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The Place of Corporate Lawmaking in American Society

Fenner L. Stewart Jr.

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THE PLACE OF CORPORATE LAWMAKING IN AMERICAN SOCIETY

Fenner Stewart, Jr.*

I. Introduction

The concept of “embeddedness” can be traced to Karl Polanyi’s The Great Transformation.1 The book is a history of the commoditization of English society from the eighteenth century forward, recounting how markets became unstitched from the fabric of society. As markets became more distinct from everyday life, society began to change in order to meet trending economic needs. One example of this transformation was the enclosure of English farmlands and the end of the ancient system of farming on land that was considered free for the use of all. This created a radical disruption in social function. Without farmland, thousands were forced to move to sites of industrial production, generating a radical shift in society from traditional agrarian life to one that was dominated by factory work. In other words, Polanyi’s book explains how markets became disembedded from society and then how these disembedded markets altered social activities as they became re-embedded into market function.2

Polanyi never believed that society could become completely embedded within the market function, concluding that society’s members would never tolerate a market function which completely overwhelmed their social needs. This resistance

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to market pressures is what Polanyi called the “double movement.” Simon Deakin has elaborated on Polanyi’s idea of the double movement, explaining how it also operates in reverse. In other words, market actors will resist projects for greater equality when these social demands compromise market functionality. The balance between favoring the needs of markets with the needs of society has fluctuated throughout the twentieth century. According to Deakin, the pendulum is swinging toward the modern economy’s increased need for markets as societal governance has become ever more closely tied to the expectations of investors. Today, certainly, the pendulum appears to be swinging in a different yet still unknown direction.

In his seminal article of 1985, Mark Granovetter elaborated upon Polanyi’s disembedded market theory and expanded it into a more complete (and complex) sociological theory of how embedded social behavior affects economic institutions. Granovetter argued that to adequately study economic institutions, like corporations, one must take into consideration how the behavior of such institutions is “constrained by ongoing social relations.” Granovetter’s central contention was that when economic reasoning ignores an institution’s social embeddedness, such reasoning is blinded to the actual social relationships within it and, accordingly, it is unlikely one will be able to understand how a particular institution functions (or fails to function).

Granovetter’s call to scrutinize the social relationships that affect an organization’s function has been seen as a sociological plea explaining why institutions behave as they do. He criticized the assumptions of New Institutional Economics by highlighting how actual social networks inside and outside of the corporation operate in ways that handcuff economic thought.

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3 For a detailed commentary on the double movement, see Fred Block, Introduction to POLANYI, supra note 1, at xxiii-xxvii.


5 Block, supra note 3, at xxvii - xxviii.

6 See Deakin, supra note 4, at 67-68.


8 Granovetter, supra note 2.

9 Id. at 482.

10 Id. at 481-82.
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Specifically, Granovetter took issue with Oliver Williamson’s theory of transaction costs, arguing that while there was a certain analytical value to Williamson’s eventually highly influential market/hierarchy model of the corporation, it remained blind to the social reality of corporate function.

Up until now, Granovetter has served as something of a connector between Polanyi’s efforts and current ongoing investigations into the concept of embeddedness. Certainly, the new interest in economic sociology and its relevance in bridging discourses in sociology, legal theory, and political economy contributes to a better understanding of the merits and boundaries of “economic governance,” something of particular importance at a time of fundamental readjustments to the financial credo of the last two decades.

Legal theory itself reflects the early beginnings of such critical engagement with an exclusively economistic bias. John Dewey, in a famous inquiry into the law’s constitution of the corporation, identified the law as a powerful tool with the ability to take an abstract idea (such as the suggestion that the corporation was a “person”) and transform it into something more concrete and real (by, for example, granting a corporation the right to contract or equipping it with constitutional protections). Such legal reification, according to Dewey, shapes how people think about a corporation. As a consequence, this reification also shapes people’s behavior within, and in relation to, corporations.

An important strand in studies on embeddedness and

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12 Granovetter, supra note 2, at 493-504.


15 Zumbansen & Calliess, supra note 11.

16 John Dewey, The Historical Background of Corporate Legal Personality, 35 YALE L. J. 655 (1926).
comparative variations in national political economies around the world has been to focus on different forms of market organization.\textsuperscript{17} Central to such inquiries has been the analysis of the particular dynamics of reform politics that often emerged against the background of historically evolved path-dependencies.\textsuperscript{18} Similarly, sociologists have long focused on sites where law is produced as “sites of contestation” between influential groups attempting to maintain or change the embedded patterns of social relationships. In \textit{Competition as a Cultural Phenomenon}, Karl Mannheim detailed how preferences become entrenched or embedded within society through social processes like lawmaking and, in particular, through the competitive actions between influential social groups within these social processes.\textsuperscript{19} From this perspective, Mannheim can be seen as providing a promising approach for connecting Polanyi’s and Granovetter’s ideas of embeddedness with Dewey’s understanding of the legal reification of business ideas. Building upon this connection of ideas, Mannheim’s article explores one of the most important sites of contestation between influential business groups; namely, the place that has historically triumphed in attracting the highest number of Fortune 500 business incorporation in America: Delaware – America’s regulatory laboratory for \textit{de facto} “national” corporate law.

The social process of how preferences become entrenched or embedded within American corporate charters is of particular importance to understanding such behavior within the American corporation. If Dewey was correct and the law shapes the behavior of actors within the business world, then the corporate charter is a central tool in this process. The corporate charter is the foundational contract of the corporation, establishing the distribution of wealth and power between its members and others outside of the corporate organization. In other words, it is a contract which formalizes social relations between the constituents of a corporation. Although the charter does not dictate all social relations within the corporation, it does set a

\textsuperscript{17} \textit{Varieties of Capitalism: The Institutional Foundations of Comparative Advantage} (Peter A. Hall & David Soskice eds., 2001).


standard for expectations for social relations and is highly influential in the embedding process.

This Note provides a history of the legal debates over corporate charters in the American context beginning with a famous dispute that originated in a series of contesting law review articles in the 1970s. A brief literature review will recount the academic arguments that have provided the intellectual support for sustaining Delaware’s primacy over corporate lawmaking in the face of constant attack. By understanding the debates that have sustained Delaware’s ability to lead the American competition for incorporation, this Note provides insight into what is regarded as the most important legal instrument for maintaining status quo for actual social relationships within the American corporation: the “market for incorporation.”

However, this Note will also draw attention to the growing skepticism over Delaware’s ability to consistently legislate optimal corporate law. This skepticism is most clearly evident in the federal government’s growing willingness to design and to pursue corporate law policies in the face of corporate governance scandal, notwithstanding the fact that corporate law in the United States is governed by the states. The consequences of these developments are subject to strict scrutiny and ongoing discussion. In sum, this Note provides an example of how shifts in lawmaking networks outside of the firm demand the potential to shift the embeddedness of the behavior of social relationships inside the firm.

II. Historical Introduction

During the American republic’s early decades, state legislatures restricted the rights of corporate action by scrutinizing petitions for incorporation just as they would any other piece of legislation. In theory, democratic representatives granted incorporation only if it served the public interest, but healthy skepticism should be reserved for anyone who claims that this was always the case. Restrictions on the corporation were

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20 For the boundaries of government’s authority over incorporation, especially after the corporate charter was issued by the state, see Trustees of Dartmouth Coll. v. Woodward, 17 U.S. 518 (1819). For greater detail, see David Millon, *Theories of the Corporation*, 1990 Duke L. J. 201, 206-10 (1990).

21 *David Sciulli, Corporations vs. The Courts: Private Power, Public Interests* 85 (1999) (arguing that each request for incorporation was
Severe by today’s standards; for instance: 1) a corporation could not accumulate more than a set amount of capital; 2) a corporation’s life was usually fixed to the time required to finish the task(s) that it was incorporated to accomplish; 3) a corporation could not engage in activities that were not explicitly defined in the terms of its incorporation; and 4) a corporation’s business activities could not extend beyond the boundaries of the state in which it was incorporated.

Yet in spite of such limitations, the corporation was still a coveted investment vehicle. One reason for this was that the status of shareholders was a rare and prestigious privilege. However, it would be misleading to conclude that this investment vehicle was desired merely because it offered a degree of social status. The main attraction to the corporation was more likely the limited liability protection it offered to businessmen and the opportunities for power and profits which large “public interest” projects presented.

By 1858, Americans had endured a depression, multiple stock market crashes, and witnessed what was perceived to be the floundering public management of large interstate canal projects. These events provoked a profound shift of public opinion regarding the relationship between public and private subject to the same lobbying and debate as any other bill, including “power plays, personal intrigues and local favoritism.”

22 For a thorough collection of references to specific legislation from the 19th century, see Ligget Co. v. Lee, 288 U.S. 517, 550-54 (1933) (Brandeis, J., dissenting).
23 Id. at 555.
24 Bank of Augusta v. Earle, 38 U.S. 519, 588 (1839) (Taney, CJ, held that since the powers conferred on the corporation can be no greater than state power, which granted the incorporation, the firm had no authority to operate outside the state).
25 Id.
27 Morton J. Horwitz, Santa Clara Revisited: The Developments of Corporate Theory, 88 W. VA. L. REV. 173, 208-09 (1985) (arguing that although the common law had evolved to the point of presuming limited liability, state legislatures enacted legislation to extend their shareholder liability a bit further than the value of their share).
28 Millon, supra note 20, at 207 (arguing that there was fear that the potential for power and wealth associated with incorporation caused Americans to fear that such organizations could threaten the opportunity of others to enter the market; adding that, as a result, governments rarely confer monopoly privileges).
power in American society. 29 People began viewing government intervention in private transactions less as a means of securing liberty and more in terms of restricting it. Public authorities found themselves faced with a public that demanded justification for why the corporation must be a servant of public interest and, more importantly from the individual’s perspective, why private citizens should not use such corporations solely for personal advantage in the pursuit of happiness. 30 Citizens also became less trusting of government discretion in granting incorporations because accusations of favoritism and corruption became widespread. 31 With these adverse changes in public opinion, the government walls that confined corporate behavior began to crumble. Emerging state policy began to challenge the long-established understanding that the function of the corporation was solely to serve the community. 32 This shift, in turn, opened the door for the considerably activist U.S. Supreme Court to determine that corporations had constitutional rights, protecting corporations from the threat of public meddling in their affairs. 33

With the loosening of state policy and advancements in technology, the number of incorporations increased exponentially. Professional management teams, in turn, were hired more frequently as majority shareholders became less commonly involved in the corporation’s day-to-day

29 For more on how the canals fiasco shifted public opinion, see CARTER GOODRICH, GOVERNMENT PROMOTION OF AMERICAN CANALS AND RAILWAY (1961); see also CARTER GOODRICH, JULIUS RUBIN, JEROME CRANMER, AND HARVEY H. SEGAL, CANALS AND AMERICAN ECONOMIC DEVELOPMENT 241, 246-47 (1961) (describing what was perceived to be the costly financial failures of the nineteenth century canal projects, of which almost 3/4 of the $188 million invested between 1815 and 1860 came from the public purse). For more on how the other mentioned financial crisis affected public opinion, see WILLIAM G. ROY, SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA 71-75 (1997).

30 SCIULLI, supra note 21, at 89.

31 HURST, supra note 26, at 33-36, 136.

32 Gregory A. Mark, The Personification of the Business Corporation in American Law, 54 U. CHI. L. REV. 1441, 1447 (1987) (arguing that changes in state law incorporation policies “eliminated any notion that incorporation was a special grant from the state, even the public nature of a corporation’s purpose could be called into doubt”).

33 Santa Clara County v. Southern Pac. R.R., 118 U.S. 394 (1886). For a detailed understanding of the case and a detailed argument regarding the fallout from this case in America, see Horwitz, supra note 27. For a contrasting point of view, see Millon, supra note 20.
management.34 These radical transformations created a flood of new and complex issues into state courts – necessitating the call for legal clarity.35 This inspired the creation of specific state judiciaries to oversee corporate practice.36 Willing jurisdictions (in particular, New Jersey and Delaware) customized regulatory environments to attract those businessmen shopping for the most advantageous jurisdiction to incorporate their businesses.37 Such states also began to adopt new management-friendly legislation, mostly because the franchise taxes, fee revenues, and taxation on extra business opportunities (which followed incorporation) filled state coffers.38

Beginning in the mid-1800s, a gradual loosening of government policy occurred. For example, in 1846, New York started a trend in state reform which blocked the legislature from creating corporations by special act, except in the rare case where the objectives for devising the corporation could not be attained under general law.39 In addition, in 1867, the U.S. Congress expanded bankruptcy protections to include corporations.40 Further, in 1875, New Jersey eliminated the restrictions on the corporation’s ability to accumulate capital.41 In 1886, the U.S. Supreme Court held that the private corporation was a “natural person” under the U.S. Constitution, therefore protected by the Bill of Rights, which broadly protected the corporations from public authority.42 New Jersey offered the first standard articles

34 SCIULLI, supra note 21, at 90.
35 HURST, supra note 26, at 82-83.
36 Id.
39 N.Y. CONST. OF 1846, art. VIII, § 1.
40 SCIULLI, supra note 21, at 91.
41 Id.
42 Horwitz, supra note 27; see also Millon, supra note 20.
of incorporation for private businesses in 1888. In one reflexive jerk away from the growing power of the mighty corporation, the Sherman Antitrust Act was signed in 1890. But still racing forward at the state level, in 1896, New Jersey adopted what could be recognized as the first modern corporate statutes and, thus, it became the home to the majority of America’s largest corporations (a title that Delaware would steal within twenty years). In 1910, the Supreme Court nullified restrictions on corporate capacity to conduct business outside the states in which it was chartered. By 1933, Mr. Justice Brandeis, reflecting on this historical trend toward state competition in corporate law in Liggett Co. v. Lee, expressed concern over how the fear of losing existing state revenue and the allure of earning greater state revenue was eroding the diligent construction of corporate legal development by replacing it with a permissive consumer product that pandered to powerful corporate interests.

III. The First Wave: Drawing the Distinction

In one of the most influential articles ever published by the Yale Law Journal, William Cary reconsidered the trends in federalism and corporate law from the nineteenth century forward and declared that modern state corporate law was a product of state competition. Most importantly, states were legislatively competing to attract incorporation to increase state revenues, creating a dangerous “race-to-the-bottom” for corporate governance standards. Cary’s focus quickly turned to the by-then leader of this race, Delaware. He opined that Delaware’s motivation for its considerably softened stance on corporate governance standards was motivated by the state’s budget dependence on revenues from incorporations, therefore creating an inversely indebted relationship between the state and those corporate managers looking to incorporate. This compelled Delaware to offer advantageous corporate legal arrangements that allowed managers broad and unchecked authority; therefore,

43 ROY, supra note 29, at 152-53.
45 Bebchuk, supra note 37, at 1443.
46 Millon, supra note 20, at 212-13.
47 288 U.S. 517, 557 (1933) (Brandeis, J., dissenting).
48 It was called the most influential piece ever published by the Yale Law Journal, see Fred R. Shapiro, The Most-Cited Articles from the Yale Law Journal, 100 YALE L. J. 1449 (1991).
49 Cary, supra note 37, at 666.
corporations were no longer faced with the disincentive required
to curb less-than-optimal corporate performance.\textsuperscript{50} Cary argued
that it was time for the federal government and the judiciary to
“import lifting standards” that would set a level beyond which
corporate standards would not be allowed to fall below and
“deteriorate.”\textsuperscript{51}

Three years later, in 1977, Ralph K. Winter wrote a reply
to Cary’s position which by this time had almost universally
become endorsed as a matter of fact. In the face of this general
consensus, Winter boldly rejected Cary’s position arguing that
state competition should “tend toward optimality so far as the
shareholders’ relationship to the corporation is concerned” and
thus corporate governance standards, like those of Delaware,
“are optimal legal arrangements.”\textsuperscript{52} Put differently, what Cary
regarded as a “race-to-the-bottom” Winter replaced as a
“race-to-the-top.”

Borrowing from the ideas of Henry Manne,\textsuperscript{53} Oliver
Williamson,\textsuperscript{54} and Armen A. Alchian,\textsuperscript{55} Winter constructed an
argument which suggested that because corporations acquired
capital by selling bonds and equity, management was therefore
forced to weigh the interests of such financial actors and
instruments.\textsuperscript{56} Winter posited that “the state which ‘rigs’ its
code to benefit management will drive debt and equity capital
away.”\textsuperscript{57} Furthermore, he argued that, although Cary was
correct in assessing that managers ultimately had the consumer

\textsuperscript{50} Id. at 668-69.
\textsuperscript{51} Id. at 705.
\textsuperscript{52} Ralph K. Winter, \textit{State Law, Shareholder Protection, and the Theory of
\textsuperscript{53} See Henry G. Manne, \textit{Mergers and the Market for Corporate Control}, 73
J. POL. ECON. 110 (1965); see also Henry G. Manne, \textit{Our Two Corporation
\textsuperscript{54} Oliver Williamson, \textit{Corporate Control and the Theory of the Firm, in
The Regulation of Corporate Securities} 281 (Henry G. Manne ed.,
1969).
\textsuperscript{55} Armen A. Alchian & Reuben A. Kessel, \textit{Competition, Monopoly, and the
Pursuit of Pecuniary Gain}, in \textit{Aspects of Labor Economics} 156 (National
http://www.nber.org.flagship.luc.edu/chapters/c0605.pdf; see also Armen A.
and the Regulation of Corporate Securities} (Henry G. Manne ed.,
1969); see also Armen A. Alchian & Harold Demsetz, \textit{Production, Information
\textsuperscript{56} Winter, supra note 52, at 289.
\textsuperscript{57} Id.
power to decide which jurisdiction to incorporate, managers would not select a jurisdiction that would cause their business to: 1) earn lower-than-normal returns; and/or 2) have a higher cost of capital. On the contrary, managers would select jurisdictions that afforded the opposite for the sake of self-preservation. Thus, state competition, also known as the charter market, produced an optimal corporate law regime which accurately reflected the demands that corporate constituents had for corporate governance.

The rationale for the charter market that causes the race-to-the-top can be restated as follows: If the corporate legal regime is structured so that management cannot maximize the corporate output (profits), debt holders may make it more expensive to: 1) hold debt; and 2) raise new debt. This corporate legal regime will also depress stock price potential thereby making it more expensive to raise new capital as well as maintain optimal relations with shareholders and creditors. Such underperforming firms will become targets for takeover, and the threat of takeover will create a market for managerial control. Thus, managers will have ample incentive to demand an off-the-rack default statutory model of corporate governance that encourages shareholder maximization. Since such a default model can be assumed to be what managers are shopping for when they select a jurisdiction to incorporate, this is what state competition will foster. Thus, the charter market creates a race-to-the-top. Furthermore, it creates a system of legal innovation that is not compromised by political interference – which would ultimately be the result of Cary’s recommendation for federal government intervention.

With the two sides of the Cary/Winter debate delineated, the stage seemed set for the next three decades with the advocates of Cary’s position representing: 1) anti-managerialism; 2) federal intervention in state competition; and 3) more centralized planning, and the advocates of Winter’s position representing: 1) managerialism; 2) unfettered state competition; and 3) more decentralized market rationality. Underpinning both positions

58 Id.
59 Id.
60 Id.
61 Id.
62 Id. at 290.
63 Id.
64 For more analysis on Winter’s theory, see Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 J. L. ECON. & ORG. 225
was an understanding that the firm was a distinct market actor that focused squarely upon finding an optimal solution to the shareholder-management problem.

IV. The Second Wave: Event Studies and the Attempts to Settle the Cary-Winter Debate

Winter’s economic analysis of charter markets forced Cary proponents to adjust their arguments by taking a more economically sophisticated position. Following Winter’s lead, they employed more economically savvy arguments to suggest that shareholders (and creditors) had much less control over managers’ incorporation preferences in practice than Winter’s charter market theory suggested and, thus, the race-to-the-top argument was flawed. In response, others became inspired to settle this theoretical tit-for-tat debate by engaging in empirical research in the form of “event studies.” These studies established that many stocks affected by the amendments rose in value when the markets learned of the amendments, thereby bolstering Winter’s position that state competition was advantageous for shareholders.

Those defending Cary’s position fired back. Melvin Eisenberg rejected these event studies, arguing that they had “only limited usefulness” in the context of the Cary-Winter


65 Eisenberg, supra note 64.

debate. Specifically, Eisenberg contended that if a uniformly low-grade corporate law regime existed – as Cary seemed to suggest – then the notice of an amendment from “one low-grade regime to another would not be a significant event.” He also suggested that Delaware’s mature case law increased predictability, which helped to countervail potentially suboptimal rules and amendments. More importantly, Eisenberg emphasized that other contributory factors may have skewed the results of the event studies. One example of such factors included packaging negative amendments to existing law with positive ones. Eisenberg suggested that such event studies were limited because the economic analysis was so superficial that it could not adequately appreciate the complexity of the American “charter market.” Lucian Bebchuk made similar arguments that suggested how negative information can be packaged with positive information in order to maintain or improve stock value, while also re-emphasizing that Cary’s position was still correct.

Within four years of Eisenberg’s reply, Roberta Romano published what would become the landmark statement in support of Winter. Aimed at responding to Eisenberg’s demand for “deeper economic analysis,” Romano employed the lenses of: 1) financial risk management within equity markets; 2) agency cost theory; and 3) the relational understanding between socio-legal norms and market forces, which - taken together - helped to better understand the mechanics of the charter market. In the end, this deeper economic analysis led both Eisenberg and Romano closer to a centrist position, with Eisenberg leaning toward Cary’s position and Romano toward Winter’s.

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67 Eisenberg, supra note 64, at 1508.
68 Id.
69 Eisenburg posited that such contributing factors were not taken into consideration during the event studies. Id.
70 Id.
71 Id. at 1509.
73 ROMANO, supra note 64.
74 See Eisenberg, supra note 64 (Eisenberg uses this language to level his criticism of the superficial nature of the event studies).
75 Id. at 1509.
76 ROMANO, supra note 64, at 148.
V. The Third Wave: Post-Enron

Alas, the debate was not dead. Lucian Bebchuk took Cary’s side and warned that state competition encouraged a race-to-the-bottom given the states’ obvious inclination to make rules attractive to managers and controllers.77 In 1999, Bebchuk and Allen Ferrell illustrated how anti-takeover statutes were inefficient and reduced shareholder wealth,78 and illustrated one clear example of how states provided default rules that benefited only managers to the detriment of all other constituents, and “should lead the many who offer unqualified support of state competition to reassess their position.”79 But in 1999, the U.S. economy was hot, the inflation-adjusted aggregate output was up, real gross domestic product was up, corporate profits were up, employment was up, and everyone was making money. Bebchuk’s concerns were inaudible over the sound of investors’ portfolios filling with money. Corporate America seemed to be anything but broken.

All that changed in 2001 when the Enron Scandal outraged Americans and pulled corporate governance under the microscope.80 In step with this change in climate, Bebchuk reiterated his position that the empirical evidence supported the view that state competition offered harmful incentives, which privileged managers to the detriment of all other corporate constituents.81 Building on this critique, Bebchuk went on to argue that Delaware’s position in the charter market was so strong that assumptions about the operation of state competition were false. In other words, Delaware was more sheltered from the influence of other states’ actions than was assumed in the literature, producing suboptimal corporate rules and justifying federal intervention.82

In the summer of 2002, the federal government induced aggressive measures to appease populist reactions to the Enron scandal. Suddenly, there was a rash movement toward Cary’s federal intervention that may have been procedurally pleasing to some corporate governance observers, but was ultimately

77 Bebchuk & Ferrell, supra note 64.
78 Id.
79 Id. at 1199.
82 Bebchuk & Hamdani, Vigorous Race or Leisurely Walk, supra note 64.
substantively disappointing to most. With this came renewed interest in the Cary-Winter debate.

In this vein, Mark Roe set out to offer some fresh insight building on Bebchuk’s suggestion that Delaware was in fact insulated from state competition, not its catalyst. Roe concluded that the nature of corporate regulatory competition had been “misconceived – and badly so,” arguing that Delaware’s chief competition was never other states but, instead, the federal government. Other states did not have the constitutional authority to trump Delaware’s default rules for corporate governance, but the federal government did. In other words, Delaware’s incorporation regime existed because the federal government tolerated it. Accordingly, the results of corporate law evolution may have been due in part to state competition, but the ever-looming threat of federal intervention was also a major factor. Which of these two factors affected the evolution of corporate law was difficult to determine because the world of Delaware policymaking was opaque.

Roe further suggested that if the competition between Delaware and the federal government was considered when attempting to understand the traditionally conceived mechanism of state competition, the state race debate did not play out the way charter market analysis had been assuming all along. He suggested that a new theory was necessary to explain how policy networks forged American corporate law, arguing that top-down “centralized strategic” planning had as much responsibility for corporate law outcomes as did lateral state competition. This would give support to the idea that the federal political dimension compromises the narrow quest for solely understanding state competition through the assumed model of charter markets as constructed during the second wave of the debate.

In 2003, one year after the Sarbanes-Oxley Act ("SOX"), Stephen Bainbridge took a polarizing position as far to the Winter end of the continuum as Bebchuk had taken to Cary’s. Bainbridge blasted the federalization of corporate law, calling the actions of Congress and other regulators “deeply
flawed.” 88 He argued that, since the Enron scandal, the actions of the federal government represented “the most dramatic expansion of federal regulatory power over corporate governance since the New Deal.” 89 Rejecting the federal reforms as an unnecessary encroachment on state jurisdiction, Bainbridge pointed to Romano’s event study in support of his claim that state competition, and Delaware’s default rules, favored shareholders by maximizing shareholder wealth.90 When addressing Bebchuk’s 1999 argument about the negative effects of state competition upon shareholder wealth by legislating anti-takeover statutes, his response was “so what . . . nobody claims that state competition is perfect.” 91 He also proclaimed that “even if Bebchuk could prove that state competition is a race-to-the-bottom, basic principles of federalism would still counsel against federal preemption of corporate law,” because the potential for regulatory innovation would be seriously compromised.92

In 2005, Roe reemphasized that American scholars ought to recognize that the presumptions on state competition were skewing their perception, arguing that instead of looking at the results of horizontal state competition, observers needed to understand when the federal government decided to leave such authority in the hands of the states and when it decided to claw back such authority for itself.93 Instead of Delaware being the product of market pressures, Roe viewed Delaware as a political group with a narrowly-defined range of concerns within the larger policy network of corporate law development.94 In this light, Delaware’s policymaking network was like a caucus of managers and investors. And within this caucus, Roe deemed that managers clearly had the “upper hand” in guiding policy development, but these same managers also appeared to exercise self-restraint because they understood “the game could move to Washington” if the scales were pushed too far toward managerialism.95

Also in 2005, Leo E. Strine, Jr., Vice Chancellor of

88 Id. at 26.
89 Id.
90 Id. at 30.
91 Id.
92 Id.
94 Id.
95 Id. at 2542.
Delaware’s Court of Chancery, set out to “take some of the mystery out of Delaware’s role in the governance of American public corporations.” When discussing the politics of state competition, however, Strine was noticeably reserved. He alluded to the fact that Delaware was and will be in the lead for some time to come in the state race for corporate law. In defining the boundaries of state competition, he stated that the issues of competition, labor, trade, and disclosures to public investors were generally regulated federally, while Delaware governed the “internal affairs of the corporation.” He never more than tacitly acknowledged that the federal government had full authority to regulate in this area as well. In other words, Strine failed to directly acknowledge that Delaware’s power was a privilege granted to the state by the federal government and not a constitutional right. Accordingly, Strine does not elaborate on this federal power other than to say that present interventions like SOX and the amendments to listing requirements were suboptimal reforms.

In an exchange in the Harvard Law Review, the issue of federal intervention in the Delaware caucus was raised once again. Bebchuk argued that managers were too powerful and were blocking shareholders from maximizing shareholder value. Accordingly, he asserted that, since managers dominated state law, the federal government had to intervene. In response, Strine entertained Bebchuk’s proposal, but emphasized that such reform “must emanate from state policymakers;” Delaware (and not the federal government) ought to be “the primary source of substantive corporate law” reform. Bainbridge, in his response to Bebchuk, did not exhibit any of the potential flexibility that Strine did. He flatly rejected Bebchuk’s call for greater shareholder empowerment by arguing that if Bebchuk’s proposal could really enhance the value of the firm, why did it not already exist? In challenging Bebchuk in this

96 Leo E. Strine, Jr., The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face, 30 DEL. J. CORP. L. 673 (2005).
97 Id. at 673-74.
98 Id. at 674.
99 Id. at 686
100 Bebchuk, supra note 64.
101 Id. at 874.
102 Strine, supra note 64, at 1775.
103 Id. at 1777.
104 Id. at 1780.
manner, Bainbridge employed a classic Winteresque race-to-the-top argument. Bainbridge rejected any changes to Delaware’s law and lawmaking capacity.

In reply, Bebchuk was somewhat encouraged by Strine’s opinions (although he believed they did not extend far enough). Bebchuk attacked Bainbridge’s race-to-the-top argument by referencing a Winteresque argument from 1983, which advocated against federal intervention to better regulate insider trading. The 1983 article argued there was nothing wrong with the existing standards since charter competition would have already corrected them if they were suboptimal. This example illustrated the error of assuming that state competition already provided optimal corporate governance arrangements as Bainbridge suggested. In an interesting twist, Bebchuk pointed out that the innovative nature of state competition implied state law was subject to improvement in an evolving context. Thus, even if one assumed Delaware produced optimal corporate law, it did not mean his proposition ought to be rejected outright.

The recent Bebchuk/Strine/Bainbridge debate helps to confirm Roe’s observation that the true motivator for corporate governance innovation is the threat of federal intervention. Bebchuk’s call for such intervention caused a defense of Delaware from both Strine and Bainbridge, and also a willingness on Strine’s part to seriously entertain various shareholder empowerment initiatives. This reflects what is at stake in these debates over Delaware: the spectrum of embedded relationships between public and private power in American society.

VI. What Place Does Delaware Reserve for the Corporation in American Society? A Reflection of Bainbridge

A. The Delaware Status Quo

Delaware attempts to enshrine managerialism within American corporate governance. Delaware’s historic trump card


107 Id. at 1805.

108 Id. at 1808.
is the race-to-the-top argument, but recent history challenges whether favoring managerialism is the optimal strategy for regulating the corporation. Amidst corporate scandal and economic downturns over the past decade, managerialism has garnered much scrutiny and created agency issues. The solutions for these agency relationship problems, which were inspired by the work of Michael Jensen and William Meckling, appear insufficient to cope with managerial opportunism as well as responsible risk management.

This section explores the writing of one of Delaware’s most loyal defenders: Stephen Bainbridge. Bainbridge defends Delaware while simultaneously distancing himself from managerialism. Bainbridge claims that American directors are undergoing a transformation, becoming more than de facto rubber stamps for managerial power. He has developed a theory he calls “director primacy,” which re-invents the manageralist position in a way that can appeal to both managerialists and anti-managerialists. By taking the shareholder/manager dichotomy and splitting it into a shareholder/director/manager trichotomy, Bainbridge places corporate directors firmly in the middle of the struggle between ownership and control. The brilliance of this position is that it personifies what Delaware’s corporate law has de jure attempted to enforce since the rise of the modern corporation. The weakness in Bainbridge’s argument, however, is that history proves that American directors have not always lived up to the model of corporate governance.

If American directors are becoming more loyal to shareholder concerns, then director primacy is the driving force in a coup d’état in American corporate governance. However, those skeptical of Bainbridge will argue that this shift is not occurring and that his director primacy argument is no more than managerialism with a twist, albeit a clever twist that distances his position from the criticism of managerialism, while still sustaining the status quo in American corporate governance. And to a degree this criticism is fair – the ends of Bainbridge’s director primacy position are still the same as those of managerialism in

111 See BAINBRIDGE, supra note 64.
112 Id.
one important respect: both empower managers, at least until such time as the boards of America’s large public corporations start behaving in the manner that Bainbridge projects they will.

Even with federal initiatives to bolster director independence, Bainbridge himself acknowledges the *Panoglossian* nature of being optimistic about the present potential for director primacy. For example, he fully recognizes the problem of directors side-stepping their accountability to important constituents, such as shareholders.113 And yet, just under the surface of American corporate law (which has always enshrined director primacy in a “wink-wink, nudge-nudge” sort of a way) may be another managerial revolution114 which will blur the classic distinctions between shareholder/manager and managerialist/anti-managerialist by encouraging the board of directors to take their duties more seriously. The director primacy norms may cause directors to start standing up to the special interests of managers and protecting shareholder interests more diligently. As a result, this may foster a better relationship between ownership and control and help resolve some of the serious agency issues that exist today.

B. Bainbridge’s Director Primacy

The necessary shift in corporate governance, which can make director primacy transcend from theory into business reality and become the dominant model, will occur when boards of directors become more than mere rubber stamps for CEOs and other top executives. Bainbridge claims that this shift has commenced, arguing that directors are finally about to seize the mantle of power that corporate law has for so long reserved for itself.115 However, until this time, directors have rarely been

113 *Id.* at 98-99, 103-04, 192-94, 200, 233.


115 See BAINBRIDGE, *supra* note 64. For examples of the development of director primacy, see Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1 (2002) (this is an introduction to the conceptual foundation for his theory of director primacy) [hereinafter
separated from “managers” in the managerialist forum, and for good reason since directors are rarely distinguishable from corporate executives in their decision making choices.\textsuperscript{116} For this reason, beneath Bainbridge’s director primacy lays a contentious theory that a functional revolution is occurring in American corporate governance. This functional revolution may or may not be happening and is difficult to substantiate, but if Bainbridge is correct, then director primacy will mark a historic shift in governance away from Chandler’s model of managerialism (which has dominated corporate thinking throughout the twentieth century) toward the board-centered fiat model, which director primacy endorses.

In promoting director primacy, Bainbridge strongly advocates Delaware’s off-the-rack default statutory model of corporate governance which protects the board’s authority against direct shareholder influence in day-to-day decision making. In fact, it has even been suggested that Bainbridge advocates a more pro-board position than even Delaware dares.\textsuperscript{117} He describes how Delaware’s corporate law protects the primacy of the directors to govern the corporation, asserting that this doctrinal position sits well with prevailing corporate

\textit{Bainbridge, Nexus of Contracts}; see also Stephen M. Bainbridge, \textit{Director Primacy: The Means and Ends of Corporate Governance}, 97 NW. U. L. REV. 547 (2003) (revisiting director primacy, including: decision-making by fiat; the primacy of the board of directors over shareholders and managers; the relationship between the director primacy model and the nexus of contracts model; and the importance of centralized decision-making for efficient corporate governance by balancing the need for balancing authority and accountability within corporate regulation).

\textsuperscript{116} For instance, read The Economist’s claim that directors are the lapdogs of managers on the critical issue of executive compensation: “…many bosses in other industries are overpaid because weak boards have allowed them to dictate the terms of their compensation. As a result, pay bears little relationship to performance and tends to rise inexorably. A chief critic of the supposed corporate gravy-train is Warren Buffett. At the annual meeting of his holding company, Berkshire Hathaway, on May 2nd the legendary investor railed against a system that lets chief executives choose the members of remuneration committees. This, he claimed, allows them to select compliant directors prepared to wave through pay proposals. ‘These people aren’t looking for Dobermans,’ he complained. ‘They’re looking for cocker spaniels.’” \textit{Attacking the Corporate Gravy Train}, THE ECONOMIST, May 28, 2009.

\textsuperscript{117} For more detail on this argument, see Brett H. McDonnell, \textit{Professor Bainbridge and the Arrowian Moment: A Review of The New Corporate Governance in Theory and Practice}, 34 DEL. J. CORP. L. 139 (2009).
theory. In particular, he contends that Delaware’s director primacy fits nicely with the contractarian concept of the firm. Bainbridge explains that decision making by fiat, which the board represents, is where the nexus of contracts meet and where the decision making power about how to manage this nexus is most efficiently allocated.

Bainbridge explains that there will always be a need to balance the authority and accountability of directors, but the complexities and demands of managing this nexus suggest that careful consideration must be taken before limiting the authority of the board. He warns that there is a great danger that limiting board authority will stifle the corporation’s ability to innovate. Bainbridge offers a number of arguments for broad directorial discretion, possibly providing his best defense of Delaware’s allocation of authority to directors (which may be at the expense of greater shareholder empowerment). However, if what he contends is true, this broad discretion is ultimately in the shareholder’s best interest.

Although Bainbridge argues that corporate boards do (and should) have final authority over decision making, his arguments also align with the shareholder primacy position: that such decision making authority must be for the sole benefit of shareholders. He justifies this position normatively by using the dubious majoritarian default model. This model suggests that the shareholder wealth maximization norm is what all stakeholders of the firm ultimately want because default rules that pander to management are inefficient – increasing the cost of capital, creating greater vulnerability to hostile takeover, and negatively affecting the overall health of the corporation. The distinction that Bainbridge makes between director primacy and shareholder primacy is that the advocates of shareholder primacy extend their backing of shareholder power beyond the shareholder wealth maximization norm by pushing for shareholders to have more direct control over the day-to-day affairs of the firm. Director primacy advocates argue only the shareholder wealth

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118 BAINBRIDGE, supra note 64, at IX–XII.
119 See Bainbridge, Nexus of Contracts, supra note 115.
120 BAINBRIDGE, supra note 64, at 32–35.
122 BAINBRIDGE, supra note 64, at 124–26.
123 For more details read Bainbridge’s relevant arguments, see BAINBRIDGE, supra note 64, at 45-75.
maximization norm.

Putting the collective action problems of a widely dispersed shareholder class aside, Bainbridge suggests that directors, who are motivated primarily by the shareholder wealth maximization norm, will more vigilantly care for the firm’s wellbeing for the benefit of shareholders than direct shareholder empowerment.124 One reason for this is the ease with which shareholders can exit the firm. Such unattached shareholder influence can shift the firm’s focus to short-term, ill-informed, and/or self-serving goals that can possibly corrupt prudent corporate strategy over the long-term. Another reason for endorsing director primacy is that such direct shareholder empowerment would serve only to endorse the special interests of those who have power within the shareholder class: institutional investors.

Bainbridge justifies why authority ought to rest with the board of directors within the corporate governance structure by arguing that a governance group (that acts collegially) is superior to a single autocrat at the apex of the corporate governance hierarchy.125 In making this argument, he offers evidence from the behavioral economics literature which explains why group decision making is of higher quality than individual decision making.126 This leads Bainbridge to conclude that corporate boards are more effective at monitoring corporate governance than a single autocrat, and thus the fiat model is generally the best option.127

The main problem with the fiat model remains: who watches the watchers? In other words, who keeps the board of directors from being poisoned by groupthink and/or other forms of collective action failure? And who keeps the board of directors from social loafing and/or other serious opportunistic behavior? Bainbridge’s answer is the board itself.128 The arguments justifying this answer are at best hopeful. The optimism of his

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124 Id. at 55-57.
125 Id. at 78-79.
126 For more details read Bainbridge’s relevant arguments, see id. at 82-104; see also Stephen M. Bainbridge, Why a Board? Group Decisionmaking in Corporate Governance, 55 VAND. L. REV. 1 (2002) (exploring why the default statutory model of corporate governance promotes a governance group that acts collegially, using evidence from the behavioral sciences to help explain why group decision-making is generally superior to individual decision-making).
127 Bainbridge, supra note 64, at 104.
128 Id. at 75-78.
answer may make some hardened anti-managerialists smile cruelly at the lack of realism that one must embrace to wholeheartedly be at ease with the potential of directors self-monitoring.

To be fair, this is a serious problem with no easy answer; and to his credit, Bainbridge attacks it directly. Ultimately, though, his arguments are more sound regarding the avoidance of collective action failure than they are regarding the avoidance of opportunistic behavior. Albeit, the group dynamic makes opportunism less attractive for one individual within the group than it would for an all-powerful autocrat with no equals. That said, the suggestion that social norms (like reputational cost and the virtues of the communal life within the boardroom) will prevent the board from acts of opportunism at the expense of all other constituents of the firm may be too sweet for some intimate observers of director politics to swallow.

Bainbridge suggests that a key problem for corporate governance is locating the appropriate balance between providing enough authority for the board to govern the firm in an efficient manner, while not providing so much discretion that authority becomes unreviewable, uncorrectable, and ultimately unaccountable. Therefore, at one extreme, efficiency demands that board decisions are shielded from shareholders and courts; otherwise, optimal risk-taking will be discouraged and the internal team governance structure could be seriously compromised by the fear of hindsight review.

What about the courts protecting shareholders from extensive director discretion? Bainbridge reasons that shareholders are protected from “optimal” risk-taking by the dual functioning of limited liability and portfolio diversity. At the other extreme, if directors flagrantly violate their obligation to maximize shareholder wealth, the threat of judicial accountability must come out as a deterrent for corporate irresponsibility. However, this is not an easy balance to strike. Bainbridge warns that judges must use caution because they are not business experts, and because hindsight can make decision making look more irresponsible when the consequences of those decisions are known to have been negatively magnified.

In determining the balance to be struck between authority and accountability, Bainbridge sides with the *Unocal Corp. v. Mesa Petroleum Co.* case, which provides a conservative

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129 *Id.* at 153.
130 *Id.* at 115.
interpretation of the application of the business judgment rule.\textsuperscript{131} The \textit{Unocal} interpretation views the business judgment rule through the lens of the doctrine of abstention. This interpretation suggests that the business judgment rule allows the courts to go no further than to assess whether a board was disinterested and independent in their decision-making process (good faith) and that the decision-making process was reasonable (sans gross negligence).\textsuperscript{132} Thus, Bainbridge endorses a presumption in favor of strong judicial deference to board decisions as long as there is some evidence of good faith and competence. He ultimately justifies this position by reasoning that directors cannot be made more accountable without compromising their authority, leading to less-than-optimal risk-taking.\textsuperscript{133}

The key to director primacy, therefore, is establishing that directors are becoming agents of change by: 1) severing their more or less exclusive loyalty to “managers;” 2) championing the rights of all shareholders; and 3) forging further corporate governance. It is here that director primacy either lives or dies by the sword, for when Bainbridge attacks managerialism as inadequate he is indirectly challenged to establish how the distinction drawn between managerialism and his director primacy is in fact defensible.

Before Bainbridge, most traditional managerialists assumed that their readers understood that directors were included in the term “managers” because no clear distinction between the decision making outcomes of directors and senior executives was thought to exist. One major reason for this predetermination was that the CEO was generally the office where actual power consolidated in public corporations. In practice, the CEO had tremendous control over: 1) who would be on the ballot for board elections; and 2) the flow of information from corporate operations to the board. Many times, the CEO was on the board (if not the chairman of the board), making frank discussions about managerial performance during board meetings difficult at best. Thus, the CEO accumulated a great deal of power to manage the corporation. So much that if there was one individual that Bainbridge had in mind in his comparison between group decision making and individual decision making, the CEO would

\textsuperscript{131} Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 947 (Del. 1985).
\textsuperscript{132} For full analysis of the Unocal test, see Bainbridge, supra note 64, at 137-40.
\textsuperscript{133} Id. at 153.
likely be that individual as he or she has historically been the corporation’s best approximation of the single autocrat at the apex of the corporate governance hierarchy. In fact, it is not always clear how much the influence of the CEO has changed in the day-to-day function of the corporation.

When Bainbridge looks to the future of corporate governance in America, he sees two competing models: shareholder primacy and director primacy.134 He petitions for greater vigilance in the face of today’s pressure to extend the shareholder franchise.135 Bainbridge notes that, although shareholders are the sole beneficiaries of corporate governance and although directors have a duty to enforce shareholder wealth maximization, there is very good reason why shareholder power is so limited.136 He argues that shareholder primacy is a flawed account of American corporate governance and, accordingly, in appreciating the reasons for this, director primacy emerges from the cries that proclaim greater shareholder primacy is the enlightened path for corporate governance.137

Bainbridge contends that no shareholder empowerment amendments are needed in order to ensure that the American corporate governance model optimizes shareholder protection.138

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135 Id. (Clarifying that most scholars in the convergence debate assume that American corporate law primarily promotes shareholder primacy, when it actually promotes director primacy, warning that such confusion may have serious consequences when transplanting the American model into recipient jurisdictions); see also Stephen M. Bainbridge, *Shareholder Activism and Institutional Investors*, UCLA Sch. of L., Law-Econ Research Paper No. 05-20 (Sept. 2005) available at SSRN: http://ssrn.com/abstract=796227 (warning of the dangers of greater institutional investor activism, arguing that such investors are motivated by narrow interests that may undermine passive investors and compromise the effectiveness of the board to make decisions in the best interest of the firm); Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006) (petitioning for greater prudence before extending the shareholder franchise, defending why only shareholders have voting rights and then defending why such voting rights are so limited); See Bainbridge 2006, supra note 105 (responding to Lucian A. Bebchuk’s article entitled: *The Case for Increasing Shareholder Power*, rejecting Bebchuk’s proposals for allowing shareholders to have greater voting power so that they can change a firm’s basic corporate governance arrangements, defending existing regime of limited shareholder voting rights).

136 BAINBRIDGE, supra note 64, at 233-35.

137 Id. at 235.

138 Id. at 234-35.
He argues that director primacy satisfies this objective by ensuring that corporate governance abides by the shareholder wealth maximization norm. He warns that shareholder primacy urges policy-makers to grant shareholders additional powers to exercise direct control over the corporation, but this will prove to be detrimental to the shareholder class as a whole. This is because special interests (institutional investors), which have consolidated power within the shareholder class, will exploit these additional powers at the expense of weaker shareholders.

Within the existing corporate governance order, Bainbridge suggests that shareholders are happy to be rationally apathetic because it is easier to exit than it is to fight. He contends that this is true even for institutional investors because of: 1) the costs of monitoring corporate activities and engaging in activism; 2) the frequency of free riding on such efforts; and 3) the marginal gains that result from such activism. Bainbridge asserts that the apathy of shareholders is normally a good thing because when institutional investors are motivated to interfere with corporate governance, they usually do so in order to champion their narrow interests which undermine shareholders’ interests as a whole and hamper the ability of directors to make decisions in the best interest of the firm.

There are a number of existing vehicles for shareholder activism including: 1) exit; 2) proxy contests; 3) withholding votes in director elections; 4) shareholder proposals; and 5) private negotiations between institutional investors and corporate management. Bainbridge asserts that shareholder primacy advocates view these vehicles as inadequate and that they promote expansion of the shareholder franchise by: 1) reforming the director nomination process; 2) reforming the mechanics of the voting process; and 3) expanding the substance of what shareholders can vote upon. Bainbridge flatly rejects that the expansion of shareholder voting rights would be prudent, reinforcing his main argument which calls for adherence to the status quo. Ultimately, he reminds his reader that one should not take lightly the dangers of interfering with board authority for

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139 Id. at 234.
140 Id. at 228-32.
141 Id. at 228-30.
142 Id. at 202.
143 Id. at 208.
144 Id. at 209.
145 For more detail on these mechanisms of shareholder voice, see id. at 209-22.
the sake of greater accountability because “the preservation of managerial discretion should always be [the] default presumption.”

The biggest test for the canonization of director primacy is whether it is simply a semantic technique to maintain the defense of the professional bureaucracy that runs the corporation or whether the function of the board can be established as changing. If the behavior of “managers” (excluding directors) is what shareholder primacy advocates are up in arms about, and if directors are really the true champions of the whole of the shareholder class, then director primacy might be the “Third Way” of corporate governance. However, if the distinction between managerialism and director primacy cannot stand the test of the Devil’s Advocate, and directors cannot be established to be different than “managers,” this theory will fail to be convincing as a new path for corporate governance.

For this reason, the stakes are at their highest when Bainbridge makes the case for the distinction between directors and managers in the post-Enron function of the American board of directors. Although Bainbridge argues that director empowerment started much earlier than the enactment of SOX and other amendments to the listing requirements of various American stock exchanges, his position is that these legal changes have finally tipped the scales as directors are now starting to enjoy enough freedom from executive officers to be able to independently exercise authority over the corporation.

Bainbridge’s narrative of the shift from managerialism to director primacy is persuasive to read. He discusses the director’s evolving role from being the rubber stamps of CEOs to potentially having a legitimate monitoring function. He explains how starting in the 1970s, the pressure mounted to improve what was seen at that time as the board’s failure to rein in the excesses of executive officers and improve management’s performance. From this arose the recognition of the important role that independent directors could play within the corporate governance structure. He explains how post-Enron developments

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146 Id. at 235.
148 BAINBRIDGE, supra note 64, at 198-200.
149 Id. at 198-200.
have bolstered a director’s ability to police managers for shareholders by: 1) improving best-practice norms; 2) strengthening the threats to a director’s reputation for turning a blind eye to managers running roughshod over shareholder interests; 3) increasing judicial pressure for better information flow from management to directors; and 4) increasing requirements for more independent directors on boards.\textsuperscript{151}

Bainbridge’s argument is weaker when he fails to provide strong empirical evidence that these changes are creating “strong, active independent directors with little tolerance for negligence or culpable conduct.”\textsuperscript{152} Again, there is little empirical evidence to support his claims that this functional shift is, in fact, occurring.\textsuperscript{153} In the end, Bainbridge sounds like E. Merrick Dodd, Jr. who, in his reply to Adolf A. Berle, Jr., merely employed optimism for the new generation of managers.\textsuperscript{154} They are both very optimistic about the potential of a bureaucratic revolution, an event which would transform the ruling fiats of the great American corporations into group decision making centers and, thereby, helping manage the economy in a manner that is more beneficial to society.\textsuperscript{155} Both arguments are inspiring, but also lack substance and amount to no more than corporate futurism.

In the end, even in his best argument for director primacy to date, Bainbridge makes quite a weak statement arguing that the “real world practice” of directors is still “supine,” but is “closer to the director primacy model than it was in earlier periods.”\textsuperscript{156} One must respect Bainbridge’s candor on this point but it does lay bare what might be the dangerously un-secret weakness of the otherwise invulnerable Siegfried-like argument.\textsuperscript{157}

\textsuperscript{151} BAINBRIDGE, supra note 64, at 176-87.
\textsuperscript{152} Id. at 198.
\textsuperscript{153} Id.
\textsuperscript{154} E. Merrick Dodd, Jr., For Whom Are Corporate Managers Trustees?, 45 HARV. L. REV. 1145, 1146, 1148, 1151-53, 1165-67 (1932).
\textsuperscript{155} Id. at 1148.
\textsuperscript{156} BAINBRIDGE, supra note 64, at 200.
\textsuperscript{157} For the story of dragon-slayer Siegfried, which inspired Richard Wagner’s “Der Ring des Nibelungen,” see SONG OF THE NIBELUNGS: A VERSE TRANSLATION FROM THE MIDDLE HIGH GERMAN NIBELUNGENLIED (Frank G. Ryder trans., 1962).
VII. Reflections on the Battle for Delaware: Form or Substance?

Strine was obviously opposed to more federal meddling within Delaware’s national corporate law regime and Bainbridge was clearly a defender of the Delaware status quo. But by encouraging greater federalization of corporate law, Bebchuk appeared willing to risk Delaware’s caucus and the American corporate law status quo in order to gain greater shareholder engagement. Although Bebchuk did not appear to want to open the Delaware arrangement to the flood of other interests that might follow the federal government into the internal affairs of the corporation, he was willing to risk it.

In *The Case for Increasing Shareholder Power*, Bebchuk used empirical evidence to establish that the power between directors and shareholders of larger American corporations with dispersed ownership was too unbalanced, as it blocked shareholders from maximizing shareholder value when management refused to cooperate. 158 Bebchuk argued that allowing shareholders to be directly involved in corporate decision making would enhance corporate governance by motivating management to be more cooperative because shareholders had the power to directly intervene. With respect to the reformation process, Bebchuk predictably stated that it should be through federal intervention. 159

Bebchuk’s writing indicated that he did not want to open the floodgates beyond shareholders and managers to other interests that influenced the federal government. 160 If he did not want these populous interests to start meddling in the internal affairs of the corporation, what was he doing? Doubtless, he was familiar with Roe’s position on the matter, so maybe he: 1) did not believe that his petition for federal involvement seriously threatened the Delaware caucus; 2) did not care if the Delaware caucus was threatened (if managers monopolized it); or 3) maybe he was using the Cary card as leverage to up the stakes and, perhaps, make Delaware concede without federal intervention. Regardless, the Cary card caused different reactions which were interesting to observe. In response to Bebchuk’s proposal, Strine suggested that the traditionalist investor would prefer the status quo to what Bebchuk proposed. 161 This was because the

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158 Bebchuk, supra note 64.
159 Id. at 874.
160 See Bebchuk, supra note 64.
161 Strine, supra note 64, at 1775.
traditionalist investor would fear that Bebchuk’s proposal might subvert their interests by compromising managerial authority.\textsuperscript{162} If managerial authority was undermined, institutional intermediaries with no interests to serve but their own would further compromise the corporate governance structure. Strine suggested that the traditionalist investor would thus “leave things where they [stood] even if the status quo [was] not ideal.” \textsuperscript{163} But Strine still entertained Bebchuk’s proposal (with some slight reframing) in order to be “open-minded” to the idea that the traditionalist investor “might embrace reform that [was] consistent with Bebchuk’s call for greater managerial accountability.” \textsuperscript{164} Strine bit Bebchuk’s bait, but why? The answer came when Strine asserted: “Therefore, if reform attractive to the traditionalist is to come, it must emanate from state policymakers who can implement a reform that coheres with an overall approach to corporate law.” \textsuperscript{165} Strine longwindedly made this argument but he reinforced his key point: whatever amendments needed to be made, Delaware and not the federal government needed to make them.\textsuperscript{166}

Strine offered hope to Bebchuk that there might be flexibility on the issue of shareholder empowerment but Delaware needed to be the innovator, not the federal government, because state competition must be preserved. It made sense that, if the choice was between Delaware (form) and the status quo (substance), Strine would advocate sacrificing some substance and managerial power and protect Delaware’s de facto preeminence. If this situation was to arise it would be ideal for Bebchuk because it would maintain Delaware’s influence while increasing shareholder influence within the political caucus.

As one might expect, Bainbridge opposed Bebchuk’s proposal by employing the race-to-the-top argument.\textsuperscript{167} He argued that existing corporate law was optimal because it survived the competitive forces of the charter market.\textsuperscript{168} He then made his director primacy argument defending why this model was the appropriate model to protect shareholder interests.\textsuperscript{169} He concluded that, since director primacy was the superior model
and since Delaware’s default rules already enshrined director
primacy, no reform was necessary.\textsuperscript{170} The bottom line was that
Bainbridge rejected any changes to the form or the substance of
Delaware’s law and lawmakers capacity.

In sum, within the battle over corporate governance, there
appears to be an impasse which allows managers to have the
luxury of a heavy hand in shaping its evolution. Bebchuk,
champion of the shareholder and, to a lesser degree, of Cary, is
unhappy with this state of affairs and is petitioning federal
intervention to shake things up. Strine, champion of Winter and,
to a lesser degree, managerialism, is happy with Delaware’s
position as the manufacturer of “national” corporate law but
appears willing to negotiate with Bebchuk’s position. And
Bainbridge is the warrior of the Delaware status quo and is
deeply entrenched in his position. Or is he? For, although he
initially attacked creeping federalism, he now uses the provision
of SOX and the amendments to listing requirements to support
his director primacy argument.\textsuperscript{171} This might suggest that his
race-to-the-top argument gives way at times to pragmatism, as
does Strine’s defense of the Delaware status quo.

VIII. Conclusions

The power to influence the development of the corporate
charter within the Delaware caucus is the power to potentially
influence Granovetter’s actual and ongoing social networks
inside and outside of the corporation and, hence, underscore its
embeddedness. The above narrative highlights the levels of
contention between managers and shareholders for control over
future reforms. To date, managers have dominated the caucus
marginalizing efforts by shareholder advocates who want other
shareholders to have greater direct participation within
America’s corporate governance structures. Historically, the
Delaware caucus has weathered tremendous economic
transformations remaining relatively unchanged when compared
to the reforms Britain and Australia took over the last twenty-five
years.\textsuperscript{172} Delaware has been less prone to amendment partly
because its corporate law regime is regarded to be the result of an

\begin{footnotes}
\item[170] Id.
\item[171] BAINBRIDGE, \textit{supra} note 64, at 176-87.
\end{footnotes}
innovative and inspirational regulatory lab which harnesses the power of state competition.173

With a view to the still-open questions regarding state competition, Bebchuk petitioned for more federal intervention, challenging whether the market for charters inspires the optimal lawmaking which is claimed to exist. He called for greater power-sharing between the federal and state governments in this process, hoping this would crack open the Delaware caucus and result in more direct shareholder influence over corporate decision making. In response to Bebchuk, Vice Chancellor Strine argued that greater power-sharing with the federal government would be a mistake because Delaware’s regulatory machinery was not influenced by managers to a degree that would prevent greater shareholder participation within corporate governance (if such reforms were what shareholders really wanted and what American corporate governance really needed). Meanwhile, this dialogue between two highly regarded and influential discourse participants – the Vice Chancellor of Delaware’s Court of Chancery and America’s top legal academic advocate of shareholder empowerment – has been unsettling to the avid champions of Delaware’s present status quo.

Confidence in Delaware, like that heralded by Professor Bainbridge, has made American corporate observers less likely to look beyond national borders for inspiration in corporate reforms and also less likely to assume that such reforms are necessary.174 In this way, the charter competition argument has been very successful at maintaining a status quo in which corporate managers have greater control over corporate governance policy than similar managers have in either Britain or Australia – countries that have both seen an increase in the participatory rights of shareholders.175 However, American corporate governance can be said to be in transition as there has clearly been a shift of power away from the Delaware caucus in response to its “modest and incremental” approach to reform.176 Starting with the post-scandal regulatory responses (such as SOX), the federal government has been more willing to interfere with the presumed preeminence of the charter market.177 This may prove to be the harbinger of the demise of the monopoly which

173 Id. at 821-29.
174 Id. at 819-20.
175 Id. at 826.
176 Id. at 823.
177 Id. at 824-25.
Delaware has enjoyed for the past century, providing new opportunities to increase the participatory rights of shareholders.

Today, corporate managers are under attack for having failed to provide for adequate monitoring and oversight of their firms’ investments before the Credit Crisis. The situation has called into question the balance between managerial authority and managerial accountability. Eyes are on the capacity of state level legal mechanisms (in particular Delaware) to deal with these corporate governance failures. Meanwhile, federal reforms (such as “say on pay” and other shareholder empowerment initiatives) have either been established, or are in the works. Such federal interventions demonstrate a continued willingness to intercede in corporate regulatory development at the state level.

It is difficult to foretell the long-term impact of such federal interventions in the area of corporate governance. If this attitude prevailed, the federal government would likely face increased pressures from a number of interest groups – not just shareholder groups – pushing for further corporate governance reform. But is this a Pandora’s Box in the making? Alternatively, Delaware may want to answer to the sort of pressures that prompted the federal government’s activity in the first place. It seems that, either way, more shareholder participation rights in American corporate governance is a likely outcome.

The likelihood of such an outcome brings this argument full circle. As noted in the beginning, the British corporate governance expert Simon Deakin observed how Polanyi’s double movement had in recent times been off-set to favor market interests to the detriment of society, driven predominantly by the power exercised by investors in this era of financialization. Now, with the regulatory responses against the crisis still forthcoming, one of the questions arising out of the foregoing is whether increases in shareholder participatory rights are likely to further increase the movement toward the financialization of the firm in the American context? While only a few years ago we would have found it hard to see how it would not, the current crisis and the

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178 Id. at 841.
emerging regulatory responses might suggest otherwise. This uncertainty hints at the political stakes in the Delaware debate and beyond.

Of course, the issue is more complex. Greater shareholder participation may not be a bad thing. As Berle argued in response to Dodd in the classical American debate over managerialism, although shareholder empowerment may not be an adequate solution to managerial opportunism, enforcement of property rights is the only legal tool available to safeguard against it. But how much has changed almost eighty years later? In 1932, Berle was hopeful that new theories in sociology would soon provide the support for legal innovations which would better regulate corporate governance . . . the law is still waiting.

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183 See A. A. Berle, Jr., *For Whom Corporate Managers are Trustees: A Note*, 45 Harv. L. Rev. 1365 (1932).