CREATING A STAKEHOLDER DEMOCRACY UNDER EXISTING CORPORATE LAW

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Much of the current debate in corporate governance is framed in terms of stakeholder versus shareholder forms of corporate governance. While one would find little debate that stakeholders' interests are important to any business, there is substantial debate regarding whether any stakeholder besides shareholders should have a formal role in corporate governance. What has been largely ignored in this debate is the issue of private ordering: since corporate law is largely enabling rather than mandatory, can stakeholder governance structures be voluntarily created within the current shareholder-centric default corporate law structure? This article argues that this is clearly the case, sets forth specific methods for how this can be accomplished, and discusses the implications this has for stakeholder democracy and other stakeholder-centric corporate law reforms which have been put forth.

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INTRODUCTION

It is well-established that for any corporation or business entity, there are multiple parties, commonly referred to as "stakeholders," who have an interest in the well-being of the entity and its business endeavors.[1] One would find little debate either in academic or professional business literature that to successfully manage a business, managers and boards of directors must consider, either directly or indirectly, the interests of these stakeholders.[2] There is substantial debate, however, regarding whether any

1. *See* R. EDWARD FREEMAN, ET. AL., Stakeholder Theory: The State of the Art, 30-50 (2010) (discussing the development of stakeholder theory throughout the business literature and the origins of the term).

2. *See, e.g.*, Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 12 Bus. Ethics Q. 235, 241 (2002) (arguing that business firms should follow the single objective of long-term market value maximization, but that

stakeholder besides the shareholders of a corporation should have any formal role in corporate governance and particularly whether their interests should ever be on equal or similar footing to those of the shareholders.[3]

Within the corporate governance literature, when discussions of stakeholder rights arise, the conversation almost invariably turns toward the norm of shareholder primacy and whether corporate law needs to be reformed to formally include other stakeholders in the decision-making hierarchy of the corporate entity.[4] The idea that non-shareholder stakeholders should have a formal role in corporate governance is commonly referred to as "stakeholder democracy."[5] The aim of this article is not to directly engage in that debate, not because it is unimportant or uninteresting but because it is well-worn and it is highly unlikely that any alternative mandatory corporate governance arrangement will displace the default assumption of shareholder primacy long imbedded in corporate law. Rather, the goal of this article is to focus on a topic that is related to this debate but far less discussed and arguably much more important: could a corporation with a formal governance role for multiple stakeholders, not just shareholders, be created under existing corporate law? That is to say,

this will not be accomplished unless the interests of all firm's stakeholders are taken into account because "it is obvious that we cannot maximize the long-term market value of an organization if we ignore or mistreat any important constituency.").

3. *See, e.g.*, Kent Greenfield, *Defending Stakeholder Governance*, 58 CASE W. RES. L. REV. 1043, 1044 (2008) (arguing that corporate governance should not be focused on shareholders only and that other stakeholders should have a role in the governance of the firm); *but see* George W. Dent, Jr. *Stakeholder Governance: A Bad Idea Getting Worse*, 58 CASE W. RES. L. REV. 1107, 1144 (2008) (arguing against stakeholder governance and stating: "Shareholder primacy—real shareholder primacy, not the counterfeit version we have now—is the corporate governance system that holders the greatest promise for both investors and employees.") (internal footnotes omitted).

4. *See, e.g.*, Kent Greenfield, *Proposition: Saving the World with Corporate Law*, 57 EMORY L.J. 948, 975-983 (2008) (arguing that stakeholder governance is a more optimal from of corporate governance than a shareholder-centric model, and advocating changes to corporate law to accommodate this); *see also* Anselm Schneider & Andreas Georg Scherer, *Corporate Governance in a Risk Society*, 126 J. BUS. ETHICS 309, 310 (2015) (arguing that corporate governance based upon shareholder primacy is inadequate and conceptualizing a more democratized form of corporate governance through both law and soft law); *see also* Peter Muchlinski, *Implementing the New UN Corporate Human Rights Framework: Implications for Corporate Law, Governance, and Regulation,* 22 BUS. ETHICS Q. 145,166 (2012) (discussing implementation of more stakeholder focused governance models almost exclusively in terms of changes to law, not voluntary stakeholder focus under existing corporate law).

5. Dirk Matten & Andrew Crane, *What is Stakeholder Democracy? Perspectives and Issues,* 14 BUS. ETHICS: EUR. REV. 6, 6 (2005) ("'Stakeholder democracy' is an intriguing idea. The basic proposition – that stakeholders participate in processes of organizing, decision making, and governance in corporations – is for many people an alluring prospect.").

can some measure of stakeholder democracy, or some other stakeholder-centric alternative to shareholder primacy, be voluntarily created under existing law without waiting for legal reform?

This is a question of critical importance because there are vocal advocates for stakeholder democracy who argue that managing the corporation in the interests of all stakeholders will result in more optimal societal outcomes.[6] The basic underlying logic of stakeholder democracy is an extension of stakeholder theory – if interests of multiple important stakeholder groups matter to the firm, then these multiple stakeholder groups, not just shareholders, should have an opportunity to engage in the governance of the corporation through some type of participation in decision making.[7] If such a form of corporate governance truly is superior to the dominant shareholder-centric position of corporate law, then businesspeople and lawyers alike should not wait for the law to catch up and force the adoption of stakeholder governance principles. Rather, companies should voluntarily begin to adopt such governance principles to the extent possible. Indeed, if stakeholder democracy is actually superior to the current corporate governance model, its voluntary adoption could at the very least be a source of competitive advantage for forward-thinking companies who adopt such an arrangement absent legal mandate and at best begin a revolution in corporate governance that leads to more inclusive and socially beneficial business organizations.

In this article, I address this previously ignored issue and argue that it is clearly the case that existing corporate law allows for the creation of corporate entities in which multiple stakeholders have a formal role in governance. Because modern corporate law consists largely (although not entirely) of default statutory provisions that can be modified by the corporate contract,[8] through creative drafting, a corporation can be arranged in such a way to give at least some governance authority to multiple stakeholders. This article further contributes to the literature by providing specific examples of corporate governance arrangements that can be utilized to create varying levels of stakeholder democracy under existing corporate law. Certainly through creative lawyering, even more could be imagined.

By focusing on what private actors are capable of under existing

6. *See, e.g.*, Schneider & Scherer, *supra* note 4, at 315 (advocating for a readjustment of the scope of corporate governance towards a stakeholder democracy approach to better allocate risk and legitimize business organizations).

7. *See* Matten & Crane, *supra* note 5, at 7-8 (discussing the emergence of stakeholder democracy from the broader concept of stakeholder theory).

8. *See* Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1553 (1989) (discussing how corporate statutes consist of both mandatory and default provisions, which govern a corporation's inner workings).

corporate law rather than focusing on how corporate law can be reformed to force new governance arrangements on private actors, more interesting questions regarding the nature of corporate governance and corporate law arise. If a stakeholder governed corporation can be created, why is it not commonplace that such corporations are formed? This lack of stakeholder governed corporations is particularly perplexing if stakeholder theorists are correct in their assertion that managing in the interests of stakeholders results in better financial results than the traditional shareholder focus.[9] If it is the case that managing for stakeholder welfare is value maximizing, why have market forces not resulted in corporate arrangements that emphasize stakeholder governance, as contractarians would predict?[10] Surely, shareholders would gladly give up a portion of the limited governance rights they have if they would receive higher profits in return. Rather than addressing this pressing issue, most stakeholder rights advocates continue to argue for a greater emphasis on stakeholder rights in corporate governance by insisting that existing corporate law either impedes or prevents considering stakeholder's interests in corporate decision-making.[11] This results in a misguided push for legal reform to require corporate entities to consider non-shareholder stakeholders in corporate governance rather than focusing on how private actors can

9. *See* Silvia Ayuso, et. al., *Maximizing Stakeholders' Interests: An Empirical Analysis of the Stakeholder Approach to Corporate Governance*, 53 BUS. & SOC'Y 414, 425 (2014) (conducting an empirical analysis of stakeholder engagement and firm financial performance and finding that across a sample of 426 firms engaging stakeholders has a significant positive effect on financial performance).

10. *See, e.g.*, Grant M. Hayden & Matthew T. Bodie, *Larry from the Left: An Appreciation*, 8 VA. L. & BUS. REV. 121, 125-26 (2014) (discussing the contractarian view of the firm, which states that corporations are networks of contracts and corporate law provides largely default rules which the parties are free to alter to reach corporate arrangements that are value maximizing).

11. Schneider & Scherer, *supra* note 4, at 315 (advocating for a readjustment of the scope of corporate governance towards a stakeholder democracy approach to better allocate risk and legitimize business organizations); *see also, e.g.*, Kent Greenfield, *The Third Way,* 37 SEATTLE U. L. REV. 749, 763 (2014) (arguing for the formal integration of stakeholders into corporate governance by expanding fiduciary obligations to all stakeholders of the firm); *see also, e.g.*, David G. Yosifon, *The Consumer Interest in Corporate Law,* 43 U.C. DAVIS L. REV. 253, 308-309 (2009) (arguing for the rights for consumers to vote in corporate elections, and also discussing granting other stakeholders the right to such a vote); *see also, e.g.*, Kent Greenfield, *Reclaiming Corporate Law in a New Gilded Age*, 2 HARV. L. & POL'Y REV. 1, 23-25 (2008) (arguing that changes to corporate law are necessary to overcome the problems created by shareholder primacy and that one such helpful change would be requiring corporations to consider non-shareholder stakeholder interests and to give these stakeholders a mechanism for electing representatives to the board of directors); *see also, e.g.*, David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L. J. 181, 228-29 (2013) (arguing that the norm of shareholder primacy needs to be changed to a to a multi-stakeholder governance model).

advance stakeholder governance under the existing legal regime.[12]

This article proceeds in three parts. Part I begins with an explanation of stakeholder theory and the related concept of stakeholder democracy, and discusses the role that the concept of stakeholder democracy plays in the discussion of management and corporation governance. Part II provides a brief discussion of the structure of modern United States corporate law and the role that private ordering plays in this structure, and sets forth different methods for how a stakeholder governed corporate structure could be created under this extant legal structure. Part II also addresses how a voluntary form of stakeholder governance is actually more consistent with the philosophical basis of stakeholder theory and is a superior method for addressing stakeholder rights than reforming corporate law to require stakeholder governance. Part III posits and analyzes various explanations for why we do not commonly see stakeholder governed corporations in spite of the fact that they are allowed by corporate law, and discusses the implications this raises for stakeholder theory and alternative corporate governance arrangements in general. Finally, this article offers concluding remarks.

I. STAKEHOLDERS AND STAKEHOLDER DEMOCRACY IN CORPORATE GOVERNANCE

Most modern calls for increased democracy in corporate governance share stakeholder theory as their intellectual starting point.[13] What has been referred to as "stakeholder theory" is actually more akin to a broad concept of corporate management and business ethics that has been applied in management and corporate governance settings in a myriad of ways.[14] This has led to some level of conflict among stakeholder theorists, as some argue the theory requires changes to the law to put at least some non-shareholder stakeholders on equal footing with shareholders while others have argued that the focus on stakeholder theory is managerial, and the theory is agnostic with respect to the legal norm of shareholder primacy.[15]

12. *Id*.

13. *See* Matten & Crane, *supra* note 5, at 7 (2005) (discussing how stakeholder democracy arose from the growth of stakeholder theory).

14. *See* Robert Phillips, R. Edward Freeman, & Andrew C. Wicks, *What Stakeholder Theory is Not*, 13 BUS. ETHICS Q. 479, 479-80 (2003) (discussing the conceptual breadth of stakeholder theory and noting that this breadth has left the theory open to misapplication and critique); *see also* John Kaler, *Differentiating Stakeholder Theories*, 46 J. BUS. ETHICS 71, 72 (2003) (discussing differences between different versions of stakeholder theory).

15. Phillips, et al., *supra* note 14, at 480, 491 ("The notion of strict stakeholder equality, application of the theory either to the entire economy or exclusively to large, publicly held corporations, and concerns with changes in the law and corporate governance

While stakeholder theory has grown to encompass many broad and sometimes divergent concepts, which some stakeholder theorists welcome,[16] it is possible to find certain common elements of this theory that virtually all forms of stakeholder theory conform to in some degree.

A. *General Tenets of Stakeholder Theory*

The core of stakeholder theory is that businesses have multiple constituent entities (termed "stakeholders") which can affect or are affected by the businesses' actions, and that these stakeholders' interests must be managed for the business to be successful.[17] Thus, stakeholder theory is often characterized as being opposed to the shareholder primacy model of the corporation, or at least opposed to a focus on shareholder wealth maximization as the proper objective of the corporation.[18] While individual stakeholder theorists may differ as to degree, stakeholder theory writ large is concerned with both distributive aspects of stakeholder management (who benefits from firm outcomes) as well decision-making aspects (which stakeholders get a say in managerial decision making).[19]

A common issue that arises when managing the various stakeholders

are common in the literature among stakeholder theory apologists and critics alike" but noting "discourse concerning the legal relationship between the organization and its stakeholders is welcome, but the theory does not *require* a change in the law to remain viable.").

16. *See* R. Edward Freeman, *Divergent Stakeholder Theory*, 24 ACAD. OF MGMT. REV. 233, 235-36 (1999) (discussing the value of diverging narratives of stakeholder theory, stating: "What we need is a conversation that encourages such divergent views, but one that quickly throws out those views that are not useful, not simple, and that do not show us how it is possible to live better.").

17. Freeman, et. al., *supra* note 1, at 9 (discussing the genesis of stakeholder theory and noting "People engaged in value creation and trade are responsible precisely to 'those groups and individuals who can affect or be affected by their actions' – that is, stakeholders.").

18. Phillips, et al., *supra* note 14, at 486 ("[S]takeholder theory, when applied to for-profit business organizations, is consistent with value maximization. We should distinguish, however, between value maximization and *maximizing shareholder wealth* or *stock value/share price*.") (emphasis in original); *see also* Kaler, *supra* note 14, at 71 ("What is common to stakeholder theory is fairly well established. Though compromises on both sides can obviously blur differences, the primary feature is generally taken to be contradistinctiveness from the stockholder (U.S.) or shareholder value (U.K.) conception of the company: the view that the ultimate purpose of a company should be serving the interests of its shareholders.") (internal citations omitted).

19. Phillips, et al., at 487 ("Who gets how much of the organizational outcomes pie is an important question, but so is who gets a say in how the pie is baked. Stakeholder theory is concerned with who has input in decision-making as well as with who benefits from the outcomes of such decisions. Procedure is as important to stakeholder theory as the final distribution.").

of a firm is that there will invariably be times when their interests will conflict.[20] When this happens, whose interests win out? Whose interests should the manager prefer? Critics of stakeholder theory point out that the theory provides no concrete answer to this critical question, resulting in managers having little to no accountability for their decisions.[21] Unlike shareholder primacy, which states that shareholder interests always predominate, stakeholder theory does not definitively say which stakeholder(s) the firm should distribute the most to and which stakeholder(s) should matter the most to managerial decision-making.[22] Thus, when faced with difficult business decisions, critics argue that stakeholder theory does not provide the same managerial certainty that a shareholder primacy view does – since shareholders are the ultimate beneficiaries of firm success, any trade-offs should be made in their favor.[23]

Earlier articulations of stakeholder theory answered this critique by stating that the world is a complex place that defies easy answers, and thus the role of the manager is to "balance" these stakeholders' interests without necessarily always preferring one particular stakeholder(s) to the others in every situation.[24] However, as the theory has developed, more recent

20. *See* Jensen, *supra* note 2, at 241 (discussing stakeholder theory and conflict among stakeholder interests and noting "Any theory of action must tell the actors, in this case managers and boards of directors, how to choose among multiple competing and inconsistent constituent interests.").

21. *See* Eric W. Orts & Alan Strudler, *Putting a Stake in Stakeholder Theory*, 88 J. BUS. ETHICS 605, 611 (2009) (arguing that stakeholder theory provides no guidance other than to "balance" stakeholder interests when they conflict, which is unhelpful to the decision maker); *see also* Joseph Heath, *Business Ethics Without Stakeholders*, 16 BUS. ETHICS Q. 533, 543 (2006) (discussing the problems with having managerial responsibility to multiple stakeholder groups, and noting that it creates "extraordinary agency risks" because of the potential conflicts between the various stakeholder groups).

22. *See* Eric W. Orts & Alan Strudler, *The Ethical and Environmental Limits of Stakeholder Theory*, 12 BUS. ETHICS Q. 215, 219 (2002) (noting that the broader the conception of who is a stakeholder becomes "the deeper the conflicts among stakeholder interests will become; the greater number of different stakeholders one recognizes, the more divergent and irreconcilable their interests.").

23. *See e.g.* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010) ("Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders."); *see also* Jensen, *supra* note 2 at 246 (noting this problem and arguing for an "enlightened stakeholder theory" that uses long-term market value maximization of the firm's stock, more similar to the shareholder model, as the single objective "tiebreaker" for decision making).

24. R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH, 53 (1984) ("[A]n organization which understands its stakeholder map and the stakes for each group, which has organizational processes to take these groups and their stakes into account routinely as part of the standard operating procedures of the organization and which implements a set of transactions or bargains to balance the interests of these stakeholders to achieve the organization's purpose, would be said to have high (or superior) stakeholder

articulations claim that a focus on the divergent nature of stakeholders' interests is misplaced.[25] Rather, the manager's task is to reframe these apparent conflicts to focus on the joint, cooperative nature of the stakeholders' interests.[26] By focusing on the joint nature of stakeholder relationships, the manager can first find ways to create value for all stakeholders without resorting to trade-offs between them.[27] Only after attempts at joint value creation have been exhausted should the manager then focus on trading-off between stakeholder interests.[28]

B. *Stakeholder Democracy in Corporate Governance*

Advocates of stakeholder democracy essentially argue that if stakeholder theory is correct in that shareholders have no greater claim to managerial attention than other stakeholders, then it stands to reason that management should be accountable to non-shareholder stakeholders in some manner similar to its accountability to shareholders.[29] In earlier stakeholder theory writings, it was common for stakeholder theorists to advocate for some form of stakeholder democracy as an integral part of stakeholder theory.[30] However, many, but not all, stakeholder theorists have moved away from calls for formal stakeholder democracy and have

management capability.").

25. *See* Freeman, et. al., *supra* note 1, at 27 ("Many thinkers see the dominant problem of stakeholder theory as how to solve the priority problem, or 'which stakeholders are more important?' or 'how do we make trade-offs among stakeholders?' We see this as a secondary issue.") (internal footnotes omitted).

26. *Id*. ("First and foremost, we need to see stakeholder interests as joint, as inherently tied together . . . Stakeholder theory suggests that executives try to reframe the questions. How can we invest in new products and create higher earnings? How can we be sure that our employees are healthy and happy and are able to work creatively so that we can capture the benefits of new information technology such as inventory control systems?").

27. *Id*. at 28 ("The primary responsibility of the executive is to create as much value as possible for stakeholders. Where stakeholder interests conflict, the executive must find a way to rethink the problems so that these interests can go together, so that even more value can be created for each.").

28. *Id*. at 28 ("If trade-offs have to be made, as often happens in the real world, then the executive must figure out how to make the trade-offs, and immediately begin improving the trade-offs for all sides. *A stakeholder approach to business is about creating as much value as possible for stakeholders, without resorting to tradeoffs*.") (emphasis in original).

29. *See* Brendan O'Dwyer, *Stakeholder Democracy*: *Challenges and Contributions from Social Accounting*, 14 BUS. ETHICS: EUR. REV. 28, 28 (2005) ("A successful stakeholder democracy relies on stakeholders being able to hold organisations to account for decisions impacting on their welfare.").

30. *See* Jeffrey Moriarty, *The Connection Between Stakeholder Theory and Stakeholder Democracy*: *An Excavation and Defense,* 53 BUS. & SOC'Y 820, 821 (2014) (discussing the early support for stakeholder democracy in the literature on stakeholder theory).

instead argued that stakeholder theory can be implemented within the shareholder-centric corporate governance framework that is currently the norm.[31]

Even though many stakeholder theorists have moved away from calls for stakeholder democracy and corporate governance reform in general, the topic remains active in corporate governance literature. Professor Moriarty has recently made the case that perhaps stakeholder theorists gave up too early on their calls for stakeholder democracy and formal corporate governance reform.[32] He argues that if one believes that directors should act in the interests of multiple stakeholders, they will be more likely to do so if they are held jointly accountable to these stakeholder groups rather than just to shareholders.[33] This argument certainly makes sense. If accountability is not important or necessary to incentivize directors to do their jobs properly, then one must wonder why corporate law currently gives shareholders the right to vote and imposes fiduciary duties on directors in favor of shareholders.[34] The same concerns that justify this arrangement under shareholder primacy would seem to apply to stakeholder theory.[35] Thus, while not considered the *sine qua non* of stakeholder theory, the idea of stakeholder democracy and stakeholder involvement in corporate governance remains alive and well, and the

31. *Id*. ("In recent writings, however, they claim that stakeholder theory does not require changing the current structure of corporate governance, which assigns the right to elect the board to shareholders only, and further claim to be 'agnostic' about the value of doing so.") (internal citations omitted); *see also* Phillips, et al., *supra* note 14, at 480, 491 ("The notion of strict stakeholder equality, application of the theory either to the entire economy or exclusively to large, publicly held corporations, and concerns with changes in the law and corporate governance are common in the literature among stakeholder theory apologists and critics alike" but noting "discourse concerning the legal relationship between the organization and its stakeholders is welcome, but the theory does not *require* a change in the law to remain viable") (emphasis in original).

32. *See* Moriarty, *supra* note 30, at 831-32 (discussing and arguing against stakeholder theorists' abandonment of stakeholder democracy as the proper governance arrangement of stakeholder theory).

33. *Id*. at 833 ("According to stakeholder theory, one stakeholder group's interests should not always take precedence over other stakeholder groups' interests; rather, their interests should be balanced. Thus, it seems preferable, from the point of view of this theory, for directors to be jointly accountable to all stakeholders than for them to be accountable to shareholders only, as is currently the case.").

34. *Id*. at 834 ("The value of accountability is reflected in U.S. corporate law . . . One of the reasons we expect directors to maximize shareholder value is that they are accountable to shareholders in periodic elections. Directors would have less reason to do what is in shareholders' interests if they were accountable to someone else.").

35. *But see* Joseph Heath, *Business Ethics and the 'End of History' in Corporate Law*, 102 J. BUS. ETHICS 5, 6 (2011) (discussing Henry Hansmann's argument for why shareholders are uniquely suited to be the party owed fiduciary duties by management because of both homogeneity of interest and costs of ownership).

business and law literature commonly addresses reforms to corporate governance to formally integrate stakeholders.[36]

To fully understand stakeholder democracy, it is important to address exactly what its proponents mean by "democracy." Democracy is a fluid concept and does not mean the same thing to all people.[37] Professors Hielscher, Beckmann, and Pies argue that there are two types of democracy which can be applied in the organizational setting, which they term "type I" and "type II" democracy.[38] Type I democracy refers to democracy as a specific principle of organization which focuses on participation by individuals in governance and decision-making.[39] In type I democracy, the focus is on issues such as broad voting rights and participation in the decision-making process as requirements for true democracy.[40] Type II democracy focuses on the core of democracy as the voluntary consent of the governed to the governance arrangement such that it is seen as legitimate, not active participation in decision-making per se.[41]

If an organization has type I democracy then it necessarily has type II democracy, as participatory rights in governance decisions by the individuals governed is simply a formal method for giving consent.[42]

36. *See, e.g.*, Schneider & Scherer, *supra* note 4, at 315 (advocating for a readjustment of the scope of corporate governance towards a stakeholder democracy approach to better allocate risk and legitimize business organizations); *see also* Greenfield, *supra* note 11, at 763 (arguing for the formal integration of stakeholders into corporate governance by expanding fiduciary obligations to all stakeholders of the firm); *see also* Yosifon, *supra* note 11, at 308 (arguing for the rights for consumers to vote in corporate elections, and also discussing granting other stakeholders the right to such a vote).

37. *See* Matten & Crane, *supra* note 5, at 9-10 (noting the varying definitions that can be given to "democracy" and that it can carry different meanings in different cultures and contexts).

38. Stefan Hielscher, Markus Beckmann, and Ingo Pies, *Participation versus Consent*: *Should Corporations Be Run according to Democratic Principles*, 24 BUS. ETHICS Q. 533, 534 (2014) ("[W]e refine the notion of democracy and distinguish between democracy as a specific principle of organization and democracy as a more general principle of legitimation.").

39. *Id*. at 536-37.

40. *Id*. at 536 ("In other words, organizational principles for fostering participation in decision-making and participation in deliberation are seen as the essence of democracy, which has an important consequence. If participation in decision-making and in discourse defines democracy, then the degree to which these organizational principles have been implemented defines the degree to which full democracy has been realized.").

41. *Id*. at 537 (explaining type II democracy and noting, "Here, the idea of self-governance does not so much involve formal characteristics of the democratic process itself, but, instead, the ability of those affected by collective decision-making to give, in principle, their *consent* to the process.") (emphasis in original).

42. *Id*. at 540 ("Seen in comparison, the organizational model of democracy is a narrower concept that can be subsumed under the more encompassing legitimacy model of democracy—but not vice versa").

However, type II democracy is a broader concept that can still exist even if type I democracy is not present.[43] This is because governed parties can voluntarily consent to an organizational governance arrangement in which they have no formal participation in decision-making.[44] For example, from the standpoint of a type I democracy, it may be undemocratic for the creditors of a business not to have any participatory rights in corporate governance. However, one could argue that type II notions of democracy have been fulfilled in the traditional creditor arrangement because the creditors consented to it by voluntarily lending the business money without receiving any participatory rights in return.

For purposes of this article, both type I and type II democracy will be addressed. Since notions of democracy exist on this continuum and corporate law is flexible enough to allow for a great variety of governance mechanisms,[45] both type I and type II democracy are relevant to the discussion of voluntarily implementing stakeholder democracy. For purposes of stakeholder democracy arising from stakeholder theory, virtually all of its advocates discuss democracy in the type I sense.[46] For example, Harrison and Freeman describe organizational democracy in business in terms of granting a broader set of people the right to influence decision-making in the organization.[47] Likewise, O'Dwyer describes the basic proposition of stakeholder democracy in terms of stakeholders having some ability to influence managerial decision-making.[48] In line with the literature in this area, this article will set forth methods for creating a corporate governance structure that is more democratic in this type I sense by allowing for formal participation by stakeholders in corporate governance.[49] However, the voluntary corporate governance structures set

43. *Id*.

44. *Id*. at 551-52 (noting that a concentration of decision power that reduces type I democracy can be advantageous enough to the parties involved that they consent to the arrangement, thus fulfilling the requirements of type ii democracy).

45. *See infra* Part II.

46. *Id*. at 543-46 (discussing how advocates of stakeholder democracy focus predominantly on type I democracy).

47. *See* Jeffrey S. Harrison & R. Edward Freeman, *Is Organizational Democracy Worth the Effort?*, 18 ACAD. MGMT. EXECUTIVE 49, 49 (2004) ("In a broad sense of the term, any action, structure, or process that increases the power of a broader group of people to influence the decisions and activities of an organization can be considered a move toward democracy. In contrast, any action, structure, or process that works to concentrate decision power and management influence into the hands of one or a smaller group of people is a move away from democracy.").

48. *See* O'Dwyer, *supra* note 29, at 29 ("[S]takeholder democracy is considered in an organisational as opposed to a political context and is conceived of as a means by which organisational stakeholders are enabled to influence managerial decisions substantially affecting their welfare.") (internal citations omitted).

49. *See infra* Part II. B.

forth in this article are not limited to strict, type I participatory democracy such as stakeholder voting rights.[50]

Notably, type I notions of democracy are not static, as participatory rights can be granted to stakeholders in varying degrees. For example, a "pure" type I organizational democracy can be imagined in which no action is taken without the vote of the affected parties.[51] However, such an extreme form of governance is not required to make a corporation more democratic for stakeholders, even in a type I sense, as stakeholders can be given some level of formal participation in governance even absent a direct, formal vote on decisions.[52] This can be accommodated through the unique and powerful role the board of directors serves in corporate governance.[53] Thus, in the corporate setting, corporate governance structures can rest on the democracy continuum somewhat between type I and II democracy. The type of organizational democracy represented by this structure is best explained in terms of the "team production model" of corporate governance, which is relevant to this article because it borrows heavily from stakeholder theory and represents a departure from traditional shareholder-centric principal/agent models of the firm.[54]

C. *The Team Production Model and Organizational Democracy*

In the team production model of corporate governance, the role of the board of directors is not merely to act as the agent of the shareholders to maximize their wealth, but rather to manage the firm-specific inputs of all stakeholders of the firm to coordinate their efforts and maximize productivity.[55] Under this theory, the various stakeholders of the firm are

50. *See infra* Part II. A.

51. Notably, such an organizational structure would almost certainly be undesirable in a corporate setting, as it would be extraordinarily difficult and unwieldy to make timely decisions in the modern fast-paced business environment.

52. *See* Harrison & Freeman, *supra* note 47, at 49 (noting that any move to increase the power of a constituency to have a hand in decision-making is a move towards democracy).

53. *See infra* Part II.

54. *See*, *e.g.*, Allen Kaufman & Ernie Englander, *A Team Production Model of Corporate Governance*, 19 ACAD. MGMT. EXECUTIVE 9, 10 (2005) (discussing their team production model of corporate governance and acknowledging its relationship to stakeholder theory); *see also* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 254 (1999) (arguing for a theory of corporate law where the board of directors acts as a mediating hierarch to manage the inputs of all stakeholders, not just serve as agents of shareholders).

55. *See* Brian R. Cheffins, *The Team Production Model as a Paradigm,* 38 SEATTLE U. L. REV. 397, 397 (2015) (noting that, under the team production model of the corporation, the board of directors acts "as a mediating hierarchy that balances the interests of a corporation's various constituencies and does so in a way that successfully addresses, in the context of the publicly traded corporation, the challenges associated with fostering

willing to work in concert with other stakeholders to make investments in the firm through time, effort, money, or otherwise, because the board of directors acts as an independent, mediating hierarch to balance the interests of all of these stakeholders and to allocate the fruits of these labors appropriately while holding any shirkers accountable.[56] Thus, just as in stakeholder theory, the overriding goal of the firm is to maximize the productivity and value of the firm for the benefit of all stakeholders, not merely to maximize the wealth of shareholders.[57] The board of directors serves as the coordinator of the efforts of stakeholders to accomplish this goal.[58]

Advocates of the team production model indirectly call for a certain level of stakeholder democracy through diversity on the board of directors, albeit without always specifically using stakeholder democracy terminology.[59] These notions of democracy develop through board composition. Under a team production view of the corporation, the optimally constructed board of directors will be composed of members from various stakeholder backgrounds.[60] Unlike the views of some proponents of stakeholder democracy, this stakeholder presence on the board stems from instrumental concerns, not from notions of the right to democratic representation within the firm.[61] Rather, if the board of

productive activity requiring combined investment and coordinated effort."); *see also* Blair & Stout, *supra* note 54, at 280-81 ("Thus, the primary job of the board of directors of a public corporation is not to act as agents who ruthlessly pursue shareholders' interests at the expense of employees, creditors, or other team members. Rather, the directors are trustees *for the corporation itself*—mediating hierarchs whose job is to balance team members' competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together.") (emphasis omitted).

56. *See* Blair & Stout, *supra* note 54, at 277-78 (discussing the mediating hierarchy of the board of directors and noting that corporate stakeholders "enter into this mutual agreement in an effort to reduce wasteful shirking and rent-seeking by relegating to the internal hierarchy the right to determine the division of duties and resources in the joint enterprise").

57. *See id.* at 280-81 (noting that the primary job of the firm's board is to "keep everyone happy enough that the productive coalition stays together").

58. *Id.*

59. Kaufman & Englander, *supra* note 54, at 13 (arguing that the board of directors should be composed of a diverse group of stakeholders to enhance its decision-making abilities); *see also* Allen Kaufman & Ernie Englander, *Behavioral Economics, Federalism, and the Triumph of Stakeholder Theory*, 102 J. BUS. ETHICS 421, 427 (2011) ("Value creation, unique risk and strategic information comprise the basic categories for selecting corporate directors (coordinators) who can reproduce, in effect, the firm's core competencies – the firm's core stakeholders.") (internal citations omitted).

60. *Id.*

61. *See* Kaufman & Englander, *supra* note 54, at 13 ("Corporate stakeholder representation does *not* derive from democratic rights nor is the firm a democratic institution.") (emphasis in original).

directors is to act as a mediating hierarch to coordinate team member efforts and maximize productivity, the expertise brought to the table via a diverse group of stakeholders will increase the likelihood of value creation.[62]

The team production model, as originally envisioned by Blair and Stout, stops short of calling for true type I democracy, as it allows for shareholders to retain the right to elect directors and it does not necessitate legal reform to change this norm.[63] This is because, under the team production model, to best serve its function, the board of directors should be a neutral mediating hierarch and remain outside the strong influence of any particular stakeholder group who might try to influence the board to extract economic rents.[64] While granting voting rights to shareholders only would seem to give them preferable status and outsized influence over the board, under the current status quo in public companies, boards of directors are self-nominating and shareholders almost invariably elect the slate of directors put forward by the existing board, allowing the board to remain largely independent.[65] Thus, the current arrangement of shareholder voting does not cause concern for the team production model, but the lack of diversity of interests on most corporate boards does.[66]

This push for board diversity and movement away from a shareholder agency model of the firm represented by the team production model is in

62. *Id.* at 12 ("Rather than conceiving of boards solely as monitoring agents for shareholders, the team production model asks that the board replicate team members, both within and connected to the firm, who add value, assume unique risks, and possess strategic information in the corporation. When chosen by these three criteria, directors bring to the board the know-how by which the firm competes, the information required for engaging management in serious deliberations, and the expertise to evaluate managers on multiple performance standards.").

63. *See* Blair & Stout, *supra* note 54, at 327 ("Thus, at a normative level our story cautions against attempts to 'reform' corporate law either by contractarians who want to enhance shareholders' power over directors, or progressives who want to give other stakeholders greater control rights.").

64. *Id.* at 321-22 (discussing how the board of directors should remain largely independent from shareholder as well as stakeholder intervention in order to best serve its function).

65. *Id.* at 311 ("The net result is that shareholders in public corporations do not in any realistic sense elect boards. Rather, boards elect themselves. Once elected, moreover, directors almost always get to serve a full term free of shareholder control. Although shareholders can sometimes try to remove directors, the removal process is difficult at best, and subject to the same proxy rules and collective action problems.") (internal footnotes omitted).

66. *See, e.g.*, Bernard S. Sharfman & Steven J. Toll, *A Team Production Approach to Corporate Law and Board Composition*, 103 NW. U. L. REV. COLLOQUY 380, 388 (2009) (discussing how the team production model supports limiting the number of outside CEOs on boards of directors, which commonly represent a large number of the independent directors on many public company boards).

effect a call for a stronger form of organizational democracy than currently exists; somewhat between basic type II consent and type I direct participation rights.[67] Additionally, while not calling for voting rights, some proponents of the team production model have argued that the board of directors should owe fiduciary duties to certain stakeholders besides shareholders, which moves closer to type I participation rights via granting standing to stakeholders to bring a derivative suit.[68] Accordingly, while perhaps not as strong as the calls for democracy under certain branches of stakeholder theory, the team production model can also be interpreted as calling for more expansive involvement of stakeholders in corporate governance.[69] Thus, the methods set forth in this article to incorporate more stakeholder involvement in the board of directors can also be seen as a way to voluntarily create a more democratic corporate governance structure in line with this model of the firm.

D. *Legal Reform and the Instrumental Claims of Democratic Corporate Governance*

Whether based upon normative or instrumental concerns, it is unlikely that U.S. corporate law will be reformed to mandate stakeholder democracy any time soon. The prevailing norm of shareholder primacy is simply too strong and has become deeply embedded in the business and legal culture of the U.S.[70] However, this raises the issue addressed in this article, which has received little, if any, attention from advocates for stakeholder democracy. While some stakeholder theorists call for stakeholder democracy due to normative ethical concerns that rest upon notions of

67. *See supra* notes 38-53 and accompanying text (discussing type I and type II democracy).

68. *See* Gregory Scott Crespi, *Redefining the Fiduciary Duties of Corporate Directors in Accordance with the Team Production Model of Corporate Governance*, 36 CREIGHTON L. REV. 623, 634 (2003) (arguing, under the team production model, for fiduciary duties of care and loyalty to be owed to the entire enterprise and to be enforceable by each class of stakeholder); *see also* Thomas Clarke, *The Long Road to Reformulating the Understanding of Directors' Duties: Legalizing Team Production Theory?*, 38 SEATTLE U. L. REV. 433, 436 (2015) (discussing corporate governance in terms of both stakeholder theory and the team production model and calling for a reformulation of "corporate purpose, corporate governance, and directors' duties").

69. *See* Crespi, *supra* note 68, at 634 (arguing for extending decision making authority within the corporation to all classes of stakeholders).

70. *See*, *e.g.*, Matthew T. Bodie, *AOL Time Warner and the False God of Shareholder Primacy*, 31 J. CORP. L. 975, 977-82 (2006) (noting the strength of the norms of shareholder primacy and shareholder wealth maximization, and how they have gained broad acceptance in the legal and business academies).

fairness, right to representation, and accountability to stakeholders,[71] normative ethical reasoning is not the only basis for the push towards more democratic corporate governance. Many of the arguments for stakeholder democracy, from both stakeholder theorists as well as the watered-down version of democracy found in the team production model, are instrumental in nature— that a firm will be better managed and obtain better results under some level of stakeholder democracy.[72]

If the instrumental claims for more active stakeholder participation in corporate governance are valid, the more important question for advancing stakeholder democracy is not how to reform the law (a monumental and slow-moving task) but whether this allegedly superior form of corporate governance can be voluntarily enacted under current law. Because if so, and if stakeholder democracy truly is a more optimal way to manage a business, both entrepreneurial and established firms should be encouraged to implement these forms of governance without waiting for legal mandate. Furthermore, if stakeholder democracy can be voluntarily created, and I argue that it can, then stakeholder theorists need to address the inconvenient question of why market forces have not already resulted in such arrangements. To begin to address this issue, this article will next discuss the structure of corporate law in the United States, and set forth methods for how stakeholder democracy can be voluntarily created by for-profit corporations under this existing legal structure.

II. PRIVATELY CREATED STAKEHOLDER DEMOCRACY UNDER EXISTING LAW

In order to understand how stakeholder democracy can be created under existing U.S. corporate law, one must first understand its basic structure. In the United States, corporations are creatures of statute, created almost exclusively at the state level, with Delaware being the most popular state of incorporation.[73] These corporate law statutes create a web of rules,

71. *See*, *e.g.*, Moriarty, *supra* note 30, at 831-32 (discussing normative ethical grounds rooted in Kantian and Rawlsian ethics for stakeholder democracy).

72. *Id.* at 832-37 (making an instrumental argument for stakeholder democracy that because of biases, stakeholder interests will more likely be balanced if stakeholders can vote for directors); *see also* Shann Turnbull, *Stakeholder Democracy: Redesigning the Governance of Firms and Bureaucracies*, 23 J. SOCIO-ECONOMICS 321, 337-42 (1994) (setting forth various arguments for why integrating stakeholders into corporate governance can result in competitive advantages and corporate governance design criteria for doing so); Kaufman & Englander, *supra* note 54, at 13 (arguing for stakeholder representation on the board not because of democratic rights, but because the decision-making function of board of directors can best operate with a board composed of diverse stakeholders).

73. For ease of reference, and because of Delaware's preeminence in corporate law,

which set forth how private parties may form a corporation and how the corporation is to be governed.[74] Some of these rules provide mandatory requirements, which all corporations must follow.[75] However, most of these statutory provisions are simply enabling, and provide default rules that are subject to variation by the incorporator either in the certificate of incorporation or the by-laws.[76] This provides those creating corporations significant latitude in structuring a corporate form to meet their particular needs.[77]

Under the default arrangement of corporate law, commonly referred to as "shareholder primacy," the shareholders are the sole stakeholder group with the right to vote (most importantly for the board of directors), the sole stakeholder group which is owed fiduciary duties by the directors, and are considered the residual claimants of the successes of the firm through capital appreciation and dividends.[78] However, simply because this is the default arrangement of corporate law does not mean that it cannot be modified to grant power to other stakeholders fairly comparable to that wielded by the shareholders. This is largely because, within this framework, the true power center of the corporation is not the shareholders, but the board of directors.[79] While shareholders may be the residual

this article will utilize and reference only Delaware corporate law throughout as a proxy for modern United States corporate law. The provisions cited herein are common to modern United States corporate law, and thus similar or identical provisions are found in other states' incorporation statutes. Thus, the arguments made herein and the methods for creating a stakeholder governed corporation have broad applicability across the United States. Additionally, a citizen of any state may form a corporation under Delaware corporate law. *See* DEL. CODE ANN. tit. 8, § 101(a) (2011) (stating that any person or entity, "without regard to such person's or entity's residence, domicile or state of incorporation" may incorporate under Delaware corporate law).

74. *See* Gordon, *supra* note 8, at 1553 (discussing how corporate statutes consist of both mandatory and default provisions which govern the corporations inner workings).

75. *See* DEL. CODE ANN. tit. 8, § 102 (a) (2011) (setting forth the matters which must be set forth in the certificate of incorporation, such as the name of the corporation, its address, and the nature of its business or purposes); Gordon, *supra* note 8, at 1553 ("Nevertheless, many features of corporate law, great and small, are mandatory.").

76. *See* Williams v. Geier, 671 A.2d 1368, 1381 (Del. 1996) ("At its core, the Delaware General Corporation Law is a broad enabling act which leaves latitude for substantial private ordering, provided the statutory parameters and judicially imposed principles of fiduciary duty are honored.").

77. *Id.*

78. *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 550 (2003) (stating that "shareholder primacy models assume that shareholders both control the corporation, at least in some ultimate fashion, and are the appropriate beneficiaries of director fiduciary duties.").

79. *See Id.* at 559 (discussing the board of directors as the nexus of the firm and primary decision-making body); *see also* In re CNX Gas Corp. S'holders Litig., 4 A.3d 397, 415 (Del. Ch. 2010) (establishing that "[a] subsequent decision involving the same

claimants of the firm and possess a modicum of decision-making authority because of their right to vote for the board of directors, corporate law is clear that the actual decision-making authority rests with the board of directors and not with the shareholders.[80] Because so much power rests with the board, by creatively structuring the board, as well as the mechanisms by which membership on the board is determined, a corporation can be created whereby multiple stakeholders have representation to varying degrees.

A. *Stakeholder Representation Through Director Qualifications*

The simplest method for creating a modicum of stakeholder democracy in corporate governance is through prescribing membership qualifications for directorship. Corporate law specifically allows for setting director qualifications in either the certificate of incorporation or the bylaws.[81] Thus, to create a corporation whereby different stakeholder groups have representation, the corporate documents would simply need to be initially drafted or amended to reflect the stakeholder director qualifications desired.[82] For example, the certificate of incorporation could state that the corporation will have five directors with the following make-up: two directors who have no specific qualifications, one director who is a non-managerial employee or a union representative, one director who is a member of management, and one director who is a member of the board of directors of an environmental advocacy group that is important to the corporation. Of course, the size of the board and relevant stakeholder groups will vary by corporation. The important point is that there is nothing prohibiting any existing corporation from structuring their board in such a way.

It can be fairly argued that such a change to board structure does not represent a true stakeholder democracy, because the shareholders would still be the only party with the authority to vote for the directors.[83] Additionally, even if a director is a member of particular stakeholder group,

controlling stockholder recognizes that director primacy remains the centerpiece of Delaware law, even when a controlling stockholder is present.").

80. *See* DEL. CODE ANN. tit. 8, § 141(a) (2011) (establishing that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of the board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.").

81. DEL. CODE ANN. tit 8, § 141(b) (2011) ("The certificate of incorporation or bylaws may prescribe other qualifications for directors.").

82. *Id*.

83. *See id*. at § 211, 212 (recognizing stockholders as the only party entitled to vote, unless otherwise provided in the certificate of incorporation).

in discharging his duties as a director, he would still owe fiduciary duties only to the corporation and its shareholders, not to the stakeholder group of which he is a member.[84] Nevertheless, a board of directors with stakeholder group representation would represent a move *towards* stakeholder democracy-type governance in some very real and tangible ways.[85]

While the shareholders do have ultimate voting authority to elect directors, once the directors are elected the shareholders do not have the right to interfere with the directors' decision-making power.[86] Thus, the shareholders could not directly impose their will on the board of directors, giving such a stakeholder board significant autonomy in managing the corporation's affairs. Neither is the fiduciary requirement to "promote the value of the corporation for the benefit of its stockholders"[87] a strong impediment to stakeholder focused decision-making by such a board. Due to the business judgment rule, managerial decisions made by a board of directors are largely insulated from judicial review.[88] Provided that the board of directors can rationally link their decisions to the promotion of the corporation's best interest, the courts will not invade their decisions.[89]

84. *See, e.g.*, eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010) (stating that "[h]aving chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders.").

85. *See* Harrison & Freeman, *supra* note 47, at 49 (noting that, "[i]n a broad sense of the term, any action, structure, or process that increases the power of a broader group of people to influence the decisions and activities of an organization can be considered a move toward democracy.").

86. *See* Hollinger, Inc. v. Hollinger Int'l, Inc., 858 A.2d 342, 387 (Del. Ch. 2004) (explaining that "[t]he reality is that controlling stockholders have no inalienable right to usurp the authority of boards of directors that they elect."); *see also* Margaret M. Blair & Lynn A. Stout, *Specific Investment: Explaining Anomalies in Corporate Law*, 31 J. CORP. L. 719, 726 (2006) (noting that "[t]he result is that among the vitally important choices reserved to directors and denied to shareholders by corporate law are not only general business strategy but also such key matters as the selection of executives and other employees; the declaration and distribution of dividends; the setting of directors' fees and employees' salaries; and the decision to use corporate assets or earnings to benefit nonshareholder constituencies like creditors, employees, the local community, or even general philanthropic causes.").

87. *See eBay*, 16 A.3d at 34 (clarifying that fiduciary standards and requirements include "promot[ing] the value of the corporation for the benefit of its stockholders.").

88. *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 128 (2004) (noting that "[t]he business judgment rule thus builds a prophylactic barrier by which courts pre-commit to resisting the temptation to review the merits of the board's decision."); *see also* Blair & Stout, *supra* note 86, at 726 (acknowledging that "[a]s long as directors refrain from using their power to line their own pockets, however, the doctrine known as the business judgment rule protects their decisions from shareholder challenge.").

89. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (holding that "[a]

Indeed, if focusing on the interests of all stakeholders is a way to attain better business outcomes,[90] the directors on a board composed of various stakeholders should actually be able to better fulfill their fiduciary duties than a non-diverse board focused only on shareholder interests.

For advocates of the team production model of corporate governance, this structure would be a more optimal form of governance, as it adds diversity to the board without jeopardizing its independence.[91] In an existing corporation, such a change to the corporate structure could be implemented simply by a vote of the shareholders,[92] or if allowed in the certificate of incorporation, by a vote of the board of directors.[93] This change would be fairly low-risk, since the board could be reverted to a more traditional form through the same process.[94] Because such a stakeholder board could be fairly easily undone, such an arrangement is subject to criticism from those advocating for stronger forms of stakeholder democracy. If this is a concern, by using share classifications, more complex forms of stakeholder democracy can be created which would be far more difficult to unravel.

B. *Stakeholder Governance Through Share Classification*

Modern corporate governance rhetoric commonly frames issues of corporate governance essentially in terms of shareholders versus non-shareholder stakeholders.[95] Such a view ignores the reality that the status of shareholders is gained through the relatively simple expediency of

board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose.").

90. *See* Ayuso et al., *supra* note 9, at 425 (conducting an empirical analysis of stakeholder engagement and firm financial performance, and finding that, across a sample of 426 firms, engaging stakeholders has a significant positive effect on financial performance, specifically in customer engagement, grievance resolution, and engagement scope and progress).

91. *See supra* notes 54-68 and accompanying text.

92. *See* DEL. CODE ANN. tit. 8, § 109(a) (2011) (allowing for the amendment of a corporation's bylaws by vote of the shareholders entitled to vote); *see also* DEL. CODE ANN. tit. 8, § 242(b) (2011) (allowing for the amendment of a corporation's certificate of incorporation by vote of the shareholders upon a resolution from the board of directors).

93. *See id.* (allowing for the bylaws to be amended by the board of directors, if so stated in the certificate of incorporation).

94. *Id.*

95. *See* Steve Letza et al., *Shareholding Versus Stakeholding: a Critical Review of Corporate Governance*, 12 CORP. GOV. 242, 243 (2004) (noting that "[c]urrent analyses on corporate governance draw more attention to evaluating and judging the superiority of either the shareholder model or stakeholder model and often take part in one-sided arguments, sometimes with a slight modification such as an enlightened shareholder model and an enlightened stakeholder model.").

owning stock.[96] This means that stakeholder democracy can be accomplished by turning non-shareholder stakeholders into shareholders through stock ownership.[97] When a non-shareholder stakeholder becomes a shareholder, they do not lose their stakeholder interests, and, in most situations, their non-shareholder interests will likely be more important than their interests as a shareholder.[98] For example, an employee of a company who also owns stock likely considers their ongoing employment much more important to their well-being than their ownership interest in the company. Thus, ownership of shares by a previously non-shareholding stakeholder is a significant move towards stakeholder democracy because the stakeholder will likely use whatever power they have as a shareholder to advance their stakeholder interests.

Of course, if a corporation is publicly held, any stakeholder can become a shareholder on their own by simply purchasing shares in the public securities markets. But many stakeholders will not have the financial wherewithal to purchase a sufficient number of shares to have any real power in corporate governance. In a privately held corporation, there will likely not be shares available for stakeholders to purchase, and existing shareholders would almost certainly resist having their financial interest in the company watered down through an issuance of shares significant enough to accommodate stakeholder democracy. However, through share classification, the goal of stakeholder democracy can be accomplished in both publicly and privately held corporations, while still accommodating stockholders' financial interests.

Corporate law allows corporations to create classes and series of shares with a virtually limitless variety of characteristics.[99] These characteristics include voting rights, financial rights, and restrictions on transferability.[100] Thus, for example, shares could be created which have

96. *See* Katharine V. Jackson, *Towards A Stakeholder-Shareholder Theory of Corporate Governance: A Comparative Analysis*, 7 HASTINGS BUS. L. J. 309, 386 (2011) (making a similar argument by advocating for "stakeholder-shareholders" who use shareholder activism to influence corporate governance).

97. *Id*.

98. *Id*. at 386-87 (discussing how stakeholder-shareholders such as employees and pension beneficiaries can use stock ownership to assert their stakeholder interests).

99. *See* DEL. CODE ANN. tit. 8, § 151(a) (2011) (allowing for the creation of one or more classes of stock and one or more series of stock within each class).

100. *Id*. (noting that "[e]very corporation may issue 1 or more classes of stock or 1 or more series of stock within any class thereof, any or all of which classes may be of stock with par value or stock without par value and which classes or series may have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the certificate of incorporation or of any amendment thereto, or in the resolution or resolutions providing for the issue of such stock

voting rights but no rights to the payment of dividends, which can only be owned by certain individuals or entities, and which may not be transferred without the permission of the corporation.[101] Classes of shares can even be created which give the holders of that class the express right to elect their own director(s), as corporate law expressly provides for directors which are elected only by owners of a particular class or series of stock.[102]

The use of share classification schemes to elect directors is not unprecedented. For example, in *Lehrman v. Cohen*, a corporation owned and controlled by two families created a class of stock which held only one $10 par value share, but which held the right to elect a fifth member to the board of directors in order to break deadlocks.[103] The share had no dividend rights, and was subject to redemption only by affirmative vote of four of the five directors.[104] The court held that such a shareholder classification was valid, and that corporate law allows the creation of shares with or without voting rights, including special rights to elect a director, if so specified in the certificate of incorporation.[105]

Through the creative use of share classification and restrictions, different stakeholder groups can be given voting rights such that they have the right to elect one or more directors without watering down the financial rights of shareholders who only desire a financial stake in the company. Due to the flexibility allowed to incorporators in classifying shares, there is a virtually endless array of methods for accomplishing this. This article will provide a few example arrangements, which could be utilized to produce varying levels of stakeholder democracy.

1. Stakeholder Democracy With Ultimate Control Maintained by Shareholders

Suppose a corporation desires to give certain stakeholder groups formal representation on the board of directors but still wants to maintain a

adopted by the board of directors pursuant to authority expressly vested in it by the provisions of its certificate of incorporation.").

101. *See* DEL. CODE ANN. tit. 8, § 202 (2011) (allowing for the creation of restrictions on transfer and ownership of securities).

102. *Id*. at § 141(d) ("The certificate of incorporation may confer upon holders of any class or series of stock the right to elect 1 or more directors who shall serve for such term, and have such voting powers as shall be stated in the certificate of incorporation.").

103. 222 A.2d 800, 803 (Del. 1966).

104. *Id*.

105. *Id*. at 233 (holding that DEL. CODE ANN. tit. 8, § 151(a) "permits the creation of stock having voting rights only, as well as stock having property rights only. The voting powers and the participating rights. . .being specified in the Company's certificate of incorporation, we are of the opinion that the Class AD stock is legal by virtue of § 151(a).").

vestige of the traditional corporate governance structure where the financial shareholders have ultimate control of the corporation. To create such a structure, the certificate of incorporation would need to be amended to create new classes of shares with the voting rights and restrictions desired.[106] This can be accomplished by a majority vote of the shareholders upon a resolution from the board of directors proposing the amendment.[107]

If the directors and shareholders wish to maintain majority control in the hands of the existing financial shareholders, the additional share classifications would simply need to be structured such that the existing shareholders would always maintain their majority vote.[108] As a simple example, suppose a corporation currently has one million shares of common stock issued and outstanding and a board of directors with seven directors. Three additional share classes (referred to herein for ease of reference as Class "A," "B," and "C") could be created with no voting rights except that each has the right to elect one member of the board of directors.[109] The amendment could further provide that the other four directors would continue to be elected by a majority vote of the shareholders of the common stock.[110] If the directors and shareholders so desire, the shares could expressly be given no rights to any dividend payments or any other financial rights.[111] The shares could further be expressly limited to ownership only by individuals with certain characteristics endemic to the relevant stakeholder groups, have restrictions on their transferability, and be subject to redemption at any time by the corporation.[112] Thus, for example, if the stakeholder groups considered

106. *See* DEL. CODE ANN. tit. 8, § 102(a)(4) (2011) (requiring the corporation to set forth any classes of stocks and the rights and restrictions relating thereto in the certificate of incorporation); DEL. CODE ANN. tit. 8, § 242(a)(5) (2011) (providing that a certificate of incorporation may be amended "[t]o create new classes of stock having rights and preferences either prior and superior or subordinate and inferior to the stock of any class then authorized, whether issued or unissued").

107. *See* DEL. CODE ANN. tit. 8, § 242(b) (2010) (setting forth the process for amending the certificate of incorporation).

108. *Id*.

109. *See id*. at § 141(d) ("The certificate of incorporation may confer upon holders of any class or series of stock the right to elect 1 or more directors who shall serve for such term, and have such voting powers as shall be stated in the certificate of incorporation.").

110. *Id*.

111. *See id*. at § 151(a) (providing broad rights to place limits and restrictions on shares, and expressly stating that classes of stock may have "such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the certificate of incorporation or of any amendment thereto").

112. *See id*. at § 202 (c)(4) (providing for restrictions on transfer and ownership of securities); *see also id*. at § 151(b) (providing that stock may be made subject to redemption at the option of the corporation).

most important to the corporation are employees (Class A), a particular environmental advocacy group (Class B), and members of the community where the corporation is headquartered (Class C), the amendment could state specific restrictions on the issuance and transfer of the shares such that members of these particular stakeholder groups will be the only owners of the shares.[113]

Under such an arrangement, the board of directors would be composed of four directors traditionally elected by the common stock holders, and three directors each individually elected by the members of these stakeholder groups. Thus, the traditional common stock holders would maintain control of the board but the remaining three directors would be elected by these important stakeholder groups. While this would not give control of the corporation to stakeholders, it would certainly give them an opportunity to have a voice in the formal governance of the corporation.

One advantage of this approach for the existing common stockholders is that the arrangement can be unraveled and corporate governance returned to the status quo if the experiment in stakeholder democracy is deemed a failure. However, a full unraveling of this stakeholder democracy could become a fairly complex process. The basic process for unraveling this corporate governance structure would be to once again amend the certificate of incorporation to cancel or redeem the new classes of shares created.[114] However, once the new classes of shares are issued and outstanding, this could be difficult. The first impediment is that once additional classes of stock are created, holders of that class of stock are required to be allowed to vote as a class on any amendment to the certificate of incorporation that would affect the powers or rights of their shares, even if they would not otherwise have a vote under the certificate of incorporation.[115] Since any amendment to the certificate of incorporation requires a majority vote of the outstanding stock entitled to vote, as well as the majority vote of each class of stock entitled to vote, this would mean that a majority of the stakeholder group would have to vote to cancel their own voting rights.[116] Thus, even if the original common stock holders own

113. *Id*.

114. *See id*. at §§ 242-245 (providing the processes for amending the certificate of incorporation and reducing the capital of the corporation through retiring or redeeming stock).

115. *See id*. at § 242 (b)(2) ("The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment, whether or not entitled to vote thereon by the certificate of incorporation, if the amendment would increase or decrease the aggregate number of authorized shares of such class, increase or decrease the par value of the shares of such class, or alter or change the powers, preferences, or special rights of the shares of such class to as to affect them adversely.").

116. *See id*. at § 242(b)(1) (requiring that amendments to the certificate of incorporation

a majority of the shares they could not unilaterally pass an amendment to the certificate of incorporation to cancel the new share classes or strip them of their voting rights.[117]

There is a way to work around this problem. Shares can be issued with restrictions on transferability and with redemption rights.[118] Thus, the Class A, B, and C shares in our example can be structured to be non-transferable to any other party other than the corporation itself and can additionally carry a restriction that obligates the shareholders to sell or transfer the securities back to the corporation or be subject to redemption at the option of the corporation.[119] There are a myriad of ways that these restrictions could be structured to accomplish the objective at hand. To provide a specific example, the original certificate of amendment creating the stakeholder class shares could expressly provide that they are issued for $.01 per share, non-transferable without the permission of the corporation, only may be held by individuals or groups possessing certain characteristics endemic to that stakeholder class, and redeemable at the option of the corporation for $0.01 per share. Then, if the directors elected by the majority owners decide that it is in the best interest to end the experiment with stakeholder democracy, they could pass a resolution to redeem the stakeholder shares.[120] Once the shares have been redeemed, there would no longer be any other classes of shares outstanding. The original common stock holders would then be free to amend the certificate of incorporation by majority vote to cancel the additional classes of shares.[121] Thus, under existing corporate law a corporation can provide a representative voice to stakeholder groups while still retaining a place of primacy to the common stockholders.

2. Stakeholder Democracy Without Ultimate Control by Financial

be approved by "a majority of the outstanding stock entitled to vote thereon, and a majority of the outstanding stock of each class entitled to vote thereon as a class").

117. *Id.*

118. *See id.* at § 202(c)(4) (providing for restrictions on transfer and ownership of securities, specifically including a restriction that obligates the holder to sell or transfer shares back to the corporation); *see also id.* at § 151(b) (providing that stock may be made subject to redemption at the option of the corporation).

119. *Id.*

120. *See id.* at § 151(b)(2) ("Any stock which may be redeemable under this section may be redeemed for cash, property or rights, including securities of the same or another corporation, at such time or times, price or prices, or rate or rates, and with such adjustments, as shall be stated in the certificate of incorporation or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to subsection (a) of this section.").

121. *See id.* at § 242(b)(1)-(2) (noting the methods for making amendments to a certificate of incorporation after receipt of payment for stock).

Shareholders

Just as corporate law is sufficiently flexible to provide for stakeholder democracy where traditional, financial shareholders maintain ultimate control of the board of directors, shareholder classification can also be used to structure a stakeholder democracy corporate governance structure that is virtually impossible to unravel without the support of all stakeholders. The process for doing so is essentially the same as the process outlined above, with the difference that a sufficient number of share classes are created to dilute shareholder power and fewer restrictions are placed on the new share classes.

For example, using the same corporation as set forth above with 1,000,000 shares of common stock outstanding and a board of directors consisting of seven directors, four or more additional share classes can be created, each with the right to elect a director.[122] As long as the existing common stock holders can never elect a majority of the board, the existing shareholders would not have the ability to unilaterally amend the certificate of incorporation again.[123] This would be a more "true" form of stakeholder democracy where no one stakeholder group has control of the board. Even with such a structure, restrictions on transferability and ownership of the new share classifications would likely be desirable to ensure that only individuals who can be verified as members of the respective stakeholder group tied to the share class could own the shares.[124]

3. Share classification restrictions under Delaware corporate law

An arguable restriction to this share classification approach is Delaware's limitation on the number of classes in which the board may be divided.[125] Delaware law allows for classified boards in which different classes of directors are elected in successive years, but only allows up to

122. *See id*. at § 141(d) ("The certificate of incorporation may confer upon holders of any class or series of stock the right to elect 1 or more directors who shall serve for such term, and have such voting powers as shall be stated in the certificate of incorporation.").

123. *See id*. at § 242(b) (stating that the certificate of incorporation may only be amended by resolution of the board of directors proposing the amendment, which then must be approved by the shareholders).

124. *See id*. at § 202(c)(4) (stating that restrictions on shares can include restrictions on the amount of the corporation's securities that may be owned by any person or group of persons); *see also id*. at § 151(a) (providing that classes of stock may contain "qualifications, limitations, or restrictions" in the certificate of incorporation).

125. *See id*. at § 141(d) (providing that the board of directors may be divided into three classes, which each class standing for election in successive years).

three such classes.[126] This provision is clearly directed towards the traditional staggered board arrangement, which is commonly used as an anti-takeover or board entrenchment device.[127] Since this statutory provision expressly addresses board classes that stand for election in separate years,[128] its limit of three classes arguably should not restrict the stakeholder classification structure proposed in this article. This seems to clearly be the case since the same statutory provision that limits the boards to three classes if said directors are to be elected in staggered terms also states that the "certificate of incorporation may confer upon holders of any class or series of stock the right to elect 1 or more directors . . . ." without limiting how many different classes of stock may have this right. [129] This part of the statute directly addresses the shareholder classification structure advocated for in this article and indicates that as long as the directors all stand for election in the same year, the number of classes of directors based upon shareholder classification is limitless.[130] Nevertheless, the argument could be made that since the shareholder classification proposed herein also requires classifying the board, even though this provision is clearly not intended to address this type of classification structure by its strict terms, it still limits the classification of the board to only three classes.[131] While I believe the stronger argument is that this provision only limits classified boards that create a staggered structure, if a corporation wishes to avoid this argument altogether they could simply incorporate in a state like Nevada, which expressly imposes no such restrictions on board classes as long as all of the directors are elected every year.[132]

126. *Id*.

127. *See* Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 893-95 (2002) (discussing the traditional staggered board structure with three classes, each standing for election in successive years, and noting its power as an anti-takeover device).

128. *See* DEL. CODE ANN. tit. 8, § 141(d) (2011) ("The directors of any corporation organized under this chapter may, by the certificate of incorporation or by an initial bylaw, or by a bylaw adopted by a vote of the stockholders, be divided into 1, 2, or 3 classes; the term of office of those of the first class to expire at the first annual meeting held after such classification becomes effective; of the second class 1 year thereafter; of the third class 2 years thereafter; and at each annual election held after such classification becomes effective, directors shall be chosen for a full term, as the case may be, to succeed those whose terms expire.").

129. *Id*.

130. *Id*. (simply stating that "one or more" classes or series of stock can have the right to elect a director).

131. *Id*.

132. *See* NEV. REV. STAT. § 78.330(2) (2007) (providing that the board of directors may be classified into any number of classes, as long as at least one-fourth of the directors is elected annually).

Another potential concern is the consideration for which the stakeholder share classes must be issued. Fortunately, Delaware law is very flexible in this regard. The stakeholder exclusive share classes can either be sold to the relevant stakeholders or issued to the stakeholders in consideration of any other type of good or service the stakeholder provides the corporation.[133] For example, if one of the share classifications is designated for certain important suppliers, the shares could be issued to them in consideration of their efforts in supplying goods, services, or both to the corporation.[134] There are arguments that can be made for either approach. By requiring stakeholders to purchase the shares, even if only for a nominal amount, the corporation ensures that the stakeholders care enough about their right to representation to pay for it. However, by issuing shares to existing stakeholders in consideration of some other, non-monetary ongoing interests in the corporation, greater participation may be obtained and goodwill engendered with the stakeholder group. The overriding point is that corporate law gives corporations a great deal of discretion to bring these stakeholders into the fold as nominal shareholders under virtually limitless terms, financial or otherwise.

C. *Potential Publicly Traded Company Limitations: Independence, Voting Rights, and Board Classification Restrictions*

A potential impediment to creating stakeholder democracy through the board qualification or shareholder classification schemes discussed herein is the listing standards imposed on publicly traded companies by the New York Stock Exchange (NYSE) and the NASDAQ.[135] While not a concern for private companies, companies traded on either of these exchanges must follow these listing standards.[136] The NYSE listing requirements provide restrictions related to director independence, board classification schemes,

133. *See* DEL. CODE ANN. Tit. 8, § 153(a), (b) (2011) (providing that shares of stock may be issued for "such consideration, having a value not less than the par value thereof, as determined . . . by the board of directors" for par value shares and for "such consideration as is determined from time to time by the board of directors" for shares without par value).

134. *Id*. (allowing shares to be issued for whatever consideration the board of directors decides).

135. *See* NEW YORK STOCK EXCHANGE, NYSE LISTED COMPANY MANUAL §§ 301.00-315.00 (2015), http://nysemanual.nyse.com/LCM/Sections [https://perma.cc/SF39-SF4J] [hereinafter NYSE Manual] (setting forth the listing standards imposed on publically traded companies by the New York Stock Exchange); *see also* NASDAQ STOCK MARKET, NASDAQ LISTING RULES §§ 5600-40 (2015), http://nasdaq.cchwallstreet.com [perma.cc/VJS6-RDLC] [hereinafter NASDAQ Rules] (setting forth the listing standards for publically traded companies on the NASDAQ).

136. *Id*.

and shareholder voting rights.[137] The NASDAQ requirements also contain restrictions related to director independence and shareholder voting rights, but have no express restrictions on board classification.[138] While the director independence standards are not a difficult obstacle to overcome, determining how the board classification and shareholder voting rights restrictions would apply to the stakeholder democratization structures set forth in this article is a more difficult task.

1. Board of directors independence requirements

Both the NYSE and NASDAQ require listed companies to have majority independent boards, with few exceptions.[139] The NYSE generally defines an independent director as someone who the board of directors "affirmatively determines . . . has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company)."[140] The commentary to the NYSE requirements notes that this determination should focus on independence from management and avoiding any conflicts of interest that could impair the director's independent judgment.[141] Because this definition is quite broad and vague, the NYSE manual provides several "bright line" standards for when a director will be automatically disqualified as independent.[142] The NASDAQ definition follows a similar structure by first providing a general definition requiring board determination of independence, followed by several specific categories of persons who will not be considered independent.[143]

These independence requirements are relevant to stakeholder

137. *See* NYSE Manual, *supra* note 135, §§ 303A.01-.07, 304.00, 313.00 (describing and defining independent directors, independence tests, executive sessions, the nominating/corporate governance committee, the compensation committee, the audit committee, the audit committee's additional requirements, classified boards of directors, and voting rights).

138. *See* NASDAQ Rules, *supra* note 135, §§ 5605, 5640 (describing and defining the board of directors and committees and voting rights).

139. NYSE Manual, *supra* note 135, § 303A.01; NASDAQ Rules, *supra* note 135, § 5605(b)(1).

140. NYSE Manual, *supra* note 135, § 303A.02(a)(i).

141. *Id.* ("In particular, when assessing the materiality of a director's relationship with the listed company, the board should consider the issue not merely from the standpoint of the director, but also from that of persons or organizations with which the director has an affiliation. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships, among others. However, as the concern is independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding.").

142. *Id.* at § 303A.02(b)(i)-(v).

143. NASDAQ Rules, *supra* note 135, § 5605(a)(2).

involvement on the board because some stakeholders might not be considered truly independent due to their level of involvement with the corporation or management. For example, if a corporation decides to implement a director qualification stating that one of the members of the board must be affiliated with a major supplier that the corporation works with closely, it is possible that an executive officer or director of such a supplier would not be considered independent if the supplier received too much of its revenue from the company.[144] Notably, this does not prevent the individual from serving as a director; they would just not be considered an "independent director" for purposes of the majority independent director requirement. This restriction is not insurmountable, but does require consideration by an exchange-traded corporation wishing to construct a more diverse board of directors through stakeholder qualifications.

2. Voting rights policies limitations on share classification

Both the NASDAQ and the NYSE have a "voting rights policy," which places restrictions on any corporate action or issuance that could "disparately reduce or restrict" the voting rights of existing common stockholders.[145] The shareholder classification scheme proposed in this article, which would grant voting rights to various stakeholder groups, could certainly be interpreted as running afoul of these voting rights policies, since allowing stakeholders a vote through special classified shares would reduce the voting rights of the financial shareholders. However, when looking at the environment in which these voting rights policies were created, including SEC Rule 19c-4 which gave birth to them, it is apparent that these policies were designed to prevent the use of shareholder classifications to entrench management and were not intended to prevent the creation of more democratic corporate structures.[146]

144. *See* NYSE Manual, *supra* note 135, § 303A.02(b) (stating that individuals who are a current employee, or have an immediate family member who is a current executive officer, of a company that has received payments from the corporation in any of the last three fiscal years that exceed the greater of $1 million or 2% of the company's consolidated gross revenues are not considered independent); *see also* NASDAQ Rules *supra* note 135, § 5605(a)(2)(D) (stating that an individual who, or has a family member who is, a partner, controlling shareholder, or executive officer of a company which received payments in any of the last three fiscal years that exceed the greater of 5% of the company's consolidated gross revenues or $200,000 is not considered independent).

145. NYSE Manual, *supra* note 135, § 313.00; NASDAQ Rules, *supra* note 135, § 5640.

146. *See, e.g.* Stephen M. Bainbridge, *The Short Life and Resurrection of SEC Rule 19C-4*, 69 WASH. U. L. Q. 565, 566-567 (1991) (discussing the history behind the creation of SEC Rule 19c-4, the progenitor of the current voting rights policies of the NYSE and NASDAQ).

SEC Rule 19c-4 was passed in response to share classification schemes, namely dual class shares, which were being used to prevent takeovers and entrench management.[147] In these dual class structures, two classes of shares were created, one of which had superior voting rights.[148] If the shares with superior voting rights could be concentrated in friendly hands (preferably management's) in sufficient amounts to grant control, then the company was essentially immune from hostile takeover.[149] These structures were seen as being non-shareholder friendly and subject to abuse as a method for entrenching underachieving management at the cost of shareholder value.[150] At the time of the passing of Rule 19c-4, any restrictions on dual class shares arose almost exclusively from the exchange listing standards, as state corporate law provided corporations with substantial flexibility to classify shares.[151] The NASDAQ had no voting rights restrictions and thus allowed dual class structures.[152] Although the NYSE had previously prohibited dual class shares, it proposed a rule modification to the SEC that would allow dual class share structures in order to remain competitive with the NASDAQ.[153] Rather than approve the NYSE's proposal, the SEC instead adopted Rule 19c-4 which created a uniform voting rights standard across exchanges.[154] Rule 19c-4 was similar to the current voting rights policies of both the NASDAQ and the NYSE and did not prohibit all dual class structures, but only prohibited corporate actions that "nullified, restricted, or disparately reduced the per share voting rights of existing common stockholders."[155] Rule 19c-4 was ultimately struck down by the D.C. Circuit as being outside the scope of the authority of the SEC.[156] Nevertheless, since the exchanges retain the authority to regulate voting rights for listed stocks, both the NYSE and the NASDAQ have retained voting rights policies similar to Rule 19c-4.[157]

147. *Id*.
148. *Id*. at 571.
149. *Id*.
150. *Id*. at 566.
151. *Id*. at 574-75.
152. *Id*. at 576-77.
153. *Id*. at 577.
154. *Id*. at 577-78.
155. *Id*. at 578.
156. *Id*. at 617 ("In contrast, as the D.C. Circuit concluded, the Act denies the Commission authority over corporate governance generally or the substance of shareholder voting rights specifically.").
157. NYSE Manual, *supra* note 135, § 313.00(A) ("On May 5, 1994, the Exchange's Board of Directors voted to modify the Exchange's Voting Rights Policy, which had been based on former SEC Rule 19c-4. The Policy is more flexible than Rule 19c-4. Accordingly, the Exchange will continue to permit corporate actions or issuances by listed

The strict text of these voting rights policies would seem to indicate that a shareholder classification plan structured as proposed in this article would not be allowed for companies traded on the NASDAQ or NYSE, because the implementation by an existing business of a shareholder classification plan proposed in this article would undoubtedly reduce and restrict the voting rights of existing common stockholders.[158] However, with the aforementioned history in mind, and in light of actions that have been allowed by the NASDAQ and the NYSE's interpretation of its policy, it is not at all clear that a share classification scheme designed to create stakeholder democracy would be disallowed. Both the NYSE and the NASDAQ have significant flexibility in applying these policies. Indeed, in its interpretations of its own voting rights policy, the NYSE has focused on flexibility and the economic circumstances and rationale behind the reason for an issuance that dilutes voting rights.[159] These interpretations also repeatedly cite to the SEC's own language in approving the voting rights policy which specifically mentioned flexibility and the business justifications behind disparate voting rights as issues to focus on in interpreting the policy.[160] Thus, the NYSE's key focus on the interpretation of its policy, consistent with the history behind its enactment, is ensuring that the corporate action or issuance has a valid economic or business rationale and is not merely being passed for the purpose of entrenching management and disenfranchising shareholders.[161]

companies that would have been permitted under Rule 19c-4, as well as other actions or issuances that are not inconsistent with the new Policy."); NASDAQ Rules, *supra* note 135, § IM-5640 ("The following Voting Rights Policy is based upon, but more flexible than, former Rule 19c-4 under the Act. Accordingly, Nasdaq will permit corporate actions or issuances by Nasdaq Companies that would have been permitted under former Rule 19c-4, as well as other actions or issuances that are not inconsistent with this policy.").

158. *See* NYSE Manual, *supra* note 135, § 313.00(A) (noting that "[v]oting rights of existing shareholders of publicly traded common stock registered under Section 12 of the Exchange Act cannot be disparately reduced or restricted through any corporate action or issuance."); *see also* NASDAQ Rules, *supra* note 135, § 5640 (stating that "[v]oting rights of existing Shareholders of publicly traded common stock registered under Section 12 of the Act cannot be disparately reduced or restricted through any corporate action or issuance.").

159. *See* NEW YORK STOCK EXCHANGE, PARA. 313, INTERPRETATION NO. 95-01 (1995), http://nysemanual.nyse.com/LCM/pdf/voting_rights.pdf [perma.cc/AJV6-QDWE] [hereinafter NYSE Voting Rights Interpretations] (stating that "[I]n evaluating a transaction, the Exchange 'will consider, among other things, the economics of [the issuer's] actions,' and that the Exchange's interpretations 'will be flexible, recognizing that both the capital markets and the circumstances and needs of listed companies change over time.'").

160. *Id*. ("There may be valid business or economic reasons for corporations to issue disparate voting rights stock. [Para. 313] provides the [Exchange] with a voting rights standard which will provide issuers with a certain degree of flexibility in adopting corporate structures, so long as there is a reasonable business justification to so doing, and such transaction is not taken or proposed primarily with the intent to disenfranchise.").

161. *Id*.

Similarly, while the NASDAQ does not provide the same in-depth interpretations that the NYSE does, it is clear that they have interpreted their policy quite flexibly. Google was recently allowed to issue Class C non-voting shares on the NASDAQ to grant its founders even greater control than they already had under the company's existing dual class structure.[162] While it is true that Google already had an existing dual class structure, this additional issuance of shares notably diluted the voting power of the existing Class A voting shares even further, yet was still allowed by the NASDAQ.[163] Thus, clearly the NASDAQ has not enforced its voting rights policy according to its strict terms.

Even though these voting rights policies might require public companies to confront the exchange they are listed on before implementing a stakeholder democracy structure, it seems likely that a company could successfully implement such a structure, given the flexibility afforded by these exchanges in the past. This is especially true if the shareholders themselves approve it. The intent behind the new share issuances clearly would not be to entrench management, and if a company believes that stakeholder democracy is truly a better corporate governance structure, it would seem that it would not be hard to explain this business rationale to the exchanges. In any case, if a change to this listing requirement is needed to accommodate stakeholder democracy, it would be much easier to enact this exchange level change as opposed to the wholesale change of corporate law sought by many stakeholder democracy advocates.

3. Classified board restrictions

The final listing standard that could affect public companies listed on the NYSE is the restrictions related to classified boards.[164] This listing requirement provides that boards of directors are expected to be elected by all of the shareholders as a class, except in limited situations with respect to preferred stock, and that the NYSE will refuse to list companies with a board featuring more than three classes of directors.[165] The NASDAQ has no such similar restriction, but does note that a board with more than three

162. *See* Nick Summers, *Why Google Is Issuing a New Kind of Toothless Stock,* BLOOMBERG (April 3, 2014), http://www.bloomberg.com/bw/articles/2014-04-03/why-google-is-issuing-c-shares-a-new-kind-of-powerless-stock [http://perma.cc/N3ZK-6NLL] (discussing Google's issuance of Class C shares, further increasing the voting power of Google's founders who already had control under a dual class structure with Class A shares possessing only one vote each and Class B shares owned by the founders which possessed ten votes each).

163. *Id*.

164. *See* NYSE Manual, *supra* note 135, at § 304.00.

165. *Id*.

classes may run afoul of its voting rights policy.[166] Like the voting rights policy, this classification restriction is clearly aimed at board structures designed to prevent hostile takeovers or insulate the board from shareholder accountability, as the classified (or staggered) board is synonymous with takeover defenses.[167] In the typical classified board, the board of directors is divided into classes (usually three) and each class stands for election in different years and serves a three year term.[168] Such a structure serves as a strong takeover deterrent, because any hostile bidder would be required to win two successive annual board elections in order to gain control of the board.[169] Winning two such elections is difficult and costly in its own right, but the takeover is made all the more difficult because in the intervening year the existing majority directors can implement further anti-takeover devices prior to the hostile takeover being completed.[170] This makes a properly structured classified board a strong anti-takeover device.[171]

The shareholder classification structure set forth in this article does not meet this classical definition of a classified board.[172] Under the structure I advocate, all of the directors would stand for annual election and are only divided into classes to the extent that they are elected by a certain class of shares.[173] Accordingly, it is not clear that such a structure would be considered a "classified board" under the NYSE listing rules, even though

166. *See Listing Center Frequently Asked Questions,* NASDAQ, http://listingcenter.nasdaq.com/Material_Search.aspx?cid=108&mcd=LQ [https://perma.cc/UD7M-655L] (last visited April 17, 2015) (noting that the NASDAQ has no classified board restrictions, but that "if the board is divided into more than three classes, the structure may raise concerns under Nasdaq's voting rights and public interest rules.").

167. *See, e.g.*, John C. Coates IV, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence,* 79 TEX. L. REV. 271, 326 (2000) (discussing classified boards, along with poison pills, as one of the most important takeover defense structures); Michael D. Frakes, *Classified Boards and Firm Value*, 32 DEL. J. CORP. L. 113, 113 (2007), ("Classified boards constitute one of the most potent takeover defenses for U.S. firms today.").

168. *See* Bebchuk, Coates IV, & Subramanian, *supra* note 127 at 893, ("In a company with a staggered board, directors are grouped into classes (typically three), with each class elected at successive annual meetings. For example, a board with twelve directors might be grouped into three classes, with four directors standing at the 2001 annual meeting, four more directors standing for reelection in 2002, and the remaining four directors standing for reelection in 2003. With three classes, directors in each class would be elected to three-year terms.") (internal footnotes omitted).

169. *Id*. at 914. (discussing an effective staggered board with three classes, and noting that "[i]n fact, to our knowledge, no bidder has successfully fought through two proxy contests to win control of an ESB target.") (internal footnote omitted).

170. *Id*. at 890.

171. *Id*.

172. *See supra* Part II.A.

173. *Id*. at 890-893.

it would technically create different classes of directors. However, although the goal of the shareholder classification structure proposed in this article is not to serve as an anti-takeover device, if a sufficient number of classes were created such that no one class of shares controls a majority of the board, it could certainly have such an effect.[174] Thus, it is not clear if this NYSE listing requirement would prevent a NYSE traded company from creating a stakeholder board with more than three classes or if the NYSE would grant an exemption from this requirement to a company creating the class structures for the purpose of implementing organizational democracy. Of course, a company could simply move to the NASDAQ exchange and avoid this restriction altogether, needing to address only the voting rights policy.[175]

While these restrictions may pose some problems to public companies wishing to employ a stakeholder democracy, the problems are not insurmountable. Additionally, the presence of these listing restrictions does not undercut the basic argument of this article –- that corporate law itself, namely the norm of shareholder primacy, is not the constraint prohibiting the creation of a stakeholder democracy as many advocates of stakeholder rights in corporate governance assert.[176] And since these restrictions only apply to companies listed on these exchanges, they do not prevent any other corporation from implementing stakeholder democracy as set forth herein. Accordingly, the argument stands that it is still not a legal requirement of shareholder primacy found in corporate law preventing the creation of stakeholder democracy.

D. *Voluntary Stakeholder Democracy is Superior to Corporate Law Reform*

I have argued that existing corporate law is clearly flexible enough to allow for corporations to voluntarily conduct their business under varying levels of stakeholder democracy. Now I also argue that a further claim can be established –- that the existing permissive legal framework of corporate law is superior to reforming it to mandate stakeholder democracy or any

174. For example, if the public float of the company only has the power to elect three directors of a seven member board, and each of the other four directors is elected by a different class of shares owned by different stakeholder groups, the company would be effectively immune from hostile takeover.

175. *See supra,* note 166.

176. *See, e.g.*, Greenfield, *supra* note 11, at 772-773 (arguing that changes to corporate law are necessary to overcome the problems created by shareholder primacy and that one such helpful change would be requiring corporations to consider non-shareholder stakeholder interests and to give these stakeholders a mechanism for electing representatives to the board of directors).

other form of stakeholder governance. This argument rests upon both philosophical and practical grounds.

As an initial philosophical matter, stakeholder theory has its roots in libertarianism and voluntary managerial action, not government mandate.[177] R. Edward Freeman, widely regarded as the progenitor of modern stakeholder theory, states that stakeholder theory has as its basis in libertarian principles such as freedom, individual property rights, voluntary positive obligations based in contracts and promises, minimal government intervention, and personal responsibility.[178] Thus, the philosophical underpinnings of stakeholder theory, and concepts of stakeholder democracy which arise from it, support the idea of corporations voluntarily creating stakeholder governance structures and managers looking out for the interests of stakeholders for normative ethical (it is the right thing to do) as well as instrumental (superior business results) reasons, not because of government mandate.[179]

Reforming corporate law to require stakeholder governance goes against these original libertarian underpinnings and infringes upon the right of parties to order their own private affairs. To argue for mandatory stakeholder governance is to essentially say to incorporators "Stakeholder governance is superior to shareholder primacy on both an ethical and instrumental level, and it is so superior to shareholder primacy that its forced implementation outweighs your right to privately order your own business affairs how you see fit." This is not only inconsistent with the libertarian background of stakeholder theory, but it is also a fairly difficult policy argument to make since freedom of contract is a deeply held American value. The corporate governance structures advocated herein are consistent with the original libertarian intent behind the development of stakeholder theory and also respect this value of freedom of contract. Thus, they are more philosophically consistent with stakeholder theory than mandating stakeholder democracy by law.[180]

Philosophical consistency aside, as a purely practical matter advocates of stakeholder democracy and alternative corporate governance arrangements in general stand a better chance of furthering their agendas by focusing on freedom of contract rather than trying to change corporate law. The essentials of corporate law, particularly the norm of shareholder

177. *See* R. Edward Freeman & Robert A. Phillips, *Stakeholder Theory: A Libertarian Defense*, 12 BUS. ETHICS Q. 331, 332,337 (2002) (noting that stakeholder theory needs to be refocused towards its "'Libertarian' background conditions" which are based upon voluntary managerial action).

178. *Id*. at 336.

179. *Id*. at 337-38 (discussing the instrumental and normative theses behind stakeholder theory).

180. *Id*.

primacy, are firmly rooted in the U.S.[181] If one were to walk into any university finance class in the U.S. and ask the students what the ultimate objective of the corporate manager is, one would almost certainly hear that it is maximization of shareholder wealth or something similar.[182] Faced with this powerful established paradigm and its arguable success in creating economic growth, arguing that corporate law needs wholesale reform is a hard sell, and so far efforts to cast down the shareholder-centric state of corporate law in the U.S. have largely failed.[183] If the instrumental claims of stakeholder democracy are correct, its growth is more likely to be encouraged by advancing practical methods for voluntarily implementing these structures and convincing business leaders of their superiority, rather than attempting the Sisyphean task of changing corporate law.

Another practical impediment to legally mandating stakeholder governance is a continuing problem of stakeholder theory — defining exactly who the relevant stakeholders of any given corporation are.[184] The most commonly used definition of "stakeholder" is incredibly broad — "[A]ny group or individual who can affect or is affected by the achievement of the organization's objectives."[185] While this breadth can be frustrating to the application of stakeholder theory in a managerial setting, one can see some wisdom to casting a wide net for potential stakeholders so that managers are thinking broadly about the various parties who their actions may affect.[186] However, for purposes of crafting enforceable corporate law, a higher level of certainty regarding exactly who the stakeholders that managers and directors owe duties to, fiduciary or

181. *See, e.g.*, Brodie, *supra* note 70, at 976-82 (noting the broad acceptance of shareholder primacy in law and business).

182. *See, e.g.*, Sumantra Ghoshal, *Bad Management Theories are Destroying Good Management Practices*, 4 ACAD. MGMT. LEARNING AND EDUC. 75, 79-80 (2005) (decrying the entrenchment of shareholder-centric views and agency theory being taught in management schools and arguing that they lead to bad management practices).

183. *See* Yosifon, *supra* note 11, at 226 (while decrying the fact and calling for reform, admitting "[s]hareholder primacy is undoubtedly the law of Delaware, the most important corporate law jurisdiction in the known universe.").

184. *See, e.g.*, Ronald K. Mitchell, Bradley R. Agle, & Donna J. Wood, *Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts*, 22 ACAD. MGMT. REV. 853, 853 (1997) (noting a lack of consensus on how to define what stakeholders really matter to the firm such that managers should pay them attention); *see also* Andrew Crane & Trish Ruebottom, *Stakeholder Theory and Social Identity: Rethinking Stakeholder Identification*, 102 J. BUS. ETHICS 77, 78-80 (2011) (discussing various theories and methods of stakeholder identification).

185. R. EDWARD FREEMAN, Strategic Management: A Stakeholder Approach 46 (1984).

186. *See, e.g.*, R. Edward Freeman, *Divergent Stakeholder Theory*, 24 ACAD. MGMT. REV. 233, 235 (1999) (noting the conceptual breadth of stakeholder theory, but welcoming diverse "narratives" of stakeholder theory that are useful to management).

otherwise, is necessary.[187] This is an inherent problem with implementing a legally required stakeholder corporate governance structure.[188] The world is a complex place, and each corporation will have a different set of stakeholders that it considers to be its most important. Thus, no matter where a corporate law statute draws the line with respect to which stakeholders have corporate governance rights and which do not, this line will always be under or over inclusive for some companies.[189] Faced with this level of uncertainty, shareholder primacy provides a much higher level of workability through its simplicity.[190]

The voluntary stakeholder democracy structures proposed in this article resolve this issue. Through private ordering, as allowed by existing corporate law, each individual corporation can decide which stakeholders are sufficiently important to give them a role in corporate governance. In a complex business world, attempting to mandate which stakeholders should have rights is a road fraught with peril. More freedom, not less, is desirable, such that corporations and stakeholders can govern their own affairs and reach the arrangements that are most beneficial to them.[191] If a particular stakeholder group feels that it should have a "seat at the table" in corporate governance, that group is free to negotiate for such rights.[192] If a particular corporation with strong stakeholder values, such as a social enterprise,[193] feels that for normative, ethical, or instrumental business reasons a particular stakeholder should have a say in corporate governance

187. *See* Andrew Keay, *Stakeholder Theory in Corporate Law: Has it Got What it Takes?*, 9 RICH. J. GLOBAL L. & BUS. 249, 290-91 (2010) (noting that the Company Law Review Steering Group charged with examining U.K. company law for reform was against stakeholder theory as unworkable because of its breadth).

188. Id.

189. *Id*. at 292 (discussing the difficulty of determining exactly which stakeholders should have representation on a board of directors in a stakeholder governance structure).

190. *Id*. at 290 ("It has always been perceived that one of the strengths of the shareholder primacy position, certainly when compared with stakeholder theory, has been that it provides greater certainty and is workable.") (footnote omitted).

191. *See* Virginia Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59, 104 (2010) (noting that the freedom to contract and the "hypothetical bargain" that all stakeholders enter into by interacting and contracting with corporations absent corporate governance rights is a basis of the dominant contractarian theory of corporate law).

192. *Id*.

193. *See* Justin Blount & Patricia Nunley, *What is a "Social" Business and Why Does the Answer Matter?*, 8 Brook. J. Corp. Fin. & Com. L. 278, 303-04 (2014) (citing Felipe M. Santos, *A Positive Theory of Social Entrepreneurship*, 111 J. BUS. ETHICS 335, 341 (2012)) (discussing the difficulties of defining what differentiates social enterprises from other businesses, but arguing that "social enterprise" should be defined as "an organization that utilizes an earned income strategy to accomplish a primary organizational mission of creating value for one or more stakeholders besides the organizations' shareholders or owners").

matters, it is free to grant them this role. There is simply no reason to believe that requiring any level of stakeholder governance by corporate law mandate would result in a consistently applied more optimal arrangement than what currently exists.

Some commentators have asserted that stakeholder theory is gaining popularity even among large, traditional corporations.[194] However, implementing a strong form of stakeholder democracy through share classification may be difficult for an existing corporation, particularly a large one, as the shareholders, directors, and managers would likely be wary of giving up power to other stakeholders. But a newly formed or smaller corporation could much more easily implement such a structure. Social enterprises and businesses that otherwise self-identify as being socially-minded,[195] tend to be smaller corporations and it is common for these types of businesses to discuss their businesses using stakeholder rhetoric.[196] For firms such as these that are already conducting business in a non-traditional way by not predominantly focusing on profits, voluntarily adopting some degree of a stakeholder democracy governance structure while still relatively small would seem to be an attractive proposition and fairly non-controversial to their shareholders.

Nevertheless, I could find no examples of any U.S. business, even among those self-identifying as social enterprises, utilizing a governance structure that embeds stakeholder democracy through share classification or that otherwise requires diverse stakeholder representation on the board of directors. Why, when corporate law is flexible enough to allow for stakeholder participation in governance, do we not observe companies, including social enterprises, adopting such structures? If the widely-held "contractarian" view of corporate law is correct and the corporation is a nexus of contractual arrangements that can be freely modified by the parties involved,[197] we should expect to see unique corporate governance

194. *See* P.M. Vasudev, *The Stakeholder Principle, Corporate Governance, and Theory: Evidence from the Field and the Path Onward*, 41 HOFSTRA L. REV. 399, 399-400 (2012) (conducting a survey of the U.S., U.K., and Canadian companies in the 2012 Global 500 and finding "near-unanimous" support for stakeholder theory at some level).

195. *See* Santos, *supra* note 193, at 341-42 (contrasting the value-creating motivations of socially-minded corporations with the value-capturing motivations of others).

196. *See, e.g.*, Press Release, Breckinridge Capital Advisors, Breckinridge Awarded B Corp. Status, (Feb. 19, 2013), http://www.breckinridge.com/insights/news_and_noteworthy/breckinridge_awarded_b_corporation_status/ [perma.cc/444E-DT2E] (announcing that Breckinridge was awarded "B Corporation" certification, which "legally expanded their corporate responsibilities to include consideration of stakeholder interests").

197. *See* Hayden & Bodie, *supra* note 10, at 123-24 (noting the dominance of the contractarian theory of the firm and how it has shaped corporate law over the last three decades).

arrangements like stakeholder democracy emerge to accommodate the needs of managers and directors that subscribe to stakeholder theory.[198] This is especially the case if stakeholder participation in governance will result in better business outcomes, as some stakeholder theorists suggest.[199] This observed absence of stakeholder based governance structures despite the legal ability to create them is an important issue for stakeholder theory in general, and stakeholder democracy specifically, which needs to be addressed by stakeholder theorists before the instrumental claims for stakeholder theory can be taken seriously. Next, this article will take on this issue and discuss potential explanations for why corporations do not take advantage of the flexibility of existing corporate law and voluntarily create governance structures which incorporate features of stakeholder democracy.

III. ADDRESSING THE ABSENCE OF STAKEHOLDER DEMOCRACY

While there is a notable absence of voluntarily created stakeholder democracies and other stakeholder-centric governance structures, there are large and high profile companies that seem to expressly support stakeholder theory.[200] A specific example is Whole Foods Market, Inc., a publicly traded grocery store chain which claims as its core value a "Declaration of Interdependence" that embeds many of the sentiments found in stakeholder theory.[201] For example, this Declaration of Interdependence states that Whole Foods seeks to "instill a clear sense of interdependence among our various stakeholders (the people who are interested in and benefit from the success of our company)."[202] The statement even seems to support at least some level of stakeholder democracy, as it states that keeping stakeholder interests in balance requires "participation and communication by all of our stakeholders. . . . Creating and nurturing this community of stakeholders is critical to the

198. *See* Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later,* 31 J. CORP. L. 779, 783 (2006) (noting that under the contractarian theory of the firm "[f]irms are believed to be heterogeneous in their governance needs and are expected to adopt a diverse assortment of governance arrangements. . . . All the law needs to do is provide 'off the rack' contract terms that can be adopted, or not, to the extent they enhance the firm's value.") (citations omitted).

199. *See supra* text accompanying notes 71-72 (discussing the suggestion by stakeholder theorists that stakeholder democracy will result in fairness, representation, and accountability).

200. *Id*.

201. *Declaration of Interdependence*, WHOLE FOODS MARKET, INC., http://www.wholefoodsmarket.com/mission-values/core-values/declaration-interdependence [https://perma.cc/WF6S-3BT4] (last visited Mar. 13, 2015).

202. *Id*.

long-term success of our company."[203] However, Whole Foods retains a traditional corporate governance structure with a fairly typical board of directors composed of outside and inside directors with business expertise.[204] Arguably the board of Whole Foods is actually very shareholder-centric, as six of the eleven directors are involved to some degree in professionally managing equity investments.[205] Thus, even a company with strong self-stated stakeholder management (and arguably stakeholder democracy) values has not formally integrated these values into its corporate governance structure.

There are of course numerous plausible explanations for this absence of stakeholder democracy in corporate governance. Evaluating these potential answers to this question raises interesting questions and criticisms with respect to stakeholder theory and stakeholder democracy, and indeed corporate governance in general.

A. *Creating a Stakeholder Democracy is Too Complex*

One potential explanation for this absence is that creating a stakeholder democracy is simply too complex. It requires an in-depth understanding of the flexibility of corporate law and the creation of different rights, classifications, and restrictions with respect to shares. This complexity is further exacerbated by the strength of the norm of shareholder primacy, which could lead to a mistaken belief that such complex governance structures are not permissible.[206] Accordingly, the entrenched paradigm of shareholder primacy, coupled with the complexity of the shareholder arrangements necessary to create a democracy, could arguably serve as a barrier preventing interested companies from

203. *Id*.

204. *Board of Directors*, WHOLE FOODS MARKETS, INC., http://www.wholefoodsmarket.com/company-info/board-directors [perma.cc/M3DG-W64H] (last visited Mar. 13, 2015).

205. *Id*. Gabrielle Greene-Sulzberger serves as the principal of a diversified investment fund Rustic Canyon/Fontis Partners, LP; Hass Hassan is a general partner of Greenmont Capital; Jonathan A. Seiffer and Jonathan D. Sokoloff are both partners in Leonard Green & Partners, LP, an affiliate of Green Equity Investors V, LP; and Dr. Ralph Z. Sorenson is the managing partner of Sorenson Limited Partnership, a venture investment partnership.

206. *See, e.g.*, Matthew T. Brodie, *AOL Time Warner and the False God of Shareholder Primacy*, 31 J. CORP. L. 975, 976-82 (2006) (noting the strength of the norms of shareholder primacy and shareholder wealth maximization, and how they have gained broad acceptance in the legal and business academies); *see also* Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefit Corps.*, 25 REGENT U. L. REV. 269, 276 (2013) (noting that calls for legal reform in corporate law spring from a false perception "that for-profit corporations must/should serve shareholder interests exclusively or primarily") (citation omitted).

experimenting with unique corporate governance arrangements or changing shareholder rights.

This argument would perhaps be convincing were it not for the presence of existing complex shareholder arrangements. A common example of such complexity is found in the area of corporate takeovers and devices designed to prevent them, which inevitably involve shareholder rights.[207] In order to prevent hostile takeovers, boards of directors and managers have created incredibly complex defensive schemes such as poison pill shareholder rights plans, "shark repellent," and staggered boards of directors.[208] Even a basic "flip-in" poison pill is more complex than the shareholder classification scheme posited in this article.[209] In a "flip-in" poison pill arrangement, existing shareholders of a target company are granted the right to purchase additional shares at below market value if an acquirer or its affiliate purchase a threshold amount of the target company's stock, usually something like ten to twenty percent of the outstanding shares.[210] This right to purchase shares at a below market price dilutes the value of the acquirer's stake, making it essentially impossible for the acquirer to complete a hostile takeover.[211]

This is an example of one of the most basic hostile takeover defenses, and it is more complex than creating a simple stakeholder democracy via share classes with different voting rights. Thus, when an adequate incentive is in place, complexity is not an impediment to creative corporate arrangements that contract around the default positions of corporate law. It would appear that the proper incentive for corporate law creativity is simply protection of company management, not improvement of business results or corporate governance.[212] This observation leads to another

207. *See* Jordan M. Barry & John William Hatfield, *Pills and Partisans: Understanding Takeover Defenses*, 160 U. PA. L. REV. 633, 655-73 (2012) (discussing various models of takeover devices, including the players and incentives involved).

208. *See, e.g.*, Coates IV, *supra* note 167, at 318, 326 (discussing various anti-takeover devices).

209. *See* Barry & Hatfield, *supra* note 207, at 642 (discussing the structure of the "flip-in" and "flip-over" poison pill).

210. *Id.*

211. *Id.* at 642-43 ("Accordingly, acquirers are careful to avoid 'swallowing' the poison pill—that is, acquiring enough stock to trigger its dilutive provisions. In fact, bidders essentially never trigger modern poison pills. As long as a poison pill remains in place, a takeover of the target corporation is effectively impossible.") (footnotes omitted).

212. *See* Julian Velasco, *The Enduring Illegitimacy of the Poison Pill,* 27 J. CORP. L. 381, 385 (2002) (arguing "that the poison pill is an illegitimate defense tactic that allows management to entrench itself at the expense of shareholders"); *see also* J. Robert Brown, Jr. & Sandeep Gopalan, *Opting Only in: Contractarians, Waiver of Liability Provisions, and the Race to the Bottom*, 42 IND. L. REV. 285, 309 (2009) (noting that in a study of the U.S. based Fortune 100 companies that were non-federally chartered, all but one had waiver of liability provisions in their certificates of incorporation waiving director and officer liability

potential explanation for the absence of more diverse boards that include stakeholder representation.

B. *Corporate Governance Arrangements, including Boards of Directors, are Not Selected for Effectiveness*

Since the board of directors serves as the main power center for a corporation and is the mediating hierarchy between management and shareholders, one would assume that the main criteria for a directorship would be competency and the ability to add value to the business.[213] The team production model of the firm is built upon the assumption that the various stakeholders of the firm are willing to make firm-specific investments into the firm because the board of directors acts as an independent hierarchy to manage the inputs and outputs of the firm and manage disputes among stakeholders.[214] Such a view of the board of directors assumes that the stakeholders, who voluntarily make their inputs into the firm, believe that the board of directors is reasonably independent and competent.[215] If the role of the board of directors truly is to optimally manage these diverse stakeholders' inputs, then diversity on the board, including diversity of interests, such as those that would arise from stakeholder democracy, should lead to better firm management.[216] Thus, if directors, and by extension corporate governance mechanisms, truly are selected for competency and ability to maximize business outcomes, and if a market for corporate control does exist, one would expect at least some firms to have developed stakeholder representation on the board of directors as a method for creating competitive advantage.[217]

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to the fullest extent allowed by law, indicating that management entrenchment and protection drives choices in corporate governance structures).

213. *See* Seletha R. Butler, *All on Board! Strategies for Constructing Diverse Boards of Directors*, 7 VA. L. & BUS. REV. 61, 70-72 (2012) (discussing qualifications for boards of directors and stating that "[a] key challenge for board composition is building a group that can work cohesively, offer constructive dissent, leverage each member's experience to better understand tough issues, ask thought-provoking questions, demand pertinent information, and make the best informed decisions, while consistently adding value").

214. *See* Blair & Stout, *supra* note 54, at 251 (discussing that the inputs of various "team members" to the firm are controlled by the board of directors as "an internal hierarchy whose job is to coordinate the activities of the team members, allocate the resulting production, and mediate disputes among team members of that allocation").

215. *Id*. at 277-78 (discussing how various stakeholders are willing to give up control over their own investments in the firm because "they judge their chances of capturing some of the significant rents that can flow from team production to be greater if they give up control to a decisionmaking hierarchy").

216. *See* Butler, *supra* note 213, at 73-75 (discussing the business rationale for more diversity on boards of directors).

217. *See, e.g.*, Thomas J. Bamonte, *The Dynamics of State Protectionism: A Short*

Professor J. Robert Brown, Jr. refutes this argument, and asserts that the idea that directors are selected based upon competency is in fact a myth.[218] Rather, he argues that the reality is that, because of the high level of control of the CEO in most publicly traded companies, boards of directors are selected based upon their willingness to support the CEO, not because of their qualifications.[219] Professor Brown argues that this overriding criterion of CEO support is a factor leading to the observed lack of gender and racial diversity on boards of directors.[220] This same logic can be extended to the lack of boards of directors reflecting stakeholder democracy. If the main criterion for board membership is support for management, then management and existing directors comfortable in their positions will be unlikely to support stakeholder representation on the board of directors. Stakeholder representative directors would undoubtedly be more likely to question and monitor managers than individuals hand-picked by the CEO.

Thus, it is possible that a board representing stakeholder democracy would be a better form of corporate governance, but the reality of the power of management in the board selection process has halted its manifestation. While this explanation is plausible for existing public companies, it does not explain why social enterprises and other socially-minded companies have not adopted such structures.[221] In a company founded on principles of prioritizing value creation for society over profit for shareholders,[222] CEO control over the director nomination process should not be a significant impediment to stakeholder representation. If the CEO truly believes in the stakeholder-centric mission of the organization, as should be the case in a social enterprise, there should be little to no hesitancy to provide for stakeholder representation on the board. Accordingly, while CEO control over the director nomination process

Critique of the CTS Decision, 8 N. ILL. U. L. REV. 259, 260 (1988) (discussing how the market for corporate control results in corporate assets being put towards their best use, and noting that "[a]n open market for corporate control is a prerequisite for the dynamic process of economic reordering necessary for long-term economic growth.").

218. *See* J. Robert Brown, Jr., *The Demythification of the Board of Directors*, 52 AM. BUS. L.J. 131, 137 (2015) ("The general assumption is that directors are selected on the basis of their substantive qualifications. This, however, is a myth.").

219. *Id*.

220. *Id*. at 166 (arguing that in selecting board members based upon "reliability", CEOs commonly seek out nominees from pools that tend to lack diversity: other CEOs and their own social and professional circles).

221. *See supra* Part II.B.2. (describing how firms can use shareholder classification to promote stakeholder democracy in corporate governance).

222. *See* Blount & Nunley, *supra* note 193, at 303-04 (discussing the defining characteristics of the social enterprise, and emphasizing the inclusion of prioritized value creation for non-shareholders in the definition).

might be a strong impediment to stakeholder democracy in traditional profit-centric public corporations, it cannot sufficiently account for the lack of stakeholder democracy in corporate governance in social enterprises. Regardless, even if CEO control over director selection exists and is a problem, it might justify minor legal reform to change management involvement in board of director selection, but it does not justify the wholesale change to corporate law advocated for by some stakeholder theorists.[223]

C. *Shareholders Would Not Accept the Loss of Control Required of Stakeholder Democracy*

Another possible explanation for the observed lack of stakeholder democracy in corporations is opposition by shareholders due to a perceived loss of control. If the default position of corporate law is that of shareholder primacy, and if shareholders value the rights that this position of primacy entails, then it is logical that investors would avoid becoming shareholders in companies that alter this norm and dilute their power in corporate governance. This explanation presumes that shareholders actually have significant power in the modern corporation and that this power is valued. At least in publicly held corporations, there is strong evidence that this is not the case.

The common view of the publicly held corporation in the United States is that it is owned by a diffuse group of public shareholders with no single individual shareholder possessing substantial holdings.[224] Diffuse ownership creates a distinct agency problem as it leads to a difficulty in shareholders monitoring directors through their voting power.[225] This is because each individual shareholder has insufficient ownership to exert voting power individually, and lacks the ability or desire to attempt to build a voting coalition with other shareholders.[226] This diffuse ownership, coupled with the ability to easily sell shares in public securities markets,

223. *See supra* note 4. (citing multiple scholars' assertions that a shift away from shareholder primacy towards a more democratic stakeholder corporate governance approach is much needed in corporate law).

224. *See* Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUDIES 1377, 1377 (2009) ("Two stylized facts dominate thinking about the ownership concentration of public corporations—U.S. firms generally are diffusely owned, and U.S. firms are more diffusely owned than comparable firms elsewhere.").

225. *See* Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 789 (2007) ("In a public company with widely dispersed share ownership, it is difficult and expensive for shareholders to overcome obstacles to collective action and wage a proxy battle to oust an incumbent board.").

226. *Id*.

has led to shareholders commonly being referred to as "rationally apathetic" about exerting their shareholder rights, including their right to vote.[227] Under diffuse ownership, shareholder voting often becomes a mere formality and the slate of directors presented by the current board is elected as a matter of course.[228]

In recent history, this paradigm has changed due to institutional ownership of shares.[229] Now, most individuals invest in equity holdings through institutional ownership arrangements, such as mutual funds, exchange-traded funds, or pension funds in which the stock shares are held by the institutional owner for the benefit of the individual investors.[230] Theoretically, these institutional holders should have greater voting power as well as the ability to more easily overcome the collective action problem and work with other institutional owners to have a greater impact on corporate governance through their votes.[231] This greater concentration of ownership in the hands of professional investment managers could arguably lead to the observed lack of unique corporate governance arrangements, such as stakeholder democracy, as these institutional holders would reasonably value their voting rights much more than individual shareholders and would not wish to have them diluted. However, it would appear that even though institutional ownership has concentrated equity holdings, these institutional owners still do not highly value the right to

227. *See, e.g.,* Christopher Gulinello, *The Retail-Investor Vote: Mobilizing Rationally Apathetic Shareholders to Preserve or Challenge the Board's Presumption of Authority*, 2010 UTAH L. REV. 547, 573 (2010) ("Most retail investors are rationally apathetic. It does not make economic sense for them to invest the time to gather the information they need to make educated voting choices.").

228. *Id.* at 573 (noting that, because of their rational apathy, individual shareholders will typically either vote for management's director nominees or not vote at all).

229. *See* Ronald J. Gilson & Jeffrey N.Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights,* 113 COLUM. L. REV. 863, 874 (2013) (discussing how U.S. equity ownership has changed from individual ownership to institutional ownership since the 1950s).

230. *Id.* ("In 1950, the Berle-Means description advanced some twenty years earlier remained accurate. Equities were still held predominantly by households; institutional investors, including pension funds, held only approximately 6.1% of U.S. equities. By 1980, however, the distribution of shareholdings had begun to shift away from households toward institutions. At that time, institutional investors held 28.4% of U.S. equities. By 2009, institutional investors held 50.6% of all U.S. public equities, and 73% of the equity of the thousand largest U.S. corporations.").

231. *See* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 573 (2006) ("With shareholdings becoming increasingly concentrated in institutional hands, many believed shareholder passivity would no longer act as a bar to effective shareholder oversight of corporate managers. This was thought to be especially true with respect to issues exhibiting economies of scale, such as process and structural issues, in contrast to firm-specific issues, because institutional shareholders generally own shares in many companies.").

vote or have a hand in corporate governance.[232] Rather shareholders, even institutional ones, appear to value their right to "vote" with their dollars by selling shares more than their right as shareholders to vote to elect directors.[233]

This devaluation of the vote in publicly traded companies is evident from the continued existence of a significant number of large publicly held companies with multiple share classes, which dilute the voting power of the publicly traded shares.[234] A typical arrangement for such companies is a "dual class" structure wherein the publicly traded shares carry one vote per share, but a superior class, usually owned only by insiders, has superior voting rights.[235] For example, both Facebook, Inc. and Google, Inc. went public with a dual class structure that ensured that public shareholders would never have the ability to usurp the founders' control over their companies.[236] Mark Zuckerberg, the founder of Facebook, retains over fifty percent of the company's voting power while owning a much smaller percentage of the market capitalization.[237] In spite of this retention of control by insiders, both companies had successful initial public offerings.[238] Google has recently diluted shareholder voting rights again, further entrenching the control of the company's founders, by publicly issuing new non-voting shares.[239] Since these companies have successfully raised equity capital from investors in a situation where the investors could never use their voting rights, even acting in concert, to elect a single board

232. *See* Gilson & Gordon, *supra* note 229, at 867 (referring to institutional owners as being "rationally reticent" to utilize their voting power in corporate governance).

233. *Id*. at 893 ("That is, the fact of poor governance or poor management at a portfolio company may be an element in comparative evaluation, but the indicated action for the institution—but not its beneficiaries—may be to 'sell,' not to 'intervene.'").

234. *See* Paul A. Gompers, Joy Ishii, & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. FIN. STUDIES 1051, 1052 (2010) (noting that "[a]bout 6% of the publicly traded companies in the United States have more than one class of common stock").

235. *Id*. ("In the typical dual-class company, there is a publicly traded 'inferior' class of stock with one vote per share and a nonpublicly traded 'superior' class of stock with ten votes per share.").

236. *See* Richard Moroney, *Not All Shares are Created Equal: More Multiclass Stocks to Join Google in the S&P 500*, FORBES (July 16, 2014, 11:42 AM), http://www.forbes.com/sites/investor/2014/07/16/not-all-shares-are-created-equal-more-multiclass-stocks-to-join-google-in-the-sp-500/#5ae9d4be739e [perma.cc/5MHF-RRMK] (explaining that "[m]ultiple share classes [like those of Google and Facebook] let company founders maintain control by creating closely held shares with super voting rights even after they have sold off the majority of their economic stake in the company.").

237. *Id*. (noting that, at the time of the newsletter's writing, Mark Zuckerberg held 57% of the voting shares of Facebook, but only 18% of the market capitalization).

238. *Id*.

239. *See* Summers, *supra* note 162 (discussing Google's issuance of Class C non-voting shares).

member, it would appear that investors do not highly value shareholder voting rights or board representation. Thus, there is no reason to believe that shareholder opposition, due to a loss or dilution of control, is a substantial impediment to corporations adopting a stakeholder democracy. As long as the public shareholders are free to sell their shares in a competitive securities market, the loss of the right to elect the board through voting is fairly insignificant.

D. *Network Externalities Make the Cost of Unique Governance Arrangements Too High*

Even if, as contractarians assert, a market that helps direct private ordering in corporate contracts exists for corporate governance,[240] it does not follow that this market is perfect and will always result in optimal corporate contracting terms. We know that markets are often not perfect and have imperfections (such as externalities), which can lead to unexpected and undesirable results.[241] If stakeholder democracy truly is a better form of corporate governance, and can be voluntarily created under the law, it could be that some type of market imperfection is preventing market forces from giving rise to stakeholder democracies or otherwise stakeholder governed corporations.

Professor Klausner has proposed that a particular market imperfection, network externalities, may be at work in corporate contracting, resulting in homogeneous corporate contract terms when heterogeneity may be more optimal.[242] Network externalities exist when the value of a product or service is dependent upon the number of other users of that product or service.[243] The quintessential example of a product with network externalities is the personal computer.[244] If only few people own

240. *See* Brett H. McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 SMU L. REV. 383, 384 (2007) (discussing how, under the contractarian view of the firm, provided that markets work well, "the parties involved will be in the best position to choose the rules that should govern them").

241. *See, e.g.*, Alain Marciano, *Why Market Failures are not a Problem: James Buchanan on Market Imperfections, Voluntary Cooperation, and Externalities*, 45 HISTORY OF POL. ECON. 223, 223 (2013) (discussing the common view among economists that market imperfections, such as externalities, exist and are common causes of sub-optimal allocation of resources).

242. *See* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts,* 81 VA. L. REV. 757, 774-89 (1995) (discussing the various network externalities that corporate contracts appear to exhibit).

243. Michael L. Katz & Carl Shapiro, *Technology Adoption in the Presence of Network Externalities*, 94 J. OF POLITICAL ECON. 822, 822 (1986).

244. *See* Klausner, *supra* note 242, at 762-63 (designating personal computers as an example of a product with network externalities).

computers, the value of those computers to each individual user is greatly diminished, as it is unlikely that complimentary products such as software and peripheral devices will be created unless computers are widely adopted.[245] As more people adopt computers, the value of the computer to each individual owner is increased, due to the networked nature of the product.[246] Network externalities can lead to new innovations not being adopted by the market, even if an innovative new product or service is inherently superior to previous offerings, because of the built up value offered by the existing network.[247] This potentially undesirable effect is referred to as "lock in."[248]

Corporate contracts appear to exhibit network externalities.[249] As more people adopt particular corporate contract terms, those terms have more value because benefits accrue around the terms, such as judicial rulings interpreting them and the ability to market the firm's securities because of the terms' general acceptance.[250] Thus, it could be that corporate governance has "locked in" around the majoritarian default of shareholder primacy, and the network effects of its widespread adoption makes it cost prohibitive for corporations to adopt alternative structures. This lock in effect could be exacerbated because majoritarian defaults, like those used in corporate law, will also tend to be "sticky" by nature of them being chosen as the statutory default because they are the likely majority position which parties would freely choose.[251]

This network externalities argument has strong explanatory value for why we do not see more diversity in corporate contracting. It is quite possible that unique corporate governance arrangements, such as stakeholder democracy, do not arise through market forces because network externalities make switching costs from the default position of

245. *Id.*

246. *Id.*

247. *See* Katz & Shapiro, *supra* note 243, at 832 (Noting that "[f]irst-period consumers choose first and lock in their preferred technology, even when it is socially optimal to standardize on the other technology . . . . The preferred technology of the larger consumer group can prevail even when it is socially optimal for the preferred technology for the smaller group to do so.").

248. *Id.*

249. *See* Klausner, *supra* note 242 at 774-89 (describing ways in which network externalities exist in corporate contracts).

250. *Id.*

251. *See* Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults,* 51 STAN. L. REV. 1591, 1598 (1999) (Declaring that "[e]xternalities are important because the costs of express contracting often make defaults 'sticky.' More parties will be covered by a rule if we make that rule a default than will be covered by that rule if we make a different rule the default . . . . This is the iron law of default inertia.").

shareholder primacy too high.[252] However, a market defect such as this does not justify wholesale changes to corporate law to mandate stakeholder democracy over shareholder primacy. Each firm is different, and thus it is entirely possible that stakeholder democracy will be optimal for some firms, while shareholder primacy will be optimal for others, necessitating a level of private ordering. The current structure of corporate law allows for this level of diversity.

If network externalities are the market imperfection inhibiting corporate contracting, the most viable area for corporate law reform is to modify the majoritarian default to try to reduce the lock in around shareholder primacy and encourage heterogeneous contracting.[253] For example, rather than being used as a majoritarian default that incorporators must expressly contract around, shareholder-only voting could be set out in the statute as just one of a menu of other corporate governance options which a corporation must expressly select.[254] Such a change to corporate law may help remove the stickiness of the majoritarian default and encourage alternative corporate governance arrangements through private ordering, without upsetting all of corporate law.

E. *Stakeholder Democracy, and Perhaps Even Stakeholder Theory, Are Inferior to Conventional Corporate Governance*

A final argument for why we do not see voluntarily created stakeholder democracies is quite simple and straightforward, but very possibly true—stakeholder democracy is simply inferior to the conventional arrangement of shareholder primacy.[255] There is certainly a strong contingent of scholars who continue to argue that the maximization of shareholder wealth is the optimal objective of the corporation for both society and individual firms, and thus placing fiduciary duties and voting power solely in the hands of shareholders is appropriate.[256] Perhaps the

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252. *See* Marcel Kahan & Michael Klausner, 83 VA. L. REV. 713, 728 (1997) (discussing how network benefits arising from commonly adopted corporate contract terms can result in high switching costs if a firm considers adopting a unique corporate contract term).

253. *See* Ayres & Gertner, *supra* note 251, at 1598 (discussing how majoritarian defaults will by their nature tend to encourage lock-in)

254. *See, e.g.*, Klausner, *supra* note 242, at 839-40 (arguing that to battle the stickiness of majoritarian defaults, "menus" of optional terms could be utilized).

255. *See* Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1339 (2013) (noting that one potential implication of the uniformity in corporate contracting is that the defaults of corporate law are value-maximizing for virtually all firms).

256. *See, e.g.*, Anant K. Sundaram & Andrew C. Inkpen, *The Corporate Objective Revisited*, 15 ORG. SCI. 350, 353-56 (2004) (asserting that the maximization of shareholder

dearth of alternative governance arrangements, despite the ability to create them, is nothing more than further evidence that shareholder primacy has become the entrenched standard of corporate governance because of its superiority.[257] Simplicity does not mean inaccuracy, and oftentimes the opposite is the case. The absence of alternative corporate governance arrangements, despite the opportunity to create them, may be nothing more than very strong evidence that the calls for more democratic forms of corporate governance are in fact unfounded. Regardless of whether this assertion is true or not, it is an argument that those calling for corporate law reform need to face. So far it has not been adequately addressed by stakeholder theorists, and has been largely ignored.

IV. CONCLUSION

The debate about optimal corporate governance structures is an important one, and it is one that society should continue to have on an ongoing basis. However, what must not be lost in this debate is that it must be grounded in reality, as corporate law is ultimately tested in the marketplace, not in academia. The reality of corporate law is that it is sufficiently flexible to accommodate high levels of stakeholder governance through voluntary private ordering. To advance their cause, stakeholder democracy advocates need to address the positive aspects of this reality for their theory (that democratic structures of corporate governance can already be implemented to a great extent),[258] as well as the negative aspects (the fact that this has not yet happened in the real world casts doubt on the desirability of democratic forms of corporate governance).[259] By addressing this issue at the level of private ordering rather than corporate law reform, new avenues for stakeholder governance research can be explored, and perhaps more creative and effective methods of corporate governance reforms can be developed.

Stakeholder theorists should embrace this reality and develop more nuanced reforms to corporate governance that respect the right to contract for specific corporate governance arrangements, while also encouraging experimentation and diversity. Such an approach allows stakeholder theorists to maintain the original libertarian underpinnings of stakeholder

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wealth is the optimal corporate objective).

257. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439, 468 (2001) (discussing competitors to the shareholder model, including stakeholder models, and their flaws, and arguing that the "end of history" in corporate law has been reached and corporate law globally will continue to converge around the shareholder model).

258. *See supra* Part II.

259. *See supra* Part III.

theory through encouraging private ordering, and also recognizes the diversity in corporate governance structure that is necessary to accommodate diverse business needs.[260] The hallmarks of stakeholder theory based law reforms should be facilitating private ordering, ameliorating or eliminating any market imperfections which may exist, and encouraging optimal firm-specific corporate governance, not seeking to mandate corporate governance arrangements applicable to all firms. Then, if stakeholder theorists' assertions are correct, they should expect to see stakeholder principles, such as stakeholder democracy, voluntarily incorporated into corporate governance structures.

260. *See* Freeman, *supra* note 177, at 337 (demonstrating the libertarian underpinnings of stakeholder theory).