BEYOND INTERNAL AND EXTERNAL: A TAXONOMY OF MECHANISMS FOR REGULATING CORPORATE CONDUCT

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Corporate discourse often distinguishes between internal and external regulation of corporate behavior. The former refers to internal decisionmaking processes within corporations and the relationships between investors and corporate managers, and the latter refers to the substantive mandates and prohibitions that dictate how corporations must behave with respect to the rest of society. At the same time, most commenters would likely agree that these categories are too simplistic; relationships between investors and managers are often regulated with a view toward benefitting other stakeholders.

As a result, this Article will seek to develop a taxonomy of tactics available to, and used by, regulators to influence corporate conduct, without regard to their nominal categorization of "external" or "internal" (or "corporate" and "non-corporate") in order to shed light on how those categories both obscure and misdescribe the existing regulatory framework. By reframing the shareholder/stakeholder debate, we can identify underutilized avenues for encouraging prosocial, and discouraging antisocial, corporate action, and recognize areas of contradiction and incoherence in current regulatory policy. Finally, this exercise will demonstrate how corporations, far from being "privately" ordered, are in fact the product of an overarching set of choices made by state actors in the first instance.

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INTRODUCTION

One of the oldest debates in corporate law concerns whether corporations should be run to benefit only their investors, or whether instead corporations should be run with a view to benefitting society as a whole.[1] In many ways, though, that frame is misleading. No one disputes that corporations exist in order to contribute to society and to promote human flourishing. We charter corporations, and develop rules regarding their form, in the expectation that organizers will employ the form to innovate, grow the economy, provide desirable goods and services, and generate wealth for investors, employees, and contracting parties.

At the same time, few would dispute that corporations pose risks to society. Their limited liability feature may create moral hazards that ultimately result in uncompensated harm to third parties. Because corporations may marshal staggering resources contributed by hundreds or thousands of people, they are capable of inflicting injuries on a scale far greater than most individuals acting alone can manage. For good or ill, they may exercise significant influence over the political system, and via sheer size, exert quasi-regulatory power over everyday life, dictating everything from working conditions to consumers' privacy rights.[2]

As a result, we have developed myriad legal systems designed to encourage corporate behavior that society believes to be prosocial, so as to protect all corporate stakeholders. Labor law, environmental law, consumer protection law, and the like, all exist to protect workers, consumers, and communities in general from the harms that corporations can inflict. Simultaneously, corporate and securities laws channel investment toward profitable and productive business activity, while protecting investors from exploitation.

In this respect, then, most commenters are stakeholder primacists, in the sense that they agree that corporations should be run in a manner that contributes to society as a whole, and that legal systems have a role to play in ensuring that they do so.[3] Where disputes arise is not about whether legal rules should encourage the prosocial use of corporate power and discourage its antisocial use, but about whether the *mechanisms* by which the law accomplishes these tasks should vary depending on the corporate stakeholders whose interests are being protected.

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1. *See* William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins*: *Adolf Berle and* The Modern Corporation, 34 J. CORP. L. 99, 143 (2008).

2. *E.g.*, Stacy-Ann Elvy, *Paying for Privacy and the Personal Data Economy*, 117 COLUM. L. REV. 1369 (2017).

3. *See* Stephen M. Bainbridge, *Corporate Social Responsibility in the Night-Watchman State*, 115 COLUM. L. REV. SIDEBAR 39, 45 (2015) [hereinafter Bainbridge, *Corporate Social Responsibility*] (describing this point as "uncontroversial").

In the current system, which is generally understood to be oriented toward "shareholder primacy,"[4] corporate and securities law are viewed as "internal" to the corporation and as such, dictate the architecture of the corporate form and its decisionmaking processes, such as shareholders' governance rights, the procedures by which major corporate decisions are made, and the management responsibilities of certain personnel.[5] Meanwhile, other areas of law, such as antitrust, labor and employment law, intellectual property law, civil rights law, and the like, are conceptualized as "external" regulation, and operate by substantively commanding or prohibiting certain forms of corporate behavior.[6] Thus, one of the central organizing principles for how we legally circumscribe corporate conduct is that the *tools* used in the corporate and securities realm are only appropriate to deploy for the purposes of facilitating investment and wealth creation, while external regulation must only employ *the tools* of command and control.[7] Corporate architecture and decisionmaking processes are said to be solely the province of corporate and securities law, which in turn are solely concerned about facilitating profitable relationships between investors and managers.[8]

As the traditional story has it, in the earliest days of the business corporation, and prior to the growth of the administrative state, there was no regulatory system designed to prevent and punish harmful business activities. Instead, business regulation was accomplished through corporate law. Corporate law rules limited corporate size, capitalization, and activity, in order to enable states to direct economic activity toward particular projects, oversee their development, prevent monopolization,

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4. Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 639, 656 (2016) ("[C]orporate social responsibility has not changed the fundamental division of corporate law, as . . . focused on the relationship of shareholders and directors, and outside legal regimes, which are relied on to regulate specific activity as part of our environmental laws, labor laws, etc.").

5. D. Gordon Smith, *Response: The Dystopian Potential of Corporate Law*, 57 EMORY L.J. 985, 990 (2008) (Corporate law is "the set of rules that defines the decision making structure of corporations.").

6. Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 WM. & MARY L. REV. 2075 (2016).

7. Kent Greenfield, *Proposition: Saving the World with Corporate Law*, 57 EMORY L.J. 948 (2008); Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135 (2012); Pollman, *supra* note 4.

8. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001); Pollman, *supra* note 4; STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 425 (2002) (corporate "externalities should be constrained through general welfare legislation, tort litigation, and other forms of regulations"); Bainbridge, *Corporate Social Responsibility*, *supra* note 3, at 52; Smith, *supra* note 5, at 1008; Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 356–57 (2015).

and protect creditors. Eventually, however, these blanket limits on business activities proved too stifling, and restrictions were loosened. In their stead, specialized areas of law were developed to set substantive limits on the types of business activities that would be required or prohibited.[9]

The rationale for the split was one of efficiency and competency. Substantive limits on corporate behavior could guide business activities more effectively than broad-strokes regulation of the corporate form and could do so without inhibiting beneficial economic expansion. Private parties could effectively contract with the corporation to protect their own interests, subject to regulation in the event of market failure.[10] Government came to be viewed as incompetent to dictate corporate process in a manner that would both protect third parties and advance business goals.[11] Corporate law—namely, internal arrangements among investors and managers—was viewed as a body of private arrangements among contracting parties, providing little reason to regulate terms for the benefit of nonparties.[12]

That origin story, however, is overly simplistic. A plethora of corporate architectural rules still exist primarily, if not exclusively, as mechanisms of regulation for the benefit of non-investor constituencies. Some are controversial—detractors contend they are less effective than substantive regulation[13]—but not all of them are. More generally, even "external" regulation depends on, and assumes the presence of, corporate law rules to function effectively. And today, large corporations are so complex—and their design so heavily structured by law—that it is simply not possible to design rules addressing internal relationships without impacting non-investor constituencies. Refusing to acknowledge this reality only results in unintended consequences and, less benignly, allows interested actors to manipulate corporate regulation to achieve their own externally focused ends.

This Article seeks to develop a taxonomy of mechanisms that can be used to exert social control over corporate conduct, without regard to whether particular strategies are characterized as "external" or "internal." The hope is that, by focusing on how legal rules operate rather than their nominal categorization as "corporate law" or "external law," we can

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9. JAMES WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970, at 161–62 (1970); Adam Winkler, *Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History*, 67 L. & CONTEMP. PROBS. 109, 110–11 (2004); Pollman, *supra* note 4, at 646–47.

10. Hansmann & Kraakman, *supra* note 8.

11. Griffith, *supra* note 6; Hansmann & Kraakman, *supra* note 8, at 446–47.

12. Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CALIF. L. REV. 373, 375–78 (2018); Griffith, *supra* note 6, at 2079.

13. Griffith, *supra* note 6; Steven A. Bank & George S. Georgiev, *Securities Disclosure as Soundbite: The Case of CEO Pay Ratios*, 60 B.C. L. REV. 1123 (2019).

improve our regulatory processes with more strategic interventions that are more mindful of unintended consequences. As the Article will demonstrate, corporate function is dictated by its form, and any attempt to restrict certain tools of corporate regulation solely for use with respect to investors relative to managers is both unwise and, in a real sense, futile.

I. THE FIRST METHOD: CONTROLLING CORPORATE AGENTS

Companies do not act; individuals within them do.[14] Therefore, the most obvious way to control corporate behavior is for the legal system to directly impose obligations on managers to run the corporation in a manner that accomplishes societal goals.

Perhaps the most fundamental legal obligation imposed on corporate managers is the fiduciary obligation to advance shareholder interests, which are assumed to be the attainment of profit.[15] That legal rule exists to ensure that businesses activities are directed toward productive endeavors and to protect investors against exploitation. Some have argued that these duties may incentivize managers to harm third parties in pursuit of profit; as a result, they have proposed expanding them to require consideration of third party interests.[16] Yet the legal obligation of wealth maximization has little practical force and, standing alone, is unlikely to exert much pull on managerial behavior either way; managers are in fact incentivized to pursue wealth maximization by other means, discussed in the next Part.

Beyond fiduciary obligations to shareholders, managers also operate under a host of other legal mandates. If they cause the company to participate in fraud, or environmental contamination, or the production of unsafe products, they will incur direct penalties from relevant authorities. Some statutes may impose penalties on managers based on negligence, or even strict liability, when prohibited acts occur within their scope of authority.[17] The threat of legal sanction (not to mention the collateral consequences that follow) directly incentivize managers to steer corporate behavior in socially preferred directions.

14. Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687 (1997).

15. Ann M. Lipton, *What We Talk About When We Talk About Shareholder Primacy*, 69 CASE W. RES. L. REV. 863, 867 (2019).

16. *See, e.g.*, S. 3348, 115th Cong. § 2 (2018).

17. Thaddeus J. North, Exchange Act Release No. 84500, 2018 WL 5433114 (Oct. 29, 2018); J.S. Nelson, *The Corporate Conspiracy Vacuum*, 37 CARDOZO L. REV. 249, 283–90 (2015).

II. THE SECOND METHOD: ENLISTING PRIVATE ACTORS TO CONTROL CORPORATIONS

Another technique for controlling corporate behavior is to enlist private actors to do the work of policing corporate managers, with the expectation that these private actors will incentivize managers to promote prosocial corporate activity and avoid antisocial activity. This is accomplished by making managers directly accountable to corporate constituencies whose interests are aligned—or whose interests can be *made* to align—with society overall.

This, of course, is the rationale behind the American movement for co-determination.[18] Many commenters have argued that the interests of labor mirror the interests of the country as a whole, and that therefore labor should be given a formal role in selecting corporate managers.[19] Because the managers would be accountable to labor, they would presumably operate the corporation in a manner that accommodates labor's interests.[20]

The current system, however, is more complex. Managers are accountable to shareholders, who are presumed to be concerned about profits.[21] Though the attainment of profit is one desirable corporate activity—profit itself is evidence of meeting some unmet societal need[22]—

18. Grant M. Hayden & Matthew T. Bodie, *Reconstructing the Corporation: A Mutual-Control Model of Corporate Governance* (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3441307; S. 3348, 115th Cong. § 2 (2018).

19. Hayden & Bodie, *supra* note 18, at 68–71.

20. The earliest corporations operated as cooperatives, granting governance rights to those who consumed their services, as a mechanism for ensuring that the corporation operated in the interests of its patrons. Henry Hansmann & Mariana Pargendler, *The Evolution of Shareholder Voting Rights: Separation o-f Ownership and Consumption*, 123 YALE L.J. 948 (2014).

21. In the early days of the large business corporation, the shareholders, rather than labor, were viewed as something of a stand-in for society, so that to represent their interests was roughly equivalent to representing the interests of the broader polity. *See* Bratton & Wachter, *supra* note 1, at 129–30. Modern forms of that theory continue today. *See, e.g.*, Michal Barzuza et al., *Shareholder Value(s): Index Fund Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3439516; Leo E. Strine, Jr., *Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending* (Univ. Pa. Law Sch. Inst. for Law & Econ., Research Paper No. 19-03, Dec. 20, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3304611.

22. Hester M. Peirce, Commissioner, SEC, My Beef with Stakeholders: Remarks at the 17th Annual SEC Conference, Center for Corporate Reporting and Governance (Sept. 21, 2018), https://www.sec.gov/news/speech/speech-peirce-092118 [https://perma.cc/MJQ3-B9UX] ("The company's price, which reflects the market's view

profit-generation is only acceptable to the extent it is accomplished via permissible means. Therefore, a variety of other regulatory mechanisms are used to make profits easier or harder to achieve depending on corporate compliance with social norms. The expectation is that shareholders, in pursuit of profit, will then do *public* work of selecting managers who conform with societal dictates and disciplining those who do not.

Most obviously, regulations can require the confiscation of corporate assets when corporate agents violate the law. These mechanisms are usually governed by principles of vicarious liability, and the resulting loss of profit presumably angers shareholders, who then hold managers to account.[23] Alternatively, the government may provide benefits to the corporation—tax incentives, or regulatory privileges[24]—when the corporation engages in prosocial conduct. Or, the state may use its own purchasing power to favor some types of business conduct over others.[25] The profits occasioned by these programs presumably please shareholders, who are then incentivized to select managers who will steer the corporation in directions favored by the state.

More subtly, the government may enact regulations that enhance or inhibit the ability of *other private actors* to influence corporate profits, by increasing their power vis a vis corporations when bargaining for their own interests. Disclosure regulations—such as those aimed at consumers,[26] employees,[27] and community members[28]—fall into this category, making

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about the company's long-term value, serves a critical role in ensuring that the company is actually meeting the public's needs.").

23. Arlen & Kraakman, *supra* note 14, at 699.

24. Reuven S. Avi-Yonah, *Corporations, Society and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193, 1246–49 (2004).

25. *E.g.*, Steve Janoski, *NJ Won't Buy from Gun Manufacturers, Dealers Who Don't Comply with Safety Rules*, NORTH JERSEY RECORD (Sept. 10, 2019), https://www.northjersey.com/story/news/new-jersey/2019/09/10/nj-blocks-gun-sales-unless-manufacturers-meet-its-safety-rules/2275428001/ [https://perma.cc/HFV8-SAV3]; Aimee Pichi, *Billionaire Ken Fisher's Sexist Comments Have Cost Him Almost $1 Billion*, CBS NEWS (Oct. 18, 2019), https://www.cbsnews.com/news/billionaire-ken-fishers-sexist-comments-have-now-cost-him-almost-1-billion/ [https://perma.cc/HW7S-FUYM]; Ana Swanson, *Chinese Investment Pits Wall Street Against Washington*, N.Y. TIMES (Oct. 28, 2019), https://www.nytimes.com/2019/10/28/business/china-investment-federal-employees.html [https://perma.cc/7C3W-XKA9]; Nathan Heller, *Is Venture Capital Worth the Risk?*, THE NEW YORKER (Jan. 20, 2020), https://www.newyorker.com/magazine/2020/01/27/is-venture-capital-worth-the-risk [https://perma.cc/9Y7S-6J8C].

26. *E.g.*, Scot Burton et al., *Attacking the Obesity Epidemic: The Potential Health Benefits of Providing Nutrition Information in Restaurants*, 96 AM. J. PUB. HEALTH 1669, 1674 (2006).

27. Cynthia Estlund, *Just the Facts: The Case for Workplace Transparency*, 63 STAN. L. REV. 351, 396–97 (2011).

28. Charles M. Lamb et al., *HMDA, Housing Segregation, and Racial Disparities in Mortgage Lending*, 12 STAN. J. C.R. & C.L. 249, 254–60 (2016); Virginia

it easier for stakeholders to insist that their interests be accommodated before profits can be achieved. Labor law, writ large, is also intended to strengthen the bargaining power of employees relative to the corporation, and thus ensure that profits cannot be achieved without labor's buy-in.[29] Ultimately, then, the regulatory framework aligns the interests of shareholders with the interests of the broader society, providing further incentives for shareholders to select managers who will accommodate a wide array of corporate stakeholders.[30]

Critically, the government's role here goes well beyond simply facilitating a market in which private actors may act on their own preferences; regulation may be designed to either inhibit or alter those private preferences. For example, nutrition labeling may be designed to focus consumer attention on calorie counts, which will ultimately incentivize food manufacturers to offer healthier options.[31] Labels may also be used to *obscure* facts about products in order to prevent consumer choices from influencing corporate behavior.[32]

III. THE THIRD METHOD: SHAPING THE CORPORATE FORM TO INFLUENCE ITS FUNCTION

The final tool that can be used to control corporate behavior is the corporate architecture itself, namely, the rules that govern the form, its

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Harper Ho, *Nonfinancial Risk Disclosure and the Costs of Private Ordering*, 55 AM. BUS. L.J. 407, 452 (2018).

29. Brian R. Cheffins, *Corporate Governance and Countervailing Power*, 74 BUS. LAW. 1 (2019).

30. In particularly recursive fashion, the government may threaten penalties against private businesses unless they penalize business partners who fail to adhere to governmentally-mandate standards of conduct. *See* Rory Van Loo, *The New Gatekeepers: Private Firms as Public Enforcers*, 106 VA. L. REV. 467 (2020); *see also* Scott Killingsworth, *The Privatization of Compliance*, *in* TRANSFORMING COMPLIANCE: EMERGING PARADIGMS FOR BOARDS, MANAGEMENT, COMPLIANCE OFFICERS, AND GOVERNMENT 33, 33 (2014).

31. *See generally* Cass R. Sunstein, *Do People Like Nudges?*, 68 ADMIN. L. REV. 177 (2016); Jane Black, *Pizza Chains are Making a Desperate Push to Avoid Posting Calories on Menus*, WASH. POST (Apr. 7, 2017, 7:30 AM), https://www.washingtonpost.com/lifestyle/food/pizza-chains-are-making-a-desperate-push-to-avoid-posting-calories-on-menus/2017/04/06/080a8d5e-18b0-11e7-bcc2-7d1a0973e7b2_story.html ("[M]enu labeling affects corporate as well as consumer behavior.").

32. *See, e.g.*, Alina Selyukh, *What Gets to be a 'Burger'? States Restrict Labels On Plant-Based Meat*, NPR (July 23, 2019, 3:57 PM), https://www.npr.org/sections/thesalt/2019/07/23/744083270/what-gets-to-be-a-burger-states-restrict-labels-on-plant-based-meat [https://perma.cc/T248-RHQB]; Robert V. Percival, *Who's in Charge? Does the President Have Directive Authority Over Agency Regulatory Decisions? Over Agency Regulatory Decisions?*, 79 FORDHAM L. REV. 2487, 2509 (2011); Douglas A. Kysar, *Preferences for Process: the Process/Product Distinction and the Regulation of Consumer Choice*, 118 HARV. L. REV. 525, 584–87 (2004).

internal decisionmaking processes, and how power is allocated among corporate constituents.

Architecture is often described as a mechanism for balancing the interests of investors and ensuring that businesses can be managed profitably. Meanwhile, the strategies above—usually described as "external" to the corporation—are deemed appropriate to mediate the corporation's relationship to the broader society. This is striking because in the context of political theory, it has often been argued that architectural constraints are necessary to effectively cabin power; "external" strategies, such as relying on an outside decisionmaker to set down hard limits, are likely to fail due to capture. James Madison, for example, vigorously contended that merely relying on judicial constraints on state overreaching would fail; limitations on political power needed to be built directly into the government's structure.[33] In the corporate context, a similar argument is advanced by those who object to shareholder primacy: not only may corporations use their wealth and power to influence external decisionmakers,[34] but more subtly, corporate architecture necessarily dictates how the corporation interacts with society. This point is implicitly recognized among corporate governance experts, who justify their preferred arrangements with arguments about everything from encouraging research and development—thus advancing society's technological capabilities[35]—to discouraging risk-taking—thus preventing harms to third parties.[36] Even the well-recognized fiduciary obligation of corporate managers to advance long-term corporate wealth maximization has been characterized as an implicit effort to encourage managers to accommodate non-investor interests.[37]

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33. Brandon L. Garrett & James S. Liebman, *Experimentalist Equal Protection*, 22 YALE L. & POL'Y REV. 261, 272–73 (2004).

34. David G. Yosifon, *The Public Choice Problem in Corporate Law: Corporate Social Responsibility After* Citizens United, 89 N.C. L. REV. 1197, 1205 (2011).

35. *See generally* Rachelle C. Sampson & Yuan Shi, *Are US Firms Becoming More Short-Term Oriented? Evidence of Shifting Firm Time Horizons from Implied Discount Rates, 1980-2013*, STRATEGIC MGMT. J. (forthcoming); MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 122 (1995); Martin Lipton, *Empiricism and Experience; Activism and Short Termism; the Real World of Business*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 28, 2013), https://corpgov.law.harvard.edu/2013/10/28/empiricism-and-experience-activism-and-short-termism-the-real-world-of-business/ [https://perma.cc/LQ2Q-WVXY].

36. Steven L. Schwarcz, *Excessive Corporate Risk-Taking and the Decline of Personal Blame*, 65 EMORY L.J. 533, 556–78 (2015); Pornsit Jiraporn & Sang Mook Lee, *How Do Independent Directors Influence Corporate Risk-Taking? Evidence from a Quasi Natural Experiment*, 18 INT'L REV. FIN. 507 (2018).

37. *See generally* J. B. Heaton, *The "Long Term" in Corporate Law*, 72 BUS. LAW. 353 (2017). Of course, many states' corporate codes explicitly permit corporate directors to make decisions that advance the interests of nonshareholders. *See* Joan MacLeod Heminway, *Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic Documents*, 74 WASH. & LEE L. REV. 939 (2017).

In truth, corporate architecture can be—and often is—employed as a mechanism to control corporate conduct in several ways: to facilitate substantively "good" corporate decisionmaking, to incapacitate corporations from engaging in prohibited behavior, and to provide entry points for public participation in the corporate decisionmaking process. Going further, architecture can construct the actual shareholders who invest in the first place, thus manipulating corporate preferences at a fundamental level.

A. Facilitating "Good" Decisionmaking

The most obvious deployment of corporate architecture in service of a particular goal is the well-recognized expectation that the rules governing the corporate form—shareholder voting, managerial power and qualifications, disclosure obligations, trading regulation, and so forth—will be designed to ensure that corporate managers make "good" business decisions, namely, those that maximize shareholder wealth. The corporate form thus enables the use of a centralized, expert management team, subject to shareholder discipline, while minimizing the opportunity for rent-seeking and conflict among shareholders themselves.[38] Much ink has been spilled about whether optimal designs for this function include independent directors[39] who have particular qualifications,[40] the use of subcommittees,[41] and different types of shareholder voting[42] and information rights.[43] Properly calibrated, it is this design—which balances power among investors, directors, and corporate officers—that

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38. *See, e.g.*, Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 572 (2003); Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 769 (2017).

39. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007); Gregory H. Shill, *Independent Board as Shield*, 77 WASH. & LEE L. REV. (forthcoming 2020) (manuscript at 6), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3454619.

40. Lawrence J. Trautman, *Who Qualifies as an Audit Committee Financial Expert under SEC Regulations and NYSE Rules?*, 11 DEPAUL BUS. & COM. L.J. 205, 213–18 (2013).

41. Shill, *supra* note 39, at 1, 5.

42. Goshen & Squire, *supra* note 38, at 805–10.

43. Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 376 (2013); George S. Geis, *Information Litigation in Corporate Law*, 71 ALA. L. REV. 407 (2019); *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998) ("The duty of disclosure obligates directors to provide the stockholders with accurate and complete information material to a transaction or other corporate event that is being presented to them for action.").

incentivizes managers to pursue shareholders' interests, far more so than the formal fiduciary obligations to which managers are subject.[44]

Though the design may be intended to ensure that corporate managers make wealth maximizing decisions on shareholders' behalf, it is also a necessary component of any corporate regulatory system that operates by manipulating the conditions under which shareholders can benefit. If the law imposes penalties on the corporation itself for lawbreaking in the expectation that shareholders will discipline errant managers to avoid those penalties, shareholders must be granted sufficient control and information rights to render the threat of discipline credible.[45] And within that design, there are numerous subsidiary choices: we might ask, for example, whether and under what circumstances shareholders should have a right to recover damages against managers who engage in unlawful activity. On the one hand, such damages may be a critical mechanism by which shareholders control their managers, but on the other, it is precisely the threat of loss that incentivizes shareholders to select law-abiding managers in the first place.

The current design has a mixture of elements. Managers may be deemed to have breached their state-imposed fiduciary obligations when they cause the corporation to break the law,[46] and owe damages to the corporation as a result. Meanwhile, under the federal securities laws, they may owe damages to investors directly if they falsely describe the corporation's business activities as lawful.[47] Presumably, these forms of liability promote managerial honesty—which makes it easier for shareholders to monitor their behavior—and make managers accountable to shareholders and the corporation, which deters them from lawbreaking in the first place. If we assume these managerial payments are unlikely to fully compensate shareholders for losses the regulatory system imposes on the company for its misconduct, so much the better; investors remain firmly incentivized to prevent misconduct at their portfolio companies.

Somewhat incongruously, however, the securities laws also make the corporation *itself* liable for damages to individual investors who were

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44. Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 765–74 (2015).

45. Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation*, 2009 WIS. L. REV. 333, 340; Lawrence E. Mitchell, *The "Innocent Shareholder": An Essay on Compensation and Deterrence in Securities Class-Action Lawsuits*, 2009 WIS. L. REV. 243, 258. This point is implicitly recognized in policy prescriptions that purport to make corporations more socially responsible by empowering shareholder constituencies. *See* Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. CORP. L. 359, 378 (2016).

46. *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019).

47. James D. Cox, *"We're Cool" Statements After* Omnicare*: Securities Fraud Suits for Failures to Comply with the Law*, 68 SMU L. REV. 715, 716–19 (2015).

fooled into thinking the corporation's actions were law-abiding,[48] which seems at odds with a system that depends on investors bearing losses from corporate misconduct they were in a position to control. That is, if we expect shareholders to experience loss as a result of corporate legal liability and punish the managers responsible, it does no good if the corporation itself reimburses those injured shareholders. Such liability suggests that illegal conduct is a betrayal by the corporation of its own investors, whereas the former forms suggest that illegal conduct represents managerial betrayal of the corporation and its shareholders.[49]

The inconsistency makes some sense, however, once we recognize that the federal securities laws only provide damages to new purchasers, who presumably were not in a position to control the misconduct (or benefit from it) at the time it occurred.[50] That is the effect of the Supreme Court's decision in *Blue Chip Stamps v. Manor Drug Stores*:[51] only investors who purchase securities due to the fraud, rather than those who simply held during the fraud period, are entitled to bring a securities fraud claim (and thus recover from the corporation directly). We even have something like a ratification defense, in which investors who were on notice of the misconduct at the time of their purchase cannot receive compensation from their guilty agents.[52]

Yet architecture to enhance shareholder control over managers, in order to facilitate oversight, stands in tension with regulatory systems that seek to deter corporate misconduct by making managers personally liable to governmental authorities. Shareholders, after all, *may* use their control to encourage legal compliance, but, the alternative possibility is that, safe in their limited liability, they may use their control to push corporations to maximize profits in antisocial ways.[53] In this scenario, managers are subject to conflicting mandates, and shareholder control undermines the effectiveness of the legal tactics used to incentivize law-abiding managerial behavior.[54] As a result, the law may choose to encourage

48. Mitchell, *supra* note 45, at 246–47 (describing vicarious liability).

49. Ann M. Lipton, *Reviving Reliance*, 86 FORDHAM L. REV. 91, 129–30 (2017).

50. *See* James C. Spindler, *Optimal Deterrence When Shareholders Desire Fraud*, 107 GEO L.J. 1071 (2019).

51. 421 U.S. 723 (1975).

52. *See* Ann M. Lipton, *Fact or Fiction: Flawed Approaches to Evaluating Market Behavior in Securities Litigation*, 20 TRANSACTIONS: TENN. J. BUS. L. 741, 748–50, 759 (2019).

53. John Armour, *Shareholder Rights*, 36 OXFORD REV. ECON. POL'Y 314 (2020); Margaret M. Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999).

54. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 757–60 (2005) (describing how managers can use weaknesses in shareholder control to advance public goals). For example, scholars have documented how pay-packages used to bond managers to shareholders may incentivize lawbreaking and other antisocial behavior. *See, e.g.*, Justin Chircop et al., *CEO Risk Taking Equity*

prosocial managerial (and thus corporate) behavior by *loosening* shareholder control.[55]

These impulses were on display recently in the context of Facebook's settlement with the Federal Trade Commission over corporate actions that violated users' privacy. Facebook is managed by Mark Zuckerberg, who is both its controlling shareholder and its CEO. In the settlement, Facebook agreed to create a committee of independent directors to handle privacy policies, and their members would be chosen by independent directors on Facebook's nominating committee. In practical effect, then, the settlement limited Zuckerberg's control *as a shareholder* by constraining his ability to select board members.[56] Or, to put it another way, shareholder power within Facebook was restricted so as to enable corporate personnel to comply with the law, free from shareholder pressure for wealth maximization.

Whatever the optimal design, the larger point is that the "build" of the corporate form is an inextricable feature of any legal attempts to regulate corporate behavior. The rules governing the relationships among shareholders and managers can provide greater—or lesser—incentives for corporations to engage in antisocial or prosocial conduct.[57]

But this regulatory design has a Rube Goldberg quality; it requires precise calibrations of shareholders' desire for profit, balanced against their level of control of corporate operations, balanced against corporate

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Incentives and Workplace Misconduct (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3511638; Gretchen Morgenson, *Safety Suffers as Stock Options Propel Executive Pay Packages*, N.Y. TIMES (Sept. 13, 2015), https://www.nytimes.com/2015/09/13/business/safety-suffers-as-stock-options-propel-executive-pay-packages.html [https://perma.cc/FM77-UKT6]; Jill E. Fisch, *The Mess at Morgan: Risk, Incentives and Shareholder Empowerment*, 83 U. CIN. L. REV. 651 (2015).

55. This is what Martin Lipton of the Wachtell Lipton law firm has argued for most of his career, namely, that shareholder control rights should be limited in order to grant managers greater freedom to pursue prosocial policies. *See, e.g.*, Martin Lipton, *Corporate Governance: The New Paradigm*, HARV. L. SCH. F. CORP. ON GOVERNANCE (Jan. 11, 2017), https://corpgov.law.harvard.edu/2017/01/11/corporate-governance-the-new-paradigm/ [https://perma.cc/CZ8X-SVRW]; *Unocal Corp. v. Mesa Petroleum*, 493 A.2d 946, 955 (Del. 1985).

56. Matt Levine, *Facebook Gets a New Committee*, BLOOMBERG (July 24, 2019, 11:00 AM), https://www.bloomberg.com/opinion/articles/2019-07-24/facebook-gets-a-new-committee [https://perma.cc/FU5A-J4NC].

57. The point can be extended further, because fundamentally, the basic building blocks of the corporate form—rules of agency, vicarious liability, and veil-piercing—are intentionally designed to promote beneficial business activity while discouraging conduct that would harm third parties. For that reason, the most radical proposals to reform corporate incentives involve lifting the shield of limited liability. *See, e.g.*, Alessandro Romano et al., *Extended Shareholder Liability for Systemically Important Financial Institutions* 4–5 (European Corp. Governance Inst., Working Paper No. 477, 2019), https://ssrn.com/abstract=3475828; Stop Wall Street Looting Act, S. Res. 2155, 116th Cong. (2019).

penalties, taking into account the costs of administering an effective enforcement apparatus, so as to obtain the optimal level of corporate compliance with the law. When we fear that this calculus is too complex for the regulatory system to comfortably bear, we may regulate the corporate decisionmaking process more directly. Specifically, government authorities may promise that corporations will enjoy reduced penalties for the lawbreaking of their employees, so long as they employ practices for detecting and deterring misconduct that the government deems to be reasonably effective. In this manner, the government more directly aligns shareholder interests in profit-making with corporate governance, depending now not simply on law-abiding outcomes, but on the decisionmaking procedures used to achieve these outcomes.[58] This is the broad area known as "compliance," and might involve such matters as information flow within the corporation, monitoring of employee actions, and collection of data regarding business practices.[59] As numerous scholars have recognized, compliance itself is a direct regulation of corporate governance.[60]

To some extent, compliance may be viewed as any other architectural regulation that facilitates wealth maximizing behavior: At least one theory is that agency costs—either managerial incompetence or managerial disloyalty—prevent corporations from designing compliance systems that, taking into account expected corporate penalties from lawbreaking, will maximize corporate wealth, and that this task is made easier if the government provides an appropriate template.[61] Meanwhile, when the government promises reduced penalties for lawbreaking for firms that, ex ante, adopt preferred compliance arrangements, there is still room for

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58. Arlen & Kraakman, *supra* note 14, at 693; Veronica Root, *The Compliance Process*, 94 IND. L.J. 203, 210–15 (2019).

59. Griffith, *supra* note 6, at 2095–98. Compliance regulation should be distinguished from other kinds of regulation of corporate decisionmaking procedure, such as prohibitions on sex or race discrimination. *Cf.* Greenfield, *supra* note 7, at 971–72 (categorizing regulation of procedure as a distinct mechanism of corporate regulation). Antidiscrimination law prohibits a type of decisionmaking that is itself inherently viewed as an affront to human dignity; it is, to put it in traditional terms, malum in se. By contrast, when the government encourages particular compliance procedures, it is not because there is any moral good attached to the procedure itself, but because the procedure is instrumental in achieving other aims.

60. Mercer Bullard, *Caremark's Irrelevance*, 10 BERKELEY BUS. L.J. 15, 33 (2013); Griffith, *supra* note 6.

61. *See, e.g.*, Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation Through Non-Prosecution*, 84 U. CHI. L. REV. 323, 353 (2017); Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 973–74 (1984); Donald C. Langevoort, *Cultures of Compliance*, 54 AM. CRIM. L. REV. 933, 938–39 (2017); David Orozco, *Compliance by Fire Alarm: Regulatory Oversight Through Information Feedback Loops*, J. CORP. L. (forthcoming) (manuscript at 19), https://ssrn.com/abstract=3550124.

firms to police lawbreaking using their own methods, if they believe they can do so more efficiently.

That said, there is widespread skepticism that the compliance procedures demanded by the government are any more effective at detecting and deterring misconduct than procedures that could be developed privately, leading some critics to argue that the government should simply dole out penalties for misconduct and leave the question of appropriate preventive measures to wealth-maximizing corporations (and by extension their shareholders).[62] The system makes more sense, however, when we recognize that mandated compliance is not about (or not merely about) ensuring good corporate governance in the sense of facilitating the appropriate wealth-maximizing tradeoff between the risks associated with lawbreaking and the expenses of prevention. Rather, regulation of corporate process, like other aspects of corporate architecture, facilitates social control via other means.

B. Incapacitation

As above, firms are structured to align managerial interests with those of the shareholders, with further regulation intended to align shareholder interests—profit-seeking—with the interests of society as a whole. But in some circumstances, we may fear that the potential costs to society, coupled with the potential costs of legal enforcement, are too great to manage merely by structuring the firm to maximize wealth while manipulating its incentives.[63]

At this point, architectural choices may be intended less to facilitate wealth maximizing decisionmaking than to *inhibit* it, by directly incapacitating corporations from taking action within certain spheres. This is how corporate regulation operated in the pre-Industrial era: by prohibiting corporations from holding stock, mandating levels of capitalization, requiring unanimous consent among shareholders to act, and other measures, corporations were inherently inflexible, which limited their ability to accumulate wealth and influence.[64]

In the modern era, other aspects of corporate design serve similar functions. Most obviously, the corporate law of many states makes it difficult if not impossible for one corporation to acquire another over the objection of the target's board of directors. These statutes, which as a

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62. Griffith, *supra* note 6, at 2134–35.

63. Brian Galle, *In Praise of Ex Ante Regulation*, 68 VAND. L. REV. 1715, 1725–26 (2015).

64. These examples demonstrate that, contrary to the views of some commenters, *see, e.g.*, Reuven S. Avi-Yonah, *Corporations, Society and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193 (2004), corporate governance reform can, in fact, limit corporate power.

practical matter make mergers more difficult and thus less likely to occur, are widely recognized as serving the interests of local employees and community stakeholders by protecting them from corporate operational changes that could result in layoffs or other cutbacks.[65] And the trend is not limited to legislation: Delaware has used its common law to reify directors' ability to resist hostile offers, originally justifying its moves on the ground that employees may need protection from rapacious takeover artists.[66] Though subsequent caselaw rooted the justification more firmly in shareholder primacy,[67] it has become increasingly difficult for Delaware to square the near plenary power directors have to resist merger offers with a shareholder wealth maximization norm.[68]

Similarly, antitrust laws prohibit directors from simultaneously serving on the boards of competing companies.[69] The underlying *substantive* mandate of antitrust law is to prohibit corporations from engaging in monopolizing or collusive behavior, but rather than solely rely on prohibitions against such conduct, antitrust laws act on corporate architecture directly to prevent collusion before it begins. Indeed, as the prohibitions on conspiracies in restraint of trade are among the earliest forms of substantive corporate regulation, first arising at a time when corporate architecture was still the dominant mechanism for controlling business activity, it is not surprising that the Clayton Act of 1914 operates, in part, by manipulating the corporate form itself.

Compliance procedures also function as a form of incapacitation.[70] Though, as above, some compliance procedures are traded for reduced penalties when misconduct occurs, in many instances, compliance procedures are simply mandated by law,[71] or imposed by regulators in

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65. Winkler, *supra* note 9, at 122–23.

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

67. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

68. *See, e.g.*, *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 57–58 (Del. Ch. 2011) (openly expressing disagreement with Delaware precedent on this issue); Myron T. Steele, Commentary, *Continuity and Change in Delaware Corporate Law Jurisprudence*, 20 FORDHAM J. CORP. & FIN. L. 352, 362 (2015) (same). Similarly, Delaware's flat prohibition on intentional lawbreaking by corporate directors—even if accomplished to benefit the corporation—serves more of a regulatory purpose than a purpose to further shareholder interests. *See* Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2026 (2019).

69. 15 U.S.C. § 19 (2018).

70. W. Robert Thomas, *Incapacitating Criminal Corporations*, 72 VAND. L. REV. 905, 911 (2019).

71. *See, e.g.*, 15 U.S.C. §§ 78m(b)(2), 7241 (2018); 21 C.F.R. §§ 211.100, 211.115 (2020); Know Your Customer Notice, 75 Fed. Reg. 71479 (Nov. 23, 2010); Veronica Root, *Coordinating Compliance Incentives*, 102 CORNELL L. REV. 1003, 1010–12 (2017); Bullard, *supra* note 60, at 46.

exchange for foregoing more onerous forms of monitoring.[72] When this occurs, there is no longer even the pretense that compliance is designed to help the corporation make "correct" wealth maximizing decisions for shareholders.[73] Instead, it operates by increasing both the efforts required to evade the law and the likelihood of detection, thus (ideally) raising the cost of lawbreaking prohibitively. Compliance procedures create a paper trail for investigators, force specific corporate officers to take responsibility for aspects of corporate performance[74]—thus limiting plausible deniability—and perhaps even contribute to a corporate culture that treats abidance with the law as routine and correct,[75] regardless of whether shareholders would benefit from law breaking. In this respect, corporate governance is directly harnessed to serve public—i.e., nonshareholder—interests.[76]

Shareholder voting represents another incapacitating procedure, in that it introduces friction into the corporate decisionmaking process by dividing authority between decisionmaking bodies, akin to separation of powers in government.[77] Historically, the shareholder vote was an especially powerful mechanism of incapacitation because of unanimity requirements (predicated on the need for each shareholder's consent in accord with traditional contractual principles).[78] Because unanimity was so difficulty to achieve, the requirement of a shareholder vote prevented corporations from acting at all. Later, due to a sense that unanimity inhibited too much corporate activity, majority votes were permitted, justified by a weaker concept of consent that holds that the mere act of

72. Rory Van Loo, *Regulatory Monitors: Policing Firms in the Compliance Era*, 119 COLUM. L. REV. 369, 398–402 (2019).

73. *E.g.*, Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 910 (2003) (describing how federally mandated compliance standards—such as the internal control certifications required under the securities laws—function to enforce a duty of care).

74. J.S. Nelson, *Paper Dragon Thieves*, 105 GEO. L.J. 871, 879–81 (2017); Bullard, *supra* note 60, at 39; *see also* Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 974–75 (1984).

75. Veronica Root Martinez, *Complex Compliance Investigations*, 120 COLUM. L. REV. (forthcoming 2020) (manuscript at 16–17), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3350463.

76. Bullard, *supra* note 60, at 22 ("The administrative state, through regulatory law, uses internal corporate structures to effectuate public policy.").

77. *See, e.g.*, Jonathan R. Macey, *Transaction Costs and the Normative Elements of the Public Choice Model: An Application to Constitutional Theory*, 74 VA. L. REV. 471, 494–95 (1988) (describing how transaction costs associated with the separation of powers impede all lawmaking).

78. MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW 1870-1960, at 90 (1992).

investing represents shareholders' agreement to the full suite of corporate law rules and directorial powers.[79]

Even majority votes, however, can create frictions that slow and deter corporate activity. This is why, in the merger context, transaction planners have lobbied for—and achieved, in certain states—a faster alternative that avoids the vote altogether.[80] By contrast, additional shareholder votes have been proposed by those who seek to slow or prevent corporate actions that have a political valence, such as political spending.[81]

One of the more powerful incapacitation rules is the stock exchange prohibition on mid-stream adoption of dual-class voting structures.[82] The presence of a controlling shareholder makes shareholder assent—and thus corporate action—far easier to accomplish, by concentrating decisionmaking power in a small number of hands. Though a controlling stake in a corporation may often be obtained by a simple capital outlay (i.e., a large stock purchase), this may be infeasible in the largest companies.[83] Thus, the limits on dual-class recapitalization ensure that the most powerful companies operate under fractured and time-consuming decisionmaking procedures, and prevent a single person, or small group of persons, from wielding unconstrained power not simply over the corporation itself, but in the public spheres in which the corporation has influence.[84]

Frictions may also be introduced at the board level. The separation of chair and CEO roles, for example, is often advocated as a means of providing substantive oversight of management decisionmaking,[85] but the fracturing of power itself limits the CEO's ability to take action, if only because of the justification costs the separate roles impose.[86] Independent

79. *Id.* at 92–93; *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

80. *E.g.*, DEL. CODE. ANN. tit. 8, § 215(h) (2019).

81. *See, e.g.*, Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83, 97–98 (2010); Jennifer S. Taub, *Is* Hobby Lobby *a Tool for Limiting Corporate Constitutional Rights?*, 30 CONST. COMMENT. 403, 426–27 (2015); Ciara Torres-Spelliscy, *Corporate Democracy from Say on Pay to Say on Politics*, 30 CONST. COMMENT. 431 (2015).

82. NASDAQ LISTING RULE 5640; NYSE LISTED COMPANY MANUAL § 313.00(A).

83. Additionally, as discussed more below, *see supra* Section III.D.2., various rules governing shareholder rights and powers are designed to inhibit the accumulation of influential stakes by a small group of persons or institutions.

84. Jeffrey N. Gordon, *Dual Class Common Stock: An Issue of Public and Private Law*, THE CLS BLUE SKY BLOG (Jan. 2, 2019), https://clsbluesky.law.columbia.edu/2019/01/02/dual-class-common-stock-an-issue-of-public-and-private-law/ [https://perma.cc/WW3H-FEX6].

85. Joel Seligman, *A Modest Revolution in Corporate Governance*, 80 NOTRE DAME L. REV. 1159, 1175–79 (2005).

86. Claire A. Hill & Alessio M. Pacces, *The Neglected Role of Justification Under Uncertainty in Corporate Governance and Finance* (Eur. Corp. Governance Inst.,

directors—required under federal law—must be educated about the company, introducing an additional layer of bureaucracy that may slow corporate action. Numerous corporate actions must be filtered through independent committees in order to ensure a favorable standard of review should they become the subject of a shareholder lawsuit,[87] and those procedures alone may be daunting enough that they deter corporate action in the first instance.[88]

To be sure, these procedures all have alternative functions. Most obviously, corporate separation of powers may be viewed as a function of "good" decisionmaking—providing oversight of agents to ensure their faithfulness, or even just "slow[ing] down" decisionmaking to ensure proper deliberation.[89] But the procedures themselves also inhibit the exercise of power by the simple expedient of making it difficult for corporations to act at all.

It is likely that at least some advocates recommend these types of measures precisely because of the frictions they impose. Commenters will not say so directly. Usually, demands for increased independence and segmentation within the corporation are formally promoted on the grounds that they contribute to wealth maximizing governance. It is also true that empirically, we know very little about which measures (independent directors, separation of chair and CEO roles) increase wealth at which companies.[90] However, pension fund shareholders, for example, tend to advocate for "friction-creating" policies at companies across the board, whereas mutual funds treat these matters on a more case-by-case basis.[91]

Law Working Paper No. 429/2018, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3312596.

87. Shill, *supra* note 39.

88. Certainly, many a corporate transaction has faltered in litigation because of flaws in the committee process. *See, e.g.*, Deepa Seetharaman & Sarah E. Needleman, *Facebook Abandons Plan to Change Share Structure, Avoiding Lawsuit*, WALL STREET J. (Sept. 22, 2017), https://www.wsj.com/articles/facebook-abandons-plans-to-change-share-structure-avoiding-lawsuit-1506114877 [https://perma.cc/2PZS-9Y8C]; *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 939–40 (Del. Ch. 2003).

89. Robert B. Thompson, *Anti-Primacy: Sharing Power in American Corporations*, 71 BUS. LAW. 381, 408–09 (2016) (describing corporate directors as functioning to "slow down" hasty shareholder decisionmaking).

90. Sean J. Griffith, *Opt-In Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority*, 98 TEX. L. REV. (forthcoming 2020) (manuscript at 44–46), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3404298; Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 907–16 (2007).

91. *Independent Board Leadership*, COUNCIL OF INSTITUTIONAL INV., https://www.cii.org/independent_board [https://perma.cc/8KPQ-FF3Y]; *BlackRock Investment Stewardship*, BLACKROCK (Jan. 2020), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf [https://perma.cc/B4XT-R3L9]; *Summary of the Proxy Voting Policy for U.S. Portfolio Companies*, VANGUARD, https://about.vanguard.com/investment-stewardship/portfolio-company-resources/2020_proxy_voting_summary.pdf [https://perma.cc/366Y-TRVR]. Similarly, pension funds have sought to exclude

One explanation for the divergence of views is that pension funds, as labor representatives, have dual concerns both about the value of their investment and the power that corporations wield with respect to labor; mutual funds, representing a more diverse set of beneficiaries, do not share the latter concerns.[92]

In sum, if, as described in Part II, corporations can be controlled by manipulating the balance of power between corporations and non-shareholder constituencies, we can empower those non-shareholder constituencies not only by enhancing their ability to bargain, but also by *weakening* corporations' ability to act in the first instance.[93] In this vein, the inhibiting effect of procedural friction is likely at least part of the reason why some commenters have recommended that controversial corporate activity—like political spending—receive independent director approval.[94]

There are legitimate questions about whether, and to what extent, friction should be introduced into corporate decisionmaking for its own sake, rather than as a means to improve outcomes. Certainly, it's not an unfamiliar regulatory technique: in addition to mirroring the separation of powers in governments, it is the basis for antitrust law, and has historically been applied in banking regulation.[95] Yet, as Cary Coglianese points out:

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companies with dual-class shares from indices; mutual funds have not. Ning Choiu, *BlackRock Wants Equal Voting Rights but Opposes Exclusion from Indexes*, BRIEFING: GOVERNANCE (Oct. 23, 2017), https://www.briefinggovernance.com/2017/10/blackrock-wants-equal-voting-rights-but-opposes-exclusion-from-indexes/ [https://perma.cc/4A5N-5BSL]; *Major Stock Index Providers to Limit Inclusion of Multi-Class Companies*, EUR. AM. CHAMBER OF COMMERCE N.Y., https://eaccny.com/news/member-news/major-stock-index-providers-to-limit-inclusion-of-multi-class-companies-what-it-means-and-why-it-matters/ [https://perma.cc/A7C2-EFF5].

92. *See* DAVID H. WEBBER, THE RISE OF THE WORKING CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON 214–20 (2018).

93. Edward Rock and Marcel Kahan point out that the boardroom separation-of-power arrangements that are frequently the subject of debate may have little effect on shareholder value, while arrangements that might hand shareholders far more power—such as reimbursement for proxy contests—are rarely sought. They conclude that activists join battle over cosmetic measures because of their symbolic role in legitimating corporate power. *See* Edward Rock & Marcel Kahan, *Symbolic Corporate Governance Politics*, 94 B.U. L. REV. 1997 (2014). But an alternative explanation is that some activists' goal is not to enhance shareholder power, but to inhibit corporate functioning. Rules that would make it too easy for shareholders to wrest control of corporate machinery (like proxy reimbursement) might facilitate corporate action rather than impede it. This is especially true when one considers that the type of shareholder likely to run a proxy contest (a hedge fund or potential acquirer) will likely seek to shed employees—precisely the opposite of what pension funds, who are among the most dedicated advocates for friction-creating policies, would want.

94. *See, e.g.*, Bebchuk & Jackson, *supra* note 81, at 101–02.

95. Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (1933).

> The procedural mechanisms that characterize governments often reflect a high level of risk aversion to the worst abuses governments can exhibit. They are conservative in that they make it harder for government to move with a unitary voice in a direction dictated by a single individual or a single faction.[96]

He thus raises the question: "[H]ow much procedural legitimacy should society demand of corporations?"[97]

The answer may depend on the character of the corporation at issue. In general, concerns about the improper exercise of corporate power are limited to larger corporations that are built on the wealth of thousands or hundreds of thousands of natural persons.[98] Thus, some—though not all—of the incapacitating mechanisms described above are limited to the largest companies.[99] A tiered system of regulation may be appropriate, where only the largest companies are required to operate under a complete set of procedural mandates.[100]

But in governments, the separation of powers is not an arbitrary division; rather, the component groups who wield counterbalancing powers are crafted to represent different points of view or operate under different orientations and incentives, so as to ensure not only a *slow* decisionmaking process, but one that requires the cooperation of multiple constituencies.[101] And the procedural mechanisms of corporate incapacitation often do just that, as described below.

96. Cary Coglianese, *Legitimacy and Corporate Governance*, 32 DEL. J. CORP. L. 159, 167 (2007).

97. *Id.*

98. Ann M. Lipton, *Not Everything is About Investors: The Case for Mandatory Stakeholder Disclosure*, YALE J. ON REG. (forthcoming) (manuscript at 61); Langevoort & Thompson, *supra* note 43, at 374; C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77, 80 (2002).

99. For example, many director-independence mandates, and restrictions on dual-class share recapitalizations only apply to companies large enough to be listed on a stock exchange.

100. Langevoort & Thompson, *supra* note 43, at 379–80.

101. *See* Jon D. Michaels, *An Enduring, Evolving Separation of Powers*, 115 COLUM. L. REV. 515, 525–26 (2015) ("The Framers did more than simply divide power among three groups. They endowed each group with distinct dispositional, political, and institutional characteristics. And they made each group answerable to different sets of constituencies and subject to different temporal demands. Because of these differing characteristics, bases of accountability, and time horizons within which to work, the branches were expected to harbor conflicting agendas. These conflicts would, in turn, sharpen institutional rivalries, enlarge and improve federal decisionmaking . . . .").

C. Promoting Public Participation

Corporate architecture can be designed in a manner that makes it easier—or harder—for various stakeholder groups to have input and exercise influence over corporate decisionmaking. This can be done through generalized public disclosure requirements and is also part and parcel of adopting specific procedural requirements for corporate action. Whenever a corporation is required by law to make decisions according to a defined process, corporate operations are made visible to outsiders and the public is granted an avenue for participation.[102]

Generalized disclosure requirements open internal corporate operations up to scrutiny to investors as well as the general public.[103] These are unlike the targeted disclosures described above, which are intended for consumption by particular stakeholder groups for use with respect to specific transactions; by contrast, generalized disclosures are issued to the public at large and provide a holistic portrait the corporation's results of operations, internal functioning, and financial condition. They might detail such matters as the corporation's finances, lines of business, risks, trends, capitalization, relationship with employees, and governance structure.[104]

Investors, of course, can use such information to monitor managers in service of their own priorities, but other stakeholders can also use such information to steer corporate behavior in particular directions. For example, peer companies can use it to improve their own operations and thereby increase competition; employees can use it to bargain for better wages; advocacy groups can use it to adopt pressure campaigns to encourage more prosocial corporate behavior; and regulators can use it to identify red flags of lawbreaking and develop new regulations to more tightly control corporate behavior. As a result, decisions about when holistic disclosures will be required are a crucial architectural decision that will—or will not—facilitate corporate accountability to these varied audiences.[105] In the United States (and, to a lesser extent, other countries), holistic disclosures are usually required only when companies sell their securities to the public.[106] Thus, the definition of "public" investment is a crucial regulatory fulcrum on which corporate accountability rests.

Additionally, as Robert Thompson and Hillary Sale point out, in the old saw "you manage what you measure," the choice of disclosure

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102. *See, e.g.*, LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 69–70 (2010).

103. Lipton, *supra* note 98; Hillary A. Sale, *The New "Public" Corporation*, 74 LAW & CONTEMP. PROBS. 137, 137–38 (2011).

104. Lipton, *supra* note 98.

105. *Id.*

106. Lipton, *supra* note 98.

requirements necessarily dictates the types of matters to which managers will direct their attention.[107] The requirements that companies disclose such matters as their ethics policies,[108] the extent to which diversity considerations factor into their process for nominating director candidates,[109] the relationship between risk-taking and compensation,[110] and the ratio of CEO pay to the pay of the median worker,[111] necessarily ensure that corporate managers will attend to these matters, and represent another mechanism for exerting regulatory control over corporate operations.

Disclosure has particular force in combination with the *procedural* requirement that certain matters be submitted to a shareholder vote. Obviously, voting permits input by shareholders themselves—a point explored more fully below—but the very act of holding a vote and generating information in anticipation thereof provides another entry point for public scrutiny of, and input into, corporate operations.[112]

Whenever a public company holds a shareholder vote, corporate managers are required to disclose material information that may be relevant to shareholders' decision.[113] Additionally, the directors themselves almost always have their own views on how shareholders should vote (for some matters, like mergers, they are required to make a recommendation[114]), which means they must articulate their position and explain the process by which it was reached.[115]

Thompson and Sale did not focus on shareholder voting when they published their article on the substantive effects of corporate disclosure, likely because at the time of their writing it had less importance. Today, however, Delaware has put greater emphasis on the shareholder vote as a mechanism for cleansing potential breaches of fiduciary duty,[116] federal law has imposed new shareholder voting requirements,[117] and investors have taken a new interest shareholder proposals submitted under SEC Rule

107. Thompson & Sale, *supra* note 73, at 874–75.

108. *E.g.*, 17 C.F.R. § 229.406 (2019).

109. *E.g.*, § 229.407(b)(3)(vi).

110. *E.g.*, § 229.402.

111. *E.g.*, Dodd-Frank Act, Pub. L. No. 111-203, § 953(b), 124 Stat. 1376 (2010) (codified at 12 U.S.C. § 78*l*).

112. Kobi Kastiel & Yaron Nili, *The Market For Votes* (working draft; on file with the author).

113. *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998); § 240.14a-101.

114. DEL. CODE ANN. tit. 8, § 215(b) (2020).

115. Kastiel & Nili, *supra* note 112.

116. *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 308, 312 (Del. 2015); *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 646 (Del. 2014).

117. *E.g.*, 17 C.F.R. § 240.14a-21 (2013).

14a-8.[118] The collective effect is that corporate insiders have been forced to offer rationales for everything from their method of compensating directors,[119] to their efforts towards combatting climate change.[120] The mere act of submitting matters to a shareholder vote forces managers to give thought to, and justify, various corporate actions in the public sphere—and gives the public a chance to apply pressure if they are dissatisfied with their responses.[121] Thus, the architectural choice to impose a specific decisionmaking process on corporations—shareholder voting (including, necessarily, rules about when shareholders may have access to the corporate proxy to submit their own proposals)—can enhance or diminish corporate accountability to the general public.

A similar dynamic obtains with other procedural requirements, such as filtering decisionmaking processes through board committees. If the committee must communicate with the full board, further documentation is created that may eventually be disclosed, if not in proxy materials, then via a shareholder lawsuit or demand for internal records.[122] And the same could be said about the compliance function: By requiring that corporate decisionmaking involve specific procedures, with documentation of each point in the process, corporate internal operations are made legible to representatives of the public, namely, government actors. These representatives are then positioned to comment on, and request changes to, the process by which decisions are made. Moreover, the government's greater insight into corporate functioning and incentives may be used to design more effective regulation of substantive behavior.

It is worth noting that the separation of powers in government serves the same purpose. By defining separate branches and procedures for governmental decisionmaking, the lawmaking process is not only made

118. *See, e.g.*, Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, 84 Fed. Reg. 66458, 66483 (proposed Dec. 4, 2019), https://www.sec.gov/rules/proposed/2019/34-87458.pdf [https://perma.cc/P93U-28M2] (describing increasing investor support for such proposals); Jackie Cook, *How Fund Families Support ESG-Related Shareholder Proposals*, MORNINGSTAR (Feb. 13, 2020), https://www.morningstar.com/insights/2020/02/12/proxy-votes [https://perma.cc/FNK9-7L3C].

119. *In re Investors Bancorp, Inc. Stockholder Litig.*, 177 A.3d 1208, 1211 (Del. 2017).

120. *See, e.g.*, Exxon Mobil Corp., Proxy Statement (Schedule 14A), at 61 (Apr. 13, 2017), https://www.sec.gov/Archives/edgar/data/34088/000119312517122538/d182248ddef14a.htm#toc182248_23 [https://perma.cc/3UKZ-DTYL]; Amazon.com, Inc., Proxy Statement (Schedule 14A), at 30–32 (Apr. 11, 2019), https://www.sec.gov/Archives/edgar/data/1018724/000119312519102995/d667736ddef14a.htm [https://perma.cc/FFQ9-58BJ].

121. RIBSTEIN, *supra* note 102, at 70.

122. Roy Shapira, *The Recalibration of Corporate Law: Section 220 and the Undoing of* Corwin (working draft; on file with the author).

slower and more cumbersome, but also made more *available* to the public, who then have the opportunity to exert influence.[123]

D. Build a Better Shareholder

Corporate architecture is obviously designed to accept scrutiny and input from shareholders and render managers accountable to shareholder interests. And, as described above, based on the assumption that shareholders desire to maximize profits, we can manipulate the fact that managers are so accountable in order to incentivize the corporate behavior we wish to generate.

That description, however, implies a certain passivity with respect to the identity and interests of shareholders themselves. In fact, the regulatory system can construct shareholders and guide their preferences, much the way it does with respect to corporations. By doing so, the regulatory system promotes particular values within the corporate form and exerts even more (indirect) control over corporate managers and therefore corporate behavior.

1. AGENDA SETTING

First and most obviously, shareholders can be guided towards taking particular factors into account when making investment decisions. This can be accomplished via mandatory disclosure, much the same way it is done in other contexts (which only highlights the fact that the tools used in the corporate law space cannot be confined to that area of law). Thus, myriad securities disclosure requirements are imposed in a transparent effort to capture the attention of institutional investors in the hopes that these investors will use their influence over corporate managers to change their behavior.

For example, in the wake of the financial crisis of 2008, Congress passed Dodd-Frank, which requires corporations to disclose the relationship between risk-taking and incentive compensation.[124] The new requirement is intended to encourage investors to assess and—as necessary, devalue—corporations that promote excessive risk-taking.

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123. JEREMY WALDRON, POLITICAL THEORY: ESSAYS ON INSTITUTIONS 63 (2016); *see also* Michaels, *supra* note 101, at 548–49 (making a similar observation with respect to agency structure and administrative decisionmaking). Corporations may also be directly required to include non-shareholder constituencies in their decisionmaking via the imposition of bargaining requirements. Certain regulatory spheres may impose such obligations, *e.g.*, 47 C.F.R. § 76.65 (2019), but more broadly, labor law imposes on corporations the obligation to negotiate in good faith with labor representatives. Rather than impose a specific outcome, this regulation, in practical effect, grants employees a formal voice in corporate governance. *See* Winkler, *supra* note 9, at 130–31.

124. 17 C.F.R. § 229.402 (2019).

Similarly, Dodd-Frank requires corporations to disclose the ratio of CEO pay to median worker pay, and requires (though the SEC has not created rules to implement) that corporations disclose CEO pay relative to total shareholder return.[125] Both of these rules encourage shareholders to evaluate pay practices in specific ways, namely, as a function of whether the CEO produces measurable profits for shareholders, and whether the corporation as a whole promotes income inequality or furthers CEO rent-seeking. The significance here is that these are the products of regulatory choice, and regulators could choose different disclosure requirements. For example, regulators could choose to require disclosure of CEO pay relative to carbon emissions—hardly implausible, given recent investor interest.[126] But regulators have chosen to focus investor attention on specific aspects of corporate performance.

By the same token, we can *impede* disclosure of information when we do *not* want investors to interfere with management prerogatives, and in that respect give corporations a free hand. The most obvious example in this space concerns "ESG" information, pertaining to corporate social performance, especially environmental impact. There is increasing evidence that investors greatly desire such information in a standardized, decision-useful format,[127] but the SEC has resisted engaging in any

125. Dodd-Frank Act, Pub. L. No. 111-203, § 953(b), 124 Stat. 1376, (2010) (codified at 12 U.S.C. § 78*l*); Francine McKenna, *A Decade After the Crisis, the SEC Still Hasn't Passed Executive Compensation Rules*, MARKETWATCH (Sept. 14, 2018, 3:37 PM), https://www.marketwatch.com/story/a-decade-after-the-crisis-the-sec-still-leaves-executive-compensation-rules-unwritten-2018-09-10 [https://perma.cc/Q263-Y3P7].

126. It is not as outlandish as it sounds; some companies have adopted pay practices that depend in part on managers achieving certain environmental objectives. *See, e.g.*, *Royal Dutch Shell Ties Executive Pay to Carbon Reduction*, BBC NEWS (Dec. 3, 2018), https://www.bbc.com/news/business-46424830 [https://perma.cc/5RXT-222V]; Dieter Holger, *Clorox Will Attach Environmental, Animal-Testing Goals to Executive Compensation*, MARKETWATCH (Oct. 2, 2019, 2:52 PM), https://www.marketwatch.com/story/clorox-will-attach-environmental-animal-testing-goals-to-executive-compensation-2019-10-02 [https://perma.cc/28YY-EAYQ].

127. David Caleb Matua & Jacqueline Poh, *These Agencies Want to Check Who's Naughty and Who's Nice*, BLOOMBERG (Nov. 22, 2019), https://www.bloomberg.com/news/articles/2019-11-22/moody-s-s-p-race-into-esg-rating-business-in-acquisition-binge [https://perma.cc/GS5R-8Y9K]; David Caleb Matua, *Green Bonds Get Rubber-Stamped as Investors Question the Label*, BLOOMBERG (Nov. 7, 2019, 10:29 AM), https://www.bloomberg.com/news/articles/2019-11-07/green-bonds-get-rubber-stamped-as-investors-question-the-label [https://perma.cc/XED3-QP35]; Maitane Sardon, *The Potentially High Cost of Not Disclosing ESG Data*, WALL STREET J. (Sept. 22, 2019, 10:04 PM), https://www.wsj.com/articles/the-potentially-high-cost-of-not-disclosing-esg-data-11569204241 [https://perma.cc/JG5Q-S5VD]; Kelly Gilblom, *Neptune Says Readying for IPO Means Readying Low-Carbon Strategy*, BLOOMBERG (Nov. 22, 2019), https://www.bloomberglaw.com/document/XFSMJL2K000000; Jamie Smith, *What Investors Expect From the 2020 Proxy Season*, EY (Feb. 5, 2020), https://www.ey.com/en_us/board-matters/what-investors-expect-from-the-2020-proxy-season [https://perma.cc/4LUL-VMFN]; Dieter Holger, *S&P Adds Climate Change Data*

rulemaking on the subject,[128] and even routinely bars investor proposals requesting that corporations produce such information voluntarily.[129] The current administration has strongly suggested that it wishes to leave the energy industry relatively unencumbered by shareholder environmental activism,[130] and *failure* to require or coordinate disclosure to investors of these matters is one of its tactics.[131]

The battle over financial reporting provides another example. Currently, public companies are required to report their financial results on a quarterly basis, which some conclude causes investors to focus on short-term results at the expense of long-term corporate health. They therefore argue that reporting should occur semi-annually, as a mechanism of manipulating investor attention, often explicitly claiming that the change would allow corporations to engage in more hiring, research and development, and otherwise create more positive externalities that benefit society as a whole.[132]

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to Investor Tools, WALL STREET J. (Feb. 18, 2020), https://www.wsj.com/articles/s-p-adds-climate-change-data-to-investor-tools-151582026151.

128. Allison Herron Lee, *"Modernizing" Regulation S-K: Ignoring the Elephant in the Room*, *Public Statement*, U.S. SEC. & EXCHANGE COMMISSION (Jan. 30, 2020), https://www.sec.gov/news/public-statement/lee-mda-2020-01-30 [https://perma.cc/3F3Z-QTFA].

129. SEC Staff Legal Bulletin No. 14K (CF) (Oct. 16, 2019), https://www.sec.gov/corpfin/staff-legal-bulletin-14k-shareholder-proposals [https://perma.cc/U2RB-NYJ6].

130. Promoting Energy Independence & Economic Growth, Exec. Order No. 13783, 82 Fed. Reg. 16093 (Mar. 28, 2017), https://www.whitehouse.gov/presidential-actions/executive-order-promoting-energy-infrastructure-economic-growth/.

131. Regulators can also direct shareholder attention via the power to define certain types of statements as false or misleading, and thus fraudulent. For example, the stock exchanges, in conjunction with the SEC, have adopted particular definitions of "independence" as applied to corporate directors. Proxy advisors like Glass Lewis and ISS often define independence more stringently in their voting recommendations to investors, prompting the SEC to suggest that these recommendations may run afoul of antifraud rules, at least if they do not include potentially more burdensome disclosures. *See* Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, 84 Fed. Reg. 66518 (proposed Dec. 4, 2019) (to be codified at 17 C.F.R. pt. 240), https://www.sec.gov/rules/proposed/2019/34-87457.pdf [https://perma.cc/2D4H-DRXG]. In this manner, the SEC constrains the aspects of director independence that shareholders can, as a practical matter, consider when making voting and investment decisions.

132. *See, e.g.*, John D. Stoll, *For Companies, It Can Be Hard to Think Long Term*, WALL STREET J. (Dec. 3, 2018, 9:14 AM), https://www.wsj.com/articles/for-companies-it-can-be-hard-to-think-long-term-1543846491 [https://perma.cc/4QWU-N6VS]; Alana Semuels, *How to Stop Short-Term Thinking at America's Companies*, THE ATLANTIC (Dec. 30, 2016), https://www.theatlantic.com/business/archive/2016/12/short-term-thinking/511874/ [https://perma.cc/8UJ4-A923]; Haresh Sapra, *How to Curb Short-Termism and Boost the US Economy*, CHICAGO BOOTH REV. (May 3, 2019), https://review.chicagobooth.edu/accounting/2019/article/how-curb-short-termism-and-boost-us-economy [https://perma.cc/6EDH-QR6U].

Almost as important as the disclosure requirements themselves are our mechanisms for enforcing those requirements. Put simply, if corporations incur no penalty for lying about an aspect of corporate behavior, investors will learn to disregard it. Thus, it is significant that certain kinds of corporate statements—often those pertaining to the corporation's internal governance policies, the quality of its data collection, and its ethics codes—are routinely deemed by courts to be immaterial to investors, despite the fact that these disclosures are required by federal law.[133] In this manner, courts use their power of enforcement to divert investor attention *away* from federally-mandated topics.[134]

2. SHAREHOLDER ARCHITECTURE

Disclosure is a relatively subtle mechanism for guiding investor preferences; investors can and do ignore disclosures that they do not find material and seek out information that mandatory disclosures do not include. Thus, the regulatory system also directs investor priorities more explicitly: by legally shaping the constitution and investment strategies of investors themselves.

Regulations in this space often come from two distinct motivations. First, regulators may be concerned that if shareholders in a single company become too powerful, they will exploit other shareholders in the same company; therefore, regulations are designed to prevent this eventuality. Alternatively, regulators may be concerned that institutional investors, who invest on behalf of their natural-person beneficiaries, may expose those beneficiaries to undue risk, and regulations may be designed to ensure their prudence. Whatever the theoretical rationale, however, regulation of investors necessarily shapes particular shareholder constituencies whose voices can be elevated—or suppressed—within the corporation itself, thus giving them a greater or lesser influence over corporate behavior.

For example, the Employee Retirement Income Security Act (ERISA) encouraged the development of two distinct types of shareholders: pension funds, whose fortunes are tied to the capital markets rather than any single employer, and the giant mutual funds who populate 401(k) plans.[135] As described above, these shareholders have different incentives: Because pension funds represent a relatively coherent set of

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133. Lipton, *supra* note 49; *see also In re Liberty Tax, Inc. Sec. Litig.*, 2:17-CV-07327 (NGG) (RML), 2020 WL 265016, *6 (E.D.N.Y. Jan. 17, 2020).

134. Lipton, *supra* note 49, at 131 (courts "develop a vision of what shareholders will be permitted to value, such that their interests will be judicially acknowledged").

135. Martin Gelter, *From Institutional Theories to Private Pensions*, *in* COMPANY LAW AND CSR: NEW LEGAL AND ECONOMIC CHALLENGES (IVAN TCHOTOURIAN ED., BRUYLANT 2014); WEBBER, *supra* note 92.

beneficiaries with somewhat unified interests—and who have a say in the governance of their plans—they often take confrontational stances with their portfolio companies and pursue policies that protect the interests of labor.[136] Mutual funds, by contrast, represent a far more diverse set of beneficiaries who have little influence over fund governance,[137] and have historically been more passive.[138] At the same time, mutual fund companies must market themselves to wide swaths of the American public, and as such are responsive to public pressure.[139]

Both pension funds and mutual funds are subject to a bevy of regulations that encourage diversification.[140] These regulations ensure that some of the most powerful institutional shareholders do not have sufficiently large stakes in particular companies to invest significant resources in monitoring on an individualized basis, and inhibits coordinated shareholder action.[141] At the same time, diversified shareholders may have distinct preferences: they may encourage risky behavior at portfolio companies that may eventually result in bankruptcies, to the detriment of employees and other creditors.[142] Conversely, they may

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136. WEBBER, *supra* note 92.

137. *Id.*; John Morley & Quinn Curtis, *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds*, 120 YALE L.J. 84 (2010).

138. *See, e.g.*, Sean J. Griffith & Dorothy S. Lund, *Toward a Mission Statement for Mutual Funds in Shareholder Litigation*, 87 U. CHI. L. REV. (forthcoming 2020); Yaron Nili & Kobi Kastiel, *The Giant Shadow of Corporate Gadflies*, S. CAL. L. REV. (forthcoming) (manuscript at 26–27), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3520214.

139. *See, e.g.*, Jeff Sommer, *Want a Bigger Say on Corporate Behavior? Move Your Money*, N.Y. TIMES (Dec. 12, 2019), https://www.nytimes.com/2019/12/12/business/corporate-behavior-move-your-money.html [https://perma.cc/J6ML-ZH35]; Leo E. Strine Jr. & Antonio Weiss, *Why Isn't Your Mutual Fund Sticking Up for You*, N.Y. TIMES (Aug. 23, 2019), https://www.nytimes.com/2019/08/23/opinion/mutual-funds-shareholder-activism.html [https://perma.cc/2QYX-4SD5]; Steven Mufson & Rachel Siegel, *Blackrock Makes Climate Change Central to its Investment Strategy*, WASH. POST (Jan. 14, 2020), https://www.washingtonpost.com/business/2020/01/14/blackrock-letter-climate-change/ [https://perma.cc/5AB8-9HVX]. *But see* Gretchen Morgenson, *Your Mutual Fund Has Your Proxy, Like It or Not*, N.Y. TIMES (Sept. 23, 2016), https://www.nytimes.com/2016/09/25/business/your-mutual-fund-has-your-proxy-like-it-or-not.html [https://perma.cc/NNN3-SGMS].

140. John Morley, *Collective Branding and the Origins of Investment Fund Regulation*, 6 VA. L. & BUS. REV. 341 (2012); Bainbridge, *supra* note 38, at 569–70; John D. Morley, *Too Big to Be Activist*, 92 S. CAL. L. REV. 1047 (2019); BLAIR, *supra* note 35, at 157; MARK ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994).

141. Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2057, 2120–21 (2019); ROE, *supra* note 140.

142. Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021, 1073–75(1996); Fisch, *supra* note 54, at 668.

be exposed to such a broad segment of the market that they seek to reduce systemic risks like climate change.[143]

But just as critical as the funds we *do* regulate are the funds we *do not*—specifically, those that are exempt from investment company regulation, and therefore are not subject to the same requirements of disclosure and diversification. For many years, funds could only escape regulation if they had fewer than one hundred investors and did not sell shares to the "public"—a vague standard that inhibited fund growth. In 1982, however, the SEC created a bright-line rule that defined offerings as "private" so long as they only involved investors with a significant net worth.[144] In 1996, Congress and the SEC expanded the scope of the exemption, essentially eliminating the one hundred-person cap so long as the investors were even wealthier.[145] Doing so opened the door to the meteoric growth of hedge funds, venture capital, and private equity funds.[146] The rise of these investors, who may concentrate their holdings and are not subject to mutual fund liquidity requirements, has reshaped the corporate landscape, fueling mergers, increased leverage, stock buybacks, and take-private deals in public companies, and providing crucial capital that allows private companies to delay public offerings and all of the scrutiny that accompanies them.

What we see, then, is the overarching impact of the regulatory framework. Regulations created the modern pension fund and the modern mutual fund industry; regulations dictate their incentives and therefore the actions they take with respect to their portfolio firms. Regulators then made the decision to permit bigger funds to avoid regulation, and the behavior of these shareholders is dramatically different than regulated funds: they take a more interventionist stance with companies, with a greater emphasis on immediate returns to shareholders and cash

143. Madison Condon, *Externalities and the Common Owner*, WASH. L. REV. (forthcoming) (manuscript at 14), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3378783; Jim Hawley & Jon Lukomnik, *The Long and Short of It: Are We Asking the Right Questions?*, 41 SEATTLE U. L. REV. 449, 459 (2018).

144. Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 88–89 (2011).

145. *Id.* at 89. Currently, to avoid federally required disclosure, the fund must not accept more than 2,000 investors. 15 U.S.C. § 78l(g) (2020). As a practical matter, the 2,000-person limit imposes few practical restraints on funds' capital raising.

146. Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 468 (2017); Cheffins & Armour, *supra* note 144, at 89–90; *see also* Michael Ewens & Joan Farre-Mensa, *The Deregulation of the Private Equity Markets and the Decline in IPOs* 3 (Nat'l Bureau of Econ. Research, Working Paper No. 26317, 2019), http://www.nber.org/papers/w26317.

distributions.[147] Those choices have real-world effects that flow well beyond finance.

Beyond the crafting of different types of investors, regulatory choices directly dictate the *priorities* of investors, specifically by obliging institutions to consider (or not consider) certain aspects of corporate performance when making an investment or engaging with portfolio companies. For example, the Department of Labor administers ERISA, and the past several presidential administrations have ping-ponged in their guidance regarding the degree to which trustees of ERISA plans are free to take aspects of corporate social performance into account when making investment decisions.[148] The United States' approach stands in sharp contrast to Europe's, where asset managers are expected to integrate an analysis of corporate social performance into their investment decisionmaking as part of their fiduciary obligations to their beneficiaries.[149]

Regulation cannot dictate the priorities of retail investors—who make up twenty to thirty percent of the public company shareholder base—in the same way, but it can elevate, or minimize, their voices. Retail investors almost certainly have different preferences than institutions, both in terms of timelines and risk tolerance, and many speculate that they may have distinct views on corporate social performance, as well.[150] As a result,

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147. The different behaviors of hedge funds versus mutual funds does not establish that hedge funds—freed of regulation—represent the "true" shareholder; regulations require that hedge funds only sell shares to wealthy institutions, which likely affects their preferences and tactics.

148. Lipton, *supra* note 15, at 889–90. The guidance is more subtle than outright prohibiting or permitting the use of such factors; rather, different administrations impose a greater or lesser "burden of proof" on investors to establish that such factors contribute to plan wealth maximization.

149. European Commission Press Release IP/19/1571, Capital Markets Union: Commission Welcomes Agreement on Sustainable Investment Disclosure Rules (Mar. 7, 2019); KPMG, IMPACT OF ESG DISCLOSURES 4 (Sept. 2019), https://assets.kpmg/content/dam/kpmg/xx/pdf/2019/09/impact-of-esg-disclosures.pdf [https://perma.cc/W5DF-4MQW]; Myriam Vander Stichele, *Investor's Disclose of Sustainability Risks*, SOMO (Sept. 27, 2019), https://www.somo.nl/new-eu-law-obliges-investors-to-disclose-sustainability-risks/ [https://perma.cc/X3VW-C3AP]. Additionally, in 2000, the UK enacted legislation that required pension funds to disclose how they incorporate ESG in their investment processes. *See* ISS, *European and U.S. Asset Owners' Approaches to ESG: What Investment Managers Need to Know* (Nov. 2017), https://www.issgovernance.com/file/publications/european-and-u.s.-asset-owners-approaches-to-esg.pdf [https://perma.cc/72UQ-FNBN]; *see also* Prudence Ho, *Disclosure Rules to Force Private Debt Funds to Address ESG*, REUTERS (Dec. 11, 2019), https://www.reuters.com/article/disclosure-rules-to-force-private-debt-f/disclosure-rules-to-force-private-debt-funds-to-address-esg-idUSL8N28L4L8 [https://perma.cc/Y2ZC-6MCT] (describing EU rules requiring asset managers to disclose how sustainability issues affect asset values).

150. Alon Brav et al., *Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement, and Voting* 22 (ECGI, Working Paper No. 637/2019, 2019),

regulatory choices that make it easier, or harder, for them to vote are likely to impact the choices corporations make with respect to labor, the environment, and general risk-taking. For example, the SEC's decision to permit companies to distribute proxy ballots via the internet rather than in hard copy reduced the likelihood of retail shareholder voting.[151] SEC Rule 14a-8, which currently permits shareholders with holdings as little as $2,000 to submit matters to a shareholder vote,[152] is an especially salient tool for elevating retail shareholder voices—and regulation can either enhance that voice, or quash it.[153]

To put the point more bluntly: the existence of different types of investors, their preferences with respect to corporate behavior, their risk tolerance, and their time horizons, are all at least partially a product of regulatory choice. Since corporations are designed to respond to the preferences of their shareholder base, these choices necessarily influence corporate action not merely with respect to investors, but with respect to the broader society, whether they're about allocating capital to dirty projects or clean ones,[154] whether to cooperate with or fight unionization drives, whether to merge and eliminate competition, jobs, and product lines, or whether to operate as a public company—with all of the

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https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3387659; Scott Hirst, *Social Responsibility Resolutions*, 43 J. CORP. L. 217, 219 (2018); Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 250 (2017); Caleb N. Griffin, *We Three Kings: Disintermediating Voting at the Index Fund Giants*, MD. L. REV. (forthcoming) (manuscript at 32), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3365222.

151. Choonsik Lee & Matthew E. Souther, *Managerial Reliance on the Retail Shareholder Vote: Evidence from Proxy Delivery Methods*, MGMT. SCI. (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2970650; Fabio Saccone, *E-Proxy Reform, Activism, and the Decline in Retail Shareholder Voting*, DIRECTOR NOTES 4 (Dec. 2010), http://www.shareholderforum.com/e-mtg/Library/20101200_ConferenceBoard.pdf [https://perma.cc/3Q6X-WLYT].

Regulators can also encourage or discourage voting by mutual funds using their authority under the Investment Company Act and Investment Advisors Act. Over the years, the SEC has promulgated regulations and issued guidance strongly encouraging funds to vote their shares as an aspect of the fiduciary obligations to fund beneficiaries, *see* Ann M. Lipton, *Family Loyalty: Mutual Fund Voting and Fiduciary Obligation*, 19 TRANSACTIONS: TENN. J. BUS. L. 175, 183–84 (2017), but more recently, it has proposed regulations that would impede the vote by, among other things, limiting funds' ability to use a computerized platform to preprogram standardized voting instructions. Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, 84 Fed. Reg. 66,518, 66,519–20 (proposed Dec. 4, 2019) (to be codified at 17 C.F.R. pt. 240).

152. 17 C.F.R. § 240.14a-8 (2013).

153. *See* Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, 84 Fed. Reg. 66458, 66459 (proposed Dec. 4, 2019) (to be codified at 17 C.F.R. pt. 240) (proposing to raise the dollar thresholds for shareholders to submit matters to a vote under Rule 14a-8).

154. John C. Coffee, Jr., *The Agency Costs of Activism: Information Leakage, Thwarted Majorities, and the Public Morality* 36 (ECGI, Working Paper No. 373/2017, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3058319.

associated scrutiny—or instead adopt private status. More importantly, there is no "neutral" option: information will be required, or it will not; investors will have a responsibility to consider certain matters, or they will not; there is no option not to decide. If we believe, for example, that corporations are too quick to outsource labor, or are likely to choose immediate cost-cutting measures over long-term research and development, the simplest solution would be to return to the pre-1996 regulatory landscape that dramatically limited hedge fund growth.

The typical response to this kind of argument is to claim that it is reasonable to assume that all investors want to maximize their wealth, and corporate and securities regulation should effectuate that preference. Regulations that attempt to accomplish some other goal are therefore inefficient and substantively misguided. The difficulty, as many have documented, is that wealth maximization has a variety of different meanings due to investors' differences with respect to diversification, time horizons, tax status, among other matters,[155] and these differences *are controlled by the regulatory system itself*.[156] This is why mutual funds and hedge funds—both of which presumably are maximizing fund wealth—operate in dramatically different ways. Moreover, even choices to require greater or lesser *evidence* of the wealth-maximizing properties of "green" investments over "brown" ones,[157] for example, reflects a regulatory skepticism that is not simply an unbiased effectuation of investor preference.

In the face of institutions' divergent preferences, commenters have developed new models of shareholder voting to replace the more traditional assumption that all shareholders desire wealth maximization.[158] These include arguments that institutions should maximize the total welfare of their ultimate beneficiaries,[159] and that shareholder voting

155. Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 564 (2006); Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 448 (2008); Omri Y. Marian, *Is All Corporate Tax Planning Good for Shareholders?*, 52 UC DAVIS L. REV. 905, 910 (2018). Additionally, though it is reasonable to assume that all investors hope to make a profit, it is not reasonable to assume that all investors hope to profit *at the expense of all other values. See* Lipton, *supra* note 15, at 869.

156. Additionally, though it is reasonable to assume that all investors hope to make a profit, it is not reasonable to assume that all investors hope to profit *at the expense of all other values*. *See* Lipton, *supra* note 15, at 869.

157. *See supra* note 148.

158. *See* Andrzej Rapaczynski, *Impact Investing as a Form of Lobbying and its Corporate-Governance Effects*, 11 CAPITALISM & SOC'Y 1, 6 (2016); Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775, 788; *Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 377, 388 (Del. 2010).

159. *See, e.g.*, Leo E. Strine, Jr., *Toward a Fair and Sustainable Capitalism*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3461924; WEBBER, *supra* note 92. By contrast, Professor Sean Griffith would prohibit mutual funds from voting their shares so as to maximize the wealth of a particular fund if doing so would diminish wealth at any

should serve as a "mechanism for aggregating heterogeneous preferences."[160] But on a broader level, we can see that these regulatorily-constructed shareholders—mutual funds catering to the general public, pension funds for union members, hedge funds for wealthier investors seeking greater risk, retail investors with idiosyncratic focus on, or knowledge of, particular companies—must, despite their differences, find common ground to wield influence over their portfolio companies. Scholars have documented how different types of shareholders play different roles in corporate governance, working collaboratively to exchange information and steer the performance of their investments.[161] Increasingly, activist funds—who ordinarily are known for aggressive financial engineering—are shifting tactics to respond to the needs of longer term holders.[162] As larger fund managers express more interest in sustainability as an investment strategy, hedge funds have entered into the space, appealing to long-term holders' environmental and social concerns.[163]

The system, then, has settled upon an arrangement that, if not by design, then in practical effect, approximates the separation of powers in governments, where factions with specific interests are deliberately

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specific company; instead, they would be required to cast each vote so as to maximize wealth at the specific firm. Griffith, *supra* note 90. In that respect, funds would be forced to cast each ballot as though they had the preferences of an undiversified, concentrated shareholder.

160. Paul H. Edelman et al., *Shareholder Voting in an Age of Intermediary Capitalism*, 2014 S. CAL L. REV. 1359, 1364. Significantly, this represents a shift in views of at least two of that article's authors, who previously wrote that shareholders have relatively homogeneous preferences, and therefore voting's sole purpose would be to aggregate their private information as to the best course of corporate action. Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129, 152 (2009).

161. Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013); Ian R. Appel et al., *Standing on the Shoulders of Giants: The Effect of Passive Investors on Activism*, 32 REV. FIN. STUD. 2720 (2019); Jill E. Fisch & Simone Sepe, *Shareholder Collaboration*, TEX. L. REV. (forthcoming) (manuscript at 36), http://ssrn.com/abstract=3227113; Edward Rock & Marcel Kahan, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders* (NYU Law and Economics Research Paper No. 18-39), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3295098; Nili & Kastiel, *supra* note 138.

162. Lipton, *supra* note 15, at 887–88.

163. Amy Whyte, *Hedge Fund Activists Pivot to ESG*, INSTITUTIONAL INV. (Jan. 23, 2020), https://www.institutionalinvestor.com/article/b1k0ztq7n2wc6d/Hedge-Fund-Activists-Pivot-to-ESG [https://perma.cc/9EDR-DTF6]; Brooke Sutherland, *Activists Should Take the Lead on Board Diversity*, BLOOMBERG (Apr. 5, 2018, 9:21 AM), https://www.bloomberg.com/opinion/articles/2018-04-05/activist-investors-should-taker-the-lead-on-board-diversity [https://perma.cc/HUA3-FZ2R] (describing one fund's strategy of faulting incumbent boards for lack of diversity); Alexander Kraik, *Environmental, Social, and Governance Issues: An Altered Shareholder Activist Paradigm*, VERMONT L. REV. (forthcoming) (manuscript at 57).

constructed in order to ensure that decisions require the cooperation of multiple constituencies.[164]

Viewing corporate governance through this lens opens up the possibility of more deliberate efforts to ensure a heterogeneous set of interests are represented in the corporate polity. For example, scholars have proposed various technological mechanisms that would make it more likely that retail shareholders vote their shares.[165] Others have recommended that more use be made of employee-stock ownership, with a voting trust given responsibility for casting ballots on employees' behalf.[166] There are proposals that retail shareholders be given more control over how mutual funds vote their shares, either with pass-through voting,[167] or other measures.[168] There have even been proposals to use financial incentives to encourage active over passive investing, in the expectation that doing so will alter corporate business strategies.[169] The mere fact that these options are under consideration—where they can be adopted, or not—makes visible the role that the state plays in dictating which voices influence corporate behavior. Nor are these choices limited to public companies. There have been proposals, for example, to grant retail shareholders more opportunities to invest in startups, perhaps via funding vehicles designed for that purpose.[170] Should such proposals become law, we can imagine that these vehicles—likely catering to individuals with a modest, but not extreme, amount of wealth—will have very different preferences than the venture capitalists that fund startups

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164. Michaels, *supra* note 101, at 525–26; THE FEDERALIST NO. 51 (James Madison) ("[T]he great security against a gradual concentration of the several powers in the same department consists in giving to those who administer each department the necessary constitutional means and personal motives to resist encroachments of the others.").

165. *See* Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 11 (2017); Kobi Kastiel & Yaron Nili, *In Search of the "Absent" Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55 (2016).

166. *Corporate Accountability and Democracy*, BERNIE SANDERS (2020), https://berniesanders.com/issues/corporate-accountability-and-democracy/ [https://perma.cc/Z7GW-69EE]; Jonathan Ford, *Labour Takes Aim at Shareholder Capitalism*, FIN. TIMES (Sept. 3, 2019), https://www.ft.com/content/f4d9c1a8-ca48-11e9-a1f4-3669401ba76f [https://perma.cc/PL2H-75VL].

167. *Index Funds Votes: Take Back Control*, FIN. TIMES (Feb. 11, 2020), https://www.ft.com/content/1d31407a-6817-4524-a6c5-9ce11ed5058c [https://perma.cc/A755-BQZ7]; Griffin, *supra* note 150.

168. Hart & Zingales, *supra* note 150; Hirst, *supra* note 150.

169. Adi Libson & Gideon Parchomovsky, *Reversing the Fortunes of Active Funds* (Univ. of Pa., Inst. for Law & Econ. Research Paper No. 20-04, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3517849.

170. Concept Release on Harmonization of Securities Offering Exemptions, Release Nos. 33-10649, 34-86129, IA-5256, IC-33512 (June 18, 2019), https://www.sec.gov/rules/concept/2019/33-10649.pdf [https://perma.cc/VH79-8YRW].

today, with concomitant effects on the behavior and business strategies of early-stage companies.

In a real sense, modern businesses have invited this type of governance structure: Business leaders publicly insist on the right to make decisions that affect the rights not only of investors, but other corporate stakeholders,[171] and though the intent may simply be to stave off command-and-control style regulation,[172] the natural implication is that a variety of stakeholders must be have an opportunity to influence corporate decisionmaking.[173]

CONCLUSION

As the above discussion demonstrates, there is no way to silo a corporate governance law for investors while leaving other constituencies to seek protection elsewhere. In everything from compliance to vicarious liability, corporate processes are designed with the broader society in mind. This is, in fact, unavoidable: corporate managers react to the incentives they are given, and those incentives come both from substantive regulatory commands, and the levers of power within the corporate form.

The implication is not that any particular regulator—be it the Delaware courts, the SEC, or corporate prosecutors—should attempt to solve all of society's ills with a holistic redesign of corporate law. Rather, the point is that as a descriptive matter, when all sources of law are considered, the build of the corporate form represents a compromise that accounts for the interests of multiple stakeholders. Therefore, as a normative matter, there is nothing illegitimate about regulators, acting within their sphere of competence, consciously using all of the tools—including corporative governance tools—available to them to achieve society's ends. The illusion that corporate design is solely intended to benefit investors—or, worse, that it is largely the province of "private ordering"—can blind commenters and policymakers to the implications of regulatory choice. Decades ago, commenters devoted a classic symposium to the question whether corporate law rules were imposed by the state or

171. BUSINESS ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION (2019).

172. Helaine Olen, *CEOs Don't Want to Be Blamed for Inequality—Or Do Anything About It*, WASH. POST (Aug. 22, 2019, 5:54 PM), https://www.washingtonpost.com/opinions/2019/08/22/ceos-dont-want-be-blamed-inequality-or-do-anything-about-it/ [https://perma.cc/V3GM-JERW]; Martin Lipton, *Stakeholder Corporate Governance Business Roundtable and Council of Institutional Investors*, HARV. L. SCH. F. CORP. ON GOVERNANCE (Aug. 21, 2019), https://corpgov.law.harvard.edu/2019/08/21/stakeholder-corporate-governance-business-roundtable-and-council-of-institutional-investors/ [https://perma.cc/6TF3-U6RZ].

173. *See* Strine & Walter, *supra* note 8; Yosifon, *supra* note 30.

privately chosen;[174] however relevant that debate may have been at the time, today it should be apparent that mandatory regulation shapes both the corporate form and the investors who contribute capital and participate in governance. As a result, policy questions regarding the impact of these choices on the broader society cannot be avoided; they can only be submerged or confronted directly.

174. *Symposium: Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989).