



---

Fall 9-1-2006

## Shareholders as Proxies: The Contours of Shareholder Democracy

Dalia Tsuk Mitchell

Follow this and additional works at: <https://scholarlycommons.law.wlu.edu/wlulr>



Part of the [Business Organizations Law Commons](#), and the [Securities Law Commons](#)

---

### Recommended Citation

Dalia Tsuk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 Wash. & Lee L. Rev. 1503 (2006).

Available at: <https://scholarlycommons.law.wlu.edu/wlulr/vol63/iss4/10>

This Article is brought to you for free and open access by the Washington and Lee Law Review at Washington and Lee University School of Law Scholarly Commons. It has been accepted for inclusion in Washington and Lee Law Review by an authorized editor of Washington and Lee University School of Law Scholarly Commons. For more information, please contact [christensena@wlu.edu](mailto:christensena@wlu.edu).

# Shareholders as Proxies: The Contours of Shareholder Democracy

Dalia Tsuk Mitchell\*

## *Table of Contents*

I. Introduction .....	1504
II. 1900s–1930s: Disclosure, Organization, and Trust .....	1514
A. Disclosure Part I: Regulating Monopolies .....	1514
B. The Problem of Control .....	1519
C. Voting, Organization, and Trust .....	1528
III. 1930s–1970s: Consumerism, Democracy, and Its Limits .....	1535
A. Disclosure Part II: Regulating Markets .....	1535
B. William O. Douglas’s Crusade .....	1542
C. Democracy .....	1547
D. Democracy’s Limits .....	1554
IV. 1970s–1980s: Markets, Voters, and Convergence .....	1560
A. Disclosure Part III: Free and Unregulated .....	1560
B. Social Responsibility Proposals: The Final Crusade .....	1564
C. Convergence: Exit, Voice, and Legitimacy .....	1572
V. Epilogue .....	1576

---

\* Associate Professor of Law, The George Washington University Law School. I am grateful to David Millon and Lyman Johnson for organizing this symposium and for inviting me to participate, and to the other participants for their comments and suggestions. For their comments on an earlier draft, I am also thankful to Bill Bratton, Dan Ernst, Fred Lawrence, and to the participants in the Legal History Colloquium at UCLA Law School, especially to Stephen Bainbridge, Steven Bank, Stuart Banner, Kathy Stone, Lynn Stout, and Adam Winkler. I owe special thanks to Kathy Stone for suggesting the title, "Shareholders as Proxies." Last but certainly not least, thanks and appreciation go to Larry for commenting on drafts, for editorial suggestions, and for innumerable conversations about corporate legal history. Courtney Rodgers provided great research assistance. The George Washington University Summer Research Fund provided financial support. All errors remain mine.

"All the stockholders act like a flock of sheep."<sup>1</sup>

"We put a man on the moon, but we *can't* manage the consequences of shareholder democracy."<sup>2</sup>

### I. Introduction

On March 31, 2006, just as the spring annual meeting season began, The Corporate Library released a study of eleven of the largest U.S. companies revealing that "compensation committees authorized a total of \$865 million in pay to CEOs who presided over an aggregate loss of \$640 billion in shareholder value."<sup>3</sup> Around the country, corporate directors and executives felt, some for the first time, the wrath of organized, discontented shareholders who demanded more say about director elections and executive compensation. In the annual meetings that followed, shareholders considered proposals to limit or, at the least, monitor directors' and executives' compensation, as well as proposals to permit shareholders to withhold votes from directors (especially those serving on compensation committees) as a means of requiring them to resign. In some companies, shareholders were even asked to vote on proposals that would require a director to gain a majority of "yes" votes to be elected.<sup>4</sup> As one commentator put it: "There is a whiff of revolution in the air. America's shareholders are growing restless, and the bosses of the companies they own seem increasingly nervous as they peer out from behind their boardroom curtains."<sup>5</sup>

---

1. Robert F. Herrick (cited in WILLIAM Z. RIPLEY, *MAIN STREET AND WALL STREET* 96 (1927)).

2. Gretchen Morgenson, *Who's Afraid of Shareholder Democracy?*, N.Y. TIMES, Oct. 2, 2005, § 3, at 1.

3. Press Release, The Corporate Library, \$865MM in CEO Compensation While Shareholders Suffer \$640BN in Losses (Mar. 31, 2006), [http://www.thecorporatelibrary.com/tcl-store/PressReleases/865mm\\_in\\_ceo\\_compensation\\_while.htm](http://www.thecorporatelibrary.com/tcl-store/PressReleases/865mm_in_ceo_compensation_while.htm) (last visited Jan. 31, 2007) (on file with the Washington and Lee Law Review).

4. Gretchen Morgenson, *The Shareholder Spring: Investor Discontent Fills Annual Meeting Agendas*, N.Y. TIMES, Apr. 27, 2006, at C1. Currently, in most corporations, a candidate only has to win more votes than any other candidate. Hence a candidate can be elected with only one "yes" vote if the remaining votes are withheld. See Dennis K. Berman, *Boardroom Defenestration—As Proxy Season Heats Up, Companies Consider Rules to Boot Unwanted Directors*, WALL ST. J., Mar. 16, 2006, at B1 (discussing a potential shift toward majority voting in director elections).

5. *Ownership Matters; Shareholder Democracy*, ECONOMIST, Mar. 11, 2006, at 10.

Some might celebrate this new (or renewed) shareholder activism as an important milestone in empowering shareholders to negotiate corporate governance structures that would benefit them and other investors.<sup>6</sup> Others might caution against giving shareholders too much power.<sup>7</sup> And many will agree that despite these developments, there is no reason to believe that the way corporations, their directors, or their executives behave would dramatically change in the absence of financial incentives that require them to do so.<sup>8</sup> In this respect, a pointed comment in *The Economist* a couple of years ago rings true: "America is the world's most prominent democracy, and its most successful exponent of shareholder capitalism. But when it comes to shareholder democracy, America has barely moved beyond the corporate equivalent of the rotten borough."<sup>9</sup> In this Article I turn to history to explore why.

I should emphasize at the start that I do not attempt to evaluate whether the active participation of shareholders will improve how corporations are run. Nor do I engage in the debate as to whether shareholder democracy is a useful concept in characterizing the relationship between shareholders, their directors,

---

6. See, e.g., Press Release, Harvard Law School, AIG, Bristol-Myers and Time-Warner amended bylaws in response to Bebchuk's proposals, Apr. 5, 2006, [http://www.law.harvard.edu/news/2006/04/05\\_bebchuk.php](http://www.law.harvard.edu/news/2006/04/05_bebchuk.php) (discussing binding bylaw provisions adopted by these companies to limit board power with respect to poison pills, to reimburse shareholders for expenses incurred in conjunction with a shareholder proposal that won a majority of the votes, and to allow shareholders to withhold their votes as a means of requiring directors to resign) (on file with the Washington and Lee Law Review).

7. See generally Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006) (arguing that the separation of ownership from control offers important efficiency benefits which justify limited shareholder participation, at least as a default rule); Lynn Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. (forthcoming 2007), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=929530](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=929530) (arguing that board control offers shareholders in public corporations important economic benefits that shareholder control does not).

8. *Ownership Matters*, *supra* note 5, at 10; see also Gretchen Morgenson, *Can't Take It Anymore?*, N.Y. TIMES, Apr. 30, 2006, § 3, at 1 (reporting on the re-election of Pfizer's directors); Joe Nocera, *The Board Wore Chicken Suits*, N.Y. TIMES, May 27, 2006, at C1 (reporting on the annual meeting of Home Depot and concluding that "[i]f there is one thing the meeting proved, it is that [the directors] don't much care what their shareholders think"); Chad Terhune & Joann S. Lublin, *At Home Depot, CEO 'Pay Rage' Boils over in Vote*, WALL ST. J., June 2, 2006, at A3 (reporting that although 30% of the shareholders' votes were withheld from ten of the eleven directors of Home Depot, these directors didn't plan to step down); Jeffrey Ball, *Exxon Holders Defy Management with Resolution*, WALL ST. J., June 1, 2006, at A10 (reporting that even though Exxon Mobil's shareholders approved a management-opposed resolution requiring a majority rather than a plurality vote for board member elections, the board's response was to take the resolution under advisement).

9. *No Democracy Please, We're Shareholders: American Corporate Governance*, ECONOMIST, May 1, 2004, at 13.

and their corporations. My goal is limited to exploring the historical roots of current discussions about the shareholders' role in publicly held corporations.

Proponents of shareholder democracy might want to fault those who caution against it for the fact that meaningful shareholder participation in corporate affairs, independent of financial incentives, seems to remain out of our reach. But, as I argue, the reality of the shareholder's role in public corporations is a product of a broader phenomenon—a century-long suspicion of the individual shareholder-participant and a corresponding ambivalence toward shareholder (participatory) democracy. History shows that attempts that appeared to foster shareholder democracy, independent of financial demands, were never really about promoting the shareholders' active involvement in managing the affairs of their corporations. Rather, reformers used the rhetoric of shareholder democracy to promote broader goals and visions. In the process, they gradually made shareholder (participatory) democracy much talk about, well, nothing.

Currently, the ability of shareholders to affect corporate change is limited. First, the individual vote in large public corporations makes little if any difference. At least in part, this is why most shareholders vote for what the incumbent board wants (or why most proxy solicitations by the board are successful). Institutional investors might have more voting power (and, indeed, many of the above-mentioned proposals are promoted by pension funds)<sup>10</sup> but, ultimately, these institutions also have more to lose by pushing too hard, especially in terms of their ongoing relationships with corporate management.<sup>11</sup>

---

10. The idea that institutional investors would monitor management was prevalent during the 1990s. For an analysis of these investors' ability to do so, see, e.g., Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992).

11. For example, Gretchen Morgenson notes that:

[D]ata for the 12 months ended June 30 show that Fidelity . . . sided with corporate management and directors in 92.5 percent of its votes and supported 99 percent of the directors whom management nominated. On shareholder proposals intended to give investors more say in board elections or to limit executive or director pay, Fidelity repeatedly voted "no."

Gretchen Morgenson, *Fidelity, Staunch Defender of the Status Quo*, N.Y. TIMES, Oct. 8, 2006, § 3, at 1; see also Gretchen Morgenson, *How to Find a Fund's True Colors*, N.Y. TIMES, Sept. 10, 2006, § 3, at 1 (examining funds' votes to determine whether they were motivated by shareholders' interests or their own). But see Gretchen Morgenson, *Belated Apologies in Proxy Land*, N.Y. TIMES, Aug. 20, 2006, § 3, at 1 (reporting on the Putnam Funds' campaign to change corporate governance by emphasizing "director independence, executive compensation, and shareholder proposals that have been approved by a majority of owners but have still not been put into effect by companies"). According to Morgenson, Putnam Funds "opposed directors in 16 percent of elections and voted against 64 percent of proposals by these companies to adopt or amend stock option or restricted stock plans for company executives or

Hedge fund activism is similarly dubious.<sup>12</sup>

A shareholder seeking to challenge the actions of her corporation's management (by which I mean directors and executives) may engage in a proxy contest, and, if successful, be able to upset management's plans, perhaps even oust the board. But this is rare. The board almost always dominates the proxy process. First, the only votes that count are those cast in favor of the names on the proxy, which usually are proposed by management. Furthermore, management often proposes only one candidate for each open board seat. Finally, 60% of American firms have a staggered board, which means that only one-third of board seats are up for election each year. A shareholder could still submit her own proxy "carrying a rival slate of candidates." But unlike management, which has the right to use corporate funds to promote its slate, the dissident shareholder has to incur the cost of the proxy contest. This can amount to several million dollars. Not surprisingly, proxy contests rarely happen.<sup>13</sup>

---

directors." *Id.*

12. In a recent study of hedge fund activism, William Bratton concludes that this new form of shareholder activism has the potential to change "the balance of power between managers and shareholders," especially through the usage of the proxy system. William W. Bratton, *Hedge Funds and Governance Targets*, Georgetown Law & Econ. Research Paper, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=928689](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=928689). Yet, as Bratton also notes, hedge funds, like institutional investors in the 1990s, act only when there are financial incentives to do so. *Id.* at 7. As Bratton puts it, their activism is "benign" and in many cases, "[a]ctivists have joined many target board of directors, modifying their tactics in so doing." *Id.* at 6; see also Jesse Eisinger, *Hedge-Fund Activism Wins Plaudits, But the Focus Is Really on Firms' Cash*, WALL ST. J., Oct. 12, 2005, at C1 (noting that "[t]he problem with the new wave of hedge-fund activism is that it is, for the most part, friendly and modest. Hedgies are notorious for being short-term thinkers; the question is whether they will follow through on their activism in the face of resistance").

13. *No Democracy Please*, *supra* note 9, at 13; see also Lucian Arye Bebchuk, *The Case for Shareholder Access: A Response to the Business Roundtable*, 55 CASE W. RES. L. REV. 557, 559 (2005) (noting that "in the seven-year period 1996–2002 . . . 215 contested proxy solicitations took place, about 30 per year on average"). According to Bebchuk:

The majority of the contested solicitations . . . did not involve attempts to replace the board with a new team that would run the firm differently. About a quarter of the contests did not involve director elections at all, but concerned other matters such as proposed bylaw amendments. Among contests over the election of directors, a majority involved a fight over a possible sale of the company or over a possible opening or restructuring of a closed-end fund. Contests over the team that would run the (stand-alone) firm in the future occurred in about 80 companies, among the thousands that are publicly traded, during the seven-year period 1996–2002.

Furthermore, most of the firms in which such contests occurred were small. Of the firms in which such contests occurred, only 10 firms had, in the year of the contested solicitation, a market capitalization exceeding \$200 million. Thus, the

While an individual shareholder might demand that management include a shareholder proposal along with its proxy solicitation under Rule 14a-8 of the Securities Exchange Act of 1934, the Securities and Exchange Commission (SEC) and the courts have limited the permissible scope of shareholder proposals. Most important, a board can refuse to include a proposal dealing with "ordinary business" activity. In any event, a shareholder proposal that is included and approved typically has no binding force. It is legally nothing more than advice to the board, and the board can ignore it.<sup>14</sup>

Shareholders' voting power would increase if boards of directors were to adopt charter provisions allowing shareholders to force the resignation of any board member by withholding their votes. It would also increase if corporations adopt a majority vote rule,<sup>15</sup> or if shareholders are allowed to introduce shareholder proposals to demand shareholder access proposals in their bylaws. (Shareholders access proposals would permit shareholders to nominate their own candidates for the board in certain circumstances.)<sup>16</sup>

---

incidence of such contests for firms with a market capitalization exceeding \$200 million was remarkably low—less than two per year on average.

*Id.*

14. See *No Democracy Please*, *supra* note 9, at 13 (noting that shareholder resolutions generally do not bind corporate boards).

15. On January 17, 2006, the Committee on Corporate Laws of the Section of Business Law of the American Bar Association released a preliminary report detailing possible amendments to the Modern Business Corporation Act. These amendments would allow either the board of directors or the shareholders unilaterally to amend their corporation's bylaws to require majority voting. This change would "have the effect of not seating, for more than a 90-day transitional period, a director whose election or re-election has effectively been rejected by a majority of votes cast." Press Release, Committee on Corporate Laws of the Section of Business Law of the American Bar Association, Corporate Law Committee Releases Preliminary Report on Director Voting (Jan. 17, 2006), <http://www.abanet.org/buslaw/committees/CL270000pub/directortesting/20060117000001.pdf>. Pfizer, Inc., Microsoft Corp., Gannet Co. and Safeway Inc. have already amended their election guidelines, so that "any director who receives more 'withhold' votes than 'for' votes must submit his or her resignation." Phyllis Plitch, *Critics Fault Changes to Board Votes—Corporate Democracy Move Draws Fire as Smoke Screen; Time for Majority Standard?*, WALL ST. J., Nov. 29, 2005, at B8. It is important to remember, however, that the board "can reject a resignation and retain an unpopular director." Gretchen Morgenson, *Finally, Shareholders Start Acting Like Owners*, N.Y. TIMES, June 11, 2006, § 3, at 1. As Morgenson also notes,

[P]roposals that would require directors to win more than half of the shareholders' vote to gain a board seat have appeared at 140 companies this year. At companies including Bank of America, the Borders Group, the EMC Corporation, International Paper, Raytheon and Verizon, more than half of the votes cast supported such proposals.

*Id.*

16. In September 2006, a decision of the United States Court of Appeals for the Second Circuit altered a long-standing SEC policy allowing companies to exclude shareholder

Yet, as I argue in this Article, none of these mechanisms is likely to change the century-long suspicion of the individual shareholder-participant and the corresponding empty rhetoric about shareholder democracy that helped bring, shape, and sustain today's reality. This Article explores this suspicion and rhetoric as they are seen in conversations about the shareholder's role in the modern public corporation from the beginning of the twentieth century roughly through the 1980s. It examines how these conversations shifted from the group to the individual to the market as the basis for analysis, gradually eliminating the possibility of meaningful shareholder participation in corporate affairs. While the Article does not engage more recent debates, it offers important historical grounding for them.

As this Article demonstrates, corporate scholars have embraced two competing conceptions of the shareholder's role in the corporation: one focuses on the role of shareholders as investors, the other emphasizes the role of shareholders as potential participants in corporate management.<sup>17</sup> These visions are not mutually exclusive. Yet scholars throughout the twentieth century developed different conceptions of shareholder democracy by prioritizing one vision over the other.

Scholars who viewed shareholders as investors typically argued that the role of law was to guarantee that shareholders had adequate information to participate intelligently in the market for securities. In turn, scholars who

---

proposals having to do with director elections. *Am. Fed'n of State, County & Mun. Employees, Employees Pension Plan v. Am. Int'l Group, Inc.*, 462 F.3d 121 (2d Cir. 2006). The court upheld that the SEC rule applied only to proposals having to do with particular elections and not to proposals seeking to establish "procedural rules for governing elections generally." *Id.* at 131. The court required the American International Group to bring to a shareholder vote a proposal, submitted by the American Federation of State, County, and Municipal Employees' pension plan, to amend the corporation's bylaws to include a shareholder access proposal. The shareholder access proposal would allow a shareholder who has owned "at least 3 percent of the company's stock for a year to nominate directors to appear on the company's proxy as alternatives to the candidates nominated by the existing board." Floyd Norris, *Court Decision Prompts S.E.C. to Revisit a Rule on Shareholder Proposals*, N.Y. TIMES, Sept. 8, 2006, § C, at 5; see also Gretchen Morgenson, *All's Not Lost, Disgruntled Investors*, N.Y. TIMES, Oct. 1, 2006, § 3, at 1 (reporting that the SEC might revise Rule 14a-8 to circumvent the Second Circuit's ruling); Gretchen Morgenson, *Fresh Air for Board Elections?*, N.Y. TIMES, Oct. 15, 2006, § 3, at 1 (reporting that the SEC postponed discussion of the shareholder access proposals, thus leaving the Second Circuit's ruling standing).

17. Some scholars collapse this dichotomy. See, e.g., Patrick J. Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy*, 23 GA. L. REV. 97, 104-05 (1988-89) (observing that "shareholder voting constitutes the investor voice in managing corporate affairs"); Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 78 (2000) (describing the traditional view of shareholders as marginalized owners as a "one-dimensional model of the past" while suggesting expanded roles for shareholders in modern corporations).



envisioned shareholders as participants in management sought to empower or protect them by making changes to the corporation's internal structure. As should be apparent, these two conceptions of the shareholder's role corresponded to two basic models of regulating corporations: regulation of the market for securities and regulation of the corporation's internal structure.

The idea of shareholders as investors limited the location of shareholder democracy to the market. Scholars who viewed shareholders this way focused on mandatory disclosure rules as the means of achieving shareholder democracy. At times they argued that disclosure would provide government agencies with information which they could use to constrain corporate power. At other times, they described shareholders as regulators and claimed that disclosure would provide shareholders with information, which they could use in determining where to invest. At still other times, they proclaimed that shareholders could receive information from others on the market. Throughout the twentieth century, these scholars' basic premise remained the same: The shareholder's role in the large public corporation was limited to her decision to invest or divest.

But scholars and reformers who argued that shareholders should have a more active role in corporate management were also reluctant to give shareholders meaningful access to the corporate decision-making processes. They were afraid that shareholders were too passive to participate in corporate management and, more significantly, that they could not be trusted to make the correct decisions. For the most part, they ended up using the rhetoric of shareholder democracy (and the shareholders) as a proxy for achieving other goals. In the course of the twentieth century, as their attention shifted from the group to the individual to the market as the foundation for legal and political analysis, these scholars also changed their goals from taming the power of the control group to constraining management to legitimating managerial power. More important, because they refused truly to empower shareholders, these scholars' attempts presumably to promote shareholder democracy ultimately drained the idea of any content. By the end of the twentieth century, the participant shareholder was the investor shareholder.

This Article is divided into three parts. The first Part, Disclosure, Organization, and Trust, begins the story of shareholder democracy by examining debates about the modern corporation in the first two decades of the twentieth century. I argue that during this era, corporate scholars' dominant frame of reference was the increasing power of the large public corporation. While scholars in the 1900s and 1910s expressed concern about the disappearance of the individual investor in the large public corporation, they were more worried about the growth of trusts. Seeking either to eliminate

monopolies or to subject them to national regulation, these early-twentieth-century scholars converged on disclosure, either to local or national authorities, as a means of guaranteeing the prosperity of modern economic markets.

By the 1920s, as growing numbers of investors flooded the market, scholars grew more concerned about potential abuses of corporate power and how the rapid separation of ownership from control augmented these potential abuses. At the same time, they also wanted to legitimate the large public corporation and the power of management to run it. As a means of mediating these seemingly conflicting ends, the 1920s reformers emphasized the role that minority shareholders as a group could play in preventing the control group from dominating the corporate decision-making process. (As we will see, in the early twentieth century, the control group was often another group of shareholders or investment bankers, not necessarily corporate management.)<sup>18</sup> If their 1910s predecessors called for mandatory disclosure rules, the 1920s reformers called for minority shareholder organization.

Prominent legal scholars and economists like Adolf A. Berle, Jr. and William Z. Ripley advocated the creation of minority shareholders' protective organizations. Their vision grew out of a new vision of the American state as composed of multiple countervailing powers. They appeared to take their cue from the contemporaneous efforts to empower workers through collective bargaining and from the collective economic power represented by the corporation itself. But, as will become apparent, their interest focused on imposing checks and balances on the power of the control group, be it investment banks, controlling shareholders, or management, not on giving shareholders meaningful voice in corporate management. When forced to choose between trusting shareholders as active agents to tame corporate power and using the goal of protecting shareholders to constrain the exercise of corporate power by those in control, these scholars chose the latter. Ambivalent about granting minority shareholders real power to influence their corporations' affairs, these reformers substituted a regime of fiduciary duties for shareholder organization. The first attempt to give meaningful voice to shareholders ended with protection but not empowerment.

---

18. The present equation of the control group with management is a product of the post-New Deal corporation and a very different structure of share ownership that has characterized American corporations in the second half of the twentieth century. This equation has helped sustain the agency paradigm of corporate law, which has dominated discussions of corporate law in the last decades of the twentieth century. On the economic and legal definitions of control, see Gardiner C. Means, *The Separation of Ownership and Control in American Industry*, 46 Q. J. ECON. 68 (1931).

The second Part of this Article, *Consumerism, Democracy, and Its Limits*, demonstrates how the crash of 1929 and the following Depression shifted scholars' and reformers' attention from the corporation back to the market. Amid investigations of fraud and manipulation that contributed to the 1929 crash, revelations of corruption that permeated the securities market eclipsed earlier concerns about corporate power. The securities acts of 1933 and 1934 did not try to empower or protect shareholders. Their goal was to reinforce the ideal of a healthy free market. Accordingly, the government's role was limited to ensuring the free flow of honest information. Seeking to restore investors' trust, the securities acts (unlike other early-New Deal legislation) were not predicated upon the need for government planning, but on the ideal of consumerism. As long as individual shareholders, like individual consumers in general, were fully informed about their product, they would be able to make intelligent decisions about their securities purchases. As long as individual shareholders had access to internal corporate information, they would help free the market from fraud and manipulation.

The vision of the shareholder as participant did not disappear. In the mid-1930s, William O. Douglas reiterated Berle's and Ripley's ideas (and E. Merrick Dodd endorsed them), and in the early-1940s, the SEC adopted Rule 14a-8 to give shareholders the participatory role state law effectively denied them in managing the affairs of their corporations. By requiring the board to include shareholder proposals in its proxy solicitations, reformers wanted to protect the rights of individual shareholders to share with others their ideas about the corporation's goals.

However, this new participatory role was no longer a collective role. Amid fears of creeping totalitarianism (and later communism), these 1940s reformers turned away from the collectivism of earlier generations and instead embraced the ideal of individual rights as the cornerstone of American and corporate democracy. They wanted to guarantee that both political and economic markets were committed to protecting individual rights and to encouraging dialogue between the rulers and the ruled. As share ownership became widely dispersed and professional management replaced bankers and controlling shareholders as the control group, concerns about corporate power in society and about the power of the control group toward minority shareholders were replaced by concerns about the relationship between management and individual shareholders. Yet, by protecting the rights of individual shareholders to participate in their corporation's annual meetings, the New Deal reformers and their successors hoped not only to constrain the board but also to legitimate its power to run the corporation. More broadly,

they hoped to create an individualist basis for a democracy founded on professional management of collective property.

The 1940s reformers believed that corporations could play an important role in sustaining the ideal of American political democracy. Yet they remained ambivalent about granting power to shareholders; they limited shareholder participation to "proper subjects," leaving an open door for restrictive interpretations of this term. In the following decades, as the idea that the state and its agencies should protect individual shareholders lost its power, together with the ideal of a social welfare state that sustained it, such interpretations helped minimize the shareholders' power. Gradually the SEC, with the courts' approval, used Rule 14a-8 to help legitimate a rather limited vision of shareholder democracy. It was predicated upon the ability of the individual shareholder to protect herself by electing directors who would, presumably, act as her agents. The rise of institutional investors helped sustain this assumption.

The focal point for analysis in the 1970s and 1980s was the market. Mainstream legal scholars and economists came to believe that the market was the most effective institution to constrain corporate activities. If policymakers and legal scholars in the early twentieth century focused on minority shareholders as a group, and mid-century reformers wanted to protect the individual shareholder's right of participation, scholars in the latter part of the twentieth century emphasized the ability of individual shareholders freely to shape their own economic (and political) destinies (albeit in a corporate world radically dominated by institutional investors). Concerns about corporate social, economic, and political power or about managerial abuse of power dissipated; the corporation and, with it, corporate hierarchies, disappeared.

As the third Part, *Markets, Voters, and Convergence*, explores, the argument that shareholders can self-protect underlay the economic theory of the firm, which dominated corporate law in the 1970s and 1980s. Endorsing a strong separation between the roles of shareholders and those in control, proponents of this vision argued that dissatisfied shareholders should either use their voting power or sell their stock. Just as insider professional management became more powerful and the board of directors lost its control, scholars turned to the rhetoric of the law of agency to describe directors as agents of the shareholders and to emphasize the shareholders' power to elect them. All that was left of the shareholder's role in the corporation was her ability to vote or exit, based upon the assumption that when fully informed investors rationally exercised their rights, the market would thrive. At the same time, procedural equality became the cornerstone of American democracy.

The hostile takeovers of the 1980s might have undermined the strength of these scholars' convictions, but it did not alter the basic premise: Shareholder democracy thrived in the market. The vision of the shareholder as participant has converged with the vision of the shareholder as investor. In either role, the shareholder's only goal was to maximize her profits. The shareholders' potential power to exit and vote legitimated the insiders' real market power. The rhetoric of democracy became an apology for the status quo.

On this background, recent calls to give shareholders more meaningful voice in the selection and removal of directors seem to resonate with earlier attempts to foster shareholder democracy. In an intellectual milieu that developed out of the idea that the market was the locus of shareholder democracy, some recent board decisions that allow shareholders to force the resignation of board members by withholding their votes and the shareholder proxy access proposal can easily be described as empowering investors, especially institutional investors.

But these recent efforts are more limited than the earlier attempts described in this Article. Gone is the Progressives' concern with corporate power in society and with it the assumption that minority shareholders could help channel corporate actions to achieve socially beneficial goals. Gone is the New Dealers' concern about hierarchy within corporations and with it the assumption that the individual shareholder should be guaranteed a right of participation. Gone also is the concern about the shareholder's willingness or ability to tame corporations and their managements. All that remains of the ideal of shareholder democracy is the power of shareholders to elect their directors, directors who might have little say in how executives run the corporation, and to exit if they cannot. The participating shareholder is the investor shareholder. If her share price does not soar, she can try to oust the board or sell her stock. Corporations are run as "rotten boroughs"<sup>19</sup> because, in the course of the twentieth century, the ambivalence about shareholder democracy has wiped out all other alternatives.

## *II. 1900s–1930s: Disclosure, Organization, and Trust*

### *A. Disclosure Part I: Regulating Monopolies*

The turn of the twentieth century witnessed a dramatic growth in the scale of private business organizations. Increasing consumer demand, rising numbers of skilled and unskilled workers, and an expanding pool of capital

---

19. *No Democracy Please*, *supra* note 9, at 13.

made the creation of large enterprises possible, while corporate lawyers created a variety of legal devices to help their clients increase the scope of their operations through "cooperation and combinations."<sup>20</sup> Trusts, holding companies, and mergers became common, even if often contested in state courts.<sup>21</sup> The nineteenth-century corporation, which was subject to strict constraints on its powers as well as limitations on its capital structure, was replaced by larger and larger units. Between 1888 and 1893, New Jersey revised its general incorporation statute to eliminate restrictions on "capitalization and assets, mergers and consolidations, the issuance of voting stock, the purpose(s) of incorporation, and the duration and locale of business."<sup>22</sup> Other states followed suit, enacting more enabling incorporation statutes (including Delaware, which by the second decade of the twentieth century would become the revolution's leader).<sup>23</sup> And corporations were quick to use the power that these enabling statutes granted them. Between 1898 and 1901, "2,274 firms disappeared as a result of merger, and merger capitalization totaled \$5.4 billion."<sup>24</sup>

The concentration of power in the trusts and large business corporations undermined nineteenth-century democratic ideals. Progressives feared that corporations were wearing away the function of the individual producer and, with it, the nineteenth-century democratic and economic ideals. These ideals were the power of markets equally to "distribute the rewards of individual industry" and to help "conform individual liberty" to socially beneficial ends.<sup>25</sup> For some scholars, individual ownership of property and participation in the market economy were a means of cultivating social and political citizenship. They saw in the corporation's collective ownership a threat to the idea of "ordinary producers," who "shape their world on equal footing."<sup>26</sup> For others, private property was a means of constraining the exercise of public power.

---

20. AMERICAN LEGAL REALISM 130–31 (William W. Fisher, III, Morton J. Horwitz & Thomas A. Reed eds., 1993).

21. *See id.* at 131 (tracing the development of corporate ownership structures and corresponding government regulations); *see also* ROLAND MARCHAND, *CREATING THE CORPORATE SOUL: THE RISE OF PUBLIC RELATIONS AND CORPORATE IMAGERY IN AMERICAN BIG BUSINESS* 7 (1998) (noting the proliferation of corporate mergers between 1895 and 1904).

22. SCOTT R. BOWMAN, *THE MODERN CORPORATION AND AMERICAN POLITICAL THOUGHT: LAW, POWER, AND IDEOLOGY* 60 (1996).

23. *Id.*

24. Melvin I. Urofsky, *Proposed Federal Incorporation in the Progressive Era*, 26 AM. J. LEGAL HIST. 160, 161 (1982).

25. L.S. Zacharias, *Repaving the Brandeis Way: The Decline of Developmental Property*, 82 NW. U. L. REV. 596, 618 (1988).

26. *Id.* at 619.

They saw in the concentration of power in a few corporations a threat to individual autonomy. Giant corporations obfuscated "the traditional relationships between individual liberty, competition and social utility," and made impossible assessment of the national wealth based on aggregations of individual valuations.<sup>27</sup>

Seeking to sustain the nineteenth-century ideals of civic engagement in the twentieth-century organizational society—to reconstitute the American democratic ideal—and to add organization, stability, and reason to what seemed to be the chaotic nature of industrial capitalism, Progressives focused their attention on the growing trusts.<sup>28</sup> Some reformers emphasized the need to control business units locally in order to encourage civic participation and tame corporate power. Others wanted to subject large corporations to national regulation.<sup>29</sup> Interestingly, while endorsing two presumably opposing positions—decentralization and centralization of power, respectively—Progressive scholars seemed to converge on mandatory disclosure as the ultimate means of regulating corporate power.

Proponents of centralization viewed large business units (and an economy of scale) as inevitable and sought to subject them to national control. While the Sherman Act attempted to regulate trusts, the main attempt to involve the federal government in corporate regulation was the federal incorporation movement of the first decade of the twentieth century. It called for federal licensing of state-chartered corporations that engaged in interstate commerce, or alternatively federal chartering of all corporations engaged in interstate commerce.<sup>30</sup> As President Theodore Roosevelt put it in his message to Congress on December 3, 1901, "In the interest of the whole people . . . the Nation should, without interfering with the power of States in the matter itself, also assume power of supervision and regulation over all corporations doing an interstate business."<sup>31</sup> Roosevelt did not want to do away with big business, but rather to find ways, through national supervision and regulation, to encourage the growth of good trusts while constraining the power (or eliminating) bad trusts.<sup>32</sup>

---

27. *Id.* See generally LAWRENCE E. MITCHELL, *THE SPECULATION ECONOMY: HOW FINANCE TRIUMPHED OVER INDUSTRY* ch. 4 (forthcoming 2007) (on file with the author).

28. On Progressive ideology, see RICHARD H. PELLIS, *RADICAL VISIONS AND AMERICAN DREAMS: CULTURE AND SOCIAL THOUGHT IN THE DEPRESSION YEARS* 3 (1998).

29. On the positions of decentralization and centralization, see MICHAEL J. SANDEL, *DEMOCRACY'S DISCONTENT: AMERICA IN SEARCH OF A PUBLIC PHILOSOPHY* 211–21 (1996).

30. Urofsky, *supra* note 24, at 160–70.

31. *Id.* at 168.

32. *Id.* at 168–70.

Even though none of the numerous bills introduced in Congress between 1900 and 1914 to enact some form of federal incorporation or licensing law matured into law, the idea of federal incorporation received the support of business leaders. For instance, "George W. Perkins of the House of Morgan, railroad magnate James J. Hill, and Elbert H. Gary of U.S. Steel" endorsed the proposal discussed in a 1904 report of the Bureau of Corporations.<sup>33</sup> So did the *Wall Street Journal* and *Manufacturers' News*.<sup>34</sup> Their support revealed the limits of the proposal. While all corporations engaged in interstate commerce would have to secure a federal license (or charter), to do so they had to meet only minimal criteria regarding organization, capitalization, and disclosure. Seeking to fight monopolies (or bad trusts), proponents of federal incorporation put their faith in mandatory disclosure. While the Bureau of Corporations would not have the power to mandate certain behavior, proponents of federal incorporation believed that by requiring corporations to publicize their finances and activities, the Bureau could ensure that "corporations represented themselves honestly and . . . [abided] by federal rules."<sup>35</sup>

Despite their concerns about the disappearance of the individual producer, proponents of centralization accepted the dominant view of their time, that is, that shareholders were investors, not proprietors.<sup>36</sup> Moreover, they treated shareholders—the investors—as a homogeneous group, and did not pay much attention to potential conflicts of interest among shareholders (specifically, among controlling and minority shareholders). Perhaps because they were mostly concerned about the growth of trusts, the centralizers did not focus on intra-corporate relations, but rather on ways to prevent or regulate monopolies. They assumed that by imposing mandatory disclosure rules on corporations

---

33. *Id.* at 175.

34. *Id.* Congress established the Bureau of Corporations in 1903 "to investigate further the distinction between 'good' and 'bad' businesses." *Id.* at 169.

35. Urofsky, *supra* note 24, at 177, 170–82; see also Philip A. Loomis, Jr. & Beverly K. Rubman, *Corporate Governance in Historical Perspective*, 8 HOFSTRA L. REV. 141, 158–61 (1979–1980) (examining early twentieth century proposals for federal incorporation or licensing); Horace L. Wilgus, *A Proposed National Incorporation Law*, 2 MICH. L. REV. 501 (1904) (discussing the need for a federal incorporation law to "promote the general welfare"). It is important to note that publicity in this context meant disclosure to the Department of Commerce and the President, not to the investor. MITCHELL, *supra* note 27, at ch. 6.

36. See, e.g., MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1870–1960: THE CRISIS OF LEGAL ORTHODOXY* 93 (1992) (arguing that "[b]y the time of the First World War, it was common for legal writers to observe that . . . 'stockholders today are primarily investors and not proprietors'") (quoting J.T. CARTER, *THE NATURE OF THE CORPORATION AS A LEGAL ENTITY* 160 (1919)).



(through local or national agencies), they would protect the market from the threat of monopoly; the protection of investors was not their main concern.<sup>37</sup>

Disclosure as a means of regulating monopoly was also the solution proposed by proponents of decentralization, as reflected in the writing of Louis Brandeis. According to Brandeis, large business units undermined democratic institutions and eroded "the moral and civic capacities that equip workers to think and act as citizens."<sup>38</sup> Because he was concerned about political as well as economic concentration of power, Brandeis did not want "to confront big business with big government."<sup>39</sup> Rather, he wanted to encourage competition by protecting small businesses from "the predatory practices of monopolies and national chains."<sup>40</sup> In this vein, Brandeis urged more effective enforcement of the Sherman Act and proposed banning such practices as interlocking directorates and investment bankers acting as middlemen in corporate transactions (in direct conflict with their role as trustees for investors).<sup>41</sup>

Yet the most important element of Brandeis's position was disclosure. He believed that the acquisition of information "concerning the great monopolistic trusts" would allow lawmakers and policymakers to create intelligent solutions to the problem of trusts.<sup>42</sup> Moreover, he recognized the importance of publicity as a tool of regulating manipulative practices. "Compel bankers when issuing securities to make public the commissions or profits they are receiving,"<sup>43</sup> and require, also, "a disclosure of all participants in an underwriting," he wrote.<sup>44</sup>

Brandeis hoped that those involved in predatory practices would stop them once they were required to report them. But his disclosure solution was also meant to solve a different problem—the problem of control. As we will see in the next section, by the second decade of the twentieth century, Progressives became concerned not only about the growth of trusts, but also about the growing separation of ownership from control in large business units. The realization that the power of giant corporations was controlled by a relatively small number of prominent investors exacerbated Progressives' fears about monopoly. "The goose that lays golden eggs has been considered a most

---

37. MITCHELL, *supra* note 27, at ch. 5.

38. SANDEL, *supra* note 29, at 211.

39. *Id.* at 212.

40. *Id.*

41. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY: AND HOW THE BANKERS USE IT 61–62, 81, 109, 199–200 (1914).

42. THE CURSE OF BIGNESS: MISCELLANEOUS PAPERS OF LOUIS D. BRANDEIS 135–36, 129–37 (Osmond K. Fraenkel ed., 1934).

43. BRANDEIS, *supra* note 41, at 101.

44. *Id.* at 105.

valuable possession," Brandeis wrote. "But even more profitable is the privilege of taking the golden eggs laid by somebody else's goose."<sup>45</sup> According to Brandeis, by controlling other people's money, investment bankers and their associates "control[led] the people through the people's own money."<sup>46</sup> As he saw it, control of aggregate wealth threatened political and individual liberty.<sup>47</sup>

Brandeis went further. If disclosure was a means of regulating predatory practices that led to the creation of trusts, Brandeis wanted investors to act as regulators. He believed that in their investment decisions and in their selection of directors, investors could regulate corporate actions.<sup>48</sup> To be able to fulfill their tasks as regulators, investors had to be informed of the corporation's business. According to Brandeis, disclosure had to be "disclosure to the investor."<sup>49</sup> As if scolding advocates of centralization, Brandeis noted that filing statements with state or federal agencies or with the exchanges was inadequate disclosure. "To be effective, knowledge of the facts must be actually brought home to the investor, and this can best be done by requiring the facts to be stated in good, large type in every notice, circular, letter and advertisement inviting the investor to purchase."<sup>50</sup> As I argue in the following sections, the idea that the individual shareholder could help regulate corporate activities gained much support from Progressive scholars concerned not only about monopoly but also about the power of those in control of corporations.

### *B. The Problem of Control*

The practices that concerned decentralizers and centralizers were, for the most part, grounded in greed. Seeking to maximize their profits, entrepreneurs developed a variety of tools to gain them. They found ways to convince the American public to invest in their enterprises, first in bonds and preferred stock, and then, by the second decade of the twentieth century, in common

---

45. *Id.* at 17–18.

46. *Id.*

47. *Id.*

48. For one thing, Brandeis wanted directors in large businesses to be elected by regional delegates who, in turn, would be elected by members of local units (each member having one vote regardless of her capital contribution). Brandeis's model for this organization was the English Cooperative Wholesale Society, in which directors were selected by votes of delegates of retail societies, who were themselves selected by members of the local societies—that is, consumers. BRANDEIS, *supra* note 41, at 208–23.

49. *Id.* at 104.

50. *Id.*

stock. And they found ways to manipulate stock prices as well as to drain the corporation of assets purportedly intended to guarantee the payment of debt.<sup>51</sup> As this section elaborates, gradually, these entrepreneurs also helped sustain the growing separation of ownership (having an interest in an enterprise) from control (having power over the enterprise). In the nineteenth century, those who owned all or a majority of a corporation's stock controlled the corporation. But in the early decades of the twentieth century, control came into the hands of minority owners and financial institutions such as investment banks. (Management control also developed at this time but was less significant.)<sup>52</sup>

Public security financing of industry and finance began with the financing of railroads in the mid-nineteenth century, although up to the 1880s there was no important class of small individual or institutional investors in securities.<sup>53</sup> Government and railroad securities dominated the corporate securities markets, and "most railroads and industrial firms were closely held by families or small groups of investors."<sup>54</sup> Individuals invested their savings in bank deposits and insurance, or in "their own small businesses, in other local enterprises, and in real-estate mortgages."<sup>55</sup> There was no system of underwriting and the public distribution of new securities "was done upon an agency basis with the risk resting upon the issuer."<sup>56</sup> Beginning in the 1880s, however, rapid industrial and business growth increased the demand for capital and "stimulated the use of security financing as the most flexible and productive method of supplying

---

51. See MITCHELL, *supra* note 27 (arguing that the modern corporation was created to manufacture stock to enrich financiers and corporate promoters).

52. In the early 1930s, Gardiner Means counted five different forms of control—complete ownership, majority control, minority control, control through a legal device without majority ownership, and management control. Means, *supra* note 18, at 72. The twentieth century witnessed a shift from complete and majority ownership to minority control (often through legal devices) to management control. *But see* Walter Werner, *Corporation Law in Search of Its Future*, 81 COLUM. L. REV. 1611, 1629–44 (1981) (arguing that individual shareholders never participated in the management of public corporations). It should also be noted that the separation of ownership from control was never complete. Management typically owned shares of its corporation.

53. Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, 78th Congress, H.R. 1493, H.R. 1821, and H.R. 2019 (bills to suspend the authority of the Securities and Exchange Commission under section 14(a) and section 14(b) of the Securities Exchange Act to issue rules relating to the solicitation of proxies, consents, and authorizations during the period of war emergency), June 9–11, 1943, at 2 [hereinafter Hearings on H.R. 1493, H.R. 1821, and H.R. 2019].

54. Miguel Cantillo Simon, *The Rise and Fall of Bank Control in the United States: 1890–1939*, 88 AM. ECON. REV. 1077, 1080 (1998).

55. Hearings on H.R. 1493, H.R. 1821, and H.R. 2019, *supra* note 53, at 3.

56. *Id.*

capital needs."<sup>57</sup> By the mid-1910s, individual and institutional investors began to play an important role as a source of public security financing.<sup>58</sup>

This development created a need for a system of underwriting and public distribution of new issues, leading to the development of investment banking. Their economic function was to channel the public's surplus savings into productive business and industry:

The originating banker purchased the entire issue and practically simultaneously resold it at an advance in price to a so-called purchase group of which the originating banker became a member and the manager. Usually, the issue was later resold at a further step-up in price to a larger banking group of which the originating banker and members of the purchase group were members and of which the originating banker was manager. All purchases were joint and the purpose of the successive formation of, and sales to, these groups was to spread the risk and expense of purchase and carriage of the securities . . . . Distribution or sale to the investing public was accomplished solely by the manager in [sic] behalf of the purchase or banking group whichever had last repurchased the issue, through an organization of employees or agents which sometimes included some members of the purchase or banking group.<sup>59</sup>

This method of distribution was slow and costly. Moreover, it effected a limited distribution—mostly to "institutional investors and wealthy individuals with which the manager and his agents had a close customer relationship"—and thus perpetuated the negligibility of the small individual investor as a source of capital.<sup>60</sup> But with the growing demand for investment capital, and the rapid usage of the corporate form of doing business, a more effective distribution had developed. Instead of distribution by the manager of the banking group, distribution was carried through by a large and widely dispersed selling group. Members of the selling group were principals (not agents of the manager) and by agreement were required to make "a concurrent public offering of the securities at a uniform public offering price and at uniform concessions during the period selected for the original distribution."<sup>61</sup>

The growth of business combinations and the resulting quest for capital also led to the issuance of more common stock to draw in the public investor. As the new system of securities distribution increased the participation potential of small individual and institutional investors, the 1920s witnessed the widest

---

57. *Id.* Until the 1890s, security financing was primarily in railroads.

58. *Id.* at 4.

59. *Id.* at 4–5.

60. Hearings on H.R. 1493, H.R. 1821, and H.R. 2019, *supra* note 53, at 6.

61. *Id.* at 7.

participation rate in the securities market, up to that point, of the small, individual purchaser. As Gardiner Means reported, "The three largest corporations in the country, the American Telephone and Telegraph Co., the Pennsylvania Railroad, and the United States Steel Corporation, all show[ed] a tremendous growth in their list of stockholders."<sup>62</sup> The list of the American Telephone and Telegraph Company grew from 7,535 in 1900 to 454,596 in 1929; the list of Pennsylvania Railroad grew from 28,408 in 1902 to 157,650 in 1929; and the United States Steel Corporation saw a growth from 15,887 in 1901 to 110,166 in 1929. In 31 large corporations the total number of book stockholders grew from 226,543 in 1900 to 1,419,126 in 1928.<sup>63</sup>

Initially, as stock ownership in large publicly held corporations became more dispersed, the dispersal also reflected a shift of wealth. "By 1921, the rich owned a very much smaller proportion of all corporate stocks than they had owned in 1916."<sup>64</sup> But from 1921 to 1927, while shareholding continued to become more dispersed, the rich kept their proportion fairly constant.<sup>65</sup>

Moreover, just as shareholding grew more dispersed, changes in corporate law at the turn of the twentieth century eroded the individual shareholder's ability to take part in managing the affairs of the corporation. The erosion of the traditional *ultra vires* doctrine, which limited corporate activities to its prescribed charter powers,<sup>66</sup> and the reintroduction of the idea that the power of the board of directors was "original and undelegated" rather than delegated from the shareholders, helped minimize shareholder authority.<sup>67</sup> So did changing voting rules. Proxy voting, which was banned in the early nineteenth century, became at the turn of the twentieth century the norm, authorized either in a specific charter provision or a statutory provision. Gradually it became a means by which voting power was taken away from the shareholders. Shareholders' ability to remove directors at will was eliminated. In addition, while in the nineteenth century a unanimous vote was required to effect fundamental corporate changes, at the turn of the twentieth century states gradually adopted statutes allowing a majority of the shareholders to sell corporate assets. By 1926, the common law rule of unanimous vote was abrogated by statute or judicial decisions in almost every state.<sup>68</sup>

---

62. Gardiner C. Means, *The Diffusion of Stock Ownership in the United States*, 44 Q.J. ECON. 561, 563 (1930).

63. *Id.*

64. *Id.* at 562.

65. *Id.*

66. HORWITZ, *supra* note 36, at 77-78.

67. *Id.* at 99 (quoting *Manson v. Curtis*, 119 N.E. 559, 562 (N.Y. 1918)).

68. On these transformations, see *id.* at 88-89 (documenting the erosion of the unanimity

Perhaps more devastating to the individual shareholder's ability to participate in corporate management was the fact that while share ownership became more dispersed and businesses grew in size, their control became concentrated. By the 1910s, banks began to play a triple role—they were commercial lenders, institutional investors, and investment bankers. "By 1912, 18 financial institutions sat on the boards of 134 corporations with \$25.325 billion in combined assets. Of these 18 institutions, 5 banks . . . sat on the boards of 68 nonfinancial corporations with \$17.273 billion in assets. . . . U.S. GNP in 1912 was \$39.4 billion."<sup>69</sup>

By virtue of their capital and social networks, investment bankers became, as Brandeis put it in 1914, "[t]he dominant element in our financial oligarchy."<sup>70</sup> They became promoters and directors of corporations, and were able, through their economic power, to control even those boards on which they did not sit.<sup>71</sup> Gradually, investment bankers replaced control through complete ownership and even control through ownership of a majority of the votes (for example, Henry Ford's control of the Ford Motor Company).<sup>72</sup> In 1932, using statistical data, Adolf A. Berle, Jr. and Gardiner C. Means documented how some 200 corporations, controlled by less than 1800 men, administered over one-third of the national wealth.<sup>73</sup>

Having an interest in an enterprise no longer meant having power over the enterprise. This separation of ownership from control allowed corporations and, more seriously, the control group—an investment bank, a wealthy individual, or management—to amass tremendous power over individuals, groups, and even the state.<sup>74</sup> "Power without responsibility is, philosophically, a perilous matter," Berle wrote in 1925, and "the history of minority-controlled

---

rule in the early twentieth century); Adam Winkler, *"Other People's Money": Corporations, Agency Costs, and Campaign Finance Law*, 92 GEO. L.J. 871, 908–09 (2004) (noting how changes in corporate voting rules during the late nineteenth century weakened shareholder control).

69. Cantillo Simon, *supra* note 54, at 1080–81.

70. BRANDEIS, *supra* note 41, at 3.

71. *See id.* at 1–27 (describing the confluence of factors supporting the concentration of power in investment bankers).

72. Means, *supra* note 18, at 72–74.

73. *See generally* ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (2d ed., 1968) (1932).

74. On the relationship between the separation of ownership from control and corporate power, see Dalia Tsuk, *From Pluralism to Individualism: Berle and Means and 20th Century American Legal Thought*, 30 LAW & SOC. INQUIRY 179, 186–87 (2005).

corporations during the last thirty years amply demonstrates that the hazard is not imaginary."<sup>75</sup>

The individual shareholder, who in the early decades of the twentieth century gradually became a speculator,<sup>76</sup> was not necessarily troubled by these transformations, at least as long as she "held [a] soaring stock."<sup>77</sup> But economists and lawyers raised concerns about the growing power of the control group. They worried that the more dispersed stock ownership became, the easier it was for the larger shareholders—life insurance companies, trust companies, and banks—to control the activities of the corporation.<sup>78</sup> In 1912, Ripley pointed out that "the larger the number of shareholders, the more easily may a small concentrated block of minority shares exercise sway over all of the rest."<sup>79</sup> And in 1932, when Berle and Means called attention to the growing separation of ownership from control in large business corporations, they pointedly explained that individual shareholders lost control not only to management, but also to larger investors who, even without owning a majority of the shares, were able to elect the board of directors.<sup>80</sup>

Generally, allowing less than unanimous consent to determine the outcome of shareholder voting was not viewed as a serious concern. (Ripley, however, called for regulation of situations when one company purchases not the entire capital stock of another company but only 51% of it.)<sup>81</sup> It was expected that, for the most part, "the interests of a minority owner run parallel to those of the controlling majority and are in the main protected by the self-interest of the latter."<sup>82</sup> In situations where their interests diverged, the minority owner would suffer, but it seemed that such harm was an inevitable consequence of corporate, or group, enterprise.<sup>83</sup>

---

75. Adolf A. Berle, Jr., *Non-Voting Stock and "Bankers' Control,"* 39 HARV. L. REV. 673, 674 (1925–26).

76. On this transformation, see MITCHELL, *supra* note 27, at chs. 4 & 8; Walter Werner, *Management, Stock Market and Corporate Reform: Berle and Means Reconsidered,* 77 COLUM. L. REV. 388, 391–94 (1977).

77. RALPH F. DE BEDTS, *THE NEW DEAL'S SEC: THE FORMATIVE YEARS* 7 (1964).

78. For a less concerned view of the control group, see Franklin S. Wood, *The Status of Management Stockholders,* 38 YALE L.J. 57 (1928), arguing against imposing stricter fiduciary duties on controlling stockholders.

79. RIPLEY, *supra* note 1, at 95.

80. See BERLE & MEANS, *supra* note 73, at 66–111 (detailing the changing composition of the control group).

81. William Z. Ripley, *Minority Shareholders in Railroad Combinations,* 26 Q.J. ECON. 377, 380 (1912).

82. BERLE & MEANS, *supra* note 73, at 68.

83. *Id.*

Control by a minority of the owners—be it the investment banking house, a small controlling block, or even management—was alarming. In 1925, Berle called attention to the fact that because management stock would likely be controlled by the investment banking house that served as a promoter for the corporation, "it [was] possible, if not probable, that there [would] be attractive opportunities for manipulation of securities, for negotiating favorable contracts with allied interests, or even for giving value to stock which represent[ed] no real investment."<sup>84</sup> Given the "web of economic interests" which the investment banking house served and from which it made its profits, it was likely that management stock would be voted for transactions that benefited the investment banking house, or even the controlling groups, but not the controlled corporation.<sup>85</sup> Sharing Berle's views, William O. Douglas labeled the interests of investment banking houses "high finance," charging that they were "interested solely in the immediate profit."<sup>86</sup> According to Douglas, the interests of high finance were different from those of small individual shareholders or even the corporation, but with the power of control, high finance was able to profit by siphoning money from other investors.<sup>87</sup>

A small shareholder could theoretically launch a proxy contest to replace seated directors. But as Berle and Means sarcastically pointed out, the only example of a shareholder who succeeded in a proxy contest in the early twentieth century was John D. Rockefeller in his fight with the management of the Standard Oil Company of Indiana.<sup>88</sup> Rockefeller, who had owned 14.9% of Standard Oil for years, became displeased with the company's management and waged a proxy fight to replace it.<sup>89</sup> As Berle and Means explained, he won because of his relatively large ownership stake, his ability to fund the fight, and his own standing in the community.<sup>90</sup> He won his fight for control because he had control and he was wealthy.<sup>91</sup>

---

84. Berle, *supra* note 75, at 676.

85. *Id.*

86. William O. Douglas, *The Forces of Disorder*, Address delivered at the University of Chicago (Oct. 27, 1936) with additions from talks before the Economic Club of Chicago (Feb. 1, 1938) and before the Bond Club of New York (Mar. 24, 1937), in *DEMOCRACY AND FINANCE: THE ADDRESSES AND PUBLIC STATEMENTS OF WILLIAM O. DOUGLAS* 9 (James Allen ed., 1940).

87. *Id.*

88. BERLE & MEANS, *supra* note 73, at 76.

89. *Id.* at 76–77.

90. *Id.* at 77–78.

91. More recently, Mark Roe offered the example of the ineptly managed General Motors, the management of which was reinvigorated "by neither a proxy fight, nor a hostile takeover, nor a leveraged buyout in reaction to the prospect of a takeover, but by the intervention of its large shareholder. Pierre du Pont moved to Detroit, reorganized the company, and installed new



Moreover, a variety of legal tools developed to eliminate even the remote possibility that a small individual shareholder would have a meaningful voice. Not only were rules banning corporations from owning stock in other corporations replaced with statutes allowing mergers and holding companies (as early as 1889 in New Jersey), but a pyramid-style structure of ownership (that is, holding stock of a corporation which owned a majority of the stock of a subsidiary) became common.<sup>92</sup> By investing in a corporation with a line of subsidiaries, "each controlled through ownership of a majority of its stock by the company higher in the series," an investor could exercise control while having a very small ownership interest in the property so controlled. Beginning in the 1910s, restrictions on the voting rights of certain classes of shareholders also became common.<sup>93</sup> "By issuing bonds and non-voting preferred stock" to public investors in the subsidiaries (rather than voting stock), an investor could exercise control by owning an even smaller percentage of the property.<sup>94</sup> As Ripley concluded in the mid-1920s, the holding company was yet another way to wrest control from the shareholders.<sup>95</sup> And while it was especially common among public utilities,<sup>96</sup> other examples included the Van Sweringens's control over a transcontinental railway system, the Eaton's control over steel companies, and Goldman Sachs & Co.'s control of a chain of affiliated enterprises.<sup>97</sup>

Furthermore, while non-voting preferred stock was longstanding, in the early decades of the twentieth century certain states, including Delaware and New York, enacted statutory provisions allowing corporations to issue common stock with different voting powers (including non-voting stock).<sup>98</sup> Similarly, corporations began issuing conditional or contingent voting stock, that is, stock

---

managers." Mark Roe, *Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 15 (1991). As Roe also pointed out, "the J.P. Morgan investment bank monitored many of the country's railroads when reorganizing them at the turn-of-the-century." *Id.*

92. Winkler, *supra* note 68, at 907-08. The classic treatise on the holding company remains JAMES C. BONBRIGHT & GARDINER C. MEANS, *THE HOLDING COMPANY, ITS PUBLIC SIGNIFICANCE AND ITS REGULATION* (1932).

93. W.H.S. Stevens, *Shareholders' Voting Rights and the Centralization of Voting Control*, 40 Q.J. ECON. 353, 354-55 (1926). Prior to 1895, it was common to issue full voting preferred and common stock. *Id.*

94. BERLE & MEANS, *supra* note 73, at 69-71.

95. See Evans Clark, *Cleaning House in Wall Street: Professor Ripley Champions the Cause of the Small Investor*, N.Y. TIMES, Feb. 13, 1927, at BR1 (discussing Ripley's *Main Street and Wall Street*).

96. Means, *supra* note 18, at 95.

97. Adolf A. Berle, Jr., *Stockholders: Their Rights and Duties*, in HANDBOOK OF BUSINESS ADMINISTRATION 374, 387 (W.J. Donald ed., 1931).

98. BERLE & MEANS, *supra* note 73, at 72.

that could vote only on the occurrence of a particular event.<sup>99</sup> The New York Stock Exchange was opposed to privileging one class of common stock over others and refused to list new issues of non-voting common stock. But a different legal device—voting trusts—was allowed. It often gave the trustees almost complete control over corporate affairs without any ownership interest.<sup>100</sup>

All these legal mechanisms transformed the relationship between shareholders and their corporations. Ripley cautioned that democracy was replaced with the autocracy of investment bankers,<sup>101</sup> and Berle and Means concluded in *The Modern Corporation and Private Property* that:

[T]he usual stockholder has little power over the affairs of the enterprise and his vote, if he has one, is rarely capable of being used as an instrument of democratic control. The separation of ownership and control has become virtually complete. The bulk of the owners have in fact almost no control over the enterprise, while those in control hold only a negligible proportion of the total ownership.<sup>102</sup>

Berle and Ripley's analysis did not stop at critique. While in the early decades of the twentieth century mandatory disclosure seemed a sufficient means of regulating corporations, by the mid-1920s it was a necessary but certainly not a sufficient solution to the problems associated with the growth of the modern public corporation, especially to the problem of control. For one thing, as Mark Roe has shown, by the 1930s the fragmentation of financial institutions supplemented disclosure as a solution.<sup>103</sup>

Berle and Ripley offered a different solution. As the following section elaborates, they wanted to tame the power of the control group by creating a countervailing power in the minority shareholders.<sup>104</sup> They wanted to change

99. Stevens, *supra* note 93, at 362–67.

100. BERLE & MEANS, *supra* note 73, at 72–75; see also E. Parmelee Prentice, *Harry A. Cushing's Voting Trusts*, 29 HARV. L. REV. 237, 237–39 (1915) (book review) (arguing that voting trusts are not democratic). On different legal mechanisms of securing control, see also RIPLEY, *supra* note 1, at 98–105.

101. See Clark, *supra* note 95, at BR1 (discussing Ripley's *Main Street and Wall Street*).

102. BERLE & MEANS, *supra* note 73, at 83; see also Berle, *supra* note 75, at 673–93 (discussing the problems associated with investment bankers' control); Means, *supra* note 18, at 97 (noting that "[t]he individualism of Adam Smith's private enterprise has in large measure given way to the collective activity of the modern corporation, and economic theory must shift its emphasis from analysis in terms of competition to analysis in terms of control").

103. See generally MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994).

104. It is interesting to note that in the nineteenth century, the typical intra-corporation conflict was not between shareholders and management (as in the twentieth century) but between different groups of shareholders. The Progressives' concerns about the role of minority

the practices of corporate governance so as to use minority shareholders as a means of preventing potential abuses of corporate power. While some reformers sought to achieve this goal by imposing mandatory voting rights, Ripley and Berle called for establishing permanent shareholder representative organizations to communicate with management. By bringing to management's attention the concerns of minority shareholders, not only of those in control, they hoped to channel corporate power to socially beneficial goals. As I argue, viewing shareholders as a proxy to this end ultimately led Berle to shift his focus from organizing shareholders to imposing stricter fiduciary duties not only on management (toward the corporation) but also on the control group toward minority shareholders.

### C. Voting, Organization, and Trust

Given the changes that corporations introduced in their voting rights during the first decades of the twentieth century, it is perhaps not surprising that reformers wanted to impose mandatory voting regimes to empower minority shareholders. Take, for example, Eustace Seligman of Sullivan & Cromwell. In the mid-1920s, after criticizing the growingly popular corporate allocation of different voting powers to different classes of common stock, Seligman suggested that all common stock should have equal voting power.<sup>105</sup> Viewing the shareholders' right to vote as derived from their ownership interest, Seligman described non-voting stock as depriving owners of one of the essential attributes of property and allowing the concentration of power in the hands of the few "in a manner inconsistent with the democratic tendencies of our modern political, as well as business, life."<sup>106</sup> (As already noted, the New York Stock Exchange also opposed the practice of issuing non-voting stock.) Moreover, Seligman wanted to mandate that, at all elections of directors, the voting should be cumulative, or as he also put it, that there would be

---

shareholders reflected a transition from the nineteenth-century intra-corporate conflicts to the twentieth-century internal struggles. Cf. Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1367–86 (2006). Between 1900 and 1914, several bills were introduced in Congress to protect minority shareholders. MITCHELL, *supra* note 27, at ch. 6.

105. Eustace Seligman, *The Relation of Law to the Modern Developments in Property Ownership*, 11 PROC. ACAD. POL. SCI. N.Y. 88, 88–89 (1925).

106. *Id.* at 89. Reflecting his concerns about the attributes of ownership, Seligman also suggested, as solutions to the problem of control, putting limits on a corporation's accumulation of capital so as to force directors to distribute dividends, and giving employees rights to profit through tools other than stock ownership—so as to avoid restraints on alienation of employee stock. *Id.* at 98–101.

proportional representation on the board. Alternatively, Seligman argued that customers, employees, and the general public should be issued different classes of stock, each entitled to elect a number of directors proportionate to the number of shares of stock held by the class.<sup>107</sup> His was, perhaps, the first articulation of the stakeholder model of corporate governance.

To allow minority shareholders to have a meaningful vote, Seligman also insisted that corporate management be required to provide adequate financial information to shareholders (and that management be prevented from using corporate funds to defend itself in a proxy fight).<sup>108</sup> By eliminating informational or financial advantages, Seligman wanted to level off the battlefield between minority shareholders and those in control; he wanted to eliminate, or at least minimize, intra-corporate power inequalities.

Like Brandeis's disclosure ideal, Seligman's solution was predicated upon the twin assumptions that the shareholder's role in corporate management was limited to the selection of directors and that shareholders wanted to play that role. Like Brandeis, Seligman also seemed to assume that shareholders, by the sheer power of their vote, would be able to constrain the power of the control group(s).<sup>109</sup> Both Brandeis and Seligman viewed shareholders as property owners.

Other reformers did not share these assumptions. For one thing, they maintained that in public corporations directors and officers did not derive their power from the shareholders. Rather, the board of directors was an independent body, created by the corporations statute, with original and undelegated powers (including the power to appoint officers). Rather than focusing on the voting power of shareholders as derived from their ownership interest, reformers such as Ripley and Berle turned their attention to minority shareholders as a body capable of balancing the power of those in control. They recognized that the separation of ownership from control had undermined traditional assumptions about the rights associated with property ownership.

Ripley viewed the disappearance of the individual producer as impairing the march of the American civilization. "Our civilization," he wrote, "is founded on the private possession of property. We hold that the enjoyment of the fruits of labor through private property contributes to higher living standards, progress, family life and happiness."<sup>110</sup> To prevent the risk that large

---

107. *Id.* at 90–91.

108. *Id.* at 93–98.

109. For additional calls to alter voting rights rules, see Stevens, *supra* note 93 (suggesting the development of strong contingent voting stock rather than full voting stock).

110. RIPLEY, *supra* note 1, at 131–33.

corporations might eliminate the individual producer, Ripley wanted to create "some permanent agency" to represent "the shareholder's right, title, and interest" and to awake "sufficient interest among the electorate to induce at least an intelligent minority to take part."<sup>111</sup> According to Ripley, "the participation of such an intelligent minority" would make corporate democracy "tolerable."<sup>112</sup>

Ripley compared his proposed shareholder organization to the labor union. In a pointed statement he wrote:

The parallel between the post-war situation in the field of labor and that of ownership and management of corporations is striking. The following excerpt from President Wilson's Mediation Commission, substitution being made of "shareholder" for "employees" is directly in point. "Broadly speaking, American industry lacks a healthy basis of relationship between management and men. At bottom this is due to the insistence by employers upon individual dealings with their men. Direct dealings with employees' organizations is still the minority rule in the United States. . . . The leaders in industry must go further; they must help correct the state of mind on the part of labor; they must aim for the release of normal feelings by enabling labor to take its place as a cooperator in the industrial enterprise. In a word, a conscious attempt must be made to generate a new spirit in industry."<sup>113</sup>

If the result in the field of labor was "the introduction of employee investment, of the company union, and even of labor membership on the board of management," then, according to Ripley, similar solutions should be extended also to the field of ownership.<sup>114</sup>

One should be careful, however, not to read into Ripley's calls for the establishment of shareholder organizations a strong support for active shareholder participation in corporate decision-making. For one thing, Ripley derived the idea from the temporary protective committees formed to protect the property interests of security holders during corporate reorganizations. In this vein, Ripley thought that the chief goal of the permanent shareholder organization (which could take the form and role of the executive committee) was to act as a supervisory council, especially with respect to the independent auditing of accounts. It could elect the independent auditor who would be accountable to it and act under its supervision.<sup>115</sup>

---

111. *Id.* at 132–33.

112. *Id.* at 133.

113. *Id.* at 137.

114. *Id.* at 137–38.

115. RIPLEY, *supra* note 1, at 138–41. As if anticipating the creation of the SEC, Ripley noted that "the Federal Trade Commission or some other prominent governmental agency should have jurisdiction over all such matters." *Id.* at 141–42.

Ripley wanted to guarantee that minority shareholders' interests were protected but, more crucially, the organization he imagined was meant to impose checks and balances on corporate power as exercised by those in control.<sup>116</sup> Ripley stressed that the goal of the permanent shareholder organization was not to engage in wars with management.<sup>117</sup> Rather, recognizing that "full responsibility and authority are . . . vested in the directorate," Ripley wanted to create a liaison between the shareholders and management—another check on corporate power.<sup>118</sup> By bringing minority shareholders and management together, Ripley thought to make corporations self-regulating. He assumed that cooperation between small individual shareholders and management would limit potential abuses of corporate power (especially by the control group).

Ripley's concluding remarks made clear these underlying assumptions. Rather than giving voice to shareholders, the organization was meant to serve as a medium of communication between management and the passive owners. As if seeking management's approval, Ripley proclaimed that such an organization would be extremely beneficial to management.<sup>119</sup> For example, management would find it easier to raise capital if the organization endorsed management's programs, and it would find it easier to receive sufficient proxies to constitute a quorum if the organization advised shareholders as to how to vote. Moreover, by keeping shareholders informed about management plans and activities, a permanent shareholder organization would increase shareholders' loyalty even when the corporation endorsed a conservative dividend distribution plan.<sup>120</sup>

More important, according to Ripley, "positively the largest single grain of comfort which directors of our great corporations might discover in this proposed participation of shareholders [had] to do with possible amelioration of their legal liability in dollars and cents."<sup>121</sup> Predicting an increase in fiduciary duties litigation, Ripley suggested that "a representation or check-up committee of shareholders" would afford a welcome relief to management.<sup>122</sup> As he put it:

It is not that such participation by the shareholders should hamper or really divide responsibility—that would be a blunder; but rather that the fact the

---

116. *Id.* at 133–42.

117. *Id.* at 136.

118. *Id.*

119. *Id.* at 144–55.

120. RIPLEY, *supra* note 1, at 144–51.

121. *Id.* at 152.

122. *Id.* at 153.

board had taken counsel with such a continuing body, representative of shareholder opinion and interest, should serve as proof of good faith in case doubt should be raised or litigation pressed. Not even under delicate circumstances, need disclosure necessarily be made of all the facts to all the shareholders at the time. Not infrequently it might be impolitic in midstream of negotiation to indulge in such revelation. But if the case were squarely laid before the representative body, thereby affording an opportunity for a free interchange of opinion in advance of action, it might be an ever-present help to the directorate in time of trouble, especially as against the allegation of private or personal advantage as a leading motive.<sup>123</sup>

Ripley might have included these comments to gain the support of the business community, but his statements also reflected his particular view of corporate power and the role of shareholders in taming it. Ripley believed that corporations could self-regulate and he envisioned shareholders collaborating with management to pursue corporate goals. Shareholder organization was required not only as a solution to the problem of concentrating power in a few hands, but also to make passive, widely dispersed owners interested in corporate affairs. According to Ripley, solutions predicated upon individual shareholder participation were bound to go wrong, but collective action had a chance of success. As he put it, such an organization would be able to educate individual shareholders to participate in the modern economy—to become the new individual producers and put the economy on a healthy track.<sup>124</sup>

In the mid-1920s, Berle shared Ripley's belief in self-regulation and the corresponding vision of the shareholder's role in the corporation. Like Seligman and Ripley, Berle described the development of large corporations as creating "ownership which was irresponsible, and an extension not of personality but of something infinitely stronger than that—a kind of non-political sovereignty, a thing which was symbolized in the public mind by the word 'monopoly.'"<sup>125</sup> Berle's solution was similar to Ripley's. He wanted to create an intermediary organization between shareholders and management.

Specifically, Berle's early writings suggested the creation of an organization (similar to the Investment Bankers Association)<sup>126</sup> to scrutinize

123. *Id.*

124. *Id.* at 154–55; see also Ripley for Audits by Stockholders: *Harvard's Economist Believes Authorized Committees Would Assure Publicity*, N.Y. TIMES, Nov. 24, 1926, at 40 (reporting on Ripley's article in *The World's Work*).

125. Adolf A. Berle, Jr., *The New Deal and Economic Liberty*, 178 ANNALS OF THE AM. ACAD. POL. & SOC. SCI. 37, 41 (1935).

126. The Investment Bankers Association was formed in 1912, a year after Kansas passed the first blue-sky law to regulate sale of securities by out-of-state corporations. Its goal was "to secure greater uniformity in state and federal laws, governing the issuance, purchase, and sale of

"the corporate organization of the enterprises whose securities they float."<sup>127</sup> Given management's dependence on the investment banker, Berle believed the association could help limit management power with respect to the rights of investors (while allowing management to exercise its power to conduct the enterprise).<sup>128</sup> In a similar manner, Berle believed that the different depository institutions (or trust companies) could serve as a liaison "between the corporate management and the stockholders."<sup>129</sup> As he explained, these institutions were better situated than the shareholder to keep informed "as to the affairs of the corporation whose stock was deposited with them."<sup>130</sup> Moreover, "as representing their clients, [they] could take the action necessary to prevent or rectify violations of property rights where they occurred."<sup>131</sup>

In short, while Seligman wanted to give shareholders the voting rights derived from ownership, Berle and Ripley wanted to create permanent institutions that would protect shareholders. Fearing that minority shareholders might not be willing or able to protect themselves, they wanted to establish intermediary organizations to help make corporations self-regulating.

Interestingly, Berle's and Ripley's ideas resonated with a proposal made at a meeting of the Association of Partners of Stock Exchange Firms on January 7, 1914. Seeking to gain the confidence of investors, the proposal, made by Herman B. Baruch, suggested concentrating the voting power of individual shareholders by appointing a committee to vote the proxies of stock held by brokerage firms for account of clients. (It was estimated that the committee would vote thousands of proxies, representing millions of dollars of stock.)<sup>132</sup> "It was generally agreed that a concentration of voting power would undoubtedly go far to correct errors of management in corporations, provided that the committee handling the proxies knew exactly what to do."<sup>133</sup> At the

---

securities." MICHAEL E. PARRISH, *SECURITIES REGULATION AND THE NEW DEAL* 8 (1970). More important, it wanted to improve the prestige of the investment banking profession by strengthening the means of self-regulation. *Id.* at 8–9. While in the 1910s, the Investment Bankers Association also supported federal regulation to eliminate securities fraud, the prosperity of the 1920s restored the Association's "faith in its own ability to discipline the securities industry." *Id.* at 21. It withdrew its support for federal regulation and insisted instead that, with the Association's administrative assistance, state legislation was adequate and sufficient. *Id.* at 20–21, 5–21.

127. ADOLF A. BERLE, JR., *STUDIES IN THE LAW OF CORPORATION FINANCE* 37 (1928).

128. *Id.*

129. *Id.* at 38–39.

130. *Id.* at 39.

131. *Id.*

132. *The Brokers' Aim: Wall Street Men Seek to Regain Esteem of Public by Protecting Stockholders*, N.Y. TIMES, Jan. 11, 1914, § 8, at 7.

133. *Id.*



very least, it seemed that such a committee could get information from the corporation to individual shareholders (who rarely could get it themselves).<sup>134</sup>

Collective bargaining and self-regulation were common Progressive solutions; Progressives envisioned the new state as composed of multiple centers of power. But such ideas were short lived. A different idea—one that Berle articulated—ultimately won over. Berle complemented self-regulation by strengthening the fiduciary obligations of the control group.<sup>135</sup> For one thing, he argued that the control group could not, without full disclosure, allow one class of stock to appropriate to its benefit any portion of the capital contribution of any other class of stock.<sup>136</sup> In addition, the control group would be subject to fiduciary duties even when it exercised the voting rights of its own stock.<sup>137</sup> Finally, those in control were to be held "jointly liable with directors for mismanagement of corporate affairs," unless they could prove that they did not assent to the acts of the directors.<sup>138</sup>

While he did not necessarily believe in the ability of shareholders to participate in corporate management, Berle strongly believed in the potential effectiveness of fiduciary duties. In *The Modern Corporation and Private Property*, Berle (influenced both by his co-author, Means, and the 1929 crash) abandoned the ideal of self-regulation and instead emphasized the importance of strictly enforcing trust relationships between those in control (directors, officers, and controlling shareholders) and the corporation and its shareholders.<sup>139</sup>

Berle did not envision shareholders as regulators, but he viewed imposing fiduciary duties toward them as a means of constraining corporate power. He believed that forcing the control group to take into account the needs of the individual shareholder would channel corporate power toward socially beneficial goals.<sup>140</sup> Berle, who, according to his biographer, wanted to be known as the Marx of the shareholders,<sup>141</sup> did not seek to empower shareholders to make their own decisions regarding corporate affairs. Rather,

---

134. *Id.*; see also *Proxy Committee to Protect Owners: H.B. Baruch Suggests a New Idea to the Association of Stock Exchanges Partners*, N.Y. TIMES, Jan. 8, 1914, at 15.

135. Berle, *supra* note 75, at 682–93.

136. *Id.* at 682–86.

137. *Id.* at 686–90.

138. *Id.* at 690.

139. Tsuk, *supra* note 74, at 189–94.

140. Dalia Tsuk, *Corporations Without Labor: The Politics of Progressive Corporate Law*, 151 U. PENN. L. REV. 1861, 1892–93 (2003).

141. JORDAN A. SCHWARZ, *LIBERAL: ADOLF A. BERLE AND THE VISION OF AN AMERICAN ERA* 62 (1987).

he wanted to use minority shareholders to control corporate power. He used shareholders' disempowerment to impose fiduciary duties on management and the control group for the benefit of the corporation and society.

Berle and Ripley were concerned about the disappearance of the individual shareholder. Yet they had a broader goal: They wanted to protect minority shareholders so that they could limit or tame the power of those in control. By guaranteeing shareholder protection, albeit not empowerment, they avoided addressing potential conflicts between the shareholders' perceptions of their interests and broader corporate goals. In any event, as the following Part explores, by the time the New Deal administration came to power concerns about corporate hierarchies replaced concerns about corporate power. Rather than viewing shareholders as a means of taming the power of those in control, scholars and reformers focused on the minority shareholder's vulnerable position in the corporate hierarchy. As we will also see, vulnerability was an individual condition. Those viewing the shareholder as investor wanted to guarantee that the individual shareholder was informed, while those describing the shareholder as participant wanted to ensure that her (individual) voice was protected. For the most part, the idea of shareholder empowerment through organization had disappeared.

### *III. 1930s–1970s: Consumerism, Democracy, and Its Limits*

#### *A. Disclosure Part II: Regulating Markets*

Throughout the 1920s, many celebrated the separation of ownership from control and the rise of professional management as creating increased corporate gains and profits. Management was seen as "the prime mover of business—the veritable fountain-head of economic security for the bulk of the population."<sup>142</sup> By the end of 1929, management controlled 44% of the 200 largest U.S. corporations.<sup>143</sup> Of the remaining corporations, 23% were controlled by minority ownership, 21% through legal devices such as pyramiding, 5% by majority ownership, and 6% were in private ownership.<sup>144</sup> As Gardiner Means concluded:

65% of the companies and 80% of their combined wealth [were] controlled by either the management or by a legal device involving a small proportion of ownership. . . . Only 11% of the companies and 6% of their combined

---

142. *Business Versus the Public*, 8 ACCT. REV. 162, 162 (1933).

143. Means, *supra* note 18, at 94.

144. *Id.*

wealth involved control by a group of individuals owning half or more of the stock interest outstanding.<sup>145</sup>

Railroads tended to be more management controlled, while public utilities had a greater use of legal devices (voting trust, non-voting stock, and special vote-weighted stock). Industrial corporations showed the least separation of ownership and control, but were moving in that direction.<sup>146</sup>

As we saw in the previous Part, corporate law was changing to increase managerial power and consequently decrease the power of the shareholders. Moreover, as the separation of ownership from control grew, paid executives were taking over the power of the board of directors. And while letting professional executives run corporations was potentially advantageous, due to the absence of federal laws requiring and regulating corporate disclosure and inadequate self-regulation by the exchanges, this change also created tremendous imbalances of power, helping those individual entrepreneurs and businessmen seeking to benefit at the expense of the public. As one editorial put it, "[m]any managements, swollen with power, came to believe that their enterprises had ceased to be reservoirs of trust funds for stockholders and creditors but had become agencies for their own private immediate gain."<sup>147</sup> Huge salaries and bonuses, management's participation in its own underwriting, using corporate funds to manipulate the market, and other forms of self-dealing became common. Rather than an "economic savior," management turned out to be "often without vision, incapable of self-regulating, unmindful of duties to investors, and almost unaware of its responsibilities to society as a whole."<sup>148</sup>

The market's collapse in October 1929 painfully brought home the consequences of the "feverish activity of speculation" that characterized the 1920s.<sup>149</sup> But the blame for the crash was laid not only on speculation, but also on the fraudulent practices which helped fuel speculation: inadequate corporate

---

145. *Id.*

146. *Id.* at 95. As Means himself recognized, management often owned shares of its corporations. His data and analysis were not meant to draw a sharp distinction between management and shareholders, but to emphasize the shift from controlling shareholders, who did not necessarily sit on boards or held executive positions, to management control. Means did not assess management's ownership interest in the corporations he studied. For an analysis of Means's data, see Lawrence E. Mitchell, Remarks delivered at a conference at Columbia Law School on "The Structure of the Corporation: A Legal Analysis" (Nov. 17, 2006) (on file with the author).

147. *Business Versus the Public*, *supra* note 142, at 163.

148. *Id.*

149. DE BEDTS, *supra* note 77, at 11.

reporting, self-perpetuating, managements manipulating insider information, and faulty credit control.<sup>150</sup> As that same editorial put it:

Under the urge of eager investors, scrupulous promotion was well on the way of becoming a lost art. Investment bankers, competing with each other, began to capitalize once stable enterprises on the basis of highly speculative future returns. Business leaders were enunciating strange times-earnings theories to justify high stock prices. Profits were being inflated by unrealized appreciation of assets, scant provisions for depreciation, omissions of ingeniously discovered non-recurring changes, and other losses mysteriously applicable to surplus rather than current earnings.<sup>151</sup>

The consequences were devastating. The losses were tremendous. According to one report, "in the ten years before 1933, total investor losses through worthless securities were approximately \$25 billion, or half of all those issued."<sup>152</sup> According to the same report, even before the Depression, investors' losses "reached a staggering annual total of \$1.7 billion, of which \$500 million alone was accounted for within the state of New York."<sup>153</sup> Not surprisingly, the New York Stock Exchange became the focal point for reform.<sup>154</sup>

The New York Stock Exchange proclaimed its attempts to self-regulate. It recorded "its opposition to the issuance of nonvoting common stocks, and urged its listed companies to publish their quarterly earnings."<sup>155</sup> But self-regulation proved ineffective, especially with respect to disclosure. Neither the stock exchanges, which refused to enforce strict disclosure standards upon listed companies for fear of losing securities to other exchanges, nor the Investment Bankers Association were able to provide full disclosure to investors. Moreover, none of these private institutions was willing thoroughly to examine their members' conflicts of interest. For the most part, these were like private clubs "in which members could do no wrong, so long as their behavior toward each other was governed by club rules."<sup>156</sup> Their self-regulation was often meant to protect their members rather than the investing public.<sup>157</sup>

---

150. H.R. Rep. No. 73-1383, at 5-6 (1934).

151. *Business Versus the Public*, *supra* note 142, at 162.

152. DE BEDTS, *supra* note 77, at 11.

153. *Id.*

154. *Id.* at 12.

155. *Id.* at 13.

156. *Id.* at 15.

157. DE BEDTS, *supra* note 77, at 12-28; PARRISH, *supra* note 126, at 36-41.

The collapse of self-regulation as a means of regulating the securities markets eclipsed Progressive concerns about the power of corporations and the control group. Revelations of investment bankers' and management's conflicts of interest and the consequential fraud on the market helped shift policymakers' and scholars' attention from regulating the internal structure of corporations back to regulating the market for securities and investments. As Berle put it in *The Nature of the Difficulty* (a memorandum co-written with Louis Faulkner and discussed with Roosevelt, Raymond Moley, Jim Angell, Rexford Tugwell, and Sam Rosenman), the investment banking community had maintained "an attitude of irresponsibility," viewing investment bankers as merchants with no responsibility to assure the value of the sold merchandise.<sup>158</sup> Berle recommended the establishment of a federal body to "perform the functions of a federal Blue Sky Commission."<sup>159</sup>

Mark Roe has recently demonstrated how the continued hostility to investment institutions was reflected in attempts to limit the ability of these institutions to own or deal with securities.<sup>160</sup> In 1906, the Armstrong investigation into the insurance industry led New York to prohibit insurance companies from buying stock.<sup>161</sup> In 1933, the Pecora investigation of banking and securities practices led to the passage of the Glass-Steagall Act,<sup>162</sup> which "prohibited bank affiliates from owning and dealing in securities, thereby severing commercial banks from investment banks."<sup>163</sup> And in 1940, the Investment Company Act achieved a similar severance in the mutual funds industry by requiring mutual funds to be highly diversified (hence have no control over their portfolio companies) and by discouraging directors and officers of mutual funds from sitting on boards of their portfolio companies.<sup>164</sup> As if reflecting the cultural rejection of large investment institutions, the House Report on the Securities Exchange Act noted that "as management became divorced from ownership and came under the control of banking groups, men forgot that they were dealing with the savings of men and the making of profits became an impersonal thing."<sup>165</sup>

---

158. NAVIGATING THE RAPIDS, 1918–1971: FROM THE PAPERS OF ADOLF A. BERLE 46–47 (Beatrice Bishop Berle, ed., 1973).

159. *Id.*

160. Roe, *supra* note 91, at 10–12.

161. *Id.* at 36–37.

162. *Id.* at 38.

163. *Id.* at 17.

164. *Id.* at 19–20.

165. Loomis & Rubman, *supra* note 35, at 169.

Still, regulating investment institutions was only one of the ways through which New Dealers hoped to restore investors' faith in the securities market. As industrial activity and progress became "dependent upon a bewildering array of financial and organizational tools: bonds, debentures, cumulative and non-cumulative preferred stock, and common stock . . .,"<sup>166</sup> the administration was also keen to guarantee that these tools would survive the Depression. Roosevelt determined to bring an end to speculation—"The joy and moral stimulation of work no longer must be forgotten in the mad chase of evanescent profits" he said in his inaugural address.<sup>167</sup> Informed by the positions of centralization and decentralization alike, Roosevelt determined to let in "the light of day on issues of securities, foreign and domestic, which are offered for sale to the investing public."<sup>168</sup>

Regulating the market and regulating corporations were not mutually exclusive positions. Indeed, Seligman, Berle, and Ripley, while seeking to protect minority shareholders as a group, also emphasized the need for adequate disclosure. Seligman demanded that management provide adequate information to shareholders in order to make shareholder voting meaningful.<sup>169</sup> Ripley believed that permanent shareholder organizations would help supervise independent audits of the company's books.<sup>170</sup> In a New York Times article, written shortly after the publication of *Main Street and Wall Street*, he proclaimed that "the greatest single need for the protection of the public was adequate publicity by means of intelligible financial statements . . . coupled with a markedly higher standard of accountability to be anticipated at the hands of the courts."<sup>171</sup> Finally, Berle viewed the fiduciary duties of management and the control group as encompassing a duty to disclose.<sup>172</sup> Shortly after the crash, he and Means pointedly argued that corporate information was not simply a private matter of interest only to shareholders.<sup>173</sup> They wanted corporations to provide the market with periodic statements, statements pertaining to

---

166. PARRISH, *supra* note 126, at 3.

167. Franklin Roosevelt, *Inaugural Address*, (Mar. 4, 1933), in *THE PENGUIN BOOK OF TWENTIETH CENTURY SPEECHES* 26 (Brian MacArthur ed., Viking 1992).

168. JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE* 19 (1982).

169. Seligman, *supra* note 105, at 93–98.

170. RIPLEY, *supra* note 1, at 133–34.

171. *Tells Business Men Bigness is No Crime: Sargent's Aid Tells Economic Club that Federal Policy is One of Non-Interference*, N.Y. TIMES, Apr. 29, 1926, at 4.

172. BERLE & MEANS, *supra* note 73, at 284–85.

173. *Id.* at 279.

extraordinary activities, information provided to brokerage firms, as well as information provided to financial publications.<sup>174</sup>

In the 1930s, however, the obsession with disclosure obscured the need to regulate intra-corporate relations. Berle urged Roosevelt to create a federal body with powers to plan, stimulate, and stabilize economic activity; he even suggested considering a federal incorporation act.<sup>175</sup> The other brain trusters, Moley and Tugwell, an economist, did, too.<sup>176</sup> But Roosevelt believed that when bankers' activities were exposed to public scrutiny, self-interest would be curbed.<sup>177</sup> The different drafts of the Securities Act of 1933 thus reflected the idea that federal legislation should be limited to requiring "full and fair disclosure of the nature of the security being offered and that there should be no authority to pass upon the investment quality of the security."<sup>178</sup>

The different drafts of the Securities Act of 1933 aimed to guarantee that all new securities would be registered and that issues of new securities would be "accompanied by full publicity and information and that no essentially important element attending the issue shall be concealed from the buying public."<sup>179</sup> Reformers wanted corporations to disclose information about the corporation's business, its capital structure (including equity, debt, and income), the corporation's allocation of voting rights, preferences, and dividend rights, the private interests of the underwriting syndicate and the corporation in the new issue, as well as the purposes for which the new issue's proceeds were to be used. They wanted corporations to disclose this information both in a registration statement filed with the Federal Trade Commission (FTC) and in prospectuses issued to the public.<sup>180</sup> But the 1933 Act did not grant power to the FTC to assess the quality of the securities issued, and it exempted from its coverage securities already issued as well as securities issued intrastate, and several other categories.<sup>181</sup> As Felix Frankfurter pointedly noted, the 1933 Act was "a belated and conservative attempt to curb the recurrence of old abuses

---

174. *Id.* at 278.

175. SELIGMAN, *supra* note 168, at 41–51.

176. *Id.* at 40–41.

177. *Id.* at 39–63. On the renewed interest in federal incorporation during the early New Deal, see also Loomis & Rubman, *supra* note 35, at 161.

178. See SELIGMAN, *supra* note 168, at 63 (quoting James Landis's recollection of the drafting of the Securities Act of 1933).

179. PARRISH, *supra* note 126, at 47 (quoting from Roosevelt's message in support of the first draft).

180. *Id.* at 48–49; SELIGMAN, *supra* note 168, at 67–79.

181. SELIGMAN, *supra* note 168, at 70–71.

which, through failure of adequate legislation, had attained disastrous proportions."<sup>182</sup>

The 1933 Act aimed to restore public confidence in the markets by giving "impetus to honest dealing in securities."<sup>183</sup> Gone were the earlier decades' concerns about corporate power and the rapid separation of ownership from control. The drafters of the final bill embraced the view that modern business and finance could be regulated only through the combination of flexible national administration, existing state regulation, and "individual freedom to make investment decisions."<sup>184</sup> Instead of curbing corporate power through national or local regulation as the early advocates of disclosure suggested, the New Dealers trusted the individual investors—the consumers—to tame it. Traced back to Walter Weyl's *New Democracy* (1912), this approach was not predicated upon the creation of venues for Americans "to confront the impersonal world of big business and centralized markets . . . as members of traditional communities or as bearers of a new nationalism."<sup>185</sup> Rather, it rested on the assumption that individuals would be better off facing the modern economy as "enlightened, empowered consumers."<sup>186</sup> As Roosevelt described the Act, it was meant to add to the rule of *caveat emptor*, "the further doctrine, 'let the seller also beware.'"<sup>187</sup>

The Securities and Exchange Act of 1934 followed suit. While the New York Stock Exchange was trying to demonstrate, as late as 1933, that it could regulate its members, even businessmen rapidly emphasized the need for federal regulation to prohibit "costly manipulations" and guarantee the flow of information to investors.<sup>188</sup> The 1934 Act thus focused on the registration of the stock exchanges and the requirement that firms traded on these exchanges file annual and quarterly reports with a newly established agency, which the Act created—the Securities and Exchange Commission. The Act further prohibited certain manipulative devices such as short selling, which corporate insiders and exchange members used to exploit the market, and it regulated insider trading by both management and controlling shareholders.<sup>189</sup> Moreover, it limited the formation of control groups by requiring individuals or groups

---

182. *Id.* at 71.

183. DE BEDTS, *supra* note 77, at 33.

184. PARRISH, *supra* note 126, at 61–62; DE BEDTS, *supra* note 77, at 34–35.

185. SANDEL, *supra* note 29, at 221.

186. *Id.* at 221–27.

187. DE BEDTS, *supra* note 77, at 33.

188. PARRISH, *supra* note 126, at 110–11.

189. DE BEDTS, *supra* note 77, at 76–77.



owning more than 5% of a corporation's stock to file with the SEC.<sup>190</sup> In order to prevent fraudulent reporting, the Act also required "certified periodical audits for any corporation listing its securities on a national exchange."<sup>191</sup> As to the shareholders' role in the corporation—the 1934 Act put their fate in the hands of the SEC, which was authorized to adopt rules regarding proxy voting when appropriate "in the public interest or for the protection of investors."<sup>192</sup> As we will see, in the 1940s the SEC would use its power to promulgate the shareholder proposal rule.

### B. William O. Douglas's Crusade

The business community did not welcome the 1933 and 1934 Acts. Of particular concern were the liability clauses of the 1933 Act, which imposed civil liability on corporations and their officers for fraud and for misstatements in the registration statement,<sup>193</sup> and the limitations on the powers of the exchanges that the 1934 Act imposed. Those advocating broader corporate reform were also not satisfied. In an article published several months after the 1933 Act was passed, Berle cautioned that, while the Act sought to eliminate financial fraud, it did not resolve the crucial "problem of power arising from financial control exercised by investment bankers."<sup>194</sup>

Meanwhile, the number of individual shareholders continued to rise. By 1934, the House Report on the Securities Exchange bill estimated that more than 10 million individuals owned stocks or bonds, and that "over one fifth of all the corporate stock outstanding in the country [was] held by individuals with net incomes of less than \$5,000 a year."<sup>195</sup> In addition, it noted that:

Over 15,000,000 individuals [held] insurance policies, the value of which [was] dependent upon the security holdings of insurance companies. Over 13,000,000 men and women [had] savings accounts in mutual savings banks and at least 25,000,000 [had] deposits in national and State banks

---

190. Roe, *supra* note 91, at 25–27.

191. DE BEDTS, *supra* note 77, at 77.

192. SELIGMAN, *supra* note 168, at 99–100. On the creation of the SEC, see *id.* at 73–100; PARRISH, *supra* note 126, at 108–44.

193. DE BEDTS, *supra* note 77, at 49–50.

194. Adolf A. Berle, *High Finance: Master or Servant*, 23 YALE REV. 20, 41–42 (1933) cited in DE BEDTS, *supra* note 77, at 51.

195. H.R. Rep. No. 73-1383, at 3 (1934).

and trust companies—which [were] in turn large holders of corporate stocks and bonds.<sup>196</sup>

For many, these growing numbers of shareholders supported the idea that shareholders were merely investors. But the vision of the shareholder as a participant or member in need of protection did not disappear. Indeed, it was powerfully reiterated in 1934 by William O. Douglas, soon to be the SEC chairman.

Douglas emphasized that the newly enacted securities laws offered some protection to shareholders by requiring accurate disclosure in the proxy solicitation process, but he did not think disclosure was sufficient. First, like Brandeis, Douglas thought that disclosure was inadequate if it meant "registration in some dusty file in Washington or in some state capitol."<sup>197</sup> He wanted mandatory disclosure "in the sense of direct and unequivocal statement in the periodical reports to stockholders."<sup>198</sup> In this respect, Douglas would demand disclosure of directors' compensation, the shares traded during any given period, as well as directors' affiliations and conflicts of interests.<sup>199</sup> But Douglas also believed that in certain situations, only direct prohibition could be effective (for example, demanding the separation of commercial from investment banking as under the Glass-Steagall Act).<sup>200</sup>

Concerned about the separation of ownership from control, Douglas also feared that "[p]ublicity and prohibition alone are too feeble for the task at hand even when they carry adequate enforcement machinery."<sup>201</sup> Shareholders were simply too passive. As Douglas put it, given that shareholders in large public corporations "seldom have the desire or the initiative to act, or the ability to act intelligently," even with full information flow, proxy voting was likely to sustain management's control over the board.<sup>202</sup>

To make disclosure more effective, Douglas wanted the SEC to buttress standards of trusteeship and responsible management through its power to regulate corporate information. As he put it before the meeting of the International Management Congress, misrepresentation in dealing with security holders "is a direct undermining of that free economic system which is

---

196. *Id.* at 3–4.

197. William O. Douglas, *Directors Who Do Not Direct*, 47 HARV. L. REV. 1305, 1323 (1934).

198. *Id.*

199. *Id.* On Douglas's tracing of the establishment of the SEC to ideas expressed in *Other People's Money*, see DEMOCRACY AND FINANCE, *supra* note 86, at vi.

200. Douglas, *supra* note 197, at 1323–25.

201. *Id.* at 1325.

202. *Id.* at 1316, 1307–17.

necessary for the preservation and perpetuation of capitalism under a democratic form of government."<sup>203</sup> Management's diligence and tireless devotion to the standard of fiduciary responsibility toward its shareholders was the cornerstone of Douglas's democratic vision, and he wanted the SEC to take a more active role to make corporations conform to it.<sup>204</sup>

Moreover, Douglas viewed shareholders as participants in corporate affairs. Like Seligman, Douglas wanted to eliminate "non-voting, qualified voting, or contingent voting shares," and to add mechanisms such as "cumulative voting, pluralistic voting, or division of stock into blocks, each block electing a specified number of directors and no more."<sup>205</sup> He hoped that such mechanisms would empower "scattered and disorganized" investors.<sup>206</sup> But, like Berle and Ripley, Douglas also saw in organization the most important means of empowering shareholders or, at the very least, of protecting them.<sup>207</sup> Informed by the successes of the English Shareholders Protection Association and by the creation of shareholders protective committees during reorganization, Douglas wanted shareholders to form groups that could pressure corporate boards.<sup>208</sup> As he explained:

The device needed is one which will give these scattered and disorganized investors group strength and power so that they can gain admittance to the councils of business and make their influence felt around the negotiation table or in the courts. Letting each investor look out for himself merely accentuates the conditions giving rise to the need for regulation and makes more likely the recurrence of abuses which have cost the investor so dearly in recent years.<sup>209</sup>

Although Douglas followed in Berle's and Ripley's tradition, it is important to notice the nuances that distinguished their approaches. While Berle and Ripley were concerned about different groups exercising control over

---

203. William O. Douglas, *Corporation Management*, Address given in Washington, D.C., before the meeting of the International Management Congress (Sept. 27, 1938), in *DEMOCRACY AND FINANCE*, *supra* note 86, at 56.

204. *Id.* at 56–59.

205. Douglas, *supra* note 197, at 1330.

206. *Id.*

207. *Id.* E. Merrick Dodd, Jr. of Harvard Law School endorsed Douglas's position on shareholder organization. E. Merrick Dodd, Jr., *Statutory Developments in Business Corporations Law, 1886–1936*, 50 *HARV. L. REV.* 27, 51–52 n.99 (1936); E. Merrick Dodd, Jr., *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable*, 2 *U. CHI. L. REV.* 194, 197 n.10 (1935).

208. Douglas, *supra* note 197, at 1330–32.

209. *Id.* at 1330.

the corporation, Douglas's concern was about management's control.<sup>210</sup> While Berle and Ripley endorsed self-regulation, Douglas advocated a combination of self-regulation and government supervision (or administration).<sup>211</sup> Accordingly, he urged that shareholders organize on a national basis with "some form of governmental approval or backing."<sup>212</sup> Douglas was also more explicit about the role that shareholder organization would serve. While Ripley and Berle believed that shareholder organizations should aim to cooperate with management, Douglas viewed organization as constraining management's actions. As he pointedly put it, if such an organization were to develop, "as it easily can, into a respectable and vigilant organization, management would always gauge its policy by its vulnerability at the hands of such agency."<sup>213</sup> Moreover, while Ripley and Berle viewed shareholder organization as helping to self-regulate corporate power, Douglas envisioned a different role. He wanted the organization not only to protect stockholders "against the board or the officers," but to serve "as effectively in any case where bondholder, debenture holder, note holder, creditor, or stockholder needed protection."<sup>214</sup> In short, while he remained concerned about potential abuses of corporate power by those in control, the more important issue for Douglas was corporate hierarchy. He wanted the shareholders protective organization to help any member of the corporate community who needed protection against management.<sup>215</sup>

Notwithstanding such nuances, Douglas, like Berle and Ripley before him, was of two minds when assessing the shareholder's role in the large public corporation. On the one hand, Douglas wanted to empower the vulnerable, individual investor. On the other hand, he did not trust shareholders to make decisions for the greater social good. Interestingly, his solution resembled Berle's. While Berle wanted to impose fiduciary duties on management and the control group as a means of constraining their power, Douglas wanted to impose such duties on the shareholders organization itself. He insisted that the

---

210. By the mid-1930s, management still owned a relatively small proportion of its corporation's shares. R.A. Gordon, *Stockholding of Officers and Directors in American Industrial Corporations*, 50 Q. J. ECON. 622 (1936); R.A. Gordon, *Ownership by Management and Control Groups in the Large Corporation*, 52 Q. J. ECON. 367 (1938). It is important to note, however, that this small share ownership represented a large percent of management's personal income. Mitchell, *supra* note 146.

211. Louis Loss, *The Protection of Investors: The Role of Government*, 80 S. AFRICAN L.J. 53, 61 (1963).

212. Douglas, *supra* note 197, at 1332.

213. *Id.* at 1333.

214. *Id.*

215. *Id.* at 1329-34.

shareholders organization had to be organized "as a quasi-public corporation on a service rather than on a profit-making basis."<sup>216</sup> As such, it was required to act in the public interest.

When the stock market again collapsed in 1937, shortly after Douglas became chairman of the SEC, he put his plans for shareholder organization on a backburner and turned his attention to the regulation of the exchanges.<sup>217</sup> On November 23, 1937, the SEC issued its demand for the New York Stock Exchange reorganization (specifically to democratize it and to adopt short-sale trading rules).<sup>218</sup> "Fair play and simple honesty are a part of our inheritance. Individualism is our pole star," Douglas told the Association of Stock Exchange Firms.<sup>219</sup> As he saw it, the exchanges were "the greatest market places in the world," and he wanted to guarantee that the consumers—buyers and sellers alike—were able to trust the market.<sup>220</sup> The SEC, he stressed, was "first and last the investors' advocate."<sup>221</sup>

Douglas pushed the SEC toward a more statist, regulatory position. But he was never able to pass his proposed federal licensing or incorporation statute. Nor was he able to gain support for the idea of permanent shareholder organizations. Indeed when, in 1942, the SEC adopted rules to promote shareholder democracy, under the chairmanship of Ganson Purcell (Douglas resigned in 1939 to accept a seat on the Supreme Court), it was a different notion of democracy than the one Douglas, following Berle and Ripley, favored. Not only did it focus solely on corporate hierarchies rather than on

216. Douglas, *supra* note 197, at 1332.

217. See SELIGMAN, *supra* note 168, at 159–67 (detailing the collapse of the stock market in 1937, the way the collapse put the SEC on the defensive, and Douglas's attempts to press forward with stock market regulations).

218. *Id.* at 161–63.

219. William O. Douglas, *Reorganization Begins*, Speech delivered before the Economic Club of Chicago (Feb. 1, 1938) and William O. Douglas, *Reorganization of the New York Stock Exchange*, Address given before the Association of Stock Exchange Firms (May 20, 1938), in DEMOCRACY AND FINANCE, *supra* note 86, at 80.

220. DEMOCRACY AND FINANCE, *supra* note 86, at 83.

221. *Id.* at 83, 74–91. In 1938, after Congress passed the Maloney Act, empowering industry organizations to issue binding rules, the National Association of Security Dealers [NASD] was formed to organize investment bankers, brokers, and traders in over-the counter markets. The NASD was to become both a trade group and an enforcement organization under the supervision of the SEC. Phillip A. Nicholas, Jr., *The Securities and Exchange Commission and the Shareholder Proposal Rule: Agency, Administration, Corporate Influence, and Shareholder Power, 1942–1988*, at 67–81 (2002) (unpublished Ph.D. Dissertation, State University of New York at Albany) (on file with the Washington and Lee Law Review). Nicholas's is the most comprehensive study of the shareholder proposal rule. I have relied on his excellent archival research for factual background.

corporate power, it also sought to empower individual shareholders by protecting their individual rights rather than through organization.

### C. Democracy

The main actors in the history of the SEC believed that its role was to promote capitalism. Given the failure of self-regulation, they viewed government planning as required to guarantee the financial stability that could sustain capitalism. They presumed that the SEC would both "encourage rational organization within private groups and between private groups in order to achieve that stability," and eliminate those market practices that threatened it.<sup>222</sup> In short, the SEC "was both policeman and promoter; a vehicle for reform and a shield against more violent change."<sup>223</sup> It became a symbol of both economic and political tranquility.<sup>224</sup>

By the early 1940s, even the business community came to believe that "the law, effectively enforced, assisted financial operations by policing marginal elements within the industry and by promoting minimum standards of disclosure."<sup>225</sup> As more businessmen joined the government's war efforts, their influence grew. Gradually, it also became apparent that the SEC was not "opposed to business institutions or the profit motive."<sup>226</sup> In fact, it seems that the commissioners and staff members "looked upon the SEC as an extension of business enterprise."<sup>227</sup> Between 1934 and 1940, the Commission, "utilizing full disclosure, investigations, stop orders, stock exchange surveillance, and participation in utility organization, only reduced opportunities for corporate theft and restricted the methods by which individuals, while inflicting pecuniary damage upon one another, could derange the entire economy."<sup>228</sup> It was in this atmosphere that the SEC recommended an overall change to the proxy rules.

Generally, state corporation statutes and charters govern shareholder voting. They determine which issues (in addition to the election of directors) require shareholder voting as well as the particular procedures that voting processes should follow. Historically, shareholders had to attend the annual

---

222. PARRISH, *supra* note 126, at 179–80.

223. *Id.* at 180.

224. *Id.*

225. *Id.* at 229.

226. PARRISH, *supra* note 126, at 231.

227. *Id.*

228. *Id.* at 232.

meeting to vote. But, as already noted, with the rise of the large public corporation, proxy voting became the norm, gradually helping to disenfranchise the individual shareholder. Seeking to restore investors' confidence in the market for securities, the 1934 Act explicitly addressed problems associated with proxy voting.<sup>229</sup>

Section 14 of the 1934 Act was meant to regulate proxy solicitation and eliminate the proxy abuse about which Berle, Ripley, Douglas, and their contemporaries expressed deep concern. The section was not intended to empower shareholders, but only to "enhance management communication with stockholders within the framework of existing state corporation law."<sup>230</sup> From 1934 through 1942, the SEC promulgated rules to encourage management to communicate with shareholders, as well as to encourage communication among stockholders themselves.<sup>231</sup>

The SEC might have been successful in encouraging management to provide information to shareholders, but many corporations refused to refer to shareholders' proposed actions in their proxy solicitations.<sup>232</sup> In 1939, Bethlehem Steel Corporation refused to include in its proxy solicitation Lewis Gilbert's request for a shareholder vote on "moving the annual meeting site from Wilmington, Delaware to New York City, and to change the bylaws to allow stockholders to elect the auditors."<sup>233</sup> When Gilbert notified the SEC, it advised Bethlehem Steel to postpone the scheduled meeting in order to give stockholders the opportunity to revoke their proxies.<sup>234</sup> Bethlehem Steel "adjourned the meeting, and sent out a second proxy statement that made reference to Gilbert's proposed actions."<sup>235</sup>

Shortly thereafter the SEC's Office of General Counsel undertook a study of the proxy regulations and, in 1942, suggested a number of changes.<sup>236</sup> These changes aimed to provide shareholders with the information necessary to enable them to exercise their voices, for example by requiring corporations to disclose

---

229. Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1134-38 (1993).

230. Nicholas, *supra* note 221, at 108.

231. *Id.* at 108-12. For a discussion of the different rules promulgated under Section 14 of the Act, see Fisch, *supra* note 229, at 1139-41.

232. Nicholas, *supra* note 221, at 108-10.

233. *Id.* at 109.

234. *Id.*

235. *Id.* at 111; see also LEWIS D. GILBERT, *DIVIDENDS AND DEMOCRACY* 41-43 (1956) (describing his struggles with Bethlehem Steel's management).

236. Nicholas, *supra* note 221, at 111.

executive compensation in excess of \$25,000.<sup>237</sup> They also sought to give individual shareholders more meaningful voices in corporate management, for example, by allowing them to nominate director and auditor candidates in the company's proxy material and by eliminating the practice of treating unmarked proxies as affirmative positive votes.<sup>238</sup> Finally, the changes proposed adopting a rule requiring management to include proposals from security holders in its proxy solicitation, to allow shareholders to vote on these proposals, and, if management opposed the proposal, to allow the proponent to include a 100-word supporting statement.<sup>239</sup> (Before this recommended change, management only had to include a summary of the proposal in the proxy material and provide an opportunity for shareholders to indicate their preferences.)<sup>240</sup>

The changes were limited. They did not aim to empower shareholders. Their goal was to assure to shareholders rights that they traditionally held under state law and that the dispersion of stock ownership had rendered meaningless, including the right "to appear at the meeting; to make a proposal; to speak on that proposal at appropriate length; and to have [the] proposal voted on."<sup>241</sup> The changes were meant to create a deliberative corporate democracy, although, for the most part, it was created by allusion only.

The business community overwhelmingly opposed the changes, especially the rule requiring disclosure of executive compensation and the rule eliminating "management discretion in voting unmarked proxies."<sup>242</sup> Most corporations masked their objections as attempting to prevent the imposition of additional burdens on business during the war. But, with the war for democracy as important rhetoric, there was relatively little business opposition to the shareholder proposal rule (or to the rules allowing shareholders to nominate directors and auditors).<sup>243</sup>

The SEC took business opposition into account and, on December 18, 1942, promptly after Congress recessed, released a watered-down version of the

---

237. *Id.* at 112.

238. *Id.*

239. *Id.* at 108–12.

240. Hearings on H.R. 1493, H.R. 1821, and H.R. 2019, *supra* note 53, at 159.

241. *Id.* at 172; see also Daniel P. Sullivan & Donald E. Conlon, *Crisis and Transition in Corporate Governance Paradigms: The Role of the Chancery Court of Delaware*, 31 L. & SOC. REV. 713, 731 (1997) (noting that the rules rested on the assumption that "shareholders, like voters, had inalienable and preemptive claim to fair representation, candid disclosure, and clear accountability").

242. Nicholas, *supra* note 221, at 116.

243. *Id.* For an example of business opposition, see letter included in Hearings on H.R. 1493, H.R. 1821, and H.R. 2019, *supra* note 53, at 149–50.



new proxy rules.<sup>244</sup> Reacting to the general feeling that executives should not profit from the war effort, the SEC strengthened the rule requiring disclosure of executive compensation (by requiring disclosure of compensation in excess of \$20,000).<sup>245</sup> At the same time, the SEC reacted to fears about burdening corporations, whose contributions were crucial to the war effort, by omitting the rule prohibiting management from using unmarked proxies as well as the rule allowing shareholders to nominate directors and auditors.<sup>246</sup> Opponents of the latter seemed to have convinced the SEC that it would only lead to "insincere or frivolous nominations."<sup>247</sup>

Although they were not as vocal about it, business groups were also opposed to the shareholder proposal rule and any other form of "further legitimizing shareholder activism."<sup>248</sup> In various disparaging comments about the knowledge, intentions, and ability of small shareholders, business groups proclaimed that the rule would "allow 'crack-pots' to make virtually meaningless statements";<sup>249</sup> that it "would put 'dangerous weapons in the hands of the professional troublemaker'";<sup>250</sup> that it "would open the door wide to libelous, malicious, scurrilous, or abusive matter supplied by notoriety-seeking persons who need buy only a single share of stock for the purpose";<sup>251</sup> and that it would increase the length of the proxy statement, burden corporations with increased cost (at a time of war), and burden shareholders with too much information.<sup>252</sup> Some went as far as to suggest that "shareholder participation was not really necessary at all."<sup>253</sup>

Those businesses and business groups who were willing to support the rule wanted to limit the scope of shareholder participation. They suggested imposing restrictions that would permit only shareholders who owned a certain amount of stock to include their proposals and limit the number of proposals that any shareholder could submit.<sup>254</sup> They further suggested that shareholder

---

244. Nicholas, *supra* note 221, at 118.

245. *Id.* at 119.

246. *Id.* at 118–26.

247. *Id.* at 125. It is also important to note that proponents of shareholder democracy feared that "if shareholders were only permitted to nominate one director for each available directorship," management would include the weaker of the stockholders' nominees to guarantee election of management nominees. *Id.*

248. *Id.* at 129.

249. Nicholas, *supra* note 221, at 129.

250. *Id.*

251. Hearings on H.R. 1493, H.R. 1821, and H.R. 2019, *supra* note 53, at 159.

252. Nicholas, *supra* note 221, at 128–30.

253. *Id.* at 129.

254. *Id.* at 130.

proposals be limited to "proper subjects for shareholder action under state law, and not address the ordinary business activities under the purview of management."<sup>255</sup> The final rule, perhaps reflecting the New Dealers' own ambivalence about shareholder democracy, endorsed the suggested limitation.<sup>256</sup> It required management to include shareholder proposals in its proxy solicitation only when these proposals were "proper subjects for action by the security holders."<sup>257</sup>

While the SEC was willing to limit the application of the rule, it was not willing to omit it. Proclaiming that it did not see how the shareholder proposal rule would burden corporations (even in times of war), the SEC included the shareholder proposal rule in its December 1942 release.<sup>258</sup> Chairman Purcell and his team were keen on expanding the rights of shareholders, especially the small individual shareholder or, as they described her, the owner.<sup>259</sup> For one thing, Purcell explained that:

The rules are based on the fact that stockholders are the owners of their corporations and the stockholders' meetings are their meetings, and not the management's meetings. Anybody who approaches a stockholder and asks him for his proxy, must recognize that he is asking the stockholder to appoint him as the stockholder's agent. He should give the stockholder accurate information and must recognize his rights as the owner of the corporation.<sup>260</sup>

There was little public pressure to enact the rule, but the SEC staff persisted. If early New Deal programs sought to empower organized groups such as labor unions, the shareholder proposal rule aimed at empowering small, disorganized shareholders in order to allow them to fight concentrated managerial power.<sup>261</sup> It was not meant to interfere with managerial power, but to protect stockholders who were not connected with the management.<sup>262</sup> In 1954, Milton Freeman, the draftsman of the shareholder proposal rule, explained that he and his colleagues envisioned the small shareholder who treated her investment as a long-term investment as the principle beneficiary of the rule. Freeman noted that they were not concerned about holders of larger blocks of shares because they either had control or were able to launch a proxy

---

255. *Id.* at 129.

256. Nicholas, *supra* note 221, at 129.

257. *Id.*

258. *Id.* at 128–32.

259. Hearings on H.R. 1493, H.R. 1821, and H.R. 2019, *supra* note 53, at 183.

260. *Id.*

261. Nicholas, *supra* note 221, at 153–54.

262. Hearings on H.R. 1493, H.R. 1821, and H.R. 2019, *supra* note 53, at 35.

fight if they wanted to gain control.<sup>263</sup> While the 1934 Act was designed to protect all individual shareholders, the shareholder proposal rule focused on those most vulnerable among the shareholders. In a world growing rapidly concerned about totalitarianism, Purcell and his team wanted to protect the individual shareholder against management and the control group. In the process, they turned away from Berle's and Ripley's understanding of the nature of collective ownership to the earlier vision of the shareholder as an individual owner.

Guaranteeing the individual shareholder's right to participate was a means of protecting the American ideal of democracy. The New Dealers wanted to recreate the traditional annual meeting, reminiscent, perhaps, of the democratic town meeting. They wanted to create a solid corporate foundation for the ideal of American democracy. Interestingly, when members of Congress raised questions about shareholder proposals supporting communism during the hearings concerning the rules, Purcell made clear that such proposals were outside the scope of the rule.<sup>264</sup> Frank Emerson and Franklin Latcham, the avid 1950s advocates of shareholder democracy, beautifully captured the New Dealers' aspirations when they wrote:

Shareholder democracy holds promise of rekindling on a broader basis the spirit of individual inquiry and free discussion through use of the SEC provisions for security holder communication and proposals for corporate action. This, too, is salutary in that it affords a haven for human growth in an awesome atomic age.<sup>265</sup>

Robert Healy (a former FTC counsel) was the only commissioner who voted against the adoption of the shareholder proposal rule; he believed that the rule reached beyond the remedy of disclosure and thus beyond the scope of the SEC's authority.<sup>266</sup> The shareholder proposal rule became effective January 15, 1943.<sup>267</sup> In 1945, after recounting the mid-1920s attempts to empower shareholders, a commentator noted that with the enactment of the

---

263. Milton V. Freeman, *An Estimate of the Practical Consequences of the Stockholder's Proposal Rule*, 34 U. DET. L.J. 549, 552 (1956-1957).

264. Hearings on H.R. 1493, H.R. 1821, and H.R. 2019, *supra* note 53, at 163.

265. FRANK D. EMERSON & FRANKLIN C. LATCHAM, *SHAREHOLDER DEMOCRACY: A BROADER OUTLOOK FOR CORPORATIONS* 10 (1954).

266. Nicholas, *supra* note 221, at 132.

267. George D. Hornstein, *A New Form For Shareholders*, 45 COLUM. L. REV. 35, 48 (1945).

shareholder proposal rule, shareholder organization, while still theoretical, had become at least possible.<sup>268</sup>

The battle for shareholder democracy did not end with the adoption of the December 1942 rules. Business groups were able to interest Congress in the argument that the SEC had reached beyond its statutory power to regulate disclosure in adopting the shareholder proposal rule. Congressional hearings ensued, during which the House Interstate and Foreign Commerce Committee was able to express its displeasure over the rule, but not to eliminate it.<sup>269</sup> Purcell was able to convince members of Congress that by permitting communication between shareholders, the shareholder proposal rule was, for the most part, a disclosure rule. It only required management to include proposals it knew in advance a shareholder intended to propose at the meeting.<sup>270</sup>

Subsequent developments, however, were devastating to the idea of shareholder democracy as Purcell and his colleagues conceived of it. Beginning shortly after its adoption and continuing well into the 1980s, the shareholder proposal rule, especially the definition of proper subjects and the qualification of the submitting shareholders, has gone through many cycles of interpretation and amendments by the SEC and the courts. These changes corresponded to, and helped shape, changing visions of the shareholder's role in large corporations. As we will see, the conception of shareholder democracy was gradually reduced from participation to voting. Within a few decades, all that was left of the 1942 attempt to create a participatory, or deliberative, corporate democracy (as a means of constraining management power) was the right of individual shareholders to elect directors (and, alternatively, sell their shares).

---

268. *Id.* On the shareholder proposal rule, see generally Daniel E. Lazaroff, *Promoting Corporate Democracy and Social Responsibility: The Need to Reform the Federal Proxy Rules on Shareholder Proposals*, 50 RUTGERS L. REV. 33 (1997–1998).

269. Nicholas, *supra* note 221, at 132–45.

270. The Senate Report on the 1934 Act indicated that:

In order that the stockholder may have adequate knowledge as to the manner in which his interests are being served, it is essential that he be enlightened not only as to the financial condition of the corporation, but also as to the major questions of policy, which are decided at stockholders' meetings. Too often proxies are solicited without explanation to the stockholder of the real nature of the matters for which authority to cast his vote is sought.

S. Rep. No. 73-1455 (1934), cited in David C. Bayne, S.J., *The Basic Rationale of Proper Subject*, 34 U. DET. L.J. 575, 587 (1956–57); see also H.R. Rep. No. 73-1383, at 5–6 (1934); HELEN E. BOOTH, *THE SHAREHOLDER PROPOSAL RULE: SEC INTERPRETATIONS AND LAWSUITS 1* (Investor Responsibility Research Center) (1987); Nicholas, *supra* note 221, at 145.

*D. Democracy's Limits*

The SEC adopted the first set of amendments to the proxy rules in 1947.<sup>271</sup> These amendments formalized the role of the SEC's Division of Corporation Finance in reviewing shareholder proposals that corporations wanted to omit from their proxy statements. Before these amendments were adopted, the Third Circuit, in *SEC v. Transamerica*, formally established the SEC's authority to determine which shareholder proposals were "proper subjects."<sup>272</sup> The court accepted the SEC's position that shareholder proposals to change the location of the annual meeting, to require stockholder ratification of auditors, to require post-meeting disclosure of changes made to the bylaws, and to request the board to make a post-meeting report, were all proper subjects.<sup>273</sup> According to the court, "stockholders [were] entitled to employ watchmen to eye the guardians of their enterprise, the directors."<sup>274</sup> The SEC was granted power to determine the scope of the shareholders' access to the ballot.<sup>275</sup>

Even though only 135 shareholder proposals (by 56 different proponents) were presented between 1943 and 1947,<sup>276</sup> the American Society of Corporate Secretaries (founded in 1946) was keen on discouraging small shareholders from making proposals at annual meetings.<sup>277</sup> In 1948, responding to the Society's fears that shareholder proposals would become a nuisance, the SEC made additional changes to the proxy rules. It allowed corporations to omit even "proper subject proposals" in three situations. First, corporations could omit proposals that were submitted primarily to enforce a personal claim or redress a personal grievance against the company or its management. Second, they could omit proposals if management had included a proposal from the security holder in a proxy solicitation related to the last two annual meetings and the security holder failed to attend the meeting or to present the proposal for action at the meeting. Finally, corporations could omit proposals if substantially the same proposal had been voted on at the last meeting and received less than 3% of the vote.<sup>278</sup> Commissioner McConaughy noted that

---

271. EMERSON & LATCHAM, *supra* note 265, at 94.

272. *SEC v. Transamerica*, 163 F.2d 511, 518 (3d Cir. 1947).

273. *Id.*; see also Nicholas, *supra* note 221, at 164–68 (discussing *SEC v. Transamerica*).

274. *Transamerica*, 163 F.2d at 517.

275. Fisch, *supra* note 229, at 1145.

276. EMERSON & LATCHAM, *supra* note 265, at 102.

277. Nicholas, *supra* note 221, at 170. For additional information on the American Society of Corporate Secretaries (ASCS), see <http://www.governanceprofessionals.org/whatisascsc.shtml> (last visited Dec. 13, 2006) (on file with the Washington and Lee Law Review).

278. EMERSON & LATCHAM, *supra* note 265, at 95. On these amendments, see also Nicholas, *supra* note 221, at 170–73 and John G. Ledes, *A Review of Proper Subject Under the*

these changes "were only designed to eliminate crackpot propositions without impeding consideration of opposition proposals that have at least debatable merit and are proper subjects for stockholder's action."<sup>279</sup> No longer interested in encouraging the small individual shareholder to participate, the SEC aimed to protect management from its owners' presumed harassment.<sup>280</sup>

This was also the gist of a more significant amendment that the SEC adopted in 1952. As if reflecting the vision of shareholder democracy that the shareholder proposal rule embraced, this amendment focused on internal corporate hierarchies or, more specifically, the appropriate roles of shareholders and managers. It codified the SEC's practice of excluding from the scope of permissible shareholder proposals those primarily "for the purpose of promoting general economic, political, racial, religious, social or similar causes."<sup>281</sup> The SEC did not see these as proper subjects for shareholder action. At the same time, the justification for the 1952 amendment seemed to follow the one offered for the 1948 amendments. The 1952 exclusion was predicated on the assumption that management became vulnerable to the shareholders.<sup>282</sup>

The 1952 amendment followed discussions of a particular stockholder proposal, which James Peck, a founder of the Congress of Racial Equality, presented to the Greyhound Corporation in the fall of 1950. Peck wanted to require management to "consider the advisability of abolishing the segregated seating system in the South."<sup>283</sup> Peck had presented the proposal earlier, in March 1950, but it was rejected because it was not filed on time.<sup>284</sup> In March 1951, the SEC advised the Greyhound Corporation that it could omit the proposal because it involved "matters which are of a general political, social or economic nature" and thus not a proper subject for action by shareholders.<sup>285</sup> While the SEC agreed that the proposal seemed relevant to Greyhound's business, it determined that Peck was not interested in solving a problem of

---

*Proxy Rules*, 34 U. DET. L.J. 520, 522-23 (1956-1957).

279. Nicholas, *supra* note 221, at 172.

280. See, e.g., EMERSON & LATCHAM, *supra* note 265, at 45 (explaining that the 1948 amendments were required because "in a few cases management have been badgered by proposals which apparently were not submitted in good faith, or were submitted for the purpose of achieving some ulterior personal objective unrelated to the interests of the sound and fair management of corporate affairs").

281. *Id.* at 96.

282. As early as 1945, Baldwin Bane, then director of the Division of Corporation Finance, made clear that proposals pertaining to matters of general political, social, and economic interest were not proper subjects for shareholder action. Nicholas *supra* note 221, at 169.

283. *Id.* at 183.

284. *Id.*

285. *Id.*; Peck v. Greyhound Corp., 97 F. Supp. 679, 679 (S.D.N.Y. 1951).

relevance solely to the corporation, but in advancing a cause.<sup>286</sup> The 1952 amendment was meant to codify this and similar SEC reactions. Despite opposition by civil rights groups, like the NAACP and the American Jewish Congress, the amendment was adopted.<sup>287</sup>

As noted, the 1952 amendment was predicated upon a reversed vision of corporate hierarchies. Yet, by continuing to see the goal of shareholder democracy as addressing concerns raised by such hierarchies, the amendment sustained the legacy of the 1942 shareholder proposal rule. The alternative of focusing on corporate power, which would have required Greyhound to include Peck's proposal in its proxy solicitation, was articulated by Berle, also in 1952. In an article on *The Developing Law of Corporate Concentration*, Berle described the corporation as "an arm of the state, held to certain of the limitations imposed on the state itself by the Bill of Rights requiring [it] to respect certain individual rights and to assure a measure of equal protection of the laws within the scope of its power."<sup>288</sup> According to Berle, "the basic rights of individuals [were to] be . . . scrupulously protected" against corporations as "an offset to their necessary organization and power."<sup>289</sup> Individual rights were to be protected against corporations, "as they were against the erstwhile political state."<sup>290</sup>

Neither Berle nor civil rights groups were able to affect the course of events. The 1952 rule was used not only to prohibit proposals having to do with corporate power, but also those dealing with corporate hierarchies, such as Wilma Soss's proposals requesting the appointment of women directors.<sup>291</sup>

Even more damaging to the purpose of those who enacted the 1942 rule were the amendments that the SEC introduced in 1954. Despite the fact that even when included in corporations' proxy materials, shareholder proposals never posed a threat to management and, for the most part, were defeated on the floor,<sup>292</sup> the SEC determined to stop the activities of corporate gadflies like

286. Nicholas, *supra* note 221, at 186.

287. For an extensive discussion of the 1952 amendment and its critics, see *id.* at 181–94. The 1952 amendment also required shareholders to submit proposals "30 days before the time of the previous year's proxy solicitation instead of 30 days before the time of the previous year's last meeting." Ledes, *supra* note 278, at 523.

288. Adolf A. Berle, Jr., *The Developing Law of Corporate Concentration*, 19 U. CHI. L. REV. 639, 643 (1952).

289. *Id.* at 661.

290. *Id.*

291. Nicholas, *supra* note 221, at 194.

292. See Benjamin Graham, *Foreword*, in EMERSON & LATCHAM, *supra* note 265, at vi (offering possible explanations for the relative lack of success).

Soss and Gilbert.<sup>293</sup> In 1934, Congress was concerned that the separation of ownership from control and the corresponding anonymity of investors made the control group forget that they were entrusted with other people's savings. "When men do not know the victims of their aggression they are not always conscious of their wrongs," the House Report read.<sup>294</sup> In 1947 the Third Circuit proclaimed that the proxy rules were a means of reminding a corporation's executives that a "corporation is run for the benefit of its stockholders and not for that of its managers."<sup>295</sup> But the 1954 amendments were predicated upon the "near opposite premise, recorded in the *SEC Minutes*, that a corporation should be permitted 'to omit any proposal which impinges upon the duties and functions of the management.'<sup>296</sup>

Generally, shareholder proposals from the 1940s through the 1950s addressed five issues: shareholders voting rights, matters concerning directors and officers, communication between managers and shareholders, directors' and officers' compensation, and the shareholders' property interests.

Proposals addressing shareholders voting rights included proposals to change the location of the annual meeting, as well as to require cumulative voting for the election of directors. Proposals dealing with matters concerning directors and officers included proposals to allow shareholders to nominate directors using the management's proxy solicitation, to require that independent directors sit on the board, to mandate that women serve on boards (most of the latter proposals were introduced by Soss and her Federation of Women Shareholders), to eliminate staggered boards, and to allow shareholders to nominate and elect auditors. Proposals dealing with communication between management and the shareholders required the board to provide to security holders financial reports throughout the year, and to submit post-meeting reports to the security holders. Proposals focusing on directors' and officers' compensation included proposals to change executive compensation (especially during a down cycle), to impose a ceiling on executive compensation and employee pension funds, and to reduce executive compensation when dividends were not distributed. Finally, proposals dealing with the shareholders' property interests included proposals mandating the distribution

---

293. SELIGMAN, *supra* note 168, at 271.

294. H.R. Rep. No. 73-1383, at 5, 13 (1934), *cited in* Med. Comm. for Human Rights v. SEC, 432 F.2d 659, 676 (D.C. Cir. 1970).

295. SEC v. Transamerica, 163 F.2d 511, 517 (3rd Cir. 1947).

296. SELIGMAN, *supra* note 168, at 271 (quoting *SEC Minutes*, Aug. 7, 1953, Jan. 26, 1954, Feb. 19, 1954, Mar. 2, 1954, and Mar. 11, 1954).



of dividends out of existing funds or requiring preemptive rights for security holders.<sup>297</sup>

As this short summary should indicate, shareholders did not abuse their power to introduce proposals.<sup>298</sup> "Today in the world of the corporation," David Bayne wrote:

[T]he danger is not that management will be consumed by a roaring lion, nor is there danger in the foreseeable future that the overweening power of the uninformed, unorganized and even disorganized shareholder will be a threat to the cowed, beaten and hapless management. A sensible and enlightened management should on the other hand welcome the whip of shareholder complaint, criticism and suggestion, lest they atrophy or grow soft.<sup>299</sup>

Still, in 1954, the SEC further limited the scope of permissible shareholder proposals. The 1954 amendments excluded proposals referring to ordinary business from the appropriate scope of shareholders action.<sup>300</sup> Corporations could omit both those proposals having to do with a too general (economic, political, racial, religious, social) matter and those dealing with a too narrow issue, that is, ordinary business.<sup>301</sup>

With very little room to act, some commentators suggested that shareholders focus their proposals (and action in the corporation) on "two areas of major importance to them . . . (a) the adequacy of earning results, and (b) the adequacy of the dividend policy."<sup>302</sup> In pursuing these goals, shareholders were also advised to seek help from the "many agencies in the financial community that could supply such counsel."<sup>303</sup> The investment funds, stock exchange houses, security-analyst groups, and other investment organizations became the alternative for Berle's, Ripley's, and Douglas's protective organizations.

Furthermore, the 1954 amendments limited the right of the security holder to make a proposal even when the proposal's subject fit the divide between the too narrow and the too broad. The amendments allowed corporations to exclude a proposal that was submitted once within the previous three years if it

---

297. EMERSON & LATCHAM, *supra* note 265, at 101–12. On the different kinds of shareholder proposals, see Lewis D. Gilbert, *An Independent Shareholder Appraisal*, 34 U. DET. L.J. 558 (1956–1957); Bayne, *supra* note 270, at 595.

298. See also EMERSON & LATCHAM, *supra* note 265, at 117 (noting that "there is no significant evidence of any abuse of the proposal rule").

299. Bayne, *supra* note 270, at 605–06.

300. EMERSON & LATCHAM, *supra* note 265, at 96.

301. *Med. Comm. for Human Rights v. SEC*, 432 F.2d 659, 678–79 (D.C. Cir. 1970).

302. Graham, *supra* note 292, at vi.

303. *Id.*

had failed to receive 3% of the vote.<sup>304</sup> If the proposal was submitted twice within the previous three years, it could be excluded if it had not received 6% of the vote.<sup>305</sup> If it was submitted three times, it could be excluded if it had failed to receive 10% of the vote.<sup>306</sup> The 1954 amendments also required security holders to notify management of their intent to include a proposal 60 days prior to the date on which the proxy solicitation material had been released the previous year.<sup>307</sup> As proponents of shareholder democracy concluded, "[o]nly the Gilberts, the Federation of Women Shareholders in American Business, Inc., and a very few other representative proponents [were] able to operate effectively under the restrictive 1954 amendments . . . and even they [had to] resort to the seemingly devious tactic of changing proposals when a 3-6-10% favorable vote [could not] be obtained."<sup>308</sup>

Gilbert, Emerson and Latcham, and Bayne struggled to defend the shareholder proposal rule against these new tides of opposition. Writing in 1956, Gilbert, who introduced many shareholder proposals, stressed that the rule promoted "a real people's capitalism."<sup>309</sup> "Here," he wrote, was "the positive answer to communism and the communistic charges of absentee ownership, not the archaic idea of selling one's stock if dissatisfied with management."<sup>310</sup> In a similar manner, Bayne proclaimed that "the failure of democracy within the modern American corporation is the failure of democracy *pro tanto* in our culture."<sup>311</sup> And Emerson and Latcham concluded that "[t]he failure of proposals to carry or win larger votes is no criteria by which to judge the proposal rule."<sup>312</sup> As they viewed it, the significance of the rule was in promoting the exchange of stimulating ideas. Sometimes managements that opposed a certain proposal later adopted its course of action, suggesting that shareholder proposals could have extra-legal effects. "What is involved," Emerson and Latcham concluded, "is basically the right of a minority to

---

304. SELIGMAN, *supra* note 168, at 271.

305. *Id.*

306. *Id.*

307. *Id.*

308. Frank D. Emerson, *Some Sociological and Legal Aspects of Institutional and Individual Participation under the SEC's Shareholder Proposal Rule*, 34 U. DET. L.J. 528, 547 (1956-1957).

309. Gilbert, *supra* note 297, at 573.

310. *Id.* at 573-74.

311. Bayne, *supra* note 270, at 575.

312. EMERSON & LATCHAM, *supra* note 265, at 117.

express itself and have an exchange of ideas—all in a corporate context—but close to a fundamental freedom."<sup>313</sup>

But after the 1954 amendments, little was left of the original shareholder proposal rule. Indeed, it seemed that the only power that shareholders still had, other than selling their stock, was the power to launch a proxy contest. Emerson went as far as to suggest that the 1954 amendments encouraged proxy contests.<sup>314</sup> (Proxy fights were so common in the 1950s, albeit typically unsuccessful, that an article in *Barron's National Business and Financial Weekly* proclaimed 1954 as "the year of battle by proxy.")<sup>315</sup> Instead of seeking to foster communication and cooperation between individual shareholders and managers, the 1954 amendments helped pave the way for a new vision of shareholder democracy. Building on the individualist undertones of the 1940s shareholder proposal rule, this new vision was predicated on the inevitability of conflict between management and shareholders as well as on the individual's ability to self-protect. At least in part, it was sustained by the growing dominance of institutional investors. Gradually, as we will see, the shareholder's role as participant and the shareholder's role as investor converged. By the 1990s, this vision would dominate corporate law.

#### IV. 1970s–1980s: Markets, Voters, and Convergence

##### A. Disclosure Part III: Free and Unregulated

Beginning in the late 1930s and continuing until the mid-1970s, Keynesian economics gained wide acceptance. Predicated upon the belief that governments should not choose among competing, individual, visions of the public good, it helped legitimate a regulatory shift—from "planning" to "accepting existing consumer preferences" and "manipulating aggregate demand."<sup>316</sup> Both those who criticized the early New Deal as only increasing the concentration of power in a few hands and those who criticized it as increasing government power found in the consumer ideology a point of convergence. The former wanted to expand the regulatory functions of the administrative state to defend the consumer and promote full production, while

---

313. *Id.*

314. Emerson, *supra* note 308, at 547.

315. John C. Perham, *Revolt of the Stockholder: Proxy Fights Are Breaking out Everywhere These Days*, BARRON'S NAT'L BUS. & FIN. WKLY., Apr. 26, 1954.

316. Alan Brinkley, *The New Deal and the Idea of the State*, in *THE RISE AND FALL OF THE NEW DEAL ORDER, 1930–1980* 85, 92, 98 (Steve Fraser & Gary Gerstle, eds., 1989).

the latter wanted the state only to redress "weaknesses and imbalances in the private economy without directly confronting the internal workings of capitalism"—to "manage the economy without managing the institutions of the economy."<sup>317</sup>

In the 1940s, with totalitarianism in Europe, and scholars' growing concerns about the relationship between statism and tyranny, the compensatory, fiscal vision of the state, which entailed only limited power, became the more appealing one. At the same time, the economic boom produced by the war efforts made the need for regulation less urgent. The economy seemed to do well without government interference. A vision of a free market, compensated on rare occasions by the state's fiscal hand, began to dominate economic thought.<sup>318</sup>

The growing academic faith in the power of economic and political markets to serve (and produce) the common good opened a door for the introduction of economics into corporate law. Neo-classical economists, who thus far had focused their theorizing efforts on markets, turned to the corporation's internal structure. Their new economic theory of the firm offered a picture of the corporation that fit the market-centered economic policies of the postwar years. Rather than putting management hierarchies or the need to constrain corporate power at the center of the corporate paradigm, the new economic theory of the firm found a way around hierarchical power and its consequent need for regulation. Drawing on microeconomics, it painted a picture of the corporation as a nexus of private, contractual relationships. This cleared the way for egalitarian economic markets to become the relevant focal point.<sup>319</sup> The corporation was a collection of "disaggregated but interrelated transactions" among individuals or the convenient fiction of corporate entity in free and efficient markets.<sup>320</sup>

The new theory of the firm supported a shift of focus in scholarly debates—from questions of power, influence, sanctions and legitimacy to issues of cost reduction and profit maximization.<sup>321</sup> Its proponents reframed the problem of the modern corporation as the problem of the separation of ownership from control and sought to demonstrate how capital markets could

---

317. *Id.* at 94, 87–97.

318. On these developments, see *id.* at 97–121; SANDEL, *supra* note 29, at 250–73; ALAN BRINKLEY, *THE END OF REFORM: NEW DEAL LIBERALISM IN RECESSION AND WAR* 154–65 (1995).

319. William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 416–20 (1989).

320. *Id.* at 420.

321. William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1498 (1989).

eliminate the concerns about efficiency associated with this separation.<sup>322</sup> The individual shareholder's ability freely to act in economic markets, supplemented only by her right to elect her agents, was the cornerstone of their theory of corporate democracy.

Take, for example, Henry Manne. Writing in 1961 he offered a harsh critique of earlier attempts to protect the small, individual investor.<sup>323</sup> Manne dismissed the mid-1920s attempts to protect shareholders as having nothing to do with shareholder democracy. According to Manne, Berle (and Means) sacrificed the individual shareholder for the benefit of the community.<sup>324</sup> Then, having criticized Berle for never suggesting ways to improve the shareholders' franchise (and more broadly for his collectivist approach), Manne pronounced the 1940s theories of corporate democracy "the most effective of the modern philosophies of large corporations."<sup>325</sup> They were most effective because, as Manne saw it, they were completely negligible.

Focusing on Gilbert's efforts to promote shareholders' interests, Manne concluded that, in general, shareholders were not interested in business problems. Rather, they were more concerned with "establishing a system in which shareholders can have a more effective voice on [important corporate matters] if they wish."<sup>326</sup> In fact, as Manne pointedly put it:

To the extent that pure corporate democracy in the sense of the New England town meeting is deemed to be desirable, Gilbert has had a beneficial influence. Beyond that he is probably of so little consequence that his affirmative proposals need not be considered in depth at all. The sort of basic changes which Gilbert, his brother and occasionally one or two others, seem to advocate would require a kind of dedication for which most shareholders have shown little taste.<sup>327</sup>

Emerson and Latham received no better treatment. They were, Manne wrote, "almost unreasonably enthusiastic about the desirability of this [shareholder proposal] rule."<sup>328</sup> Exploiting one of Emerson's and Latham's arguments that the rule "held the greatest promise for progress towards shareholder democracy and the salvation of our corporate enterprise system," Manne sarcastically noted that "[e]xperience to date with the rule would certainly

---

322. Tsuk, *supra* note 74, at 212–15.

323. Henry G. Manne, *Current Views on the "Modern Corporation,"* 38 U. DET. L.J. 559 (1961).

324. *Id.* at 562–64.

325. *Id.* at 564.

326. *Id.* at 565.

327. *Id.*

328. *Id.* at 566.

make one less than sanguine about the salvation of our corporate system if it depend[ed] on utilization of the rule."<sup>329</sup>

It is hard, if not impossible, to challenge Manne's conclusion that the shareholder proposal rule did not result in a thriving shareholder democracy. Even Freeman, the draftsman of the rule, conceded that:

[T]he average smaller shareholder . . . buys his stocks either with a view to dividend return on his investment or more frequently . . . with a view to capital appreciation . . . . [M]ost shareholders hold their shares as long as they continue to have confidence in the future of the company and the prospects of increased market values and dividends. When they lose this confidence they sell their securities. While they hold their securities such shareholders concern themselves almost exclusively with market prices, earnings, dividends and future earnings and dividend prospects. They do not attend shareholders meetings. They normally vote proxies on the management's suggestion. Very few of them read proxy statements. And almost none of them makes proposals for action at shareholders meetings.<sup>330</sup>

Despite such an assessment, Freeman and other proponents of shareholder democracy believed it was a means to an end. They believed that protecting the small individual shareholder who was committed to her investment for the long term would help constrain management's potential abuses of power. Moreover, along with many Progressives and New Dealers, they believed that political and economic democracy was predicated upon the protection of the most vulnerable.

Manne's goals and ideals were different. He rejected all theories of shareholder democracy (including the 1960s focus on institutional investors), as well as all theorizing about the corporation, with the exception of economic theorizing. According to Manne, the solution to the problem of the modern corporation was the recognition that there was no problem at all. Only when the corporation was viewed as a hierarchical entity with social, political, and economic power did corporate power become a problem. Once corporations were seen as aggregations of individuals seeking to maximize their profits, concerns about corporate power and hierarchies disappeared.<sup>331</sup>

Once the corporation was turned into an aggregation of individuals keen on maximizing their profits, the only task left for shareholders was to ensure that such profit maximization occurred. In an article on the significance of the shareholder's voting rights and, more important, the shareholder's ability to sell her right (or her share), Manne articulated this new conception of shareholder democracy. The shareholders' role was to elect directors who would maximize

---

329. Manne, *supra* note 323, at 566.

330. Freeman, *supra* note 263, at 553.

331. Manne, *supra* note 323, at 583–88.

their profits. To achieve this goal, they needed information, which was costly. But if shareholders were attuned to the market and sold their shares to those who had both the information and the ability to elect directors (for example, those seeking to gain control over the entity), they would be able to maximize their profits without incurring additional information costs.<sup>332</sup> As Manne concluded:

The market for votes, therefore serves two critical functions. It gives the advantage of someone else's information-gathering to all the shareholders willing to sell. It also causes votes to move into the hands of those shareholders to whom the vote itself is most valuable, that is, those who know how to use it most profitably. The value of the vote, as opposed to the value of voting the shares one way rather than another, rests with those who have the most reliable information. Without the market, many small shareholders could not have any idea of what the vote itself was actually worth to them. Thus, the corporate system of allowing the sale of votes guarantees an electorate that is both relatively self-informed and more intensely interested in the outcome of the election than would be the case if votes were not transferable. And it does this with no harm to the interests of anyone associated with or affected by the corporation.<sup>333</sup>

The shareholders' power was not their voting but their selling power.<sup>334</sup> As Manne and many others saw it, there was no need to guarantee that management communicated with shareholders. Gone also was the need to guarantee that shareholders communicated with management. Power and hierarchy disappeared, and the individual shareholder gained the ability to self-protect, mostly by selling her interest in the corporation. Whether a shareholder chose to act as investor or as participant, the market became the locus of corporate democracy.

### *B. Social Responsibility Proposals: The Final Crusade*

Proponents of the shareholder proposal rule did not let go without a fight. In the 1970s, after more than twenty years in which the SEC had barred almost all social proposals,<sup>335</sup> organized efforts to force corporations to act in socially responsible ways brought about a new interest in Rule 14a-8.

---

332. Henry G. Manne, *Some Theoretical Aspects of Share Voting: An Essay in Honor of Adolf A. Berle*, 64 COLUM. L. REV. 1427 (1964).

333. *Id.* at 1444.

334. *Cf.* Dale A. Oesterle and Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 IOWA L. REV. 485, 487-88 (1994) (arguing that in the 1970s and 1980s many scholars believed that the threat of hostile takeovers increased the shareholders' power).

335. Nicholas, *supra* note 221, at 281.

The first such effort was undertaken by the Project on Corporate Responsibility (The Project), which owned twelve shares of stock of General Motors (GM).<sup>336</sup> The Project, which was formed by four lawyers who were able to enlist Ralph Nader's support, asked GM's management to include nine proposals in the company's proxy solicitation.<sup>337</sup> These proposals addressed product quality and safety, working conditions, environmental protection, and affirmative action (in selecting dealers).<sup>338</sup> Ultimately, The Project was able to bring two proposals before the shareholders: one seeking an increase in the size of the board, and the other seeking to "improve the company's social impact" by creating a "General Motors Shareholders Committee for Corporate Responsibility," "comprised of . . . persons appointed by General Motors, the United Auto Workers, and Campaign GM."<sup>339</sup> Although neither proposal gained sufficient votes (not even the 3% required for reintroduction the following year), their inclusion in the company's proxy constituted a major victory for advocates of social cause proposals.<sup>340</sup>

Three months after the SEC sanctioned the inclusion of the social responsibility proposal in GM's proxy solicitation, Senator Edmund Muskie introduced the Corporate Participation Bill which sought to bar, *inter alia*, "exclusion of shareholder proposals 'on the ground that such proposal may involve economic, political, racial, religious, or similar issues, unless the matter or action proposed is not within the control of the issuer.'"<sup>341</sup>

Shortly thereafter, the D.C. Circuit handed down its decision in *Medical Committee for Human Rights v. SEC* (1970),<sup>342</sup> reiterating the Third Circuit's 1947 statement: "A corporation is run for the benefit of the stockholders and not for that of its managers."<sup>343</sup> The decision focused on the SEC's letter of "no action" with respect to a proposal that the Medical Committee (as an owner of a few shares) wanted the board of the Dow Chemical Company to include in its proxy materials.<sup>344</sup> The proposal requested the board "to adopt a resolution setting forth an amendment to the Composite Certificate of

---

336. See *id.* at 285 (describing how the Project on Corporate Responsibility initiated "Campaign GM").

337. *Id.* at 286-87.

338. *Id.* at 285-87.

339. *Id.* at 286-87.

340. Nicholas, *supra* note 221, at 285-90, 304.

341. *SEC v. Med. Comm. for Human Rights*, 404 U.S. 403, 410 (1972) (Douglas, J., dissenting); Nicholas, *supra* note 221, at 292-93.

342. *Med. Comm. for Human Rights v. SEC*, 432 F.2d 659 (D.C. Cir. 1970).

343. *Id.* at 681.

344. *Id.* at 661-63.



Incorporation . . . that napalm [should] not be sold to any buyer unless that buyer [gave] reasonable assurance that the substance [would] not be used on or against human beings."<sup>345</sup> The board thought the proposal could be omitted, and the SEC announced that it would take no action on the matter.<sup>346</sup> The D.C. Circuit saw things differently and remanded the case to the SEC for reconsideration.<sup>347</sup> In a pointed comment about the shareholders' role in the corporation, Judge Tamm wrote:

It could scarcely be argued that management is more qualified or more entitled to make these kinds of decisions than the shareholders who are the true beneficial owners of the corporation; and it seems equally implausible that an application of the proxy rules which permitted such a result could be harmonized with the philosophy of corporate democracy which Congress embodied in section 14(a) . . . .<sup>348</sup>

On appeal, the Supreme Court declared that the case was moot because the company had included the proposal in a previous year and it failed to receive 3% of the votes.<sup>349</sup> In dissent, Justice Douglas, referring, among other things, to the Corporate Participation Bill, wrote:

The modern super-corporations, of which Dow is one, wield immense, virtually unchecked, power. Some say that they are "private governments," whose decisions affect the lives of us all. The philosophy of our times, I think, requires that such enterprises be held to a higher standard than that of the "morals of the marketplace" which exalts a single-minded, myopic determination to maximize profits as the traditional be-all and end-all of corporate concern. The "public interest in having the legality of the practices settled, militates against a mootness conclusion."<sup>350</sup>

The pressure for change was mounting, sustained in part by the social unrest regarding the Vietnam War as well as the civil rights movement that swept the country. Then, in September of 1972, the SEC amended Rule 14a-8 to open the door, albeit not widely, for social purpose shareholder proposals. It substituted for the provision allowing exclusion of proposals intent on "promoting general economic, political, racial, religious, social or similar causes" a provision allowing omission only if the proposal was "not significantly related to the business of the issuer or is not within the control of

---

345. *Id.* at 662.

346. *Id.* at 663.

347. *Med. Comm. for Human Rights*, 432 F.2d at 682.

348. *Id.* at 681-82.

349. *SEC v. Med. Comm. for Human Rights*, 404 U.S. 403, 406 (1972).

350. *Id.* at 409-10 (Douglas, J., dissenting).

the issuer."<sup>351</sup> (Notice that this rule would have allowed Dow to exclude the Medical Committee's proposal.)<sup>352</sup> In November of 1972, the SEC also made public its no-action letters, thus providing important information about the administration of the Rule to those interested in promoting social purpose proposals.<sup>353</sup>

In the following decade, as the country witnessed a wide-range of protests, social responsibility proposals became a "full-fledged phenomenon," leading the U.S. Senate to probe how to "make corporations more accountable to their stockholders and to the public."<sup>354</sup> Church groups and institutional investors replaced the earlier "scattered shareholder campaigns" (such as the Medical Committee's campaign against Dow or even the influential Campaign GM).<sup>355</sup> The Investor Responsibility Research Center (IRRC), which was established in 1972 by a group of institutional investors who were trying to assess how to vote on these new resolutions, "counted 38 social responsibility resolutions coming to votes in 1973, 72 in 1974, 83 in 1975, and 133 in 1976."<sup>356</sup>

Church groups' efforts focused on equal employment opportunities, plant closing, racism in South Africa, "activities in countries with controversial human rights records, energy conservation, nuclear power and nuclear weapons," as well military production.<sup>357</sup> Church groups sponsored proposals to postpone mining in Puerto Rico because of environmental concerns as well as concerns about the health and well-being of the people of Puerto Rico. They also introduced proposals to withdraw operations from South Africa, and proposals to reform American manufacturers' sales practices of infant formula.<sup>358</sup>

Other groups followed suit. In 1976, the American Jewish Congress turned to shareholder proposals in its campaign against the Arab nations'

351. Nicholas, *supra* note 221, at 293. On social responsibility proposals in the 1950s and 1960s and the SEC's response, see also Fisch, *supra* note 229, at 1152-55.

352. SEC v. Med. Comm. for Human Rights, 404 U.S. 403, 410 (1972) (Douglas, J., dissenting).

353. Nicholas, *supra* note 221, at 298-99.

354. *The Role of the Shareholder in the Corporate World: Hearing on S.521-4 Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the S. Comm. on the Judiciary*, 95th Cong. 2 (1977) [hereinafter *The Role of the Shareholder in the Corporate World*] (Statements by Senator Howard M. Metzenbaum, Chairman of the Subcommittee).

355. BOOTH, *supra* note 270, at 3.

356. *Id.*

357. LAUREN TALNER, *THE ORIGINS OF SHAREHOLDER ACTIVISM* 47 (Investor Responsibility Research Center) (1983).

358. *Id.* at 30-32, 47.

boycott of Israel.<sup>359</sup> In the early 1980s antinuclear activists filed many proposals about the use of nuclear power.<sup>360</sup> In 1983, Action on Smoking and Health filed thirty-seven resolutions on smoking in airports and airplanes, while the American Jewish Congress organized "a major campaign to expose lobbying by companies in support of sales of Awacs planes to Saudi Arabia."<sup>361</sup>

As to institutional investors, in 1987, the New York State Common Retirement Fund and TIAA-CREF engaged "campaigns to get companies to withdraw from South Africa, and New York City funds have stepped up their own South Africa divestment campaigns."<sup>362</sup> Also in 1987, CREF, the carpenters' union, and the public pension funds of California and Wisconsin introduced a series of resolutions "against antitakeover poison pill measures."<sup>363</sup>

Proponents of shareholder democracy celebrated the increased activity. But the 1970s and 1980s vision of the shareholder's role in the corporation was very different from the one endorsed in earlier decades. While in 1983 the IRRC reported an increasing number of shareholder proposals, for the most part, advocacy groups and institutional investors had displaced the vulnerable individual shareholder as the focal point for legal and economic analysis.<sup>364</sup>

Clearly, the participation of institutional investors helped bring about important changes. In 1982, Thomas Edwards, chairman of TIAA-CREF, commented that while institutional investors could not "out-vote management . . . even the smallest institutional investors have improved the acoustics for change, whether management admits it or not."<sup>365</sup> Yet, certain institutional investors like mutual funds were more likely to vote with management against shareholder proposals.<sup>366</sup> More important, by shifting their attention to institutions, scholars and reformers helped eradicate the potential vulnerability of the individual shareholder from the academic imagination and with it the possibility of shareholder participation independent of financial incentives.

As if reflecting the real or practical constraints on shareholder participation, a Bill of Rights for Investors, which Stanley Sporkin described at the 1977 Annual Meeting of the Society of American Business and Economic Writers, included ten fundamental rights: the right to disclosure, the right to be

---

359. BOOTH, *supra* note 270, at iv.

360. *Id.*

361. *Id.*

362. *Id.*

363. *Id.*

364. TALNER, *supra* note 357, at 46–48.

365. *Id.* at 48.

366. Nicholas, *supra* note 221, at 314.

represented by the board, the right to have management acting honestly, the right to be treated fairly, the right to assurance that management will not misuse its position, the right to have corporate professionals act responsibly and with accountability, the right to seek redress in the federal system for a violation of these rights, the right to be protected by the SEC, the right to be protected by a self-regulatory organization, and the right to "expect and depend upon an able, effective and independent financial press."<sup>367</sup> The right of participation was not mentioned.

Moreover, concerns about the rising numbers of shareholder proposals led the SEC to put additional hurdles before the shareholder-participant. In 1983, for the first time in the rule's history, the SEC imposed "shareholder qualification standards."<sup>368</sup> The 1983 amendments required that a proponent of a shareholder proposal owned "at least one percent or \$1,000, whichever is less, of securities eligible to be voted at the meeting."<sup>369</sup> The proponent had to "have owned those securities for at least one year prior to the meeting, and continue to own them through the day on which the meeting is held."<sup>370</sup> These amendments further restricted all shareholders "to one 14a-8 proposal per meeting."<sup>371</sup>

After a decade of agitation against shareholder proposals, the American Society of Corporate Secretaries and other corporations finally had the upper hand.<sup>372</sup> The SEC had embraced the Society's articulated concerns, albeit unsupported by statistical data, about "abusive shareholders who purchased small amounts of stock from several companies as a means of buying a ticket to annual meetings, especially social activist shareholders."<sup>373</sup> Interestingly, "the Staff Report on Corporate Accountability found that there was no correlation between the amount of stock a proponent owned and the level of support a shareholder proposal received at an annual meeting."<sup>374</sup> Preventing shareholders' abuse could have been achieved by a more narrowly tailored exclusionary rule, focusing, for example, only on the duration of the investment. Moreover, the new amendments made it sufficiently more difficult for the shareholder to gain access to the proxy machine by changing the "voting

---

367. *The Role of the Shareholder in the Corporate World*, *supra* note 354, at 92–94.

368. Ryan, *supra* note 17, at 115.

369. *Id.* (citations omitted).

370. *Id.*

371. *Id.*

372. Nicholas, *supra* note 221, at 364–66.

373. Virginia J. Harnisch, *Rule 14a-8 After Reagan: Does It Protect Social Responsibility Shareholder Proposals?*, 6 J.L. & POL. 415, 436–37 (1989–90).

374. Nicholas, *supra* note 221, at 365.

percentages for resubmission" of proposals from 3% to 5% for the first resubmission, and from 6% to 8% for the second.<sup>375</sup> In this context, requesting shareholders to have a particular equity interest seems to suggest that the SEC wanted to limit the individual shareholder's access. Even AT&T commented that it did not "seem sensible to exclude a long-time shareholder interested in the corporation from participating in the proposal process because his shareholding is too small."<sup>376</sup>

In qualifying shareholders according to their equity interest, the SEC also emphasized the vision of the shareholder as owner. Proponents of the shareholder proposal rule had often described shareholders as owners, but they did so in order to stress the vulnerability and different goals of the small shareholder. In turn, the 1983 rules were predicated upon the assumption that, as owners, all shareholders—large and small, institutional and individual—shared the common goal of maximizing their profits. Their participation in corporate affairs was to be limited to achieving this goal. In fact, it seems that the SEC came to Manne's conclusion. For the most part, it assumed that shareholders would prefer to sell their stock than to participate in corporate affairs. The vision of the shareholder as participant converged with the view of the shareholder as investor to recreate the universal shareholder—an owner in search of profits.

Other 1983 amendments helped sustain this market-based image of the relationship between shareholders, managers, and the corporation. For one thing, the SEC changed the rule allowing omission of proposals that were not significantly related to the issuer's business.<sup>377</sup> It defined "not significantly related" as accounting for "less than five percent of the issuer's total assets . . . and for less than five percent of its net earnings and gross sales for the most recent fiscal year."<sup>378</sup> In fact, the SEC was so obsessed with economic markets that in the course of preparing the amendments it went as far as to challenge the necessity of "a federal regulatory scheme protecting shareholder's proposals."<sup>379</sup>

---

375. Harnisch, *supra* note 373, at 439.

376. *Id.* at 437 n.132; *see also* Nicholas, *supra* note 221, at 367 (noting that "[a]fter 1983, more wealthy individuals and institutional stockholders had a higher level of democracy than those who owned less than \$1,000 in company stock, or had recently purchased any amount of stock").

377. Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, 48 Fed. Reg. 38, 218 (Aug. 23, 1983) (codified as 17 C.F.R. pt. 240).

378. 17 C.F.R. § 240.14a-8 (2006).

379. Harnisch, *supra* note 373, at 433–34.

In the year following the amendment, "42% fewer proposals were recorded."<sup>380</sup> The numbers rebounded by 1987,<sup>381</sup> but in the decade that followed, shareholder social purpose proposals were displaced as the focus of debates about shareholder democracy and the role of the individual shareholder. While social purpose proposals (on issues such as plant closing, environmental protection, apartheid, or employment discrimination)<sup>382</sup> continued to be submitted, corporate governance issues captured the attention of shareholders, especially institutional investors.<sup>383</sup>

Indeed, by the 1980s, most U.S. firms had large shareholders, typically institutional investors or the initial owners (and their families).<sup>384</sup> Many scholars came to accept that the individual shareholder would remain rationally apathetic and passive,<sup>385</sup> but trusted these large shareholders to take a more active role in monitoring corporate management. Institutional investors seemed more prone to communicate with managers, engage in proxy contests (or threaten them),<sup>386</sup> and submit shareholder proposals.<sup>387</sup> Although such

380. *Id.* at 440.

381. Nicholas, *supra* note 221, at 387–88.

382. For a detailed discussion of these proposals, see generally Lazaroff, *supra* note 268.

383. For analyses of trends in shareholder proposals, see Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879, 883–84 (1994); Randall S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, Vanderbilt L. & Econ. Research Paper No. 05-30, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=868652](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=868652).

384. Gerald F. Davis & Tracy A. Thompson, *A Social Movement Perspective on Corporate Control*, 39 ADMIN. SCI. Q. 141, 154 (1994); Andrei Shleifer & Robert W. Vishny, *Large Shareholders and Corporate Control*, 94 J. POL. ECON. 461 (1986). Shleifer and Vishny noted that in "a sample of 456 of the Fortune 500 firms, 354 have at least one shareholder owning at least 5 percent of the firm. . . . The average holding of the largest shareholder among the 456 firms is 15.4 percent." *Id.* They further noted that a large number of these shareholders are "families represented on boards of directors (149 cases) . . . pension and profit-sharing plans (90 cases) . . . financial firms such as banks, insurance companies, or investment funds (117 cases) . . . [and] firms and family holding companies with large stakes who do not have board seats (100 cases)." *Id.* at 462.

385. See generally J.A.C. Hetherington, *When the Sleeper Wakes: Reflections on Corporate Governance and Shareholder Rights*, 8 HOFSTRA L. REV. 183, 184–86 (1979–1980).

386. See generally David A. Butz, *How Do Large Minority Shareholders Wield Control?*, 15 MANAGERIAL AND DECISION ECON. 291 (1994).

387. See, e.g., Anat R. Admati, Paul Pfleiderer, & Joseph Zechner, *Large Shareholder Activism, Risk Sharing, and Financial Market Equilibrium*, 102 J. POL. ECON. 1097–98 (1994) (arguing that institutional investors had become more active). *But see* John M. Bizjak & Christopher J. Marquette, *Are Shareholder Proposals All Bark and No Bite? Evidence from Shareholder Resolutions to Rescind Poison Pills*, 33 J. FIN. & QUANTITATIVE ANALYSIS 499, 500 (1998) (concluding that, contrary to other studies of shareholder activism, their findings did not suggest that individual shareholder proposals received less support than proposals submitted by

expectations were not necessarily fulfilled—most institutional investors turned out to be less interested in spending money and effort on monitoring management<sup>388</sup>—institutional investors such as public pension funds and labor organizations helped shift the focus of debates from social issues to corporate governance, specifically management's anti-takeover tactics or compensation packages.<sup>389</sup> More recently, certain institutional investors have supported calls to improve shareholders' access to the ballot or to the proxy machine.<sup>390</sup>

In such an atmosphere, corporate democracy became strictly representative democracy; the rhetoric of shareholder democracy was rapidly associated not with shareholder participation but with the investors' twin rights of voice and exit.<sup>391</sup> But, as the following section concludes, in the 1980s and 1990s the Delaware courts did their best to render even this limited set of rights ineffective. The shareholder representative democracy was a market democracy. Shareholder participation independent of market demands was not encouraged. The individual shareholder had disappeared.

### *C. Convergence: Exit, Voice, and Legitimacy*

The Reagan years helped eradicate the vision of the social welfare state and replace it with an image of the deregulatory state. In the corporate world, very little, if anything, was left of the early twentieth century ideal of participatory shareholder democracy. With the elimination of any other alternative to influence corporate management, shareholders were supposed to exercise their (market) rights of exit and voice. But in the Delaware courts these rights were often inconsequential.

Take, for example, the right to exit. A decade of hostile takeovers gradually eroded the shareholders' right to exit (which Manne celebrated twenty years earlier). In a series of cases beginning in the mid-1980s and culminating in the mid-1990s, the Delaware Court held that in response to

---

institutional investors).

388. See, e.g., Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 629–30 (2006) (noting that although institutional investors had the ability for an active role in corporate governance, by the late 1990s most did not make efforts to monitor management, conduct proxy solicitations, put forward shareholder proposals, seek to elect representatives on the boards, or coordinate their activities).

389. Nicholas, *supra* note 221, at 429, 456.

390. See *supra* note 16 and accompanying text.

391. On the relevance of exit and voice to organizations and political governments, see generally ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINES IN FIRMS, ORGANIZATIONS, AND STATES* (1970).

hostile bidders, management could seriously encumber the shareholders' ability to sell their votes. As Justice Horsey put it in *Paramount Communications, Inc. v. Time, Inc.*:

Delaware law confers the management of the corporate enterprise to the stockholders' duly elected board representatives . . . . That [fiduciary duty to manage a corporate enterprise] may not be delegated to the stockholders. Directors are not obligated to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.<sup>392</sup>

Six years later, in *Unitrin, Inc. v. American General Corp.*, the court, while nodding to the concept of shareholder democracy, empowered directors to fight all-cash, all-shares premium tender offers and, for all practical purposes, prevent shareholders from exercising their right to exit.<sup>393</sup> As long as a proxy contest was a possibility, even if a remote one, the court announced in *Unitrin*, the shareholders' right to exit remained viable.<sup>394</sup>

As to the right to vote, Chancellor Allen's decision in *Blasius Industries, Inc. v. Atlas Corp.* seemed to encapsulate its meaning in the late 1980s.<sup>395</sup> *Blasius* involved a conflict between Atlas's board and Atlas's largest shareholder, Blasius. In an attempt to prevent or at least delay Blasius from placing a majority of new directors on the board, Atlas's board increased its size by two and filled the newly created directorships.<sup>396</sup> Allen's analysis began by reiterating the rule adopted in the seminal takeover case, *Unocal Corp. v. Mesa Petroleum Co.*<sup>397</sup> As Allen explained,

A board may take certain steps . . . that have the effect of defeating a threatened change in corporate control, when those steps are taken advisedly, in good faith pursuit of a corporate interest, and are reasonable in relation to a threat to legitimate corporate interests posed by the proposed change in control.<sup>398</sup>

But, Allen went on:

392. *Paramount Commc'n, Inc. v. Time, Inc.*, 571 A.2d 1140, 1154 (Del. 1989).

393. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361 (Del. 1995).

394. *Id.* at 1382–83. For Manne's critique of attempts to interfere with the shareholders' right to exit in these situations, see Henry G. Manne, *Cash Tender Offers for Shares—A Reply to Chairman Cohen*, 16 DUKE L.J. 231 (1967); Henry G. Manne, *In Defense of the Corporate Coup*, 11 N. KY. L. REV. 513 (1984).

395. *Blasius Indus. Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. 1988).

396. *Id.* at 652–56.

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

398. *Blasius*, 564 A.2d at 659.



[T]he ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context. . . . [A] decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance.<sup>399</sup>

On its face *Blasius* endorsed a strong conception of shareholder democracy, according to which directors could not interfere with the shareholder franchise, regardless of good faith. But a closer reading reveals the limits of Chancellor Allen's conclusion. For Allen, as it has been for many writers on the subject in the 1980s and 1990s, shareholders were owners and directors were their agents. As owners, shareholders had a right to elect (or select) their agents—the directors, who, incidentally, were no longer expected to manage the corporation, only to monitor the executives' actions.<sup>400</sup> As agents, directors were obligated to act in the best interests of their principals. But, while such obligation might seem to empower shareholders, in reality the agency rhetoric tremendously limited the shareholders' ability to participate in corporate affairs. As owners and agents, shareholders and managers were no longer in a hierarchical relationship. Power and hierarchy disappeared, and in their place the court envisioned contractual arrangements between shareholders, as owners, and managers, as agents. All that was left of the shareholder right to participate was her right to vote.

In the mid-1920s, Ripley and Berle explained that without recognizing power and hierarchy, the shareholders' right to vote was meaningless. But in Delaware during the 1980s things were different. Writing in 1988, Chancellor Allen defined the "shareholder franchise" as "the ideological underpinning upon which the legitimacy of directorial power rests."<sup>401</sup> If the shareholder investor could sell her stock, the shareholder participant could vote to replace incumbent directors. Admitting, with a nod to Berle, that the shareholders' vote had often been dismissed "as a vestige or a ritual of little practical importance,"<sup>402</sup> Allen suggested that institutional investors were in the right place to correct the situation—"to make the stockholder vote a less predictable affair than it has been."<sup>403</sup>

---

399. *Id.* at 659–60.

400. On the development of the monitoring board, see Lawrence E. Mitchell, *The Trouble with Boards* (The George Washington Univ. Law School Pub. Law & Legal Theory Working Paper No. 159, 2005), available at <http://ssrn.com/abstract=801308>.

401. *Blasius Indus. Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. 1988).

402. *Id.*

403. *Id.*

Other scholars have explored how the Delaware courts have balanced the power of shareholders and directors.<sup>404</sup> For purposes of this Article, it is more important critically to read Chancellor Allen's statement about the shareholder vote as reflecting the conclusion of a long transformation. Allen did not suggest that the vote was meaningful. Rather, for Allen, as it was for Manne in the 1960s, the shareholder's role in the corporate endeavor was to legitimate management's exercise of corporate power. While Manne offered individual shareholders the illusory power of exit (especially in light of the Delaware Court's later endorsement of anti-takeover tactics), Allen provided them with an illusory right to vote. The shareholders' voting rights were no longer seen as a means of shareholder empowerment but as a means of legitimating management's exercise of power. As Allen put it, whether the vote was "seen functionally as an unimportant formalism, or as an important tool of discipline," it was a means of legitimating the exercise of managerial power.<sup>405</sup> It "legitimate[d] the exercise of power by some (directors and officers) over vast aggregations of property that they [did] not own."<sup>406</sup>

Like Manne, Allen believed that the market would tame corporate management. Accordingly, the shareholders' rights of exit and vote as a means of influencing corporate governance were mostly symbolic. Institutional investors might be able to use them effectively but their ability to do so reflected their market power. In turn, the individual shareholder, who was left with no role to play in the public corporation, was best advised to focus her attention on profit maximization typically through portfolio diversification. The individual shareholder was an investor with little, if any, power. Individual shareholder participation in corporate affairs became a relic of years past. The rhetoric of legitimation was an apology for the status quo.

The power of courts, scholars, and legal theory is limited. But as this Article demonstrates, ideas are not only shaped by reality, they also help influence it. While we seem to witness more active shareholder participation today, the conception of shareholder democracy that grounded Manne's and Allen's positions remains with us. Even if management pays more attention to the shareholders, especially to institutional investors (and, more recently, hedge funds), adopts better codes of practice, and responds to the demands of social activists, these are not signs that individual shareholders are gaining a more meaningful voice in corporations' decision-making processes. Corporations, the control group, and managers are no less in control today than they were a

---

404. Oesterle & Palmiter, *supra* note 334, at 562–70.

405. *Blasius*, 564 A.2d at 659.

406. *Id.*

century ago. Mandatory disclosure requirements have helped eliminate certain market manipulations but have allowed others to survive. Institutional investors have become much like the controlling shareholders of the early twentieth century. Most important, shareholder activism and management's response to it are motivated almost exclusively by financial incentives. Indeed, we no longer have a substantive concept of shareholder democracy independent of market demands.

On this background, recent calls to improve shareholders' access to the ballot or to the proxy machine, as well as corporate board decisions allowing them to do so, are limited. At best, they are reminiscent of Eustace Seligman's call in the mid-1920s. The more things change, the more they remain the same.

But we see things differently. Instead of the need to protect minority shareholders by allowing them to organize or by protecting their individual right to participate, we see shareholders as sufficiently able to protect themselves (mostly by investing in mutual funds). Instead of shareholder organization or the shareholder proposal rule, our discussions focus on the ability of shareholders, typically institutional investors, to vote and exit. In short, having destroyed all other alternatives, we are back where we began. Yet the phenomenon we described at the turn of the twentieth century as a menace to the individual investor and American democracy more broadly, we describe today as democracy's sustaining and legitimating force.

### V. Epilogue

"Democracy is a word to conjure with; and its meaning is so dim and so equivocal that almost anybody can conjure with it."<sup>407</sup>

In a 1918 article, *What do We Mean by Democracy?*, philosopher Ralph Barton Perry noted that "[t]here were three great ideas associated with the democratic tradition: *Equality, Liberty, and Popular Government*."<sup>408</sup> Although much has been written about democracy since, Perry's comment offers an interesting tool to assess the history of conversations about the shareholder's role in the large public corporation. Examined with these ideas in mind, the story told in this Article is also a story about changing cultural interpretations of the democratic ideal—from equality, during the Progressive era, to liberty in the 1940s and 1950s, to popular government beginning in the

---

407. Ralph Barton Perry, *What Do We Mean by Democracy?*, 28 INT'L J. ETHICS 449, 450 (1918).

408. *Id.* at 451.

1960s and 1970s. The history of shareholder democracy is indeed a narrative about different understandings of the American ideal of democracy.

Equality grounded the Progressive ideal of social democracy, or as Perry put it, "an ideal of social reconstruction."<sup>409</sup> Progressives associated equality and rights with economic and social needs, specifically the rights of individuals to work, to a livelihood, to social insurance, and to economic independence. Moreover, for many Progressive scholars, organization was a means of achieving equality. Rather than leaving individuals to fend for themselves in the modern industrialized society, Progressives sought to empower them to organize and collectively pursue their interests. Similar assumptions underlay Ripley's and Berle's calls for shareholder organization.

With the rise of totalitarianism in Europe, the democratic ideal became associated with liberty, the idea, as Perry put it, "that in exercising restraints upon the individual's action the state shall be guided by the principle of guaranteeing to each individual under the law *the largest possible sphere* within which he may act in accord with his own desires and judgment."<sup>410</sup> Democracy became "a social organization which celebrated diversity in all forms and on all levels;"<sup>411</sup> political and legal theorists described protecting the rights of individuals—their private spheres—as the cornerstone of American democracy. Cherishing individual rights was a means of guaranteeing the resilience of American democracy in the face of ideas such as totalitarianism.<sup>412</sup> In this intellectual milieu, the individual shareholder's right to participate in corporate management became the focus of debates about shareholder democracy.

In the postwar years, process-oriented theories of democracy emphasized that the strength of American democracy was its political process, which allowed different groups to interact and trade ends in a free political market. These theories shifted attention from the ideologies that ground democratic regimes, such as commitment to equality and liberty, toward the need to protect democratic institutions—from substance to procedure. As Morton Horwitz put it, "For the process-oriented school of thought . . . political equality was, at most, the only substantive commitment that democratic theory required."<sup>413</sup> In this atmosphere,

---

409. *Id.*

410. *Id.*

411. EDWARD A. PURCELL, *THE CRISIS OF DEMOCRATIC THEORY: SCIENTIFIC NATURALISM AND THE PROCESS OF VALUE* 205 (1973).

412. *Id.* at 202–05; see also Morton J. Horwitz & Orlando do Campo, *When and How the Supreme Court Found Democracy—A Computer Study*, 14 QUINNIPIAC L. REV. 1, 28–29 (1994) (examining the turn to democratic rhetoric in the 1940s).

413. Morton J. Horwitz, *Foreword: The Constitution of Change: Legal Fundamentality*

cultural (and corporate) attention shifted to the concept of popular government, the idea that "the sovereignty of the state shall be distributed among those whose interests are at stake; that the government shall periodically secure the consent of the governed."<sup>414</sup> Corporate scholars' obsession with the shareholder's right to vote and exit was justified by reference to this third idea.

The great ideas associated with democracy—equality, liberty, and popular government—helped shape American corporate democracy. But as scholars' and jurists' goals shifted from constraining corporate power to legitimating it, the ideas of equality and liberty were gradually eroded. Without them, the idea of popular government was reduced to meaningless rituals like the annual shareholder meeting during which the shareholders' presumed agents elected themselves. Corporations are run like rotten boroughs because in the course of the twentieth century we never truly tried to guarantee shareholders' equality and liberty. Using the rhetoric of shareholder democracy as a means of promoting other goals, name it collectivism, individualism or market-theories, we made shareholder democracy an empty concept.<sup>415</sup>

---

*Without Fundamentalism*, 107 HARV. L. REV. 32, 64 (1993); see also HORWITZ, *supra* note 36, at 250–58 (exploring the turn to process in postwar American thought).

414. Perry, *supra* note 407, at 451.

415. Whether or not it would have made any difference if we chose a different path is beyond the scope of this Article. For arguments suggesting that empowering shareholders could be detrimental to corporations, see LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT 185–207 (2001); Bainbridge, *supra* note 7, at 1749; Lynn Stout & Iman Anabtawi, *Sometimes Democracy Isn't Desirable*, WALL ST. J., Aug. 10, 2004, at B2. *But see* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 842 (2005). Interestingly, while calling for increasing shareholder power, Bebchuk is careful not to call for shareholder democracy *per se*. As he explains:

Some supporters of greater shareholder power might regard increases in "shareholder voice" and "corporate democracy" as intrinsically desirable. . . . I should therefore stress at the outset that I do not view increasing shareholder power as an end in and of itself. Rather, effective corporate governance, which enhances shareholder and firm value, is the objective underlying my analysis. From this perspective, increased shareholder power would be desirable only if it would operate to improve corporate performance and value.

*Id.* at 842–43; see also Lucian Arye Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43 (2003) (making a similar statement with respect to the advocacy of shareholder access proposals).