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Towards a Moral Agency Theory of the Shareholder Bylaw Power

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TOWARDS A MORAL AGENCY THEORY OF THE SHAREHOLDER BYLAW POWER

*Jay B Kesten**

ABSTRACT

Corporate bylaws are the new leading edge of a decades-long struggle between shareholders and managers over the allocation of decision-making authority in public companies. Bylaws are the only method by which shareholders can unilaterally restrict the powers and discretion of the board. Yet the scope of this statutory authority remains notoriously uncertain. Corporate law scholars generally agree that there is a limited domain in which shareholders can restrict managerial authority, but disagree on the appropriate boundary. The Delaware Supreme Court recently confronted this issue for the first time in CA, Inc. v. AFSCME Employees Pension Plan, but that decision is doctrinally problematic (indeed, internally inconsistent) and, in any event, leaves open many questions concerning the full reach of the shareholder bylaw power.

This Article develops a novel theory of the shareholder bylaw power by examining that power's relationship to the deeper structure of corporate law. Viewed in this context, shareholder voice (of which the bylaw power is one part) should provide an avenue for action in circumstances where shareholders' other rights, i.e., the ability to exit the firm or sue its fiduciaries, are unavailing. This occurs most prominently where corporate activity implicates significant questions of social policy in addition to

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intracorporate economic matters. In other words, shareholders should be empowered to act as moral agents of the corporations in which they invest.

This Article also addresses two threshold questions related to this theory: Do corporations need moral agents? And if so, why not rely on managers to play that role?

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I. INTRODUCTION

Corporate bylaws¹ are critically important to modern corporate governance because they are the only practical mechanism by which public company shareholders can unilaterally restrict managers' powers and discretion.² Accordingly, shareholders seeking to alter the balance of power within public companies have increasingly turned to the company's bylaws to voice their governance preferences.³ Bylaws have thus

1. Bylaws are one of a company's constitutional documents. Generally, they detail the firm's operating and governance rules. WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 96 (4th ed. 2012).

2. See, e.g., DEL. CODE ANN. tit. 8, § 109(a) (West 2013) (granting shareholders the inalienable right to adopt, amend and repeal bylaws); ALAN PALMITER & FRANK PARTNOY, CORPORATIONS: A CONTEMPORARY APPROACH 380 (2009) ("A proper bylaw amendment, unlike a shareholder resolution, is binding on the board of directors."); see also STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 48 (2002) (noting unique nature of shareholder power to amend bylaws unilaterally); 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, 148 (2009) (acknowledging that shareholder power to amend bylaws is exception to general rule of shareholder powerlessness).

3. See, e.g., Christopher M. Bruner, *Managing Corporate Federalism: The Least-Bad Approach to the*

become—like hostile takeovers, deal protection devices, and proxy access fights before them—the new leading edge of a decades-long struggle between shareholders and management over the allocation of decision-making authority in public companies.⁴ While each of these points of conflict differs superficially, all are simply iterations of one of the central normative question that animates corporate law: When shareholders and managers disagree, who decides?⁵

The stakes are illustrated by the objectives of common shareholder-enacted bylaws (and other, nonbinding, shareholder proposals), which generally fall within two broad categories: firm-specific corporate governance, and what is often termed “corporate social responsibility.”⁶ The former category concerns the rules by which a particular company is governed. For example, shareholders have attempted to use the bylaw power to restrict the board’s ability to adopt antitakeover devices (such as poison pills) in order to facilitate hostile takeovers and thereby allow shareholders—at least in theory—to reap substantial acquisition premiums.⁷ Shareholders have also proposed bylaws regulating the corporate election process.⁸ These bylaws are typically intended to make it easier and/or cheaper for dissatisfied shareholders to vote directors out of office in favor of their own preferred candidates.⁹

The latter category attempts to regulate what some shareholders consider antisocial corporate behavior. Prominent historical examples include proposals to

Shareholder Bylaw Debate, 36 DEL. J. CORP. L. 1, 1–2 (2011) (“Over recent decades, shareholders in Delaware corporations have increasingly sought to augment their own power—and, correlatively, to limit the power of boards—through creative use of corporate bylaws.”); PALMITER & PARTNOY, *supra* note 2, at 380 (discussing use of this technique by “activist shareholders”). Mainstream journalists have also remarked on this trend. See, e.g., Mark Maremont & Erin White, *Stock Activism’s Latest Weapons*, WALL ST. J., April 4, 2006, at C1 (discussing the rise in shareholder proposals for binding amendments to corporate bylaws).

4. See, e.g., Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836–43 (2005) (questioning existing statutory allocation of power between board and shareholders); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1735–44 (2006) (disputing the merits of shareholder empowerment); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PENN. L. REV. 653, 716–26 (2010) (revisiting the separation of powers debate in the aftermath of the financial crisis). Several commentators have noted the importance of bylaws vis-à-vis this balance of power. See, e.g., Christopher M. Bruner, *Shareholder Bylaws and the Delaware Corporation*, 11 TRANSACTIONS: TENN. J. BUS. L. 67, 67 (2009) (“The shareholders’ statutory authority to enact bylaws has become a pivotal issue in the on-going battle for corporate governance supremacy.”); Brett H. McDonnell, *Bylaw Reforms for Delaware’s Corporation Law*, 33 DEL. J. CORP. L. 651, 651 (2008) (“Shareholder bylaw proposals have become an increasingly important part of battles over corporate governance.”).

5. McDonnell, *supra* note 2, at 140 (“How should we balance authority and accountability? That is the central normative question of corporate law.”); Bruner, *supra* note 4, at 73 (“[S]hareholder bylaws are fundamentally similar [to hostile takeovers] in that they implicate the defining issues of corporate law.”).

6. ALLEN ET AL., *supra* note 1, at 195 (noting that most “shareholder proposals fall into one of two categories: corporate governance or corporate social responsibility”).

7. See *Int’l Bhd. of Teamsters Gen. Fund v. Fleming Cos.*, 975 P.2d 907, 911–12 (Okla. 1999) (upholding a bylaw restricting the use of poison pills). *But see Invacare Corp. v. Healthdyne Techs., Inc.*, 968 F. Supp. 1578, 1582 (N.D. Ga. 1997) (invalidating a similar bylaw).

8. See, e.g., *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d at 234 (invalidating a bylaw mandating that the company reimburse reasonable proxy expenses for any successful insurgent board candidate). Title 8 of the Delaware Code (the Delaware General Corporation Law or DGCL) was recently amended to expressly authorize such bylaws. See DEL. CODE. ANN. tit. 8, §§ 112, 113 (West 2013).

9. *CA, Inc.*, 953 A.2d at 237.

restrict Dow Chemicals from manufacturing and selling napalm used in the Vietnam War effort,¹⁰ to require that Wal-Mart adopt an affirmative action program,¹¹ and to prevent Cracker Barrel from discriminating against employees on the basis of sexual orientation.¹² More recently, shareholders have turned their attention to corporate political spending.¹³ This raises a critical question for corporate law: Can shareholders voice their economic, moral, and/or social preferences concerning corporate political speech through the bylaw power?¹⁴

Section II of this Article demonstrates that despite its salience, the scope of the shareholder bylaw power is notoriously uncertain.¹⁵ The Delaware corporate statute seems to provide, simultaneously, that the shareholders' bylaw power is limited by the broad grant of authority to the board, but also that the grant of authority to the board is subject to limitation by the bylaws.¹⁶ Most commentators agree that the best that can be

10. *Med. Comm. for Human Rights v. SEC*, 432 F.2d 659, 661–62 (D.C. Cir. 1970), *vacated*, 404 U.S. 403 (1972).

11. *Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc.*, 821 F. Supp. 877, 879 (S.D.N.Y. 1993).

12. *Cracker Barrel Old Country Store, Inc.*, SEC No-Action Letter, Fed. Sec. L. Rep. ¶ 76,418 (Oct. 13, 1992).

13. The frequency of proposals related to corporate political activity has increased markedly in recent years, perhaps in response to the Supreme Court's decision in *Citizens United v. Federal Election Commission* and the D.C. Circuit Court of Appeals' subsequent decision in *SpeechNow.org v. Federal Election Commission*. See *Citizens United v. Fed. Election Comm'n*, 130 S. Ct. 876, 913 (2010) (striking down as unconstitutional federal regulations barring the use of corporate treasury funds for "independent expenditures"—i.e., spending aimed at influencing a federal election through express advocacy, but which is not formally coordinated or prearranged with the candidate in question); *SpeechNow.org v. Fed. Election Comm'n*, 599 F.3d 686, 692–93 (D.C. Cir. 2010) (holding that, in light of *Citizens United*, Congress could not constitutionally limit monetary contributions to certain independent expenditure groups), *cert. denied*, 131 S. Ct. 533 (2010). Proxymonitor.org, which tracks shareholder proposals submitted to the largest 150 U.S. public companies, lists fifty-three such proposals in 2010 and 2011 alone (though many of these proposals are phrased as requests to the board, not bylaw amendments). See, e.g., *Archer-Daniels-Midland Co.*, Proxy Statement (Schedule 14A), at 51–53 (Sep. 24, 2010) (shareholder proposals to restrict corporate political spending or require semiannual disclosures of the company's political activities, respectively).

14. Cf. *Corporate Governance After Citizens United: Hearing Before the Subcomm. on Capital Mkts., Ins., & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 111th Cong. 44–64 (2010) (testimony of Prof. John C. Coffee, Jr., Columbia University Law School) [hereinafter *Coffee Testimony*] (arguing for increased shareholder power to regulate or restrict corporate political spending); Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83, 83 (2010) (noting the "important question left unanswered by *Citizens United*: who should have the power to decide whether a corporation will engage in political speech?"); see also Larry E. Ribstein, *The First Amendment and Corporate Governance*, 27 GA. ST. U. L. REV. 1019, 1021 (2011) (arguing that the *Citizens United* case "shifted the debate over corporate speech from corporations' power to distort political debate to the corporate governance processes that authorize this speech").

15. See, e.g., *Coffee Testimony*, *supra* note 14, at 52–54 (expressing skepticism about the validity and enforceability of shareholder-adopted corporate political spending bylaws); ALLEN ET AL., *supra* note 1, at 96 ("A question of current interest . . . is this: What limits, if any, restrict the topics that shareholder-initiated bylaws can legitimately govern?"); Bebchuk & Jackson, *supra* note 14, at 87–88 (noting that distinction between proposals that may or may not be excluded is unclear); McDonnell, *supra* note 4, at 652 ("there is serious ambiguity under existing Delaware law as to whether [many] proposed bylaws are valid."); D. Gordon Smith et al., *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 140 (2011) (noting that the scope of the shareholders' bylaw power is a "heavily-disputed question").

16. Compare DEL. CODE ANN. tit. 8, § 109(b) (West 2013) (describing scope of corporate bylaws), with

said is that there is *some* limited domain for unilateral shareholder action via the bylaws, but that beyond that domain, the board's plenary authority prevails.¹⁷ The Delaware Supreme Court recently confronted this issue squarely for the first time in *CA, Inc. v. AFSCME Employees Pension Plan*,¹⁸ but its decision is both deeply problematic at a doctrinal level (indeed, it is internally inconsistent) and, in any event, leaves open substantial questions about the full scope of the bylaw power.¹⁹

Academic attempts to delimit that boundary are also largely unsatisfying. The leading approach attempts to glean the *essence* of a corporate bylaw through a combination of extensive statutory analysis and close reading of the admittedly sparse precedents. These inquiries have, thus far, led to ostensibly bright-line dichotomies, such as process-related versus substance-related bylaws, negative constraints versus affirmative directives, or direct versus indirect limitations on managerial authority.²⁰ But, while these categories may hold some superficial appeal, the distinctions rapidly collapse under their own weight.²¹

This ontological approach to the problem is misguided because, among other things, it addresses the shareholder bylaw power in isolation. Yet, the dispute is not really a fight about bylaws as such; it is just the latest battlefield in a struggle over the fundamental question of how to allocate decision-making authority within public

id. §141(a) (prescribing plenary authority of board of directors). One prominent corporate scholar, quite correctly, labeled this statutory morass a "recursive loop." Jeffrey N. Gordon, "Just Say Never?" *Poison Pills, Deadhand Pills, and Shareholder Adopted Bylaws: An Essay for Warren Buffett*, 19 CARDOZO L. REV. 511, 546 (1997); see also Bruner, *supra* note 3, at 9 (noting that sections 109(b) and 141(a) are difficult to reconcile); Smith et al., *supra* note 15, at 141 (noting that, while some academics have attempted to unravel the knot, "any purely textual examination of the DGCL reveals this unremitting circularity"). While the arguments presented in this Article are of general application to any jurisdiction in which shareholders can enact bylaws, for ease of reference only the relevant Delaware provisions are cited. For a comprehensive multistate survey of corporate bylaw provisions, see Bruner, *supra* note 3, at 52–54.

17. See, e.g., Brett H. McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills*, 3 BERKELEY BUS. L. J. 205, 218 (2005) ("[T]he statutory language . . . seems most consistent with a split-the-difference interpretation that gives effect to both sections 109(b) and 141(a) by distinguishing bylaws that section 109(b) allows from bylaws that section 141(a) forbids."). Several Delaware decisions support this starting point. See, e.g., *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 234 (Del. 2008) ("Implicit in CA's argument is the premise that *any* bylaw that in *any* respect might be viewed as limiting or restricting the power of the board of directors automatically falls outside the scope of permissible bylaws. That simply cannot be."); *Gen. DataComm Indus., Inc. v. State of Wis. Inv. Bd.*, 731 A.2d 818, 821 n.2 (Del. Ch. 1999) ("[W]hile stockholders have unquestioned power to adopt bylaws covering a broad range of subjects, it is also well established in corporate law that stockholders may not directly manage the business and affairs of the corporation, at least without specific authorization either by statute or . . . articles of incorporation." (quoting Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409, 415–17 (1998))).

18. 953 A.2d 227 (Del. 2008).

19. For further discussion of the *CA, Inc.* decision, see *infra* notes 59–79 and associated text.

20. Having proposed a boundary, many of these commentators support their conclusion with appeals to law and economics-style efficiency arguments. See, e.g., Jeffrey N. Gordon, *Shareholder Initiative: A Social Choice and Game Theoretic Approach to Corporate Law*, 60 U. CIN. L. REV. 347, 383–84 (1991) ("The best argument [for allowing shareholder initiative is] that it can reduce agency costs."); Hamermesh, *supra* note 17, at 452 (basing conclusions on efficiency rationales concerning shareholder wealth maximization); McDonnell, *supra* note 17, at 239 ("The key benefit from shareholder power of initiative emerges if we consider the agency problem that centralized management creates.").

21. See *infra* notes 52–58 and associated text for a critique of this approach.

companies. Bylaws—while unique—are not the only way shareholders interact with the companies in which they invest. A more robust theory of the shareholder bylaw power (i.e., determining when shareholders can unilaterally restrict managerial authority) should consider how that power relates to these other avenues of expression.

In Section III of this Article, I develop such a theory by assessing how the shareholder bylaw power fits within the deeper structure of existing corporate law. Briefly, public company shareholders express their preferences (and thereby discipline management) in three ways: they sell, vote, and sue.²² These categories of expression are both heavily interrelated and dependent on each other.²³ More importantly, for our purposes, Delaware jurisprudence makes clear that they are inversely proportional: when one avenue of expression is unavailable or obstructed, one or both of the others expands to fill that vacuum.²⁴ Ordinarily, in the absence of fraud, illegality, or self-dealing, the business judgment rule fully insulates management from liability—dissatisfied shareholders can either exit the firm or vote the directors out. However, when management interferes with shareholders' ability to exit the firm—such as when management attempts to block a hostile takeover bid and thereby prevent shareholders from selling their shares to the would-be acquirer—shareholders' remedial rights expand via heightened scrutiny of the transaction.²⁵ Similarly, when shareholders' statutory voice is obstructed (typically, when managers interfere with the electoral process or some other voting right), Delaware law again affords expanded remedial rights through enhanced judicial scrutiny.²⁶

Following this structural framework, shareholder voice, manifested via the bylaw power, should expand in circumstances where both exit and remedy fail. This occurs where corporate actions could create substantial externalities from which shareholders cannot exit merely by selling their shares, and could cause harms that cannot be remedied even if a shareholder successfully sued the firm's managers.²⁷ The domain

22. See, e.g., ALLEN ET AL., *supra* note 1, at 169 (“[T]he default powers of shareholders [are] three: the right to vote, the right to sell, and the right to sue.”); ROBERT C. CLARK, *CORPORATE LAW* §3.1, at 93–105 (1986) (discussing the extent of these rights); Smith et al., *supra* note 15, at 127 (“Generally speaking, shareholders in public corporations do three things: they sell, they vote, and they sue.”); Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 *LAW & CONTEMP. PROBS.* 215, 216 (1999) (“Shareholders have only a limited role: They can vote, sell, or sue.”).

23. ALLEN ET AL., *supra* note 1, at 169 (“[E]ach of these shareholder strategies for disciplining management interacts with the others . . . in practice they work together.”).

24. In this fashion, Delaware law is consistent with (and perhaps predicted by) Albert Hirschman's seminal work on the options available to dissenting members of various organizations. See ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* 34 (1970) (“In this view, the role of voice would increase as the opportunities for exit decline, up to the point where, with exit wholly unavailable, voice must carry the entire burden of alerting management to its failings.”).

25. See *infra* notes 95–97 and accompanying text for a discussion of judicial reactions to defensive measures taken by management.

26. See *infra* notes 98–105 and accompanying text for a discussion of judicial reactions to infringements of shareholder voting rights.

27. Because the potential harms arising from this domain of corporate action are, by definition, unremediable, regulation of such conduct should occur through *ex ante* private ordering, rather than *ex post* discipline through the corporate electoral machinery. See *infra* Part III.B.1 for a further discussion of the

most obviously carved out relates to corporate actions that create public goods or harms. To be more concrete, the law should recognize shareholders' entitlement to adopt, amend, and repeal bylaws that restrict managerial discretion concerning matters of substantial social, political, or moral import (collectively, "social policy"). Put slightly differently, this approach to the bylaw power empowers shareholders to act as moral agents of the corporation. I do not intend any technical or legal definition of either agency or morality, but simply that—as to a certain class of issues—shareholders can employ the bylaw power to express their welfare preferences (i.e., reduce moral agency costs), and thereby restrict or regulate the conduct of the firms in which they invest. As discussed further in Section III, the set of matters about which shareholders should be entitled to enact bylaws is a subset of, and not coextensive with, the full array of issues as to which they may hold moral preferences.

At this stage, it is worth noting two important limitations concerning the scope of this Article. First, the theory set forth herein is intended to clarify the (necessarily blurry) boundaries of the shareholder bylaw power by filling the gap left open in *CA, Inc.*; I mean to supplement, not supplant, the current statutory regime and case law.²⁸ As such, I do not here engage at any length the more extreme academic proposals to abolish the shareholder bylaw power entirely,²⁹ or to allow regulation of all or virtually all corporate activities through the bylaw power.³⁰

Second, I do not here attempt an exhaustive evaluation of the normative merits of my theory because it is likely that such an inquiry is highly contextual (i.e., the analysis

limitations on seeking ex post remedies.

28. For example, the DGCL statutorily authorizes bylaws concerning, *inter alia*, the number of board seats and director qualifications, DEL. CODE ANN. tit. 8, §141(b), the location of board meetings, DEL. CODE ANN. tit. 8, §141(g), and the date and time of the annual meeting for election of directors, DEL. CODE ANN. tit. 8, §211(b). I accept that shareholders can enact such bylaws, notwithstanding the fact that the subject matter thereof may have nothing to do with social policy.

29. *See, e.g.* BAINBRIDGE, *supra* note 2, at 48 (asserting that the shareholder bylaw power is "a historical anachronism states unthinkingly codified from old common law principles lacking either rhyme or reason" and arguing that "[t]here is simply no good reason to treat bylaws differently than articles of incorporation" which require board approval for any amendment). For a lengthy critique of Professor Bainbridge's position on shareholder empowerment, see generally McDonnell, *supra* note 2.

30. *See* Smith et al., *supra* note 15, at 181–88 (proposing reforms to the DGCL, Delaware precedent, and Rule 14a-8 of the federal securities laws). I remain highly skeptical that shareholder empowerment, writ large, would ameliorate corporate governance generally or prevent serious corporate crises. *See, e.g.*, Bainbridge, *supra* note 4, at 1736–44; Bratton & Wachter, *supra* note 4, at 709–14. For example, it seems odd to argue that the recent financial crisis was caused by excessive risk taking, but that we should nevertheless empower the most risk-seeking corporate constituency with respect to a firm's business decisions. *See, e.g.*, Christopher M. Bruner, *Corporate Governance Reform in a Time of Crisis*, 36 J. CORP. L. 309, 322 (2011) ("In this light the shareholder-empowerment position appears self-contradictory, essentially amounting to the claim that we must give shareholders more power because managers left to themselves have excessively focused on the shareholders' interests."). Several empirical studies are consistent with this conclusion. *See, e.g.*, Jay B. Kesten, *Managerial Entrenchment and Shareholder Wealth Revisited: Theory and Evidence from a Recessionary Financial Market*, 2010 B.Y.U. L. REV. 1609, 1617 (finding that firms with above-average managerial entrenchment, and thus less structural accountability to shareholders, performed better during the financial crisis); Andrea Beltratti & René M. Stulz, *Why Did Some Banks Perform Better During the Credit Crisis? A Cross-Country Study of the Impact of Governance and Regulation* 3, 14–15 (Fisher College of Business, Working Paper No. 2009-03-012, 2009) (finding that banks with the most "pro-shareholder" boards performed substantially worse than those with much less shareholder-friendly governance structures).

may be much different for bylaws regulating corporate political spending versus those regulating environmental concerns) and depends on a choice of normative ends that is beyond the scope of this Article.³¹ I do, however, address two key threshold questions related to the theory set forth herein. Section IV of the Article addresses the fundamental question of whether corporations need moral agents at all. I conclude that Milton Friedman's view that "the social responsibility of business is to increase its profits,"³² cannot be justified in a world in which corporations can actively participate in the political process that shapes the legal and regulatory regime that constrains their profit-seeking conduct.

Section V of the Article confronts the argument, championed forcefully by Einer Elhauge, that managers—not shareholders—are a corporation's true moral agents.³³ This issue turns on two analytically separate issues: (1) behaviorally, which constituency is more likely to consider and act on societal values, and (2) can shareholders truly act as moral agents when most stock in public corporations is held beneficially through financial intermediaries?

II. THE UNCERTAIN SCOPE OF SHAREHOLDER BYLAWS

Shareholder-enacted bylaws fit uneasily within the standard narrative of corporate law. This model describes public companies as republican—i.e., representative—democracies where shareholders have little or no direct involvement in corporate decision making.³⁴ Shareholders elect a board of directors, which is statutorily granted plenary authority to manage the business and affairs of that company, subject to certain fiduciary constraints.³⁵ Though they are fiduciaries, directors are not generally obliged to act in accordance with shareholders' wishes as to any particular corporate decision or strategy.³⁶ Rather, shareholder rights are set forth in the applicable statute and/or in

31. As to corporate political activity, I explore these issues in detail in a forthcoming paper. See generally Jay B. Kesten, *Democratizing Corporate Political Activity* (March 30, 2013) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2242107.

32. Milton Friedman, *The Social Responsibility of Business is to Increase Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 33.

33. In order to stay within the boundaries of the current structure of corporate law, I do not assess the merits of proposals to empower other corporate stakeholders, such as employees or customers. See, e.g., David G. Yosifon, *The Public Choice Problem in Corporate Law: Corporate Social Responsibility After Citizens United*, 89 N.C. L. REV. 1197, 1235–37 (2011) (arguing in favor of multistakeholder corporate governance); Kent Greenfield, *The Stakeholder Strategy: Changing Corporations, Not the Constitution, Is the Key to a Fairer Post-Citizens United World*, DEMOCRACY, Fall 2012, at 47, 53–55 (providing proposals to expand representation of stakeholder interests); Brett H. McDonnell, *Strategies for an Employee Role in Corporate Governance*, 46 WAKE FOREST L. REV. 429, 439–45 (2011) (assessing the merits of various strategies for empowering employee involvement in corporate governance).

34. ALLEN ET AL., *supra* note 1, at 104 ("[T]he corporation has a republican form of government, but it is not a direct democracy."). The current Chancellor of the Delaware Chancery Court is a strong proponent of the normative merits of this model. See Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 3 (2010) (arguing that "the basic social purpose of corporation law can be achieved only through a republican model of corporate democracy").

35. DEL. CODE ANN. tit. 8, §141(a) (West 2013) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . .").

36. See, e.g., ALLEN ET AL., *supra* note 1, at 104 (explaining that "board members are not required by

the company's constitutional documents—the corporate charter and bylaws. The practical consequence of this governance structure is that shareholders have few options available if they are dissatisfied with the state of their corporation's affairs: they can sell their shares, they can vote on a limited menu of issues, and they can sue for breach of managers' fiduciary obligations or to enforce other statutory or contractual rights (i.e., those set forth in the company's constitutional documents or shareholders' agreements).³⁷

First, assuming liquid securities markets, shareholders are generally free to exit the company by selling their shares.³⁸ By definition, though, exit is a market mechanism that affects a firm's corporate governance only insofar as it causes sufficient changes in the market price of a firm's shares and the signals sent thereby can be linked to the underlying conduct at issue.³⁹

Second, shareholders are entitled to vote on certain fundamental transactions, but only after such transactions have been initiated and approved by the board.⁴⁰ While shareholders also vote to elect the board, there are so many legal, economic, and structural barriers for insurgent candidates that proxy contests—i.e., contested elections—have been long been termed “the most expensive, the most uncertain, and the least used” methodology of obtaining control over a company.⁴¹ Lamenting this fact, Professor Bebchuk has written at length about the “myth of the shareholder franchise” and the rarity of contested elections.⁴²

Third, shareholders can bring suit to enforce their rights against the corporation or its directors. While the threat of lawsuits may deter some forms of managerial misconduct, the remedial nature of this process allows for recovery only after the fact,

duty to follow the wishes of a majority shareholder”); Bebchuk, *supra* note 4, at 843 (“Shareholders do not necessarily have the power to order the directors to follow any particular course of action.”); John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?*, 51 U. MIAAMI L. REV. 605, 608 (1997) (noting that shareholder resolutions are generally ineffective in directing boards to take specific actions).

37. For further discussion of these options, see the authorities cited at *supra* note 22.

38. Thompson, *supra* note 22, at 217.

39. See HIRSCHMAN, *supra* note 24, at 15–16 (explaining how selling shares sends indirect economic message to corporate management); STEPHEN M. BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE* 209 (2008) (noting that “the act of selling shares can have disciplinary effects on companies that lead to changes in governance”).

40. Shareholders also vote occasionally to ratify ordinary business transactions if the directors are self-dealing or are otherwise conflicted, but here as well the vote is entirely derivative of director-initiated corporate activity. See DEL. CODE ANN. tit. 8, § 144(a)(2) (authorizing shareholder ratification of certain self-dealing transactions); *Lewis v. Vogelstein*, 699 A.2d 327, 335 (Del. Ch. 1997) (discussing the context and legal effects of shareholder ratification); Thompson, *supra* note 22, at 217 (noting that a ratification vote can cleanse self-interested transactions or shift burden of a legal challenge).

41. Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 114 (1965). There are various impediments to proxy contests. See, e.g., *Rosenfeld v. Fairchild Engine & Airplane Corp.*, 128 N.E. 2d 291, 293 (N.Y. 1955) (setting forth the common-law rule that insurgents are not generally entitled to reimbursement for their proxy expenses); ALLEN ET AL., *supra* note 1, at 177–81 (describing the costs associated with proxy voting); BAINBRIDGE, *supra* note 39, at 210–212 (listing classified boards, elimination of cumulative voting, dual class stock plans, and the cost of compliance with the federal proxy solicitation regulations as impediments).

42. Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 682–86 (2007).

if a claim for damages, or midstream, if a claim for injunctive relief. But, neither case allows shareholders any *ex ante* say in the transaction at issue. In sum,

the statutory separation of ownership and control means that shareholders have essentially no power to initiate corporate action and, moreover, are entitled to approve or disapprove only a very few board actions. The statutory decision-making model thus is one in which the board acts and the shareholders, at most, react.⁴³

Shareholder-enacted bylaws contrast starkly with this schema. The bylaw power allows shareholders, by majority vote and *by their own initiative*, to impose their will directly on a company's affairs and governance.⁴⁴ The relevant Delaware statute provides that: "[t]he bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or power or the rights or power of its stockholders, directors, officers or employees."⁴⁵

Superficially, this power is quite broad. Shareholders can enact or amend bylaws concerning (and presumably restricting) the board's authority, as long as the bylaw does not contravene the company's charter.⁴⁶ If this power were unfettered, shareholders would have the unilateral and inalienable right to define and redefine the governance rules of the companies in which they invest.⁴⁷

However, the seemingly innocuous carve out—that the bylaws must not be "inconsistent with law"—threatens to swallow the entire grant of authority, because several other provisions of the same statute purport to require that any restraints on

43. Stephen M. Bainbridge, Director Primacy 7 (May 25, 2010) (unpublished manuscript), available at <http://ssrn.com/abstract=1615838>.

44. DEL. CODE ANN. tit. 8, § 109(a) ("[T]he power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote."); BAINBRIDGE, *supra* note 2, at 48 ("The shareholder power to initiate bylaw amendments without prior board action is unique."); PALMITER & PARTNOY, *supra* note 2, at 380 ("A proper bylaw amendment unlike a shareholder resolution, is binding on the board of directors. For this reason, activist shareholders have proposed bylaw amendments in publicly-held corporations, seeking to move the balance of power away from the board and towards shareholders."); Bruner, *supra* note 4, at 68 ("[B]ylaw authority represents essentially the only statutory mechanism through which shareholders can bring their will to bear on the governance of a Delaware corporation."); McDonnell, *supra* note 4, at 672 ("Bylaw amendments give shareholders their only power of initiative."); McDonnell, *supra* note 2, at 148 ("[F]or the moment the bylaw power still remains a—rather, *the*—limited exception to the general story of limited shareholder power . . ."). In theory, shareholders can also unilaterally dissolve the corporation, but only with unanimous consent. See DEL. CODE ANN. tit. 8, § 275(c). In practice, though, the likelihood of unanimity in a diffusely owned public company is infinitesimal.

45. DEL. CODE ANN. tit. 8, § 109(b).

46. Coffee, *supra* note 36, at 607 ("This provision clearly seems to authorize bylaws that limit the board's authority. . ."). The carve out regarding the charter codifies the hierarchy of sources of corporate authority: the charter, which can only be amended if *both* the board and shareholders agree, trumps the bylaws. Thus, shareholders cannot unilaterally subvert a right, power, or restriction contained in the corporate charter simply by amending the bylaws. See, e.g., *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1189 (Del. 2010) ("It is settled Delaware law that a bylaw that is inconsistent with the corporation's charter is invalid." (citing *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 929 (Del. 1990))).

47. See, e.g., Bruner, *supra* note 3, at 7 ("Taken at face value, section 109 would appear to offer shareholders the unilateral (and inalienable) ability to rewrite the rules of corporate governance on a company-by-company basis as, and when, they see fit.").

managerial authority must be set forth in the charter.⁴⁸ For example, title 8, section 141(a) of the Delaware Code states that: “The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.”⁴⁹

Again, though, the carve out proves problematic, because the bylaw power itself—which, on its face, contemplates the restriction of board authority—is part of “this chapter.” In other words, the statute grants the board plenary authority to manage the company unless such authority is restricted in either the company’s charter or by operation of another provision of the corporate statute, of which the bylaw provision is one. Yet, the scope of the bylaw power is simultaneously cabined by the broad grant of authority to the board.⁵⁰ As Justice Jacobs, of the Delaware Supreme Court, noted dryly, “[i]t is at this juncture that the statutory language becomes only marginally helpful in determining what the Delaware legislature intended to be the lawful scope of the shareholders’ [bylaw] power.”⁵¹

In view of these longstanding statutory and jurisprudential lacunae, many leading corporate law scholars have opined on the proper scope of shareholders’ bylaw authority.⁵² While they differ as to preferred outcomes, most commentators attempt to solve the scope problem by divining the *essence* of the shareholder bylaw power (as it

48. See *id.* (noting that despite an ostensibly broad mandate, the “not inconsistent with law” caveat may impose many limitations the bylaw power).

49. DEL. CODE ANN. tit. 8, § 141(a); see also *id.* § 102(b)(1) (detailing what may be included in the company’s charter, and allowing for “[a]ny provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders”).

50. Gordon, *supra* note 16, at 546 (terming this statutory confusion a “recursive loop”); see also Gen. DataComm Indus., Inc. v. State of Wis. Inv. Bd., 731 A.2d 818, 821 n.2 (Del. Ch. 1999) (noting, without resolving, the difficulties raised by the statutory tension between the shareholders’ bylaw power and the board’s plenary authority to manage the business and affairs of the corporation).

51. CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 234 (Del. 2008); see also William W. Bratton & Joseph A. McCahery, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 N.C. L. REV. 1861, 1932 n.274 (1995) (“[S]tate lawmakers have never had occasion to draw a clear line between board management authority and shareholder by-law promulgation authority. As a result, the extent to which a by-law may constrain . . . management authority is not clear.”); Bruner, *supra* note 4, at 69 (“It is widely recognized that these statutes provide no meaningful guidance regarding how these grants of authority relate to each other.”); Gordon, *supra* note 16, at 547 (noting that “statutory formalism really runs out”). Other scholars have provided more detailed treatments of the other statutory provisions that could plausibly bear on this question. *E.g.*, Bruner, *supra* note 3, at 5–10; Hamermesh, *supra* note 17, at 428–33; McDonnell *supra* note 17, at 213–35.

52. BAINBRIDGE, *supra* note 2, at 43–48; Coffee, *supra* note 36, at 607–08; Gordon, *supra* note 16, at 544–51; Hamermesh, *supra* note 17, at 413–17; Jonathan R. Macey, *The Legality and Utility of the Shareholder Rights Bylaw*, 26 HOFSTRA L. REV. 835, 837–38 (1998); McDonnell, *supra* note 4, at 651–53; Smith et al., *supra* note 15, at 140–43. Several prominent practitioners have also weighed in on the debate. See, *e.g.*, Frederick H. Alexander & James D. Honaker, *Power to the Franchise or the Fiduciaries? An Analysis of the Limits on Stockholder Activist Bylaws*, 33 DEL. J. CORP. L. 749, 749–50 (2008) (arguing that “[a]lthough the Delaware courts have not provided definitive guidance as to the validity of many bylaws that have been proposed by stockholder activists, Delaware’s existing statutory and common law suggest that the corporate form’s underlying structure is inconsistent with the use of mandatory bylaws to control corporate activity and curtail board authority”).

pertains to managerial authority) through a combination of sophisticated statutory analysis and a close reading of the admittedly sparse precedent.⁵³ As a purely textual matter, this mode of analysis makes sense; that divide is, after all, the crux of the statutory conundrum. These ontological inquiries—often supported by appeals to economic efficiency⁵⁴—have, thus far, led inexorably to the creation of ostensibly bright-line dichotomies that divide proper bylaws from the improper.⁵⁵ For example, Professor Coffee proposes four such distinctions—process versus substance, corporate governance versus business decisions, fundamental matters versus ordinary business, negative constraints versus affirmative instructions—in which the former are permissible, but the latter are not.⁵⁶

These categories hold more superficial appeal than analytical power.⁵⁷ First,

53. See, e.g., Coffee, *supra* note 36, at 608 (querying “[w]hat then is the proper function of bylaws?” and proposing a response based on an early corporate law decision commenting, somewhat abstractly, that “the bylaws are generally regarded as the proper place for the self-imposed rules and regulations deemed expedient for . . . [the corporation’s] convenient functioning to be laid down” (quoting *Gow v. Consolidated Coppermines Corp.*, 165 A. 136, 140 (Del. Ch. 1933))); Gordon, *supra* note 20, at 351 n.15 (“[A]nother problem is what counts as a ‘by-law’? A Delaware court, for example, could easily regard a specific business proposal as interfering with the statutory delegation to directors of power and responsibility to ‘manage’ the corporation’s business and affairs pursuant to . . . § 141(a). . . . Thus, such a proposal would not be a ‘by-law’ whose adoption by shareholders would be permitted.”); Hamermesh, *supra* note 17, at 418, 425–44 (conducting “a conventional effort to construe the governing corporate statutes that confer general authority to adopt by-laws”); Macey, *supra* note 52, at 865–71 (conducting a textual analysis and concluding that “[t]he power given to shareholders to amend the bylaws of a firm recognizes the shareholders’ contractual power to define the nature of the firm” and “[a]dopting shareholder rights bylaw is merely an exercise of that definitional power”); McDonnell, *supra* note 17, at 212–35 (conducting a nuanced textual analysis and querying, *inter alia*, whether “any pattern emerge[s] from this list of statutory provisions [related to bylaws]”).

54. See, e.g., Gordon, *supra* note 16, at 547 (analyzing the bylaw power through the lens of a “shareholder choice model,” which queries what rational, wealth-maximizing shareholders would bargain for *ex ante*); Hamermesh, *supra* note 17, at 419, 452–67 (setting aside the controlling statutes and asking, from an economic perspective, “whether simply allowing stockholders to adopt by-laws limiting director managerial power would be beneficial”); Macey, *supra* note 52, at 841–65 (describing the economic function of the market for corporate control and utility of shareholder bylaws in policing managerial attempts to interfere with efficient takeovers); McDonnell, *supra* note 4, at 654 (“Two main arguments, both drawn from law and economics analyses, argue for giving shareholders broad powers to use bylaws to shape the contours of authority and governance within a corporation.”).

55. E.g., Coffee, *supra* note 36, at 613–16.

56. *Id.* at 613–15. Several other commentators concur with some of these categories. See, e.g., Alexander & Honaker, *supra* note 52, at 753 (arguing that “[t]his distinction between regulating procedural aspects of the board’s decision-making process and the selection of directors, on the one hand, and the actual decisions made by directors, on the other hand, is no accident”); Gordon, *supra* note 16, at 548 (endorsing a distinction between “discrete business decisions” and a “structural shift that affects the board’s power in all transactions”); McDonnell, *supra* note 4, at 661 (concurring generally with Professor Coffee’s distinctions, with particular emphasis on the process versus substance and governance versus business pairs). As will be discussed further, the Delaware Supreme Court partially endorsed the process versus substance distinction in *CA, Inc. v. AFSCME Employees Pension Plan*.

57. Professor Hamermesh argues along similar lines. Hamermesh, *supra* note 17, at 433–44 (concluding that these dichotomies “fail[] to afford either predictability or even compelling logic”). Professor Hamermesh rejects these categories in favor of delineating between direct versus indirect restraints. *Id.* at 418 n.33. It is unclear how this alternative dichotomy solves the problems described in the text, and Professor Hamermesh spends little time explaining the distinction. McDonnell, *supra* note 17, at 215 n.43. However, one reading of Professor Hamermesh’s argument is that shareholders are only entitled to deploy restrictive bylaws insofar as

semantic changes to substantively identical bylaws would lead to divergent results concerning validity. For example, why is a bylaw affirmatively requiring that a company employ only union laborers more or less objectionable than an identical bylaw restricting the board's ability to employ nonunion laborers? Similarly, a bylaw that requires the board to seek unanimous or supermajority shareholder approval of certain types of transactions is (at least on its face) procedural but, in practice, likely has the same result as a bylaw purporting to bar such a transaction outright. Second, the process versus substance distinction often collapses under its own weight. Does a bylaw imposing exceptionally specific qualifications for directorships, such as a commitment not to engage in corporate political spending, regulate the process for directorial selection or the board's substantive decision making?

Finally, the lines between business versus governance and ordinary versus fundamental are increasingly blurry in the modern corporate context. For example, Professors Subramanian, Arlen, and Talley have documented the difficulties facing the courts when confronted by "embedded defenses"—contracts between the company and some nonshareholder constituency (such as employees or customers) that have both legitimate, day-to-day business purposes and strong antitakeover effects.⁵⁸

In a recent case, *CA, Inc. v. AFSCME Employees Pension Plan*, the Delaware Supreme Court squarely confronted the scope of the shareholder bylaw power for the first time, but its decision is exceptionally problematic.⁵⁹ In that case, *CA, Inc.* (CA) challenged the validity of a shareholder-proposed bylaw mandating that the board reimburse (from the company's treasury) all proxy expenses reasonably incurred by any insurgent director candidate who successfully won a board seat.⁶⁰ The company argued, in essence, that the broad grant of managerial authority in section 141(a) trumps the shareholders' bylaw power, and thus that this bylaw impermissibly interfered with the board's discretion.⁶¹ After reviewing the statutory authority

such bylaws are explicitly authorized elsewhere in the corporate statute. Hamermesh, *supra* note 17, at 476–86. Even here, though, Professor Hamermesh hedges with respect to any categorical validity. *Id.* at 483 (noting that the DGCL explicitly authorizes bylaws concerning director qualifications, but arguing that certain types of qualifications may nevertheless encroach too far on the board's managerial discretion).

58. See Jennifer Arlen & Eric Talley, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV. 577, 654–57 (2003) (discussing the problems courts face when trying to regulate "embedded defenses"); Guhan Subramanian, *The Emerging Problem of Embedded Defenses: Lessons from Air Line Pilots Ass'n, International v. UAL Corp.*, 120 HARV. L. REV. 1239, 1242 (2007) (finding that "the validity of embedded defenses remains murky territory in corporate law").

59. I am not alone in this conclusion. See, e.g., McDonnell, *supra* note 4, at 652 ("The law does not clearly spell out rules or principles for distinguishing what matters can be addressed in bylaws, as opposed to matters that must be addressed in the certificate of incorporation. A very recent Delaware Supreme Court decision has started to clear up some of the ambiguity, but in some ways it has actually increased the uncertainty surrounding shareholder bylaws.").

60. *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 229–30 (Del. 2008). The common law rule is that incumbents are authorized to reimburse their own reasonable expenses when defending a proxy fight, but insurgents are not entitled to any reimbursement unless they capture a majority of the board (and can thus choose to reimburse themselves). E.g., *Rosenfeld v. Fairchild Engine & Airplane Corp.*, 128 N.E. 2d 291, 299 (N.Y. 1955). Even then, such reimbursement might be attacked as self-dealing unless it is ratified by the shareholders. See, e.g., *Heineman v. Datapoint Corp.*, 611 A.2d 950, 953 (Del. 1992) (discussing how a corporation's reimbursement of proxy expenses to directors raised concerns of self-dealing).

61. There was no dispute that, in the ordinary course, the board has plenary discretion concerning such

described above, the court rejected CA's claim that *any* restraint on the board's authority rendered a bylaw invalid.⁶² Justice Jacobs explained that "[s]ection 109(a) carves out an area of shareholder power to adopt, amend or repeal bylaws that is expressly inviolate," and that CA's argument would remove that power entirely because every bylaw is binding on the board, and therefore could be seen as limiting its discretion.⁶³

To determine the validity of the bylaw at bar, the court split its analysis into two parts: first, was the bylaw a proper subject for shareholder action and second, if so, was the bylaw nevertheless inconsistent with Delaware law by virtue of impermissibly restricting managerial authority?⁶⁴ The court answered both questions in the affirmative.⁶⁵ With respect to the former, Justice Jacobs partially endorsed the process/substance distinction, but then—unsurprisingly—struggled to fit the bylaw at issue within either category.⁶⁶ The court framed the question as "whether the [b]ylaw is one that establishes or regulates a process for substantive director decision-making, or one that mandates the decision itself."⁶⁷ But, this formulation illustrates precisely the frailty of the dichotomy, and the inherently problematic nature of bright-line tests in this context, because the characterization turns entirely on the selection of vantage point or level of abstraction. Clearly, the bylaw in question *both* regulates the process for directorial elections and also mandates the reimbursement decision itself. Indeed, the entire point of the bylaw—as with virtually all contested bylaws—is to bind the board to a course of action that it might not otherwise have taken or restrict it from pursuing its preferred course. Notwithstanding this (to my mind fatal) slippage, the court ultimately concluded that the bylaw was sufficiently procedural to survive this hurdle, explaining that "even though infelicitously couched as a substantive-sounding mandate to expend corporate funds, [the bylaw] has both the intent and the effect of regulating the process for electing directors of CA."⁶⁸

However, the court nevertheless invalidated the bylaw.⁶⁹ In reaching this conclusion, the court imported a line of authority from its takeover jurisprudence, which provides that the board (and, here, the shareholders) cannot not precommit to a future course of conduct in which the directors could be required to act in a way that violates their fiduciary duties.⁷⁰ I term this the fiduciary precommitment constraint.

reimbursement decisions. *CA, Inc.*, 953 A.2d at 230.

62. *Id.* at 234–36.

63. *Id.* at 234 (noting that CA's argument, if "taken to its logical extreme, would result in eliminating altogether the shareholders' statutory right to adopt, amend or repeal bylaws").

64. *Id.* at 231.

65. *Id.* at 237, 240.

66. *Id.* at 236–37; *see also* McDonnell, *supra* note 4, at 663 ("The court had difficulty classifying this bylaw. . .").

67. *CA, Inc.*, 953 A.2d at 235.

68. *Id.* at 235–36. Further illustrating why the process/substance divide is unsatisfying, the court felt obliged to go outside the test itself to justify its conclusion. *See id.* at 237 (supporting its conclusion by noting "[t]he context of the [b]ylaw at issue here is the process for electing directors—a subject in which shareholders of Delaware corporations have a legitimate and protected interest").

69. *Id.* at 231–37.

70. *Id.* at 238–40 (citing *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1291–92 (Del. 1998); *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 51 (Del. 1994)).

More concretely, the court concluded that the bylaw was invalid because it might require the directors to reimburse an insurgent in circumstances where they honestly believe, after reasonably informing themselves, that doing so would not be in the best interests of the company.⁷¹ The court ended its opinion by stating that, in order to be valid, the bylaw in question should have included a “fiduciary out” clause, which would have allowed the directors to ignore the bylaw in the circumstances noted above.⁷²

This holding, too, is exceptionally problematic if it is generally applicable to all shareholder bylaws. Leaving aside the merits of importing wholesale a doctrine previously applied only to takeover cases in which *the board* was attempting to tie its own hands in ways that were potentially injurious to shareholders,⁷³ the fiduciary precommitment constraint undermines the court’s holding—from earlier in the same case—that at least some shareholder-enacted bylaws were permissible.⁷⁴ As Justice Jacobs explained, to hold otherwise “would result in eliminating altogether the shareholders’ statutory [bylaw right].”⁷⁵ Yet, requiring inclusion of a fiduciary out clause in any bylaw that could theoretically constrain board authority (i.e., virtually every bylaw) has exactly the same effect by transforming a mandatory bylaw into a precatory shareholder resolution.⁷⁶

* * *

What can reasonably be drawn from the foregoing? First, there is some domain in which shareholders can enact bylaws that restrain the board’s plenary managerial authority.⁷⁷ Second, the boundary of that domain remains undefined. While the court

71. *Id.* at 239–40.

72. *Id.* at 240.

73. See Sabrina Ursaner, *Keeping ‘Fiduciary Outs’ Out of Shareholder-Proposed Bylaws: An Analysis of CA, Inc. v. AFSCME*, 6 N.Y.U. J.L. & BUS. 479, 501–05 (2010) (arguing against the importation of fiduciary outs from takeover jurisprudence to bylaw jurisprudence). Several commentators have criticized this fiduciary precommitment constraint more generally on various grounds, including economic efficiency concerns. See, e.g., Stephen M. Bainbridge, *Precommitment Strategies in Corporate Law: The Case of Dead Hand and No Hand Pills*, 29 J. CORP. L. 1, 27–33 (2003) (arguing that directors should be given discretion to make binding decisions); Sean J. Griffith, *The Costs and Benefits of Precommitment: An Appraisal of Omnicare vs. NCS Healthcare*, 29 J. CORP. L. 569, 622–23 (2004) (weighing the costs and benefits of utilizing precommitment strategies).

74. *CA, Inc.*, 953 A.2d at 234; see also Brett H. McDonnell, “Private Ordering” Taken a Tad Too Far, 80 FORDHAM L. REV. RES GESTATE 32, 35 (2011) (stating, as to the fiduciary precommitment constraint, that “it is hard to adequately describe how bad the reasoning is here relative to the general high quality of Delaware court opinions”); Smith et al., *supra* note 15, at 154 (finding it “hard to imagine” how the court was persuaded by the argument about fiduciary precommitment).

75. *CA, Inc.*, 953 A.2d at 234.

76. See McDonnell, *supra* note 4, at 668 (“This conclusion, however, leaves boards with a degree of discretion that may go against the very point of these bylaws, which seek to limit board discretion in areas where the shareholders do not trust the board.”). In other work, Professor McDonnell suggests that “the practical effects of this bungled logic are probably not too bad” because shareholders could enact bylaws with a fiduciary out, which—at least putatively—boards might be hesitant to violate. McDonnell, *supra* note 74, at 35.

77. See *CA, Inc.*, 953 A.2d at 234 (“Implicit in CA’s argument is the premise that *any* bylaw that in any respect might be viewed as limiting or restricting the power of the board of directors automatically falls outside the scope of permissible bylaws. That simply cannot be.”); McDonnell, *supra* note 17, at 218 (stating that “the statutory language that we have considered so far seems most consistent with a split-the-difference

partially endorsed the process/substance distinction, Justice Jacobs was careful to state that regulating process is *a*, rather than *the*, proper function of corporate bylaws.⁷⁸ And third, as illustrated by the *CA, Inc.* decision itself, trying to define that boundary ontologically holds little analytical appeal.⁷⁹ In the following Section, I attempt to fill the gap left by *CA, Inc.* by examining where the bylaw power fits within the deeper structure of corporate law.

III. A MORAL AGENCY THEORY OF THE SHAREHOLDER BYLAW POWER

Bylaws are not the only way that shareholders interact with their companies: shareholders are also entitled to exit the firm by selling their shares, voice their preferences by voting on certain transactions, and seek legal remedies in certain circumstances. These powers do not exist in isolation; as described further below, each of these rights not only interacts with the others, but in many ways depends on the others.⁸⁰ It thus makes sense to examine how the bylaw power fits within the larger framework of interaction. In this Section, I argue that this deep structure of corporate law illuminates a path towards defining an appropriate boundary of the shareholder bylaw power. Specifically, shareholder bylaws should fill the gap where other avenues of interaction (exit and remedies) fail.

A. *The Interdependent Relationship Between Exit, Voice, and Remedy*

Nearly half a century ago, Albert Hirschman formalized two ways in which members of organizations could express their displeasure: exit and voice.⁸¹ Exit is economic expression; to improve their welfare, dissatisfied members cut their ties with the organization, often in favor of a competitor.⁸² Exit is private, impersonal, and often quiet.⁸³ The target is affected, if at all, through market forces such as declining stock prices (in the case of a selling shareholder) or reduced revenue (in the case of a departing customer).⁸⁴ However, exit is typically also cheap, and is therefore generally

interpretation that gives effect to both sections 109(b) and 141(a) by distinguishing bylaws that section 109(b) allows from bylaws that section 141(a) forbids"). One open question is whether the fiduciary precommitment constraint applies to the entire universe of shareholder-proposed bylaws. I return to this question in the context of social policy bylaws in Part III.C, *infra*.

78. *CA, Inc.*, 953 A.2d at 234–35; *see also* Bruner, *supra* note 3, at 19 ("While *CA, Inc.* offers some limited guidance on the permissible scope of shareholder bylaws through its effective endorsement of the procedural-substantive distinction, the practical difficulty of identifying any coherent 'bright line,' coupled with the court's resort to the board's fiduciary duties as an evaluative principle, leave numerous questions unanswered."); McDonnell, *supra* note 4, at 668 (arguing that, even after *CA, Inc.*, "[i]t is not clear how to draw the line between bylaws that may illegally force the board to violate its fiduciary duties in some circumstances, and those that do not").

79. Bruner, *supra* note 3, at 20 (asserting that attempts to explore "intrinsic nature" of bylaws are pointless).

80. ALLEN ET AL., *supra* note 1, at 169 ("[T]he default powers of shareholders [are] three: the right to vote, the right to sell, and the right to sue. It is important to recognize, however, that each of these shareholder strategies for disciplining management interacts with the others.").

81. HIRSCHMAN, *supra* note 24, at 3–4, 129–31 (describing and modeling these avenues of interaction).

82. *Id.* at 15, 27.

83. *Id.* at 15–16.

84. *See id.* at 23–24 (theorizing three potential consequences arising from exit: small exit triggers no

viewed as the most efficient option.⁸⁵

By contrast, voice is political expression.⁸⁶ Rather than leave the firm, the dissatisfied member attempts to change the practices, policies, or strategies of the organization from within.⁸⁷ It is public, critical, and can be exercised with varying levels of intensity.⁸⁸ It is thus typically messier and more expensive than exit.⁸⁹ Yet, voice may nevertheless be the preferable mode of expression in certain circumstances, such as when there are substantial barriers to exit.⁹⁰ Voice is arguably most important where the member's dissatisfaction stems from an issue that involves both private goods (i.e., firm-specific concerns) and public goods or harms (i.e., externalities), such that a full exit is impossible.⁹¹ By way of example, Hirschman explains:

If I disagree with an organization, say, a political party, I can resign as a member, but generally I cannot stop being a member of the society in which the objectionable party functions [I am] at first both producer and consumer of such public goods [I] can stop being a producer, but cannot stop being a consumer.⁹²

Ultimately, Hirschman concludes that exit and voice are dependent upon each other and inversely related: the role of one expands—and perhaps *should* expand—where opportunities for the other vanish or are thwarted.⁹³

Hirschman's theory very closely describes modern Delaware corporate jurisprudence, if one adds shareholders' right to seek legal remedies through litigation to the framework of exit (selling) and voice (voting). As the theory predicts, where shareholders' exit rights are thwarted, their ability to seek legal remedy is augmented. Hostile takeover cases are the prototypical example. The standard fact pattern is that a hostile acquirer makes a bid for the target company, and the board would either like to oppose the takeover outright or would prefer a transaction with a different buyer. Absent managerial interference, shareholders would have an unfettered choice about whether and how to exit the firm, i.e., which deal to choose. However, managers often interfere with this process by installing various antitakeover or deal-protection devices that hinder the hostile acquirer or favor the board's preferred deal partner.⁹⁴ Whereas

adjustment, moderate exit triggers potentially positive reactions as the firm tries remedy the faults that led to defection, and sufficiently large exits send the firm beyond the brink of recovery).

85. *Id.* at 15–16.

86. *Id.* at 16.

87. *Id.* at 30.

88. *Id.* at 16.

89. *See id.* at 16, 40 (noting that the cost of voice depends on identity of speakers; diffuse speakers face collective action problems, and thus additional costs, when employing voice as a mechanism of dissent).

90. *See id.* at 36–43.

91. *See id.* at 98–105 (describing the difficult exit from “public goods”).

92. *Id.* at 102.

93. *Id.* at 34. In later writings, Hirschman makes clear that this assertion was intended as both descriptive and normative. *See* Albert O. Hirschman, *Exit, Voice and Loyalty: Further Reflections and a Survey of Recent Contributions*, 13 SOC. SCI. INFO. 7, 8 (1974) (“My approach was both positive and normative. I explained the conditions under which voice comes into existence and can be expected to be powerful, but I also argued that, in some situations, the proper balance of institutional incentives ought to be adjusted so as to strengthen voice in relation to exit.”).

94. *See, e.g.,* *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 930 (Del. 2003) (describing deal-

board action is usually protected by the business judgment rule, the adoption of defensive measures in this context is subjected to heightened judicial scrutiny whereby the initial burden shifts to the board to demonstrate the propriety of their conduct.⁹⁵ Among other things, the board must show that the defensive measures employed are neither preclusive, such that shareholders are fully deprived from receiving a hostile bid,⁹⁶ nor coercive, in the sense of “causing the stockholders to vote in favor of the [management-]proposed transaction for some reason other than the merits of that transaction.”⁹⁷ Thus, where managerial conduct interferes with shareholders’ ability to sell their shares as they see fit, Delaware law responds by expanding the scope of shareholders’ remedies with a particular sensitivity to preserving shareholders’ voice.

Augmented remedies also fill the void when shareholder voice is silenced. Two famous attempts to thwart proxy contests (i.e., elections intended to oust incumbent management) are illustrative. In *Schnell v. Chris-Craft Industries, Inc.*,⁹⁸ managers advanced the date of the firm’s annual meeting by a month in an attempt to prevent a contested election.⁹⁹ While this action complied with all pertinent provisions of the statute, the Delaware Supreme Court nevertheless held that “[u]tilizing the corporate machinery and the Delaware Law . . . for the purpose of obstructing the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management . . . may not be permitted to stand.”¹⁰⁰

In *Blasius Industries, Inc. v. Atlas Corp.*,¹⁰¹ Chancellor Allen confirmed that “the ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context.”¹⁰² Accordingly, he concluded that the board is afforded no deference if it acts primarily to thwart the shareholder franchise.¹⁰³ Instead, as with the takeover cases, the burden of proof shifts to the board, which must bear “the heavy burden of demonstrating a compelling justification” for its conduct.¹⁰⁴ The *Blasius* standard of review is arguably the most searching in all of corporate law.¹⁰⁵

protection devices as defensive measures that hinder stockholders’ “ability to effectively reject a merger agreement”).

95. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954–55 (Del. 1985). One might legitimately question the potency of this heightened scrutiny. But, the point here is not that shareholders necessarily win when their exit rights are infringed, just that the scope of their remedial rights expands.

96. See, e.g., *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995).

97. *Williams v. Geier*, 671 A.2d 1368, 1382–83 (Del. 1996); see also *Brazen v. Bell Atl. Corp.*, 695 A.2d 43, 50 (Del. 1997) (expressing the test for coercion as “whether a particular stockholder vote has been robbed of its effectiveness” (quoting *Williams*, 671 A.2d at 1383)).

98. 285 A.2d 437 (Del. 1971).

99. *Schnell*, 285 A.2d at 438–39.

100. *Id.* at 439 (reversing and remanding with instructions to reinstate the original date for the annual meeting).

101. 564 A.2d 651, (Del. Ch. 1988).

102. *Blasius*, 564 A.2d at 659. The Delaware Supreme Court later adopted the *Blasius* standard. See *MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1132 (Del. 2003) (finding no compelling justification for incumbent board’s attempts to interfere with a contested election).

103. *Blasius*, 564 A.2d at 662.

104. *Id.* at 661.

105. See Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79

In sum, as predicted by Hirschman's theory, when shareholders' exit or voice rights are infringed, Delaware law affords greater remedial rights. This is not to say that shareholders necessarily win. To the contrary, neither the *Unocal/Unitrin* doctrine, nor the *Blasius* standard establishes a per se rule of liability.¹⁰⁶ However, the interrelationship of these rights is indisputable and, when there are substantial infringements of exit, voice, or both, remedy is made available.¹⁰⁷ But what happens when remedy and exit fail?

B. Bylaws Should Fill the Gap Where Exit and Remedy Fail: Questions of Social Policy

Shareholders have two methods of voicing their preferences: by voting on fundamental transactions (including elections) and on bylaw amendments. A contextual view of the shareholder power suggests that these voice rights should expand when either remedy or exit fails.¹⁰⁸ Delaware law already enshrines this idea with respect to exit; shareholders are entitled to vote on most transactions that fundamentally change the nature of their investment such that they are, either in actuality or in substance, forced to exit the firm. For example, absent a contrary agreement, shareholder votes are required when a company sells all (or substantially all) of its assets or otherwise winds up its affairs,¹⁰⁹ when a company is acquired via merger,¹¹⁰ or when a nonmerger transaction alters the "powers, preferences, or special rights of the shares . . . so as to affect them adversely."¹¹¹

IOWA L. REV. 485, 535 (1994) (The *Blasius-Schnell* standard of review "is perhaps the most exacting in corporate law. It unequivocally reverses the business judgment presumption. Director action that interferes with the voting process is presumptively inequitable." (footnote omitted)).

106. See, e.g., *MM Cos.*, 813 A.2d at 1128 ("In *Blasius*, the Chancellor did not adopt a rule of *per se* invalidity . . .").

107. This theory may explain the odd, and heavily criticized, decision in *Omnicare*, in which the Delaware Supreme Court split three-two and invalidated a merger agreement that contained two deal-protection devices (a "force the vote" provision and a shareholder agreement by which the majority shareholders committed to vote in favor of the merger), despite the fact that both of these devices are statutorily authorized. The majority opinion's analysis seems focused on the fact that the minority shareholders' exit and voice rights are *both* impaired because the combination of the deal-protection devices made the merger a *fait accompli*. See *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 934–36 (Del. 2003) ("The record reflects that the defensive devices employed by the NCS board are preclusive and coercive in the sense that they accomplished a *fait accompli*.").

108. I thank Shawn Bayern and Mark Spottswood for independently pointing out that adding remedy to Hirschman's bilateral framework creates a potential three-body problem. I do not need to resolve that thorny issue here, because my proposed expansion of the bylaw power pertains to circumstances in which both remedy and exit have substantially failed. Further, as described above, the Delaware courts have, in large part, set the parameters concerning failures of exit and voice.

109. DEL. CODE ANN. tit. 8, § 271(a) (West 2013) (sale of assets); *id.* § 275 (dissolution and winding-up).

110. *Id.* § 251(c). Shareholders of the acquiring company may also be entitled to vote on the transaction if the consideration for the merger consists of shares of the acquiring company that amount to more than twenty percent of the common stock outstanding prior to the transaction. *Id.* § 251(f). In other words, shareholders get to vote if the capital structure of the acquiring company will be substantially changed—i.e., shareholders have, in essence, exited from their initial investment into a new investment.

111. *Id.* § 242(2).

Shareholders' voice-based rights should expand even farther if both exit *and* remedy fail.¹¹² There are two necessary conditions. First, the conduct at issue must pose a threat, at least from the shareholders' perspective, of negative externalities from which (by definition) the shareholder cannot escape merely by selling her shares. Second, these harms must be unremediable in the sense that if the conduct occurred and a shareholder successfully sued the company's fiduciaries challenging that conduct, the remedy would not resolve the problem, either because the remedy does not reach the harm suffered by the shareholder or because the harms that the shareholder fears are largely suffered by third parties. While this boundary is not a bright line, it generally delimits issues of political, social, or moral importance that reach beyond pure wealth creation.

Pursuant to this theory, shareholders should be entitled to take affirmative and binding action to express their preferences concerning corporate activity that implicates meaningful matters of social policy. The bylaw power should be a viewpoint-neutral mechanism for shareholders to express moral boundaries to which the firm must adhere in conducting its affairs. In sum, the bylaw power should allow shareholders to exercise their *moral agency*. Of course, not all shareholders will agree on these questions. Insofar as other shareholders' preferences differ, they can vote against those proposals—the company will only be bound if and when such a proposal garners a majority vote. It is worth noting that this boundary is consistent with federal securities laws, which govern the process by which shareholder proposals (including proposals to amend corporate bylaws) are brought to vote.¹¹³ Specifically, pursuant to Rule 14a-8, shareholders can place certain proposals on the company's own proxy card.¹¹⁴ That Rule, however, allows the company to exclude a wide range of proposals, if they are deemed unsuitable for shareholder action. While the Securities and Exchange Commission's (SEC) policy has wavered somewhat over time, its most recent interpretation of the Rule allows proposals that focus on "significant social policy issues."¹¹⁵ Based on this framework, the SEC has repeatedly refused exclusion of shareholder proposals relating to various social issues, including corporate political spending.¹¹⁶

112. Modifying Hirschman, "the role of voice would increase as the opportunities for exit [and remedy] decline, up to the point where, with exit [and remedy] wholly unavailable, voice must carry the entire burden." HIRSCHMAN, *supra* note 24, at 34.

113. *See generally* 17 C.F.R. § 240.14a-8 (2012).

114. This is also important from a practical perspective. The costs associated with soliciting proxies are prohibitive for most shareholders, so absent compliance with Rule 14a-8, most shareholder proposals would never be made. *See* McDonnell, *supra* note 17, at 208 ("Favorable state court rules will be worthless to shareholders unless they can use the corporate proxy materials to propose bylaws.").

115. ALLEN ET AL., *supra* note 1, at 225–28; *see also* Strine, *supra* note 34, at 23 n.76 ("As to social proposals, I accept the reality that 14a-8 has long created a low-cost forum for social activists to raise issues of concern with public companies . . . I advocate no reduction in voice of this kind.").

116. *See, e.g.*, Home Depot, Inc., SEC No-Action Letter, 2011 WL 291324, at *1 (March 25, 2011) (finding that Home Depot could not exclude request for shareholder advisory votes on electioneering activities); Goldman Sachs, SEC No-Action Letter, 2011 WL 145595 (Feb. 18, 2011) (finding that Goldman Sachs could not exclude request for reports on "expenditures made with corporate funds to trade associations and other tax-exempt entities that are used for political purposes"); Boeing, Inc., SEC No-Action Letter, 2010 WL 5279921, at *1 (Feb. 14, 2011) (finding that Boeing could not exclude request for semi-annual report

Several caveats are necessary lest, contrary to the premise that bylaws afford shareholders a limited domain for direct action, this power subsume all corporate activities. Shareholders should not be entitled to enact bylaws merely because certain conduct might create *some* externalities. All corporate conduct creates externalities, both positive and negative. Rather, the bylaw power should be limited to those issues where the unremediable harms (i.e., moral agency costs) are substantial. Similarly, the definition of “unremediable” harms should not include the economic opportunity costs inherent in all corporate activities. Market forces and fiduciary obligations already protect shareholders’ purely economic rights. Indeed, controlling economic agency costs (but not moral agency costs) has been one of the core foci of modern corporate law. Thus, exit and remedy are the paths by which shareholders should seek to vindicate complaints that they, qua shareholder, have suffered economic harm as a result of activities authorized by the board.

To illustrate the application of this theory more concretely, I apply these criteria to two contested categories of shareholder bylaws: restrictions on corporate political spending and restrictions on board authority to employ antitakeover devices. I conclude that the former would be permissible pursuant to the formulation set for herein, while the latter would not.

1. Applying the Moral Agency Theory: Corporate Political Spending

Since the Supreme Court’s decision in *Citizens United v. Federal Election Commission*,¹¹⁷ shareholders have submitted numerous proposals seeking to restrict or regulate (typically, by requiring public disclosure of) corporate political spending.¹¹⁸ To date, these proposals have been precatory, but it is only a matter of time before a similar bylaw amendment is proposed. While corporate political spending almost certainly has economic consequences for the firm, such activities are fundamentally about social policy. Indeed, assuming managers are acting in good faith, the entire point of such activities is to shape the regulatory landscape (or maintain the status quo) to benefit the firm. As to the first criterion, a dissenting shareholder cannot avoid the impact of these activities simply by exiting the firm. As to the second, remedy fails even if a dissenting shareholder sued the firm for breach of fiduciary duty and won. While the board (or its insurers) would be obliged to repay the amount spent, the political and social impact of that activity would remain.

One might legitimately inquire about why the focus here is on the availability of ex post remedies, rather than injunctive relief? Context matters a great deal. Most governance issues of concern to activist shareholders (such as the adoption of takeover

disclosing political activities); Wal-Mart, Inc., SEC No-Action Letter, 2010 WL 543622, at *1 (March 29, 2010) (finding that Wal-Mart could not exclude request for report “on Wal-Mart’s process for identifying and prioritizing legislative and regulatory public policy advocacy activities”); American International Group, Inc., SEC No-Action Letter, 2004 WL 346068, at *1 (Feb. 19, 2004) (finding that AIG could not exclude entire shareholder proposal seeking disclosure and accounting of political contributions made by the company and its employees).

117. 558 U.S. 310 (2010).

118. See JAMES R. COPLAND, PROXY MONITOR 2012: A REPORT ON CORPORATE GOVERNANCE AND SHAREHOLDER ACTIVISM 2, 13 (2012) (finding that political spending proposals submitted to Fortune 200 companies in 2012 was fifty percent higher than in 2011, and double the number submitted in 2010).

defenses, the selection of merger or acquisition partners, majority vs. plurality voting structures, et cetera) are matters of public record, easily ascertained by those looking to alter the status quo, and thus readily challengeable *ex ante*. Yet, many corporate activities that implicate questions of social policy only become visible after they have occurred. Or, in the case of political spending, are meaningfully opaque to shareholders due to a lack of disclosure requirements.¹¹⁹

Thus, because both exit and remedy fail in this context, shareholders should be entitled to regulate corporate political activities through the bylaw power.¹²⁰

2. Applying the Moral Agency Theory: Restrictions on Antitakeover Devices

Shareholders have also used the bylaws in an attempt to alter the balance of decision-making power in the context of takeovers or other fundamental transactions.¹²¹ Here, the question is closer under a moral agency theory. On one hand, shareholders who dislike their company's use of poison pills or other antitakeover devices can simply exit the firm and invest in other companies that do not employ such devices. On the other, one could argue that, especially for a diversified investor, the use of antitakeover devices across many firms is a question of substantial social policy,

119. See Jill E. Fisch, *Frankenstein's Monster Hits the Campaign Trail: An Approach to Regulation of Corporate Political Expenditures*, 32 WM. & MARY L. REV. 587, 638 (1991) (finding stockholders' inability to discover managers' political spending to be a substantial limitation); see also Bebchuk & Jackson, *supra* note 14, at 104–05 (discussing importance of informing shareholders about corporate political speech decisions); *Coffee Testimony*, *supra* note 14, at 5 (arguing that decisions about corporate campaign contributions are hidden from shareholders). Indeed, several attempts to mandate such disclosure through the federal securities laws have failed. Even if shareholders could obtain disclosure of such activities prior to their occurrence, the costs of potentially serial litigation weigh heavily in favor of *ex ante* private ordering through bylaws rather than *ex post* enforcement through the courts.

120. This conclusion is bolstered by the Supreme Court's corporate political activity jurisprudence. In *Citizens United*, Justice Kennedy reasoned that disputes between shareholders and managers concerning corporate political spending could be "corrected by shareholders 'through the procedures of corporate democracy.'" *Citizens United*, 558 U.S. at 362 (emphasis added) (quoting *First Nat'l Bank of Bos. v. Bellotti*, 433 U.S. 765, 794 (1978)). As a practical matter, it is unlikely that Justice Kennedy was speaking exclusively of the directorial election process for several reasons. First, in *Bellotti*, Justice Powell argued that shareholders could bind managerial authority *ex ante* through protective provisions in the company's constitutional documents. *Bellotti*, 433 U.S. at 794. Second, given the lack of complete disclosure concerning corporate political activity, it is presently impossible for shareholders to discern whether or not to challenge the incumbent board. See Lucian A. Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending*, 101 GEO. L.J. 923, 930 (2013) ("Shareholders in most public companies in the United States do not have the information they need to determine whether the company engages in political spending, how much is spent, or who the recipients are."). Third, even if shareholders could overcome collective action problems to vote out the incumbent board, absent a method of constraining managerial discretion going forward, there is no guarantee that the replacement board would, in the future, abide by shareholder preferences concerning the firm's political activity. See Elizabeth Pollman, *Citizens Not United: The Lack of Stockholder Voluntariness in Corporate Political Speech*, 119 YALE L.J. ONLINE 53, 57–58 (2009) (noting that shareholder proposals "offer limited promise for dissenting stockholders"). Finally, it would be inefficient to vote out a slate of directors and replace executives, who have critical firm-specific knowledge and expertise, simply because of a disagreement over corporate political spending. See Bebchuk & Jackson, *supra* note 14, at 100 (arguing that there are "substantial advantages" associated with unbundling decisions about corporate political activity from overall assessments of the incumbent board's performance).

121. For examples of this use of the bylaws, see *supra* notes 3, 7, and accompanying text.

insofar as it theoretically impedes allocating resources to their highest-valued use. These harms, though, are the type of economic opportunity cost for which exit and remedy are the appropriate paths for relief. In other words, the harm is not unremediable. Once put in place, antitakeover devices can be challenged pursuant to the well-developed *Unocal* doctrine described above.¹²² If that challenge is successful, the device(s) will be invalidated, thus fully remedying the shareholder's complaint. Accordingly, absent peculiar factual circumstances that satisfied the criteria described above, bylaws aimed at restricting the use of antitakeover devices would not be authorized by the moral agency theory.

C. Coordinating the Moral Agency Theory of the Shareholder Bylaw Power with CA, Inc.: Proposed Limits of the Fiduciary Precommitment Constraint

As set forth at the outset, the moral agency theory of the shareholder bylaw power is intended to supplement, not replace, the current statutory and precedential regime. It is thus worthwhile to make explicit the full scope of the shareholder bylaw power envisioned herein. If the moral agency theory of the bylaw power was adopted, shareholders would be empowered to enact (and amend or repeal) three categories of bylaws: (1) bylaws explicitly authorized by the Delaware General Corporation Law, (2) procedural bylaws, of the kind envisioned by *CA, Inc.*, and (3) bylaws concerning questions of social policy that satisfy the criteria set forth in Part III.B.

One open question of particular importance is how these categories are restricted by the fiduciary precommitment constraint. Taking *CA, Inc.* at face value, shareholders' ability to enact bylaws in this second category is subject to such constraint.¹²³ Less clear is the applicability to bylaws falling within the first and third categories.¹²⁴ I take up only the third category here, and conclude that social policy bylaws should not be subject to the fiduciary precommitment constraint.

The fiduciary precommitment constraint is typically described as a mechanism for

122. See *supra* notes 95–97 and accompanying text for further discussion of this doctrine.

123. Though, as described in *supra* notes 73–74 and accompanying text, the fiduciary precommitment constraint has attracted substantial criticism in the context of shareholder bylaws. Indeed, Justice Jacobs, the author of the decision, has himself expressed concerns over the reasoning adopted by the Court.

In a talk at Harvard Law School that took place shortly after the court issued the *AFSCME* decision, Justice Jacobs, who authored the opinion, discussed some of the issues driving the court to decide the case the way it did:

The opinion . . . was basically our best effort to reach a decision unanimously given a set of facts that was basically hypothetical If we had more than two weeks and were not under the pressure of time because there was a shareholder vote coming up . . . we might have been able to write it better I'm not suggesting that it was the best way it could have been handled.

Ursaner, *supra* note 73, at 507–08 (omissions in original) (quoting Justice Jack B. Jacobs, Del. Sup. Ct., Comments at Harvard Law School (Dec. 1, 2008)). Thus, while the continued validity of the case is at least questionable, I assume that the fiduciary precommitment constraint described therein remains good law for the purposes of this paper.

124. Professor McDonnell further explores bylaws explicitly authorized by the DGCL. See McDonnell, *supra* note 74, at 35 (“[I]t may be that the fiduciary duty analysis of *CA, Inc.* does not apply to bylaws that are valid under more specific statutory grants of authority as opposed to the general grant of authority under section 109(b).”).

protecting the corporation (as an entity) and its shareholders from hand tying that may result in future harm.¹²⁵ As originally conceived in the context of takeover negotiations and related jurisprudence, the constraint required boards to include a contractual escape hatch in merger agreements, which would allow the board to terminate its contractual undertakings to one bidder in the event that the company subsequently receives a bid that the directors consider superior.¹²⁶ Thus, leaving aside the normative merits of the constraint, the original purpose of the fiduciary precommitment constraint was shareholder protection. That is, in the context of merger negotiations, the board could not bind its own hands to the detriment of the company's shareholders.

The *CA, Inc.* decision holds that not only is the board restrained from tying its own hands in circumstances that could harm the corporation's shareholders, shareholders themselves cannot tie the board's hands.¹²⁷ Though the rationale for this pivot is never explicitly stated in the decision,¹²⁸ the explanation seems to be that the board authority to advance the best interests of the corporation must remain intact. As the court explained in support of its conclusion, the bylaw at issue in *CA, Inc.* was invalid because it could have, at least hypothetically, required the board reimburse insurgent candidates whose proxy contest was intended "to promote interests that do not further, or are adverse to, those of the corporation."¹²⁹ In other words, where shareholders (even a majority) and the board differ about what governance structure or process is ultimately in the company's best interests, shareholders' desires must yield to the judgment of the board.

Social policy bylaws transcend those inward-looking concerns. By definition, they address substantially distinct subject matter: potential harms to third parties, and the moral agency costs borne by shareholders. In the context of social policy bylaws opposed by management,¹³⁰ the tension arises not from a dispute over how best to further shareholders' intracorporate financial interests, but instead stems from a dispute concerning what constraints, if any, should be placed on managers' pursuit of those interests. It is not clear why, in a system of corporate law that does not impose any social obligations on managers directly, we should constrain shareholders' attempts to

125. See, e.g., *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 238 ("[W]e conclude that the Bylaw, as drafted, would violate the prohibition, which our decisions have derived from Section 141(a), against contractual arrangements that commit the board of directors to a course of action that would preclude them from fully discharging their fiduciary duties to the corporation and its shareholders.").

126. Fiduciary outs in the context of merger agreements have been explored elsewhere. See William T. Allen, *Understanding Fiduciary Outs: The What and the Why of an Anomalous Concept*, 55 *BUS. LAW.* 653, 654-55 (2000) (discussing a fiduciary's potential duty to violate contracts during an acquisition); Dennis J. Block & Jonathan M. Hoff, *Protective Provisions, Fiduciary Outs in Merger Agreements*, N.Y. L.J., Aug. 24, 2000, at 30 (detailing use of protective provisions during merger agreements). The courts have also evaluated their use in connection with the fiduciary precommitment constraint. E.g., *Omicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003); *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998).

127. *CA, Inc.*, 953 A.2d at 240.

128. Indeed, the court attempts to diminish the significance of the analytical move, suggesting that the "distinction is one without a difference." *Id.* at 239.

129. *Id.* at 240 (emphasis added).

130. If managers and a majority of shareholders both agreed to social policy in question, they can amend the firm's charter and avoid all of these thorny problems. See, e.g., *id.* (noting that the substance of the bylaw at issue in that case would have been unproblematic if enacted in the company's charter).

impose those constraints themselves.¹³¹

This, of course, raises two threshold questions that I turn to next: Do firms need moral agents at all? And, if so, why empower shareholders over managers? Sections IV and V address these two questions, respectively.

IV. ON THE NEED FOR SHAREHOLDER MORAL AGENCY

In theory, corporate law seeks to advance overall societal well-being.¹³² In practice, corporate law is almost entirely focused on facilitating shareholder wealth maximization.¹³³ The traditional rationale bridging this gap between theory and practice is that maximizing shareholder wealth *also* maximizes societal wealth.¹³⁴ Whether this is, in fact, true is an extraordinarily complex empirical question.¹³⁵

131. The main alternative, of course, is to grant managers sufficient discretion to pursue their own view of the social good. See Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738–39 (2005) (arguing that granting managers discretion to spend corporate funds in the public interest is both more profitable and more socially beneficial). I address this possibility in Section V, *infra*.

132. See REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 18 (2d ed. 2009) (“As a normative matter, the overall objective of corporate law—as of any branch of law—is presumably to serve the interests of society as a whole.”).

133. See, e.g., Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001) (“[A]s a consequence of both logic and experience, there is convergence on a consensus that the best means to this end (that is, the pursuit of aggregate social welfare) is to make corporate managers strongly accountable to shareholder interests and, at least in direct terms, only to those interests.”); see also BAINBRIDGE, *supra* note 39, at 53 (“[D]espite occasional academic arguments to the contrary, the shareholder wealth maximization norm indisputably is the law in the United States.”); Leo E. Strine, Jr., *Human Freedom and Two Friedmen: Musings on the Implications of Globalization for the Effective Regulation of Corporate Behavior*, 58 U. TORONTO L. J. 241, 264 (2008) (“As a practical matter, the American corporate law question of the corporation’s purpose has been settled in favour of stockholders.”). Even critics of the shareholder wealth maximization norm concede that, “as pure description, Hansmann and Kraakman’s portrayal is more right than wrong.” KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS & PROGRESSIVE POSSIBILITIES* 22 (2006).

134. See KRAAKMAN ET AL., *supra* note 132, at 28 (describing the argument that “focusing principally on the maximization of shareholder returns is, in general, the best means by which corporate law can serve the broader goal of advancing over-all social welfare”); Hansmann & Kraakman, *supra* note 133, at 441 (explaining that the elevation of shareholder interests comports with maximizing societal returns); Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1200 (“[T]he best argument for shareholder primacy does not rest on its benefits for shareholders alone. Rather, it rests on the notion that shareholder primacy is a second-best solution that is good for *all* the stakeholders in the firm, because it limits what might otherwise be the runaway agency costs that might be incurred by all if directors were not held to a clear and easily observed metric of good corporate governance.”); Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001) (shareholder wealth maximization may be the most efficient governance norm because “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”). Professor Greenfield offers a critical view of this line of argument. GREENFIELD, *supra* note 133, at 22 (“This is simply the trickle-down theory superimposed onto corporate law: what is good for shareholders is good for corporations, and what is good for corporations is good for society.”).

135. See Stout, *supra* note 134, at 1201 (“[T]he question ultimately cannot be answered *except on the basis of empirical evidence*. Before we know whether social wealth is best promoted by a rule of shareholder primacy or a rule that allows directors discretion to consider other stakeholders, we must actually know the costs and the benefits that flow from each rule.”).

However, given the structure of corporate law, there are substantial reasons to doubt the accuracy of the claim. A brief description of this structure is necessary to explain the critique.

As described above, corporate law statutorily creates a strong, centralized management in public companies. These managers are tasked with deploying the firm's assets to generate wealth for the company and its shareholders.¹³⁶ They are also afforded extraordinarily broad discretion concerning how to achieve this objective; illegality is the only constraint on the pursuit of profits.¹³⁷ Put differently, corporate law does not impose mandatory social or moral obligations on companies or their managers.¹³⁸ Some commentators take this lack of legal obligation one step farther—as Milton Friedman famously asserted, “the social responsibility of business is to increase its profits.”¹³⁹

Due (at least in part) to this structure, corporations are exceedingly successful at generating wealth—indeed, the modern corporation has been termed “the basis of the prosperity of the West and the best hope for the future of the rest of the world.”¹⁴⁰ Yet, creating this wealth almost always also entails generating costs, only some of which are internalized by the firm itself.¹⁴¹ In the language of economics, costs not borne by the firm are termed “negative externalities.”¹⁴² Profit-maximizing firms have strong

136. See, e.g., Strine, *supra* note 34, at 2 (“I believe that the generation of durable wealth for its stockholders through fundamentally sound economic activity, such as the sale of useful products and services, is the primary goal of the for-profit corporation.”).

137. See, e.g., Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L. J. 629, 640 (2010) (“[O]ne of the most important Delaware corporate lawyers involved in the last comprehensive revision of the DGCL, S. Samuel Arshat, was said to have described the essence of Delaware corporate law as follows: ‘Directors of Delaware corporations can do anything they want, as long as it is not illegal, and as long as they act in good faith.’ That statement is only a bit exaggerated.” (internal citations omitted)). Some scholars even question the legitimacy of this boundary. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155, 1168 n.36 (1982) (arguing that “[m]anagers have no general obligation to avoid violating regulatory laws, when violations are profitable to the firm”). For a thoughtful critique of this position, see GREENFIELD, *supra* note 133, at 73–105.

138. To the contrary, managers' fiduciary obligations run exclusively to the corporation and its shareholders. See WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 296 (3d ed. 2009) (“That director loyalty to the ‘corporation’ is, ultimately, loyalty to equity investors is an important theme of U.S. corporate law.”). The merits of this model have been debated for nearly a century. Compare Adolph A. Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (arguing that “all powers granted to a corporation or to the management of a corporation, or to any group within the corporation . . . [are] at all times exercisable only for the ratable benefit of all the shareholders as their interest appears”), with E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932) (asserting that “the business corporation as an economic institution . . . has a social service as well as a profit-making function”).

139. Friedman, *supra* note 32, at 32 (emphasis added).

140. JOHN MICKLETHWAIT & ADRIAN WOOLRIDGE, *THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA* 77 (2003) (asserting that the corporate form has “improved the living standards of millions of ordinary people, putting the luxuries of the right within the reach of the man in the street”); see also Yosifon, *supra* note 33, at 1234–35 (noting the “great efficiencies . . . that corporate organization provides”).

141. See GREENFIELD, *supra* note 133, at 16 (noting that “most companies create a huge range of externalities”).

142. In this context, negative externalities are “the costs or burdens that [a corporation] creates for others

incentives to shift costs and risks onto third parties.¹⁴³

Yet corporate law is unconcerned with the negative externalities arising from corporate activities.¹⁴⁴ This parochial view is traditionally justified by the assertion that external regulation (such as labor laws, consumer protections regulations, environmental codes, and the like) adequately constrains corporate behavior that society deems too costly.¹⁴⁵ However, society is only better off if these regulations impose penalties stringent enough to deter inefficient transactions.¹⁴⁶ Thus, corporate law is ultimately a paean to Messrs. Kaldor and Hicks.¹⁴⁷ Its core purpose is to maximize aggregate corporate wealth; efficiency and distributional concerns are left to others.¹⁴⁸

From this perspective, corporations are much like Holmes' "Bad Man," pursuing their self-interest (i.e., profit maximization) and constrained only by the laws around them.¹⁴⁹ But corporations are not, like the Bad Man, outsiders to the law; they are

but for which it doesn't pay." CLARK, *supra* note 22, § 1.4, at 31 n.10.

143. LAWRENCE MITCHELL, CORPORATE IRRESPONSIBILITY 49–65 (2001) (terming the corporations as "externality machine[s]").

144. See, e.g., CLARK, *supra* note 22, § 1.4, at 30 ("Students studying corporate law for the first time are often puzzled or angered by the failure of legal doctrines they encounter to do anything toward the effective solution of numerous social problems caused by corporations. . . . [T]raditionally, the subjects of corporation law and securities regulation are simply defined to deal only with relationships between shareholders and managers (directors and officers), i.e., with the most capitalistic of relationships affecting capitalist enterprise.").

145. See, e.g., *id.* at 31 ("The general public is thought to be protected against some major negative externalities of corporations . . . by a set of extremely complex federal statutes and the rules and administrative activities thereunder . . ." (internal citations omitted)); Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1431 (1993) ("General welfare laws designed to deter corporate conduct through criminal and civil sanctions imposed on the corporation, its directors, and its senior officers are . . . [i]n the long run . . . probably more efficient [than forcing shareholders to internalize costs through liability]."); Yosifon, *supra* note 33, at 1201–02 ("Even where such problems [i.e., negative externalities] emerge, however, the standard account insists that the solution does not reside in altering the shareholder primacy norm at the heart of firm governance. Instead, firms should be restrained from engaging in such exploitative conduct by external governmental regulation, such as labor laws, consumer protection statutes, and environmental codes.").

146. Most commentators would also require an acceptable distribution pattern. See, e.g., CLARK, *supra* note 22, § 16.4, at 702 (noting that this "viewpoint has great strengths but presupposes and depends on a just distribution of wealth and acceptable institutional arrangements in government"); KRAAKMAN ET AL., *supra* note 132, at 28 n.79 (advocating for a broader measurement of social welfare).

147. The Kaldor-Hicks criterion states that a transaction is efficient if the resulting wealth gain is sufficiently large that the "winners" could compensate the "losers" and still be in a better position than when they started. No actual compensation is required, though. ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 43–44 (2d ed. 1997).

148. CLARK, *supra* note 22, § 16.2, at 678 ("The duties to all other groups need simply be satisfied—they function as constraints—but the duty to shareholders is open-ended: Profits should be made as large as possible, within the constraints.").

149. Jill E. Fisch, *The "Bad Man" Goes to Washington: The Effect of Political Influence on Corporate Duty*, 75 FORDHAM L. REV. 1593, 1609 (2006) ("Because the corporation lacks an internal moral perspective, it, like the bad man, is constrained only through legal limits."); Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 135–36 (2012) ("I confess to bearing weary of the naivete . . . [manifested by the fact that i]nstead of recognizing that for-profit corporations will seek profit for their stockholders using all legal means available, we imbue these corporations with a personality and assume they are moral beings capable of being 'better' in the long-run than

intimately involved in the lawmaking process.¹⁵⁰ Indeed, for many companies, political activity is simply another means to the end of profit maximization.¹⁵¹ Corporations, lacking a societal point of view, have strong incentives to oppose efficient regulation, if such laws constrain their ability to externalize costs and thereby maximize profits.¹⁵²

Until recently, this public choice problem was only rarely acknowledged in corporate law scholarship.¹⁵³ When it is discussed, the typical assertion is that the “proper response . . . is to insulate the political and regulatory realms from corporate influence.”¹⁵⁴ And, though one might legitimately question their efficacy and scope, federal laws regulated corporate political activity for more than a century.¹⁵⁵ However, post-*Citizens United*, which struck down one of the last remaining campaign finance laws on First Amendment grounds, this path is now constitutionally foreclosed.¹⁵⁶ There is no longer any legal distinction between firms maximizing their value through operational improvements or pursuing profits by changing legal and regulatory regimes to their advantage. If one assumes, as both persuasive theory and empirical evidence suggest,¹⁵⁷ that public corporations can effectively influence legislative and rule-

the lowest common denominator.”).

150. See Fisch, *supra* note 149, at 1604 (“From a static perspective, this analysis makes sense. If the corporation, like the Holmesian bad man, is an outsider to the law, legal rules are the appropriate mechanism for ensuring that the corporation acts in accordance with societal values. Unlike the bad man, however, the corporation is not external to the lawmaking process; corporations actively participate in the process of creating, molding, and modifying those rules.”).

151. *Id.* at 1607 (“Political activity is an integral component of a corporation’s business strategy.”).

152. Yosifon, *supra* note 33, at 1203 (“Because regulation threatens to diminish profits, and because directors are given the fiduciary obligation to pursue profits, combating the development and implementation of regulation becomes an important aspect of the firm’s work.”).

153. *Id.* at 1204. Dean Clark, as is often the case, proves an early exception. See CLARK, *supra* note 22, § 16.2, at 683 (“A more debatable form of corporate activity outside of normal business operations consists of corporate political activities, including expenditures for political speech.”).

154. Yosifon, *supra* note 33, at 1204.

155. See, e.g., Fisch, *supra* note 149, at 1609 (noting that Tillman Act of 1904 was passed, in part, as “an effort to reduce corporate political influence”).

156. See *Citizens United v. Fed. Election Comm’n*, 558 U.S. 310, 365 (2010). I am not suggesting that *Citizens United* opened the floodgates to corporate political activity as a doctrinal matter. To the contrary, corporations have long been able to lobby, engage in issue advocacy, and otherwise express their political views beyond the realm of independent campaign expenditures. As noted by Michael Kang, though, the absolutist language employed by the Court in rejecting the anticorruption/antidistortion rationale upon which most campaign finance regulation was premised “marks the end of campaign finance law as we knew it.” Michael S. Kang, *The End of Campaign Finance Law*, 98 VA. L. REV. 1, 21 (2012).

157. The literature on this question is voluminous. See, e.g., Robert H. Sitkoff, *Corporate Political Speech, Political Extortion, and the Competition for Corporate Charters*, 69 U. CHI. L. REV. 1103, 1113 (2002) (asserting that there is “a plausible argument that the corporate form furnishes a competitive advantage in the market for legislation” and setting out a theoretical model); Yosifon, *supra* note 33, at 1205–12 (detailing public choice treatment of regulatory capture, including the capture of corporate law itself); Letter from Michael Hadani, Assistant Professor of Mgmt., Long Island Univ., to Elizabeth Murphy, Sec’y, SEC 7–8 (Oct. 13, 2011), available at <http://www.sec.gov/comments/4-637/4637-8.pdf> (in connection with conducting a meta-analysis of seventy-one studies, spanning the prior thirty-two years, concerning the impact of corporate political spending and concluding that “firms petitioning or contacting regulatory agencies tend to significantly reduce regulatory action and thus benefit their bottom line”). Hadani also notes, though, that PAC expenditures and lobbying were only weakly correlated with congressional voting outcomes. *Id.* at 8. Of course, since much corporate political spending is opaque, it is impossible at present to measure the effects comprehensively. See,

making processes, we might legitimately be concerned that the “rules of the game” no longer constrain behavior that society deems too costly (be it rent seeking, the imposition of negative externalities, or matters of distributional efficiency). The realities of globalized capital and product markets, with their associated competitive pressures, only serve to amplify this concern.¹⁵⁸ Thus, as at least one commentator argues, the external regulation justification for the shareholder wealth maximization norm is an “analytic dead end.”¹⁵⁹ At the very least, while the ability to change the rules of the game might be constitutionally protected, one might nevertheless question its legitimacy when undertaken by an entity with no moral compass.¹⁶⁰

From the point of view of the firm (though I hesitate to reify the entity), corporate political activities are just another transaction that must be subjected to a cost-benefit analysis, the expected value of which should be considered alongside other allocations of corporate resources. Yet, to society, these activities are qualitatively different from ordinary business transactions. Accordingly, if corporations have a constitutionally protected right to participate in shaping the very laws that govern them, *moral agents*, and not just economic agents, should guide their activities.

V. OBSTACLES TO SHAREHOLDER MORAL AGENCY

At least at a glance, people who invest in public companies have moral preferences.¹⁶¹ They invest capital in public companies with the hope of generating financial returns, but wealth maximization is not necessarily their only objective.¹⁶² That is, shareholders may have boundaries that they would prefer not be crossed in pursuit of profits. For example, shareholders may not want the companies in which they invest to break the law, obtain goods or services from contractors that do not

e.g., *id.* at 9–10 (“One thing thwarting a full assessment of future corporate treasury spending is the lack of transparency currently imposed on publicly traded companies, which constrains researchers and investors from fully assessing the scope and impact of post-*Citizens United* [corporate political activity].”).

158. *See, e.g.*, Strine, *supra* note 149, at 167 (arguing that globalized markets create a greater need for regulation in the public interest).

159. Yosifon, *supra* note 33, at 1203.

160. *See* Fisch, *supra* note 149, at 1609 (“[C]orporate law sets forth the corporation’s purpose as the maximization of firm value subject to applicable legal rules. The corporation’s effort to challenge legal limits may be seen as an illegitimate attempt to privilege the goal of profit maximization over those legal limits that qualify this very goal.”); Robert B. Reich, *The New Meaning of Corporate Social Responsibility*, 40 CAL. MGMT. REV. 8, 16 (1998) (“Companies have no independent moral or legal authority to use their resources to influence the creation of laws defining their responsibilities to stakeholders other than investors.”). Milton Friedman’s take on this point is particularly intriguing: “[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game” Friedman, *supra* note 32, at 124. Of course, Friedman was not speaking directly of corporate political spending. Rather, he was referring to free competition without deception or fraud. So, one might argue that corporate political spending is now just part of the “rules of the game.” But query Friedman’s opinion of the legitimacy of efforts to repeal or water down the antitrust regime (ostensibly intended to ensure open and free competition) or antifraud regulations?

161. *See, e.g.*, Grant Hayden & Matthew T. Bodie, *Shareholder Democracy and the Curious Turn Toward Board Primacy*, 51 WM. & MARY L. REV. 2071, 2095 (2010) (“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.”).

162. Even if they favor pure wealth maximization, that too is a moral choice.

adhere to certain minimal worker-safety standards, or deploy corporate funds for political activities—even if such conduct would raise the company’s stock price. In the language of welfare economics, shareholder *welfare* is not necessarily identical to shareholder *wealth*: Wealth generation is only one (admittedly significant) variable in shareholders’ utility functions, which may also include concern for certain negative externalities that arise from corporate conduct.

Yet, when it comes to creating those externalities, many view shareholders as the problem, not the solution. Shareholders, acting through the pressures of the capital markets, are typical characterized as one of the main drivers of the profit-maximization norm.¹⁶³ Indeed, many corporate law scholars assume away any divergence between shareholder wealth and shareholder welfare.¹⁶⁴ Accordingly, to the extent that corporate law scholars advocate in favor of any corporate constituency acting as moral agents, managers—not shareholders—are often the chosen actors.¹⁶⁵

The arguments against shareholders acting as moral agents fall into two general categories. The first is behavioral: due to the separation of ownership from control inherent in modern public corporations, shareholders are legally divorced from the salutary pressures of social and moral norms which might otherwise guide their behavior. In this view, we should rely on managers to act as moral agents for the company. The second is structural: most shareholders do not invest directly in corporations, but rather do so through financial intermediaries such as mutual funds, index funds, or pension funds, and as such could not vote on social policy bylaws even if they wanted to.

A. *A Brief Inquiry into the Merits of Managers Versus Shareholders as Moral Agents*

The standard argument in favor of managerial moral agency, argued most forcefully by Einer Elhauge, is as follows. While corporations are barred from engaging in unlawful activity, it is extraordinarily unlikely that legal sanctions will deter, condemn, or detect all conduct deemed socially undesirable.¹⁶⁶ We thus rely on social sanctions and moral norms to supplement this system, and guide people towards

163. See, e.g., Elhauge, *supra* note 131, at 799 (“[W]e should expect corporate shareholders to be more relentless than other business owners in pressing managers for unabashed profit-maximizing untempered by social consequences”); GREENFIELD, *supra* note 133, at 22 (critiquing shareholder primacy); Strine, *supra* note 149, at 136 (arguing that “firms subject to pressures to deliver short-term profits for their stockholders pose a serious risk of generating societally destructive externalities”).

164. See, e.g., Bainbridge, *supra* note 145, at 1433 n.35 (The “[a]nalysis should begin with the assumption that wealth maximization is a significant part of the utility function for virtually all investors. Once we move beyond this common goal, the probability is very high that the shareholders’ nonwealth concerns will vary considerably. In a large and diverse shareholder community, the nonwealth components of the collective utility function are thus likely to wash. Shareholder wealth maximization therefore becomes not just the lowest common denominator, but the only common denominator.”); Ribstein, *supra* note 14, at 1029 (arguing that diversified “shareholders may have little idea which stocks they are holding and are concerned only with the total risk and return of their portfolio”); Strine, *supra* note 133, at 264 nn.65–66 (expressing skepticism that most investors have non-wealth-maximizing objectives and noting that only nine percent of professionally managed assets were in so-called socially responsible investments).

165. The seminal example is Einer Elhauge, who argues that “[m]anagerial discretion to sacrifice corporate profits is both inevitable and affirmatively desirable.” Elhauge, *supra* note 131, at 868.

166. *Id.* at 748.

socially desirable conduct.¹⁶⁷

But, the modern structure of large corporations shields shareholders from much of the weight of those social and moral sanctions. Sole proprietors, as both owners and managers, feel the full brunt of both profit-maximizing motivations and reputational/moral norms, and would thus balance the two according to their own welfare preferences.¹⁶⁸ However, modern corporate structure separates equity ownership from active management. In doing so, it—at least plausibly—shields shareholders from that calculus, due to their distance from management and relative anonymity.¹⁶⁹ Moreover, ordinary shareholders are largely ignorant about the day-to-day operations of the companies in which they invest, and thus often disconnected from the social effects of those operations.¹⁷⁰ Finally, even if they were inclined to act on moral impulses, dispersed shareholders face a collective action problem that impedes any such action.¹⁷¹

By contrast, managers are the public face of the corporation and are intimately involved in the firm's operational activities.¹⁷² Thus, managers are more fully exposed to the salutary moral and social norms described above than shareholders.¹⁷³ Based on this analysis, Elhauge concludes that “[m]anagerial responsiveness to social and moral sanctions should thus compensate for shareholder pressure to ignore those social and moral sanctions.”¹⁷⁴

Elhauge's construct is powerful—in theory—but it is insufficient to preclude empowering shareholders' moral agency through the bylaw power.¹⁷⁵ Initially, one might question whether the practical effect of social and reputational sanctions on corporate managers is as large as Elhauge's theoretical model implies. As Oliver Williamson notes, “the efficacy of reputation effects is easily overstated.”¹⁷⁶ Ultimately, this is an empirical question that I do not attempt to answer fully here,¹⁷⁷

167. *Id.* at 749–56.

168. *Id.* at 797.

169. *Id.* at 798.

170. *Id.* at 798–99.

171. *Id.* at 799–800.

172. *See id.* at 800 (noting that managers are not only aware of the corporation's actions, but also have the most interaction with the public).

173. *Id.* (“Managers will know what the corporation is doing and see its effects sufficiently to experience moral guilt for causing any ill effects that violate moral norms.”).

174. *Id.*

175. To be clear, Professor Elhauge's core claim is that managers should be granted more discretion to act in the public interest. *Id.* at 804. While he tangentially argues that shareholders are not up to the task, he does not directly consider the possibility of shareholder bylaws addressing social policy.

176. OLIVER E. WILLIAMSON, *THE MECHANISMS OF GOVERNANCE* 116 (1996). Indeed, even the staunchest opponents of shareholder empowerment are skeptical of relying on managers to pursue the public good. *See, e.g.,* Bainbridge, *supra* note 145, at 1434 (“One who relies on management's moral sense to prevent corporations from externalizing certain costs relies upon a very thin reed indeed.”).

177. In fact, as Mark Roe suggests, the question may not have a clear answer.

Possibly there's no one right view here. . . . The situation might vary from industry to industry, from owner to owner, from one manager to another, or from time to time. But as a matter of logic and observation, it's not clear and certain that it's the owner-manager who is always the ideal type that we'd want social policy to replicate.

Mark J. Roe, *On Sacrificing Profits in the Public Interest*, in ENVIRONMENTAL PROTECTION AND THE SOCIAL

but there are several plausible reasons to believe that the effects are not as strong as Elhauge suggests. First, conduct must be visible to attract reputational and social sanctions. Perhaps recognizing this point, corporations increasingly attempt to shield controversial conduct, such as corporate political activity, from public view.¹⁷⁸ Relatedly, the full impact of antisocial or unpopular corporate behavior is often only visible *ex post*—sometimes long after the decisions that set those events into motion. This gives rise to last-period problems, as CEO turnover is relatively high, and many high-level executives are close to retirement in any event.¹⁷⁹

Second, the substantial economic gains on offer for maximizing corporate profitability might overwhelm potential social or reputational sanctions, and even managers' own moral impulses. Recent behavioral research suggests that high-powered incentive compensation schemes, which are now ubiquitous for public company executives, discourage acting conscientiously and encourage opportunistic behavior in at least three interrelated ways.¹⁸⁰ So-called "pay-for-performance" compensation tends to crowd out prosocial behavior by managers who might otherwise be capable and willing to heed the voice of their conscience.¹⁸¹ Additionally, through selection effects, such compensation schemes are likely to attract those whose character already tends towards the opportunistic.¹⁸² The combination of these two phenomena—subverting prosocial behavior and increasing the number of opportunistic colleagues—tends to drive out the remaining prosocial actors.¹⁸³ As explained by William Black, strong incentive compensation structures thus lead to a "Gresham's dynamic[] in which bad ethics drives [out] good ethics."¹⁸⁴

Third, we might challenge directly the strength of reputational sanctions. Even in the aftermath of massive, highly publicized failures, executives and even *moreso* directors of large corporations emerge with their professional reputations relatively unscathed. To be sure, executives are often fired, and board members replaced, after major corporate fiascos.¹⁸⁵ Yet, there is ample evidence that the reputational damage

RESPONSIBILITY OF FIRMS 88, 93–94, (Bruce L. Hay et al. eds., 2005).

178. See, e.g., Hadani, *supra* note 157, at 10 (noting that "on average companies that spend the most on political activities are in reality the ones disclosing the least information about their political activity to outsiders, such as shareholders" (citing DONALD H. SCHEPERS & NAOMI A. GARDBERG, BARUCH INDEX OF CORPORATE POLITICAL DISCLOSURES: 2010 RESULTS 3 (2011))).

179. See, e.g., Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1088 (2007) (discussing turnover rate and executive age); Usha Rodrigues, *Corporate Governance in an Age of Separation of Ownership from Ownership*, 95 MINN. L. REV. 1822, 1834 (2011) (noting that "managers naturally bias towards the short term").

180. See, e.g., Lynn A. Stout, *Killing Conscience: The Unintended Behavioral Consequences of 'Pay For Performance'* 4–11 (March 2010) (unpublished manuscript), available at <http://www.law.leeds.ac.uk/assets/files/research/cblp/conf-jan13/killing-conscience.pdf> (canvassing behavioral science research).

181. *Id.* at 25.

182. *Id.* at 26.

183. *Id.* at 26–27.

184. See, e.g., *Examining Lending Discrimination Practices and Foreclosure Abuses: Hearing Before the S. Comm. on the Judiciary*, 112th Cong. 3 (2012) (statement of Prof. William K. Black, UMKC School of Law) (internal quotation mark omitted), available at <http://www.judiciary.senate.gov/pdf/12-3-7BlackTestimony.pdf>.

185. See Marne L. Arthaud-Day et al., *A Changing of the Guard: Executive and Director Turnover Following Corporate Financial Restatements*, 49 ACAD. MGMT. J. 1119, 1119 (2006) (finding that "CEOs and

suffered, if any, is exceptionally short-lived.¹⁸⁶ As one industry insider noted, “[i]n too many cases, the radioactivity of a board member of a collapsed company has a half life measured in milliseconds.”¹⁸⁷ This phenomenon manifests itself most prominently in the fact that many CEOs and directors of failed or embattled companies are not removed from their other outside directorships, and some even obtain new ones following their forced departures.¹⁸⁸ For example, as of summer 2011, four former Enron directors still served on public company boards.¹⁸⁹ Others shifted to careers in academia, or simply continued on as executives in other private-sector companies.¹⁹⁰ Perhaps even more surprisingly, given the sheer magnitude of the collapse and concomitant public outcry, an identical pattern emerged from the recent financial crisis. Numerous executives and directors of Citigroup, Merrill Lynch, Lehman Brothers, Wachovia, Washington Mutual, Bear Stearns, and AIG gained new directorships—at some of the largest and most prestigious public companies—shortly after their departures.¹⁹¹

Why does this happen? One significant possibility is that these public failures simply do not materially tarnish reputations within the relevant peer group. In a 2011 survey of executives and directors, more than two-thirds of the respondents answered affirmatively when asked if a board member at a company with “substantial accounting and ethical problems” could be a good board member at another company.¹⁹²

CFOs of firms filing a material financial restatement were more than twice as likely to exit their firms as their counterparts in a matched sample”); David F. Larcker & Brian Tayan, *Scarlet Letter: Are the CEOs and Directors of Failed Companies “Tainted”?* 1 (Stan. Closer Look Series, Paper No. CGRP-19, 2011) (noting that “there is elevated turnover in both the executive suite and the boardroom, as companies signal to the market that they are serious about reform”).

186. See Susanne Craig & Peter Lattman, *Companies May Fail, but Directors Are in Demand*, N.Y. TIMES DEALBOOK (Sept. 14, 2010, 8:27 PM), <http://dealbook.nytimes.com/2010/09/14/companies-may-fail-but-directors-are-in-demand/> (noting “how the directors of the companies at the center of the financial crisis—A.I.G., Bear Stearns and Lehman itself—still play an active role in the governance of corporate America”); Joann S. Lublin, *Staying on Boards After Humble Exit*, WALL ST. J., June 6, 2011, at B1 (noting that “[a] surprising number of embattled CEOs, forced out for poor performance or legal problems, find a warm reception from outside corporate boards on which they sit”); Elizabeth G. Olson, *CEO Careers: A Case of Rinse and Repeat?*, CNN MONEY (Sept. 16, 2011, 11:43 AM), <http://management.fortune.cnn.com/2011/09/16/ceo-careers-a-case-of-rinse-and-repeat> (“One thing seems certain: When executives or board members head for the exit—for whatever reason—they often don’t get tagged as tainted. In fact, they regularly pop up again on the corporate landscape in similar jobs with little apparent damage to their careers.”).

187. Craig & Lattman, *supra* note 186 (quoting John Gillespie, “a longtime Wall Street investment banker”).

188. See, e.g., Larcker & Tayan, *supra* note 185, at 1 (“Recent experience suggests that many CEOs and directors of failed companies are able to retain outside directorships—and even obtain new ones—following their forced departures.”).

189. See Steven M. Davidoff, *Ex-Directors of Failed Firms Have Little to Fear*, N.Y. TIMES DEALBOOK (Aug. 2, 2011, 8:56 PM), <http://dealbook.nytimes.com/2011/08/02/ex-directors-of-failed-firms-have-little-to-fear>.

190. *Id.*

191. See Larcker & Tayan, *supra* note 185, at 1, 3 (documenting current directorships, including positions at TD Ameritrade, JPMorgan Chase, Con Edison, Sony, Altria, Dow Chemical, Hewlett-Packard, Occidental Petroleum, Nike, Walt Disney).

192. *Id.* at 4. As to ex-CEOs in similar companies, the respondents were more judgmental, yet still over thirty-seven percent concluded that such an individual could be a valuable board member at another company. *Id.* at 1, 4.

Moreover, despite the fact that the vast majority of large public companies have board-resignation policies (i.e., stated policies that require outside directors to resign, among other things, if their professional status changes), boards rarely accept such resignations after a member leaves a CEO position, regardless of the reason for such departure.¹⁹³ As Eleanor Bloxham, president of a board advisory firm explained, “[i]t’s part of the ‘not giving up on your friends’ kind of thing.”¹⁹⁴ Former Citigroup CEO Charles Prince, who resigned his position following catastrophic losses related to the bank’s involvement in the mortgage-backed securities market,¹⁹⁵ is the prototypical example of this collegiality. Upon his departure from Citigroup, Prince attempted to resign his contemporaneous board position at Johnson & Johnson.¹⁹⁶ Not only did the company refuse to accept the resignation, Prince remains head of the board’s compensation committee, where he recommends the appropriate payment schemes for the firm’s executives and board members.¹⁹⁷ Johnson & Johnson’s lead independent director defended these decisions on the basis that Prince was still “a valuable member” of the board and “had done the honorable thing” by resigning from Citigroup.¹⁹⁸

All of the above calls into question claims of strong social or reputational effects working on corporate managers. Thus, it’s far from clear that such managers are categorically more attuned to the public interest than shareholders. Nevertheless, it is important to recall that empowering shareholders to enact social policy bylaws does not remove managers’ discretion to act in the public interest. By default, there are no constraints on managerial authority. Accordingly, unless and until a voting majority of the company’s shareholders overcome their collective action problem and act in favor of a particular restriction or regulation, managerial discretion is unfettered. Thus, Elhauge’s observations about shareholders’ informational gaps and collective action problems carry much less weight with respect to the question addressed here. If shareholders never exercise their powers, we will be no worse off than the status quo. If, on the other hand, shareholders propose uneconomic restrictions on corporate activity, the board remains free to state its case and thereby bridge the informational gap by providing shareholders with an insider’s appraisal of the true costs of such a course of conduct.¹⁹⁹

B. *Structural Impediments to Shareholder Moral Agency*

There is also a structural challenge to empowering shareholders as moral agents: most public company shareholders are not actually people. Rather, the majority²⁰⁰ of

193. Lublin, *supra* note 186 (“Still, many governance watchers and veteran directors say boards rarely accept a resignation after a member loses a CEO spot—no matter the reason.”).

194. *Id.*

195. See *Statement from Citigroup on the Resignation of C.E.O. Charles O. Prince III*, N. Y. TIMES, Nov. 5, 2007, http://www.nytimes.com/2007/11/05/business/05citi-text.html?_r=0 (announcing the retirement of Charles Prince, Chairman and Chief Executive Officer of Citigroup).

196. Lublin, *supra* note 186.

197. *Id.*

198. *Id.* (quoting James G. Cullen).

199. One could argue that such a dialogue, in which shareholders are forced to confront the trade-offs associated with their decisions, is intrinsically valuable.

200. See Strine, *supra* note 34, at 10 (noting that institutional investors control nearly seventy percent of

publically traded equity is held by institutional investors such as mutual funds, public and private pension funds, and insurance companies.²⁰¹ Retail investors often do not hold a direct equity interest (and thus do not vote) in the companies in which they invest, but instead rely on financial intermediaries to act in their best interests.²⁰²

This “separation of ownership from ownership” poses several problems for corporate governance generally,²⁰³ but one key problem for the expansion to the bylaw power described herein. At present, that power would not, in large part, be exercised by the individuals who have invested their capital in the company, but would instead fall to the institutional investors themselves.²⁰⁴ The motivations of these intermediaries are varied: some, like hedge funds, have short-term profits as their stated goal, others, like actively traded mutual funds, seek to outperform a particular index or benchmark over a given period, still others merely attempt to track that index. Collectively, though, their aims are largely economic.²⁰⁵ Put differently, fund managers—like corporate managers—face substantial impediments to acting as moral agents, and, even if they did, we face the same problem as above concerning why we would delegate this decision-making power to a group of agents that may not represent the moral views of their principals.

VI. CONCLUSION

Modern public companies need moral agents. Corporate law can empower shareholder moral agency by allowing shareholders to enact bylaws that restrict managerial discretion as to matters of social policy. While this would be an expansion

U.S. publicly traded equities). The exact ratio depends on the sample and the time period. See Rodrigues, *supra* note 179, at 1828 n.27 (noting that in 2009, institutional investors owned fifty percent of total U.S. equities, and in 2007, owned more than seventy-six percent of the largest 1,000 companies). In any event, institutional ownership has increased markedly over the past few decades. See Jennifer S. Taub, *Money Managers in the Middle: Seeing and Sanctioning Political Spending After Citizens United*, 15 N.Y.U. J. LEGIS & PUB. POL’Y 443, 461 (2012) (citing JAMES P. HAWLEY & ANDREW T. WILLIAMS, *THE RISE OF FIDUCIARY CAPITALISM: HOW INSTITUTIONAL INVESTORS CAN MAKE AMERICA MORE DEMOCRATIC* xii (2000)) (noting that in the 1970s, individual investors owned about eighty percent of U.S. corporate equity).

201. Taub, *supra* note 200, at 461.

202. *Id.* at 449, 469.

203. Rodrigues, *supra* note 179, at 1828 (citing Leo E. Strine Jr., *Why Excessive Risk-Taking Is Not Unexpected*, N.Y. TIMES DEALBOOK (Oct. 5, 2009, 1:30 PM), <http://dealbook.nytimes.com/2009/10/05/dealbook-dialogue-leo-strine/>); see also *id.* at 1829 (describing the added layer of agency costs created by financial intermediaries); Taub, *supra* note 200, at 449 (“Institutional shareholders are often managing the money of real people who count on the institutions to cast proxy votes in their interests. Yet these institutions often have business reasons to side with corporate managers rather than the investors who entrust them to manage their money.”).

204. See Taub, *supra* note 200, at 448 (“But by granting shareholders voting rights over political spending, power would not shift to the real individual investors who have their capital at risk. Instead, such a requirement would simply shift authority from corporate managers to giant institutional investors who hold more than 70% of the shares in the largest U.S. public companies.”).

205. It is worth noting, however, that many of the most active institutional investors, such as pension funds, are probably the least likely to be motivated purely by short-term profits, and pursue, to some degree, their vision of the long-term and public good. See Roe, *supra* note 177, at 93 (“And today the most active institutional investors (public pension funds, AFL-CIO) are the least likely to be solely profit-oriented and the most likely to look to wider social values.”).

of the current scope of the shareholder bylaw power, it is consistent with the deeper structure of Delaware corporate law. Moreover, it is a limited intervention. By default, managers are empowered to direct the company's affairs in any way they see fit, within the boundaries of the law; shareholders' ability to restrict that discretion would arise only in those circumstances where they could overcome their collective action problems and achieve a broad consensus. Thus, it may well be that successful shareholder action on this front would be rare.

Nevertheless, mainstream corporate scholarship views shareholders as the problem, not the solution, in this regard; they, not managers, are the ones single-mindedly focused on maximizing their own wealth. Critics present both behavioral and structural arguments against shareholder empowerment. As to the former, opponents of shareholder empowerment argue that reputational and social sanctions—felt strongly by managers, and either weakly or not at all by diffuse, anonymous, and remote shareholders—cause managers to act in prosocial ways. There are several reasons to doubt this conventional wisdom. First, there is a growing body of research illustrating that shareholders do not, in fact, have homogenous preferences for wealth maximization. As Chancellor Strine stated, albeit in a different context:

Delaware law should not be based on a reductionist view of human nature that simplifies human motivations on the lines of the least sophisticated notions of the law and economics movement. *Homo sapiens* is not merely *homo economicus*. We may be thankful that an array of other motivations exist that influence human behavior; not all are any better than greed or avarice, think of envy, to name just one. But also think of motives like love, friendship, and collegiality, think of those among us who direct their behavior as best they can on a guiding creed or set of moral values.²⁰⁶

Second, there is real-world evidence that the magnitude of social and reputational sanctions is greatly overstated. If that's so, there is no a priori reason to believe that managers are categorically more likely to act in the public interest than are shareholders.

Thus we encounter an important tension: Assuming both managers and shareholders can act in the public interest, what do we do when shareholders and managers disagree? An example from a case mentioned earlier sets the stage nicely. In the 1960s, Dow Chemical was attacked by public interest groups concerning the company's manufacturing of napalm in support of the Vietnam War effort.²⁰⁷ Shareholders of Dow made a proposal to amend the company's constitutional documents to prohibit the sale of napalm "unless the purchaser gives reasonable assurance that the napalm will not be used against human beings."²⁰⁸ In defending its napalm operations, Dow's managers did not claim that it must continue manufacturing in order to maximize profits. To the contrary, Dow's management

proclaim[ed] that the decision to continue manufacturing and marketing napalm was made not *because* of business considerations, but *in spite of*

206. *In re Oracle Corp. Derivatives Litig.*, 824 A.2d 917, 938 (Del. Ch. 2003) (describing the risk of nonfinancial conflicts of interest on special litigation committees of the board of directors tasked with assessing the merits of litigation against other directors).

207. *Sec. Exch. Comm'n v. Med. Comm. for Human Rights*, 404 U.S. 403, 404 (1972).

208. *Id.*

them; that management . . . decided to pursue a course of activity which generated little profit for the shareholders and actively impaired the company's public relations . . . because management considered this action morally and politically desirable.²⁰⁹

I am not taking sides, but simply pointing out that managers' vision of the good society may diverge sharply from that of shareholders, activists, experts, or the popular consensus. We might legitimately believe that public company management possesses special expertise concerning business decisions, and thus insulate from challenge their exercise of business judgment, but why would we consider them expert at determining what is best for society? Put slightly differently, why grant an already powerful group, which in no way resembles or represents the electorate as a whole, the exclusive right to make quasi-political (or in the case of corporate political activity, *actually* political) decisions?

Notwithstanding the above, critics argue that empowering shareholders does not empower the retail investors who provide capital and may have moral preferences. Instead, it simply empowers large, institutional investors who are not actually moral agents, and may in fact have stronger wealth-maximization preferences than do managers.

Rather than disposing of the matter, however, these behavioral and structural critiques point to the way forward. As an initial matter, we must assess more fully the normative merits of empowering shareholders in the limited role delineated herein. In doing so, we should also be clear about the ends that we employ as benchmarks. Is the goal to maximize shareholder welfare or social welfare? Should we consider nonconsequentialist theories of the public good? Depending on the normative theory employed, the answers may depend contextually on the type of social activities regulated.²¹⁰ We must also consider the relative merits of empowering institutional investors as opposed to retail investors. If we wish to empower shareholders to act as moral agents, we should focus on creating a low-cost mechanism by which the ultimate beneficial holders of equity securities can express their moral preferences.

209. *Med. Comm. for Human Rights v. Sec. Exch. Comm'n*, 432 F.2d 659, 681 (D.C. Cir. 1970).

210. As to corporate political activity, I explore these questions in more detail elsewhere. *See generally* Kesten, *supra* note 31.

