University of St. Thomas Law Journal

Volume 10
Issue 4 *Spring 2013*

Article 3

2013

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Bluebook Citation
Lyman Johnson, *Law and the History of Corporate Responsibilities: Corporate Governance*, 10 U. St. Thomas L.J. 974 (2013).

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ARTICLE

LAW AND THE HISTORY OF CORPORATE RESPONSIBILITY: CORPORATE GOVERNANCE

LYMAN JOHNSON*

INTRODUCTION

This article is one part of a multi-article project on the role of law in the history of corporate responsibility in the United States. Key background material for the project is set forth in the introduction to an earlier article addressing corporate personhood.[1] This paper deals with corporate governance while other articles cover (or will cover) corporate purpose and corporate regulation.[2]

Corporate responsibility concerns associated with corporate personhood, corporate purpose, and corporate regulation all ultimately relate to a far more basic issue: corporate governance. As the commercial demands of nineteenth century industrialization led to substantial displacement of the partnership form of business enterprise by large corporations with dispersed shareholders, control of these corporations—i.e., their governance—centered in the hands of senior managers, not investors themselves. This phenomenon of "separation of ownership from control" is quite different than in the typical partnership and was seminally described by Adolf Berle and Gardiner Means in their 1932 book, *The Modern Corporation and Private Property*.[3] It has continued to occupy center stage in corporate law for the past eighty years.

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1. Lyman Johnson, *Law and Legal Theory in the History of Corporate Responsibility: Corporate Personhood*, 35 SEATTLE L. REV. 1135, 1135–40 (2012).

2. Lyman Johnson, *Unsettled and Unsettling Issues in Delaware Corporate Law: The Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405 (2013) [hereinafter Johnson, *Unsettledness*]; Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefit Corporations*, 25 REGENT L. REV. 269 (2012) [hereinafter Johnson, *Pluralism*].

3. ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 68 (1932).

From a legal history vantage point on corporate responsibility, the stupendous rise in commercial significance of the corporation in the nineteenth century corresponded to the precipitous decline of a regulatory approach to corporations under state corporate law,[4] and instead, the twentieth century "outsourcing" of such regulation to an array of other legal regimes designed to protect both investor and noninvestor groups. This meant that corporate law itself developed in such a way as to loosen, not tighten, most constraints on those who govern public corporations. The thesis of this article, developed in Parts I and II, is that corporate governance, both as a body of law and as a field of academic study, has historically had little to say on the important subject of corporate responsibility. Instead, the quest for greater responsibility in the United States largely has come from "external" legal regulation and from ongoing shifts in business and social norms. Recently, corporate law's long and unsustainable neglect of corporate responsibility concerns has led to the emergence of a new type of business corporation, the "benefit corporation." Benefit corporations expressly permit the directors to advance both investor and noninvestor interests, in aid of pursuing a larger public benefit. The implications of this development for governance of the regular business corporations are unknown. One potential outcome is the "ghettoization" of corporate responsibility within benefit corporations, leading to even less attention to such concerns in the traditional business corporation.

I. Corporate Law's Historical Neglect of Corporate Responsibility

The most famous lamentation of the deregulatory movement within corporate law is found in Justice Louis Brandeis' 1933 dissenting opinion in *Liggett v. Lee*.[5] Justice Brandeis, writing one year after publication of *The Modern Corporation and Private Property*—to which he refers—chronicles in detail how a largely suspicious regulatory stance toward corporations gradually and entirely subsided throughout the nineteenth and early twentieth centuries.[6] Early in the nineteenth century, states had strictly controlled corporate attributes and powers in numerous ways. For example, states typically limited the amount of capital a single corporation could assemble; restricted the scope of corporate powers; limited the duration of a corporation to a period ranging, generally, from twenty to fifty years; placed limits on company indebtedness; prohibited the holding of stock in another corporation; and gave stockholders broad veto powers over proposed transactions.[7] These strictures, Brandeis noted, fell away as several states earnestly competed for new corporate charters—an important source of state reve-

4. *See* Johnson, *supra* note 1, at 1159–64.
5. Liggett v. Lee, 288 U.S. 517, 541 (1933) (Brandeis, J., dissenting).
6. *See Liggett*, 288 U.S. at 542–60; *see* Johnson, *supra* note 1, at 1144–52.
7. *See Liggett*, 288 U.S. at 542–60; *see* Johnson, *supra* note 1, at 1144–52.

nue—by adopting a low cost and deregulatory philosophy of corporate law in which legal restrictions were curtailed and powers were enhanced. This so-called "race" was famously, and distressingly, described by Brandeis as being one "not of diligence but of laxity."[8]

The upshot of the simultaneous rise of the commercial and socioeconomic significance of the corporation and the substantial slackening of corporate regulation by states meant that those who controlled corporations possessed enormous financial and legal power. This had several important consequences for developments pertinent to corporate responsibility. First, the growth of concentrated power was of course directly germane to the subject of corporate personhood. Neither large numbers of passive stockholders nor a handful of professional managers of gargantuan enterprises could sensibly be equated to the "corporation" itself. After a failed but valiant effort during the late nineteenth and early twentieth centuries to conceive of the corporation as simply an "aggregation of individuals,"[9] eventually the corporation was recognized as an institution in its own right, and legal personhood was simply the inevitable conceptual and linguistic acknowledgement of that phenomenon.[10] Second, as to corporate purpose,[11] it was centralized managerial control as well that spurred the debate, ongoing today, over whether managerial duties should run singularly to stockholders—to ensure strict accountability to them—or should extend to a broader group of stakeholders to ensure more socially responsible corporate conduct. Third, given the decline of regulation within corporate law itself, external regulation was designed to constrain the manner in which powerful managers deployed the vast corporate resources under their control. In light of such control, certain regulation, such as federal securities law, was pointedly designed to protect stockholders, while other laws were designed to protect various other vulnerable constituencies such as consumers, employees, and the natural environment.

Finally, however, as to genuine reform of the deep decision-making architecture of corporate governance itself as a possible pathway to more responsible corporate conduct, little truly innovative thinking—beyond the occasional boosting of stockholder protection via federal securities law—ever was seriously advanced until the middle of the twentieth century, when new ideas were at least proposed even though they ultimately went nowhere. The lone academic exception prior to that time was a provocative early 1930s debate between Adolf Berle and Merrick Dodd over the proper

8. *Liggett*, 288 U.S. at 560. Over the last quarter of the twentieth century, the "race" debate broadened to include arguments that, contrary to Brandeis' view, the race was to the "top" or to "nowhere." *See* William Bratton, *Corporate Law's Race to Nowhere in Particular*, 44 U. Toronto L.J. 401, 401–03 (1994) (collecting scholarship).

9. Johnson, *supra* note 1, at 1154.

10. *See id.*

11. *See* Johnson, *Unsettledness*, *supra* note 2, at 435–38.

focus for directors—i.e., shareholders only or a broader group of stakeholders[12]—but no structural governance changes immediately followed from that debate. In short, once states had essentially abandoned corporate law itself as a way to regulate corporate activity, they never turned back.[13] The various halting and unsuccessful efforts to broadly improve corporate conduct through corporate governance reform are described in Part II. Only with the recent emergence of the benefit corporation, however, has the effort to deploy the mechanisms of corporate governance to advance corporate responsibility borne any legal fruit.

II. Corporate Governance Reform Efforts

A. *Mid-Twentieth Century*

A glimmer of truly innovative, if fairly vague, governance reform can be seen in Professor Abram Chayes' 1959 essay in which he hinted that noninvestor groups need greater "say" in corporate affairs, while also recognizing that this would not be easy to do:

> A more spacious conception of "membership," and one closer to the facts of corporate life, would include all those having a relation of sufficient intimacy with the corporation or subject to its power in a sufficiently specialized way. Their rightful share in decisions on the exercise of corporate power would be exercised through an institutional arrangement appropriately designed to represent the interests of a constituency of members having a significant common relation to the corporation and its power.
>
> It is not always easy to identify such constituencies nor is it always clear what institutional forms are appropriate for recognizing their interests. The effort to answer those questions is among the most meaningful tasks of the American legal system.
>
> The trail is not without its blazes, however. Among the groups now conceived as outside the charmed circle of corporate membership, but which ought to be brought within it, the most important and readily identifiable is its work-force . . . .

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12. *See, e.g.*, A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 Harv. L. Rev. 1049 (1931) (arguing that corporate managers should use control for shareholder benefit); A. A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 Harv. L. Rev. 1365 (1932) [hereinafter Berle, *Corporate Managers*] (arguing that corporate managers should largely serve stockholders); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 Harv. L. Rev. 1145 (1932) (arguing that corporate managers do not only owe a duty to their stockholders to make a profit but should advance a range of broader "corporate" interests).

13. The most striking positive law exception arose in the 1980s when legislatures sought to curb high levels of takeover activity through their corporate statutes. *See infra* note 33. These statutes had a clear pro-management thrust but the point is that states in the 1980s chose to "regulate" a widespread economic activity thought to be socially disruptive—hostile corporate takeovers—by means of their corporate statutes, a legislative strategy that had long lain dormant but was successfully, if briefly, revived in that era.

> Direct worker representation on the managing board, however, has not proved fruitful in this country, although it is being experimented with in a variety of forms by different European nations.[14]

One proposed governance reform that surfaced periodically—and that would serve to institutionally flesh out Professor Chayes' suggestion—was the suggested use of "public interest" directors on corporate boards. These persons, in theory, would take a broader-gauged view of how a corporation's activities affected groups other than investors.[15] As noted by Professor Douglas Branson, the 1870s reorganization of the Union Pacific Railroad board and the late twentieth century board of the Communications Satellite Corporation included public interest directors.[16] Justice William Douglas in 1940,[17] and other commentators since then,[18] also have advocated for public interest directors. Unlike certain European nations providing for employee representation on supervisory boards,[19] however, changing the composition of the board of directors from a completely stockholder-elected body to one more broadly representative of other groups never took hold in the United States with respect to solvent companies.[20] Today, only common stockholders enjoy statutory suffrage under American corporate law.[21]

Other noteworthy proposed reforms of corporate governance during the 1970s included Professor William Cary's advocacy of federal minimum standards for large corporations and Ralph Nader's (and his coauthors') proposal for outright federal chartering of corporations.[22] Concerned about what Justice Brandeis had called a "race of laxity,"[23] and that he branded a

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14. Abram Chayes, *The Modern Corporation and the Rule of Law*, *in* THE CORPORATION IN MODERN SOCIETY 25, 41 (Edward S. Mason ed., 1959).

15. One problem with any "special constituency" directors—including "public interest" or employee- or creditor-elected directors—is that all directors have fiduciary duties demanding that they place the interests of the beneficiary of those duties above all other considerations. If those duties run only to the "corporation," a "special interest" director must advance the corporation's interests, not those of his or her electors. If the duties also run to stockholders, their interests must be paramount. Thus, either the special interest director must argue that advancing the interests of his or her special constituency is consistent with and advances corporate and/or stockholder well-being, or that constituency's interests must remain subordinate. *See generally* Simone M. Sepe, *Intruders in the Boardroom: The Case of Constituency Directors*, 91 WASH. U. L. REV. 1 (2013).

16. *See* Douglas M. Branson, *Corporate Governance "Reform" and the New Corporate Social Responsibility*, 62 U. PITT. L. REV. 605, 613 (2001).

17. *See* WILLIAM O. DOUGLAS, DEMOCRACY AND FINANCE 52–53 (1940).

18. *See, e.g.*, CHRISTOPHER STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 157–73 (1976).

19. Detlav Vagts, *Reforming the "Modern" Corporation: Perspectives from the German*, 80 HARV. L. REV. 23, 50–53 (1966).

20. For financially distressed companies, creditors, including unions and the federal government, may have a role in selecting directors. *See* Sepe, *supra* note 15.

21. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 211, 216 (2013).

22. *See* Branson, *supra* note 16, at 615–18.

23. Liggett v. Lee, 288 U.S. 517, 559 (1933) (Brandeis, J., dissenting).

"race to the bottom,"[24] Professor Cary believed that Delaware corporate law had degenerated so far in a deregulatory direction as to have become too promanagement and antishareholder in orientation. The solution proposed by Cary was to establish mandatory federal "minimum standards" that would preempt more lax state law rules on certain key subjects.[25] Cary's proposal did not fundamentally alter the board-centered model of corporate governance, however, nor its focus on protecting investor interests. It sought only to ensure that such a model adhered to certain standards imposed by federal law because, Cary believed, interjurisdictional competition among states had produced intolerably low corporate law standards. Thus, from a broad corporate responsibility perspective, Cary's proposal was, as a substantive matter, quite modest. Beyond generating scholarly comment, however, the proposal at the time went nowhere, although the landmark 2002 Sarbanes-Oxley Act and the 2010 Dodd-Frank Act certainly embody the principle of federal standards sought long ago by Cary.[26]

More ambitious was the federal chartering proposal. Nader and his coauthors believed that the largest United States corporations should be chartered by the federal government, not states,[27] because, they reasoned, under state law managers were not sufficiently attentive either to investor interests or those of other constituencies. Moreover, Nader and his coauthors believed that such a federal corporate law should be more overtly regulatory in philosophy and should mandate public interest directors who would advance employee, consumer, and community welfare, as well as heightened responsibility to stockholders. Furthermore, their proposal would require a certain amount of periodic social auditing and reporting.[28] Corporations also would, under this proposal, have only limited duration, not perpetual—reverting on this point to early nineteenth century law—and they would have to renew their charters every twenty or twenty-five years.[29] Like Cary's proposal, Nader's idea generated scholarly commentary. Unlike Cary's proposal, it also resulted in several congressional hearings.[30] It never went beyond that, however.

Other, later proponents of corporate social responsibility have sought less to change the core mechanisms of corporate governance—or the source of laws comprising them—than to work innovatively within them. At the

24. William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 665–66 (1974).

25. *Id.* at 663.

26. Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 745 (codified at 15 U.S.C. §§ 7201 et seq.) (2006); Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111–203, 124 Stat. 1376 (codified as amended at 12 U.S.C. §§ 5301–5641) (2010).

27. *See* RALPH NADER, MARK GREEN & JOEL SELIGMAN, TAMING THE GIANT CORPORATION 7–9 (1976). Professor Stone also advocated federal incorporation for large corporations. *See* Stone, *supra* note 18, at 72.

28. *See* Branson, *supra* note 16, at 616.

29. *See id.*

30. *See id.*

board level, many reformers have called for greater racial, ethnic, and gender diversity on corporate boards to broaden the perspectives brought to bear on strategic challenges.[31] A 2013 study by the Conference Board, for example, traces the rise of women and ethnic minorities serving on the boards of nonfinancial companies, and notes that about one-half of large companies now have a formal policy on board diversity.[32] This represents a shift in business norms and practices, however, rather than a mandated legal change, unlike the case in certain European nations. Also, in the 1980s, almost thirty states enacted laws permitting, but not mandating, directors to consider various nonshareholder constituencies in making decisions.[33] After aiding in quelling hostile takeover activity during that tumultuous period, however, these laws appear to have had little visible and enduring impact on corporate governance.

B. *Early Twenty-first Century*

Since corporate law's deregulatory turn over the course of the nineteenth century, the two most extensive regulatory initiatives touching on corporate governance were not enacted until the first decade of the twenty-first century. These were the landmark Sarbanes-Oxley Act of 2002,[34] and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank").[35] The Sarbanes-Oxley Act ("SOX") grew out of the widespread corporate frauds revealed at such brand name companies as Enron, Tyco, WorldCom, HealthSouth, and many others.[36] SOX took a smorgasbord-like approach to regulation, touching on a number of areas. For example, SOX created the Public Company Accounting Oversight Board to oversee auditing firms, enhanced the independence of public company auditors, increased financial disclosures by public corporations, regulated securities analyst conflicts of interests, and added new crimes under the securities laws and boosted penalties for violations.[37] Importantly, however, SOX also addressed in unprecedented fashion certain subjects associated

31. *See* Lisa M. Fairfax, *Some Reflections on the Diversity of Corporate Boards: Women, People of Color, and the Unique Issues Associated with Women of Color*, 79 ST. JOHN'S L. REV. 1105, 1114 (2006). Effective February 28, 2010, the SEC amended Item 407(c) of Regulation S-K to require public reporting companies to disclose whether, and if so how, nominating committees consider diversity in identifying nominees for directors and also to disclose how companies assess the effectiveness of diversity policies.

32. *See* Matteo Tonello, *Director Compensation and Board Practices*, THE CONFERENCE BOARD (13th ed. 2013).

33. *See* JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS § 4:10, at 245 (3d ed. 2010).

34. Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 745 (codified at 15 U.S.C. §§ 7201 et seq.) (2006).

35. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111–203, 124 Stat. 1376 (codified as amended at 12 U.S.C. §§ 5301–5641) (2010).

36. *See generally* Lyman Johnson & Mark Sides, *The Sarbanes-Oxley Act and Fiduciary Duties*, 30 WM. MITCHELL L. REV. 1149 (2004) (describing background and overview of Act).

37. *See id.* at 1154.

with corporate governance, which historically had been left to state corporate law, notwithstanding the provocative but ill-fated proposals noted earlier. For example, SOX imposed new responsibilities on the audit committee and required greater independence of committee members, prohibited corporate loans to officers, enhanced requirements associated with officer certifications of periodic reports, provided for forfeiture of certain bonuses and profits in connection with restatements of financial statements, and required management to assess and report on the quality of internal controls.[38]

Implementation of SOX also corresponded with growth in the promulgation of "soft law" associated with corporate activity. Corporations increasingly adopted internal codes of conduct and committee charters, and sought to voluntarily conform to various governance metrics of "best practices." In addition, diverse guidelines and principles were elaborated to guide corporate behavior, and different indexes and ratings were developed to assess the soundness of various corporate practices.[39] These various nonbinding initiatives did not have the legal "bite" of positive law, but they served to alter internally the evolving normative expectations as to what responsible corporate conduct should look like in the twenty-first century. Moreover, by voluntarily adopting them, corporate directors and managers likely sought to ward off yet additional legal regulation.

The Dodd-Frank Act, signed into law by President Obama on July 21, 2010, arose out of congressional concerns about the near collapse of U.S. financial markets in the autumn of 2008, the greatest economic crisis since the Great Depression, which itself spawned extensive regulation. During this period in 2008, officials at the Federal Reserve Bank and the U.S. Treasury Department essentially stepped in and directed activities at large, systemically significant financial firms.[40] Whether correct decisions were made or not, their very intervention again demonstrates the profound social stakes associated with large businesses. During this crisis, government elites navigated companies through uncharted financial water rather than simply defer to decisions that, historically, had been made by private sector business elites.

Like SOX, the Dodd-Frank Act continues to extend federal law into what was traditionally considered the province of state corporate law. For example, under that Act public companies must give shareholders a periodic nonbinding advisory vote on executive compensation ("say on pay");[41]

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38. *See id.* at 1155–85.

39. *See* Sanjai Bhagat, *The Promise and Peril of Corporate Governance Indices*, 108 COLUM. L. REV. 1803, 1803 (2008).

40. *See* ROBERT W. HAMILTON, ET AL., CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 561–63 (11th ed. 2010).

41. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111–203, § 951, 124 Stat. 1376 (codified as amended at 12 U.S.C. §§ 5301–5641) (2010).

all the members of a company's compensation committee must be independent;[42] disclosure of the relationship between executive compensation and financial performance ("pay for performance") must be made;[43] the SEC was authorized to craft rules giving shareholders greater access to the company's proxy statement to advance shareholder nominees for membership on the board;[44] and disclosure is required as to whether, and why if so, a company has selected the same person to serve as chair of the board of directors and chief executive officer.[45] Also, in an effort to encourage the reporting of corporate wrongdoing, Dodd-Frank strengthens whistleblower incentives. Under this provision, from ten to thirty percent of a monetary recovery may be paid to someone who provides "original information" leading to successful prosecution of an SEC enforcement action that results in a sanction exceeding $1 million.[46]

These two federal regulatory efforts undoubtedly evince profound frustration with state corporate law's ongoing resistance to meaningful attention to corporate reform. Nonetheless, they focus almost exclusively on investor interests, not broader concerns. Thus, however unprecedented the recent federal incursions into corporate governance might be, in fact they continue the longstanding neglect of broad corporate responsibility by means of corporate governance reform.

C. *The Rise of Shareholder Activism*

Moving from a discussion of governance reform aimed at the director level to reform directed at the shareholder level, a key legal tool for attempted governance reform is SEC Rule 14a-8,[47] which has long permitted qualified shareholders of public reporting companies to place proposals for the annual shareholder meeting in the company's own proxy statement. Two key proxy initiatives taking place around 1970 used this tool of shareholder democracy in a surprising way: not to advocate that managers pay greater heed to shareholder well-being—the usual focus of federal securities laws—but to advocate for a broadened focus on corporate responsibility.

Following community activist Saul Alinsky's efforts to use share ownership in Eastman Kodak as a basis to attend Kodak's annual meeting and protest its racial hiring practices,[48] anti-Vietnam War activists used Rule 14a-8 to place before Dow Chemical's shareholders a proposal that the

42. *See id.* § 952.
43. *Id.* § 953.
44. *See id.* § 971.
45. *See id.* § 972.
46. *Id.* § 922.
47. Shareholder Proposals, 17 C.F.R. § 240.14a–8 (2011).
48. *See* C. A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77, 114 (2002).

company should no longer manufacture napalm.[49] The resolution garnered less than 3 percent of the actual vote, but it achieved the larger strategic goal of gaining extraordinary publicity for the anti-war effort.[50] Campaign GM, another movement involving the intrepid Ralph Nader, sought to transform GM from a purely profit-seeking firm into a firm serving the general social welfare.[51] Thus, under Nader's proposal, GM would remain board-governed, but public interest directors would be added to the GM board in an effort to balance the interests of various stakeholders such as investors, employees, consumers, and the general public. The two Campaign GM proposals appearing on GM's proxy statement were fiercely opposed by the company and received less than 3 percent of the stockholder vote, but, as with the Dow Chemical campaign, they succeeded in obtaining an extraordinary amount of publicity,[52] the overall strategic aim.

Widespread efforts to use the federal proxy machinery to advance shareholder proposals seeking more socially responsible corporate conduct continued into the twenty-first century,[53] with mixed success. These proposals are sponsored by various religious, environmental, labor, and consumer groups, among others, and they deal with a wide range of subjects.[54] Recent examples range from efforts to force companies to disclose their political contributions,[55] to PETA's purchase of SeaWorld stock in order to sponsor a proposal to curb what that organization considers to be animal cruelty.[56]

A strikingly different "shareholder democracy" movement emerged in the 1990s and early twenty-first century to turn, once again, to the rights of voice and vote accorded shareholders under state corporate law. The aim was not broad corporate social responsibility, however, but improved investor well-being. In brief, investor activists reverted to creative uses of shareholder suffrage after the initially promising and robust market-centered hostile takeover period of the 1980s had come to a decidedly antishareholder end.[57] Takeovers were widely touted during the 1980s as an efficient, shareholder-friendly, market solution to the governance problem

49. *See* Med. Comm. for Human Rights v. Sec. & Exch. Comm'n, 432 F.2d 659, 662–63 (D.C. Cir. 1970), *vacated*, 404 U.S. 403 (1972).

50. *See* Wells, *supra* note 48, at 114–15.

51. *See id.* at 115–17.

52. *See id.*; *see* Branson, *supra* note 16, at 614.

53. *See* MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 238 (9th ed. 2005).

54. *See id.*

55. *See, e.g.*, EXXON MOBIL CORP., 2013 PROXY STATEMENT 67–69 (2013), *available at* http://www.sec.gov/Archives/edgar/data/34088/000119312513152355/d460324ddef14a.htm.

56. *See* Aaron Smith, *PETA takes a stake in SeaWorld, demands whales be freed*, CNNMONEY, http://money.cnn.com/2013/04/24/news/companies/seaworld-peta/ (last visited Jan. 8, 2014).

57. *See* HAMILTON ET AL., *supra* note 40, at 519–25.

of entrenched and complacent corporate management.[58] Hostile bidders could use tender offers, the thinking ran, to directly acquire a majority of a company's stock by offering stockholders a generous premium and then, using their new found voting power, replace incumbent directors and management with more savvy, investor-oriented candidates who would alter business strategy and/or operations. The role of law, in this view, was essentially deregulatory in thrust; it was simply to make sure that incumbent directors and managers did not wrongly impede the effective functioning of the capital markets.[59] This proposed market-based solution to traditional corporate governance ills was itself part of the larger "law and economics" movement that was imported from financial economics and that took deep ideological hold of corporate law scholarship during the 1980s.[60] The steely focus on investor well-being via hostile takeovers, moreover, was congruent with a renewed theoretical conception of the corporation that, while pragmatically accepting legal personhood for the corporation, at the same time, sought analytically to disaggregate the corporate institution into a mere "nexus" of various contracting parties in which investor interests were paramount.

Numerous factors combined to abruptly halt rampant hostile acquisition activity around 1990. These included, besides economic recession, the demise of Drexel Burnham Lambert, Inc.—the investment banking firm most associated with arranging infamous "junk bond" financing of hostile bids—and the jailing of Michael Milken, the chief financial architect at Drexel.[61] On the law front, the passage of antitakeover legislation by numerous states[62]—including constituency statutes[63]—received strong judicial approval from both the Supreme Court in the 1987 *CTS* case and the estimable Seventh Circuit Court of Appeals in 1989.[64] Moreover, the influential Delaware Supreme Court also closed out the 1980s with a very high-profile decision—involving a battle for Time, Inc.—that strongly endorsed management defensive measures in response to hostile bids.[65] That decision, moreover, emphasized that corporate directors were legally responsi-

58. *See* Lyman Johnson & David Millon, *Misreading the Williams Act*, 87 MICH. L. REV. 1862, 1862–64, 1910–12 (1989) (discussing the effect of federal and state statutes on takeovers).

59. *See* Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215, 2246–47 (1992) (describing this deregulatory viewpoint).

60. *See id.* These "law and econ" proponents also were the persons who renewed the long-slumbering aggregation theory of the corporation by means of their "nexus of contracts" conception. *See* Johnson, *supra* note 1, at 1158–64; *see* David Millon, *Radical Shareholder Primacy*, 10 U. ST. THOMAS L.J. 1013 (2013).

61. *See* Victor F. Zonana, *Milken to Pay $500 M, Serve 40 Months Under Settlement*, THE TECH, http://tech.mit.edu/V112/N9/milken.09w.html (last visited Jan. 22, 2014).

62. *See* Johnson & Millon, *supra* note 58, at 1862 n.3.

63. *See* COX & HAZEN, *supra* note 33, at 245.

64. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987); Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496 (7th Cir. 1989), *cert. denied*, 493 U.S. 955 (1989).

65. Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989).

ble for directing the "corporation's" best interests and that such company interests were not necessarily the same as those of investors seeking a near-term premium for their stock.[66] This entity conception of the corporation, like the Supreme Court's endorsement of state power over the design of corporate attributes in the *CTS* decision, stood in stark contrast to—and in repudiation of—the revived private-bargain "aggregate" theory advanced by economics-oriented corporate law scholars.

With both legislation and judicial decisions strongly favoring incumbent management, proinvestor activists in the 1990s necessarily shifted their focus from pure capital market-centered approaches to more traditional voice/vote governance methods. Although this required an overcoming of traditional shareholder passivity, doing so became more likely given the growing concentration of corporate stock in the hands of institutional investors during the late twentieth century, a trend that continues today.[67] As recently noted by Professors Marcel Kahan and Edward Rock, traditional institutional investors such as mutual funds and pension funds have become even more active in the twenty-first century and have been joined by (or are led by) activist hedge funds, which benefit greatly from partnering with more traditional and permanent investors.[68] This heightened activism was legally facilitated by 1992 amendments to federal proxy rules that freed institutional investors to more easily (and economically) share their views with one another on incumbent directors up for re-election and on strategic structural issues.[69] Moreover, by 2008, activist investors using SEC Rule 14a-8 to advance proshareholder proposals saw a marked increase both in the number of such proposals receiving a majority of shareholder support and in the number actually adopted.[70] This proxy success has accompanied a significant decline in the number of staggered ("classified") boards and the dramatic rise of majority voting for directors in the first decade of the twenty-first century. Both of these developments make corporate boards far more sensitive to shareholder concerns.[71]

These and other "proinvestor" developments, such as tougher NYSE listing standards and the end of discretionary voting by brokers,[72] combine with the governance reforms in Dodd-Frank[73]—and recent SEC proxy ac-

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66. *See id.* at 1150, 1154.

67. *See* HAMILTON ET AL., *supra* note 40, at 520.

68. *See* Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 998–1005 (2010). *See* Emily Glazer & Joann S. Lublin, *Funds Get Active Over Director Pay*, WALL ST. J. (May 21, 2013), http://online.wsj.com/news/articles/SB10001424127887323398204578489140831989094 ("Now, mutual-fund firms, which normally have aligned with management, are adding muscle to activist efforts.").

69. *See* Kahan & Rock, *supra* note 68, at 1013–15.

70. *See id.* at 1012.

71. *See id.* at 1049.

72. *See id.* at 1015–16, 1022–23.

73. *See supra* notes 41–46.

cess initiatives thereunder[74]—to substantially bolster modern investor voice/vote in corporate governance. This raises a host of important issues for modern corporate governance such as the optimal balance of power among investors, directors and managers, and the appropriate relationship between federal and state law in producing corporate governance rules. Only one issue in particular will be noted here, however, because it directly pertains to the subject of corporate responsibility as viewed historically.

Today, boards of public companies, for the reasons noted, seem far more receptive to shareholder concerns than was true for much of the twentieth century. In fact, it was the perceived lack of director responsiveness to investor interests noted by Berle and Means that sustained corporate law scholarship as a viable field of inquiry during most of the twentieth century.[75] To be sure, much corporate misconduct over the past several years—as in periods before—greatly harmed investors.[76] And, the reputations of corporate elites have taken a dramatic social beating in the twenty-first century due to repeated scandals and costly market miscues, coupled with lavish compensation packages. Thus, in 2013, corporate directors and managers do not enjoy especially broad popularity or have wide societal support and understanding. Consequently, utterly unlike the 1980s when managers successfully resisted hostile takeovers by rhetorically championing noninvestor interests,[77] managers today have largely been unable to muster strong credible resistance to various measures heralded as "good for investors" and as a necessary countervailing force to powerful managers. Perhaps this is because business norms have dramatically shifted over the past several years so that more managers have come to agree with those investors who want corporations to mainly (or exclusively) focus on investor well-being. Alternatively, even if many managers still disagree with such a narrow focus—and would prefer a broader, more responsible vision of corporate endeavor—perhaps they believe it is often futile (and against self-interest) to resist a share price-maximizing strategy pushed by a determined group of activists. Whatever the explanation, as the investor voice is being amplified within the modern corporation in relation to managers,[78]

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74. On August 25, 2010, the SEC amended the proxy rules to facilitate certain shareholders placing director nominees on the company's proxy statement. Facilitating Shareholder Director Nominations, Securities Act of 1933 Release No. 9136, 2010 WL 3343532 (Aug. 25, 2010). The SEC voluntarily suspended the effectiveness of its rules pending the outcome of a lawsuit challenging the legality of the changes by the Business Roundtable and the Chamber of Commerce. The rule was struck down in 2011 by the U.S. Court of Appeals for the D.C. Circuit and was not reproposed by the SEC. *See* Business Roundtable v. Sec. and Exch. Comm'n, 647 F.3d 1144 (D.C. Cir. 2011).

75. *See* BERLE & MEANS, *supra* note 3, at 223–26 (describing the fiduciary duty of a director to his corporation).

76. *See supra* notes 36–37 and accompanying text.

77. *See* COX & HAZEN, *supra* note 33, at 245.

78. During the 2013 proxy season, investors continued to advocate for governance changes. For example, both Institutional Shareholder Services, Inc. and Glass Lewis & Co., influential

this apparent corporate governance triumph (long sought by many) simply opens a new chapter in the broader saga of corporate responsibility and raises this question: Is this historic re-empowerment of investors, vis á vis managers, a socially desirable outcome?

D. Shareholder Power and Corporate Responsibility

As noted recently by Professors Bratton and Wachter, shareholder empowerment was not one of the political outcomes envisioned by Berle and Means' iconic 1932 depiction of relationships within the modern corporation.[79] That book certainly began with the well-known description of how stock ownership had become separated from corporate control, the very separation that recent shareholder empowerment developments are working to overcome in the twenty-first century. Berle and Means saw tighter allegiance to shareholder interests as undoubtedly superior to unfettered managerial power but not automatically equivalent to the most socially desirable outcome.[80] They considered the de facto shareholder surrender of control and responsibility as meaning shareholders also had surrendered the right to have the corporation operated in their sole interest.[81] It is highly unlikely they envisioned a twenty-first century world of dramatically heightened shareholder power. Professors Bratton and Wachter believe that Berle in particular would not fundamentally alter his belief that a public corporation should broadly serve societal goals, since powerful institutional investors simply represent one set of oligarchs replacing another—corporate managers.[82]

The very basic question of corporate purpose, in other words, resurfaces yet again—in a new corporate governance guise—in the twenty-

proxy advisory firms, joined in a rare united endorsement of a rival slate of directors for Hess Corporation earlier proposed by 4.5% shareholder Elliott Management Corp. *See* Liz Hoffman, *ISS Backs Crusader Elliott in Hess Board Fight*, LAW360, http://www.law360.com/articles/438564/iss-backs-crusader-elliott-in-hess-board-fight (last visited Jan. 22, 2014). Even Jamie Dimon, powerful CEO and Chair of J.P. Morgan Corp., faced a Glass Lewis and ISS proposal that Dimon relinquish the chairmanship. *See* Dawn Kopecki, *JPMorgan Should Replace Most of Board, Glass Lewis Says*, BLOOMBERG, http://www.bloomberg.com/news/2013-05-07/jpmorgan-should-split-chairman-and-ceo-roles-glass-lewis-says.html (last visited Jan. 22, 2014). On May 21, 2013, shareholders of J.P. Morgan rejected that proposal. *See* Dan Fitzpatrick, et al., *Vote Strengthens Dimon's Grip—J.P. Morgan Shareholders Reject Proposal to Divide Top Posts; Board Under Fire*, WALL ST. J., May 22, 2013, at A1, *available at* http://online.wsj.com/news/articles/SB10001424127887324787004578496814286493352.

79. *See* William W. Bratton & Michael L. Wachter, *Tracking Berle's Footsteps: The Trail of The Modern Corporation's Last Chapter*, 33 SEATTLE U. L. REV. 849, 855 (2010).

80. *See id.*

81. *See* Erika George, *See No Evil? Revisiting Early Visions of the Social Responsibility of Business: Adolf A. Berle's Contribution to Contemporary Conversations*, 33 SEATTLE U. L. REV. 965, 976 (2010).

82. *See* Bratton & Wachter, *supra* note 79, at 862–64. Berle believed the corporation should serve broad societal goals, not simply investor welfare, even though as a pragmatic governance matter, he thought managers should focus on investors to constrain managerial discretion. *See* Berle, *Corporate Managers*, *supra* note 12.

first century. Moreover, it has become even more acute than in the economic doldrums of the 1930s or during the 1980s takeover frenzy precisely because the shareholder voice now—unlike then—is so much more prominent within contemporary corporate governance. Thus, in apparently rectifying a longstanding internal corporate governance problem—i.e., achieving accountability to shareholders—the recent rise of shareholder power unavoidably reinvites attention to broader social concerns largely neglected by state corporate laws, and federal securities laws, traditionally narrow ambit of concern.

As early as 1959, Professor Chayes wrote critically—more than fifty years before the latest developments—about what he considered to be the SEC's misguided efforts to revitalize shareholder democracy.[83] Acknowledging that investors, of course, should be assured of full information and be protected against fraud and manipulation by those in control of corporations, Chayes was dismissive of the idea that shareholders were the best social mechanism for keeping corporate power responsible:

> Of all those standing in relation to the large corporation, the shareholder is least subject to its power. Through the mechanism of the security markets, his relation to the corporation is rendered highly abstract and formal, quite limited in scope, and readily reducible to monetary terms. The market affords him a way of breaking this relation that is simple and effective. He can sell his stock, and remove himself, qua shareholder, at least from the power of the corporation.
>
> Shareholder democracy, so-called, is misconceived because the shareholders are not the governed of the corporation whose consent must be sought. If they are, it is only in the most limited sense. Their interests are protected if financial information is made available, fraud and overreaching are prevented, and a market is maintained in which their shares may be sold. A priori, there is no reason for them to have any voice, direct or representational, in the catalogue of corporate decisions with which this paper began, decisions on prices, wages, and investment. They are no more affected than nonshareholding neighbors by these decisions.[84]

Today, in the second decade of the twenty-first century, unfolding developments in the law of corporate governance—state and federal—still take no direct heed of broad corporate responsibility concerns in regular business corporations because corporate governance remains a closed system of just three groups—investors, directors, and managers. Twentieth century calls for directors and managers to be more socially responsible took place against an assumed backdrop of relative shareholder impotence,

83. *See* Chayes, *supra* note 14, at 40.
84. *Id.* at 40–41.

with the key contested issue being how powerful corporate elites should best reconcile—in theory and practice—investor and noninvestor interests to assure both financial success and societal legitimacy. Rising shareholder power, and director-manager efforts to accommodate it, mean the historical corporate responsibility approach of focusing solely on director-manager volunteerism or external legal regulation of the corporation needs rethinking. Perhaps, moreover, calls for broadly responsible conduct will work better for private companies than for those having publicly traded securities because private companies do not face such intense capital market or shareholder voting pressures. Perhaps, too, the corporate responsibility focus in the public corporation will migrate (or broaden) to include calls for more fully exploring—culturally and legally—the "social responsibility" aspects of share ownership. Just as ownership of real property is far more extensively regulated than one hundred years ago, given rather obvious negative externalities associated with modern land use, perhaps more hegemonic share ownership in the future will not carry unfettered rights. Indeed, the state law effort to curb takeover activity in the 1980s was, in essence, a legal curtailment of unhindered shareholder ability to exit the corporation en masse.[85]

In short, heightened shareholder activism of the kind witnessed today may reduce agency costs and tighten accountability of directors and managers to investors as a corporate governance matter, but it may also usher in new concerns. Shareholders are heterogeneous in their preferences,[86] including as to their preferred time horizon, and empowered minority shareholders might seek special preferences for themselves, possibly at the expense of other shareholders or stakeholders.[87] Although Professor Lucian Bebchuk now argues that investor activism does no real harm to long term investors, he explicitly does not consider the effects of activism on noninvestor constituencies.[88] If certain intracorporate interests do clash, then, as has repeatedly happened before with respect to strong corporate managers, the debate will center on whether voluntary self-restraint by muscle-flexing hedge funds and other activist investors will suffice, or whether novel legal regulation will be called for, such as an imposition of newly-contoured fiduciary duties on active shareholders, tougher disclosure re-

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85. *See* Johnson, *supra* note 59, at 2224 (discussing state law changes to shareholder characteristics).

86. *See* Paul Rose, *Common Agency and the Public Corporation*, 63 VAND. L. REV. 1355, 1370–72 (2010).

87. *See id.* This heterogeneity extends to the indirect holding of stock by many Americans in retirement accounts. *See* Anne M. Tucker, *The Citizen Shareholder: Modernizing the Agency Paradigm to Reflect How and Why a Majority of Americans Invest in the Market*, 35 SEATTLE U. L. REV. 1299, 1305, 1326 (2012) (discussing the ability of mutual fund managers to represent investors' interests).

88. *See* Lucian A. Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1644 nn. 26–27 (2013).

quirements,[89] tenured voting,[90] longer terms of office for directors,[91] or yet other measures.

E. The New Benefit Corporation Statutes

If the skimpy existent mechanisms of corporate governance do not themselves accommodate a modern society's evolving expectations of corporate power—whether control lies in investor or manager hands, or is held jointly—then it is to be expected that renewed efforts to somehow bring noninvestor voices (and concerns) into corporate governance will begin again, or that even more extensive legal regulation or reform addressing various kinds of such interests will be forthcoming. One striking example of this former phenomenon is the new "benefit corporation" statutes spreading across the country, including in Delaware.[92] These statutes, which represent an avowed rejection of a strict and exclusive focus on investor welfare, expressly permit corporate directors to craft corporate strategy in a way that both benefits investors and advances a larger general or specific social and environmental purpose.[93] Whether and how this effort to address corporate responsibility through corporate governance reform will alter the governance of regular business corporations remains to be seen. What is clear, however, is that, today, for the first time since the late nineteenth century, the corporate governance realm itself has been used by state law to address the larger issue of corporate responsibility.

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89. *See* Rose, *supra* note 86, at 1401–04.

90. *See* Lynne Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 IOWA J. CORP. L. 265, 350–55 (2012).

91. *See* Jack B. Jacobs, *"Patient Capital": Can Delaware Corporate Law Help Revive It?*, 68 WASH. & LEE L. REV. 1645, 1658–59 (2011).

92. *See generally* Johnson, *Pluralism*, *supra* note 2 (discussing the dual purpose of benefit corporations to produce profits and further social goals). Delaware passed a benefit corporation statute which became effective on August 1, 2013. 79 Del. Laws ch. 122 (2013) (codified at DEL. CODE ANN. tit. 8, §§ 361–68 (2013)).

93. *See* DEL. CODE ANN. tit. 8, § 365 (2013). Various noninvestor interests also may be given regard by directors.