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Shareholder Democracy and the Curious Turn Toward Board Primacy

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SHAREHOLDER DEMOCRACY AND THE CURIOUS TURN TOWARD BOARD PRIMACY

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Abstract

Corporate law is consumed with a debate over shareholder democracy. The conventional wisdom counsels that shareholders should have more voice in corporate governance, in order to reduce agency costs and provide democratic legitimacy. A second set of theorists, described as "board primacists," advocates against greater shareholder democracy and in favor of increased board discretion. These theorists argue that shareholders need to delegate their authority in order to provide the board with the proper authority to manage the enterprise and avoid short-term decision making.

In the last few years, the classical economic underpinnings of corporate law have been destabilized by a growing recognition that shareholders are not a homogeneous group of wealth maximizers. This recognition has, among other things, undercut the arguments made in support of the typical corporate structure where shareholders alone possess the right to vote in corporate elections. Board primacy seems well-positioned to retheorize corporate law to adapt to this new reality. In their analyses of the issue, however, board primacy theorists have conflated two very different aspects of group decision processes: the responsiveness of the governance system and the composition of the electorate. This confusion ends up putting many board primacy theorists in the curious position of moving away from the public choice emphasis on preference aggregation toward a

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more civic republican model of less responsive, more deliberative decision making.

By restricting the franchise, board primacists have detached their governance structures from the underlying desires of their constituents without substituting anything in their place. We argue, however, that the breakdown of this particular distinction between shareholders and other constituents could mean that we should investigate treating other constituents more like shareholders, rather than the other way around.

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INTRODUCTION

Shareholder democracy is back from the dead. Dating back to Berle and Means' autopsy of corporate democracy,[1] it had long been assumed that the shareholder franchise was relatively meaningless—a de jure power with little de facto effect.[2] Building on reforms from the 1970s, 1980s, and 1990s, however, scholars have taken an ever-more aggressive stance towards shareholder empowerment.[3] Institutional shareholders and the advocacy groups that represent them have become powerful players in corporate boardrooms and in the public markets.[4] With this new emphasis on the role of shareholders, it is only natural to focus on the power to vote—which is, after all, the power to select those who control the company. Given the course of corporate law scholarship, strengthening the shareholder franchise is the logical next step.

Corporate law centers on the relationship between the corporation, the board, and shareholders. And the primary concern of corporate law scholarship has been to reduce the agency costs imposed upon shareholders by delegating those powers to the board and its appointed officers.[5] Successive waves of scholarship have carried in new suggestions for reform, such as the facilitation of the takeover market,[6] the expanded use of independent directors,[7] and greater reliance on intermediaries.[8] It only makes sense for reformers to look to the franchise, as it is the direct structural power source for shareholders. Shareholders can vote out directors and officers;

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1. ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

2. *See, e.g.*, Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 568-69 (2003) [hereinafter Bainbridge, *Director Primacy*].

3. *See, e.g.*, Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).

4. Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887 (2007).

5. *See, e.g.*, Bainbridge, *Director Primacy*, *supra* note 2, at 565-68.

6. *See, e.g.*, Lucien Arye Bebchuk, *A New Approach to the Takeover Law and Regulatory Competition*, 87 VA. L. REV. 111, 164 (2001).

7. *See* Victor Brudney, *The Independent Director-Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597 (1982) (describing reform proposals).

8. *See* Stephen M. Bainbridge, *The Politics of Corporate Governance*, 18 HARV. J.L. & PUB. POL'Y 671 (1995).

strengthening the franchise is the most meaningful way to fulfill the norm of shareholder primacy.[9]

Thus, much of corporate law scholarship of the past decade has focused on shareholder democracy. The most well-known shareholder democracy advocate in academia is Lucian Bebchuk.[10] In earlier work, Bebchuk advocated for pro-shareholder reforms such as eliminating staggered boards,[11] monitoring managerial pay more carefully,[12] and preventing boards from vetoing takeover bids that have been approved by shareholders.[13] Bebchuk's recent work has focused on fostering shareholder democracy as a way of effectuating shareholder primacy.[14] Other commentators in academia and the business press have also advocated for pro-democracy reforms. Institutional shareholders are taking their voting rights more seriously, and the proxy advisory sector continues to grow in size and importance.[15] The SEC has yet again proposed changes to the proxy that would allow for greater shareholder access,[16] and shareholders have also tried to take matters into their own hands with shareholder proposals and bylaw amendments that would facilitate their voting power.[17]

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9. LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT 101 (2001) ("[T]he fact that stockholders vote and have the power to oust the board of directors and corporate management is a very powerful incentive for directors and managers to focus their attention on stockholder happiness.").

10. *See, e.g.*, Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53, 55 (2008) (describing Bebchuk as "one of the most outspoken proponents of shareholder democracy").

11. Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence & Policy*, 54 STAN. L. REV. 887 (2002).

12. LUCIAN A. BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE (2005).

13. Lucian Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002).

14. Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 682-94 (2007); Bebchuk, *supra* note 3; Lucian Arye Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43 (2003).

15. Rose, *supra* note 4, at 889-91.

16. Stephen Labaton, *S.E.C. Proposes To Widen Investors' Say on Boards*, N.Y. TIMES, May 21, 2009, at B3.

17. *See, e.g.*, Latham & Watkins, *Binding By-Law Shareholder Proposals: The Next Frontier for Corporate Activists*, M&A DEAL COMMENT., Aug. 1, 2006, http://www.lw.com/upload/pubContent/_pdf/pub/620_1.pdf ("[A]ctivist investors are shifting their focus to shareholder proposals for by-law amendments to implement corporate governance reform in place of traditional nonbinding shareholder proposals that merely recommend board action.").

It may seem hard, as a rhetorical matter, to be against shareholder democracy. However, there are a set of commentators and theorists who remain committed to the old ways.[18] Instead of advocating for greater shareholder involvement, they advocate for greater board independence.[19] Rather than exposing the board to the will of the electorate, they believe the board should be insulated from such exposure.[20] Instead of shareholder primacy, they argue for some variant of board primacy—namely, that the board, not the shareholders, should be the focus of the corporation.

Theories of board primacy have developed relatively recently, perhaps in part because shareholder democracy has languished so long. These theories and their policy prescriptions represent an important body of thought about the nature and purpose of corporate structure. Rather than following the fairly intuitive notion that voters should have more power to choose their representatives, board primacists argue for a more insulated board.[21] They do so for a variety of reasons—some common, some variegated. But they all believe that facilitating shareholder democracy, and thereby shareholder power, would create costs that would outweigh the purported benefits.[22]

At this stage of our inquiry into the shareholder franchise, it is important to consider the counter-revolutionary turn toward board primacy.[23] This Article seeks to disentangle the various justifica-

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18. A well-known advocate of board primacy is Martin Lipton, the inventor of the poison pill. *See, e.g.*, Martin Lipton & Steven A. Rosenblum, *Elections in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW. 67 (2003); Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733 (2007). Academic advocates for board primacy include Lawrence Mitchell, Stephen Bainbridge, Lynn Stout, and Margaret Blair. *See* MITCHELL, *supra* note 9, at 111-32 (discussing board-centered reforms); Bainbridge, *Director Primacy*, *supra* note 2, at 550; Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 309-15 (1999); Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 802-06 (2007).

19. *See supra* note 18.

20. *See supra* note 18.

21. *See supra* note 18.

22. *See supra* note 18.

23. For earlier works in our ongoing examination of the exclusive shareholder franchise, see Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445 (2008) [hereinafter Hayden & Bodie, *One Share, One Vote*], and Grant Hayden & Matthew Bodie, *Arrow's Theorem and the Exclusive Shareholder Franchise,* 62 VAND. L. REV. 1217 (2009) [hereinafter Hayden & Bodie, *Arrow's Theorem*].

tions for board primacy and thereby illustrate the underlying value judgments and practical assumptions made by board primacists. As a result, we argue that board primacists may in fact be a rather unstable coalition—one that might be best served by a reexamination of their underlying interests.

In Part I of this Article, we situate the corporate governance debate within the larger context of democratic theory, focusing on the basic distinction between public choice and civic republican approaches to social decision making. Part II of the Article is devoted to an examination of the standard law-and-economics underpinnings of shareholder primacy and the destabilization of those underpinnings by recent research showing that shareholders are not the homogeneous group of wealth maximizers they were once thought to be. The Article then turns to the approaches of board primacy theorists. These theorists, despite having a wide range of normative goals, all argue for governance structures that put greater distance between the shareholder electorate and the board.

The crux of the Article is in Part III, where we critically evaluate the resulting position of board primacy theorists in the context of democratic decision making. Initially, the arguments for many of their positions rely upon a conflation of two very different aspects of group decision-making processes: the responsiveness of the governance system and the composition of the electorate. This confusion ends up putting the board primacy theorists in the curious position of moving away from the public choice emphasis on preference aggregation toward a more civic republican model of less responsive, more deliberative decision making. But by restricting the franchise to shareholders, they have needlessly detached their governance structures from the underlying preferences of their constituents without substituting anything in their place. In other words, these theorists have become civic republicans without any meaningful sense of the public (or, in this case, corporate) good.

I. CORPORATE GOVERNANCE IN A POLITICAL CONTEXT

Corporate governance scholarship has largely concerned itself with structuring corporations in a way that maximizes the utility of

corporate constituents.[24] Corporate constituents are variously defined, but typically include shareholders, employees, suppliers, customers, and creditors.[25] Sometimes this list is expanded to include others who don't necessarily contract with corporations but are nonetheless affected by corporate decisions, such as neighbors, towns, or, even more generally, society.[26] A corporation should be organized in the way that allows it to best increase social welfare, however defined.[27]

The mechanisms of corporate decision making are many, extending from the top to the bottom of a corporate hierarchy. As creatures of state law, corporations must follow the specific requirements set forth by each state for corporate formation. The corporation must have a person or set of persons who serve as the situs of responsibility and authority on behalf of the fictional corporate person.[28] In almost all corporations, this locus of power is the board of directors.[29] The board has the authority to bind the corporation, make contracts on its behalf, and dispose of its property.[30]

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24. Most corporate law theorists have focused on the maximization of a particular set of constituents—namely, shareholders. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 72-74 (1991) (discussing how the corporate voting structure maximizes utility). However, the concept of shareholder primacy is based on the theory that maximizing shareholder welfare also maximizes the overall welfare of all corporate constituents. *See id.* at 73. For an in-depth discussion on the nature and purpose of the corporation, see Symposium, *The Klein Criteria Project*, 2 BERKELEY BUS. L.J. 1 (2005) (including articles by Paul S. Edwards, Mitu Gulati, William Klein, J. Mark Ramseyer, Edmund W. Kitch, Tomotaka Fujita, William W. Bratton, Stephen M. Bainbridge, Robert B. Thompson, David A. Skeel, Jr., Stewart Macaulay, Randall S. Thomas, Ronald J. Gilson, Lawrence E. Mitchell, and Melvin Aron Eisenberg).

25. *See, e.g.*, Unocal Corp. v. Mesa Petroleum, Co., 493 A.2d 946, 955-56 (Del. 1985) (defining the various constituencies that boards can consider when plotting defensive moves to a hostile takeover); Jonathan D. Springer, *Corporate Constituency Statutes: Hollow Hopes and False Fears*, 1999 ANN. SURV. AM. L. 85, 97 (discussing the definition of "constituency" in corporate constituency statutes).

26. *Unocal*, 493 A.2d at 955; Springer, *supra* note 25, at 96 (discussing Minnesota's corporate constituency statute, which considers "the economy of the state and nation" and "community and societal considerations").

27. This assumes a utilitarian orientation. *See, e.g.*, Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001).

28. *See* Bainbridge, *Director Primacy*, *supra* note 2, at 550 (discussing how boards of directors control corporations). For an example of the statutory provisions giving directors control, see DEL. CODE ANN. tit. 8, § 141 (2009).

29. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141.

30. *See id.*

However, boards generally delegate swaths of their authority to the officers of the corporation.[31] These officers then fill out the rest of the structure of the corporation through additional hiring. The chief executive officer is usually regarded as the head of the corporation, and large corporations have complex structures in which officers oversee divisions, departments, and even separate corporate entities as part of the overall enterprise.[32] Most boards of directors, in contrast, delegate most decision making and meet only a few times each year.[33] Corporate law scholarship, though, concentrates attention on the relationship between what it sees as the principal actors: the board, the officers, and the shareholders.

Given the importance of governance to corporate law, it is natural to turn to political theory in analyzing the structures and relationships. Public choice theory, with its emphasis on the interests of different groups and its analysis of the effect of different structures on outcomes, is a natural methodology for studying corporate governance.[34] More generally, political theory concerns the allocation and transfer of power in decision making and the roles of different institutions in the governance of a polity. Economics has dominated corporate law to the almost complete exclusion of political theory, perhaps because corporate law theorists are sometimes quite suspicious of political analogies (despite borrowing what they think is useful).[35] At the fundamental level of the structure of the corporation, however, the lessons of politics may be instructive.

In political theory, there are two basic ways of conceptualizing democratic decision processes: a public choice approach and a civic republican approach.[36] The public choice version views group

31. *See* Bainbridge, *Director Primacy*, *supra* note 2, at 559.

32. *See* ROBERT CHARLES CLARK, CORPORATE LAW § 3.3 (1986).

33. *See* Bainbridge, *Director Primacy*, *supra* note 2, at 559.

34. *See generally* DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE (1991).

35. *See* Blair & Stout, *supra* note 18, at 256-57, 323-24; Ian B. Lee, *Citizenship and the Corporation*, 34 LAW & SOC. INQUIRY 129 (2009) (discussing how economic theory has dominated corporate law and arguing that political theory should play a larger role).

36. *See* Bernard Grofman, *Public Choice, Civic Republicanism, and American Politics: Perspectives of a "Reasonable Choice" Modeler*, 71 TEX. L. REV. 1541, 1547-51 (1993). This is not the only way to describe this basic distinction. As we will see later in the Article, it may also be at the heart of the difference between direct and representative democracy, and Kenneth Arrow's distinction between consensus and authority decision-making structures.

decision processes mainly as an exercise in preference aggregation.[37] Individual preferences are taken as given, and individual and social welfare is measured in terms of preference satisfaction.[38] The best group decision processes, then, are those that best aggregate individual preferences into social choices.[39]

A civic republican approach, by contrast, posits a substantive concept of the public good that goes beyond mere preference aggregation.[40] This notion of the public good is capable of being perceived and refined through deliberation and, in fact, may counsel a decision that does not maximize the satisfaction of existing preferences.[41] The public good is not unrelated to preference satisfaction but it is not beholden to it.[42]

While these two aspects of group decision processes are rarely seen in their pure forms, they provide a useful way of illustrating some of the features of actual decision processes and, more to the point, examining the scholarship in support of them. When focusing on the aggregative function of decision making, for example, it makes little sense to describe outcomes as good or bad, though one may decide that some flaw in the process led to an outcome that was "not really what most people wanted."[43] From the point of view of a civic republican, on the other hand, decisions are good or bad depending upon whether they advance or retard the public good.[44] Most democratic decision procedures are designed to take advantage of the benefits of both approaches and thus are composed of a mix of public choice and civic republican features.

These two views may also help sharpen our assessment of some of the scholarly claims about governance structures. For example, scholarship that tends to emphasize aggregation sometimes over-

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See infra notes 140-47, 169-79 and accompanying text.

37. Grofman, *supra* note 36, at 1549 (citing Cass A. Sunstein, *Beyond the Republican Revival*, 97 YALE L.J. 1539, 1554-55 (1988)).

38. *Id.*

39. *Id.*

40. *See id.* For a brief historical survey of republicanism, see Brett H. McDonnell, *Employee Primacy, or Economics Meets Civic Republicanism at Work*, 13 STAN. J.L. BUS. & FIN. 334, 344-47 (2008).

41. Grofman, *supra* note 36, at 1549-50.

42. *See id.*

43. *Id.* at 1549.

44. *See id.*

looks the value of deliberation in decision making, and scholarship that focuses on deliberation and the public good may overlook the useful corrective force and empirical grounding of actual preferences in the decision process.[45] Using this simple dichotomy—between aggregative and deliberative processes, preferences and judgments—may help us assess and compare features of group decision-making structures and the scholarly arguments in support of them.

II. THE THEORIES OF BOARD PRIMACY

A. The Traditional Story of Shareholder Primacy

1. Shareholder Primacy

Public choice theory meshes well with the existing corporate law literature, as most of the literature is based on a utilitarian approach.[46] Under this approach, the goal of corporate law—as with all law—is to maximize social utility.[47] Using Kaldor-Hicks efficiency theory, social utility is maximized by the aggregation of all individual utility.[48] Thus, corporate law theory generally seeks to foster a system of corporate governance that maximizes overall individual utility.[49] The structure of control rights and property rights is designed to generate the most corporate wealth at the lowest cost to society.[50] Shareholder primacy is the core concept of U.S. corporate law.[51] Although there are various approaches to the concept, shareholder primacy generally means that corporations

45. *See id.* at 1551.

46. *See, e.g.*, Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283, 325 (1998).

47. Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law*, 59 ALA. L. REV. 1385, 1427-32 (2008).

48. Lewis A. Kornhauser, *Constrained Optimization: Corporate Law and the Maximization of Social Welfare*, *in* THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 87, 98-100 (Jody S. Kraus & Steven D. Walt eds., 2000).

49. Bruner, *supra* note 47, at 1427; Lawrence E. Mitchell, *Vulnerability and Efficiency (of What?)*, 2 BERKELEY BUS. L.J. 153, 153-54 (2005).

50. Bruner, *supra* note 47, at 1427; Mitchell, *supra* note 49, at 153-54.

51. Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1423-25 (1993) [hereinafter Bainbridge, *In Defense*].

exist to serve the interests of shareholders.[52] The basic structural component of shareholder primacy is the right of shareholders to elect the board of directors.[53] Because the board is the locus of final authority within the corporation, the right to choose the board gives shareholders ultimate authority. In addition, shareholders are granted rights to vote on essential corporate decisions, such as mergers and the sale of substantially all of the corporation's assets.[54] Shareholders are generally given the right to amend the corporation's charter,[55] and in some jurisdictions may retain the power to amend corporate bylaws.[56] In addition, federal regulations permit shareholders to propose resolutions regarding governance issues that are placed on the corporation's proxy ballot and voted upon at the annual meeting.[57]

However, the concept of shareholder primacy extends well beyond these structural mechanisms. Shareholder primacy is a theory—a belief system, if you will—that maximizing shareholder wealth is in the best interests of society.[58] Scholars have referred to the notion that corporations should seek primarily, if not solely, to maximize returns to their shareholders as the shareholder primacy norm[59] or the shareholder wealth maximization norm.[60] This norm is much more than a descriptive account of shareholders' rights; it is instead a normative judgment on the most socially efficient way of organizing the economy. Proponents of this norm argue that we will maximize our utility as a society only through a system of corporate law that recognizes and perpetuates shareholder primacy.

One of the basic tenets of shareholder primacy is that, with few exceptions, shareholders alone possess the right to vote in corporate board elections.[61] There have been many arguments advanced in

52. *See* D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 277 (1998) ("The structure of corporate law ensures that corporations generally operate in the interests of shareholders.").

53. *See, e.g.*, DEL. CODE ANN. tit. 8, § 211 (2009).

54. *See, e.g.*, *id.* § 251.

55. *See, e.g.*, *id.* § 242.

56. *See, e.g.*, *id.* § 109. *But see* OKLA. STAT. tit. 18, § 1013 (2009).

57. Proxy Rule 14a-8, 17 C.F.R. § 240.14a-8 (2009).

58. *See* Hayden & Bodie, *One Share, One Vote*, *supra* note 23, at 472-74.

59. Smith, *supra* note 52, at 278 & n.1.

60. Bainbridge, *In Defense*, *supra* note 51, at 1425.

61. *See* Smith, *supra* note 52, at 299 (describing the development of the principle of

support of this particular arrangement. One argument is that shareholders are the owners of the corporation and thus, ultimately, should be able to control corporate decisions.[62] But it is unclear why, among the many groups of corporate constituents, shareholders are deemed to be the owners.[63] They do not, for example, possess many of the traditional rights that come with property ownership—including the right to exclude, or the right of possession.[64] Moreover, this entire line of reasoning is circular. Shareholders purchase a set of rights from a corporation. That set of rights typically includes the right to vote for directors, but the stock ownership "bundle" could easily be constructed without that right.[65] In the end, "[l]abeling shareholders 'owners' is no more of a justification for the vote than is labeling them 'voters.'"[66]

A second argument in favor of the exclusive shareholder franchise is that shareholders are the sole residual claimants and, as such, are in the best position to exercise control for the good of all corporate constituents.[67] This argument assumes that the interests of all other corporate participants—employees, suppliers, customers, and creditors—are captured by rigidly set contractual entitlements.[68] Shareholders benefit from maximization of the residual because they are not paid until all other claimants receive their entitlements.[69] This gives shareholders, and shareholders alone, the appropriate incentives to exercise discretion in a way that maximizes value for the entire corporation.[70]

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shareholder primacy as deriving in part from the fact of "the exclusive right of shareholders to vote").

62. For a version of this argument, see, for example, Milton Friedman, *The Social Responsibility of Business Is To Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970 (Magazine), at 32-33, 122-26 (arguing that shareholders are "the owners of the business" and that therefore the only "social responsibility of business is to increase its profits").

63. *See* Stout, *supra* note 18, at 804-05.

64. *See* Lipton & Savitt, *supra* note 18, at 754.

65. Hayden & Bodie, *One Share, One Vote*, *supra* note 23, at 473.

66. *Id.*

67. For a version of this argument, see, for example, EASTERBROOK & FISCHEL, *supra* note 24, at 67-70, 91.

68. *See id.* at 67-68.

69. *See id.*

70. *See id.* at 68.

The residual argument, while more substantive than the "shareholders are owners" argument, is not without shortcomings.[71] First, there is no doubt that constituents other than shareholders have interests in the corporate residual that are uncaptured by their contracts.[72] Employees with firm-specific skills, for example, have an interest in the residual because, by definition, there is no market that would allow them to capture the full value of their skills by contract.[73] Second, the argument also has a circularity to it. While it may make sense to give the right to vote to those with a residual interest, this just changes the question to "who should have contractual rights to the corporate residual?" Without some additional argument that, for some additional reason, shareholders should have a right to the corporate residual, we really haven't progressed very far. The "argument" becomes a mere description of the current state of affairs, not an independent reason to assign the residual (and voting rights that come with it) to shareholders alone.[74]

In order to get away from these potential circularities, many scholars have made further arguments as to why only one class of constituents should have the right to vote and why shareholders are best suited for the task. The residual argument, for example, ceases to be circular when one gives a reason that shareholders alone should be contractually entitled to the residual (and thus, the vote). So what are these additional arguments?

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71. For an extended critique of the argument based on shareholders as sole residual claimants, see MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 227-34 (1995).

72. *See id.* at 275-76.

73. *See id.* at 255-57.

74. There are additional shortcomings to the argument from the residual. For one, the "residual" is not simply the money left over, because that is a function of all of the other agreements that have come before it. Employees may have a claim to the residual if they have some profit sharing or stock options—and these programs generally do not give any control rights. This argument can be expanded further into the nature of the shareholders' claim to the residual, etc. Second, shareholders have the right to profits based on their right to control, as well as their position as the residual claimants. Their share prices reflect the possibility that someone will buy them out in order to take control of the company. This is not really part of the residual—it is the monetary value of control itself. Third, even if the residual has some meaning (that is, the right to firm profits), it is not a static concept—some shareholders will want to increase the short-term residual, while others will want to plow more money into research and design for long-term profits. There is no one "residual payment" that everyone can agree on maximizing.

2. Shareholder Homogeneity and the Right To Vote

Many of the arguments for the exclusive shareholder franchise have, at their core, an assumption of (at least relative) shareholder preference homogeneity. Shareholders, it is argued, have a single-minded interest in profit maximization. This makes them the most homogeneous group of corporate constituents, and certainly more homogeneous than a combined electorate including, for example, shareholders and employees. This homogeneity is thought to bring many advantages when it comes to designing the structures of corporate governance.

Those who champion a more homogenous electorate typically pose their arguments in the negative: a more heterogeneous electorate causes all sorts of problems. For example, a more diverse electorate is believed to introduce various procedural inefficiencies to the corporate governance process. Members of such an electorate would be prone to the kind of squabbling that would bog down decision making, or, worse yet, would have the kind of preferences that give rise to the voting pathologies described by Arrow's theorem. A more diverse electorate is also said to produce substantive inefficiencies. The argument here is that voters with special interests would be in a position to exploit other voters or other corporate constituents rather than pursue a common goal of maximizing corporate wealth. Corporate scholars from across the spectrum who argue in favor of the exclusive shareholder franchise rely on one or both of these sets of inefficiencies to advance their vision of corporate governance.

Scholars typically point to three basic types of procedural inefficiencies that come with a more diverse board electorate: political breakdowns, voting pathologies, and difficulties in apportioning voting power. The political breakdowns (which we have elsewhere called the argument from politics)[75] come in the form of disagreements, internal bickering, information asymmetries, and other internal conflicts that make for less efficient corporate decision making.[76] (This is argued to be true whether the asserted diversity

75. *See* Hayden & Bodie, *Arrow's Theorem*, *supra* note 23, at 1225-27.

76. *See, e.g.*, STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 45-50 (2008) [hereinafter BAINBRIDGE, CORPORATE GOVERNANCE]; Blair & Stout, *supra* note 18, at 313; Henry Hansmann & Reinier Kraakman, *The Basic Governance*

is among an electorate that includes different groups of constituents, a group of constituents other than shareholders, or in some cases, shareholders themselves.) Many corporate theorists have advanced versions of the political breakdown argument. It usually takes the form of a parade of horribles that would accompany the resulting decision-making process. Henry Hansmann and Reinier Kraakman, for example, point out that adding employee representatives would lead to "highly cumbersome and costly" decision processes.[77] In any case, the political breakdown argument is that more diverse constituents, and the corporate board it elects, will come to agreement on corporate decisions less readily than a board representing more homogeneous constituents.

The second type of procedural inefficiency said to accompany a more diverse electorate is the threat of voting pathologies, or cycles. One of the central arguments for the exclusive shareholder franchise, for example, relies upon Arrow's theorem.[78] The reasoning here is that if voters hold dissimilar preferences, the theorem tells us that it will not be possible to design a voting system that produces a transitive (that is, acyclical) outcome.[79] If corporate voting produces cyclical results, the resulting inconsistencies could, in the view of Frank Easterbrook and Daniel Fischel, cause a firm to "self-destruct."[80] Thus, voting should be limited to those with similar, or at least "single peaked," preferences.[81] Shareholders, according to

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Structure, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 33, 33, 64 (Reinier Kraakman et al. eds., 2004) [hereinafter Hansmann & Kraakman, *Governance Structure*]; Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 447-49 (2001) [hereinafter Hansmann & Kraakman, *End of History*].

77. Hansmann & Kraakman, *Governance Structure*, *supra* note 76, at 64. Among the costs is the problem of a tyrannical majority exploiting a minority interest. *See infra* notes 87-88 and accompanying text.

78. This argument was first made by Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 405 (1983) [hereinafter Easterbrook & Fischel, *Voting in Corporate Law*], and later recounted in their book, EASTERBROOK & FISCHEL, *supra* note 24, at 70. It has since been repeated by a variety of scholars. *See, e.g.*, HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 44 (1996); Blair & Stout, *supra* note 18, at 313.

79. *See* Easterbrook & Fischel, *Voting in Corporate Law*, *supra* note 78, at 405.

80. *Id.*

81. *See id.*

those who make this argument, best fit the bill because of their homogeneous interest in wealth maximization.[82]

The third procedural inefficiency offered for restricting voting to shareholders is that we have a nuanced proxy for their degree of interest in the corporation: the number of shares they own.[83] Shareholders have a common interest in maximizing the value of shares. Each share represents an equal bit of financial interest in the firm, and thus, the thinking goes, each shareholder's stake in the outcome of a board election is proportionate to the number of shares she possesses.[84] The one share, one vote rule, then, allows us to perfectly tailor one's stake in the outcome of the election to one's voting power.[85] With respect to other stakeholders—employees, creditors, customers, and the like—we do not have an obvious way to fine tune the levels of interest within each group, much less against shareholders.[86] Shareholders, then, with their well-calibrated voting scheme, are the constituency best suited to vote.

In addition to these more procedural inefficiencies, there are said to be substantive inefficiencies that would accompany an expanded electorate. The most straightforward of these is that a more diverse set of voters just means more opportunities for groups to exploit each other.[87] This is viewed as especially problematic when a tyrannical majority imposes its will on other constituents, but may also occur when a minority, for some reason or another, comes to dominate the process.[88] Either way, expanding the electorate to include other constituents would allow factions to advance their own special interests over the good of the corporate whole. For that reason, voting should be limited to a single group of constituents,

82. *See id.*

83. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 50; Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 612-13 (2006).

84. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 50.

85. *See id.*

86. *See id.*

87. *See id.* at 48 (arguing that diverse constituencies may pursue their own special interests or, in some cases, allow management to pursue its own self-interest by playing different constituencies off against each other); HANSMANN, *supra* note 78, at 41; *see also* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 574-77 (2006) (arguing that if shareholders have divergent interests, they will act opportunistically).

88. *See* HANSMANN, *supra* note 78, at 41.

and the most homogenous group at that.[89] Shareholders, once again, fit the bill.

In sum, many of the arguments used to support shareholder primacy theory, and the exclusive shareholder vote in particular, are based on shareholder homogeneity. The like-minded views of shareholders make it easier to reach consensus and avoid the risk of damaging voting cycles. They also alleviate the concern that one group of voters will hijack the decision process to favor their own special interests over those of the firm. Shareholder homogeneity, then, provides some of the most important undergirding to shareholder primacy theory; without it, we would need to significantly revise our view of corporate governance.

B. The Counter-Narratives of Board Primacy

Throughout the reign of shareholder primacy as the dominant theoretical narrative of corporate law, there have been dissenting voices. At various points, some of these voices have coalesced into groups of like-minded theorists.[90] As it stands now, however, there is no one school of thought standing in opposition. Instead, a collection of academic commentators have individually rallied around various versions of what we call "board primacy." All of these commentators agree that the board of directors should be accorded more power and deference within the corporate structure. They stand opposed to greater shareholder democracy and they believe that the corporation is best served by a board that can make decisions largely free of shareholder influence. These commentators come from a variety of backgrounds—law professor, economist, and corporate attorney—as well as a variety of political viewpoints, ranging from conservative to progressive. They disagree on the appropriate purpose and goals of the corporation and of corporate law. However, they all stand in support of a version of "board primacy" in which

89. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 48; HANSMANN, *supra* note 78, at 44.

90. In the early 1990s, for example, a group of scholars rallied around the progressive banner in their critiques. *See, e.g.*, PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995).

the board can operate in a more independent manner than shareholder primacists currently advocate.

Below are brief descriptions of four prominent board primacy theories: Stephen Bainbridge's director primacy theory, Margaret Blair and Lynn Stout's team production theory, Lawrence Mitchell's self-perpetuating board, and Martin Lipton and Steven Rosenblum's quinquennial election model. Based on similarities in their approaches, we categorize Bainbridge as well as Blair and Stout as "wise ruler" theorists, while we characterize Mitchell as well as Lipton and Rosenblum as "long-term interests" theorists.[91]

1. The "Wise Ruler" Theorists

Shareholder democracy advocates generally bemoan director independence. They view the disconnect between shareholders and directors as the primary source of intrafirm agency costs—namely, the costs shareholders must bear for delegating control of the corporation to someone else. If shareholders can find ways to exert more power over the board, they posit, the corporation will focus more on shareholder interests and less on their own self-interest. This change will cut down on agency costs and lead to greater firm and societal efficiency. However, Bainbridge as well as Blair and Stout disagree with this analysis. They have argued instead that the board must be free to make its own decisions without undue pressure from shareholders. Freed to operate more independently, directors will make better choices about how the firm should proceed.

We call these commentators the "wise ruler" theorists because they invest the board with a great deal of acumen, as well as power. Bainbridge has described the board as the "Platonic guardian" of the firm.[92] He argues that the board sits at the center of a nexus of contracts between various constituents of the firm and the fictional "firm" itself.[93] Similarly, Blair and Stout describe the board as

91. These categorizations are our own; we do not mean to imply that the members of each group have adopted these labels or are working in concert.

92. Bainbridge, *Director Primacy*, *supra* note 2, at 560; Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1, 33 (2002) [hereinafter Bainbridge, *Nexus*].

93. Bainbridge, *Director Primacy*, *supra* note 2, at 560 ("[T]o the limited extent to which

"mediating hierarchs" who manage the relationships of various corporate constituencies.[94] Under both scenarios, the board is envisioned as a body that exists above all the other participants, with authority apart from them. Indeed, independence and insulation are critical to the performance of their roles.

Bainbridge's "director primacy" theory has a significant descriptive component in that he believes the theory offers the best account of why boards are structured to have the independence that they are generally afforded.[95] However, Bainbridge also defends the status quo, arguing that shareholder democracy reforms would be harmful to corporate welfare.[96] He largely relies on the work of Kenneth Arrow with regard to the tension between authority and accountability.[97] Although greater board accountability to shareholders might reduce agency costs, Bainbridge argues that such reforms would create much inefficiency within the corporation. As he describes:

> Active investor involvement in corporate decisionmaking seems likely to disrupt the very mechanism that makes the widely held public corporation practicable: namely, the centralization of essentially nonreviewable decisionmaking authority in the board of directors. The chief economic virtue of the public corporation is ... that it provides a hierarchical decisionmaking structure well-suited to the problem of operating a large business enterprise with numerous employees, managers, shareholders, creditors, and other constituencies.[98]

Bainbridge does not quarrel with shareholder primacy as the goal of the corporation; in fact, he believes that the board should direct itself toward shareholder wealth maximization.[99] However, he

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the corporation is properly understood as a real entity, it is the board of directors that personifies the corporate entity.").

94. Blair & Stout, *supra* note 18, at 280.

95. Bainbridge, *Director Primacy*, *supra* note 2, at 591-92.

96. Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1754-57 (2006) [hereinafter Bainbridge, *Shareholder Disempowerment*].

97. Bainbridge, *Director Primacy*, *supra* note 2, at 572-73.

98. Bainbridge, *Shareholder Disempowerment*, *supra* note 96, at 1749.

99. Bainbridge, *Director Primacy*, *supra* note 2, at 563.

believes that the proper means to achieve this end is through director primacy.

Blair and Stout see a comparable role for the board within their model of the corporation. Similar to Bainbridge and other contractarian theorists, Blair and Stout see the firm as a series of relationships between the various constituencies that make up the business.[100] These relationships result in the joint production of goods or services that in turn create wealth. The directors serve as the ultimate authority when it comes to assigning responsibilities, mediating disputes, and divvying up the profits.[101] Board insulation and independence is therefore critical to their role. The board must be independent from all constituencies in order to be trusted with such a crucial and uncertain responsibility. If the board favored one constituency over others, the unfavored groups would be less willing to make the proper investments of capital and labor to make the firm function.

Unlike Bainbridge, Blair and Stout do not argue that shareholder wealth maximization should be the goal of the corporation.[102] Instead, they argue that directors owe a duty to the corporation and that the corporation consists of all of the stakeholders who are responsible for the business of the enterprise.[103] Blair and Stout focus on shareholders and employees, but they also cite to creditors and the local community as potential stakeholders as well.[104] According to the model, these stakeholders contribute their resources to the enterprise with the implicit bargain that the enterprise itself will fairly apportion the responsibilities and rewards.[105] The board is hired by these stakeholders to serve as the apportioning body. Thus, although the board is in some sense an agent for the stakeholders, it must have authority above them in order to carry

100. Blair & Stout, *supra* note 18, at 254 (stating that the team production approach is "consistent with the 'nexus of contracts' approach").

101. *Id.* at 251.

102. *Id.* at 293-94.

103. *Id.*

104. *Id.* at 250 (stating that along with shareholders, other corporate contributors include "[e]xecutives, rank-and-file employees, and even creditors or the local community"); *id.* at 278 (describing participants in the corporation as "shareholders, employees, and perhaps other stakeholders such as creditors or the local community").

105. *Id.* at 250.

out its function. The role is thus less one of an agent and more that of a trustee.[106]

Neither Bainbridge nor Blair and Stout offer extensive policy reforms. Instead, both theories are best characterized as descriptions of the status quo that explain, as well as justify, the current regime. Bainbridge and Stout have both extensively criticized efforts to expand upon shareholder democracy.[107] However, they have not argued (unlike the commentators below) for efforts to further insulate or protect directors' discretion. Instead, they largely believe the status quo (circa the turn of the century) offers the proper balance.[108]

2. The "Long-Term Interests" Theorists

Another set of theorists also argues for board primacy: namely, board insulation and independence from shareholder pressure.[109] However, they base their analyses not on a model of corporate structure, but rather on concerns about the influence of short-term interests. In their view, shareholders have developed an extremely short time horizon by which they judge the success of the corporation and its leadership. As boards and officers have come under more pressure to follow the desires of shareholders, they have adopted the goal of short-term share price maximization. This focus, they argue, has skewed the perspectives of shareholders and, as a result, has hurt the long-term efficiency of corporations.

Although a number of commentators share this concern about short-termism, we look at two sets of commentators who have long focused on it. Since the early 1990s, Lawrence Mitchell and Martin Lipton have criticized shareholder primacy on the grounds that it inexorably leads to short-term share price primacy. And both have proposed somewhat dramatic solutions to this problem.

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106. *Id.* at 280-81.

107. Bainbridge, *Shareholder Disempowerment*, *supra* note 96; Stout, *supra* note 18, at 791-92.

108. Lynn Stout has argued in later articles for greater constraints on shareholders. *See, e.g.*, Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1256 (2008) (arguing that corporate law should impose a duty of loyalty on shareholders). She has also echoed the concerns about shareholders' short-term time horizons that drive the proposals of Mitchell and Lipton, and Rosenblum, discussed *infra*.

109. *See infra* notes 110-25.

In an article and a subsequent book, Mitchell has argued that boards at large public companies should be self-perpetuating.[110] As Mitchell describes his proposal: "[O]nce the members of the board [are] put in place, either by a one-time stockholder vote or public appointment or something like it, the board itself [is] to fill the periodic vacancies resulting from death, resignation, and increases in board size by selecting the people to fill those vacancies."[111] Mitchell acknowledges that this is a "pretty radical idea,"[112] but he believes such a radical approach would best free managers to manage the firm. Because any control by shareholders would focus directors on share price, Mitchell believes that complete freedom from shareholder oversight would "enable them to manage responsibly and for the long term."[113]

Because his proposal is such a dramatic departure from current law, Mitchell also endorses the quinquennial election proposal of Lipton and Rosenblum.[114] In the article outlining their approach, Lipton and Rosenblum also deplore the short-term focus that shareholder primacy brings to the corporation.[115] In a complex set of reforms, they establish a new framework for corporate governance, the centerpiece of which is lengthening directors' terms to five years. During these five years, directors could not be ousted save for illegal conduct or "willful malfeasance."[116] Directors would also be entitled to approve all mergers, acquisitions, buyouts, or takeovers, except that such changes could only be accomplished at the time of the directors' election.[117] As part of the election, the directors would be required to propose an in-depth five-year plan, and their compensation would be tied to achieving the goals set forth in the plan.[118] The board would also be responsible for hiring

110. MITCHELL, *supra* note 9; Lawrence E. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263, 1272 (1992) [hereinafter Mitchell, *A Critical Look*].

111. MITCHELL, *supra* note 9, at 112.

112. *Id.*

113. *Id.* at 119.

114. *Id.* at 129 (settling on the quinquennial plan as a "middle ground" proposal that is a "good idea" and "a little less scary to contemplate" than the self-perpetuating board).

115. *See* Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 205-14 (1991).

116. *Id.* at 225; *see also id.* at 229-30.

117. *Id.* at 244-45.

118. *Id.* at 233-40.

independent advisors prior to the election to provide a critique of their plan.[119]

Both the self-perpetuating board and the quinquennially elected board are significantly more insulated from shareholders than current law provides. Neither set of commentators seem too concerned about the downgrade in shareholder power, as they view that power as the problem in the first place. Under the quinquennial election plan, Lipton and Rosenblum believe that shareholders would in fact have a limited but revitalized role, as they conceive of the election as a time for shareholders to make a meaningful vote on the corporation's future. As such, they provide that shareholders holding at least 5 percent of the corporation's equity would have access to the proxy ballot.[120] In the original description of Mitchell's self-perpetuating plan, the board would only become self-perpetuating once the corporation went public. Therefore, the board of the privately-held company—elected by the private shareholders—would essentially become the board ad infinitum. Mitchell recommends, however, that this board "replace itself with a group of directors who are neither managers nor stockholders[;]" instead, the board would be made up of independent directors.[121] Mitchell believes that this change would render the board "far less likely to feel allegiance to management."[122] In his later discussion of the policy, Mitchell is more oblique about the composition, stating that "the members of the board [would be] put in place, either by a one-time stockholder vote or public appointment or something like it."[123] And when he endorses Lipton and Rosenblum's proposal, he also tepidly endorses an expansion of the electorate to include employees and creditors. Mitchell argues that "there's no reason to think, unless you view stock price maximization as the corporation's only legitimate goal, that allowing employees and creditors to vote too would damage the corporation."[124]

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119. *Id.* at 235-36.

120. *Id.* at 231. However, the proposal would also eliminate shareholder proposals under SEC Rule 14a-8, as the authors believe that such proposals are "the tool of gadflies who seek to promote special interests." *Id.* at 231-32.

121. Mitchell, *A Critical Look*, *supra* note 110, at 1303.

122. *Id.*

123. MITCHELL, *supra* note 9, at 112.

124. *Id.* at 131. However, Mitchell frames this change as a potential change, rather than an essential one, and he acknowledges that his proposed change to the electorate is not

Indeed, Mitchell has gone even further in his most recent work, arguing that "ideally (although most likely improbably), the right of public shareholders to vote should be eliminated."[125]

From these brief sketches, it is clear that all board primacists believe the board should not become more responsive to shareholder concerns. The "wise ruler" theorists largely believe the system is balanced properly, while the "long-term" theorists would reorient the board toward a longer-term outlook by extending the tenure of board members. Only Mitchell suggests any changes to the electorate, and he does so in a somewhat offhanded way. Instead, these theorists largely believe that tinkering with the board itself, rather than those who choose the board, would be the best course of reform. We now turn to a deeper examination of the theories and, in particular, the issue of the electorate.

III. BOARD PRIMACY, BOARD RESPONSIVENESS, AND THE COMPOSITION OF THE ELECTORATE

Over the last several years, it has become increasingly clear that shareholders are not, in fact, the homogeneous wealth maximizers they were once thought to be. Shareholders, it turns out, have interests that diverge along a number of dimensions.[126] Commentators have recently focused attention upon the problems caused by equity derivatives, which carve up various shareholder rights into discrete financial securities.[127] But there are many other ways in which

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"thoroughly develop[ed]." *Id.* at 130-31.

125. Lawrence E. Mitchell, *The Legitimate Rights of Public Shareholders* 34-35 (George Washington Univ. Law Sch. Pub. Law Research Paper No. 461, 2009), *available at* http://ssrn.com/abstract=1352025. Again, however, Mitchell acknowledges that the ramifications of this change are "beyond the scope of my task here." *Id.* at 35 n.91 (citing again to the quinquennial election proposal of Lipton & Rosenblum, *supra* note 115). In another recent article, Mitchell has also developed an entirely different policy proposal: direct election of the chief executive officer by shareholders, creditors, and employees, each voting as a class. Lawrence E. Mitchell, *On the Direct Election of CEOs*, 32 OHIO N.U. L. REV. 261, 263 (2006). Mitchell argues that the addition of creditors and employees to the voting pool would provide a better-informed, more balanced electorate. *Id.* at 280-82.

126. *See* Anabtawi, *supra* note 87, at 577-93 (cataloguing the ways in which shareholder interests diverge); Hayden & Bodie, *One Share, One Vote*, *supra* note 23, at 477-98 (same).

127. Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 815 (2006); Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775, 778.

shareholders fail to share common interests.[128] And even when shareholder interests line up and they agree on a definition of wealth maximization, they may differ as to the best way to achieve that goal.[129] Ultimately, the notion that shareholders have homogeneous preferences is a simplifying assumption that is increasingly under strain.[130]

One possible response to shareholder heterogeneity is to move away from shareholder primacy toward a system of governance that is less responsive, in the direction of board primacy. The preferences of the shareholder electorate, it turns out, are as diverse (read: scary) as those of other constituents. Thus, many of the reasons for restricting the voting rights of those other constituents (the procedural and substantive inefficiencies) now apply to shareholders as well. For those reasons, then, corporate boards should be less responsive to shareholder interests and more power and discretion should be accorded to these boards.

Shareholder diversity has pushed many scholars, touting both board and shareholder primacy, in this direction. One sees this new pressure throughout the corporate law literature when a question arises as to the appropriate level of responsiveness of a system of corporate governance. Hedge funds, for example, may have shorter time horizons than other investors, and critics have cited this potential for short-term focus as a reason for dampening their influence.[131] Others have argued that sovereign wealth funds—investment funds run by nations, rather than capitalists—have skewed incentives that differ from other shareholders. In fact, one

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128. For example, some shareholders may be in a control group and others may not. *See* Hayden & Bodie, *One Share, One Vote*, *supra* note 23, at 477-80. Employee and pension-holding shareholders have different interests from nonemployee shareholders. *See id.* at 486-88. And even traditional shareholders may have different time horizons for wealth maximization that cannot be costlessly equalized through existing financial instruments. *See id.* at 492-94.

129. *See* Hayden & Bodie, *Arrow's Theorem*, *supra* note 23, at 1230-32.

130. *See* Martin & Partnoy, *supra* note 127, at 778 ("It is simply not true that the 'preferences of [shareholders] are likely to be similar if not identical.'" (quoting Easterbrook & Fischel, *Voting in Corporate Law*, *supra* note 78, at 405)); *see also* Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021, 1052 (1996) ("For fictional shareholders, whatever else the people behind them may want, all want to maximize the value of their shares."); Hayden & Bodie, *One Share, One Vote*, *supra* note 23, at 477-99.

131. Anabtawi & Stout, *supra* note 108, at 1290-92.

set of commentators has even suggested that sovereign wealth funds forego the right to vote in shareholder elections.[132] Divergent interests among shareholders may point in a variety of different governance directions. That is, although shareholder heterogeneity provides general support for board primacy, it is relevant to almost any feature of corporate governance that makes the system more or less responsive to the shareholders, and it generally exerts pressure in the direction of making the system *less* responsive.

Thus, it is important to disentangle the two kinds of arguments that are generally made in response to the diversity of preferences exhibited by shareholders and other corporate constituents. One set of arguments, which go to the level of responsiveness in the governance system, make some sense. The other set, however, goes beyond responsiveness and continues to argue for a particular and exclusive electorate—shareholders. These claims are often made together and are sometimes conflated. But they are very different aspects to a governance system—corporate or otherwise.

A. System Responsiveness to the Electorate

The worries about an overresponsive system of corporate governance drive most board primacy theories.[133] The corporation, board primacy proponents argue, should be structured in a way that the board is relatively insulated from the whims of the shareholder electorate.[134] The arguments here echo debates from political science about the relative strengths and weaknesses of direct and representative democracies.[135] Direct democracies have a great deal of responsiveness to the electorate's preferences, and, as a result, may be viewed as more legitimate. The downsides to such responsiveness, however, are that decision making on such a massive scale is relatively costly and that direct democracies are more susceptible to tyranny of the majority types of issues. Representative decision

132. Ronald J. Gilson & Curtis J. Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 60 STAN. L. REV. 1345, 1362-65 (2008).

133. *See* MITCHELL, *supra* note 9, at 99; Bainbridge, *Director Primacy*, *supra* note 2, at 563-74; Blair & Stout, *supra* note 18, at 290-92; Lipton & Rosenblum, *supra* note 115, at 205-14.

134. *See* Bainbridge, *Director Primacy*, *supra* note 2, at 572-73.

135. For an early discussion of the strengths and weaknesses, see THE FEDERALIST NO. 10 (James Madison).

procedures, by contrast, are less responsive (and thus less susceptible to a tyrannical majority) and more conducive to deliberation by the elected representatives. The shortcoming of such a system, though, is that as its representatives become less responsive to the electorate, they may fail to make decisions that do, in fact, advance the interests of their constituents.

It should come as no surprise that this distinction between direct and representative decision structures maps, somewhat roughly, onto our earlier discussion of the difference between public choice and civic republican theories of democracy.[136] Public choice theories, with their emphasis on preference aggregation, tend to favor more direct decision procedures such as initiatives that allow the immediate aggregation of preferences into policy or, in some cases, markets driven by individual choices.[137] Civic republican theories favor the detached deliberation afforded by more insulated groups of representatives.[138] The overlap isn't perfect, and most theories of governance fall somewhere in between the extremes, but it may help sharpen some of the different approaches.

The fear of an overresponsive system of governance is the primary force motivating a shift in power away from shareholders to the board. As mentioned above, it resolves into two kinds of concerns. First, a system that is too responsive to shareholders may give rise to various procedural inefficiencies. Put simply, being more responsive costs time and money. A system of shareholder initiative, for example, is viewed as problematic because it slows down corporate decision making and because of the potential cost of running the electoral machinery.[139]

The main proponent of board primacy, Stephen Bainbridge, makes the point largely on the basis of Kenneth Arrow's models of consensus and authority decision making.[140] According to

136. *See supra* Part I.

137. Grofman, *supra* note 36, at 1577-78.

138. *See supra* note 21 and accompanying text.

139. For an argument against shareholder proxy proposals on grounds of inefficiency, see Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174 (2001).

140. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 46-49. Arrow's models of consensus and authority decision making are another way to describe this difference between more and less responsive systems of governance. *See* KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 63-79 (1974).

Bainbridge, shareholders with differing interests and levels of information would bog down corporate decision making.[141] Bainbridge, citing Arrow, argues that decision making by consensus works best when the participants have similar—if not identical—preferences and information. There are, initially, "mechanical difficulties" in achieving consensus among thousands of shareholders.[142] But even if such difficulties could be overcome, "active shareholder participation in corporate decision making would still be precluded by the shareholders' widely divergent interests and distinctly different levels of information."[143] Thus, Bainbridge concludes, corporate governance systems are—and should be—structured to enhance authority-based decision making, with the board being the ultimate authority.[144]

Along these lines, a system responsive to shareholder preferences may also be prone to voting pathologies, or cycles, which further diminish the ability of firms to move decisively in some consistent direction. The voting cycles argument was originally made in defense of the exclusive shareholder franchise.[145] Its premise, though, was that there is a direct relationship between the diversity of an electorate and the likelihood of damaging voting cycles. With mounting evidence that shareholder preferences are actually quite a bit more diverse than previously thought, such an argument would also militate against expanded voting powers for shareholders as well. Indeed, Jeffrey Gordon, for one, argued for the absolute delegation rule (and against shareholder initiatives) on precisely those grounds years ago,[146] and Bainbridge has made a similar point.[147] The possibility of voting cycles is problematic enough to distance the board from its shareholder electorate and, as noted earlier, keep other constituents out of that electorate altogether.

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141. *See* Stephen M. Bainbridge, *Participatory Management Within a Theory of the Firm*, 21 J. CORP. L. 657, 725 (1996) ("The resulting conflicts of interest inevitably impede consensus-based decisionmaking within the board.") [hereinafter Bainbridge, *Participatory Management*]; *see also* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 40-41.

142. *See* Bainbridge, *Director Primacy*, *supra* note 2, at 557-59.

143. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 56.

144. *See id.* at 57.

145. *See supra* notes 61-70 and accompanying text.

146. Jeffrey N. Gordon, *Shareholder Initiative: A Social Choice and Game Theoretic Approach to Corporate Law*, 60 U. CIN. L. REV. 347, 351-53, 359-61 (1991).

147. *See* Bainbridge, *Participatory Management*, *supra* note 141, at 667 & n.51, 725 & n.409.

The second and greater drawback to more responsive corporate governance systems is that they give rise to tyranny of the majority. They are, in other words, *too efficient* at translating the will of a majority of the electorate into corporate action. This criticism comes in various guises. For some, the worry is that certain "special interest" shareholders will exploit other shareholders rather than act for the good of all shareholders.[148] Others worry that shareholders generally will exploit other corporate constituents.[149] Either way, a more responsive system of corporate governance will enable these self-interested, sometimes transient majorities to manipulate corporations toward their own selfish ends.

Several of the board primacy theorists cite to this fear of "tyranny of the shareholder majority." Blair and Stout establish their model of "mediating hierarchs" on the notion that shareholder dominance will lead the other team members to disinvest or invest less than optimally. As they explain: "[T]eam members [including shareholders] understand they would be far less likely to elicit the full cooperation and firm-specific investment of other members if they did not give up control rights."[150] Thus, it is the directors' job to "balance team members' competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together."[151] Accordingly, it only makes sense to Blair and Stout that "American law in fact grants directors tremendous discretion to sacrifice shareholders' interests in favor of management, employees, and creditors."[152] This need to "sacrifice" shareholder interests explains the desire to insulate the board from shareholder importuning.

Similarly, the long-term theorists want to insulate the board against shareholder pressure to maximize short-term gain. Lipton and Rosenblum argue that institutional shareholders—the shareholder group with the greatest voice and power—are biased toward short-term results, and as a consequence such shareholders have

148. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 228-32; Anabtawi, *supra* note 87, at 574-77.

149. *See* Blair & Stout, *supra* note 18, at 291-92.

150. *Id.* at 277.

151. *Id.* at 281.

152. *Id.* at 291.

pushed companies to favor quick results over long-term growth.[153] Insulating the board with five-year terms allows the directors to pursue a longer-term strategy without the risk of shareholder wrath.[154] In turn, this will "benefit the corporation's other constituencies, which prosper if the enterprise's business operations prosper over the long term."[155] Similarly, Mitchell argues that his self-perpetuating board would best free directors "to do what it is they do best, and that is manage (or provide for the management of) corporations for the long term."[156] In order to accomplish this, "[c]orporate management should be entirely separated from stockholder pressure."[157]

These arguments all point to a disconnection between the will of the electoral majority and the good of the corporation. In order to properly pursue the social good, the board has to be insulated from the shareholders. Thus, these reformers all seek to dampen the responsiveness of the corporate structure to shareholder concerns. As a result, the board is (or would be) freed up to follow its own discretion, even if it conflicts with a clear and uniform preference of the electorate.

B. Board Primacy and Shareholder Homogeneity

It is clear that shareholders have less homogeneous preferences than previously believed.[158] This, in all likelihood, provides some additional support for less responsive systems of corporate governance. It does not, however, counsel in favor of a corporate electorate restricted to shareholders. Indeed, as discussed above,[159] the recent recognition that shareholders are more diverse than once thought actually undercuts many of the arguments for their favored position among corporate constituents. Board primacists, however, have generally eschewed such analysis and simply kept the shareholder electorate unchanged.[160] But there is nothing in the typical

153. Lipton & Rosenblum, *supra* note 115, at 205-13.
154. *Id.* at 227.
155. *Id.*
156. MITCHELL, *supra* note 9, at 118.
157. *Id.* at 119.
158. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 50.
159. *See supra* notes 129-30 and accompanying text.
160. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 50-53; Blair & Stout,

arguments in favor of a less responsive system that entails this result. The exclusive shareholder franchise just gets dragged along for the ride into board primacy positions. And board primacists' failure to reconsider the proper composition of the electorate leaves them in an increasingly untenable position. Some, like Blair and Stout, operate under the assumption that shareholder preferences are quite homogeneous and argue accordingly when it comes to the proper composition of the electorate.[161] Others, like Bainbridge, concede that shareholder preferences are less homogeneous than once thought and instead argue that they are still *more* homogeneous than those of other constituents, or of a combined electorate.[162] Either way, the set of arguments from (relative) shareholder homogeneity to their exclusive entitlement to the franchise are similar.

Coming from advocates of board primacy, with its civic republican emphasis on detached deliberation, these arguments for the exclusive shareholder franchise are surprising. Take the first argument—the argument from politics—that expanding the board electorate to include other constituents will lead to the kind of bickering that will frustrate corporate decision making. Blair and Stout, for example, ask us to "[i]magine the chaos and politicking likely to attend an election in which a firm's creditors, executives, rank-and-file employees, and other stakeholders with unique and often conflicting interests could vote on their favored candidates."[163] The electorate's diverse interests, it is argued, would bog down the decision-making process,[164] either at the point of the election or in the boardroom. Of course a more diverse electorate would, at some level, make decision making less elegant. But this is not a compelling argument for restricting the franchise to shareholders alone, especially coming from advocates of board primacy. Initially, any group choice procedure is intended to work with diverse preferences. The entire point of most voting systems or other social choice procedures is to take a set of individual preference profiles and aggregate them into a group choice (indeed, if preferences were

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supra note 18, at 313-14; Lipton & Rosenblum, *supra* note 115, at 225-26.

161. *See* Blair & Stout, *supra* note 18, at 313.

162. BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 50.

163. *See* Blair & Stout, *supra* note 18, at 313.

164. *See supra* note 141 and accompanying text.

completely homogeneous, we could just poll one member of the electorate and skip the rest of the process). A diverse board electorate could vote in a single election (as shareholders now do) or in separate elections for stakeholder representatives (like the German codetermination model).[165]

The worry should be no greater at the board level—one can always force a decision. Corporate boards, for example, traditionally follow internal procedures requiring majority votes, with the chair having tie-breaking authority.[166] If the particular decision procedures don't seem to be working smoothly, one can usually identify the problem and reduce or eliminate the difficulty by tinkering with institutional design features. In the end, one can always design a procedure for forcing a vote and thus reach a decision on any particular issue—there may be winners and losers, but a decision will be made that is based on voter preferences.

More to the point, though, advocates of board primacy appear to be overvaluing consensus in the boardroom. One of the primary benefits of more deliberative governance processes is that representatives, in addition to expressing their own views about the interests of their constituents, may also persuade others to change their minds. And they may be persuaded to change their own minds. Indeed, a wide range of studies demonstrate that a greater diversity of views mediated through the deliberative process may well lead to better decision making.[167]

A governance system in which a diverse body of voters elects a relatively insulated group of representatives should be especially appealing to civic republicans with no fixed sense of the good. Through the deliberative process and, if it comes to it, a vote, board

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165. For a discussion of the structure of the codetermined board, see Mark J. Roe, *Codetermination and German Securities Markets*, *in* EMPLOYEES AND CORPORATE GOVERNANCE 194-205 (Margaret M. Blair & Mark J. Roe eds., 1999).

166. *See* DEL. CODE ANN. tit. 8, § 141(b) (2009) ("The vote of the majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors unless the certificate of incorporation or the bylaws shall require a vote of a greater number.").

167. *See* Lynne L. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors*, 76 TUL. L. REV. 1363, 1388-1405 (2002) (documenting the many ways in which increasing board diversity would promote better decision making); Lisa M. Fairfax, *The Bottom Line on Board Diversity: A Cost-Benefit Ananysis of the Business Rationales for Diversity on Corporate Boards*, 2005 WIS. L. REV. 795, 831-33 (documenting studies that link greater diversity with better decision making).

members can come to a shared notion of the common good. Consensus among the voters or the board members, in other words, is overrated, especially when that consensus is bought at the price of excluding those with differing views from the process.[168] And claims of efficiency all depend upon what is being maximized, which is sometimes at the heart of the disagreement.

Bainbridge couches this political breakdown argument in terms of Kenneth Arrow's scheme of consensus and authority decision making.[169] The arguments made with respect to shareholder diversity apply with even more force to other constituents because, according to Bainbridge, an electorate expanded to include other constituents, like employees, would be even more diverse.[170] Thus, corporations are no place for consensus-based decision making, and the vote should accordingly be limited to shareholders alone.

Bainbridge's version of this argument does not work that well as a general matter or as applied to this issue of the proper scope of the corporate electorate. Initially, his position—that constituents with differing interests and levels of information counsel, according to Arrow, an authority-based structure—is incomplete. Arrow does postulate a tension between authoritarian- and consensus-based governance.[171] But, as Brett McDonnell recently pointed out, "Bainbridge moves very, very quickly from recognizing the tension between authority and accountability to arguing that we should presume a legal structure that favors authority over accountability."[172] These moves, which McDonnell dubs "Arrowian moments," occur throughout Bainbridge's work, and are noteworthy for their complete lack of substantive argument that the more authoritiarian, board-centric solution is the correct one.[173] In other words, recognizing the tension does not tell us where on the continuum we should be with respect to each institutional design feature and certainly

168. *See supra* notes 87-88 and accompanying text.

169. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 45-49.

170. *See id.* at 50.

171. *See* ARROW, *supra* note 140, at 69. This dichotomy roughly follows our earlier discussion of the degree of responsiveness of governance systems.

172. Brett H. McDonnell, *Professor Bainbridge and the Arrowian Moment: A Review of 'The New Corporate Governance in Theory and Practice,'* 34 DEL. J. CORP. L. 139, 142-43 (2009) (book review).

173. *See id.*

doesn't tell us that we should always tilt toward the more authoritarian solution.

As applied to other constituencies and their voting power, Bainbridge's argument is even more tenuous. First, it conflates the responsiveness of the governance system with those to whom it is responsive. Arrow's conceptual scheme argues for more authoritarian (that is, less responsive) systems in certain situations, not a restriction on the scope of the (however distant) electorate. Second, once Bainbridge concedes shareholder diversity, his point on the exclusive shareholder franchise hangs on the *difference* in preference homogeneity between a shareholder electorate and either an electorate composed of another constituency or an electorate expanded to include shareholders and other constituents. There is little argument that a material difference even exists.[174] And, as with the general version of his argument, there is nothing here to suggest that the difference justifies this move to the extreme end of the authority-consensus spectrum. In this situation, unlike when he makes his general arguments from shareholder diversity to board primacy, Bainbridge needs, if anything, a stronger argument, for here he is deploying Arrow's concepts toward cutting other constituents completely out of the governance process, not merely making the process less responsive to them.

Another argument made for the exclusive shareholder franchise trades on the looming specter of voting cycles.[175] Its basic premise, as noted before, is that there is a direct relationship between the diversity of an electorate and the likelihood of damaging voting cycles. In order to reduce the chance of a voting cycle, the electorate should be limited to one corporate constituency, and the most homogeneous one at that. Shareholders, with their common desire to maximize share price, are just such a constituency.

But now that we know shareholder preferences are more diverse than previously thought,[176] what is left of the voting cycles argument for an exclusive shareholder franchise? Once again, the first part of an answer to that question involves an assessment of how

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174. Bainbridge asserts that there is great diversity among different classes of employees but provides little evidence that the asserted diversity is any greater than among shareholders. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 48.

175. *See supra* notes 61-66 and accompanying text.

176. *See supra* notes 96-100 and accompanying text.

solid the argument was to begin with. As we argued in a previous paper, the argument from Arrow's theorem was misconceived from the start.[177] First, it assumed shareholder preference homogeneity with respect to the ends of the firm, not the means, and not the best slate of directors to effectuate those means. That is, even taking shareholder homogeneity with respect to profit maximization at face value, the argument did not involve agreement on the right level—on board candidates—to avoid a cyclical result.[178] Second, the argument never made clear how a nascent intransitivity in a board election, even if it were to arise, would translate into inconsistent firm choices. For a variety of reasons, most of which have to do with the way corporate boards and their elections are structured, there is almost no chance that such a cycle would manifest itself in the form of a damaging corporate decision, much less one that would cause a firm to self-destruct.[179] The argument from Arrow's theorem, then, wasn't very persuasive to begin with.

Even assuming that there was something to the argument, what is left of it in the face of the recent assaults on the concept of shareholder homogeneity? The answer is "not much," but that hasn't kept board primacy theorists from continuing to rely upon it. Bainbridge, for example, appears to think that preference homogeneity is a one-dimensional concept and that more is better when it comes to reducing the incidence of cycling.[180] In fact, however, there are various conditions that reduce or eliminate the incidence of cycling, but, short of complete agreement, most have less to do with shared preferences with respect to outcomes than they do with shared dimensions upon which those preferences may be arrayed.[181] Indeed, if anything, it turns out that placing two constituencies with oppositional interests within the same electorate (say, shareholders and employees) may be the best way to reduce the incidence of cyclical outcomes because preferences would polarize across a shared dimension of capital and labor.[182]

177. *See* Hayden & Bodie, *Arrow's Theorem*, *supra* note 23, at 1229.
178. *See id.* at 1232-34.
179. *See id.* at 1234-43.
180. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 50-52.
181. *See* Hayden & Bodie, *Arrow's Theorem*, *supra* note 23, at 1235-38.
182. *See id.* at 1238.

The third procedural argument for the exclusive shareholder franchise is also undercut by the revelation of shareholder diversity. The argument, remember, is that shareholders alone have a very good proxy for the degree of their interest in the firm, the number of shares owned, which allows us to perfectly calibrate their voting power.[183] But the number of shares owned is not such a good proxy once we have shareholders with interests that go beyond the mere monetary value of their stock. There are bigger problems with this argument, however, than the fact that one of its assumptions—shareholder homogeneity—has been undercut.

The biggest problem is that a ready proxy for shareholder interest and the one share, one vote rule tells us little about whether or how voting power should be distributed among stakeholders. The number of shares owned by particular shareholders may be a good indication of their interest in comparison to other shareholders; it tells us nothing, however, about their interest in comparison to, say, an employee, a creditor, or a customer. More specifically, it is not an independent reason to conclude that the present arrangement, which gives shareholders alone the right to vote, is any better at capturing the preferences of interested parties than, say, giving employees alone the right to vote and capturing everyone else's interest through contract. The difficulty in assessing how much to weight the aggregate shareholder interest or vote against the aggregate interests of any other group of stakeholders runs both ways and does not demand resolution in any particular direction.

Perhaps a simpler way to think about this point is in terms of a board with members who represent different constituencies.[184] On an eleven-member corporate board that represents the interests of many different stakeholders, the fact that one group of stakeholders has a particularly nuanced way of apportioning voting power amongst its own members tells us nothing about how many board representatives that group should be apportioned as a whole. That

183. *See supra* notes 83-86 and accompanying text.

184. This assumes that the various constituencies would elect their board representatives in separate elections, which, by the way, is how the German system of codetermination works. *See* David H. Brody et al., *Alternatives to the United States System of Labor Relations: A Comparative Analysis of the Labor Relations Systems in the Federal Republic of Germany, Japan, and Sweden*, 41 VAND. L. REV. 627, 635-36 (1988). But the point here would be equally applicable in an election in which all constituencies vote in the same election and we need to decide how much to weight each vote.

is, the one share, one vote rule is a good way of apportioning voting power among shareholders, but it tells us nothing about how voting power should be distributed among different stakeholders.

This is not to say that the presence of an effective measure of stakeholder interest is irrelevant to determining whether any particular group of stakeholders receives the right to vote. Distribution of a corporate franchise operates, at one level, like that of a political franchise. Voting is a collective decision-making process designed to reflect preferences of those interested in the outcome of an election. For that reason, we usually tie the right to vote to the strength of one's preferences in the election.[185] Because we have no direct method of observing people's preferences, we are forced to rely on various proxies for the strength of their interest.[186] In the political arena, we historically relied upon property holding and taxpaying requirements as proxies for voter interest; we now use residency and citizenship requirements for much the same reason.[187] Because the presence of a good proxy for voter interest is central to the issue of the scope of the franchise, the fact that shareholders have a pretty good proxy for interest is an appropriate factor to consider when doling out corporate voting rights.

But, again, the fact that we have a good proxy for shareholder interest does not mean that we lack good proxies for other corporate constituents, or that shareholders, therefore, should receive all of the voting power. When assessing proxies for voter interest, we are usually looking for two things: does the proxy accurately capture voter interest, and is the proxy manageable.[188] Shares are a relatively accurate, manageable proxy for shareholder interest, and therefore, shareholders are a group whose interests can be reasonably captured through voting (rather than merely through some other device, like contract).[189] Employees are another group. Employment status is a good proxy: it is a good indication of interest in corporate decision making, and employees are pretty easy to identify. But there may not be good proxies for all corporate constituents. It may be difficult, for example, to devise an accurate,

185. *See* Hayden & Bodie, *One Share, One Vote*, *supra* note 23, at 453.
186. *See id.* at 453-54.
187. *See id.* at 454-56.
188. *See id.* at 460-62.
189. *See id.* at 447-48.

manageable proxy for customer interest in a retail firm. Any individual customer's interest in the firm may be irregular and it may be hard to identify the customers before they become interested parties (and make, or decide not to make, a purchase). For that reason, individual contracts may be the best way to capture their interests.[190] The presence of a good voting proxy for one group of constituents has little bearing to the decision to extend the franchise to any other group; those decisions can, and should, be made independently.

The final, substantive argument for the exclusive shareholder franchise was that more diverse constituents, if granted the vote, would pursue their own special interests to the detriment of others in their group or, more generally, other stakeholders; shareholders, with their common interests, would not.[191] Once again, before examining how this argument fares without the assumption of shareholder homogeneity, we should examine it on its own terms. The premise—that democratic processes may allow a majority to exploit minority interests—is well known.[192] The conclusion, though, is a bit perverse. The presence of a tyrannical majority is usually offered in support of structures designed to protect the exploited minority; here, though, it is offered as a reason for pushing the minority group out of the decision process altogether. That is, in such situations, we are usually worried about the exploitation of the minority interest, not the possibility that the majority or their representatives will feel put upon by having to consider interests other than their own.

This is not to say that tyranny of the majority is not an issue. It is an issue with corporate governance as it is with any democratic decision procedure. Most political democracies attempt to blunt the effects of what the founders called "faction" by making a system of government less responsive to the electorate and providing substantive protections to minorities.[193] The same approach is taken in

190. This depends, of course, on the type of corporation. The customers of a utility company, for example, are clearly interested in the corporation and would be relatively easy to identify.

191. *See supra* notes 67-70 and accompanying text.

192. James Madison described this as the danger of majority faction. THE FEDERALIST NO. 10 (James Madison).

193. In the United States, this meant, among other things, dividing the government into three branches with checks on each other, dividing the federal legislature into two chambers,

corporate law, where there are many layers between shareholders and most corporate decision making and various protections for minority shareholders.[194] Minority shareholders in closely held corporations, for example, enjoy wide-ranging equitable protections through the "minority oppression" doctrine.[195] Minority shareholders in publicly held corporations are protected by the fiduciary duty of loyalty, which prevents the majority shareholder from pushing through lopsided self-interested transactions that harm the corporation as whole.[196] Such protections are a rational response to the possibility of an exploitive majority faction; eliminating minority interests from the corporate electorate just adds insult to injury.

Once shareholder diversity enters the picture, this argument, like the others, makes even less sense. The claim again comes down to one of relative diversity and the assumption that any marginal increase in the diversity of the electorate militates in favor of a less responsive system and restrictions on the scope of the electorate. In corporate governance, as in politics, there are many reasons to embrace more deliberative systems of governance. Some of those reasons have to do with the cost of more responsive systems—putting every single corporate decision to a vote of an electorate, however defined, is a waste of time and money. Some of those reasons have to do with the heterogeneity of the electorate and the worry that permanent or even temporary majorities may pursue their own interests to the detriment of a minority.[197]

But, in such cases, it takes only a slight departure from complete homogeneity to push in favor of a less responsive system of governance. For example, even shareholders who are completely unanimous in their support of maximizing shareholder value may still disagree on, say, the time frame for that, and thus may want to pursue very different strategies.[198] In an overly responsive system,

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and making one of those chambers (the Senate) less responsive to the people. The substantive protections are embodied in the Bill of Rights and some of the subsequent amendments to the Constitution. *See, e.g.*, Gerhard Casper, *An Essay in Separation of Powers: Some Early Versions and Practices*, 30 WM. & MARY L. REV. 211, 211-24 (1989).

194. For a discussion of protections for corporate minority shareholders, see Anupam Chander, *Minorities, Shareholder and Otherwise*, 113 YALE L.J. 119, 119-65 (2003).

195. *See id.* at 143-45.

196. *See id.* at 130.

197. *See* BAINBRIDGE, CORPORATE GOVERNANCE, *supra* note 76, at 228-30.

198. Hayden & Bodie, *One Share, One Vote*, *supra* note 23, at 492-94.

a tyrannical majority may be able to exploit a minority given this, or really any, differentiation in preference profiles. As discussed above, this has already been recognized and built into corporate governance systems in the form of board duties and other devices.[199] The recent recognition that shareholder interests are actually more diverse than once theorized doesn't really add that much more weight to arguments for less responsive systems. Most of the arguments in favor of a less responsive system, such as the costs and potential for exploitation, apply regardless of the exact level of diversity within the electorate.

So, in sum, what does increased shareholder diversity mean for the scope of the electorate or, more to the point, the exclusive shareholder franchise? Unlike the arguments for a more deliberate system, the arguments for a less expansive electorate, at least the ones based on shareholder homogeneity, were not very good to begin with. But even if we take them at face value, shareholder heterogeneity undercuts one of their critical assumptions. That is, to the extent that shareholders now have diverse interests, they are more prone to inefficient squabbling; more likely to produce damaging voting cycles; in better position to exploit their differences; and the one share, one vote system is less well-calibrated to their interests. Scholars attempt to salvage these claims by hanging them on the *relative* homogeneity of shareholder interests, but the claims are not fine-tuned enough to turn on these new, largely theoretical differences in preference profiles. Instead, shareholder diversity just makes these bad arguments worse.

So we are left with slightly stronger arguments for a less responsive governance structure and increasingly poorer arguments for the exclusive shareholder franchise (arguments that, for the most part, came out of shareholder primacy positions to begin with). To a large degree, this occurs because preference homogeneity, or the lack thereof, is viewed as having an equivalent effect on both the ideal level of board responsiveness and the composition of the board electorate. It does not.

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199. *See supra* Part I.

C. Board Primacy and the Corporate "Good"

As time has proven shareholder preferences to be not quite as homogenous as envisioned, board primacists have continued to distance the decision-making processes from the shareholder electorate.[200] This push is consistent with the civic republican impulse of board primacy theorists to insulate decision makers from the whims of the electorate. An insulated board is in a better position to deliberate and reach decisions that advance the interest of the firm. But when it comes to defining the electorate, the very thing that makes such deliberation valuable—the clash of different interests and opinions, the pull and haul of politics—is viewed as so troublesome that voting must be limited to a single group of constituents.

The strange thing about this is that many public-choice style corporate scholars, firmly entrenched in the law and economics tradition, begin to look like civic republicans when faced with preference profiles that troubled them. They moved from wanting to aggregate voter preferences to wanting some distance between voters and their representatives.[201] But what, exactly, is their sense of the corporate good? It is here that we see the strange feature of this move in the direction of board primacy. It is civic republicanism without any sense of what counts as the public good; or, to be more precise, not much accountability to any of the constituents besides shareholders who make up that public. Where does the sense of the corporate, or public, good come from? And how does the system of governance keep the corporate board honest in its duty to pursue those ends?

Those are questions that board primacy theorists have trouble answering. Shareholder primacy dictates that both the corporate and public good are best pursued by maximizing shareholder wealth.[202] Within that framework, there may be debates about the best means of achieving that maximization, but the ends are agreed upon. Bainbridge fits within this category. Even though he has set up his "director primacy" theory in opposition to shareholder

200. *See supra* Part II.B.1.
201. *See supra* Part II.B.
202. *See supra* Part II.A.2.

primacy, he still believes that shareholder wealth maximization is the proper corporate purpose.[203] His debates with shareholder primacists such as Lucian Bebchuk revolve around the best means for pursuing these agreed upon ends.

However, other board primacists have difficulty in establishing the corporate good and the board's connection to it. Blair and Stout give a perfectly respectable answer as to corporate purpose: the board is supposed to be advancing the interests of all corporate constituents and needs to be somewhat insulated in order to do that (as to not be dominated, at a minimum, by shareholder interests).[204] The directors are viewed as the "independent hierarchs" serving the interests of the corporation, which "can be understood as a joint welfare function of all the individuals who make firm-specific investments and agree to participate in the extracontractual, internal mediation process within the firm."[205] The list of possible individuals may include executives, employees, and shareholders, as well as creditors and even a local community.[206] But when it comes to the composition of the electorate that will, ultimately, make the board accountable to all parties, they oddly fall back upon some of the arguments that turn on shareholder homogeneity, like the argument from politics and the argument from Arrow's theorem, to argue for an exclusive shareholder electorate.[207]

This is a strange turn for several reasons. Initially, it seems to run against the rest of their theory, which views the board as acting on behalf of all corporate constituents. On this front, the best they can do is argue that the exclusive shareholder franchise is not inconsistent with the rest of their theory, which is true, but it is certainly not dictated by it.[208] Moreover, we are left with the question of why a board elected by shareholders alone would feel any pressure to act on behalf of all corporate constituents. True, board members are relatively insulated from shareholders, but with this scheme, they are even more insulated from other constituents. And although it may be true that most board decisions advance or

203. *See* Bainbridge, *Director Primacy*, *supra* note 2, at 563.
204. *See* Blair & Stout, *supra* note 18, at 288.
205. *See id.*
206. *See id.*
207. *See id.* at 313.
208. *See id.* at 313-14.

retard the interests of all corporate constituents, such a generalization is not always true. In any case, it does not really cut one way or the other, because when all interests line up, then shareholders have no special claim to representation. It is one thing to say that the board should act on behalf of all corporate stakeholders, but it is unclear why they actually would.

The history of corporate constituency status should be instructive here. Thirty-one states have provisions that permit directors to take the needs of all corporate constituencies into account when making certain decisions.[209] Some constituency statutes apply only to change-in-control transactions, while others apply more broadly to all board decisions.[210] The purpose of these statutes is to give directors the freedom to consider the impact of a board decision on stakeholders other than shareholders.[211] However, most commentators generally recognize that constituency statutes fail to provide any meaningful incentive to the board to actually consider all constituencies.[212] The statutes merely provide authorization to consider these broader sets of needs; they provide no sanction for failing to do so.[213] Directors are not legally accountable to any of the stakeholders for failure to consider the decision's impact on their group.[214] Instead, directors can use constituency statutes as a "fig leaf" for decisions that are in their own interest.[215] Even those who

209. *See* Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REG. 209, 215 tbl.1 (2006) (finding that thirty-one states have constituency statutes).

210. New York, for example, provides that when considering a change or potential change in the control of the corporation, a director "shall be entitled to consider" the effects that the corporation's actions may have upon the corporation's various stakeholders, including current employees, retired employees, customers, creditors, and the communities in which it does business. N.Y. BUS. CORP. LAW § 717(b) (Consol. Supp. 2009).

211. For a recent summary of the arguments for and against constituency statutes, see Brett H. McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1227, 1232-36 (2004).

212. Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1992).

213. *See, e.g.*, *id.* at 581.

214. *See, e.g.*, N.Y. BUS. CORP. LAW § 717(b) (McKinney 2006) ("Nothing in this paragraph shall create any duties owed by any director to any person or entity to consider or afford any particular weight to any of the foregoing or abrogate any duty of the directors, either statutory or recognized by common law or court decisions.").

215. Mitchell, *supra* note 212, at 580 n.4; *see also id.* at 581 ("The principal criticism of rejecting this traditional relationship is that authorizing the board to consider constituencies that have no monitoring or enforcement powers would leave the board accountable to

have supported constituency statutes have deep concerns about this lack of accountability.[216]

Blair and Stout's model suffers from a similar flaw in its incentive structure. Directing a board to consider the interests of various members of the team does not mean that they will do so. Blair and Stout argue that corporate law provides for such discretion, and much of their argument is a positive one.[217] However, to the extent they are making a normative case for the team production model, it is difficult to see where team members other that shareholders would have any leverage over the board or input into its composition. Although they acknowledge that exclusive shareholder voting rights "pose[ ] something of a problem for the mediating hierarch approach,"[218] they make two arguments attempting to reconcile this anomaly. First, they argue that shareholders may have the best preferences for serving the corporation as a whole.[219] As discussed above,[220] they argue that shareholder homogeneity provides for a cleaner electorate with "fewer pathologies."[221] Because of this, shareholders serve as the best possible electorate for serving the interests of the corporation as a whole.[222] Second, they argue that shareholder voting rights may be "partial compensation for share-

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nobody."); Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001) ("[A] stakeholder measure of managerial accountability could leave managers so much discretion that managers could easily pursue their own agenda, one that might maximize neither shareholder, employee, consumer, nor national wealth, but only their own.").

216. *See* David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, *in* PROGRESSIVE CORPORATE LAW, *supra* note 89, at 1, 30 ("However attractive [the constituency] model might be in theory, communitarian scholars have yet to show persuasively that it could function effectively in practice."); Katherine Van Wezel Stone, *Employees as Stakeholders Under State Non-Shareholder Constituency Statutes*, 21 STETSON L. REV. 45, 70 (1991) (noting that constituency statutes provide "very little" actual protection to employees and other constituents). Some have applied this criticism more broadly to progressive communitarian efforts as a whole. David Millon, *New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001, 1040 (2000) [hereinafter Millon, *New Game Plan*] ("[P]rogressives have yet to devise a sufficiently rigorous analytical framework to structure director decisionmaking in cases in which shareholder and nonshareholder interests conflict.").

217. *See, e.g.*, Blair & Stout, *supra* note 18, at 286-87, 298.

218. *Id.* at 312.

219. *See id.* at 313-14.

220. *See supra* Part III.B.

221. Blair & Stout, *supra* note 18, at 313.

222. *Id.*

holders' unique vulnerabilities."[223] These arguments are contradictory, of course; in one, the shareholders are acting as representatives for all stakeholders, while in the other they are using the vote to protect themselves against other stakeholders. Blair and Stout ultimately dismiss such concerns, however, by hearkening back to the relative impotence of the shareholder franchise.[224] One wonders why they did not further consider the possibility of expanding the electorate to include other team members.[225]

The long-term theorists have not laid out their model as clearly as Blair and Stout, and thus it is more difficult to pinpoint where exactly they fit on the spectrum. Their chief problem with shareholder primacy seems to be its endemic short-term focus (although shareholder primacists themselves would dispute that the model is short-sighted).[226] Lipton and Rosenblum want corporations to focus on long-term success, and they emphasize that corporations need to "realign[ ] ... the interests of stockholders and corporations around the long-term health of the business enterprise."[227] However, they do not differentiate between the communal stakeholder success emphasized by Blair and Stout and the long-term shareholder wealth maximization that others such as Bainbridge would endorse. Instead, they seem to imply (at least under our reading) that long-term success would benefit both shareholders and other stakeholders equally.[228] While their quinquennial board would still be elected solely by shareholders,[229] Lipton and Rosenblum seem to advocate the "we're all in this together" model, rather than a long-term, but otherwise traditional, shareholder primacy norm.

Mitchell presents a more complicated case. Like Lipton and Rosenblum, Mitchell is most aggrieved by the short-term focus

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223. *Id.* at 314.

224. *See id.* at 314-15.

225. *Cf.* Millon, *New Game Plan*, *supra* note 216, at 1019 ("At the very least, under a [team production model]-based conception of the board's role, one might expect the board to have the power and duty to veto shareholders' decisions that harm nonshareholder constituencies.").

226. For example, shareholder primacists Reinier Kraakman and Henry Hansmann characterize the goal of shareholder primacy as "striv[ing] to increase long-term shareholder value." Hansmann & Kraakman, *End of History*, *supra* note 76, at 439.

227. Lipton & Rosenblum, *supra* note 115, at 215.

228. *Id.* at 227-28 (arguing that "[t]he quinquennial system would benefit the corporation's other constituencies, which prosper if the enterprise's business operations prosper over the long term").

229. *Id.* at 228.

induced by shareholder control.[230] Thus, his main concern is separating the board from short-term shareholder influence.[231] But Mitchell also seems concerned about the cost in externalities generated by a share-price maximization norm, whether it be short- or long-term.[232] Mitchell opens his book, *Corporate Irresponsibility*, with tales of massive layoffs, forced labor, product defects, and a corporate restructuring that harmed debtholders.[233] He criticizes the singular corporate focus on share price so strongly that he ultimately compares this focus to that of genetically-engineered man-eating sharks.[234]

Given his concern about share-price maximization and corporate externalities, Mitchell seems less interested than Lipton and Rosenblum in ever getting shareholder input. In fact, as he puts it, "[m]aking directors accountable to constituencies with specific interests will lead them to favor those interests unless the incentive structures to do so are broken."[235] Thus his initial and favorite proposal is for a self-perpetuating board.[236] When it comes to the quinquennial election proposal, Mitchell is open to the possibility of including other stakeholders in the electorate.[237] However, Mitchell only briefly entertains this idea before noting that he does not want to "thoroughly develop" the proposal.[238] Like the others, Mitchell does not follow the logic of his concerns out to the composition of the corporate electorate.

Bainbridge is at least more consistent here, wholeheartedly importing the idea that corporate actions should be directed at increasing shareholder wealth, and thus making the board answer, albeit weakly, to a shareholder electorate.[239] But Bainbridge is making the familiar mistake of assuming he knows what it is that shareholders want. He does not seem to care what shareholders

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230. *See* MITCHELL, *supra* note 9, at 3.

231. *See id.* at 111-12.

232. *See, e.g.*, *id.* at 4-6.

233. *Id.* at 20-27.

234. *Id.* at 47-48 (comparing corporations to the sharks from the film *Deep Blue Sea* and noting that "the sharks ran amok threatening anyone that might come in their path").

235. *Id.* at 132.

236. *Id.* at 112.

237. *Id.* at 130-31.

238. *Id.*

239. Bainbridge, *In Defense*, *supra* note 51, at 1423-25, 1442-43.

actually want in particular circumstances; instead, he is content to make "shareholder wealth maximization" the constant and easily implemented goal of the board.[240] He avoids the messiness of actual elections by assuming that boards will act in what he considered to be the best interests of the electorate.[241]

Of course, as we have discussed in an earlier project, it is unclear what, exactly, it means to maximize the wealth of a shareholder electorate with a very diverse set of preferences.[242] Some shareholders will desire short-term share price maximization, while others will prefer long-term dividend maximization.[243] Some may have different ideas about the best way of pursuing wealth maximization.[244] Others still will desire to maximize their overall utility by advocating for corporate activity that promotes social welfare goals.[245] Elections can be useful devices for sorting out these various preferences into results that best map onto the preferences of the electorate.[246]

Thus, directing a relatively unresponsive board to maximize shareholder wealth gives them, at best, incomplete guidance. The only way to make it more complete is by building a system of governance that responds in some way to the actual preferences of shareholders. The problem with Bainbridge's argument is that just as the governance system should be getting more responsive to shareholder interests, he argues that it should be less responsive.[247] What we are left with is a vision of shareholder "wealth" that bears less and less of a relationship to the well-being of actual shareholders.

So why should we expect a less responsive board to better manage this diverse set of interests? For Bainbridge, as for Blair and Stout,

240. Bainbridge, *Director Primacy*, *supra* note 2, at 557-58, 574 (noting the difficulties of shareholder collective action when disagreements exist as to what maximizes value, and contrasting this difficulty with the ease of director primacy when the directors are bound to seek shareholder wealth maximization alone).

241. *Id.* at 579 (arguing that, given the opportunity in a hypothetical negotiation to choose default rules for corporations, a shareholder would choose shareholder wealth maximization as the ideal option).

242. *See* Hayden & Bodie, *One Share, One Vote*, *supra* note 23, at 499-504.

243. *See id.* at 492-94.

244. *See id.*

245. *See id.* at 494-96.

246. *See id.* at 504-05.

247. *See* Bainbridge, *Shareholder Disempowerment*, *supra* note 96, at 1749.

the answer is that corporate boards can be trusted to pursue proper ends.[248] But Bainbridge goes a step further than Blair and Stout's notion of the board as a group of "meditating hierarchs"[249] constrained by norms of trust: for Bainbridge, "the corporation's board of directors in fact is a Platonic Guardian."[250]

Such a claim would ordinarily be laughable, or accepted as a *reductio ad absurdum* of the whole board primacy project, if it weren't delivered with such seriousness (and so often). The resort to describing directors as Platonic Guardians is a complete surrender of any workable notion of what directors should be doing or why they would be expected to do it. We can't rely on philosopher kings to act as directors of our corporations for the same reason we can't rely on them to run our governments: Platonic Guardians do not exist. For that reason, we tend to favor more democratic decision structures with a little more accountability to the electorate.

Corporate constituents, other than shareholders, were never viewed as the proper board electorate in large part because their preferences were so heterogeneous. Now that shareholders are known to be more like those other constituents, they, despite holding onto the franchise, are to be further distanced from the board. This leaves the board in a curious position—it must pursue the corporate good, but is not accountable to many of its constituents and is only weakly accountable to shareholders. The resultant corporate board, as Bearle and Means pointed out over seventy-five years ago, ends up resembling a communist committee of commissars:

> The communist thinks of the community in terms of a state; the corporation director thinks of it in terms of an enterprise; and though this difference between the two may well lead to a radical divergence in results, it still remains true that the corporation director who would subordinate the interests of the individual stockholder to those of the group more nearly resembles the communist in mode of thought than he does the protagonist of private property.[251]

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248. Bainbridge, *Nexus*, *supra* note 92, at 28-29.
249. *See* Blair & Stout, *supra* note 18, at 280-81.
250. Bainbridge, *Nexus*, *supra* note 92, at 33 (emphasis omitted).
251. BERLE & MEANS, *supra* note 1, at 278.

At least the commissars, though, had a well-defined notion of the public good.

D. The Road Less Taken: Other Constituencies into Corporate Governance

While a push in the direction of board primacy may be one possible response to the news of shareholder heterogeneity, there is a second way to frame the issue. With respect to their preference profiles, shareholders are more like other corporate constituents than once thought. Instead of focusing on the fact that shareholders are now as "bad" as other constituents for the purposes of corporate governance, we could view this as evidence that the other constituents are just as "good" as shareholders, at least in this respect. That is, the breakdown of this particular distinction between shareholders and other constituents could mean that we should treat the other constituents more like shareholders rather than the other way around.

Such a change in treatment could be taken in many different directions, but one of the most obvious, since shareholder homogeneity is most frequently put forward in support of their exclusive franchise, would be to expand corporate voting systems to include other constituents. To be sure, there are arguments for the exclusive shareholder franchise that do not rely on an assumption of shareholder homogeneity. Blair and Stout, for example, argue for a shareholder electorate because shareholders are more vulnerable than other constituents.[252] And there are certainly other considerations that go into any discussion of the corporate franchise.[253] It may be difficult, for example, to come up with an accurate and manageable way of identifying specific members of a constituency, like customers, for an election. But the breakdown of the fundamental distinction between shareholders and other constituents should at least force a reexamination of the scope of the corporate franchise.

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252. Blair & Stout, *supra* note 18, at 314.

253. *See* Hayden & Bodie, *One Share, One Vote*, *supra* note 23, at 504.

CONCLUSION

Over the last several years, it has become clear that one of the basic assumptions of corporate governance theory—that shareholders have a homogeneous interest in wealth maximization—is simply not true. Shareholders, it turns out, are much like other corporate constituents in that they have a wide range of preferences with respect to the corporation and its decision making. This discovery has moved many corporate scholars, especially board primacy theorists, to argue for further distance between the board and the shareholder electorate. These scholars, many of whom come out of a public choice, aggregative approach to decision making, have begun to look more like civic republicans, arguing for a more insulated governing body. But this leaves them in a curious position—they are civic republicans but do not have any real sense of the corporate good and, more pointedly, they lack any way to tie their sense of the corporate good to the actual preferences of their preferred constituents.

There is, however, another potential path to explore in response to the news of shareholder diversity. We now know that other corporate constituents are more like shareholders, at least when it comes to preference diversity, than once believed. This undercuts one of the critical assumptions of many arguments for the exclusive shareholder franchise. That said, scholars have either left this issue alone or attempted to reformulate the arguments to hang on the relative homogeneity of shareholder preferences. This approach, however, is misguided, in large part because it conflates two very different concepts in a system of governance: responsiveness and the identity of the electorate.