powerful, and far more central to the aims of the corporation than are

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placement of stock in "trust offices" rather than with investors directly. *Id.* at 18, 183.

2. *See* Cheffins, *supra* note 1, at 12–13; *see also* Peter A. Hall & David Soskice, *An Introduction to Varieties of Capitalism*, *in* VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 1, 8–10, 19 (Peter A. Hall & David Soskice eds., 2001).

3. Throughout the Article, I refer to "corporate governance systems" to emphasize that decision-making within a corporation is not solely a matter of corporate law (or company law, as it is called in the United Kingdom). Although definitions vary enormously (see, for example, GOUREVITCH & SHINN, *supra* note 1, at 1, 293–95), I use the term to describe the rules governing decision-making within the corporation, whether they reside in corporate law or elsewhere.

4. Armour & Skeel, *supra* note 1, at 1751; *see also* Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997, 2001 (1994); Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459, 460 (2001).

Some scholars have argued that the structure of common-law legal systems, as in the United States and the United Kingdom, plays a decisive role in the emergence of shareholder-centric corporate governance systems, as well as in the growth of capital markets that are characterized by dispersed shareholders. *See, e.g.*, La Porta et al., *supra* note 1; Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997). However, while the corporate governance systems of other countries with common-law legal traditions, such as Australia and Canada, do share certain commonalities with the corporate governance systems in the United States and the United Kingdom, these other common-law countries in fact differ markedly because ownership of their corporations tends to be dominated by blockholders. *See* BRIAN R. CHEFFINS, CORPORATE OWNERSHIP AND CONTROL: BRITISH BUSINESS TRANSFORMED 5–6 (2008); Cheffins, *supra* note 1, at 13.

5. *See infra* Part II.

shareholders in the United States. U.K. shareholders possess considerably greater corporate governance authority and capacity to discipline errant officers and directors. In addition, U.K. shareholders benefit from fiduciary duties and a conception of corporate purpose that focuses far more clearly on their interests than is the case in any U.S. state[6]—including Delaware, the jurisdiction of incorporation for most U.S. public corporations.[7] The practical consequence is that U.K. shareholders loom much larger in the boardroom than U.S. shareholders do.[8] Additionally, the theoretical consequences of this divergence are of equal or greater significance for those seeking to understand public corporations and the societal roles they play. As I will argue, the differing posture of shareholders in the United States and the United Kingdom suggests that public corporations in these countries do not, in fact, perform identical functions in their respective societies. Put differently, the purpose of the U.S. corporation and the purpose of the U.K. corporation are not, strictly speaking, the same.[9]

6. I have argued elsewhere that corporate governance in the United States in fact reflects an underlying ambivalence regarding the merits of shareholder power and the consistency of shareholders' interests and incentives with those of society at large. *See generally* Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law*, 59 ALA. L. REV. 1385 (2008).

7. The Delaware Division of Corporations boasts that over "850,000 business entities have their legal home in Delaware including more than 50% of all U.S. publicly-traded companies and 63% of the Fortune 500." Delaware Division of Corporations, Why Choose Delaware as Your Corporate Home?, http://corp.delaware.gov (last visited Feb. 26, 2010). *See also* WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 88–90 (2d ed. 2007). Under the internal-affairs doctrine, the state of incorporation governs a corporation's internal affairs. *See id.* at 87. Numerous attempts to shift incorporation to the federal level have failed, though federal securities laws have increasingly made incursions into the realm of corporate governance. *See generally* Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 LAW & CONTEMP. PROBS. 215 (1999).

8. Though beyond the scope of this Article, note that the U.K. bankruptcy system is likewise substantially more creditor-centric than the U.S. bankruptcy system. Thus, one might generalize that a greater focus on the residual claimant prevails in the United Kingdom than in the United States. *See* John Armour, Gerard Hertig & Hideki Kanda, *Transactions with Creditors*, *in* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 115, 149–50 (2d ed. 2009); La Porta et al., *Law and Finance*, *supra* note 4, at 1135–38; Marco Pagano & Paolo Volpin, *The Political Economy of Finance*, 17 OXFORD REV. ECON. POL'Y 502, 514–15 (2001); *see also* David Millon, *The Single Constituency Argument in the Economic Analysis of Business Law*, 24 RES. L. & ECON. 43, 47–49 (2009). On the relationship between bankruptcy law and corporate governance—and the effects that debt financing can have on corporate governance more generally—see John Armour, Brian R. Cheffins & David A. Skeel, Jr., *Corporate Ownership Structure and the Evolution of Bankruptcy Law: Lessons from the United Kingdom*, 55 VAND. L. REV. 1699 (2002) [hereinafter Armour et al., *Corporate Ownership Structure*]; David A. Skeel, Jr., *Corporate Anatomy Lessons*, 113 YALE L.J. 1519, 1550–62 (2004).

9. *See infra* Parts III–IV.

That the United States and the United Kingdom would diverge on such a fundamental matter as the purpose of the corporation is surprising enough in light of the legal, financial, and cultural similarities between the two countries. But it is even more striking that, between the two, the United Kingdom would exhibit the more shareholder-centric corporate governance system, given the countries' relative political leanings. To the degree that the two countries differ in political orientation, the United Kingdom is typically thought to be the more left-leaning. For example, a poll conducted by the *Economist* in 2008 that assessed "Anglo-Saxon attitudes" regarding "a number of social, political and economic matters" concluded that Americans and Britons "may have less in common than they think"—and specifically that "Britons tend to have more left-wing views than Americans."[10] Yet shareholder-centrism, as a normative position, is typically associated with the economic right.[11] Given these facts, one might reasonably have predicted that any divergence between the United States and the United Kingdom would reveal a greater degree of shareholder-centrism in U.S. corporate governance, but that is emphatically not the case.

Unraveling why the United States and the United Kingdom differ in this fundamental way should be of great intrinsic interest to scholars of comparative corporate governance, but, as this Article aims to demonstrate, this inquiry is not merely a philosophical exercise. Ultimately, the comparative perspective on these corporate governance systems indicates that the larger social and political goals that these countries pursue through the institution of the public corporation are not co-extensive. I argue that the U.S. and U.K. corporate governance systems diverge because of the different ways in which they relate to external

10. *Anglo-Saxon Attitudes*, ECONOMIST, Mar. 29, 2008, at 71. For purposes of the poll, "'left' implies a big-state, secular, socially liberal, internationalist and green outlook; right, the reverse." *Id.*

11. *See, e.g.*, David Millon, *Default Rules, Wealth Distribution, and Corporate Law Reform: Employment at Will Versus Job Security*, 146 U. PA. L. REV. 975, 976–77 (1998). Millon explains that "[s]cholars who have expressed concern about the social costs of shareholder primacy have been labeled 'communitarians'"—a term associated with "progressive" politics. *Id.*; *see also* MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT 2–3 (2003).

Note that the "law and economics movement," which has strongly advocated shareholder wealth as the proper metric of corporate governance, "start[ed] in the United States and from there spread[] all over Europe." *See* Klaus J. Hopt, *Comparative Company Law*, *in* OXFORD HANDBOOK OF COMPARATIVE LAW 1161, 1184–86 (Mathias Reimann & Reinhard Zimmermann eds., 2006).

regulatory structures that affect relationships among stakeholders in the corporate enterprise.[12]

I begin with an examination of methodological challenges faced in comparative studies generally, and in comparative corporate governance in particular. I argue in Part I that much recent comparative corporate scholarship reflects a functionalist approach. By functionalism, I mean an analytic approach that assumes that corporate governance regimes have been crafted to manage identical, or at least very similar, sets of broadly defined problems. Chief among these problems is minimizing agency costs. In suggesting that corporate governance regimes differ mainly in their approaches to commonly defined problems, this formulation tends to obscure the very real differences in how these corporate governance systems function, and diverts attention from the possibility that differing degrees of shareholder orientation reflect more deep-seated differences in social views and market structures. Put differently, a clear examination of comparative methodology forces us to confront the possibility that differing corporate governance structures in fact represent differing institutional responses to political and social challenges. By the same token, however, the move away from functionalism raises an equal and opposite problem—excessive contextualism, introducing a degree of historical, cultural, and political contingency that threatens to render meaningful comparison impossible. Ultimately, I select the prevailing politics in each country as my explanatory variable, but I focus particularly on policies that affect social welfare protections available to non-shareholders—notably, employees. This approach, I believe, permits a more nuanced exploration of divergence and change over time in the U.S. and U.K. corporate governance systems than functionalist approaches can achieve, while avoiding the debilitating contingency of a broad contextualist approach.

Part II proceeds to provide an overview of significant differences between these systems. Whereas in the United States—and, notably, in Delaware—shareholders' capacity for autonomous action and ability to discipline boards and officers are relatively circumscribed, effectively leaving disgruntled shareholders with only limited *ex post* (and often expensive) means of redress, U.K. shareholders possess far greater capacity to intervene in management decision-making *ex ante*, and they possess virtually unfettered freedom to sell the firm to a hostile bidder.

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12. *Cf.* John Parkinson, *Corporate Governance: The Company Law Review and Questions of 'Scope*,' 8 HUME PAPERS ON PUB. POL'Y 29, 39–41 (2000) ("[C]ompany law is only one of a number of factors that influence the operation of the corporate economy.").

U.K. shareholders also benefit from directors' duties that focus far more intently on their interests.

I turn to potential explanations for this divergence in shareholder orientation in Part III. Although I acknowledge the importance of institutional differences that have been identified in the comparative corporate literature, and I broadly accept that the earlier rise to prominence of institutional investors in the United Kingdom was critical to the emergence of its shareholder-centric corporate governance system, I nevertheless argue that these factors cannot explain the political stability of this approach over the course of decades. A complete explanation of the divergence between U.S. and U.K. corporate governance requires addressing the range of regulatory structures that affect relationships among stakeholders within the corporation, as well as the political, social, and cultural factors affecting perceptions of shareholders' interests and incentives. These factors, I argue, are critical to understanding the political equilibrium struck in each country, of which the corporate governance system is just one part. Through such an examination of broader political forces, I develop the argument that stronger stakeholder-oriented social welfare policies and legal structures permitted the U.K. corporate governance system to focus more intently on the interests of shareholders without giving rise to political backlash and, conversely, that weaker stakeholder protections have inhibited the U.S. corporate governance system from doing the same. A particularly vivid example discussed in this Part is the impact of employee health care on takeover regulation, with the employer-based U.S. system arguably resulting in greater political pressure to account for employee interests in takeovers relative to the United Kingdom, where health care is not linked to employment status. In developing the broader political argument, I distinguish my approach from other political theories of corporate governance, which I argue fail to account for the divergences discussed here.

My view is that the political paradox of greater shareholder orientation in the more left-leaning country contains the key to its own resolution—so long as we understand corporate governance in relation to other institutions and regulatory structures through which relationships among corporate stakeholders are established and regulated. Notably, an important factor permitting the U.K. corporate governance system to evolve toward a high degree of shareholder-centrism—and to have this shareholder centrism represent a stable political equilibrium over time—was the fact that employees enjoyed social safety nets and employment protections substantial enough to diminish the perceived need to demand greater regard for their interests within corporate governance itself.[13] In the United States, on the other hand, the fact that extra-corporate protections have always been quite limited has resulted in the imposition of substantial political pressure on legislatures and courts to permit some regard for stakeholders' interests by corporate management (that is, the officers and directors), thereby inhibiting the emergence of a starkly shareholder-centric corporate governance system.[14]

This analysis, I argue, holds important implications for comparative corporate governance, as well as for domestic debates regarding the future of corporate governance in the United States. In Part IV, I argue that my analysis exposes substantial shortcomings in comparative theories predicting—and in some cases, advocating—convergence on a shareholder-centric model of corporate governance, to the degree that those theories fail to address the historical, cultural, and political factors that have conditioned the relative degree of shareholder-centrism observed in the United States and the United Kingdom. More broadly, I argue that my analysis casts doubt on the descriptive power of economically driven theories of corporate governance built on the portrayal of the corporation as a purely private endeavor—a depiction of relations among corporate stakeholders that, while popular among academics, bears only limited resemblance to observed reality.

I. FUNCTIONALISM AND CONTEXTUALISM IN COMPARATIVE CORPORATE GOVERNANCE

Much recent scholarship in the area of comparative corporate governance is underwritten by faith—often unexamined[15]—that juxtaposing

13. *See infra* Part III.B. Others, to be sure, have argued that the degree of shareholder-centrism in a given corporate governance system is intimately related to the degree of broader stakeholder protections. For example, Martin Gelter argues that the degree of "shareholder influence" under a given ownership structure affects the degree of employment protection in a given legal system. *See* Gelter, *supra* note 1, at 132–34; *see also* Marianna Belloc & Ugo Pagano, *Co-Evolution of Politics and Corporate Governance*, 29 INT'L REV. L. & ECON. 106 (2009). In contrast, I argue that extra-corporate stakeholder protections are a critical factor in the coalescence of a shareholder-centric corporate governance system. As I argue below, a dynamic process may be at work, with the corporate governance system and extra-corporate stakeholder protections evolving in response to one another. *See infra* Parts III–IV.

14. *See infra* Part III.C.

15. *See, e.g.*, Ralf Michaels, *The Functional Method of Comparative Law*, *in* OXFORD HANDBOOK OF COMPARATIVE LAW, *supra* note 11, at 339, 341; *see also* David S. Clark, *Developments of Comparative Law in the United States*, *in* OXFORD HANDBOOK OF COMPARATIVE LAW, *supra*, at 175, 210.

corporate governance systems from various countries and cataloguing apparent similarities and differences will generate useful information. The predominant methodological approach can be termed functionalist, in that regulatory systems are viewed as presenting a range of potential institutional solutions to universally encountered problems.[16] With respect to corporate governance in particular, the tendency toward functionalism has been reinforced over recent decades by the rise of the law and economics movement. Law and economics proponents tend to view the corporation as a purely private endeavor in which the fundamental legal problem is easily generalized and universalized—minimizing agency costs where one actor (for example, management) exercises control over resources belonging to others (in this case, shareholders' money).[17] "Modern economic theory," Klaus Hopt observes, "has developed the principal-agent problem as its basic question," and "company law reform initiatives in all industrialized countries have tried to address this problem."[18] Hopt attributes "a new and increased interest in comparative company law" directly to the law and economics approach, which purports to render corporate governance structures amenable to something resembling scientific investigation.[19]

The best known recent example, *The Anatomy of Corporate Law*—a book reflecting "collaboration among nine authors from six countries," including Hopt—describes itself as "predicated on the idea of a field of corporate—or company—law, with problems and legal strategies that, at a mid-level of abstraction at least, are independent of the laws of specific jurisdictions."[20] Methodologically, then, the book is "functional" in its focus on "the economic logic of corporate law."[21] From this perspective, the core and universal problem of corporate law is "reducing the scope for value-reducing forms of opportunism among different constituencies"—that is to say, agency costs, whether between managers and

16. *See, e.g.*, Michaels, *supra* note 15, at 342; Russell A. Miller, *Comparative Law and Germany's Militant Democracy*, *in* US NATIONAL SECURITY, INTELLIGENCE AND DEMOCRACY: FROM THE CHURCH COMMITTEE TO THE WAR ON TERROR 229, 236–37 (Russell A. Miller ed., 2008).

17. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 14–15 (1991). "Agency costs" arise from imperfect alignment of the agent's and the principal's incentives. *Id.* For an in-depth discussion of the concept, see Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). Conceptions of the corporation associated with the law and economics movement are discussed in greater detail in Part II.A.

18. Hopt, *supra* note 11, at 1166; *see also* Gelter, *supra* note 1, at 129–30.

19. Hopt, *supra* note 11, at 1172, 1184–86.

20. KRAAKMAN ET AL., *supra* note 8, at vii.

21. *Id.*

shareholders, among shareholders, or between shareholders and other stakeholders.[22] Others, such as Lucian Bebchuk, have implicitly adopted a functionalist approach in advocating shareholder-oriented reforms in the United States that are based at least in part on the model of the United Kingdom. Bebchuk points to the U.K. corporate governance system as evidence that "shareholders' lack of power to initiate major corporate decisions is not an inevitable element of the legal structure of the modern corporation."[23] Noting the predominance in both countries of widely held companies, Bebchuk argues that the United States should similarly embrace greater shareholder power.[24] It is assumed that U.S. corporate governance should adhere to the same metric of appropriate policy—the interests of shareholders—and regard for the interests of other stakeholders is dismissed as a ploy that is aimed solely at justifying entrenchment of the incumbent board and greater "management slack."[25]

In functionalist work of this sort, the purportedly common problem—minimizing agency costs—is effectively treated as the independent variable. Corporate governance, as the institutional response to that problem, is treated as the dependent variable.[26] *The Anatomy of Corporate Law*, to be sure, is explicitly descriptive rather than normative, taking no formal position on the convergence debate.[27] It should be observed, however, that even in advancing such descriptive claims, the functionalist approach to comparative law tends to be strongly suggestive of convergence. The purpose of the book, after all, is to emphasize "the underlying uniformity of the corporate form" throughout the world.[28] And

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22. John Armour, Henry Hansmann & Reinier Kraakman, *What is Corporate Law?*, *in* KRAAKMAN ET AL., *supra* note 8, at 1, 2; *see also* Skeel, *supra* note 8, at 1521, 1528–29 (observing Kraakman et al.'s "functional approach").

23. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 847–48 (2005)

24. *See id.* at 847–50.

25. *See id.* at 837, 908–13.

26. In general, the term "dependent variable" describes "the variable the investigator wants to account for or explain," while the term "independent variable" describes "the variable . . . that the investigator thinks may account for, or affect, the different values the dependent variable assumes." ROGER BAKEMAN & BYRON F. ROBINSON, UNDERSTANDING STATISTICS IN THE BEHAVIORAL SCIENCES 48 (2005) (emphasis removed). Bakeman and Robinson observe that while the terms have traditionally "been reserved for true experimental studies," today they are used more broadly to "indicate not necessarily experimental manipulation, but simply how investigators conceptualize relations among their variables." *Id.* at 48–49 (emphasis removed); *see also* GOUREVITCH & SHINN, *supra* note 1, at 15. Bakeman and Robinson warn, however, that broader usage of such terms "should not lull us into making stronger causal claims than our procedures justify." BAKEMAN & ROBINSON, *supra*, at 49.

27. *See* Armour, Hansmann & Kraakman, *supra* note 22, at 5, 29.

28. *Id.* at 1.

while the authors “do not believe that *every* aspect of corporate law is economically rational, still less that any particular corporate law is optimal,”[29] choosing a static causal variable naturally tends to facilitate emphasis of core commonalities in outcomes and requires the characterization of what variations do occur as deviations from some efficient or optimal solution to the common problem.[30]

It has been aptly said that “no model is better than its assumptions.”[31] The validity and utility of conclusions drawn from such comparative studies, then, will depend critically on accurate identification of a true common problem, and this determination is where functionalism encounters a substantial challenge. Critics of this approach to comparative law emphasize what they term the “functionalist fallacy”—the fact that the functionalist must assume the universality of a problem, regardless of context, in order to render regulatory institutions susceptible to straightforward cross-border comparison, to evaluate their optimality, to forecast or advocate convergence on a given type of institution, and so on.[32] Similarly, critics have highlighted the functionalists’ “faith” in the “mono-functionality” of regulatory institutions—the notion that we can identify some clear, singular function of a given type of regulatory structure, without reference to context.[33]

Strictly speaking, such strong criticisms are not fairly leveled at *The Anatomy of Corporate Law*, which acknowledges “the very real differences across jurisdictions” and advances the more modest claim that the commonalities are “at least as impressive.”[34] I broadly accept the core claim that business corporations the world over “have a fundamentally similar set of legal characteristics”[35] and that the similarities between

29. KRAAKMAN ET AL., *supra* note 8, at vii.

30. *See* Michaels, *supra* note 15, at 339, 342.

31. Helen Callaghan, *Outsiders and the Politics of Corporate Governance: How Ownership Shapes Party Positions in Britain, Germany and France*, 42 COMP. POL. STUD. 733, 757 (2009).

32. Günter Frankenberg, *Comparing Constitutions: Ideas, Ideals, and Ideology—Toward a Layered Narrative*, 4 INT’L J. CONST. L. 439, 444–45 (2006); *see also* Ruti Teitel, *Comparative Constitutional Law in a Global Age*, 117 HARV. L. REV. 2570, 2570–78 (2004) (reviewing COMPARATIVE CONSTITUTIONALISM: CASES AND MATERIALS (Norman Dorsen et al. eds., 2003)) (describing this problem in the context of comparative constitutional scholarship).

33. *See* Michaels, *supra* note 15, at 351; *see also* Caroline Bradley, *Transatlantic Misunderstandings: Corporate Law and Societies*, 53 U. MIAMI L. REV. 269, 275–76 (1999).

34. Armour, Hansmann & Kraakman, *supra* note 22, at 1.

35. *Id.* The authors describe the “core structural characteristics of the business corporation” as including “(1) legal personality, (2) limited liability, (3) transferable shares, (4) centralized management under a board structure, and (5) shared ownership by contributors of capital.” *Id.* at 5; *see also id.* at 5–16 (describing the core structural characteristics of the business corporation).

U.S. and U.K. public corporations are even more prominent.[36] Ultimately, however, while there is great value in identifying and exploring these commonalities,[37] this model provides only limited means of explaining divergences across countries and changes in corporate governance practices over time. Specifically, divergences that cannot be explained as functional equivalents, and changes that cannot be explained by reference to clear efficiency benefits, will ultimately prove explicable only by reference to history, culture, and politics.

A country's perceived needs and regulatory responses to them will inevitably be "interlinked," as Caroline Bradley puts it, with broader "social, economic, and political structures."[38] Indeed, virtually all legal rules derive meaning from their interrelationship with other rules in a given legal system, and "must be fully understood and embraced not only by law enforcers, but also by those using the law"—what Katharina Pistor calls the "living legal system."[39] Consequently, social needs and regulatory responses will inevitably be bound up with each other. As Ralf Michaels observes, society's needs are articulated in part by reference to preexisting regulatory structures within that society. Regulatory responses, in turn, will be understood by reference to how those needs have been articulated, and so on in a culturally contingent "hermeneutic circle" that would appear to foreclose the identification either of universal problems or of distinct, mono-functional regulatory solutions—the dual building blocks of the functionalists' methodological framework.[40]

The relevance of historical, cultural, and political context to comparative law is inescapable, and appeal to these factors will effectively reveal the outer boundary of the explanatory domain of any functionalist

36. *See supra* notes 1–4 and accompanying text. Others have fairly suggested that this heightened degree of similarity permits more nuanced evaluation of U.S. corporate governance. *See, e.g.*, Black & Coffee, *supra* note 4, at 2000–02; Cheffins, *supra* note 1, at 2–3.

37. As Katharina Pistor argues, for example, providing "access to information on how different legal systems create mechanisms of accountability for common problems"—including corporate directors' obligations—could "enable domestic agents to identify problems and find solutions that are adequate and potentially effective given the institutional constraints their country faces." Katharina Pistor, *The Standardization of Law and Its Effect on Developing Economies*, 50 AM. J. COMP. L. 97, 126–27 (2002); *see also* Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *Economic Development, Legality, and the Transplant Effect*, 47 EUR. ECON. REV. 165 (2003).

38. *See* Bradley, *supra* note 33, at 314; *see also* Allan Cochrane et al., *Comparing Welfare States*, *in* COMPARING WELFARE STATES 1, 7 (Allan Cochrane et al. eds., 2001); Miller, *supra* note 16, at 238.

39. *See* Pistor, *supra* note 37, at 98–99.

40. *See* Michaels, *supra* note 15, at 353–69; *see also* GOUREVITCH & SHINN, *supra* note 1, at 58; *cf.* Frankenberg, *supra* note 32, at 447–51 (examining a similar dynamic in the context of comparative constitutional law).

theory of corporate governance—a point ultimately conceded in *The Anatomy of Corporate Law*.[41] Yet, such considerations are themselves fraught with difficulties. "If the contextualists are right and context thwarts the borrowing that functionalism sought to promote," then, as Russell Miller observes, "comparative law runs the risk of being reduced to little more than socio-legal tourism."[42] Consequently, comparative theorists who are mindful of the twin challenge that functionalism and contextualism present have sought a way to manage the tension not by reconciling them, but by paying careful attention to the strength and defensibility of the claims advanced through comparative legal analysis. Miller, for example, adopts a "discursive" method focusing on the "social milieu" from which a given legal norm emerges, anticipating that such analysis "might enlighten, as a social critique, the understanding of one's own social milieu."[43] In a similar vein, Michaels advocates recognition of "similarity in difference," that is, "finding that institutions are similar in one regard (namely in one of the functions they fulfill) while they are (or at least may be) different in all other regards."[44] Accordingly, Michaels urges caution in advancing evaluative conclusions regarding the best or optimal law, notably because the multifunctionality of regulatory institutions in the real world "makes a comprehensive evaluation almost impossibly complex."[45] The comparativist does stand on more solid methodological ground, however, when evaluation is constrained to criteria internal to a given legal system. "Functionalist comparison can open up our eyes to alternative solutions," Michaels observes, "but it cannot tell us whether those alternative solutions are better or not."[46]

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41. *See* KRAAKMAN ET AL., *supra* note 8, at vii–viii; Paul Davies et al., *Beyond the Anatomy*, *in* KRAAKMAN ET AL., *supra* note 8, at 313. The second edition of the book focuses more intently on these issues, exploring the extent to which divergences across countries "can be understood as functional adaptations to differences in institutions . . . and how far they appear to be historical, cultural, or political artifacts driven by distributional rather than functional concerns." John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, *in* KRAAKMAN ET AL., *supra* note 8, at 35, 51.

42. Miller, *supra* note 16, at 243; *see also* Michaels, *supra* note 15, at 367–68.

43. Miller, *supra* note 16, at 243.

44. Michaels, *supra* note 15, at 371.

45. *See id.* at 375–77; *cf.* Sanford M. Jacoby, *Corporate Governance and Employees in the United States*, *in* CORPORATE GOVERNANCE AND LABOUR MANAGEMENT: AN INTERNATIONAL COMPARISON 33, 44–45 (Howard Gospel & Andrew Pendleton eds., 2005) ("[B]ecause governance institutions are complex, path-dependent, and embedded in complex social systems, haphazard borrowing does not guarantee an improvement in the borrower's economic performance.").

46. Michaels, *supra* note 15, at 379–80; *cf.* Clark, *supra* note 15, at 210 (describing comparative law as "a 'subversive' discipline" that "can promote cultural criticism, which allows us better to understand our basic assumptions about law").

Undoubtedly the conflicting impulses of functionalism and contextualism caution restraint in the conclusions drawn from comparative studies. At the same time, however, it is important to recognize the opportunity that this insight presents for a more nuanced understanding of regulatory structures and strategies in different countries—including in the realm of comparative corporate governance. In particular, relaxing the assumption that corporate governance systems in different countries respond to a single common problem forces us to address the possibility that regulatory divergences reflect not differing degrees of success by some universal objective metric, but rather differences in what each society expects corporate governance to achieve. Regulatory divergences may actually reflect variation in the social needs and problems that each society aims to address through the corporate governance system.

In the remainder of this Article, I will argue that this is, in fact, what a careful comparison of the U.S. and U.K. corporate governance systems reveals. To assert that the defining problem of corporate governance is the management of some form of agency cost is effectively to take the issue of corporate purpose off the table. A single constituency, often public shareholders, is declared to be the principal, at least economically, if not in the legal sense.[47] This move implicitly forecloses meaningful examination of corporate purpose, or how each country conceptualizes the aims and ultimate beneficiaries of the corporate enterprise.[48] While acknowledging broad structural similarities of the sort emphasized in functionalist comparative scholarship,[49] I reject any implicit assumption that issues of corporate purpose are treated identically, identifying divergence both as to power and purpose within U.S. and U.K. public corporations. Effectively, I take the broader prevailing politics in each country as my independent variable. These politics are a dynamic set of processes that permit a more nuanced exploration of why the divergence has occurred between these two countries and how corporate governance has changed over time within each of them.[50] To

47. *See* ALLEN ET AL., *supra* note 7, at 105 (observing that "corporate directors are not legal agents of the corporation" under U.S. law).

48. *Cf.* David Millon, *State Takeover Laws: A Rebirth of Corporation Law?*, 45 WASH. & LEE L. REV. 903, 903 (1988) (observing that "doctrinal preoccupation with accountability takes for granted an underlying principle," namely that a "corporation exists for the financial benefit of its shareholders").

49. *See, e.g.*, *supra* notes 34–36 and accompanying text.

50. *See* GOUREVITCH & SHINN, *supra* note 1, at 7–8 (observing that "constants" cannot serve as independent variables where the effort is to explain change); Pagano & Volpin, *supra* note 8, at 504, 517; Raghuram G. Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the Twentieth Century*, 69 J. FIN. ECON. 5, 7 (2003).

avoid the problem of excessive contingency, however, I focus on a specific set of political issues that I believe has particular explanatory power with respect to the development of corporate governance systems—the politics of the welfare state and related structures that impact social protections available to non-shareholders. In the final Part of the Article, I explore the implications of this mode of analysis for both comparative corporate governance and for reform-oriented debates concerning the U.S. corporate governance system.

II. SHAREHOLDERS AND CORPORATE GOVERNANCE IN THE UNITED STATES AND THE UNITED KINGDOM

Corporate governance systems in the United States and the United Kingdom clearly exhibit substantial similarities. As observed at the outset, public corporations in both countries tend to be widely held by dispersed, passive shareholders, none of whom possess voting control, and both countries' corporate governance systems tend to emphasize shareholder interests to a greater extent than one finds elsewhere.[51] Though undoubtedly accurate by global standards, this generalization falls far short of a full and accurate picture of how these systems evolved and how they function today. The two systems in fact differ quite substantially in their degree of shareholder orientation, a point of divergence that, I argue, gives rise to important practical and theoretical implications.

To facilitate this analysis, this Part provides an overview of corporate regulatory structures in each jurisdiction to illustrate the divergence. The aim is not to present a comprehensive catalogue of distinctions between the U.S. and U.K. corporate governance systems, but rather to focus on those particular regulatory structures (summarized in Figure 1 below) that most clearly reflect the divergence in terms of shareholder power and orientation toward shareholder interests.

A. The Ambivalence of U.S. Corporate Governance

Although a "staple narrative of comparative corporate governance" holds that "Anglo-Saxon systems . . . do not take stakeholder interests into account,"[52] this in fact represents a gross oversimplification of the U.S. corporate governance system. In prior work, I have discussed the "ambivalence" of U.S. corporate law "with respect to each of three fun-

51. *See supra* notes 1–4 and accompanying text.
52. Gelter, *supra* note 1, at 131.

damental and related issues: the locus of ultimate corporate governance authority, the intended beneficiaries of corporate production, and the relationship between corporate law and the achievement of the social good."[53] To facilitate the comparative discussion that follows, I briefly develop that argument here, focusing particularly on the shareholders—the constituency for which U.S. corporate law exhibits the deepest ambivalence.[54]

Contrary to the broad characterization of "Anglo-Saxon" systems as single-mindedly pro-shareholder, U.S. corporate law in fact sharply constrains the power of shareholders to undertake independent action. The Delaware General Corporation Law, which governs most U.S. public corporations,[55] establishes in section 141(a) the broad principle that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors."[56] Majority shareholders cannot directly compel the board to take any particular action,[57] and apparently cannot be given the power to do so.[58] In other words, "the corporation has a republican form of government, but it is not a direct democracy."[59]

To be sure, it is the shareholders who elect the board,[60] and the Delaware courts have taken a decidedly dim view of board actions primarily aimed at interfering with the effective exercise of the "shareholder franchise," which one Delaware jurist famously described as "the ideological underpinning upon which the legitimacy of directorial power rests."[61] This formulation obviously tends to characterize board power as derivative of a shareholder-granted mandate.[62] Yet, beyond the election of directors, the shareholders' scope of unilateral action is quite

53. Bruner, *supra* note 6, at 1386. I intend no pejorative connotation in using this term. Rather, I use it to describe a state of balancing "either or both of two contrary or parallel values, qualities, or meanings." 1 OXFORD ENGLISH DICTIONARY 388 (2d ed. 1989) (defining "ambivalent"). *Compare* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1096 (2002) (characterizing Delaware law as "ambivalent" on shareholder primacy), *with* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 261 (1993) (describing the modern U.S. corporation as "schizophrenic").

54. *See* Bruner, *supra* note 6, at 1427–32.

55. *See supra* note 7 and accompanying text.

56. DEL. CODE ANN. tit. 8, § 141(a) (2001).

57. *See* ALLEN ET AL., *supra* note 7, at 100–05.

58. *See* Bebchuk, *supra* note 23, at 888–90.

59. ALLEN ET AL., *supra* note 7, at 101.

60. DEL. CODE ANN. tit. 8, § 211(b) (2001).

61. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) (Allen, C.).

62. *See* Bruner, *supra* note 6, at 1395.

narrow. As a default matter, shareholders can remove directors "with or without cause." But, if the board is classified—meaning that it has been divided into classes elected in subsequent years (a common practice)[63]—then shareholders may remove directors without cause only if the charter expressly permits it.[64] The ability of Delaware shareholders to remove directors is further impeded by the fact that shareholders cannot call special meetings unless expressly given such power in the charter or bylaws.[65] Shareholders likewise cannot initiate a fundamental transaction[66] or a charter amendment.[67] Both of these actions require prior proposal by the board, effectively installing the board as a "gatekeeper"[68] and rendering any such endeavor at most a "shared enterprise," as the Delaware Supreme Court put it.[69] Indeed, the Delaware

63. *See* DALE A. OESTERLE, THE LAW OF MERGERS AND ACQUISITIONS 519 (3d ed. 2005) (reporting that almost sixty percent of large U.S. corporations in a 2004 survey reported having classified boards). Note, however, that Senator Charles Schumer's (D-N.Y.) "Shareholder Bill of Rights Act" would, among other things, require that exchange-listed companies hold annual board elections. *See* Shareholder Bill of Rights Act, S. 1074, 111th Cong. § 5 (2009) (adding a new § 14A to the Securities Exchange Act of 1934); *see also infra* note 364. Naturally, the proposal has been lauded by institutional shareholders and reviled by corporate management. *Compare* Press Release, Council of Institutional Investors, CII Applauds Introduction of Shareholder Bill (May 19, 2009) (on file with the Virginia Journal of International Law), *available at* http://tinyurl.com/yatdpg3, *and* Press Release, California Public Employees' Retirement System, CalPERS Backs Federal Legislation to Create Shareholder Bill of Rights (May 19, 2009) (on file with the Virginia Journal of International Law), *available at* http://tinyurl.com/ow4u4a, *with* Press Release, Business Roundtable, Business Roundtable Statement on Senator Schumer's Proposed Shareholder Bill of Rights Act (May 19, 2009) (on file with the Virginia Journal of International Law).

64. DEL. CODE ANN. tit. 8, § 141(d), 141(k)(i) (2001). For U.S. corporations, the charter (typically referred to as the "articles of incorporation" in corporate statutes) represents the core governance document, and contains a handful of mandatory items, such as the company's name and address, the nature and purpose of the business (generally phrased to embrace "all lawful acts and activities," as permitted by the statute), the authorized stock, and the incorporators. *See id.* § 102(a). The charter may also address various other topics, notably including a waiver of directors' monetary liability for breaches of the duty of care. *Id.* § 102(b)(7). The actual governance mechanics typically appear in the "bylaws," which must conform to the charter, but which can be unilaterally amended by the shareholders or—if the charter so permits—by the directors. *Id.* § 109. On the nature of the charter and the bylaws more generally, see ALLEN ET AL., *supra* note 7, at 91–93.

65. DEL. CODE ANN. tit. 8, § 211(d) (2001).

66. *Id.* §§ 251(c), 271(a) (requiring that the board propose mergers and sales of substantially all assets for shareholder approval).

67. *Id.* § 242(b) (requiring that the board propose amendments to the certificate of incorporation for shareholder approval).

68. *See* Thompson, *supra* note 7, at 217, 234.

69. *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 930 (Del. 2003). It should be noted that shareholders in corporations listed on the New York Stock Exchange have more expansive voting rights, including "in any transaction or series of related transactions" involving issuance of common stock equaling twenty percent or more of the previous outstanding shares or

statute does not even contemplate the possibility of giving shareholders such unilateral power (say, by express charter provision), suggesting that such a move would be invalid.[70] The authority for direct action that shareholders do possess, such as suing directly or derivatively to vindicate a breach of fiduciary duty,[71] tends to be quite limited and post hoc.[72] As Robert Thompson aptly put it, U.S. shareholders effectively have three modes of action: "They can vote, sell, or sue."[73]

Even this formulation, however, may overstate the powers of shareholders in the United States, because in the critical context of corporate takeovers, which are said to represent an important means of disciplining management,[74] target boards are afforded substantial latitude to interfere with the shareholders' freedom to sell their stock to a hostile bidder. In its 1985 *Unocal* opinion, the Supreme Court of Delaware purported to apply "enhanced" scrutiny to a target board's deployment of defensive tactics, requiring that the board earn the protections of the business judgment rule (a presumption that board decisions are informed and taken in good faith[75]) by showing "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that the defensive measure taken was "reasonable in relation to the threat posed."[76] Subsequent opinions applying *Unocal*, however, have revealed just how board-friendly the standard is. For example, in *Moran v. Household International, Inc.*, the court permitted preemptive adoption of a poison pill, concluding that the very existence of coercive ten-

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voting power, and for any "issuance that will result in a change of control." *See* NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL § 312.03(c)–(d) (2009), *available at* http://nysemanual.nyse.com/lcm.

70. *See* Bebchuk, *supra* note 23, at 889.

71. In a derivative suit, a shareholder seeks to advance a corporate claim. Because the decision regarding whether or not to advance a corporate claim is, in the first instance, the board's to make, a Delaware shareholder who seeks to advance a derivative claim must either make "demand" on the board (that is, for the board to advance the claim itself) or convince the court that doing so would be "futile" (say, because the claim is against the board). *See* Levine v. Smith, 591 A.2d 194 (Del. 1991), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

72. *See, e.g.*, Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 603 (2006).

73. Thompson, *supra* note 7, at 216; *see also* ROBERT CHARLES CLARK, CORPORATE LAW 93–105 (1986).

74. *See, e.g.*, Bainbridge, *supra* note 72, at 614.

75. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm*, 746 A.2d 244.

76. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954–55 (Del. 1985); *see also* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1377–87 (Del. 1995) (indicating that the second step of the *Unocal* test requires that the defensive measure be neither "preclusive" nor "coercive," and fall within a "range of reasonableness").

der offers in the marketplace was a sufficient threat and that the ability to dislodge the pill through a proxy contest—by first replacing the recalcitrant board—rendered it a proportionate response to that generalized threat.[77] Then, in *Paramount v. Time,* the court reasoned that section 141(a) and the business judgment rule placed "the selection of a time frame for achievement of corporate goals" in the board's discretion.[78] This permitted the Time board to refuse to negotiate with Paramount, a hostile bidder, and to conclude that its own plan for the company—involving $10 billion in new debt to finance a cash tender offer for Warner, its preferred strategic partner—offered better long-term benefits for Time's shareholders than the all-cash, all-shares, fifty-nine percent premium offer that Paramount had made for Time itself.[79]

In essence, this Delaware case law awkwardly phrases the rejection of shareholder power by reference to the shareholders' own interests. As Lyman Johnson observes, "the chief attraction of the long-run phantom is its marvelous ability to apparently harmonize management discretion with shareholder primacy while, in fact, sweeping the whole thing under the rug."[80] But Delaware's takeover case law goes further, tending to reject a shareholder-centric conception of corporate purpose as well. The Delaware Supreme Court did state in *Revlon v. MacAndrews & Forbes Holding, Inc.* that in some instances the board is required to focus single-mindedly on the shareholders' interests, but the duty to maximize short-term return to shareholders is narrowly limited to circumstances where a sale, break-up, or change of control of the company has become "inevitable."[81] Beyond such instances, *Unocal* itself explicitly permits the board to consider the effects of a hostile bid on "the corpo-

77. 500 A.2d 1346, 1350, 1354 (Del. 1985). A poison pill, or "shareholder rights plan," attaches rights to the company's common stock that, if triggered by an unauthorized bid for the company or accumulation of stock beyond a specified threshold (say, fifteen percent), would permit all shareholders except the hostile bidder to buy heavily discounted stock. The threat of substantial dilution provides a powerful deterrent against hostile takeover attempts. *See* ALLEN ET AL., *supra* note 7, at 536–39.

78. Paramount Commc'ns v. Time Inc., 571 A.2d 1140, 1154 (Del. 1990).

79. *See id.* at 1149–54.

80. Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 902 (1990); *cf.* Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 429 (2001) (describing the *Paramount v. Time* outcome as meaning that "a decision reducing the immediate market value of the Time shareholders' interests by thirty-five percent did not violate the directors' duties of loyalty or care").

81. Revlon, Inc. v. MacAndrews & Forbes Holding, Inc., 506 A.2d 173, 182 (Del. 1986); *see also* Paramount Commc'ns v. QVC Network Inc., 637 A.2d 34, 43–44 (Del. 1994) (addressing change of control cases).

rate enterprise" more broadly, including "the impact on 'constituencies' other than shareholders" such as "creditors, customers, employees, and perhaps even the community generally."[82]

The authority of target boards in the United States to look beyond the interests of shareholders in responding to hostile bids is even clearer and farther reaching outside Delaware. Many states have adopted "other constituency statutes" that unequivocally establish the legitimacy of such considerations in the hostile takeover context, and in some states, in all board decision-making.[83] Over recent years shareholders have endeavored to assert themselves in the takeover context through use of their unilateral authority to enact bylaws—for instance, by proposing a bylaw restricting the adoption or maintenance of a poison pill—but the Delaware Supreme Court has yet to decide how far the shareholders can go in carving back the board's statutory management authority.[84] If the court's takeover cases are any indication, no straightforward answer will be forthcoming.[85]

The emergence and ramifications of the U.S. approach to hostile takeover regulation will be examined in greater depth below,[86] but for the moment the critical point is the ambivalence it reflects regarding shareholders' governance capacity, as well as the consistency of their interests and incentives with those of the broader public.[87] This ambiva-

82. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985). *Revlon* additionally states that regard for non-shareholder constituencies under *Unocal* must involve "rationally related benefits accruing to the stockholders." 506 A.2d at 182. As *Paramount v. Time* makes eminently clear, however, the extraordinary discretion afforded the board to determine what is in the shareholders' long-term interests likely saps this statement of any substantial force. *See supra* notes 79–80 and accompanying text.

83. *See* Bruner, *supra* note 6, at 1420–21.

84. *See id.* at 1442–48. On these competing sources of statutory authority, compare DEL. CODE ANN. tit. 8, § 141(a) (2001) (giving the board authority to manage the "business and affairs" of the corporation), with DEL. CODE ANN. tit. 8, § 109(a) (2001) (giving shareholders the unilateral and inalienable right to enact bylaws "relating to the business of the corporation" and "the conduct of its affairs").

85. *See* Christopher M. Bruner, *Shareholder Bylaws and the Delaware Corporation*, 11 TRANSACTIONS: TENN. J. BUS. L. 67 (2009).

86. *See infra* Part III.C.

87. Beyond these state corporate law structures, management is further insulated by the Williams Act, a set of federal securities rules that, among other things, ensures ample warning that a hostile bid may be in the offing—notably the requirement that five-percent beneficial owners publicly report their plans and intentions for the company. *See, e.g.*, 17 C.F.R. § 240.13d-1(a) (2009) (requiring a public filing on Schedule 13D upon becoming "directly or indirectly the beneficial owner of more than five percent" of a public company's stock); 17 C.F.R. § 240.13d-101, item 4 (2009) (requiring disclosure on Schedule 13D of "the purpose or purposes of the acquisition of securities," including "any plans or proposals" relating to acquisition of further securities, fundamental transactions, or "change in the present board of directors or management").

lence is further reflected in the nature of the board's fiduciary duties. Delaware has long adhered to the view that management owes fiduciary duties of care and loyalty "to the corporation and its stockholders" simultaneously,[88] a formulation reflecting a studied ambiguity regarding whose interests should prevail when push comes to shove. To be sure, the shareholders are favored over other constituencies as a practical matter, at least insofar as they alone can sue directly for breaches of fiduciary duty and pursue derivative litigation in the corporation's name (so long as the corporation remains solvent, anyway).[89] But at the same time, this formulation reflects a decided reluctance to focus solely on the shareholders, to the exclusion of the other constituencies contributing to the corporate enterprise—a reluctance further reflected in the absence of a clear duty to maximize shareholder wealth in any but the narrowest circumstances, the enormous discretion afforded management under the business judgment rule,[90] and the takeover jurisprudence described above. As Johnson has suggested, Delaware's ambivalent statement of fiduciary duties long persisted as "a pragmatic doctrinal accommodation" of differing views on the nature of the corporation, but with the rise of hostile takeovers, which clearly pit the interests of shareholders against those of other stakeholders, "the dormant tension between duty to the corporation and duty to its shareholders resurfaced."[91] Delaware's awkward doctrinal approach to hostile takeovers primarily reflects a strong desire to avoid clear endorsement of either a shareholder- or stakeholder-oriented conception of the corporation, even in the face of transactions with clear winners and clear losers.[92]

As I have argued elsewhere, none of the prevailing theories of corporate governance can account for the ambivalence reflected by these core principles of U.S. corporate law.[93] The shareholder primacy theory—the view that shareholders straightforwardly "own" the corporation, and

88. Guth v. Loft, 5 A.2d 503, 510 (Del. 1939); *see also* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007) (reiterating the *Guth* formulation).

89. *See supra* note 71 and accompanying text; *Gheewalla*, 930 A.2d at 101–03 (clarifying that creditors have derivative standing once the company becomes insolvent, but not before, and that they never have direct standing to sue for fiduciary breaches).

90. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 299–309 (1999); Bruner, *supra* note 6, at 1402, 1418–21; Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 770–76 (2005); Johnson, *supra* note 80, at 900–02.

91. Johnson, *supra* note 80, at 900 n.133.

92. *See infra* Part III.C.

93. For a more detailed treatment of the theories discussed here, see Bruner, *supra* note 6, at 1395–1408.

thus are entitled to dictate its aims in the way that any principal would direct her agent[94]—is plainly contradicted both by the sharp constraints placed on shareholder action and the range of structures permitting deviations from shareholder wealth maximization. The remaining theories, however, do not fare much better. The "team production" theory of the corporation, developed by Margaret Blair and Lynn Stout, styles the board as a "mediating hierarch" with the duty and capacity to protect all of the various corporate stakeholders from opportunism at the hands of the others, facilitating the range of firm-specific investments required for a successful corporate enterprise.[95] This theory of corporate governance depends critically on the characterization of directors as "trustees *for the corporation itself*,"[96] without favoring any particular group, because otherwise their claim to protect all stakeholders from opportunism would lack credibility. As David Millon observes, however, the board's substantial discretion under the business judgment rule does not support this view of the corporation, and in fact tends to contradict it. As Millon explains, the "very discretion that allows corporate boards to pay attention to nonshareholder as well as shareholder interests also allows them to pursue shareholder value with relentless disregard for social costs."[97] In this light, the board's discretion under the business judgment rule is every bit as inconsistent with the team production theory as it is with the shareholder primacy view described above. Blair and Stout likewise fail to account for the privileged position of shareholders in advancing derivative claims on the corporation's behalf,[98] as well as the fact that the formulation of fiduciary duties in Delaware, ambivalent as it may be, does mention just one constituency by name—the shareholders.[99]

The "nexus of contracts" view of the corporation—probably the leading theory of corporate governance among U.S. academics[100]—also fails

94. *See, e.g.*, Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, at SM17. More moderate work in this vein is discussed in Bruner, *supra* note 6, at 1405–07.

95. *See* Blair & Stout, *supra* note 90, at 269–81. *See generally* Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33 (Alan J. Auerbach ed., 1988).

96. Blair & Stout, *supra* note 90, at 281.

97. David Millon, *New Game Plan or Business As Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001, 1022 (2000).

98. *See id.* at 1013.

99. *See* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99–103 (Del. 2007).

100. STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 26 (2002) ("[I]t is fair to say that the economic theory of the firm is now the dominant paradigm in corporate law. Not only legal scholars, but also judges and lawyers are becoming adept at using economic analysis.

to account for the fundamental characteristics of U.S. corporate law. Though there are variations on the theme, the core claim is that the corporation, as a descriptive matter, is fundamentally private and contractual in nature, and, as a normative matter, ought to be treated as such. Specifically, as Frank Easterbrook and Daniel Fischel express it, the idea is that "corporate law should contain the terms people would have negotiated, were the costs of negotiating at arm's length for every contingency sufficiently low," and that, in practice, it "almost always conforms to this model."[101] As to how the hypothetical negotiation among the various parties (e.g., shareholders, boards, employees, creditors, and communities) would work out, the claim is that they would favor strong boards—and correlatively weak shareholders—for the efficiency of such an arrangement. The apathy of public shareholders and heterogeneity of their interests are said to justify only weak voting rights, particularly in light of the disciplinary potential of the market for corporate control.[102] However, rational shareholders with a mere residual claim in an enterprise over which they have limited formal control would demand the right to elect the board, and would also demand fiduciary duties focusing squarely on their interests.[103] Stephen Bainbridge takes these claims substantially further in his "director primacy theory," arguing that the board is itself the nexus at the heart of the corporation, wielding "*sui generis*" powers as "a sort of Platonic guardian"[104]—a claim rooted in a particularly strong view of the superiority of centralized management.[105]

Those adhering to the nexus view typically argue that other stakeholders, such as employees, creditors, and communities, are entitled only to what they can secure through "explicit, negotiated contract"[106] and that corporate law should not mandate regard for non-shareholders. The preferable alternative is "to alter incentives by establishing rules that at-

Hence, even those who reject economic analysis must respond to those who practice it.").

101. EASTERBROOK & FISCHEL, *supra* note 17, at 15.

102. *See id.* at 70–71; *see also* Bainbridge, *supra* note 72, at 607, 614, 623. A shareholder's choice to remain passive where the costs of action exceed the benefits is typically described by economists as "rational apathy." *See* ALLEN ET AL., *supra* note 7, at 178.

103. *See* EASTERBROOK & FISCHEL, *supra* note 17, at 36–39, 92–93; Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 577–85 (2003). It should be observed, however, that a contractarian approach to corporate law does not inherently preclude regulation aimed at redressing flaws in the bargaining process. *See* Joseph F. Morrissey, *A Contractarian Defense of Corporate Regulation*, 11 TRANSACTIONS: TENN. J. BUS. L. 135 (2009).

104. *See* Bainbridge, *supra* note 103, at 560.

105. *Id.* at 554–59.

106. EASTERBROOK & FISCHEL, *supra* note 17, at 37.

tach prices to acts, such as pollution and layoffs, while leaving managers free to maximize the wealth of the residual claimants subject to the social constraints."[107]

The shortcomings of the nexus view as a descriptive account of the U.S. public corporation's internal governance are substantial. As Easterbrook and Fischel acknowledge, the argument that disciplinary effects of hostile takeovers compensate shareholders for their weak governance powers is undercut by the ability of management to deploy defensive tactics warding off hostile bids.[108] Bainbridge, who views shareholder voting "not as an integral aspect of the corporate decision-making structure, but rather as an accountability device of last resort to be used sparingly,"[109] accepts limits on takeovers as a second-best solution necessary to the preservation of board authority in other contexts.[110] This explanation, however, rests on elements of his director primacy theory, and finds little support in existing law. Delaware case law clearly establishes that the legitimacy of board authority derives from election by the shareholders, rejecting the depiction of directors as "Platonic masters."[111] This conceptualization of board authority—taken in combination with the authority at least to approve fundamental matters such as charter amendments and mergers—tends to contradict the notion that shareholder voting can be dismissed as a mere accountability device. Additionally, all nexus-based theories, like the shareholder primacy view, fail to explain the fact that U.S. corporate law does not mandate shareholder wealth maximization as the defining aim of the corporation,[112] and that it is in fact replete with structures permitting substantial deviations from shareholders' interests in an enormous range of circumstances.[113] In this light, it should come as no shock that the Delaware Court of Chancery has recently rejected the notion that "freedom of contract" constitutes the defining feature of Delaware corporations.[114]

The descriptive shortcomings of all three prevailing theories of the U.S. public corporation are as substantial as they are inescapable. But

107. *Id.* at 37–39; *see also* Bainbridge, *supra* note 103, at 587–91.

108. *See* EASTERBROOK & FISCHEL, *supra* note 17, at 205–06.

109. Bainbridge, *supra* note 72, at 627.

110. Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 827–28 (2006).

111. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659, 663 (Del. Ch. 1988).

112. *See* Elhauge, *supra* note 90, at 738.

113. These points are ultimately conceded by nexus scholars. *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 17, at 205–06; Bainbridge, *supra* note 110, at 778 & n.43.

114. *See* Sutherland v. Sutherland, No. 2399-VCL, 2009 WL 857468, at *4 (Del. Ch. Mar. 23, 2009).

their normative thrust is, of course, another matter.[115] In the concluding Part of the Article, I will argue that the descriptive shortcomings of the prevailing nexus theory, in particular, should be brought to bear on assessment of its normative claims, an argument that draws upon the comparative analysis set out in the following Parts of the Article.

B. *The Shareholder-Centrism of U.K. Corporate Governance*

In contrast with the position of shareholders in a U.S. public corporation, U.K. shareholders possess substantial powers to intervene directly in corporate governance, and benefit from directors' duties and a conception of corporate purpose focusing far more intently on their interests. (For the sake of clarity, the contrasts discussed below are summarized in Figure 1.) The result is a decidedly shareholder-centric governance system exhibiting little of the ambivalence that characterizes U.S. corporate governance.[116]

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115. *See, e.g.*, BAINBRIDGE, *supra* note 100, at 32 ("[M]ost contractarians probably regard the normative story as being the more important of the two."); EASTERBROOK & FISCHEL, *supra* note 17, at 15.

116. Some measures suggest that a higher level of shareholder protection prevails in the United States. For example, Gourevitch and Shinn place the United States at the top of their list, with the United Kingdom a few places behind. GOUREVITCH & SHINN, *supra* note 1, at 48. However, their broad measure of shareholder protections includes not only control rights, but also disclosure requirements, board independence, and incentive compensation. Moreover, their definition of "control" is a narrow one (borrowed from La Porta et al., *supra* note 1) that assigns the same score to both countries. GOUREVITCH & SHINN, *supra* note 1, at 42–48. They do note, however, that "in the judgment of many observers [the United Kingdom] has better shareholder protections in practice than the United States." *Id.* at 259.

FIGURE 1: SHAREHOLDERS' DEFAULT POWERS AND DIRECTORS' DUTIES IN PUBLIC CORPORATIONS

	U.S. (Del.)	U.K.
Call special meetings	No	Yes
Remove directors without cause	No, if board is classified	Yes
Initiate charter amendments	No	Yes
Compel board action	No	Yes
Approve takeover defenses	No	Yes
Beneficiaries of directors' efforts	Corporation & Shareholders	Shareholders

Unlike in the United States, shareholders in a U.K. public corporation[117] can, under the Companies Act (2006), unilaterally amend the company's constitution (its core governance document)[118] by special resolution of a seventy-five percent majority.[119] This differs enormously from the Delaware approach, which permits the board to play a gatekeeping role by requiring that any change to the charter be proposed by the board before the shareholders may approve it. Additionally, U.K. shareholders possess far greater capacity to replace directors. Shareholders representing five percent voting power can demand a meeting, at which directors can be removed by ordinary resolution of a simple majority.[120] It should also be noted that U.K. shareholders do not en-

117. I refer to "public companies" for ease of reference. I in fact mean the "public limited company," or "plc," as opposed to the "private limited company," or "ltd." Public limited companies may offer securities to the public, but they are subject to more onerous regulation—notably, the requirement that a "trading certificate" be obtained before doing business and that "the nominal value of the company's allotted share capital" be at least £50,000 (or the "euro equivalent"). Companies Act, 2006, c. 46, §§ 4, 755–756, 761–763 (U.K.).

118. The company's constitution includes its "articles," together with certain resolutions and agreements. *Id*. § 17. The articles set out "regulations for the company," though "model articles" prescribed by the Secretary of State apply by default. *Id*. §§ 18–20.

119. *Id*. §§ 21(1), 283.

120. *Id.* §§ 168, 282, 303–304; The Companies (Shareholders' Rights) Regulations, 2009, S.I. 2009/1632, ¶ 4 (U.K.) (lowering the requirement from ten to five percent). This removal power applies "notwithstanding anything in any agreement" between the corporation and the director, *id*. § 168(1), but the director "is entitled to be heard on the resolution at the meeting." *Id*. § 169. For a historical overview of shareholder governance in U.K. company law, see R.C. Nolan, *The Con-*

counter the sorts of regulatory impediments to coordinated action that U.S. securities regulation imposes.[121]

As in the United States, the model articles that apply to U.K. public companies by default[122] state that generally "the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company."[123] Thus, as in U.S. corporations, the board is clearly "the most important decision-making body within the company."[124] However, there is a critical difference: the model articles permit U.K. shareholders literally to "*direct the directors*," by special resolution, "to take, or refrain from taking, specified action."[125] This notion of directing the directors is utterly foreign to Delaware law and, at least in theory, would appear to give the shareholders a very strong card to play in discussions with management.

As a practical matter, the removal power, which requires only an ordinary resolution, is far more significant. As Paul Davies observes, "the disgruntled shareholders can say, in effect, to the directors: if you choose not to follow our views, we will by ordinary majority seek to remove you from office"—a "powerful inducement" to follow the shareholders' wishes.[126] In general, British institutional shareholders have been content to leave governance entirely to the board, but when trouble arises, the removal power gives them tremendous leverage in discussions with management over the future of the company.[127] The power to "direct the directors," however, does remain significant at a

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tinuing Evolution of Shareholder Governance, 65 CAMBRIDGE L.J. 92, 98–115 (2006).

121. *See* Armour et al., *Corporate Ownership Structure*, *supra* note 8, at 1751–52; Gelter, *supra* note 1, at 188; *see also supra* note 87.

122. *See supra* note 118. On the typical content of listed company articles, see Nolan, *supra* note 120, at 115–19. Nolan argues that the shareholders' role in corporate governance should presumptively be left to private ordering through the articles, though he acknowledges that the issue of corporate purpose is more inherently political. *See id.* at 120–25.

123. The Companies (Model Articles) Regulations, 2008, S.I. 2008/3229, art. 3, sched. 3 (U.K.) [hereinafter Model Articles].

124. PAUL L. DAVIES, GOWER AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW 365–71 (8th ed. 2008); *see also* ALAN DIGNAM & JOHN LOWRY, COMPANY LAW 143–44, 265–68 (5th ed. 2009).

125. Model Articles, *supra* note 123, art. 4(1) (emphasis added).

126. DAVIES, *supra* note 124, at 371. On the relationship between authority and accountability in organizational decision-making more generally, see KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 63–79 (1974).

127. *See* DAVIES, *supra* note 124, at 425. Davies speculates that increasing investment in U.K. equities by institutions and hedge funds from other countries may result in more substantial shareholder activism. *See id. But see* CHEFFINS, *supra* note 4, at 382–404 (arguing that such developments "will not compromise the divorce of ownership and control that characterizes UK corporate governance").

theoretical level, vividly illustrating that the board's powers in a U.K. corporation are fundamentally a matter of "private ordering." U.K. directors' powers emanate solely from "delegation via the articles and not from a separate and free-standing grant of authority from the State," a fact that, in Davies' view, "helps to underline the shareholder-centred nature of British company law."[128]

Even more significant and illuminating differences, however, emerge in the area of takeover regulation. In the United Kingdom, a target company's board is effectively sidelined in a hostile takeover. This stands in stark contrast with Delaware's elaborate system of fiduciary duty-based tests, granting corporate boards substantial discretion to employ defensive measures to impede tender offers, as well as the more far-reaching authority to do so under the constituency statutes enacted by numerous other states. Indeed, takeovers in the United Kingdom are regulated only in a qualified sense, because they are effectively overseen by the market itself. The City Code on Takeovers and Mergers (City Code) has, since 1968, been implemented by an independent body called the Panel on Takeovers and Mergers (City Panel), which "draws its members from major financial and business institutions," including members nominated by the major organizations of insurers, investment companies, pensions, banks, accountants, stockbrokers, and industry.[129] Although recently given a statutory mandate in order to comply with a European Community directive,[130] the City Panel in practice remains very much a creature of the private sector.[131]

Whether a takeover bid succeeds or fails is, as a practical matter and by regulatory design, left entirely to the shareholders. The City Code,

128. DAVIES, *supra* note 124, at 366–67.

129. The Takeover Panel: Panel Membership, http://www.thetakeoverpanel.org.uk/structure/panel-membership (last visited Feb. 26, 2010); *see* The Takeover Panel: About the Panel, http://www.thetakeoverpanel.org.uk/structure/about-the-panel (last visited Feb. 26, 2010); The Takeover Panel: The Panel on Takeovers and Mergers, http://www.thetakeoverpanel.org.uk/index.php?page_id=45 (last visited Feb. 26, 2010).

130. *See* Companies Act, 2006, c. 46, §§ 942–43 (U.K.) (recognizing the Panel as the authority responsible for implementing the EC takeover directive); Council Directive 2004/25/EC, art. 4, 2004 O.J. (L 142) (EC) ("Member States shall designate the authority or authorities competent to supervise bids . . . ."). For additional background on European takeover regulation, see Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEX. INT'L L.J. 171 (2006).

131. *See, e.g.*, JOHN BIRDS ET AL., BOYLE & BIRDS' COMPANY LAW 788–89 (6th ed. 2007). Though currently left to the private sector, the government could of course become more directly involved in the future. The U.K.'s Financial Services Authority does possess authority to intervene in matters relating to takeovers, though it has traditionally declined to do so. *See* Brian E. Rosenzweig, Note, *Private Versus Public Regulation: A Comparative Analysis of British and American Takeover Controls*, 18 DUKE J. COMP. & INT'L L. 213, 217–20 (2007).

which consists of various principles and rules, states in clear terms that as soon as a target board "has reason to believe that a bona fide offer might be imminent," it cannot "take any action which may result in any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits" without shareholder approval.[132] This central rule of U.K. takeover regulation is extraordinary from the American perspective, for its clarity as much as its shareholder-centrism: shareholders decide on the bid, end-stop. In fact, the very purpose of this regime is to protect shareholders. As one former Executive Director of the City Panel explained, the City Panel "has nothing to say about the merits of an offer. It is almost solely the offeree company's shareholders whose interest the Code has at heart."[133]

The City Code does include the so-called "mandatory offer" rule, generally requiring that upon reaching thirty percent voting power a bid must be made for all shares.[134] One could imagine this requirement insulating incumbent management by increasing the cost of tender offers.[135] It remains the case, however, that "takeover activity in general (including friendly mergers) is more intense in the United Kingdom" than in the United States.[136] And, in any event, the clear intent of the mandatory offer rule is to protect shareholders by permitting them to cash out should they harbor "a low opinion of the new controller's business ability or methods" and to receive part of the control premium.[137]

This discussion illustrates the shareholder-centrism of the U.K. system relative to the approach taken in the United States. While the U.S. takeover regime reflects substantial doubts regarding the consistency of shareholders' interests and incentives with those of the larger public, the U.K. takeover regime reflects no such misgivings. Indeed, this divergence holds true across the two countries' corporate governance systems more generally. In addition to the substantial powers possessed by

132. THE PANEL ON TAKEOVERS AND MERGERS, THE TAKEOVER CODE I18 (9th ed. 2009); *see also id.* at B1.

133. T.P. Lee, *Takeovers—the United Kingdom Experience*, *in* TAKEOVERS, INSTITUTIONAL INVESTORS, AND THE MODERNIZATION OF CORPORATE LAWS 192, 195 (John H. Farrar ed., 1993).

134. *See* THE PANEL ON TAKEOVERS AND MERGERS, *supra* note 132, at B1, F1.

135. *See* Ventoruzzo, *supra* note 130, at 192, 214.

136. Gelter, *supra* note 1, at 151. Armour and Skeel report that "an M&A transaction in the United Kingdom is more likely to be hostile, and if hostile, is more likely to succeed," but that "the overall level of [U.S.] takeover activity, adjusted for the size of the economy, actually seems slightly higher than in the United Kingdom." Armour & Skeel, *supra* note 1, at 1738–41. As Gelter observes, however, the data that Armour and Skeel report translate to a higher rate of U.K. M&A activity relative to gross domestic product. Gelter, *supra* note 1, at 151 n.138.

137. Lee, *supra* note 133, at 198–99.

U.K. shareholders to intervene in corporate affairs, and consistent with the strongly shareholder-centric takeover regime, U.K. company law has confirmed explicitly that the defining aim of the corporation is to advance the interests of shareholders. While section 170 of the Companies Act establishes that duties are owed to the company itself[138]—a fact that becomes significant in enforcing them[139]—section 172 requires that a director "must act in the way he considers, in good faith, would be most likely *to promote the success of the company for the benefit of its members* [i.e., the shareholders] as a whole."[140] The provision does instruct the director to consider the interests of various stakeholder groups, including employees, suppliers, customers, and the community. Directors are also to consider larger issues including environmental impacts, the company's business reputation, and the "long term" consequences of board decisions, naturally giving the board substantial room to maneuver, just as in the United States.[141] Ultimately, however, as a formal matter, such considerations are relevant only to the extent that they relate to the actual duty imposed on directors to make a good faith effort to advance the shareholders' interests.[142] Notwithstanding the po-

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138. Companies Act, 2006, c. 46, § 170(1) (U.K.).

139. *See* DAVIES, *supra* note 124, at 479–80 (explaining that this formulation limits enforcement of directors' duties to derivative litigation); DIGNAM & LOWRY, *supra* note 124, at 301.

140. Companies Act, 2006, c. 46, § 172(1) (U.K.) (emphasis added). On the status of investors as "members" of the company, see *id.* §§ 112–113.

141. *Id*. § 172(1). Section 172 reads in full:

> Duty to promote the success of the company
>
> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
>
> (a) the likely consequences of any decision in the long term,
>
> (b) the interests of the company's employees,
>
> (c) the need to foster the company's business relationships with suppliers, customers and others,
>
> (d) the impact of the company's operations on the community and the environment,
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
>
> (f) the need to act fairly as between members of the company.
>
> (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.
>
> (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

142. *See* DAVIES, *supra* note 124, at 506–09; DIGNAM & LOWRY, *supra* note 124, at 311–18. Section 309 of the 1985 Companies Act required directors to have regard for the interests of employees, but this provision was not enforceable by the employees themselves. The 2006 revisions

litical nod to other stakeholders and issues of larger social interest, the core duty articulated in section 172 is clear, reflecting none of the ambivalence that continues to characterize the prevailing formulation of a U.S. director's fiduciary duties.

One might fairly ask whether the far greater capacity of U.S. shareholders to sue, either derivatively under corporate law or through a direct class action, narrows the gap in shareholder orientation between U.S. and U.K. corporate governance described above.[143] To be sure, the shareholder suit is a far more developed means of enforcement in the United States than elsewhere.[144] As a matter of U.K. company law, the fact that directors' duties are owed to the company alone, the restrictive rules on derivative standing, and the subjective nature of the directors' duty to pursue shareholders' interests (requiring only "good faith" effort), combine to render it quite difficult for U.K. shareholders to bring suit.[145] The notion that greater capacity to sue in the United States might tend to focus management more intently on the shareholders' interests certainly has intuitive appeal, but ultimately it remains a matter of speculation. For example, James Cox and Randall Thomas, in a review of studies on U.S. securities litigation, attribute the paucity of empirical research on the deterrence value of private suits to the difficulty of assessing how the world might look in their absence. The degree to which governance is improved, from the shareholders' perspective, "out of fear of the securities class action is at best speculative and indeterminate and, hence, beyond the empiricists' reach."[146] Likewise, establishing

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sought to eliminate confusion by repealing this provision and clarifying that regard for employee interests is relevant solely in connection with the pursuit of shareholders' interests. *See id.* at 315–16.

143. *See, e.g.*, ALLEN ET AL., *supra* note 7, at 369–422; STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 238–350, 492–566 (2d ed. 2008). On the nature of derivative suits, see *supra* text accompanying note 71.

144. *See, e.g.*, Eilís Ferran, *Are US-Style Investor Suits Coming to the UK?*, 9 J. CORP. L. STUD. 315, 339–40 (2009); James D. Cox & Randall S. Thomas, *Mapping the American Shareholder Litigation Experience: A Survey of Empirical Studies of the Enforcement of the U.S. Securities Law* 2 (Vanderbilt Univ. Law Sch. Law & Econ., Research Paper No. 09-10, 2009; Duke Univ. Law Sch. Pub. Law & Legal Theory, Research Paper No. 246, 2009), *available at* http://ssrn.com/abstract=1370508.

145. *See* BIRDS ET AL., *supra* note 131, at 674–77; DAVIES, *supra* note 124, at 480–82, 507–10, 614–27; DIGNAM & LOWRY, *supra* note 124, at 187–90, 301–02, 312. In fact, the Companies Act even contains a provision permitting a court to relieve any liability for breach of duty, "on such terms as . . . the judge may think proper," where the court concludes that the individual "acted honestly and reasonably, and that having regard to all the circumstances . . . he ought fairly to be excused." Companies Act, 2006, c. 46, § 1157 (U.K.); *see also* Ferran, *supra* note 144, at 342 (discussing impediments to private U.K. securities suits).

146. Cox & Thomas, *supra* note 144, at 20.

that securities suits actually cause improvements in corporate governance to be made "may prove very difficult."[147] Indeed, even if such questions were more amenable to empirical research, applying any such findings to the issue of corporate purpose would presumably require weighing fears of shareholder litigation against fears of other forms of litigation by employees and creditors, introducing further complexity into the analysis.[148] What is clear, however, is that U.K. shareholders' ability to threaten removal of directors who fail to adhere to their wishes vastly eclipses any direct powers over corporate governance possessed by U.S. shareholders, which may itself explain the limited reliance on litigation in the United Kingdom. As Eilís Ferran suggests, "the [U.K.] investor community is dominated by sophisticated institutions that are accustomed to exerting influence via informal, reputational and market mechanisms underpinned by governance rights conferred by company law and which do not (yet?) regard private litigation as an important control tool."[149]

Overall, it would appear that the U.K. corporate governance system is substantially more compatible with theories emphasizing shareholders' interests than the U.S. corporate governance system is. In particular, the U.K. approach would appear broadly compatible with the nexus view of the corporation. The default corporate governance arrangement resembles the nexus corporation in granting relatively broad managerial authority to a board elected by the shareholders. This mode of accountability is bolstered by the clarity of the board's duty to shareholders under section 172, as well as by the U.K.'s relatively unfettered market for corporate control.[150] Moreover, the Companies Act explicitly characte-

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147. *Id.* at 38; *see also* Andrew S. Gold, *A Decision Theory Approach to the Business Judgment Rule: Reflections on Disney, Good Faith, and Judicial Uncertainty*, 66 MD. L. REV. 398, 453 & n.333 (2007).

148. Indeed, in the *Revlon* case discussed above, part of what the shareholders found objectionable about the lock-up agreement with the target board's preferred bidder was that part of the value received in the sale of the company would take the form of a promise to support the value of previously issued notes. This was prompted by the target board's fear of litigation by the noteholders, who would otherwise be hurt by the leveraged structure of the deal. *See* Revlon, Inc. v. MacAndrews & Forbes Holding, Inc., 506 A.2d 173, 178–79, 182–83 (Del. 1986); *see also supra* note 81 and accompanying text.

149. Ferran, *supra* note 144, at 342–44. Ferran observes that the restrictive U.K. civil liability regime in the securities context reflects the view that U.S. shareholder litigation is "wastefully circular, involving a wealth transfer from one group of shareholders (those who happen to own the company at the time when the claim is brought) to another (the victims of the wrongdoing)." *Id.* at 340.

150. By the same token, however, nexus scholars would have a difficult time explaining U.K. shareholders' extraordinary power to intervene directly in corporate affairs. *See supra* notes 102–05 and accompanying text.

rizes the corporation as contractual in nature, stating that the company's constitution "bind[s] the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe those provisions."[151] Whether the nexus theory can, in fact, be said to provide a compelling description of U.K. corporate governance is questioned below,[152] but there is certainly evidence that the nexus view carries some sway among scholars and practitioners in the United Kingdom. The steering group for the comprehensive company law review that culminated in the 2006 Companies Act even stated in a consultation document that this structure "serves the interests of shareholders by conferring on them ultimate control of the undertaking," citing Easterbrook and Fischel's *The Economic Structure of Corporate Law* for "economic justification."[153]

As this overview of U.S. and U.K. corporate governance demonstrates, the "Anglo-American" corporation is, at best, a stylized fact. As such, its utility in global comparative analysis comes at a cost: a lack of nuance that obscures the substantial and fundamental differences that emerge on closer analysis.[154] The next Part of this Article aims to illuminate why the substantial divergences described above have arisen between two corporate governance systems that appear so similar from the global perspective.

III. CORPORATE GOVERNANCE IN POLITICAL CONTEXT

Tackling why the U.S. and U.K. corporate governance systems diverge on the fundamental issue of corporate purpose requires engaging with the substantial literature addressing a related though distinct subject: how, when, and why ownership dispersal occurred in the United States and the United Kingdom, respectively. As discussed below, the protection of minority shareholder interests has been identified as a critical factor in the dispersal of ownership in these systems. Such protections are thought to enhance the willingness of investors to part with

151. Companies Act, 2006, c. 46, § 33(1) (U.K.); *see also* BIRDS ET AL., *supra* note 131, at 145–53. Note, however, that while this provision "uses the language of contract," it is a contract "of a special kind" in that, among other things, it arises by statute rather than by bargain, and it can be altered by special resolution of the shareholders alone. *See id.* at 146.

152. *See infra* Part IV.

153. COMPANY LAW REVIEW STEERING GROUP, MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY: THE STRATEGIC FRAMEWORK 34 (1999) [hereinafter STRATEGIC FRAMEWORK].

154. A "stylized fact" is a "broad generalization, true in essence, though perhaps not in detail." GRAHAM BANNOCK ET AL., DICTIONARY OF ECONOMICS 370 (4th ed. 2003).

their money on favorable terms, notwithstanding the practical difficulties that minority investors face in seeking to influence corporate affairs. The manner in which this process has unfolded in each country has undoubtedly had critical consequences for the development of their corporate governance structures and the relative position of shareholders within them. In this Part of the Article, I respond to this literature by describing the degree to which such developments have been reinforced by larger political trends in each country, including the degree of support for non-shareholders outside the corporate governance system.

Contrary to prevailing theories on the role of politics in the emergence of these corporate governance structures, I argue that left-leaning politics and the construction of the post-war welfare state in the United Kingdom actually facilitated the emergence of shareholder-oriented structures within its corporate governance system by deflecting stakeholder-oriented political pressures that might otherwise have been directed toward the corporate structure itself. Conversely, I argue, the reliance on private employers in the United States to provide the sorts of social welfare protections provided by government in the United Kingdom resulted in stakeholder-oriented political pressures being focused on the corporate structure itself, inhibiting the development of a strongly shareholder-centric corporate governance system in the United States. As I argue in this Part of the Article, once ownership dispersal has substantially occurred within a given country, left-leaning politics may actually facilitate a higher degree of shareholder-centrism within its corporate governance system.

A. Politics and the Formation of Corporate Governance Systems

In a highly influential series of papers, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny—economists who have been referred to collectively as LLSV—theorized that legal protection of minority shareholders against exploitation by managers and controllers is a prerequisite to ownership dispersal, and that the quality of such protections relates critically to the general orientation of the legal system within a given country.[155] In particular, common law systems such as the United States and the United Kingdom were found to provide stronger minority shareholder protections than civil law sys-

155. *See* La Porta et al., *supra* note 1; La Porta et al., *Investor Protection and Corporate Governance*, *supra* note 4; La Porta et al., *Law and Finance*, *supra* note 4; La Porta et al., *Legal Determinants of External Finance*, *supra* note 4.

tems,[156] suggesting that the emergence of a dispersed ownership system or a concentrated ownership system in a given country was literally "a consequence" of one or the other preexisting legal orientation.[157]

This "law matters" theory, as it has come to be called,[158] has been hotly disputed and largely discredited in its literal form. As discussed above, the United States and the United Kingdom are the quintessential dispersed ownership systems, yet detailed historical accounts of ownership dispersal in each country demonstrate that strong shareholder protections did not achieve recognition in law until after dispersal had substantially occurred. These accounts demonstrate that while safeguarding minority interests was indeed important, the operative protections in both countries initially emerged out of private ordering, prompted particularly by the desire of financial firms and stock exchanges to develop and preserve good reputations with investors.[159] "Legal reforms," John Coffee concludes, "are enacted at the behest of a motivated constituency that will be protected," but "the constituency (here, dispersed public shareholders) must first arise before it can become an effective lobbying force and an instrument of legal change."[160] Additionally, politically

156. *See* La Porta et al., *Legal Determinants of External Finance*, *supra* note 4.

157. *See, e.g.*, La Porta et al., *supra* note 1, at 511–12. The authors attribute this difference to the state's "relatively greater role in regulating business in civil law countries than in common law ones," and note that "common law evolved to protect private property," including that of investors, "against the crown." La Porta et al., *Investor Protection and Corporate Governance*, *supra* note 4, at 12.

158. *See, e.g.*, Armour et al., *Corporate Ownership Structure*, *supra* note 8, at 1713; Cheffins, *supra* note 4, at 462.

159. *See, e.g.*, Cheffins, *supra* note 4, at 466–76; Brian R. Cheffins, *Law as Bedrock: The Foundations of an Economy Dominated by Widely Held Public Companies*, 23 OXFORD J. LEGAL STUD. 1, 7–12 (2003); John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 25–44 (2001). Brian Cheffins has further emphasized the capacity for dividend policy to act as a minority shareholder-protective device in the absence of strong legal protections—notably as a signal of health in the absence of legally mandated financial disclosures, and as a means of limiting self-dealing and "the squandering of corporate assets by those running public companies." Brian R. Cheffins, *Dividends as a Substitute for Corporate Law: The Separation of Ownership and Control in the United Kingdom*, 63 WASH. & LEE L. REV. 1273, 1302 (2006).

160. Coffee, *supra* note 159, at 7. Coffee concludes that this correction of the historical sequencing suggests a "reinterpretation" of LLSV's work to the effect that, while shareholder protections permitting ownership dispersal can arise outside law, formal legal protections are required to optimize those protections and stabilize capital markets. *Id.* at 65–66. In a later paper, LLSV take an expansive view of "law" as including "stock exchange regulations and accounting standards," and envision enforcement not only by the state but also by "market participants themselves," perhaps in response to such criticisms. *See* La Porta et al., *Investor Protection and Corporate Governance*, *supra* note 4, at 7; *see also* Bebchuk & Roe, *supra* note 1, at 154; Millon, *supra* note 48, at 911. The difficulty of measuring and assessing the quality of shareholder protections across disparate jurisdictions has also been emphasized. *See, e.g.*, ROE, *supra* note 11, at

oriented theorists have observed that the focus on a country's legal family, an established historical fact, cannot explain why that country's corporate governance system would evolve over time.[161]

The insight that one must look beyond formal law to explain the emergence of ownership dispersal indicates the importance not only of considering market-based substitutes for law but also of considering how broader societal politics may condition the laws and regulatory structures that ultimately take shape. One of the most influential efforts in this vein has been Mark Roe's social democracy theory, which associates the persistence of blockholding with broader social democratic policies, and ownership dispersal with deviation from such policies.[162] Roe defines "social democracies" to include "nations committed to private property but whose governments play a large role in the economy, emphasize distributional considerations, and favor employees over capital-owners when the two conflict"[163]—policy positions associated with the political left.[164] Ultimately, Roe posits two equilibria: the first "has weakly competitive markets fitting with social democratic politics and concentrated ownership," and the second "matches fiercely competitive markets, conservative almost *laissez-faire* politics, and diffuse ownership."[165]

Roe's principal comparison is between Europe and the United States,[166] an approach that tends to lend support to his theory. For example, the fact that blockholding prevails in Germany, where the codetermination system provides substantial board-level representation for employees, would seem to support the theory that pro-labor policies impede ownership dispersal by rendering the corporation less directly res-

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183–85.

161. *See* GOUREVITCH & SHINN, *supra* note 1, at 86–87; Marco Pagano & Paolo F. Volpin, *The Political Economy of Corporate Governance*, 95 AM. ECON. REV. 1005, 1005–06 (2005); Pagano & Volpin, *supra* note 8, at 504–06; Rajan & Zingales, *supra* note 50, at 7, 14, 42–43. For a critique of LLSV's work in the economic development context, see Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *supra* note 37, at 165 (concluding that "the way the law was initially transplanted and received is a more important determinant [of effective legal institutions] than the supply of law from a particular legal family").

162. ROE, *supra* note 11, at 2–3.

163. *Id.* at 24.

164. *See id.* at 3.

165. *Id.* at 6. As Peter Gourevitch observes, "Roe's treatment resonates strongly with the 'Varieties of Capitalism' literature," which similarly contrasts "coordinated market economies" and "liberal market economies." *See* Peter A. Gourevitch, *The Politics of Corporate Governance Regulation*, 112 YALE L.J. 1829, 1842, 1855 (2003) (reviewing ROE, *supra* note 11).

166. *See* ROE, *supra* note 11, at 4, 16 (contrasting concentrated ownership and high levels of labor participation in corporate governance in Europe with diffuse ownership and low labor participation in the United States).

ponsive to shareholders' interests.[167] But in the United States, Roe explains, where distrust of large financial institutions resulted in ry structures fragmenting them, social democracy never really took root for lack of "visible targets." As a result, "norms like shareholder-wealth maximization flourished more easily than they otherwise would have," permitting widely held public corporations to emerge and thrive.[168] This likewise would seem to support the theory by associating shareholder-centric institutions and ownership dispersal with the relative absence of social democratic policies.[169]

Roe's theory founders, however, when he turns to the United Kingdom. Specifically, the United Kingdom raises two problems for Roe. First, the United Kingdom does not conform to the theory because it appears to have made the transition to dispersed ownership during a period of British history in which social democratic policies prevailed—including in tax, labor, and industrial policy.[170] Second, while Roe's theory can describe the position of either the United States or the United Kingdom on the left-right spectrum relative to other countries, it cannot explain their positions relative to each other since, as discussed above, the more left-leaning country proves also to be substantially more shareholder-oriented in outlook.

While it is relatively clear that ownership dispersal had occurred in the United States by the 1930s,[171] the timing of ownership dispersal in the United Kingdom has been a matter of some controversy. Roe acknowledges that "[t]he United Kingdom would seem the hardest case for the political theory," given the social democratic leaning of British politics following World War II, but he argues nevertheless that U.K.

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167. *See id.* at 71–82.

168. *Id.* at 104–05.

169. Roe marshals data supporting the association of ownership patterns with left-right politics based on "a poll of political scientists from around the world." *Id.* at 49.

170. *See* CHEFFINS, *supra* note 4, at 46–51; Cheffins, *supra* note 1, at 32–34; Coffee, *supra* note 159, at 39–40. Cheffins further observes, conversely, that ownership dispersal did not occur in the early twentieth century, when the United Kingdom tended not to pursue social democratic policies. *See* Cheffins, *supra* note 1, at 30–31.

171. *See* ADOLPH A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932); *see also* Brian R. Cheffins, *Corporate Law and Ownership Structure: A Darwinian Link?*, 25 U. NEW S. WALES L.J. 346, 347 (2002); Coffee, *supra* note 159, at 24–25. While a recent paper reports that U.S. public companies in fact typically have substantial shareholders, a low threshold of just five percent ownership is employed. *Compare* Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377 (2009), *with* Brian R. Cheffins & Steven A. Bank, *Is Berle and Means Really a Myth?* (UCLA School of Law, Law-Econ Research Paper No. 09-05, 2009), *available at* http://ssrn.com/abstract=1352605.

securities markets only "flourished when Britain moved rightward" following Margaret Thatcher's rise to power in 1979.[172] Historians have dated ownership dispersal in the United Kingdom from as early as the 1950s to as late as the 1980s, straddling the line between periods of social democracy and right-leaning politics, respectively.[173] The best available evidence, however, tends to suggest that dispersed ownership in fact took root in the United Kingdom before the 1980s, casting doubt on Roe's theory. A recent and exhaustive treatment of the available data by Brian Cheffins indicates that whereas in the early 1950s large U.K. companies still tended to be controlled by families (via stock ownership and board positions), by the 1970s blockholding (i.e. ownership of substantial blocks of stock) "had become the exception to the rule."[174]

Observing the problems that Roe's theory encounters, others have engaged in less parsimonious but more nuanced analyses highlighting the variety of economic and financial factors that contributed to the emergence of ownership dispersal and shareholder-centric regulatory structures in mid-twentieth century Britain. One notable factor was the rise of institutional shareholders capable of exerting substantial dominance in politics and the marketplace. Unlike in the United States, where populist banking and securities regulatory reforms enacted in the 1930s tended to constrain and marginalize institutions,[175] and where institutional investors would achieve their current degree of prominence only in the 1990s,[176] in the United Kingdom, individuals "became persistent net sellers of equity" following World War II, and "[p]ension funds and insurance companies largely filled the gap."[177] While the causes are

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172. ROE, *supra* note 11, at 98–103.

173. *See* Brian R. Cheffins, *Law, Economics and the UK's System of Corporate Governance: Lessons from History*, 1 J. CORP. L. STUD. 71, 80–84 (2001). Cheffins notes "an unfortunate data gap" during the 1950s and 1960s, rendering it difficult to say whether ownership of British companies was substantially dispersed during this period. CHEFFINS, *supra* note 4, at 11–17.

174. *See* CHEFFINS, *supra* note 4, at 304–07. While dispersed ownership had emerged in certain U.K. industries by 1914—notably railroads, banking, and insurance—such industries remained exceptional. *See id.* at 221–51.

175. *See* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994); *see also* GOUREVITCH & SHINN, *supra* note 1, at 243–45; Armour & Skeel, *supra* note 1, at 1751–52; Pagano & Volpin, *supra* note 8, at 512 (citing the Glass-Steagall Act of 1933, the Securities Act of 1933, and the Securities Exchange Act of 1934).

176. Institutional ownership began to accelerate in the 1970s and 1980s. For a discussion of the rise of U.S. institutional shareholders, see Bruner, *supra* note 6, at 1432–35; *see also* Armour & Skeel, *supra* note 1, at 1767–68.

177. CHEFFINS, *supra* note 4, at 87; *see also* Armour & Skeel, *supra* note 1, at 1767–68. In a recent paper, John Armour and Jeffrey Gordon argue that these historical differences resulted in strikingly different regulatory approaches. The U.S. bias against institutions resulted in use of the passive "retail investor as its regulatory heuristic," leading in turn to an emphasis on disclosure

numerous and complex, the institutions' earlier rise to prominence in the United Kingdom has been aptly described as "an unintended consequence of various legislative measures that had the effect of actively promoting their ownership of stock."[178] Of critical importance was the fact that while individuals' investment income was taxed at very high rates following World War II (until Thatcher rose to power), insurance companies were taxed at a much lower rate, and pension funds were literally exempt from taxes on investment income until 1997.[179] High individual dividend tax rates, along with high income tax and estate tax rates for the affluent, gave family blockholders strong incentives to sell their shares, with institutions prepared to buy.[180]

These historical developments offer important insights into the emergence of starkly shareholder-centric corporate governance structures in the United Kingdom. With respect to takeover regulation, for example, John Armour and David Skeel have observed that the effort to fragment financial power in the United States short-circuited self-regulatory efforts, leaving the regulation of takeovers primarily to state courts. This development, they suggest, may have created "a structural bias in favor of the directors," who would naturally argue that they "need to resist the unwanted takeover in order to preserve order and stability."[181] In the United Kingdom, by contrast, a self-regulatory approach focusing intently, if not exclusively, on shareholders' interests reflected the dominance of institutional shareholders.[182] "In a range of different contexts," Armour and Skeel observe, "U.K. institutional investors have been active either in lobbying regulators or in seeding market norms," and given their "clear interest in rules that maximize expected gains to shareholders, it is not surprising that the emergence of a pro-shareholder approach to takeover regulation coincided with the emergence of institutional investors as a significant force in British share ownership."[183] In

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coupled with "aggressive enforcement," but weak governance powers. The U.K. facilitation of institutional investment, on the other hand, led to stronger governance powers but less reliance on disclosure rules. *See* John Armour & Jeffrey N. Gordon, The Berle-Means Corporation in the 21st Century 3–4 (2008) (unpublished manuscript, on file with the author).

178. Armour & Skeel, *supra* note 1, at 1768.

179. *Id*. at 1768–69; *see also* CHEFFINS, *supra* note 4, at 341–49.

180. *See* CHEFFINS, *supra* note 4, at 323–28, 345–46.

181. Armour & Skeel, *supra* note 1, at 1781–84.

182. *See id.* at 1756–64, 1771–72.

183. *Id*. at 1771. The explanatory power of this divergence in regulatory approaches is reinforced by the fact that takeover cases litigated in U.K. courts by the time the Takeover Panel had established itself "bear a striking resemblance to several of the leading Delaware takeover decisions," exhibiting relatively greater tolerance for target board defensive measures. *Id.* at 1782–83. For a detailed discussion of these cases, see Andrew Johnston, *Takeover Regulation: Historical*

both the United States and the United Kingdom, they conclude "the regulatory mode was the largely unintended consequence of regulation designed to achieve other objectives."[184]

That said, however, the institutional explanation for the greater shareholder-centrism of U.K. corporate governance leaves some vexing questions unanswered. One can readily accept that shareholders left to regulate themselves will likely adopt shareholder-centric rules, and yet reasonably suspect that such a regime could only endure if that outcome were compatible with prevailing views regarding broader social interests. Put differently, explaining an institution's origin is one thing, but explaining its persistence is another.[185] As Roe aptly observes, "[b]efore a nation can produce, it must achieve social peace," a larger goal to which corporate governance must respond in different ways in different countries.[186] A corporate governance system that is incompatible with the prevailing politics will eventually lead to one form of "backlash" or another. "Corporate structures," Roe suggests, are "resolved continually, not sequentially, with some packages more stable than others."[187]

Other theorists have looked to politics in search of an explanation for why corporate governance systems persist or change over time, and why they vary from country to country. Like Roe, however, these theorists have tended to take a global approach, lumping the United States and the United Kingdom together and thus providing only limited insight into why these particular countries diverge as they do. The varieties of capitalism (VOC) approach, for example, usefully places corporate governance within the broader context of various "spheres in which firms must develop relationships to resolve coordination problems central to their core competencies," including industrial relations, vocational training, relationships with other companies (e.g., customers and suppliers), and, of course, coordinating with employees.[188] VOC scholars, however, posit just two equilibria for managing these coordination problems: the so-called "coordinated market economies," where companies rely on cooperative non-market coordination mechanisms to incentivize firm-specific investment, and so-called "liberal market economies," such as the United States and the United Kingdom, where companies interact

and Theoretical Perspectives on the City Code, 66 CAMBRIDGE L.J. 422, 436–41 (2007).

184. Armour & Skeel, *supra* note 1, at 1784.

185. *See* Hall & Soskice, *supra* note 2, at 13–14.

186. ROE, *supra* note 11, at 1.

187. *Id*. at 120; *see also* GOUREVITCH & SHINN, *supra* note 1, at 3; Peter A. Hall & Kathleen Thelen, *Institutional Change in Varieties of Capitalism*, 7 SOCIO-ECON. REV. 7, 11–15 (2009).

188. Hall & Soskice, *supra* note 2, at 6–7.

through competitive market-based exchanges, favoring shareholder interests and labor market flexibility.[189] Like Roe's theory, this framework is useful in comparing either the United States or the United Kingdom with other countries, but does not offer a straightforward means of distinguishing between them.

Peter Gourevitch and James Shinn, building on the VOC framework[190] and likewise aiming for global explanatory power,[191] posit a similarly limited range of potential outcomes. For Gourevitch and Shinn, corporate governance and ownership structure are functions of how shareholders, managers, and employees pursue their varying preferences through the political structures prevailing in a given country and, particularly, how coalitions among them are formed.[192] Alignments are conceptualized in terms of three "cleavages," each isolating one group: "class conflict," which isolates employees; "sectoral," which isolates shareholders; and "property and voice," which aligns shareholders with workers via growing pension fund investment, isolating management.[193] In this schema, the United States and the United Kingdom are examined through the "property and voice" conceptual lens. Gourevitch and Shinn emphasize the efforts of institutional shareholders (including pensions) to advance corporate governance reforms and explain their greater success in the United Kingdom by reference to the strongly majoritarian political structure. This structure, they argue, permits faster policy shifts than in the United States, where the fragmented governmental structure provides more points of entry for managers aiming to impede such reform efforts.[194]

Like the Roe and VOC theories, however, this framework does not permit a compelling explanation for the points of divergence explored here. The U.S. legal response to hostile takeovers is primarily characterized by Gourevitch and Shinn as management entrenchment,[195] leaving

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189. *Id.* at 8–10, 19–20, 24–30; *see also* Gourevitch, *supra* note 165, at 1842; Hall & Thelen, *supra* note 187, at 9–11.

190. *See* GOUREVITCH & SHINN, *supra* note 1, at 11, 53 (incorporating the VOC concept of "institutional complementarity"); Hall & Thelen, *supra* note 187, at 8, 25 (citing criticisms of the VOC approach as "overly static" in its focus on two equilibria and suggesting that the coalition approach may enhance its ability to explain change).

191. *See* GOUREVITCH & SHINN, *supra* note 1, at 277.

192. *Id*. at 8–9. For similar investigations of the role of political coalitions in corporate governance, see Marco Pagano & Paolo F. Volpin, *Managers, Workers, and Corporate Control*, 60 J. FIN. 841 (2005); Pagano & Volpin, *supra* note 161; Pagano & Volpin, *supra* note 8.

193. GOUREVITCH & SHINN, *supra* note 1, at 59–62.

194. *Id.* at 241–62. For data reflecting increasing equity ownership by U.S. and U.K. workers through pension funds, see *id.* at 224 & tbl. 7.4.

195. *See id*. at 250–54.

unexplored the degree to which a coalition of management and labor formed to the exclusion of shareholders.[196] Similarly, the greater success of U.K. shareholders vis-à-vis management is explained primarily as a failure of managers to get their way in a strongly majoritarian political structure,[197] leaving unexplored the fact that shareholder-centric U.K. regulatory structures largely took shape during the left-leaning years between World War II and 1979—a period that also saw the coalescence of a substantial welfare state.[198] Perhaps these points of emphasis reflect the fact that both resistance to hostile takeovers and the construction of a welfare state are elsewhere associated with successful alignment of management and employees to the exclusion of shareholders—a state of affairs that the Gourevitch and Shinn schema predicts should result in corporatism and blockholding.[199] In any event, while the stakeholder alignments and the differences in the two countries' political systems that they emphasize may well illuminate important dimensions of their respective corporate governance systems, the rigidity of the framework, presumably stemming from the pursuit of global explanatory power, undercuts its ability to provide a full explanation for the substantial divergences discussed here.[200]

All of this said, however, these theories do advance important insights that are critical to explaining the divergences between U.S. and U.K. corporate governance. First and foremost, Gourevitch and Shinn, Roe, and the VOC literature all emphasize the centrality of politics in the formation of corporate governance systems, and that the corporate governance system itself can only be fully understood by reference to a larger set of regulatory structures—particularly employment-related

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196. Gourevitch and Shinn themselves emphasize that employees part ways with shareholders in the context of hostile takeovers, where employees prefer management latitude "to factor in the consequences on employment." *Id.* at 222–23; *see also* Pagano & Volpin, *supra* note 8, at 506, 510. *See generally* Pagano & Volpin, *supra* note 192.

197. *See* GOUREVITCH & SHINN, *supra* note 1, at 261–62.

198. *See infra* Part III.B.

199. *See* GOUREVITCH & SHINN, *supra* note 1, at 149. Gourevitch and Shinn find that corporatism—"the inclusion of economic and social groups in the process of policy formation"—is associated with ownership concentration and weaker shareholder protections in their overall sample. *Id.* at 157–58; *see also* Pagano & Volpin, *supra* note 8, at 508–10.

200. Pagano and Volpin encounter a similar though more substantial problem by simply lumping together the United States and the United Kingdom as "majoritarian" systems, which are expected to produce "strong shareholder protection and weak employment protection." *See* Pagano & Volpin, *supra* note 161, at 1007, 1018–20, 1027. This categorization provides no straightforward means of explaining the fact that the United Kingdom in fact exhibits both stronger shareholder protections and stronger employment protections than the United States. *See infra* Parts III.B–C.

structures—that condition relationships among corporate stakeholders. The notion of "institutional complementarity" employed by Gourevitch and Shinn and the VOC literature—broadly, the relationship and degree of fit between various forms of regulation—figures prominently in the argument developed below.

I part ways with all of these theorists, however, in suggesting that the manner in which these various regulatory structures interact with the corporate governance system may change in a fundamental way once substantial dispersal of ownership has already occurred in a given country. While left-leaning, stakeholder-oriented regulatory structures may correlate with weaker shareholder orientation in the corporate governance system where concentrated ownership remains the norm, the U.S. and U.K. developments discussed below suggest that, once dispersed ownership is established, the correlation may actually reverse. Put differently, while shareholder protection devices may be critical to the emergence of dispersed ownership, stakeholder protection devices may be critical to its maintenance. Moreover, the form that those stakeholder protection devices take may have an enormous impact on the degree of shareholder orientation exhibited by a country's corporate governance system.

B. Shareholders and Stakeholders in the United Kingdom

In this Section, I argue that placing corporate governance within its broader political context is critical to understanding both the origin and persistence of shareholder-centric regulatory structures in the United Kingdom. Specifically, I argue that left-leaning social democratic structures are not only compatible with shareholder-centrism, but that the stark form of shareholder-centrism embraced in U.K. corporate governance could only have taken root in tandem with social democratic policies serving to deflect political pressures by lowering the stakes of corporate governance for non-shareholder groups.

1. The British Welfare State

Perhaps ironically, a balance of internal and external forces is implicitly recognized by nexus theorists who argue that stakeholders' interests are best addressed through external contracts and regulation. Yet, these theorists routinely fail to recognize the degree to which shareholder-centric corporate governance and external stakeholder protections interrelate. Nexus scholars portray the position of shareholders' interests in corporate governance as fundamental and primary; external stakeholder protections are either assumed to be sufficient,[201] or the consequences of their insufficiency for corporate governance itself are left unexplored.[202] In reality, as the evolution of U.K. corporate governance illustrates, both internal and external structures have continually responded to one another in a dynamic process, and it is only by reference to such a process that one can fully explain the strong association of the U.K.'s shareholder-centric corporate governance structures with social democratic policies and Labour Party politics.

Martin Gelter has similarly argued that shareholder-centrism and extra-corporate stakeholder protections are intrinsically related, but concludes that preexisting ownership structures in a given country will determine which legal structures are ultimately adopted.[203] Gelter observes that "stronger shareholder influence"—including through European-style blockholding, as opposed to greater formal governance authority as a matter of corporate law—"implies a greater risk of expropriation for stakeholders, such as employees."[204] In Europe this problem has been addressed through stakeholder-oriented directors' duties, employee governance powers (for example, co-determination), and restrictive employment law rendering it "difficult and costly to lay off workers, thus eliminating potential threats that can result in holdup-type renegotiations."[205] In the U.S. context, on the other hand, this problem has been addressed through broad managerial discretion to deviate from shareholders' interests.[206] The United Kingdom, then, is treated as an "intermediate" case, with shareholder influence greater than one finds in the United States but weaker than that of a blockholder, and employment protections likewise falling somewhere between the weaker U.S. protections and the stronger European protections.[207]

Ultimately, Gelter argues that in each case the prevailing ownership structure predated the arrival of employment legislation, the stakeholder protection on which he focuses.[208] Gelter concedes, however, that this is hardly surprising in Europe, as "one could speak of concentrated owner-

201. *See supra* notes 106–07 and accompanying text. For discussions of this analytical weakness, see, for example, Millon, *supra* note 11, at 987–88, 1022–40; Millon, *supra* note 8, at 47; Parkinson, *supra* note 12, at 43–44.

202. *See, e.g.*, Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 442, 449 (2000).

203. *See* Gelter, *supra* note 1, at 132–35, 181–86.

204. *Id*. at 144.

205. *Id*. at 168–76; *cf.* Belloc & Pagano, *supra* note 13.

206. Gelter, *supra* note 1, at 148–54.

207. *Id*. at 186–93.

208. *Id*. at 181–84, 188–93.

ship as the primeval state of any corporate governance system," and that "it is not the persistence of concentrated ownership, but rather its unraveling in the United States and the United Kingdom that calls for an explanation."[209] In these dispersed ownership systems, however, I argue that we have to look beyond the employment law protections that Gelter considers for a full explanation of the varying degrees of shareholder-centrism that they exhibit. Another form of stakeholder protection actually co-evolved with the U.K.'s starkly shareholder-centric corporate governance structures—welfare state protections. In fact, these extra-corporate stakeholder protections arguably preceded the emergence of the relevant corporate governance structures. To this extent, the welfare state might be aptly characterized as a form of what David Millon has called "precontractual" state action—independent state action that conditions how various corporate stakeholders conceptualize their interests and negotiate their claims upon the corporation.[210]

As the *Economist* has explained,

> Britons are an incoherent lot. Convinced of their Anglo-Saxon tight-fistedness, left-wing politicians have felt obliged to moderate or camouflage their egalitarian urges. Free-marketeers, meanwhile, moan that the British are at bottom soggy socialists. Both are right: British voters are willing to tolerate greater inequalities than many Europeans, but are stubbornly attached to a few totems of communitarianism.[211]

In addition to the institutional factors discussed above, a full explanation of the degree of shareholder-centrism exhibited by the U.K. corporate governance system requires examining the array of political forces at work in British society throughout the decades following World War II.

Though its roots date back to the Liberal government of the early Twentieth Century,[212] the modern U.K. welfare state[213] arose out of in-

209. *Id*. at 182.

210. *See* Millon, *supra* note 11, at 990–92 (applying the concept to the impact of a default rule—employment at will—on negotiated contractual outcomes).

211. *Bagehot: The Shock of the Old*, ECONOMIST, July 5, 2008, at 70.

212. *See* CHEFFINS, *supra* note 4, at 47. The Liberal party held power from 1905 to 1922. Number10.gov.uk, Prime Ministers in History, http://www.number10.gov.uk/history-and-tour/prime-ministers-in-history (last visited Feb. 26, 2010); *see also* John Clarke et al., *The Construction of the British Welfare State, 1945–1975*, *in* COMPARING WELFARE STATES, *supra* note 38, at 29, 32, 39 (arguing that early twentieth-century British welfare programs were "part of the attempts by the state to appease, supervise and control an increasingly militant working class").

213. The term "welfare state" generally describes a set of baseline protections relating to income, health and unemployment insurance, and various other "social services." *See* Sanford Le-

ter-war economic difficulties and what one observer described as the consequent "craving for stability [that] dominated British public life"—a fact recognized by the left and the right alike, with both parties "increasingly accept[ing] the idea that the state had to provide jobs and comforts when business could not."[214] The post-war expansion of the welfare state, though enacted by the Labour government of 1945 to 1951, grew directly from "foundations . . . laid during the war and accepted by Mr. Churchill's coalition Government."[215] As Richard Fry, financial and industrial editor of the *Manchester Guardian*, summarized for American readers in 1949:

> Today the Englishman is offered—in return for his taxes, local rates, and national insurance contributions—a wide range of benefits: free education; medical attention, including medicines, spectacles and the now-famous false teeth; family allowances for each child except the first; free milk for school children; a fixed weekly payment in times of sickness or unemployment—as a right, not as charity; a pension in old age, and a funeral free of charge.[216]

The National Health Service—founded in 1948[217] and endorsed as broadly successful today by the right-leaning *Economist*[218]—is still

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vinson, *The Welfare State*, *in* A COMPANION TO PHILOSOPHY OF LAW AND LEGAL THEORY 553, 555 (Dennis Patterson ed., 1996); *see also* Cochrane et al., *supra* note 38, at 5–7, 12. Views on the appropriate scope of the welfare state are inevitably bound up with broader views on "distributive justice"—that is, the desirable "allocation of economic resources found within a given society and the state's role, if any, in rectifying ostensible maldistributions." Levinson, *supra*, at 554. As Allan Cochrane and his coauthors observe, welfare state programs have historically reflected prevailing prejudices regarding gender roles and family structure, as well as race and ethnicity. *See* Cochrane et al., *supra* note 38, at 14–17.

214. Richard H. Fry, *Appraisal of Britain's Welfare State*, N.Y. TIMES, Sept. 25, 1949, at SM12 (providing analysis of the financial and industrial editor of the *Manchester Guardian*); *see also* CHEFFINS, *supra* note 4, at 48 (observing that the Conservative Party "captured the middle ground of British politics" during the interwar period "by adopting sufficiently left-wing policies to ensure swing voters did not defect"); Clarke et al., *supra* note 212, at 34.

215. Fry, *supra* note 214, at SM12; *see also* Number10.gov.uk, *supra* note 212. The Labour Party, created in 1900 by disaffected "working people, trade unionists and socialists," rose to prominence following the split of the Liberal Party in 1916, and achieved its first government in 1924. The Labour Party, History of the Labour Party, http://www.labour.org.uk/history_of_the_labour_party (last visited Feb. 26, 2010).

216. Fry, *supra* note 214. Rajan and Zingales observe that the creation of welfare state programs brought a substantial increase in developed-economy government expenditures relative to the early part of the twentieth century. The United States, which "emerged from World War II with its industries largely intact and highly competitive," naturally pushed for free trade, but in return the British and others demanded flexibility to implement capital controls in order to maintain fiscal autonomy to pursue welfare-state spending. Rajan & Zingales, *supra* note 50, at 37–39.

217. National Health Service (UK), About the NHS, http://www.nhs.uk/NHSEngland/

touted by the Labour Party as one of its greatest achievements.[219] The leftward shift reflected by its foundation would, in fact, pervade British politics throughout the period between the end of World War II and Margaret Thatcher's rise to power in 1979. Although the Labour Party ruled for just half of that period,[220] governing platforms remained left-leaning under both parties[221]—including with respect to tax policy[222]—and pre-Thatcher governments of both parties broadly adhered to a corporatist, "tripartite relationship between state, business and organized labour."[223]

2. Takeovers and Labour Party Politics

In light of these broad trends, it should come as no surprise that both the post-war wave of takeovers and the regulatory response to them were, to a great extent, products of the political left. British economic historian Leslie Hannah has observed that hostile takeovers "were virtually unknown before 1950," in part due to "the inadequacy of the information possessed by shareholders about the asset and profit position of their companies."[224] This began to change, however, under the post-war Labour government. The Companies Act of 1948 mandated far more elaborate financial reporting than had previously been required, enabling investigation of targets by would-be bidders.[225] Additionally, the newly granted ability of shareholders to remove directors by ordinary resolution (i.e., by a simple majority) enhanced the governance

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thenhs/about/Pages/overview.aspx (last visited Feb. 26, 2010).

218. *See Bagehot: The Shock of the Old*, *supra* note 211.

219. The Labour Party, *supra* note 215.

220. *See* Number10.gov.uk, *supra* note 212. Labour governments ruled from 1945 to 1951 (Attlee), 1964 to 1970, 1974 to 1976 (Wilson), and 1976 to 1979 (Callaghan). *Id.*

221. *See* CHEFFINS, *supra* note 4, at 49.

222. *See id*. at 323–27.

223. *Id*. at 50; *see also* TOM HADDEN, COMPANY LAW AND CAPITALISM 439 (2d ed. 1977); Michael Blanden, *The City Regulations on Mergers and Takeovers*, *in* READINGS ON MERGERS AND TAKEOVERS 199, 215–16 (J.M. Samuels ed., 1972); Alan Dignam & Michael Galanis, *Corporate Governance and the Importance of Macroeconomic Context*, 28 OXFORD J. LEGAL STUD. 201 (2008).

224. LESLIE HANNAH, THE RISE OF THE CORPORATE ECONOMY: THE BRITISH EXPERIENCE 149 (1976).

225. *See* Brian R. Cheffins, *Mergers and the Evolution of Patterns of Corporate Ownership and Control: The British Experience*, 46 BUS. HIST. 256, 270 (2004); *see also* Johnston, *supra* note 183, at 427. Cheffins observes, however, that "the UK did not begin to experience a merger wave until a decade after reform took place," suggesting that "even if enhanced disclosure regulation did help to foster amalgamation activity, the contribution of company law was merely secondary." Cheffins, *supra*, at 270.

power associated with acquisitions of shares in the marketplace, setting the stage for hostile takeovers.[226]

When takeover attempts arose in the 1950s—the first successful takeover being Charles Clore's acquisition of J. Sears in 1953—the business community's response was decidedly negative.[227] But so too was the market's response to defensive tactics aimed at circumventing the shareholders, as management attempted in the Savoy Hotel battle later in 1953 and the British Aluminium battle in 1958. In the latter case, the British Aluminium board's attempt to ensure a deal with its favored bidder by issuing the bidder a sizeable share of the company's stock "provoked widespread calls for takeover regulation," and in 1959, "the Governor of the Bank of England secretly invited a committee comprised of trade groups representing merchant banks, institutional investors, the largest commercial banks, and the London Stock Exchange to devise a code of conduct to regulate takeover bids."[228] This effort resulted in the Notes on Amalgamation of British Businesses (Notes), which established as a matter of principle that shareholders should decide the fate of hostile takeover bids.[229] Lacking an enforcement mechanism, the Notes were widely disregarded, but in 1968 the Notes were replaced by the City Code, described above in Part II.B.[230] Though still self-regulatory in nature, the City Code brought enhanced compliance through oversight by the City Panel), as well as an enforcement capacity that "piggybacked" on those of the City Panel's constituents—notably the London Stock Exchange's ability to sanction listed companies, the Board of Trade's ability to sanction securities dealers, and the trade associations' ability to sanction their members.[231] The efficacy of this mode of self-regulation was substantially bolstered through this focus on "repeat players,"[232] as well as the general proximity and homogeneity of the inhabitants of "the City"—London's financial district.[233]

226. *See* CHEFFINS, *supra* note 4, at 363.

227. *See* Armour & Skeel, *supra* note 1, at 1756–57.

228. *Id.* at 1757–58.

229. *See id.* at 1759.

230. *See supra* notes 116–54 and accompanying text.

231. Armour & Skeel, *supra* note 1, at 1759–62. For additional background on events leading to the development of the City Code and the City Panel, see HADDEN, *supra* note 223, at 370–78; Johnston, *supra* note 183, at 428–36.

232. Armour & Skeel, *supra* note 1, at 1771–72; *Square Mile's Sheriff*, FINANCIAL WORLD ONLINE, Mar. 2008, https://www.financialworld.co.uk/Archive/2008/2008_03mar/Features/the_takeover_panel/13916-print.cfm.

233. Armour & Skeel, *supra* note 1, at 1771–72; *see also* Blanden, *supra* note 223, at 200–12; Bradley, *supra* note 33, at 299–300. In contrast, U.S. institutional investors' interests differ substantially with respect to time horizon and involvement in corporate governance. *See* Bruner, *su-*

Again, that the City, left to itself, would select shareholder-centric principles by which to self-regulate is hardly surprising. What perhaps is surprising, however, is that these principles would endure and in fact take on a more decidedly shareholder-friendly form under the Labour government in place from 1964 to 1970.[234] After all, takeovers forced the issues of corporate power and purpose in the United Kingdom, driving a wedge between the interests of shareholders and those of other constituencies, just as they latter would in the United States. As Alexander Johnston, a member of the City Panel, would observe in 1980, historically it was understood that directors owed a duty "to the company (whatever that might mean in a specific case) rather than to the shareholders," but that defensive measures by target boards "raised in an acute form the questions—who was ultimately in charge of a company and whose interests should be safeguarded?"[235] Comprehending the coalescence and persistence of this deeply shareholder-centric structure, which took its final form in the City Code and the City Panel developed during a Labour administration, requires grappling with the party's complex views on both shareholders and takeovers during this period.

"Government policy and public opinion" in the 1950s and 1960s were, as James Foreman-Peck and Leslie Hannah explain, "prone to conclude that Britain needed to become more like the United States in the scale of its industrial businesses,"[236] giving rise to a broadly shared predisposition in favor of mergers and acquisitions. Hannah explains that the U.K. government throughout this period was "directly active in the promotion of mergers," a policy that was, "despite differences of approach and emphasis, broadly bipartisan."[237] Cheffins likewise observes the "general consensus that the formation of large firms should be encouraged because UK industry was failing to take sufficient advantage of size-oriented opportunities for increased efficiencies," a view shared by the political left. Labour Prime Minister Harold Wilson him-

pra note 6, at 1439–42. For a summary of prominent U.K. takeover attempts in the 1950s, see ALEXANDER JOHNSTON, THE CITY TAKE-OVER CODE 8–18 (1980).

234. *See* Number10.gov.uk, *supra* note 212.

235. JOHNSTON, *supra* note 233, at 11, 13.

236. James Foreman-Peck & Leslie Hannah, *Britain: From Economic Liberalism to Socialism—And Back?*, *in* EUROPEAN INDUSTRIAL POLICY: THE TWENTIETH-CENTURY EXPERIENCE 19, 44 (James Foreman-Peck & Giovanni Frederico eds., 1999).

237. HANNAH, *supra* note 224, at 171; *see also* SECRETARY OF STATE FOR PRICES AND CONSUMER PROTECTION [U.K.], A REVIEW OF MONOPOLIES AND MERGERS POLICY: A CONSULTATIVE DOCUMENT, 1978, Cm. 7198, at 97 [hereinafter REVIEW OF MONOPOLIES AND MERGERS POLICY]; R. Goodman, *Taming and Controlling Power*, *in* READINGS ON MERGERS AND TAKEOVERS, *supra* note 223, at 218, 219.

self remarked of the mergers of the 1960s that they brought the United Kingdom "kicking and screaming into the twentieth century."[238] Hostile bidders were similarly viewed as offering hope of turning around weak companies and making them more competitive.[239]

Labour's position on takeovers evolved considerably over this period, reflecting simultaneous concerns regarding employment stability and industrial competitiveness. As of the early 1950s, Harold Wilson "complained about the asset stripping and large tax-free profits associated with hostile bids."[240] And in 1959, as shadow chancellor, he criticized the Conservative government of Harold Macmillan in a House of Commons debate, charging that "[j]ust as shareholders are becoming more and more avid for quick gains, so the Government regard any quick capital gains as good business, to be encouraged whatever the production realities."[241] Wilson asked how the Government could "appeal for wage restraint in the payment of a job honestly and well done, while millions of pounds can be made in this effortless manner"—that is, through takeovers—"by a section which does no work at all?"[242] Labour's 1959 election manifesto derides "the retiring company director with a tax-free redundancy payment due to a take-over bid," and, among other things, calls for increased funding of the National Health Service and overall "ex tension [sic] of the Welfare State."[243]

As of 1959, the year the Notes were adopted, the Labour party was clearly in favor of statutory regulation of takeovers.[244] By the time the party was in power, however, it evidently saw things differently. Whereas Labour's 1964 election manifesto expresses continued hostility toward takeovers, the 1966 manifesto makes no mention of them whatever.[245] Both documents emphasize Labour's ongoing commitment to

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238. CHEFFINS, *supra* note 4, at 360 (quoting WILLIAM DAVIS, MERGER MANIA 2 (1970)).

239. *Id.* at 365–66.

240. Callaghan, *supra* note 31, at 744–45.

241. *Id.* at 745 (quoting Wilson).

242. *Id.*; *see also* DAVIS, *supra* note 238, at 6.

243. LABOUR PARTY [U.K.], BRITAIN BELONGS TO YOU: THE LABOUR PARTY'S POLICY FOR CONSIDERATION BY THE BRITISH PEOPLE (1959), *available at* http://politicsresources.net/area/uk/man/lab59.htm (Labour Party election manifesto). "Redundancy" in this context refers generally to job loss following the elimination of one's position. *See* 13 OXFORD ENGLISH DICTIONARY 438–39 (2d ed. 1989).

244. Johnston, *supra* note 183, at 432.

245. *Compare* LABOUR PARTY [U.K.], THE NEW BRITAIN (1964) [hereinafter 1964 MANIFESTO], *available at* http://politicsresources.net/area/uk/man/lab64.htm (promising that Labour would "control take-over bids and mergers"), *with* LABOUR PARTY [U.K.], TIME FOR DECISION (1966) [hereinafter 1966 MANIFESTO], *available at* http://politicsresources.net/area/uk/man/lab66.htm (silent on mergers and take-over bids).

welfare state programs benefitting employees and others,[246] but the 1966 manifesto places this in the context of a broader "National Plan" with the "central aim . . . to accelerate industrial expansion without undermining our social priorities."[247] This involved not only scaling back Labour's attacks on takeovers, but actually facilitating them through the creation of the Industrial Reorganisation Corporation (IRC), which aimed to "stimulate rationalisation, modernisation and expansion in those fields where British industry at present seems unable to compete with the giant firms of the U.S. and Europe."[248] This move would seem to be in tension with prior Labour policies, but as Hannah explains, "earlier fears of Labour leaders that mergers and rationalization created unemployment had now given way to a feeling that larger (and, it was hoped, more productive) units would in the long run be better for employment."[249] Interestingly, the same Labour government encouraging mergers through the IRC was at the same time calling for enhanced oversight of takeovers through competition (antitrust) regulation by the Monopolies Commission.[250] U.K. competition regulation was, however, "modest . . . compared with the more stringent US antitrust controls," and very few deals were in fact impeded.[251]

In practice, such tensions in regulatory philosophy were not substantial because the IRC and the Monopolies Commission were both used by the Labour government as means of intervening to direct and coordinate the conduct and outcome of takeovers toward what Labour leaders perceived to be the larger public interest.[252] The IRC's exceptionally broad mandate was to "promote or assist the reorganisation or development of any industry,"[253] permitting an extraordinary range of direct market activity by the IRC. The potential for collision with competition

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246. 1964 MANIFESTO, *supra* note 245; 1966 MANIFESTO, *supra* note 245; *see also* Clarke et al., *supra* note 212, at 44, 57.

247. 1966 MANIFESTO, *supra* note 245.

248. *Id.*; *see also* DAVIS, *supra* note 238, at 11; DOUGLAS HAGUE & GEOFFREY WILKINSON, THE IRC—AN EXPERIMENT IN INDUSTRIAL INTERVENTION 3–5, 13–14 (1983); REVIEW OF MONOPOLIES AND MERGERS POLICY, *supra* note 237, at 20; J. Hughes, *The Trade Union Response to Mergers*, *in* READINGS ON MERGERS AND TAKEOVERS, *supra* note 223, at 148, 149.

249. HANNAH, *supra* note 224, at 172; *see also* DAVIS, *supra* note 238, at 2–3.

250. HANNAH, *supra* note 224, at 172, 179; *see also* 1966 MANIFESTO, *supra* note 245 (promising to "reduce inflated costs and profit margins in production and distribution by waging a vigorous anti-monopoly policy").

251. HANNAH, *supra* note 224, at 176; *see also* REVIEW OF MONOPOLIES AND MERGERS POLICY, *supra* note 237, at 17, 97–99.

252. *See* 1966 MANIFESTO, *supra* note 245; JOHNSTON, *supra* note 233, at 31.

253. DAVIS, *supra* note 238, at 146; HAGUE & WILKINSON, *supra* note 248, at 22 (quoting section 2(a) of the Industrial Reorganisation Act of 1966).

regulation would appear significant, but in practice there was no such conflict. Where the IRC became involved in a transaction, the matter in question simply would not be referred to the Monopolies Commission.[254] Notwithstanding early recognition of the "need to reassure businessmen that the IRC was not an instrument of the Labour Government which would be used to force them, for political reasons, to do things which they did not want to do,"[255] the IRC—and, in fact, high government officials including Prime Minister Wilson—did make controversial interventions in high-profile deals. The Labour government effectively determined the outcome of the January 1968 merger between Leyland Motors and British Motor Holdings[256] and the June 1968 takeover of Cambridge Instrument by George Kent.[257] The Conservative Party naturally detested such government interventions in the marketplace, likely impacting its decision to disband the IRC upon its return to power in 1970.[258]

In any event, the governing Labour Party ultimately became comfortable with the potential employment impacts of takeover activity because its leaders believed not only that the right mergers would maximize employment opportunities,[259] but also that external structures could sufficiently mitigate any near-term harms. Hannah observes, for example, that while it was "recognized that there would be unemployment problems following mergers . . . these were now felt to be problems of a transitional phase," and that the "social costs faced by unemployed workers were also more broadly shared as a result of the redundancy payments scheme initiated by Labour."[260] For example, Labour's 1966 election manifesto, which abandons criticism of takeovers and strongly

254. DAVIS, *supra* note 238, at 131, 146; REVIEW OF MONOPOLIES AND MERGERS POLICY, *supra* note 237, at 97.

255. HAGUE & WILKINSON, *supra* note 248, at 27.

256. *See* DAVIS, *supra* note 238, at 94–109; HAGUE & WILKINSON, *supra* note 248, at 119–33.

257. *See* DAVIS, *supra* note 238, at 136–39; HAGUE & WILKINSON, *supra* note 248, at 72–90. Alexander Johnston, a member of the City Panel, observed in 1980 that the Panel "had a good working relationship" with the IRC, facilitating its intervention in the Cambridge Instrument takeover by authorizing the IRC to publicize the Panel's conclusion that its conduct had conformed to the City Code. JOHNSTON, *supra* note 233, at 138.

258. *See* HAGUE & WILKINSON, *supra* note 248, at 3, 80–81.

259. Difficult as it may be to imagine today, in the U.K. political climate of the 1960s the IRC—which Prime Minister Wilson strongly supported—may have appeared relatively moderate to Labour leaders. Conservatives predictably favored leaving the market to itself, but "left-wing [Members of Parliament] thought the IRC was a feeble alternative to what they considered to be the real solution—an extension of public ownership." DAVIS, *supra* note 238, at 132; *see also* HAGUE & WILKINSON, *supra* note 248, at 24.

260. HANNAH, *supra* note 224, at 172 n.26; *see also* Gelter, *supra* note 1, at 190.

emphasizes the benefits of modernizing and rationalizing British industry through the IRC, also reminds voters that the purpose of the Redundancy Payments Act of 1965—providing "lump sum compensation, related to service, to those affected by redundancy"—was to "[e]ase the transition from one job to another."[261] This bolstered the protections of the Contract of Employment Act of 1963, which aimed to protect non-union members lacking collective bargaining capacity by specifying minimum notice periods.[262] Ultimately a shareholder-centric corporate governance regime could be accepted as politically stable by the left, so long as other regulatory policies were enacted to address non-shareholders' interests and ensure social stability.[263]

Gelter emphasizes that labor legislation of this sort "finally arriv[ed] during the 1960s and 1970s."[264] Note, however, that the Redundancy Payments Act was passed in 1965—three years before the shareholder-centric City Code and City Panel took shape. And, of course, the National Health Service, by that time, had been in place for two decades,[265] eliminating what might otherwise have constituted one of the most pressing concerns related to employment stability, especially in the takeover context. This course of events sheds light on how Harold Wilson—the same Labour leader who had condemned takeovers as incompatible with broader social interests—could, as Prime Minister, accept a

261. 1966 MANIFESTO, *supra* note 245 (emphasis removed); *see also* Michael Bennett, *Interpreting Unfair Dismissal and Redundancy Payments Law: The Judicial Reluctance to Disapprove Employer Decisions to Dismiss*, 23 STATUTE L. REV. 135, 136–37 (2002).

262. *See* Bennett, *supra* note 261, at 136.

263. *See* Rajan & Zingales, *supra* note 50, at 45 ("[I]nsurance schemes that will soften the impact of economic adversity on individuals will help ward off an anti-market reaction."); *cf.* HANNAH, *supra* note 224, at 197 (observing that "[w]ider considerations of political and social welfare have always been important in public assessment of modern industrial tendencies," a mindset Hannah associated particularly with the Labour Party). It should also be noted that union leaders themselves appear not to have been interested in direct board representation as a means of advancing labor interests, fearing that they would lack real governance power, yet appear to employees "to have 'sold out' to management." HADDEN, *supra* note 223, at 446; *cf.* Jacoby, *supra* note 45, at 34, 50–51 (observing a similar reluctance of the AFL-CIO in the United States to push for "industrial democracy," likely due to fear that "any expansion of employee board representation . . . would of necessity require loosening of the labour law's strictures on employer involvement in representation activities").

U.K. unions were at their strongest in the 1950s and 1960s, but began to decline in the 1970s. *See* Beth Ahlering & Simon Deakin, *Labor Regulation, Corporate Governance, and Legal Origin: A Case of Institutional Complementarity?*, 41 L. & SOC'Y REV. 865, 884 (2007). This trend has been accompanied, however, by improved employment law protections. *See* John Armour, Simon Deakin & Suzanne J. Konzelmann, *Shareholder Primacy and the Trajectory of UK Corporate Governance*, 41 BRIT. J. INDUS. REL. 531, 541 (2003).

264. *See* Gelter, *supra* note 1, at 190.

265. *See supra* notes 217–19 and accompanying text.

mode of regulation strongly favoring shareholders both in stated principle and in its self-regulatory form.[266] Wilson threatened statutory regulation, to be sure, but shareholder-centric self-regulation was accepted all the same.[267]

3. "New Labour" and the Company Law Review

Like its ongoing commitment to the welfare state,[268] the British left's general tolerance for shareholder-centric corporate governance evidently had not waned by the turn of the millennium, when an in-depth review of company law culminating in the Companies Act (2006) was undertaken. A Steering Group created by the Department of Trade and Industry under Tony Blair's centrist "New Labour"[269] government to aid the company law reform effort explicitly addressed "the proper scope of company law, that is, whose interests it should be designed to serve and the legal means by which it should do so."[270] In its February 1999 consultation document, the Steering Group characterized the preexisting law on directors' duties as shareholder-centric, citing Eas-

266. Wilson's own political centrism may have played a role. Wilson in fact "hovered between moderate left and moderate right throughout the late 1950s and into the 1960s," and more left-wing Labour members considered him "a right-winger at heart." Geoffrey Goodman, *Harold Wilson: Leading Labour Beyond Pipe Dreams*, GUARDIAN, May 25, 1995, at 14.

267. *See* JOHNSTON, *supra* note 233, at 41, 46–50; Blanden, *supra* note 223, at 205; Johnston, *supra* note 183, at 442; Lee, *supra* note 133, at 192. The depth of distaste for perceived regulatory excesses in the United States should also be noted. Then-Executive Director of the Takeover Panel T.P. Lee, writing in 1993, explained that the notion of takeover legislation "appalled the City and practitioners in this field. It conjured up a ponderous bureaucracy with all the least attractive features of the then US Securities and Exchange Commission." *Id.* Tom Hadden, writing in 1977, likewise rejected the U.S. model, observing that the "British securities market, unlike the American, is very highly centralized," and that "[m]any of the functions of the SEC in America can thus be effectively carried out in Britain by the [London] Stock Exchange authorities and the City Panel without formal statutory authority." HADDEN, *supra* note 223, at 361; *see also* JOHNSTON, *supra* note 233, at 21, 170–78; Blanden, *supra* note 223, at 212, 216.

268. *See* John Clarke et al., *Remaking Welfare: The British Welfare Regime in the 1980s and 1990s*, *in* COMPARING WELFARE STATES, *supra* note 38, at 71, 103 (observing that while "there has been a withdrawal from much direct provision of services, particularly in the field of social care," the British government "remains the dominant provider of education, healthcare and income maintenance"). It is interesting to note that, notwithstanding the Thatcher government's hostility toward welfare programs, U.K. welfare expenditures remained "remarkably stable" between 1973 and 1996. Clarke and his co-authors attribute this, among other things, to "bureaucratic and professional inertia within the state," and increases in the elderly and unemployed populations during this period. *Id.* at 76–79.

269. On the centrism of "New Labour," see *Who Killed New Labour?*, ECONOMIST, Sept. 18, 2008, at 37; *see also* GOUREVITCH & SHINN, *supra* note 1, at 262; Clarke et al., *supra* note 268, at 98; Number10.gov.uk, *supra* note 212.

270. STRATEGIC FRAMEWORK, *supra* note 153, at 33, 159–65.

terbrook and Fischel and suggesting that permitting directors to pursue "a wider range of interests" would require a change to the company law.[271] The goals of the reform effort were to maximize "benefits for all participants in the enterprise" while, "to the extent it is appropriate," minimizing "the negative impacts of corporate activity on participants" and maximizing "welfare more widely."[272] This involved explicit consideration of whether to remain with a shareholder-centric formulation of directors' duties or to adopt what was termed the "Pluralist" approach, broadly reflecting the team production theory described above, requiring that directors be duty-bound to maximize aggregate benefits for all corporate stakeholders.[273]

The Steering Group rejected the Pluralist approach, taking the view that, among other things, such a "broader objective" could "dangerously distract management into a political balancing style at the expense of economic growth and international competitiveness," and suggesting that other stakeholders' interests "are best made good by changes in other areas of the law and public policy."[274] The Steering Group preferred what it termed the "Enlightened Shareholder Value" approach, which preserves "shareholder wealth maximisation" as the "ultimate objective of companies" while requiring that other stakeholders' interests be considered toward that end[275]—an approach ultimately reflected in section 172 of the Companies Act.[276] Characterized by some as "a classic piece of New Labour triangulation," and as a sort of "half way house" between shareholder wealth maximization and the Pluralist view,[277] section 172 is more widely, and accurately, recognized as a continuation of the prior law, requiring that directors pursue the best interests of shareholders.[278]

271. *Id*. at 34, 37.

272. *Id*. at 36.

273. *Id*. at 37–39.

274. *Id*. at 44.

275. *Id*. at 39–42; *see also* COMPANY LAW REVIEW STEERING GROUP, MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY: COMPLETING THE STRUCTURE 33–34 (2000), *available at* http://www.berr.gov.uk/files/file23210.pdf [hereinafter COMPLETING THE STRUCTURE]; COMPANY LAW REVIEW STEERING GROUP, MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY: DEVELOPING THE FRAMEWORK 10–11 (2000), *available at* http://www.berr.gov.uk/files/file23248.pdf [hereinafter DEVELOPING THE FRAMEWORK].

276. Companies Act, 2006, c. 46, § 172 (U.K.).

277. Giles Richardson & Serle Court, *The Companies Act 2006, Directors' Duties and the Onset of Insolvency*, 23 TOLLEY'S INSOLVENCY L. & PRAC. 138 (2007).

278. *See, e.g.*, DAVIES, *supra* note 124, at 506–09; DIGNAM & LOWRY, *supra* note 124, at 389 (observing that section 172 "particularly disappointed the non-governmental organisation (NGO) community"); Robert Goddard, *Directors' Duties*, 12 EDIN. L. REV. 468, 468–69 (2008);

The U.K. system unquestionably gives shareholders a voice in corporate governance well beyond that possessed by their counterparts in the United States. As Bernard Black and John Coffee have observed, while public governance challenges have historically been rare, U.K. institutional shareholders do "act behind closed doors," informally negotiating for their desired outcomes before the omnipresent threat that they might exert their authority to remove recalcitrant directors.[279] This "facilitates rapid and decisive action by investors when firms are in distress," potentially including "drastic adjustments at labour's expense."[280] And yet, as the discussion in this Section demonstrates, a number of the most important developments in U.K. corporate governance occurred on the Labour Party's watch. As I have argued here, Labour's willingness to see the creation of shareholder-centric governance structures reflects, to a great extent, the simultaneous construction of extra-corporate structures that address other constituencies' needs, notably welfare state structures that substantially mitigate the consequences of job loss.[281]

Johnston, *supra* note 183, at 456–57; Andrew Keay, *Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's "Enlightened Shareholder Value Approach*,*"* 29 SYDNEY L. REV. 577, 604–07 (2007); Parkinson, *supra* note 12, at 32–33. The Steering Group envisioned that the Enlightened Shareholder Value concept would be bolstered by a requirement that a public company include in its annual report an "Operating and Financial Review (OFR)" that "would cover all that is material in the directors' view for users to achieve a proper assessment of the performance and future plans and prospects of the business"—including relationships with other stakeholders. This disclosure "would enable shareholders and the community as a whole to monitor performance by directors . . . and to provide appropriate feedback to the company." DEVELOPING THE FRAMEWORK, *supra* note 275, at 13–14; *see also* COMPLETING THE STRUCTURE, *supra* note 275, at 33–34. Ultimately, however, the OFR "was unexpectedly removed from the statute book and replaced with a 'Business Review' which is considerably less prescriptive about, *inter alia*, the disclosure that must be made about employment matters." Johnston, *supra* note 183, at 457; *see also* Tom Burns & John Paterson, *Gold Plating, Gold Standard or Base Metal? Making Sense of Narrative Reporting After Repeal of the Operating and Financial Review Regulations*, 2007 INT'L COMPANY & COM. L. REV. 247 (2007). The Business Review requires that information regarding "environmental matters," employees, and "social and community issues" be included "to the extent necessary for an understanding of" the business, without further guidance. Companies Act, 2006, c. 46, § 417 (U.K.). In any event, however, such disclosure is explicitly aimed at permitting shareholders—not other constituencies—to assess directors' performance of their section 172 duty.

279. Black & Coffee, *supra* note 4, at 2002, 2028–29, 2041–42. Black and Coffee observe that British institutions have been particularly willing to intervene to protect their voting and preemptive rights, and to remove underperforming CEOs. *Id*. at 2035–37; *see also supra* notes 126–27 and accompanying text.

280. Howard Gospel & Andrew Pendleton, *Markets and Relationships: Finance, Governance, and Labour in the United Kingdom*, *in* CORPORATE GOVERNANCE AND LABOUR MANAGEMENT: AN INTERNATIONAL COMPARISON 1, 76–81 (Howard Gospel & Andrew Pendleton eds., 2005).

281. John Cioffi and Martin Höpner have argued more generally that in Germany, France, Italy, and the United States, "center-left parties and politicians have often been instrumental propo-

The explanatory power of such variables is underscored by contrast with circumstances in the United States, where the relative absence of U.K.-style welfare state structures has had an enormous impact on the development of the corporate governance system. In some instances, as the next Section explores, this has led U.S. corporate governance in a radically different direction.

C. Shareholders and Stakeholders in the United States

As we have seen, U.S. corporate law, notably in Delaware, has for decades remained deeply ambivalent regarding the shareholders' role in corporate governance and the degree to which shareholder interests and incentives can be taken as an accurate proxy for those of the public at large. We have also seen that, although this ambivalence manifests itself in various ways, the conflicting drives of U.S. corporate governance are most clearly on display in the field of takeover regulation. Consequently, this Section of the Article will focus on this area, while endeavoring to discern broader trends that illuminate the overall divergence from U.K. corporate governance. For the sake of clarity, Figure 2 provides a summary of the principal contrasts drawn below.

nents of [pro-shareholder corporate governance] reform, while conservative parties and politicians have typically resisted reform and defended the interests of incumbent managers." John W. Cioffi & Martin Höpner, *The Political Paradox of Finance Capitalism: Interests, Preferences, and Center-Left Party Politics in Corporate Governance Reform*, 34 POL. & SOC'Y 463, 464 (2006). In the case of the United States, they point to the Sarbanes-Oxley Act of 2002, which they describe as "Democrats us[ing] the post-bubble scandals and the collapse of share prices to attack a deeply conservative and pro-manager Republican leadership and as a well-placed appeal to middle-class voters in a country where mass shareholding was well established." *Id*. at 484. Helen Callaghan has concluded that the United Kingdom in fact does not fit this pattern, arguing that left/right competition "from the 1950s until the arrival of Tony Blair . . . was a straightforward battle between capital and labor," with Labour attacking the outsider-friendly takeover rules supported by the Conservatives. Callaghan, *supra* note 31, at 734. In support of this argument, Callaghan cites Wilson's strong anti-takeover rhetoric of the 1950s, but she does not grapple with how the Labour Party actually dealt with takeover regulation—and mergers more generally—once it was in power. *See id.* at 745.

FIGURE 2: TAKEOVER REGULATION IN POLITICAL CONTEXT

	U.K.	**U.S.**
Time period	1960s	1980s
Prevailing politics	left (Wilson)	right (Reagan)
Social welfare protections	stronger (welfare state)	weaker ("employee welfare state")[282]
Regulatory mode	"City" self-regulation	state courts/legislatures
Regulatory emphasis	shareholders	stakeholders

1. The "Employee Welfare State"

It should be observed, first, that the takeover debate in the United States arose at a very different time and under very different circumstances than in the United Kingdom. The core issues of takeover regulation were thrashed out in the United Kingdom between 1959, when the Bank of England spearheaded the development of the Notes on Amalgamation of British Businesses, and 1968, when the City Code on Takeovers and Mergers and the associated City Panel on Takeovers and Mergers were developed.[283] The United States likewise saw the Williams Act enacted in 1968, but this federal securities statute does not directly address the use of defensive measures by management—the issue at the heart of takeover regulation.[284] In the United States, the critical rules for hostile takeovers were not developed until the 1980s, following a wave of leveraged hostile tender offers.[285]

While regulatory divergences between different countries may sometimes be explained by reference to just such historical differences, in

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282. The "employee welfare state" concept, discussed below, was articulated by David Charny. *See infra* notes 289–91 and accompanying text.

283. *See supra* notes 227–33 and accompanying text.

284. *See supra* note 87. For a general overview of the Williams Act, see ALLEN ET AL., *supra* note 7, at 443–44. On the Williams Act's more modest pro-disclosure aims, see generally Lyman Johnson & David Millon, *Misreading the Williams Act*, 87 MICH. L. REV. 1862 (1989).

285. *See supra* notes 74–85 and accompanying text. Despite the absence of legal impediments, takeovers emerged only gradually starting in the early 1960s, perhaps reflecting cultural aversion toward this "newly emerging social phenomenon." *See* Johnson & Millon, *supra* note 284, at 1890–91.

this case, history renders the nature of the divergence more puzzling. Whereas the shareholder-centric U.K. takeover regime predominantly took shape during the left-leaning Labour administration of Prime Minister Harold Wilson, U.S. takeover regulation, which strongly favors non-shareholder constituencies such as management and employees, predominantly took shape during the presidency of Ronald Reagan, a Republican who strongly opposed governmental intrusions in the marketplace. Takeover regulation in the United States is, to be sure, largely a matter of state law, but that such an anti-shareholder regulatory regime should have emerged during the pro-market and pro-takeover Reagan administration[286] is as surprising as a pro-shareholder regime taking shape under the U.K. Labour Party.

Neither would be predicted by Roe's social democracy theory, which associates anti-shareholder policies with left-leaning politics and pro-shareholder policies with right-leaning politics.[287] Indeed the analysis of this Article has suggested that it may have been the very presence of left-leaning, social democratic regulatory structures in the United Kingdom that permitted the coalescence and maintenance of a shareholder-centric corporate governance system. This suggests that, conversely, the emergence of a more stakeholder-oriented regime in the United States may be related to the relative weakness of social democratic structures.

Unlike in the United Kingdom and most other industrialized countries, where social welfare programs have been administered predominantly by the government, in the United States large corporate employers "have been primarily responsible for workers' social welfare."[288] This includes "health insurance, pensions, unemployment insurance (in the form of severance pay, and job security and income guarantees), disability insurance, and life insurance," as well as mandatory employer contributions to various state-run programs.[289] David Charny explains

286. *See* ROE, *supra* note 175, at 156; Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 627–29 (2003); Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2510 (2005); *see also* Ronald Reagan Presidential Library, The Reagan Presidency, http://www.reagan.utexas.edu/archives/reference/pressketch.html (last visited Feb. 26, 2010); The White House, Ronald Reagan, http://www.whitehouse.gov/about/presidents/ronaldreagan/ (last visited Feb. 26, 2010).

287. *See supra* notes 162–69 and accompanying text.

288. David Charny, *The Employee Welfare State in Transition*, 74 TEX. L. REV. 1601, 1601 (1996).

289. *Id.* at 1601–03; *see also* Jacoby, *supra* note 45, at 37–39; John Clarke, *US Welfare: Variations on the Liberal Regime*, *in* COMPARING WELFARE STATES, *supra* note 38, at 113, 114–16; Orly Lobel, *The Four Pillars of Work Law*, 104 MICH. L. REV. 1539, 1542–43 (2006) (reviewing RAYMOND HOGLER, EMPLOYMENT RELATIONS IN THE UNITED STATES: LAW, POLICY, AND PRACTICE (2004) and KATHERINE V.W. STONE, FROM WIDGETS TO DIGITS: EMPLOYMENT

that this "elaborate web of legally enforceable contracts, implicit agreements, background legal norms, and discrete public regulatory and insurance systems" aims to accomplish the very things that government programs do in other countries, namely, protecting workers against the risk of lost income, and providing health and retirement benefits.[290] Charny observes that while this system "provided fairly comprehensive social insurance protections" from the 1920s to the 1970s, those elements of the U.S. approach not taking the form of enforceable legal rights—so-called implicit contracts—are inevitably difficult to maintain during periods of crisis.[291] In particular, hostile takeovers upset the relationships within the corporation that formed the foundation of what he terms "the employee welfare state."[292]

The United States and the United Kingdom have similarly emphasized private pensions,[293] and neither country's labor laws offer particularly strong protections (either in the context of hostile takeovers or more generally),[294] though as between the two countries these protections tend to be weaker in the United States.[295] The two countries have taken radically different approaches, however, to at least one of the core components of workers' social welfare that Charny identifies—health

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REGULATION FOR THE CHANGING WORKPLACE (2004)); Toni Johnson, Council on Foreign Relations, Healthcare Costs and U.S. Competitiveness (Jan. 20, 2010), http://www.cfr.org/publication/13325/.

290. Charny, *supra* note 288, at 1606; *see also* Levinson, *supra* note 213, at 555.

291. Charny, *supra* note 288, at 1601.

292. *Id.* at 1601–20; *see also* Jacoby, *supra* note 45, at 35–36, 39–42; Julia Contreras & Orly Lobel, *Walmartization and the Fair Share Health Care Acts*, 19 ST. THOMAS L. REV. 105, 111–12 (2006); Lobel, *supra* note 289, at 1542–49; *cf.* Matthew Dolan, *Blame is Put on Management, but Hourly Workers, Retirees Face More Pain*, WALL ST. J., Mar. 31, 2009, at A4 ("The three Detroit auto makers provide health care for more than one million Americans."). Others have used less flattering terms. *See, e.g.*, Clarke, *supra* note 289, at 114 (discussing European descriptions of the United States as a "laggard" or "deviant" with respect to welfare policy). On the concept of implicit contracts, see generally Shleifer & Summers, *supra* note 95.

293. *See* CHEFFINS, *supra* note 4, at 348. For a historical description of U.K. pension programs, see Simon Deakin, *Workers, Finance and Democracy*, *in* THE FUTURE OF LABOUR LAW 79, 89–94 (Catherine Barnard et al. eds., 2004).

294. *See* Simon Deakin et al., *Implicit Contracts, Takeovers, and Corporate Governance: In the Shadow of the City Code* 12 (ESRC Ctr. for Bus. Research, Univ. of Cambridge, Working Paper 254, 2002), *available at* http://ideas.repec.org/p/cbr/cbrwps/wp254.html.

295. *See, e.g.*, Margarita Estevez-Abe et al., *Social Protection and the Formation of Skills: A Reinterpretation of the Welfare State*, *in* VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE, *supra* note 2, at 145, 165–73; Gelter, *supra* note 1, at 170, 190; *cf.* GOUREVITCH & SHINN, *supra* note 1, at 153–54 (reporting OECD data indicating a higher degree of "corporatism" in the United Kingdom than the United States); Gospel & Pendleton, *supra* note 280, at 68 (reporting substantial "income inequality" in both countries, but adding that "[t]his is most marked of all in the United States").

care. In the United States, the medical profession and the insurance industry have historically opposed comprehensive national health insurance programs.[296] So unlike the United Kingdom, which maintains the reasonably well regarded National Health Service[297]—a system founded in 1948 that today "remains free at the point of use for anyone who is resident in the UK"[298]—the United States adheres to an employer-based system, at considerably higher cost, that as of 2007 provided no coverage whatsoever to 45.7 million Americans.[299]

2. *Takeovers and Stakeholders*

It is quite striking, in this light, that the most overtly stakeholder-oriented elements of U.S. takeover regulation arising out of the wave of leveraged hostile tender offers in the 1980s were often linked to the perceived insufficiency of social safety nets and the view that the political *quid pro quo* represented by Charny's "employee welfare state" was not being respected. For example, the preamble to a 1987 North Carolina anti-takeover statute noted the "increasing frequency" of hostile takeovers and the "high unemployment" that can result from such deals. It further emphasized that potentially vulnerable local corporations "provide their North Carolina employees with health, retirement and other benefits."[300] Such concerns were heightened in the 1980s, when social welfare programs were substantially scaled back.[301] As of 1983, fifty-eight percent of Americans received health coverage through their employers, and instability in the U.S. economy throughout the decade caused wide-

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296. *See* Clarke, *supra* note 289, at 123, 138. For a brief discussion of health care reform efforts following the current crisis, see *infra* notes 359–64 and accompanying text.

297. *See, e.g.*, *Bagehot: The Shock of the Old*, *supra* note 211.

298. National Health Service (UK), *supra* note 217; *see also* National Health Service (UK), NHS Core Principles, http://www.nhs.uk/NHSEngland/thenhs/about/Pages/nhscoreprinciples.aspx (last visited Feb. 26, 2010).

299. *See* Contreras & Lobel, *supra* note 292, at 108–12; Johnson, *supra* note 289 (reporting that the "United States spends an estimated $2 trillion annually on healthcare expenses, more than any other industrialized country," and that U.S. health care expenditures amounted to "16 percent of its GDP in 2008," again "higher than any other developed nation"); Press Release, U.S. Census Bureau, Household Income Rises, Poverty Rate Unchanged, Number of Uninsured Down (Aug. 26, 2008), *available at* http://www.census.gov/Press-Release/www/releases/archives/income_wealth/012528.html.

300. *See* Millon, *supra* note 48, at 922–24 (quoting and citing 1987 N.C. Sess. Laws 122, and discussing other similar state statutes); *see also* Lyman Johnson, *State Takeover Statutes: Constitutionality, Community, and Heresy*, 45 WASH. & LEE L. REV. 1051, 1053–54 (1988); Johnson, *supra* note 80, at 909–10; Johnson & Millon, *supra* note 284, at 1878–82; Lyman Johnson & David Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846, 848–53 (1989).

301. *See* Clarke, *supra* note 289, at 125–29, 133–34.

spread anxiety regarding "the security of their healthcare arrangements."[302] In effect, unemployment meant the loss of access to affordable health care.[303] Particularly in the face of such uncertainty, the quely American "employee welfare state" was perceived to be threatened by leveraged hostile tender offers, precipitating laws that, from the British perspective, appear strikingly "pluralist" and thus incompatible with the U.K. corporate governance system.[304]

These dynamics are inevitably less pronounced in states where takeover regulation has largely been left to case law, but even in Delaware, concern for non-shareholders comes through in major cases of the 1980s and in judges' subsequent discussions of these cases. In *Unocal*, the case establishing the core evaluative structure for takeover defenses, the Delaware Supreme Court stated that analysis of a defensive measure's proportionality could include "its effect on the corporate enterprise," including "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[305] While the court did hold in *Revlon* that the board must focus on maximizing the price received by shareholders in a sale, break-up, or change of control, this duty applies only where such an outcome is "inevitable."[306] Indeed, in *Paramount v. Time*, the court reiterated *Unocal's* "constituencies" language in support of its holding that a target board could refuse to negotiate with a bidder making an attractive all-cash, all-shares offer in favor of its own long-term plan for the company's future.[307]

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302. *Id.* at 137.

303. *See id.*

304. *See* STRATEGIC FRAMEWORK, *supra* note 153, at 48 (describing U.S. "stakeholder statutes" as reflecting "a pluralistic approach"). While it is clearly the perception of the matter that drives the politics, it should be noted that empirical studies on the effects of hostile takeovers report mixed results. *See, e.g.*, OESTERLE, *supra* note 63, at 660 ("The data gathered demonstrates . . . that on average, bidder gains from disadvantaging any one of the [stakeholder] groups explain only a small portion of the premiums paid to target shareholders."); Charny, *supra* note 288, at 1629 (observing that leveraged buyouts "statistically appear not to be associated with the massive employment cuts that the Summers/Schleifer [implicit contract] analysis would predict," but adding that "[o]ne might hypothesize that labor-cost savings are instead accomplished by cutting benefits"); Deakin et al., *supra* note 294, at 14 ("The quantitative methods which are used to measure the effects of bids upon shareholder wealth are not able to specify whether those gains came from increased productive efficiency or wealth transfers."); Gospel & Pendleton, *supra* note 280, at 67–68; Jacoby, *supra* note 45, at 36 ("[D]ata show that annual wage growth is 1–2 per cent higher in those companies which are subject to anti-takeover laws.").

305. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

306. *See supra* notes 80–82 and accompanying text.

307. *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1990).

That such policy-laden doctrines should take shape in judicial opinions is hardly surprising, given the Delaware General Assembly's steadfast refusal to legislate on hostile takeovers.[308] Former Delaware Chancellor William Allen, then-Vice Chancellor (now Justice) Jack Jacobs, and Vice Chancellor Leo Strine observe (in a law review article) that "amendments to the [Delaware General Corporation Law] have rarely been the method used to confront the major developments occurring in the mergers and acquisitions marketplace during the last thirty years," creating a "legislative vacuum" and thrusting upon the courts the task of creating "legal rules [that] involve policy choices."[309] Such work, they write, "unavoidably (and awkwardly) acquires legislative characteristics."[310] While the Delaware General Corporation Law has explicitly endorsed neither a shareholder-oriented nor a stakeholder-oriented view of the corporation,[311] these jurists candidly concede that judges facing takeover cases "are unavoidably aware that the interests of more than stockholders are usually at stake" and express "uncertainty over whether the [shareholder-centric] property model is, in fact, the corporate law system that will best facilitate the maximization of societal wealth."[312] Ultimately they recognize as "credibly arguable" the claim that board power over hostile takeover attempts can effectively balance the interests of shareholders and other stakeholders.[313] This notion was, of course, flatly rejected by the U.K. Steering Group spearheading the Companies Act review,[314] which declares shareholder wealth maximization to be the defining purpose of a U.K. corporation.[315] Delaware judges facing takeover cases have, for lack of legislative action, been forced to address defining issues of corporate law that can only be resolved by reference to "exogenous and broad-based social norms."[316]

308. Delaware's statute does include a business combination provision, *see* DEL. CODE ANN. tit. 8, § 203 (2001), but this provision includes a number of exceptions, and is "fairly mild as anti-takeover statutes go." ALLEN ET AL., *supra* note 7, at 609 n.59.

309. Allen, Jacobs & Strine, *supra* note 53, at 1068.

310. *Id*. at 1070.

311. *See id.* at 1074–82.

312. *Id.* at 1083–84.

313. *Id*. at 1085; *see also* Johnson, *supra* note 80, at 873–85.

314. *See* STRATEGIC FRAMEWORK, *supra* note 153, at 44; COMPLETING THE STRUCTURE, *supra* note 275, at 34; DEVELOPING THE FRAMEWORK, *supra* note 275, at 14.

315. *See* Companies Act, 2006, c. 46, § 172(1) (U.K.).

316. *See* Johnson, *supra* note 80, at 886–91.

3. *Employee Welfare in the Current Environment*

While the rise of institutional investors[317] and increasing capital mobility over recent decades may tend to favor the interests of shareholders capable of voting with their feet,[318] more recent events tend to suggest that the U.S. political dynamics described above remain just as powerful today. For example, when Walmart—the largest private sector employer in the United States as of 2006—endeavored to boost returns for shareholders at the expense of other constituencies by "shifting health care costs" to employees and to taxpayers funding limited state health care programs, states reacted angrily with legislation aimed at thrusting those costs back onto the company.[319] Although such legislative efforts were found to be preempted by federal employment legislation,[320] Walmart ultimately decided to improve the health benefits offered to its employees, "reacting to a vast range of campaigns and litigation against the corporation."[321] As Julia Contreras and Orly Lobel rightly suggest, Walmart's problems stemmed from bucking the political equilibrium represented by Charny's "employee welfare state" by excessively favoring shareholders at the expense of employees and taxpayers.[322]

Likewise, the current economic and financial crisis has brought such concerns to the fore as the U.S. public grapples with widespread fears of job loss. Opinion polls tend to suggest that loss of access to affordable health care looms large among current employment-related fears.[323] Such concerns are not unfounded. Indeed, it is thought that "nearly half

317. *See* Bruner, *supra* note 6, at 1432–35.

318. *See* Allen, *supra* note 53, at 279; Rajan & Zingales, *supra* note 50. *See generally* Dignam & Galanis, *supra* note 223.

319. *See* Contreras & Lobel, *supra* note 292, at 105–17.

320. *See id*. at 125–34 (discussing preemption of Maryland's Fair Share Health Care Act by the Employee Retirement Income Security Act, or ERISA).

321. *Id*. at 121–22.

322. *See id.* at 111–13, 134–35; *see also* Ceci Connolly, *At Wal-Mart, a Health-Care Turnaround*, WASH. POST, Feb. 13, 2009, at A01.

323. *See, e.g.*, PEW RESEARCH CENTER, MORE WORKERS ANTICIPATE PAY CUTS, LAYOFFS 1 (2009), *available at* http://people-press.org/reports/pdf/492.pdf (reporting that, as of February 2009, the "proportion of Americans citing jobs or unemployment as the nation's most important economic problem has more than quadrupled—from 10% to 42%—since early October," and that 24% of workers polled considered a loss of "some" or "all" of their health benefits "very" or "somewhat" likely over the next year); Lydia Saad, Americans Rate National and Personal Healthcare Differently, Dec. 4, 2008, *available at* http://www.gallup.com/poll/112813/Americans-Rate-National-Personal-Healthcare-Differently.aspx (reporting, as of December 2008, that 79% of Americans "say they are dissatisfied with the total cost of healthcare in this country," that 14% say the system is "in a state of crisis," and that 59% say it has "major problems"); *see also* John Fairhall & Kate Steadman, *The New Uninsured*, WASH. POST, Feb. 3, 2009, at HE01; Francesca Lunzer Kritz, *Staying Insured After Job Loss*, L.A. TIMES, Jan. 19, 2009, at F1.

of all recent home foreclosures have resulted, in part, from families being hit by health expenses not covered by insurance."[324] As of March 2009, the Big Three automakers—Chrysler, Ford, and General Motors—"provide[d] health care for more than one million Americans, including union retirees and their dependents,"[325] creating substantial complications in negotiations with unions over the fate of the struggling Chrysler and General Motors.[326] Concerns regarding loss of health care due to unemployment have become a mainstay of American popular media, with pundits offering contradictory advice on how to plan for life without access to affordable health care. One writer for the *New York Times*, for example, advises readers to "[u]se it before you lose it,"[327] while *CNN.com* warns readers at risk of losing their jobs to avoid the temptation to order last-minute tests that might reveal a "pre-existing condition," rendering it "very difficult, if not impossible" to find affordable replacement coverage directly from private insurers.[328]

Meanwhile, in the United Kingdom, the National Health Service's message to those who have lost jobs reads: "If coping is getting hard, don't hesitate to contact your GP."[329] This contrast reflects the absence in the United Kingdom of a set of weighty social concerns that have long tended to inhibit U.S. corporate governance from endorsing shareholder interests as the defining purpose of the public corporation.

D. Ownership Structure and Shareholder Orientation

In this Part, I have argued that the relative absence of social democratic structures in the United States has tended to impede the development of a starkly shareholder-centric corporate governance system resembling that in the United Kingdom—and that the fundamental

324. *Harry and Louise Ride Again*, ECONOMIST, Apr. 4, 2009, at 36, 36 (attributed to Kathleen Sebelius, nominee for U.S. Secretary of Health and Human Services).

325. Dolan, *supra* note 292, at A4.

326. *See* Johnson, *supra* note 289.

327. Walecia Konrad, *Hanging on to Health Coverage, if the Job Goes Away*, N.Y. TIMES, Mar. 7, 2009, at B6.

328. Elizabeth Cohen, *Fear a Layoff? Don't Make These Health Care Mistakes*, CNN.COM, Feb. 5, 2009, http://www.cnn.com/2009/HEALTH/02/05/ep.health.insurance.loss/index.html; *see also* John Dorschner, *Insurers Shun Those Taking Certain Meds*, MIAMI HERALD, Mar. 28, 2009, at 1A. On the strain that job loss is placing on hospitals and state-based health care programs, see Lisa Girion & Mark Medina, *Recession Has Some Hospitals on the Brink*, L.A. TIMES, Jan. 14, 2009, at A1; Kevin Sack & Katie Zezima, *Growing Need for Medicaid Puts Added Financial Burden on States*, N.Y. TIMES, Jan. 22, 2009, at A25.

329. NATIONAL HEALTH SERVICE (UK) BRISTOL, COPING WITH THE STRESS OF JOB LOSS, (2009), *available at* http://www.bristolpct.nhs.uk/PublicHealth/bristol_leaflet.pdf.

political structures resulting in U.S. ambivalence regarding shareholders remain firmly in place today.[330] One might object, however, that if social democracy and shareholder orientation are somehow correlated, then we ought to observe even more shareholder-centrism in, say, continental Europe—not less. The key to grappling with this problem is to focus again on the sequencing: that is, how and why this issue of shareholder orientation arises in the United States and the United Kingdom at all.

As previously noted, Martin Gelter rightly observes that since "concentrated ownership is the international norm and dispersed ownership the exception, one could speak of concentrated ownership as the primeval state of any corporate governance system."[331] Consequently, "it is not the persistence of concentrated ownership, but rather its unraveling in the United States and the United Kingdom that calls for an explanation."[332] As Gelter explores in some detail, in much of the world, shareholder power is simply a given due to concentrated ownership. Thus, the principal regulatory issue remains how to counteract that innate shareholder power through various types of stakeholder-oriented protections (as illustrated in Figure 3).[333] In the United States and the

330. I do not intend to suggest that shareholder-oriented reform efforts are not vigorously pursued by their advocates. For example, in 2007 North Dakota enacted the "North Dakota Publicly Traded Corporations Act," N.D. CENT. CODE §§ 10-35-01 to -33 (2005 & Supp. 2007), permitting public companies to opt into a regime with "a set of provisions that looks like a shareholder rights advocate's wish list." Given Delaware's traditional dominance and institutional capabilities, however, it remains unlikely that this development will materially affect Delaware's position as the predominant jurisdiction of incorporation for U.S. public companies. *See* The North Dakota Experiment, Posting of Larry Ribstein to the Harvard Law School Forum on Corporate Governance and Financial Regulation, http://blogs.law.harvard.edu/corpgov (Apr. 23, 2007, 23:48 EST).

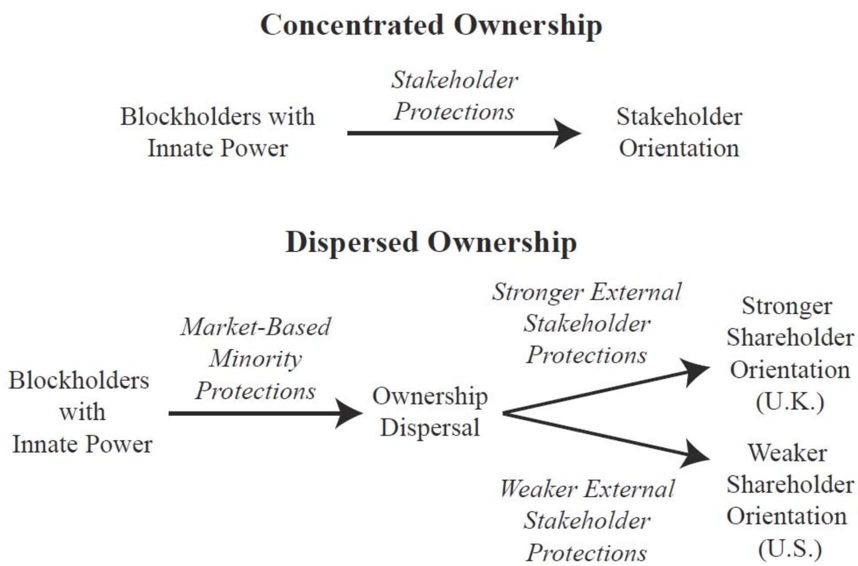
331. Gelter, *supra* note 1, at 182.

332. *Id.*

333. *See id.* at 154–76; *see also* Gerhard Schnyder, *Revisiting the Party Paradox of Finance Capitalism: Social Democratic Preferences and Corporate Governance Reforms in Switzerland, Sweden and the Netherlands*, 44 COMP. POL. STUD. (forthcoming 2011) (exploring the role of labor politics in the divergent corporate governance systems of these three countries). Note, however, that while I depict ownership structures in binary terms for the sake of clarity, there is in fact a high degree of variation across countries with respect to degree of ownership dispersal. See *supra* note 1. Intermediate cases may well defy straightforward categorization in these terms—notably, countries like Canada and Australia that, although dominated by blockholders, tend to be market-oriented in outlook. *See supra* note 4. While beyond the scope of this Article, it should be noted that the role that politics plays in corporate governance in such countries may differ from the role politics plays in other concentrated systems. This is due, among other things, to the cultural proximity of countries like Canada and Australia to the United States and the United Kingdom. *See generally* Brian R. Cheffins, *Corporate Governance Convergence: Lessons from Australia*, 16 TRANSNAT'L LAW. 13 (2002); Alan Dignam, *The Role of Competition in Determining Corporate Governance Outcomes: Lessons from Australia's Corporate Governance System*, 68

United Kingdom, on the other hand, the dispersal of ownership raises precisely the opposite regulatory issue. In the development of a dispersed ownership structure, the challenge becomes inducing people to accept the status of minority investors through the construction of shareholder-oriented protections.

FIGURE 3: OWNERSHIP STRUCTURE AND REGULATORY POSTURE REGARDING SHAREHOLDERS



As my argument in this Article suggests, however, this process of ownership dispersal requires a constant recalibration of emergent shareholder and stakeholder protections to balance shareholders' comfort with minority status and stakeholders' comfort with shareholder-centric governance. In this way, shareholder and stakeholder regulatory protections in a dispersed ownership system develop in response to one another. While shareholder protections initially inducing ownership dispersal may occur entirely in the marketplace, and thus largely outside the glare of politics, the later development of formal regulatory protections inevitably occurs in a more overtly political arena. As we have seen, where stakeholder protections are more robust outside the corporate go-

MOD. L. REV. 765 (2005); Randall Morck et al., *The Rise and Fall of the Widely Held Firm—A History of Corporate Ownership in Canada* (Nat'l Bureau of Econ. Research, Working Paper No. 10635, 2004), *available at* http://www.nber.org/papers/w10635.

vernance system, shareholder-centric corporate governance structures will encounter less political resistance. But conversely, where stakeholder protections outside the corporate governance system remain weaker, we can expect political opposition to arise, inhibiting the emergence of shareholder-centrism and favoring flexibility to accommodate stakeholders' interests within corporate governance itself.

IV. POLITICAL PRECONDITIONS TO SHAREHOLDER-CENTRIC CORPORATE GOVERNANCE

At the outset, I observed that the use of comparative analysis to generate claims about what a given country's regulatory system ought to do is fraught with complex problems and, in particular, that social, cultural, and political variables are often airbrushed out of the picture to facilitate straightforward cross-border comparisons. As the foregoing discussion suggests, comparative analyses ignoring the impact of political context will inevitably present a distorted picture, resulting in unsupported claims regarding what the future might bring.

This problem is readily apparent in normative work advocating that one country adopt a practice or norm prevalent in another—for instance, shareholder-centrism. The problem also arises in descriptive work forecasting convergence on such a global model or norm. Lucian Bebchuk, for example, has suggested that the United States should adopt something resembling the strong shareholder-centrism of U.K. corporate governance, but no analysis of the substantial political and institutional differences discussed above is provided.[334] His dismissal of stakeholders' interests as mere cover for management entrenchment—again, with no substantial political or historical analysis[335]—is perhaps ironic in light of his own prior work with Mark Roe on the power of path dependence in corporate governance, exploring, among other things, the role of "complementarities" between regulatory regimes and firm structures.[336]

To be sure, a number of variables beyond those discussed here have played important roles in determining the path of U.S. corporate governance. In the case of Delaware, one such variable is its competition with other states to attract incorporations, which might reasonably lead one to expect its law to skew toward the interests of management. Another

334. *See* Bebchuk, *supra* note 23, at 847–50.
335. *See id.* at 908–13.
336. *See* Bebchuk & Roe, *supra* note 1, at 155–56, 168.

variable is Delaware's competition with Washington, D.C., which casts a long shadow over the state, given the ability and demonstrated willingness of Congress and the Securities and Exchange Commission to "federalize" vast swathes of the corporate governance terrain in times of perceived crisis.[337] The point here is not to suggest that management entrenchment has no explanatory power with respect to stakeholder-oriented elements of U.S. corporate governance, but rather to challenge the notion that it presents a complete explanation for it. As Bebchuk himself observes (with Roe), "if countries differ systematically in their firms and technologies, then the legal rules that would be most efficient for them might differ"—that is, each may represent a unique equilibrium, depending on the interaction of firm-level relationships and legal rules.[338] "Culture and ideology," they rightly conclude, "might influence a country's choice of corporate law."[339] In my view, this approach offers considerably greater potential for illuminating stakeholder-oriented elements of U.S. corporate governance than the simplistic management entrenchment story does.

Henry Hansmann and Reinier Kraakman, meanwhile, have provocatively argued that "[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value," declaring an "end of history for corporate law."[340] Specifically, they anticipate equity market pressure toward convergence on the model of "Anglo-American corporate and securities law."[341] Having lumped together the United States and the United Kingdom as the joint shareholder-centric model for corporate governance, however, they almost immediately have to concede that substantial differences persist in core doctrinal areas illuminating corporate purpose—notably, in takeover regulation—permitting only the unsupported "conjecture that the law on both sides of the Atlantic will ultimately converge on a single regime."[342] Ultimately they concede the possibility of "efficient non-convergence"—due, among other things, to "local social struc-

337. *See supra* notes 181–84. *See generally* William J. Carney, *The Production of Corporate Law*, 71 S. CAL. L. REV. 715 (1998); Roe, *Delaware's Competition*, *supra* note 286; Roe, *Delaware's Politics*, *supra* note 286; Robert B. Thompson, *Defining the Shareholder's Role, Defining a Role for State Law: Folk at 40*, 33 DEL. J. CORP. L. 771, 778–82 (2008). Fear of foreign takeovers may also have played a role. *See, e.g.*, *Japanese Takeovers 'A Trickle*,*'* N.Y. TIMES, July 6, 1987, at 37.

338. Bebchuk & Roe, *supra* note 1, at 168.

339. *Id.*

340. *See* Hansmann & Kraakman, *supra* note 202, at 439.

341. *Id*. at 455.

342. *Id*. at 458.

tures"—but provide no substantial analysis of the relationship between corporate governance and politics.[343]

The Anatomy of Corporate Law, likewise, purports to articulate a single defining problem of corporate governance worldwide—minimizing agency costs.[344] To be sure, the concept of functional equivalence and the inclusion of multiple forms of agency costs allow the authors some capacity to account for observed divergences,[345] yet the sorts of divergences discussed in this Article inevitably sketch the outer boundary of their model's explanatory domain—again, a point the authors effectively concede.[346] For example, in the book's first edition, radical differences in U.S. and U.K. takeover regulation—providing "a timely reminder that 'Anglo-American' company law is not the unity that is sometimes assumed"—are explained as simply reflecting varying levels of confidence in the merits of "centralized management."[347] The authors do obliquely suggest that something more fundamental may be at work, observing that Delaware takeover law is "difficult to justify" in terms of agency costs to shareholders, and they ultimately concede that explaining such regulatory divergences in greater depth "requires placing the legal rules in a broader economic and social context."[348] This move, of course, involves stepping outside the methodological framework upon which the book's analysis rests[349]—which the authors more decidedly do in the book's second edition, where "the stark contrast between U.S. and UK corporate law" is cited as an "extremely powerful example" of how "history, economics, and political economy cause corporate law to differ across jurisdictions regardless of ownership structure."[350] They observe that "[t]he UK offers what is arguably the most shareholder-centered corporate law of any of our core jurisdictions," citing "particularly the City Code," whereas "U.S. law is more board-

343. *See id*. at 464–65; *see also* GOUREVITCH & SHINN, *supra* note 1, at 284 (arguing that the political complexity of corporate governance will likely preclude convergence); Hall & Thelen, *supra* note 187, at 23 ("Not all changes grouped together under the rubric of 'liberalization' produce meaningful 'convergence' . . . .").

344. *See supra* notes 21–22 and accompanying text.

345. *See supra* notes 34–37 and accompanying text.

346. *See supra* note 41 and accompanying text.

347. Paul Davies & Klaus Hopt, *Control Transactions*, *in* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 157, 172–73 (1st ed. 2004).

348. *Id*. at 189–91.

349. *See* Skeel, *supra* note 8, at 1539–43 (observing that as a consequence of the authors' decision not to address the "messy factors" of history and politics, "their explanations for jurisdictional divergences often have an arbitrary, ungrounded quality").

350. *See* Davies et al., *supra* note 41, at 313.

centric than that of any other jurisdiction," a distinction attributable "not [to] ownership structure but [to] history and political economy."[351]

This illustrates a methodological challenge that Ralf Michaels associates with functionalist comparative work—the need to state the problem at a high level of abstraction to achieve the universality that cross-border comparison would seem to demand.[352] As one might imagine, this need is particularly strong where the effort is to develop a global theory. Nuance is inevitably sacrificed and, with it, the ability to describe doctrinal structures that do not address co-extensive sets of problems in different countries. This shortcoming is what analysis of the political and social contexts surrounding U.S. and U.K. corporate governance most clearly reveals. Notwithstanding broad similarities in the corporate form the world over—which, to be sure, are both very real and well worth exploring—the public corporation does not in fact perform perfectly co-extensive sets of functions in the United States and the United Kingdom, let alone in any two countries. As we have seen, the existence of more robust protections for non-shareholders outside the U.K. corporate governance system has been pivotal in permitting a more single-minded focus on shareholders within it. And conversely, the historical role of public corporations in maintaining what Charny termed the "employee welfare state" has inextricably bound U.S. corporate governance to the achievement of a range of social goals that lie well beyond what Britons expect their own corporations to accomplish. Britons and Americans do not hold identical sets of goals for their public corporations, and consequently their corporate governance systems are subject to social and political pressures that, in some cases, are radically different.

I have endeavored to avoid the methodological problem of excessive abstraction by relaxing the assumption that there is a single defining problem at which all corporate governance structures take aim. But, at the same time, one may avoid abstraction only to disappear into the excessively "contingent"[353]—the problem of contextualism.[354] I suggested

351. *Id.* The jurisdictions emphasized in the book include France, Germany, Italy, Japan, the United Kingdom, and the United States. *See* Armour, Hansmann & Kraakman, *supra* note 22, at 3. With respect to the U.S./U.K. divergence, the authors suggest that "populism and financial collapse . . . facilitated the rise of managerial capitalism" in the United States, whereas the rise of institutional shareholders following World War II led to "a shareholder-centric company law" in the United Kingdom. Davies et al., *supra* note 41, at 313.

352. Michaels, *supra* note 15, at 367.

353. *Id*. at 368.

354. *See supra* notes 32–42 and accompanying text.

at the outset that these twin limitations counsel restraint in the conclusions we draw from comparative study, but that, at the same time, recognition of the need for restraint represents an opportunity in itself. From the perspective of domestic law, judged by reference to its own metrics, my comparative analysis suggests that the on-going debate regarding the role of shareholders in U.S. corporate life[355] simply cannot be limited to the regulatory fields typically associated with the term corporate governance (e.g., corporate law, securities regulation, exchange listing rules). The manner in which the U.S. and U.K. corporate governance systems have developed vividly illustrates the deep connection between corporate governance and numerous other forms of regulation that condition relationships within the corporate enterprise. This relationship presents a significant challenge to those who believe that issues of corporate purpose can be resolved in a politically stable manner from within the corporate governance system itself.

As described above, the prevailing view of the corporation among U.S. academics holds that the corporation should, and generally does, resemble what rational stakeholders would negotiate for themselves. The nexus view, as it is known, depicts the corporation as a fundamentally private endeavor.[356] In light of the foregoing political analysis, the most remarkable feature of this view is the implied sanctity of corporate law itself. While the negotiation is explicitly hypothetical and essentially metaphorical,[357] there is nevertheless a hierarchy of law expressed through the implicit sequencing of various regulatory structures affecting stakeholders' relationships. The corporate "contract"—representing what purportedly rational parties would settle upon—is effectively deemed sacrosanct. It is held constant while other bodies of law and contractual systems arrange themselves by reference to it.[358] Even taken as a metaphor, however, it is at best a weak one. In terms of dispersed

355. I focus here on U.S. corporate governance simply because the issue of corporate purpose has not been resolved in the United States with anything resembling the clarity or finality of the U.K. company law review process. *See supra* notes 150–53, 269–78 and accompanying text.

356. *See supra* notes 100–07.

357. *See* EASTERBROOK & FISCHEL, *supra* note 17, at 15 (depicting corporate law, by "analogy to contract," as including "standby terms . . . facilitat[ing] actual contracts"). As Lyman Johnson observes, the substitution of what a judge or legislator believes rational stakeholders would agree to for actual consent amounts to "a claim about the vitality and ubiquity of certain unerring abstract tenets of economics, and only derivatively (and secondarily) a claim about particular people's actual desires and conduct." *See* Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215, 2220–23 (1992) (reviewing EASTERBROOK & FISCHEL, *supra* note 17, and ROBERT N. BELLAH ET AL., THE GOOD SOCIETY (1991)).

358. *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 17, at 37–39.

ownership systems, the United States and the United Kingdom are the most significant data points. And as the analysis above demonstrates, both have taken shape through much larger and more complex political and social processes than the nexus theory can begin to accommodate.

That the U.S. and U.K. corporate governance systems have, with all their differences, persisted for decades suggests that there are multiple stable equilibria within the dispersed ownership structure. This raises some important considerations for U.S. policymakers contemplating corporate governance reform. First, it behooves us to understand what a given equilibrium actually consists of—that is, what balance of forces a system represents—before we set off to reform it.[359] Should we seek to adopt a more shareholder-centric conception of corporate purpose in the United States—say, for any benefits we think this clarity of mission might offer—we would do well to consider the larger structures that have made such an approach politically stable in the United Kingdom. To be sure, the U.K. case suggests that we could create a starkly shareholder-centric corporate governance system if we really wanted it. But it also suggests that, to remain politically viable over time, such an approach would require substantially greater non-shareholder protections outside corporate law[360]—a move that would require fundamental changes to existing social welfare structures that are unlikely to attract sustained political support.[361]

This gives rise to a second point for policymakers to consider. While I have argued that the U.S. and U.K. corporate governance systems reflect two different political equilibria, I most certainly do not intend to suggest that they represent functionally equivalent means of providing social welfare protections. To some degree, weaker employment protections and the persistence of a health care system that leaves tens of millions uninsured simply reflect a higher degree of tolerance for distribu-

359. *See, e.g.*, Gelter, *supra* note 1, at 194; GOUREVITCH & SHINN, *supra* note 1, at xiv.

360. *See, e.g.*, Gelter, *supra* note 1, at 186, 194 (observing the importance of "institutional complementarities" in advancing reform efforts); Hall & Soskice, *supra* note 2, at 17–18; *cf.* Contreras & Lobel, *supra* note 292, at 134–35 (arguing, in the health care context, that either a national system or a mandatory employer system is ultimately required); Dolan, *supra* note 292, at A4 (quoting a UAW representative's view that "[s]omeone is going to have to pay for health care," and that "[i]f it's not the companies, it's going to be the taxpayers in some way, shape or form").

361. *See, e.g.*, Charny, *supra* note 288, at 1638 (observing that "abandoning the employee welfare system" in favor of government-based programs would require "a major change in political and legal culture"); *Harry and Louise Ride Again*, *supra* note 324 (observing that a push for "a federal insurance scheme" in the United States "could kill health reform" due to opposition from health insurers, employers, and health-care providers "fearing higher costs").

tional inequities in the United States.[362] While I argue that stakeholder-oriented corporate governance structures reflect a response to this, there is no reason to believe that they could substantially mitigate it.[363] Consequently, normative evaluation of these corporate governance systems requires more than assessment against a narrowly defined set of efficiency metrics—it requires acknowledging and reckoning with the more fundamental distributive politics that each system reflects.

Finally, it should be observed that my argument does not constitute a prediction that pro-shareholder reforms will not make headway in the United States, but rather that the stability and sustainability of any such reforms would hinge to some degree on structures external to corporate governance. In this light, it is noteworthy that institutional shareholders long pushing for such reforms have finally made some headway during the current crisis—a period in which the U.S. government has also pursued industrial policy in the automobile sector and engaged in a serious effort toward national health care reform.[364] It is equally noteworthy that (at least as of this writing) movement toward shareholder empowerment has remained tentative, and proposed health care reforms would maintain the predominantly employer-based system and fall far short of universal coverage.[365]

Contrary to what prevailing political theories of corporate governance would predict, the highly shareholder-centric corporate governance structure embraced in the United Kingdom reflects a political

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362. *See supra* notes 293–99 and accompanying text; *see also Anglo-Saxon Attitudes*, *supra* note 10; Levinson, *supra* note 213, at 553–55.

363. *Cf.* Millon, *supra* note 97, at 1022 (observing that board discretion to deviate from shareholders' interests does not equate to a stakeholder mandate).

364. *See* Shareholder Bill of Rights Act, S. 1074, 111th Cong. § 5 (2009) ("Shareholder Bill of Rights Act," introduced by Senator Charles Schumer, D-N.Y.); Editorial, *The End of Private Health Insurance*, WALL ST. J., Apr. 13, 2009, at A14; Editorial, *The Obama Autoworks*, WALL ST. J., Mar. 31, 2009, at A20; Steve Lohr, *In U.S., Steps Toward Industrial Policy in Autos*, N.Y. TIMES, May 20, 2009, at B1; Yin Wilzcek, *In Split Vote, SEC Agrees to Propose Shareholder Proxy Access Rule Amendments*, CORP. L. DAILY (BNA), May 21, 2009; Press Release, Securities and Exchange Commission, SEC Votes to Propose Amendments to Facilitate Rights of Shareholders to Nominate Directors, *available at* http://www.sec.gov/news/press/2009/2009-116.htm (May 20, 2009).

365. *See* Fawn Johnson, *New Comments Could Broaden Debate On Proposed SEC Proxy Rules*, DOW JONES NEWSWIRES, Dec. 30, 2009, *available at* http://www.nasdaq.com/aspx/stock-market-news-story.aspx?storyid=200912301351dowjonesdjonline000419; Press Release, Securities and Exchange Commission, SEC Re-Opens Public Comment Period for Shareholder Director Nomination Proposal (Dec. 14, 2009), *available at* http://www.sec.gov/news/press/2009/2009-265.htm; Perry Bacon Jr., *Senate Health-Care Bill Would Still Leave Millions Uninsured*, WASH. POST, Jan. 2, 2010, at A02; Robert Pear, *Senate Passes Health Care Overhaul on Party-Line Vote*, N.Y. TIMES, Dec. 25, 2009, at A1.

happy medium where shareholder protections strong enough to induce ownership dispersal have arisen, yet robust social welfare protections have accompanied their recognition in law, neutralizing the potential for backlash against shareholders within corporate governance itself. Ironically, then, American individualism and the correlative fear of "big government"—cultural and social characteristics motivating the fundamentally private nexus conception of the corporation—may themselves represent the most formidable barriers to politically sustainable shareholder-centrism in the United States.[366]

366. *See, e.g.*, Kenneth G. Dau-Schmidt & Carmen L. Brun, *Lost in Translation: The Economic Analysis of Law in the United States and Europe*, 44 COLUM. J. TRANSNAT'L L. 602 (2006). Dau-Schmidt and Brun argue that these characteristics "make the United States a receptive environment for application of economic analysis to law." *Id*. at 606. By contrast, the "communitarian" and "state-oriented" leanings of Europeans are said to render them less amenable to economic analysis of legal problems, *id*. at 616, although they do clarify that the law and economics movement has been more successful in the United Kingdom than in France or Germany. *Id*. at 611; *see also* Kristoffel Grechenig & Martin Gelter, *The Transatlantic Divergence in Legal Thought: American Law and Economics vs. German Doctrinalism*, 31 HASTINGS INT'L & COMP. L. REV. 295 (2008) (arguing that the rise of utilitarianism and legal realism in the United States set the stage for the law and economics movement); Johnson, *supra* note 357, at 2248–49 (arguing that the appeal of economic analysis of law "cannot be explained solely by its descriptive power," and that its normative appeal reflects a "preference . . . for the prominence and centrality of the individual in the traditions and thinking of [American] society").