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The Seductive Comparison of Shareholder and Civic Democracy

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I. Introduction

"Democracy" is a powerful word in America. Perhaps that is why many commentators cannot resist comparing the workings of democracy within the corporation with those of democracy in the more familiar political realm. Colleen Dunlavy makes such comparisons in *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*,[1] shedding light on what a corporation's being more or less "democratic" might mean. She uses history to point out that it is not natural or obvious that votes should be allocated on the basis of share ownership.[2] Indeed, in early corporate America, each share*holder* (rather than each share) received a vote.[3] This allocation, she implies, is more truly democratic than allocating one-vote-per-share.[4]

This Comment briefly describes Dunlavy's treatment of democracy in the political and corporate worlds, and goes on to discuss how similar kinds of democracies exist in both spheres. It then focuses on one little-explored element of the political-world/corporate-world comparison by developing the striking parallel between the operations of the Electoral College in the national political setting and of boards of directors in the corporate world. The Comment then steps back from this subject and argues that comparisons

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1. Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1347 (2006).

2. *See id.* at 1356 (describing how one-vote-per-share is a relatively new phenomenon).

3. *See id.* at 1361 (noting that shareholders had one-vote-per-share for much of the nineteenth century).

4. *See id.* at 1361–62 (indicating that the democratic end of the spectrum involves one-vote-per-shareholder).

between the corporate and civic polities, while intellectually tempting, ultimately falter because participation in a corporation fundamentally differs from participation in a nation. Shareholders are not citizens; their investments are voluntary and relatively liquid, and their proxy ballots lack the meaning and power of citizens' votes. The exploration of the Electoral College/board of directors analogy ultimately dead-ends because the board of directors, unlike the modern Electoral College, plays a real and useful role in governance. All of this confirms that Dunlavy's reflections are helpful and provocative. Their primary value, however, lies more in illuminating the role of the shareholder within the corporation than in raising a sustainable critique of corporate law's failure to protect "shareholder democracy" itself.

II. Comparing Corporate and Political Democracy

Shareholder democracy has many advocates today, most of whom take for granted the idea that this form of "democracy" means that each share of stock equals one vote. Dunlavy reminds us that there is nothing natural about such a division of voting power within a corporation and that, in fact, voting rules of the nineteenth century deviated from this now-familiar pattern.[5] Dunlavy characterizes the current one-share-one-vote model of shareholder democracy as "plutocratic" because it allows the wealthier (or, at least, larger) shareholders to have more of a voice in governing the corporation.[6] She contrasts this approach with the older, more truly "democratic" version of shareholder democracy, under which each shareholder was given equal voting power regardless of his or her level of share ownership—or at least there was a cap on the voting power that came with the ownership of large numbers of shares.[7]

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5. *See id.* at 1361–62 (noting that in the early nineteenth century, the majority of corporations did not have one-vote-per-share).

6. Dunlavy, *supra* note 1, at 1355.

7. *See id.* at 1357 (expressing how "prudent-mean" rules would put a ceiling on the maximum number of votes per shareholder); *see also* Daniel J. H. Greenwood, *Markets and Democracy: The Illegitimacy of Corporate Law*, 74 UMKC L. REV. 41, 84 (2005) (criticizing corporate democracy). Greenwood claims:

> Corporate "democracy," then, fails the most basic test of democracy. It does not provide for equal citizenship, since it is based on an equality of dollar investments, not of citizen members. Moreover, such corporate "democracy" does not provide citizenship for the right people. While shareholders have limited (and unequal) say in running the corporation, many other constituents and affected parties, some of them (unlike most shareholders) even human, lack even a limited right to vote.

Id.; *see also* David L. Ratner, *The Government of Business Corporations: Critical Reflections on the Rule of "One Share, One Vote,"* 56 CORNELL L. REV. 1, 19 (1970) ("[One share, one

In examining the meaning of "democracy," Dunlavy draws a parallel between civic and corporate polities. Each involves a "body politic" (nation or corporation), and each must distribute power among its constituents.[8] She is not interested in the vertical relationships so familiar to corporate law scholars—those between manager and employee, or manager and shareholder.[9] Instead, she urges us to consider the horizontal shareholder-shareholder relationship.[10] By virtue of the one-vote-per-share principle, larger shareholders inevitably have a greater say in corporate governance than do smaller shareholders. One might say that although all shareholders are theoretically equal, some are more equal than others—in striking contrast to the operation of our modern political system, which is built on the principle of "one person, one vote."[11]

A. As Politics Democratized, Corporations Became Plutocracies

As Dunlavy notes, the one-person-one-vote rule has not always dominated American political or corporate life.[12] She observes, for example, that in the nineteenth century the government restricted the franchise based on considerations like property ownership, race, and gender.[13] Although the twentieth-century road toward universal suffrage has been rocky, these

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vote] is inherently no more logical than making voting rights in school district elections proportional to the school taxes paid by the voters or the numbers of their children enrolled in the school system.").

8. Dunlavy, *supra* note 1, at 1350.

9. *See id.* at 1366–67 (commenting on the importance of the horizontal shareholder relationship).

10. *Id.*

11. Of course, one can argue that some political voters are more equal than others—due to Senate apportionment rules, voters in less populous states have a disproportionately powerful vote in Senate elections and therefore in the presidential election via the Electoral College. However, the focus of Dunlavy's criticism is on the plutocratic division of voting power in today's corporations. Because in the political context such increased voting power is not a function of increased wealth, but rather state residency, and therefore is not really plutocratic, I will treat citizens' votes as equal for the purposes of this Comment. I refer to *voting* power, narrowly defined—I am not asserting that *political* power does not increase with wealth. Public choice theory is also relevant here. *See generally* JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT (Liberty Fund 1999); DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE (1991).

12. Dunlavy, *supra* note 1, at 1361 (noting that shareholders had one-vote-per-share for much of the nineteenth century).

13. *See id.* at 1360 (noting the restrictions that existed on voting in the nineteenth century).

restrictions on the electorate have gradually disappeared.[14] In contrast, Dunlavy suggests an opposite trend in corporate governance over the course of the nineteenth century, one tending toward greater plutocracy and less democracy, as larger shareholders gained a greater voice in governing the corporation.[15] She suggests that the resulting system is essentially undemocratic in nature. So it may be—although, as I will discuss later, there are ways in which corporate democracy is arguably *more* democratic than civic democracy.[16]

B. Taking the Analogy Further: Three Different Styles of Democracy

By comparing civic and corporate democracy, Dunlavy provides an intriguing method by which to analyze and ultimately critique current corporate voting structures. Fundamentally, Dunlavy asks, if we are to have corporate democracy, why settle for anything less than the full democracy that we enjoy in the political sphere? Indeed, with this question in mind, it becomes tempting to identify and critique other "undemocratic" features of the corporation. In particular, consider the peculiar form of "once removed" representative democracy we utilize in the corporate polity, but have long abandoned in the civic polity.

Both corporate and political democracies employ three different democratic mechanisms: direct democracy, representative democracy,[17] and what I will call representative democracy "once removed." Direct democracy means letting voters decide issues directly. State elections often present

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14. *Id.*

15. *See id.* at 1360–61 (describing how voting rights increasingly became associated with share ownership).

16. *See infra* Part IV (discussing corporate democracy's benefits).

17. *See* Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1943–44 (1996) (contrasting direct democracy to representative democracy). The authors explain:

> There are two broad strategies available in choosing a review process for corporate actions: representative democracy, under which shareholders elect representatives (a board of directors) to act on the shareholders' behalf; and direct democracy, under which shareholders directly approve particular actions. Representative democracy alone is often unsatisfactory because boards can too easily become lazy or be captured by management. Thus, the company laws of all developed countries provide direct shareholder review of selected corporate actions such as mergers. On the other hand, direct democracy is far too slow and costly for most corporate decisionmaking. Moreover, because small shareholders must act on limited information and face severe collective action problems, direct democracy can quickly deteriorate into total manager control in widely-held companies.

Id.

"directly democratic" referenda on issues ranging from bond issuances to measures to cut social services to illegal immigrants. Similarly, in the corporate world there are instances of "direct democracy," when the shareholders vote directly on a particular issue.[18] The most notable example involves corporate mergers. The Model Business Corporation Act and the Delaware General Corporation Law, like the laws of most states, require direct shareholder votes to approve mergers or the sale of all or substantially all corporate assets.[19]

Direct democracy, however, is the exception rather than the rule in both the corporate and political worlds. Relatively few issues in the political sphere are put to referendum, and at very few times in a corporation's life do its shareholders vote on major changes such as takeovers or liquidation. The main work of the shareholder is to select corporate directors in regularly held elections. Likewise, in the political arena voters select key representatives, including Senators, House members, and the President of the United States, who govern. The election of representatives involves indirect or representative democracy because elected officials—and not the voters themselves—make the critical day-to-day decisions for the polity.

Beyond direct and representative democracy, political elections—specifically presidential elections—and corporate elections share a third style of self-governance. Both involve what one might call "once removed" representative democracy. In order to select the President of the United States, citizens vote for electors who make up the Electoral College. These electors in turn vote for the President and Vice President. Similarly, within the corporate world, shareholders vote for directors. These directors then choose managers—the chief executive officer, the chief financial officer, and other officers who actually manage the corporation. In both cases, it is the elected individuals who select the ultimate manager.

To many, the use of once removed representative democracy to select the President and Vice President seems odd, unnatural, and unwise.[20] There seems to be no reason to resort to an intermediary institution rather than direct election

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18. *Id.*

19. *See* MODEL BUS. CORP. ACT § 11.04 (2005) (detailing merger provisions); DEL. CODE ANN. tit. 8, § 251(c) (2005) (same); MODEL BUS. CORP. ACT § 12.02 (noting sale of assets provisions); DEL. CODE ANN. tit. 8, § 271 (same). Shareholder approval is also required for dissolution and amendments to the articles of incorporation. *See* MODEL BUS. CORP. ACT § 14.02 (explaining dissolution); DEL. CODE ANN. tit. 8, § 275 (same); MODEL BUS. CORP. ACT § 10.03 (detailing the process for amendments); DEL. CODE ANN. tit. 8, § 242(b)(2) (same).

20. A report of the American Bar Association calls the Electoral College "archaic, undemocratic, complex, ambiguous, indirect, and dangerous." COMMISSION ON ELECTORAL COLLEGE REFORM, ELECTING THE PRESIDENT: A REPORT OF THE COMMISSION ON ELECTORAL COLLEGE REFORM 3 (Am. Bar Ass'n 1967).

to select the most important and powerful members of the federal government. To the extent that critiques of "once removed" representative democracy at the federal level have merit, they raise foundational questions with respect to corporate law: Why not vote directly for management? Indeed, why have boards of directors at all? Perhaps looking into the history of both institutions can help answer these questions and also shed light on the possibility of comparing the two.

C. *Tracing the History of the Electoral College and Board of Directors*

The Electoral College was originally designed as a way of insulating the elite from the vote of the masses (more accurately, from the property-owning, white, male masses). "What is most striking about the limited debate was the dominance of one position—a distrust of the 'people' to elect the President. As famously put by Virginia's George Mason, election by the people would be as 'unnatural' as 'to refer a trial of colours to a blind man.'"[21] George Mason posited that "the common man lacked the 'capacity' to assess a presidential candidate."[22] Hamilton praised the Electoral College because it gave the final choice to a small group who would be "most likely to possess the information and discernment requisite" to select the President.[23] Elbridge Gerry argued that "it was a 'radically vicious' idea to elect the President through the 'ignorance of the people.'"[24] Others "distrusted political parties" or "desire[d] . . . independent-minded electors."[25] In fact, "[t]he original conception of the electoral college was a body of men who, through their personal knowledge and judgment, would independently choose the President from among qualified Americans."[26]

In practice, the Electoral College never actually functioned as a group of autonomous individuals who voted without regard to the popular will.[27]

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21. Paul Boudreaux, *The Electoral College and Its Meager Federalism*, 88 MARQ. L. REV. 195, 199 (2004) (quoting THE DEBATES IN THE FEDERAL CONVENTION OF 1787 WHICH FRAMED THE CONSTITUTION OF THE UNITED STATES, REPORTED BY JAMES MADISON (Guillard Hunt & James Brown Scott eds., 1920)).

22. *Id.* at 200.

23. DAN COENEN, AMERICA RECONCEIVED: HAMILTON, MADISON, AND THE STORY OF THEIR FEDERALIST PAPERS 199 (Twelve Tables Press, forthcoming) (citing THE FEDERALIST NO. 68 (Alexander Hamilton)).

24. *Id.*

25. *Id.* at 214.

26 *Id.* at 209.

27. MARTIN DIAMOND, THE ELECTORAL COLLEGE AND THE AMERICAN IDEA OF DEMOCRACY 3 (1977).

Despite the founders' dread of factionalism, "[p]arty politics quickly obliterated the original conception of the electoral college as a body of men who, through their personal knowledge and judgment, would independently choose the President among qualified Americans."[28] And so, despite this early distrust of the general electorate, "[b]y 1824, most states decided to choose their electors through popular vote—a practice that is universal today."[29] In today's elections, voters generally do not even see the names of the electors on their ballots. Instead, they simply vote for the party candidates.[30] For these reasons, "[s]oon after 1787 the electoral college vote became, and remains today, merely a formality."[31] Although in some early elections, and in 2000, the winner of the Electoral College has not been the winner of the popular vote,[32] the electors are now basically "nullities," hardly the "wise, autonomous, detached" decision makers that the framers envisioned.[33]

In the corporate polity, by way of contrast, there has been no similar movement toward a more "direct" form of representative democracy. As we know, shareholders do not vote for the individuals who actually run the company. Instead, shareholders vote for mere representatives, the board of directors, who in turn choose the actual managers of the corporation.[34]

It is not clear, however, that once-removed representative democracy was always the dominant corporate model. There are indications that, early in the development of the corporate form, directorship positions were not in fact functionally different from management positions.[35] There is a striking, and often frustrating interchangeability of the terms "director" and "officer" in early corporate discourse. Historians also have conflated the terms "management"

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28. Boudreaux, *supra* note 21, at 209.

29. *Id.*

30. *Id.*

31. *Id.* at 210.

32. *See* Jamin B. Raskin, *What's Wrong With* Bush v. Gore *and Why We Need to Amend the Constitution to Ensure It Never Happens Again*, 61 MD. L. REV. 652, 696 (2002) (noting that in the 2000 presidential election, Gore won the popular vote, but the Electoral College awarded the presidency to Bush).

33. DIAMOND, *supra* note 27, at 2–3.

34. It may be said that a vote for the directors is a vote for management. Still, the board of directors differs from the Electoral College in that it is not merely convened every four years for the purpose of electing a leader. Votes for the board may be retrospective endorsements of the current management, but they are in no sense prospective votes that actually, if indirectly, select the officers.

35. For helpful histories of the evolution of the board of directors, see Mitchell, *infra* note 84 and Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89 (2004).

and "board of directors."[36] Thus, it is not entirely clear whether, as early shareholders voted for a board of directors, they were (1) choosing the membership of a supervisory entity that oversaw the managers of the corporation or (2) selecting the actual managers of the corporation who would run the day-to-day operations.

In fact, there are clues that the latter might be the case. For example, in the 1834 New Jersey case *Taylor v. Griswold*,[37] the charter at issue named the first president and officers, and then stated "[w]hich *president*, &c. shall continue in office during the term of one year from the time of passing this act, *or* until other person shall be appointed in their stead, by a majority of the stockholders, at a meeting of the said stockholders to be convened for *that* purpose."[38] The charter also seems to conflate the two terms: "[It] shall and may be lawful for the said corporation, or a majority thereof, to appoint annually, or at any other time *they* shall deem proper, a president, secretary, &c., or any other officer or officers *they* shall judge necessary."[39] This language at least suggests that the shareholders were voting directly for both the officers and directors.

If shareholders originally either voted directly for the officers of the corporation or voted for individuals who were "directors" in name but were functionally officers, then what caused the creation of the modern board of directors designed to carry out an oversight, rather than a management, function? According to Alfred Chandler, individual or family investors originally participated in management or at least retained power over major corporate decisions.[40] Over time, however, these family investors gave way to institutional investors that placed "part-time representatives on the firm's board."[41] And precisely because these "outside" board members could and did devote only part of their time to a particular corporate entity, they eventually ceded responsibility for day-to-day business management to a separate cadre of full-time corporate managers.[42]

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36. *See* JAMES WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780–1970 94–95 (1970) (interchanging the terms "management" and "board of directors").

37. Taylor v. Griswold, 14 N.J.L. 222 (1834).

38. *Id.* at 224 (first emphasis added).

39. *Id.*

40. ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 9 (1977) (noting that when partnerships began to incorporate, the stock stayed in the hands of individuals or families).

41. *Id.*

42. *Id.* Although according to Stephen M. Bainbridge, citing Walter Werner, this account may be incorrect. Bainbridge argues that ownership and control separated at a much earlier

This story of the rise of the managerial class explains how the board gradually relinquished power to the managers, but not how the board—rather than management—came to be the focal point of shareholder voting. Borrowing from the history of the Electoral College, we could posit that the managers and the original large investors intended to limit investors to the role of board service and to reduce shareholders to voting only for a largely functionary board, the equivalent of the modern Electoral College. Maybe the shareholders were relegated to voting for the board of directors so that the officers, the true decision makers, could be insulated from the shareholder electorate, safe from the "ignorance of the people," as Elbridge Gerry might have said.[43]

III. Problems with Comparing Political and Corporate Democracy

Why did shareholders come to vote for board members (representative democracy once removed), rather than for managers (pure representative democracy)? The answer to this question is not clear, but before going farther down this path of conjecture, it may be helpful to examine Dunlavy's assumption that useful comparisons can be drawn at all between the corporate and the civic polity. Comparisons of this kind are common and tempting.[44] But corporations and political states are marked by differences so fundamental that it is dangerous to extrapolate lessons from one realm to the other. Four key contrasts between the corporation and the state demonstrate why: (1) investing in a corporation is a completely voluntary endeavor; (2) representative democracy plays only a limited role in a corporation; (3) the shareholder vote,

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time, so that "there never was a time in which unity of control and ownership was a central feature of U.S. corporation[s]." Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 620–21 (2006) (citing Walter Werner, *Corporation Law in Search of Its Future*, 81 COLUM. L. REV. 1611, 1637 (1981)).

43. K.A.D. Camara writes of the "dark stories" that commentators tell about corporate law:

> In corporate translation, shareholder voting is something managers point to when they want to say that shareholders are in control. Managers, they meekly remind us, can be ousted annually by the shareholders they serve. In dark stories, voting is a means of power preservation for a group other than the voters or the publicly acknowledged beneficiaries of voting.

K.A.D. Camara, *Classifying Institutional Investors*, 30 J. CORP. L. 219, 246–47 (2005). Camara concludes without explanation that "[d]ark stories seem more plausible in the political than in the corporate context." *Id.* at 247.

44. *See id.* at 245 (noting that shareholder democracy is often compared to political democracy).

with the important exception of takeovers, is generally an empty exercise; and (4) shareholders have an important power that political voters lack: the power of easy exit through the sale of their shares—that is, the power to leave their polity.

A. Investing Is Voluntary; Living in a Civic Polity Is Not

First, investors choose to invest in the corporate form. They can also invest in partnerships, limited liability companies, or sole proprietorships—or not invest at all. Even more importantly, each of these alternative business forms gives the investor the potential for a much greater voice in the management of the business. Some of these entities even involve Dunlavy's favored system of "one person, one vote" democracy. Under common law, for example, partners have an equal vote in the management of the partnership, and the Revised Uniform Limited Partnership Act and the Uniform Limited Liability Company Act preserve this one-vote-per-member/partner default rule.[45] Against this legal backdrop, if an investor seeks to have an equal say in the governance of the entity in which she invests, she is free to pursue it by putting her money into profit-seeking entities that take the partnership form. However, to impose a one-person-one-vote regime on the corporate form seems to limit investors' options unduly. One-person-one-vote may resonate with the American sensibility, but so does the idea of freedom of choice.

B. Voting Is Fundamental to the Civic Polity, but Not to the Corporate Polity

There is a second basic difference between corporate and political self-governance: In most instances, investors are not looking for a democratic experience. As Greenwood has noted:

> [T]he basic self-understanding of corporate law is not political at all. Corporate law does not imagine directors to play the role of elected representatives of the "people" or even of the dollar investments of fictional shareholders for the simple reason that corporate law does not imagine directors to be making the value choices that are the appropriate realm of elective politics.[46]

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45 *See* REVISED UNIF. P'SHIP ACT (1997) § 401(f); UNIF. LTD. LIAB. CO. ACT (1996) § 404(a) (discussing member-managed LLCs, which have a more partnership-like structure).

46. Greenwood, *supra* note 7, at 84.

In other words, the shareholder does not vote "to make value choices, to reaffirm common membership in a joint enterprise, or to give meaning to collective commitments,"[47] as voters do in the political realm. Instead, she votes "to keep directors within their role requirements, [and] to ensure that they are not stealing from the corporation or distorting it to some other purpose."[48] In short, shareholder "democracy" exists only to "police the professionals."[49] It makes little sense to say that the political model for voting should carry over to the corporate context when the reasons for voting in each of the two settings are entirely different.

C. Shareholder Democracy as Empty Exercise

There is a third way in which corporate and civic democracy differ. Shareholder democracy is extremely undemocratic in actual practice because, unlike political democracy, it offers voters no real choice at all.[50] Because of corporate election structure, shareholders have no choice between nominees. The incumbent board (or, post-Sarbanes-Oxley, a nominating committee appointed by the board) puts forward a slate of candidates.[51] There is almost always only one candidate for each vacant director seat. Unlike the election for the presidency, there is no choice between Candidates *A* and *B*; a shareholder's only choice is Candidate *A*. Running an opposing ballot is possible but costly;

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47 *Id.*

48. *Id.*

49. *Id.* Even in their narrow role of voting not for value choices but simply to monitor management, shareholders face limits on their power to act as effective policemen. These limitations can generally be summed up as collective action problems. *See* David Arthur Skeel, Jr., *The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases*, 78 VA. L. REV. 461, 473 (1992) (describing shareholders' collective action problems). These include shareholders' inadequate incentives to investigate the quality of corporate decisions, the costs of campaigning and coalition-building, and redundant decision-making. *See* CAMARA, *supra* note 43, at 223–24 (listing obstacles to effective shareholder voting).

50. As Thomas W. Joo cynically (but not unfairly) observes, the ideal that shareholders govern in a "corporate democracy" is "a common American myth." Thomas W. Joo, *A Trip Through the Maze of "Corporate Democracy": Shareholder Voice and Management Composition,* 77 ST. JOHN'S L. REV. 735, 735 (2003) [hereinafter Joo, *Democracy*]. Note that this discussion of shareholder democracy, like Dunlavy's piece, focuses solely on the large Berle & Means-style publicly traded corporations. Shareholder voting power can look quite different in the closely-held setting or where there is a large majority shareholder.

51. *See id.* at 744–45 ("[T]he incumbent board typically nominates a slate of candidates without input from shareholders.").

the opposing faction must fund the expense of sending its own competing ballot to the shareholders.[52]

Shareholders do have the power to withhold votes, and have occasionally exercised it by opposing nominees for directorships in recent years. Notably, in the case of the Walt Disney Company's 2004 election, Roy Disney mounted a campaign that led holders of a then-unprecedented 45% of the company's shares to withhold votes from Chairman of the Board (and CEO) Michael Eisner.[53] Eventually this led to Eisner's resignation as CEO.[54] But the protest via non-voting had no legal significance because the default rule in most states, including Delaware, where Disney is incorporated, gives the board seat to the winner of the highest number of votes, even if this is only a small plurality.[55] Even if a board candidate receives less than a majority of votes cast—or, indeed, even if she receives just one vote and no competing ballots are cast—she is still elected.[56] The typical election is uncontested; thus, shareholders have no real choice. Each vacancy has but one nominee, and shareholders' failure to vote for that nominee has no binding legal power on either the corporation or the board of directors. Margaret Blair and Lynn Stout justifiably have concluded that "shareholders in public corporations do not in any realistic sense elect boards. Rather, *boards elect themselves.*"[57]

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52. *See id.* (describing how corporate law discourages opposition campaigns); George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 903 (noting that an insurgent must pay her own costs).

53. *See* Chad Terhune & Joann S. Lublin, *At Home Depot, CEO "Pay Rage" Boils Over in Vote*, WALL ST. J., June 2, 2006, at A3 (describing the shareholders' ousting of Michael Eisner).

54. *Id.*

55. *See* DEL. CODE ANN. tit. 8, § 216 (2006) (stipulating the quorum and vote requirements for stock corporations).

56. Joo, *Democracy*, *supra* note 50, at 745. Some current corporate governance reforms include bylaw amendments that would require a director to resign if a majority of shares cast withhold votes. On April 20, 2006, the executive council of the powerful Corporate Law Section of the Delaware State Bar Association endorsed draft legislation to amend the Delaware General Corporation Law to enable shareholders to introduce an irrevocable change of bylaws on director elections, as well as to provide for an irrevocable resignation of directors who fail to get a requisite number of votes. The American Federation of State County and Municipal Employees has led a campaign for majority voting, and 73 of the over 120 companies with majority voting in place have made changes in the past 14 months in response to the campaign. Dennis K. Berman, *Boardroom Defenestration*, WALL ST. J., Mar. 16, 2006, at B1; *see also* Mark Maremont & Erin White, *Stock Activism's Latest Weapon*, WALL ST. J., Apr. 4, 2006, at C1. The Walt Disney Company has adopted this policy. *See* Press Release, The Walt Disney Company, Disney Board Votes to Amend Corporate Governance Guidelines to Adopt Majority Vote Standard for Director Elections and Adds Anti-Greenmail Provision to By Laws (Aug. 18, 2005), http://corporate.disney.go.com/news/corporate/2005/2005_0818_disneyboardvotes.html.

57. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85

Still, some scholars insist that the shareholder vote does matter. Frank Easterbrook and Daniel Fischel view the shareholders' vote as a kind of gap-filler. According to them:

> The right to vote is the right to make all decisions not otherwise provided by contract—whether the contract is express or supplied by legal rule. The right to make the decisions includes the right to delegate them. Thus voters may elect directors and give them discretionary powers over things voters otherwise could control.[58]

Easterbrook and Fischel view this process of shareholder voting and delegation of authority as fundamental to and meaningful within the governance process—even if voters "almost always" confirm management's decisions.[59] As evidence that the shareholder vote matters, they point out that higher voting shares do trade at a premium.[60] They also argue that voting must matter because it has survived.[61]

These observations, however, offer little real comfort to the shareholders. Even if shareholder democracy might somehow legitimize corporate governance in theory,[62] that does not mean that shareholder votes have any real meaning or power. Higher voting shares may trade at a premium because in cases of direct democracy (like takeovers) the vote does matter, even though in the case of annual director elections it does not.[63] Finally, the survival of the shareholder vote for the board might be vestigial or it might have symbolic, rather than actual, value (as the "legitimation" theory of voting itself

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VA. L. REV. 247, 311 (1999).

58. Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J. L. & ECON. 395, 402 (1983).

59. *Id.* at 403.

60. *Id.* at 407 (noting that classes of stock with stronger voting rights trade at a premium of two to four percent relative to other classes).

61. *Id.* at 406. In addition, Easterbrook and Fischel cite instances of what I have termed "direct" democracy, such as votes on takeovers, and some cases where shareholder votes are not required, such as stock option plans, choice of independent auditor, and mergers that do not require a vote. *Id.* at 417. These instances fall outside of the comparison I am interested in for the purposes of this Comment.

62. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) ("The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.").

63. *See* Easterbrook & Fischel, *supra* note 58, at 417. As we have seen, takeovers are an instance of direct, rather than representative, democracy. *Id.* at 417–18; *see also* Henry G. Manne, *Some Theoretical Aspects of Share Voting: An Essay in Honor of Adolf A. Berle*, 64 COLUM. L. REV. 1427, 1444–45 (1964) (suggesting that the shareholders' takeover vote be detached from the share and sold separately for a limited period of time because of its inherent value and uniqueness).

suggests).[64] The fact remains that most shareholders who are dissatisfied with management do not rely on their voting power to effect change; instead, they sell.

D. Shareholders' Power of Exit

This blunt reality brings us to the fourth and final disconnect between voting in the corporate context and in the political sphere: shareholders, unlike the political electorate, can exit cheaply. A shareholder's power, unlike a U.S. citizen's power, does not lie only in her ability to vote. It lies also in her ability to exit—that is, her ability to sell her shares. Shareholders can "vote with their wallets" and exit from a corporation when they disagree with management's decisions. This is known as the "Wall Street Rule": shareholders dissatisfied with management will not attempt to make changes, but instead will sell their shares.[65]

The shareholder's power to sell contrasts sharply with the high cost of exit for the voter in the civic polity. There is no easy exit from citizenship. Discontented members of a particular state may choose to leave it, but the costs of uprooting a household generally far exceed those of selling shares in a corporation.[66] At the national level, costs of exit are even higher because moving to a new country typically involves substantial cultural adjustments, as well as stark disconnection from one's past. In contrast, shareholders must pay only a relatively small transaction fee in order to liquidate an investment. These observations led Henry Manne to conclude that the corporation is a "far more democratic mechanism from the viewpoint of shareholders than is government from the point of view of voters."[67]

The Wall Street Rule's admonition that shareholders will choose the path of selling rather than voting hints that the vote will matter most when selling is

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64. *See* CAMARA, *supra* note 43 and accompanying text (noting, among other things, that shareholder voting may be used to placate shareholders and insulate managers).

65. Thomas W. Joo, *The Modern Corporation and Campaign Finance: Incorporating Corporate Governance Analysis into First Amendment Jurisprudence*, 79 WASH. U. L.Q. 1, 57–58 (2001) [hereinafter Joo, *Finance*]. Note that the literature on the market for corporate control teaches us that the exit option also serves to discipline management. If enough unhappy shareholders sell, the share price drops, and the corporation becomes a target for takeover. *See generally* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981).

66. *See* Manne, *supra* note 63, at 1445 (describing the difficulty of voter mobility in politics).

67. *Id.*

expensive.[68] In keeping with this logic, the Wall Street Rule has a corollary that forces us to revisit Dunlavy's notion of corporate plutocracy:[69] There are times when it might pay to stay and fight (or vote), rather than to sell, and these instances also shed light on the differing nature of corporate and civic polities. As Thomas W. Joo explains:

> If the share price is depressed at the time the shareholder disagrees with management, the shareholder will pay a price to exit. If the share price has appreciated, exit by liquidation of stock constitutes a taxable event which may impose costs on the exit. Furthermore, notwithstanding the current boom in day-trading and other high-turnover strategies, economists generally agree that a long-term buy-and-hold strategy is the most reliably profitable method of equity investing. Thus exit may impose costs even absent a depressed stock price or a tax penalty.[70]

The noteworthy point that these concerns highlight is the essentially financial calculus that drives the shareholder's—but not necessarily the political voter's—decision-making process.

The recent spate of shareholder activism provides another example of the corollary to the Wall Street Rule. Large shareholders sometimes find it worthwhile to agitate for change within companies. Kirk Kerkorian used his nearly 10% stake in General Motors to place an ally on the board of directors and to pressure the company to make strategic changes.[71] Carl Icahn used his influence as a large shareholder of Time Warner to encourage the company to conduct a $20 billion stock buyback, to implement an additional $500 million in cost-cutting, and to appoint two new independent directors to its board in consultation with major shareholders.[72] Private-equity firms have made their voices heard at Vivendi[73] and at Wendy's International.[74] A large investor at

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68 *See* ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY 33 (1970) ("The voice option is the only way in which dissatisfied customers or members can react whenever the exit option is unavailable.").

69. *See* Dunlavy, *supra* note 1, at 10–13 (tracing the growth of corporate plutocracy).

70. Joo, *Finance*, *supra* note 65, at 57–59. For further discussion of exit and voice, see HIRSCHMAN, *supra* note 68, at 33.

71. *See* Paul Ingrassia, *General Malaise*, WALL. ST. J., Mar. 27, 2006, at A16 (describing new board member Jerome B. York as Kerkorian's agent); Monica Langley, *Newest Director Shakes Up GM with Calls for Radical Change*, WALL ST. J., Mar. 20, 2006, at A1 (explaining York's effect on General Motors).

72. *See* Matthew Karnitschnig, *Time Warner, Icahn Reach Accord*, WALL ST. J., Feb. 18, 2006, at A3 (stating Icahn's role in Time Warner's settlement).

73. *See* Aaron O. Patrick, *Equity Firm Buys 2.5% of Vivendi in Bid for Change*, WALL ST. J., Mar. 22, 2006, at C4 (reporting that private equity firm Sebastian Holdings, Inc. purchased a stake in Vivendi).

74. *See* Gregory Zuckerman, *Activist Hedge Funds Win Fans on Wall Street*, WALL ST. J.,

Six Flags successfully replaced the CEO,[75] and a large shareholder opposing Novartis AG's acquisition of Chiron Corporation threw the deal into question.[76] All of this is in addition to institutional shareholder activism from pension funds like the California Public Employees' Retirement System and the American Federation of State, County and Municipal Employees.[77]

Shareholder activism sometimes draws support from smaller shareholders, but it is led in each case by large shareholders. Motivating large shareholders to police the corporation and the interests of all shareholders is often used as a justification for the one-share-one-vote principle: "If shareholders have a single vote for each share of stock, their voting power mirrors their economic incentives."[78]

IV. Revisiting the Comparisons

The corollary to the Wall Street Rule teaches that larger shareholders, because they have more at stake, are more inclined to fight than are small shareholders. And this brings us back to Dunlavy, to plutocracy, and to the perils of comparing corporate and civic polities. It is true that in shareholder democracy larger shareholders have a greater voice. Whether you think that one-share-one-vote is a good idea depends on how much you trust large shareholders.[79] Ratner believes that there is more cause to suspect the motives of large shareholders than there is to fear the faithless manager.[80] Manne, on

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May 8, 2006, at C1 (discussing the hedge funds' recommendations to Wendy's International).

75. *Id.* (reporting Daniel Snyder's winning the contest to succeed Six Flags, Inc.'s chief executive officer in November 2005).

76. *See* David P. Hamilton, *Shareholder Insurrection Infects Novartis's $5.1 Billion Chiron Bid*, WALL ST. J., Apr. 3, 2006, at C3 (describing Chiron investors as influencing Novartis AG's deal).

77. *See* Alan Murray, *Corporate-Governance Concerns Are Spreading, and Companies Should Take Heed*, WALL ST. J., Apr. 12, 2006, at A2 (providing examples of institutional investor activism); *see also* Terhune & Lublin, *supra* note 53, at A3 (describing shareholders' voting power).

78. Skeel, *supra* note 49, at 467.

79. The Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (December 22, 1995), codified at 15 U.S.C. 77z-1 et seq.; 15 U.S.C. 78u-4 et seq., for example, favors entrusting lead plaintiff status in a securities class action to large shareholders. See, e.g., id. at Sec. 27(a)(3)(B)(iii)(bb).

80. *See* Ratner, *supra* note 7, at 20–21 (questioning powerful shareholders' motivations). Ratner explains:

> There is a much greater likelihood that the single large shareholder, with more spare money and spare time than the salaried management of the corporation, will have substantial interests in other businesses than that the salaried managers will

the other hand, disagrees, reasoning that "[w]ith very rare exceptions, there are no conflicts in the corporate interests of voting shareholders."[81] In other words, all shareholders are united in the common cause of making money.[82] In fact, Manne argues that because of this lack of conflict in motive, unlike many political decisions, "corporate decisions almost never have a direct wealth redistribution effect among the shareholders, that is, one changing relative participations of the shareholders."[83]

This disagreement poses a fundamental question about what it means to be more or less democratic. Is it more democratic to have a system that motivates large shareholders to exercise their power and voice to make changes in the management of the corporation, so that the electorate's voice, even if dominated by a large shareholder, is heard? Or is it more truly democratic to ensure that each voter's power is equal, no matter how much wealth they hold, with the consequence that resulting transaction costs mute any meaningful expression of shareholder concerns? Again, the answer depends on whether shareholder democracy has more to fear from managers or large shareholders.

And what about the undemocratic practice of holding voters once removed from their representatives? Just as a corporation differs from a nation, so does a board of directors differ from the Electoral College, despite whatever convergent evolution made them both representative democracies once removed. The board plays a decisive role in the governance of the corporation, unlike the Electoral College in the governance of the nation. This Comment earlier asked why a corporation has a board of directors.[84] After all, we could have easily moved to the system we as a nation (with our purely functionary Electoral College) have now, and away from representative democracy once removed.

> have such interests. Also, to the extent that he is less involved than the salaried managers in the running of the corporation's business, he may have a lesser sense of identification with the corporation as an entity and a consequently greater inclination to view the corporation as a means of achieving objects unrelated to the interests of the shareholders and the corporations' other constituencies.

Id.

81. Manne, *supra* note 63, at 1441.

82. *But see* Robert P. Bartlett III, *Managing Risk on a $25 Million Bet: Venture Capital, Agency Costs, and the False Dichotomy of the Corporation*, 54 UCLA L. REV. (forthcoming 2006) (explaining that conflicts do exist among shareholders); Stephen M. Bainbridge, *Shareholder Activism and Institutional Investors* (UCLA Law-Econ. Research Paper No. 05-20, September 2005) (discussing shareholder conflicts), *available at* http://www.ssrn.com/abstract=796227.

83. Manne, *supra* note 63, at 1441.

84. For an attempted answer to the question posed, see generally Lawrence E. Mitchell, *On the Direct Election of CEOs*, 32 OHIO N.U. L. REV. 261 (2006).

A corporation has a board of directors because modern boards, composed of independent (or "outside")[85] and management (or "inside")[86] directors, exist for a reason. Lawrence Mitchell suggests that the outsider/insider model evolved in order to shield managers from liability.[87] I agree, and would argue that boards exist today solely to provide the corporation with independent directors. Independent directors function not as monitors of management, nor as managers of the corporation. Rather, they provide a mechanism for the corporation to deal with issues of inherent conflict for management: hostile takeover bids, levels of executive compensation, and conflict-of-interest transactions.[88] Without the board of directors, there would be no efficient court of last resort for dealing with these situations within the corporate structure, no sanitizing mechanism for managers of the corporation to use. But that is the subject of another article.

Dunlavy tempts us with the political analogy, challenging us to find points of connection and disjuncture between corporate and civic polities. These comparisons are illuminating, but the analogy is by no means perfect. Given shareholders' right of exit and the lack of shareholder interest in democratic representation in any ordinary sense, shareholder voting rights are really not that much like political voting rights. Shareholders are different from citizens; the purpose of their voting power is distinctive and limited, and their elections function very differently from those of the civic polity. Similarly, the board of directors, although sharing the characteristic of a representative democracy once removed, differs fundamentally from the Electoral College. The board provides independent directors to address areas of management conflict, while the Electoral College serves no such additional function. Comparison of political voting to corporate voting provides a useful vehicle for understanding the characteristics of each more fully. The danger lies in taking principles from the civic polity and applying them to the corporate polity without considering the different context of each.

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85. Lawrence E. Mitchell, *The Trouble with Boards* (GWU Law Sch. Public Law Research, Paper No. 159, Sept. 9, 2005), *available at* http://www.ssrn.com/abstract=80/308.

86. *Id.*

87. *See id.* (providing a fascinating account of the evolution of the modern model of the board as monitor).

88. *Id.*