

SHAREHOLDER EMPOWERMENT AS AN END IN ITSELF: A NEW PERSPECTIVE ON ALLOCATION OF POWER IN THE MODERN CORPORATION

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[There is currently an exciting debate underway regarding the way in which power should be allocated in the modern public corporation. A special edition of the Harvard Law Review in April 2006 will be devoted to this debate.

The current debate is the result of recent proposals, both by the US Securities & Exchange Commission as well as by corporate governance commentators, to increase shareholder power.

The ironic thing about this debate, but which so far has not been addressed, is the degree of unity regarding the value of shareholder participation. Both sides (which I categorise for convenience as 'shareholder primacists' and 'director primacists') believe that the participatory rights of shareholders should be increased if this would improve corporate performance. Accordingly, there is no place for increased shareholder power if it does not strengthen the bottom line, even if shareholder empowerment is no threat to the authority of the directors, and may provide non-financial benefits to the shareholders.

This article disputes this commonly held view regarding the value of shareholder participation in the corporation. It will be argued that shareholder participation is not simply a means to an end but rather an end in itself. A fresh look at shareholder power with the assistance of empirical research in the emerging areas of happiness studies and "psycho-economics", suggest that shareholders would enjoy greater, longer-lasting happiness by using their shares to have a participatory role in the corporation.

It seems that active participation, rather than conventional passivity, may in fact be the "rational choice".

Accordingly, with the support of this emerging research, it is argued that there is a strong case for increasing shareholder power.]

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I Introduction

[S]hareholders' lack of power ... is not an inevitable element of the legal structure of the modern corporation. ... [D]ifferent allocations of power between shareholders and management should not be ruled out as inconsistent with the basic doctrinal structure of corporate law.¹

A major debate in corporate law and governance at present concerns the manner in which power should be allocated between directors and shareholders in large public corporations.

The debate has emerged mainly as a result of a series of recent initiatives in the US to increase the participatory rights, and hence the power, of shareholders.²

In a major article published in the *Harvard Law Review* in 2005, Professor Lucian Bebchuk outlined the case for increasing shareholder power, and raised a number of significant proposals to increase shareholder power.³

In highlighting the importance of the debate concerning allocation of power, in April 2006 the *Harvard Law Review* is to publish a special edition of the Law Review on allocation of power and shareholder empowerment, with articles by Professor Stephen Bainbridge and Delaware Court of Chancery's Vice-Chancellor Leo E. Strine responding to Bebchuk's article. Also included in that edition will be a riposte by Bebchuk to Bainbridge and Strine.⁴

In my view, despite the increasing amount of contemporary literature on allocation of power, there is a major irony in the debate which to date has not been addressed. Both advocates of greater shareholder power ("shareholder primacists") and of retaining the status quo ("director primacists") consider shareholder participation as a means to an end, rather than an end in itself (that end being improved company performance).

Indeed, Bebchuk- probably the chief proponent of shareholder empowerment- said in his 2005 article in the *Harvard Law Review*:

I ... stress ... that I do not view increasing shareholder power as an end in and of itself. Rather, effective corporate governance, which enhances shareholder and firm value, is the objective underlying my analysis. From this perspective, increased shareholder power would be desirable only if it would operate to improve corporate performance and value.⁵

Shareholder primacists and director primacists alike believe that the separation of ownership and control in the modern corporation inevitably produces corporate governance problems due to a divergence of executive and shareholder interests, and that the role of shareholder participation (the extent of which is obviously subject to debate) is to fix these problems. But director primacists believe that strong "managerial authority" vested in the directors, rather

¹ Lucian Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 835, 847-8 (2005).

² The two main proposals that have emerged are the SEC's proposed rule 14a-11, which would allow shareholders (in limited circumstances) to nominate candidates to the board, and have this nominee included in the company's proxy statement and on proxy cards (with the company, rather than shareholders, thus paying the cost), and the ABA's proposal to amend the Model Business Corporation Act to require a majority vote (rather than the current plurality vote) for the election of directors. A number of shareholder groups have used the ABA proposal as an impetus to put forward their own proposals for specific corporations to introduce a majority voting regime in their by laws. In their book, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION*, Lucian Bebchuk and Jesse Fried proposed that shareholders be given an intervention power, enabling shareholders to initiate proposals to change the company's state of incorporation, or to amend the company's charter. This intervention power proposal is raised again in Bebchuk's 2005 article in the *Harvard Law Review*.

³ Bebchuk, *supra* note 1.

⁴ The author has obtained drafts of Professor Bainbridge's and Vice-Chancellor Strine's papers. These are cited below.

⁵ Bebchuk, *supra* note 1, at 842-3.

than shareholder participation, is the crucial ingredient to address the separation of ownership and control. Indeed, director primacists go so far as to rebuke the privileged position of shareholders in the corporation.

According to director primacists, the corporation is a fiction, and thus something incapable of being owned, therefore shareholders are not the owners and not automatically entitled to participatory rights. Rather, participatory rights for shareholders, rather than other stakeholders, are built into the corporate contract, representing the price to be paid for shareholders agreeing to assume risk by buying shares in the corporation.⁶

Applying recent empirical and theoretical literature in the emerging areas of happiness studies and the associated “psycho-economics”, this article puts forward the case for shareholder participation as an end in itself, rather than simply a means to a corporate-oriented end. This applies to both individual retail investors and the individuals working in institutional investment houses. Increasing the power of shareholders can be justified because, through the acquisition of shares, shareholders are the ultimate owners of the corporation.⁷

Recent theoretical and empirical literature emphasises a close positive correlation between participation (particularly active, direct participation) and one’s level of happiness. Shareholders who choose to use their shares to participate in the corporation will therefore be obtaining a so-called “experiential purchase”, which have a more positive correlation with happiness. Participation is also important in contributing to what “psycho-economics” refer to as “relational goods”, which also strongly contribute to personal happiness.

The article is not about facilitating shareholder autocracy: this is not what shareholders want, and thus would not be a ‘rational’ move. There is clear empirical evidence that shareholders in large corporations understand the special skills that directors and executives bring to the corporation, and they make little or no attempt to place themselves in a management role in such corporations, rather letting the corporate governance ‘default rule’ (ie directors at the helm having primary responsibility for the management of the corporation) do its work.⁸ This is because for most shareholders, their shares remain primarily a purchase designed for material gain.

Rather, the article advocates making available enough participatory rights so that shareholders can use their shares as an ‘experiential’ purchase, and so shareholders are attracted to use their shareholding as an experiential purchase and to build relational goods, rather than having to direct available energy and resources elsewhere to gain an experience. It is about

⁶ See Stephen Bainbridge, *Director Primacy and Shareholder Empowerment*, UCLA Law School, Research Paper No. 05-25, at 18-21. Available on-line at <www.ssrn.com> Forthcoming in the *Harvard Law Review*.

⁷ For an explanation of why shares constitute a proprietary interest, and that shareholders are ultimately owners of the corporation, see my article, *Do Shares Constitute Property? Reconsidering a Fundamental, Yet Unresolved, Question*, 79 *The Australian Law Journal* 251-260 (2005).

⁸ See Lynn Stout, *The Shareholder as Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance*, 152 U. PA. L. REV. 667, 671 (2003):

Despite the enabling nature of corporate law, public firms generally avoid shareholder primacy-enhancing “reforms,” even at the initial public offering (IPO) stage where corporate promoters have the greatest incentive and ability to select governance rules that appeal to outside investors. In fact, when firms do modify the default rules of corporate governance, they almost always move in the opposite direction, selecting charter provisions that strengthen director control over the firm. This pattern strongly suggests that investors, managers, and other corporate participants collectively perceive director primacy as advantageous ex route.

Also, at 699:

[W]hen the charters of public firms do depart from the default rules of corporate governance, they almost always move in the opposite direction through modifications that strengthen directors’ power vis-à-vis shareholders. This pattern has been observable to some extent since the days of Berle and Means. It has become far more visible in recent years, however, as a result of several newly published studies of the charter provisions of firms selling shares to outside investors in IPOs.

See also Lynn Stout, *Bad and Not-so-Bad Arguments for Shareholder Primacy*, 73 SO. CAL. L. REV. 1189, 1206 (2002): ‘shareholders display a revealed preference for rules that promote director primacy at early stages of a firm’s development.’

giving willing and able shareholder bang for their buck, rather than blowing up the corporation with a shareholder autocracy “bomb”.

The structure of the article is as follows. Part II begins by providing an explanation of the governance structure in the large public corporation, being the focus of this article, and discusses how power is allocated between directors and shareholders in the corporation. Part III gives an overview of the allocation of power debate. The views of the two sides of the debate, so-called ‘director primacists’ and ‘shareholder primacists’, are provided. It is argued that an irony in the debate is that both director primacists and shareholder primacists underplay the importance of shareholder participation. Both camps believe that shareholder participation would only be valuable if it enhances the performance of the corporation, rather than appreciating that there is inherent value in shareholder participatory rights. In other words, shareholder participation is considered a means to an end, rather than an end in itself.

Part IV presents a different perspective on allocation of power, and shareholder power more specifically. Recent theoretical and empirical research in the emerging areas of happiness and “psycho-economics” is put forward to argue that shareholder participation has inherent value. It is suggested that active shareholder participation in the corporation gives a share purchase an experiential quality which research shows is conducive to greater happiness. This does not in any way jeopardise the material quality of the share purchase, but rather adds an extra dimension to the quality of shares.

It is also suggested that for those shareholders who choose to use their shareholding as an experiential purchase, participation with other shareholders along with the directors and managers would go towards building relational goods. Recent empirical research in “psycho-economics”, shows that there is a positive correlation between building relational goods and one’s level of happiness. There is no reason why these findings on experiential purchases and relational goods do not apply to shareholder participation, as they apply to other similar forms of participation- such as being a member of a voluntary association.

Accordingly, if active participation in the modern corporation potentially has this positive effect, we need to facilitate this participation (for those shareholders who choose to participate). The article concludes by suggesting how increased shareholder power can most effectively be accommodated in the modern public corporation.

As this article is essentially a normative assessment of the way in which power is allocated in the modern corporation, it is useful to commence by explaining how power is commonly allocated.

II Allocation of Power in the Modern Corporation

In this section, it is first explained how the governance structure seen in today’s large public corporations developed. This is followed by an explanation of how power is divided in the public corporation under U.S. corporation law.

(a) The Separation of Ownership and Control

Shareholders are often described as the “owners” of corporations. Since at least the days of Adolph Berle and Gardiner Means, however, corporate scholars have understood that in public corporations, shareholder “ownership” does not mean shareholder control.⁹

⁹ Stout, *supra* note 8, at 667-8.

It was once assumed that the corporation's directors were sufficiently accountable to shareholders as owners because directors are normally elected by shareholders at a general meeting, and also through being constrained in the way in which their power could be exercised due to a number of duties imposed on them by law. However, an important empirical investigation by Adolph Berle and Gardiner Means into ownership structures in public companies in the United States subjected this traditional assumption to closer examination.

In *The Modern Corporation and Private Property*, published in 1932, Berle and Means suggested that as public corporations were getting bigger and issuing new shares to raise further capital for expansion (taking advantage of the principle of limited liability by which individuals and corporate entities could become shareholders without being exposed to liability for the corporation's debts¹⁰),¹¹ shareholding was becoming more fractured and widely dispersed (particularly in the very large public companies at the time).¹² This resulted in shareholders being less inclined to take an active interest in the corporation and the corporation's officers being left with basically free rein as to how the corporation was to be run.¹³ Moreover, the assumption that shareholders had ultimate control over directors due to the power to elect which directors they wanted was a myth, as the board had effective control over proxies and the agenda of general meetings.

Accordingly, Berle and Means considered there to be a 'separation of ownership and control' in the modern corporation, with the shareholders being virtually powerless and essentially taking on the role of passive observers, and the directors having no, or very little, ownership stake in the corporation.¹⁴ The developing separation of ownership and control, and its attendant difficulties for shareholders relegated to essentially powerless observers, was captured by Berle and Means in the following statement:

In its new aspect the corporation is a means whereby the wealth of innumerable individuals has been concentrated into huge aggregates and whereby control over this wealth has been surrendered to a unified direction. The power attendant upon such concentration has brought forth princes of industry, whose position in the community is yet to be defined. The surrender

¹⁰ For a discussion of the historical influence of limited liability on shareholder apathy and passivity, *see for example* R R FORMAY, *THE HISTORICAL FOUNDATION OF MODERN COMPANY LAW* 54-5 (1923); C A COOKE, *CORPORATION TRUST AND COMPANY: AN ESSAY IN LEGAL HISTORY* 110 (1950); L S SEALY, *COMPANY LAW AND COMMERCIAL REALITY* 29 (1984).

¹¹ As to the augmentation in the size of large public companies in the US, leading to an overall increase in economic power exercised by these companies and those in management roles, *see* ADOLPH BERLE & GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 19 (1932, revised ed, 1967):

The great extent to which the economic activity is today carried on by such large companies is clearly indicated by the accompanying list of the two hundred largest non-banking corporations, compiled as of 1 January 1930. Nearly all of these companies had assets of over one hundred million dollars, and fifteen had assets of over 1 billion dollars. Their combined assets amounted to eighty-one billions of dollars, or .. half of all corporate wealth in the United States.

¹² As to the trend towards more widely dispersed shareholdings in large public companies in the US in 1932, *see id.* 47:

Accompanying the concentration of economic power, growing out of it, and making it possible, has come an ever wider dispersion of stock ownership. This in turn brought about a fundamental change in the character of wealth, - in the relation between the individual and his wealth, the value of that wealth, and the nature of property itself. Dispersion in the ownership of separate enterprises appears to be inherent in the corporate system. It has proceeded far, it is rapidly increasing, and appears to be an inevitable development.

... the process of stock dispersion has proceeded furthest in the very large companies. The stockholder lists of the largest railroad, the Pennsylvania Railroad, the largest public utility, the AT & T Company and the largest industrial, US Steel Corp, show in each case that the principal holder in 1929 owned less than one per cent of the outstanding stock. The most important holdings reported were, respectively, ..34 of one per cent, .70 of one per cent, and .90 of one per cent. In these companies no single individual holds an important proportion of the total ownership.

See id., 54.

¹³ *See* JOSEPH HEALY, *CORPORATE GOVERNANCE AND WEALTH CREATION IN NEW ZEALAND* 129 (2003), who discusses that Berle and Means' central thesis was that the growing divorce of ownership and control, where the owners are not the decision-makers, meant that managers no longer had a reason to perform well.

¹⁴ *See* the general discussion in ROBERT BAXT, KEITH FLETCHER & SAUL FRIDMAN, *CORPORATIONS AND ASSOCIATIONS* 264 (9th ed., 2003). *See also* BRIAN CHEFFINS, *COMPANY LAW: THEORY, STRUCTURE AND OPERATION* 62 (1997):

[Berle and Means] asserted that while the law treated shareholders as a company's owners, investors in public corporations usually did not act in the manner one would expect of an owner. Instead, shareholders tended to leave it to management to deal with all matters of importance. The upshot was that there was a separation of ownership and control.

of control over their wealth by investors has effectively broken the old property relationships and has raised the problem of defining these relationships anew. The direction of industry by persons other than those who have ventured their wealth has raised the question of the motive force back of such direction and the effective distribution of the returns from business enterprise.¹⁵

In *The Modern Corporation and Private Property*, Berle and Means engage in a detailed discussion of how the large modern corporation, characterised by a separation of ownership and control, had naturally developed through the simultaneous evolution of control in the hands of professional directors and diminished status of ownership, resulting from control being removed as one of the characterising features of property. Berle and Means suggested that the evolution of control in the hands of directors and managers was primarily the result of dispersed ownership, with no one shareholder holding a large enough stake to exercise control,¹⁶ and the control by directors of the proxy system for the nomination and election of directors. As to the latter point, Berle and Means explained that in such companies, where there is a large separation of ownership and control due to the managers holding a small combined amount of the corporation's stock

...it is necessary to examine in greater detail the conditions surrounding the election of the board of directors. In the election of the board the stockholder ordinarily has three alternatives. He can refrain from voting, he can attend the annual meeting and personally vote his stock, or he can sign a proxy transferring his voting power to certain individuals selected by the management of the corporation, the proxy committee. As his personal vote will count for little or nothing at the meeting unless he has a very large block of stock, the stockholder is practically reduced to the alternative of not voting at all or else of handing over his vote to individuals over whom he has no control and in whose selection he did not participate. *In neither case will he be able to exercise any measure of control. Rather, control will tend to be in the hands of those who select the proxy committee by whom, in turn, the election of directors for the ensuing period may be made.* Since the proxy committee is appointed by the existing management, the latter can virtually dictate their own successors. *Where ownership is sufficiently sub-divided, the management can thus become a self-perpetuating body even though its share in the ownership is negligible.*¹⁷

As to the diminished nature of property, resulting from the increasing power and control wielded by directors, Berle and Means highlighted the problem facing shareholders in the modern corporation:¹⁸

The position of ownership has changed from that of an active to that of a passive agent. In place of actual physical properties over which the owner could exercise direction and for which he was responsible, the owner now holds a piece of paper representing a set of rights and expectations with respect to an enterprise. But over the enterprise and over the physical property—the instruments of production—in which he has an interest, the owner has little control. At the same time he bears no responsibility with respect to the enterprise or its

¹⁵ BERLE & MEANS, *supra* note 11, at 4.

¹⁶ *Id.* at 78:

When the largest single interest amounts to but a fraction of one per cent—the case in several of the largest American corporations—no stockholder is in the position through his holdings alone to place important pressure upon the management or to use his holdings as a considerable nucleus for the accumulation of the majority of votes necessary to control.

¹⁷ *Id.* at 82 (emphasis added).

¹⁸ *Id.* at 5:

Outwardly the change is simple enough. Men are less likely to own the physical instruments of production. They are more likely to own pieces of paper, loosely known as stocks, bonds, and other securities, which have become mobile through the machinery of the public markets. Beneath this, however, lies a more fundamental shift. Physical control over the instruments of production has been surrendered in every growing degree to centralized groups who manage property in bulk, supposedly, but by no means necessarily, for the benefit of the security holders. Power over industrial property has been cut off from the beneficial ownership of this property— or, in less technical language, from the legal right to enjoy its fruits. ... There has resulted the dissolution of the old atom of ownership into its component parts, control and beneficial ownership. This dissolution of the atom of property destroys the very foundation on which the economic order of the past three centuries has rested.

physical property. It has often been said that the owner of a horse is responsible. If the horse lives he must feed it. If the horse dies he must bury it. No such responsibility attaches to a share of stock. The owner is practically powerless through his own efforts to affect the underlying property.¹⁹

Berle and Means reaffirm this view later on in the thesis:

In examining the break up of the old concept that was property and the old unity that was private enterprise, it is therefore evident that we are dealing not only with distinct but often with opposing groups, ownership on the one side, control on the other— a control which tends to move further and further away from ownership and ultimately lie in the hands of the management itself, a management ultimately capable of perpetuating its own position. The concentration of economic power separate from ownership has, in fact, created economic empires, and has delivered these empires into the hands of a new form of absolutism, relegating ‘owners’ to the position of those who supply the means whereby the new princes may exercise their power.²⁰

It is said that both a feature of the separation of the ownership and control, as well as a consequence of this separation, is that shareholders, particularly individual shareholders, lack interest in participating in the corporation. They are content to sit back and let the corporation’s directors and executives get on with the business of managing the corporation. They are, what has come to be known as, “rationally apathetic”.

That is, due to the enormous size of corporations and the large number of shareholders in the large modern corporation, even if shareholders were to try and take an active role in the corporation, it is unlikely that they will have any influence as to the ultimate decisions that are made by the corporation (the so-called ‘collective action problem’).²¹ In other words, how is an individual minority shareholder, or even a small group of individual minority shareholders, typically representing only a fraction of the total number of shares in the corporation, likely to even be heard by the board, let alone change the direction of the corporation? Hence, given that the management of the corporation is obliged to act in the best interests of shareholders anyway, and given the cost involved if shareholders do decide to take on an active role, the argument runs that it is “rational” for shareholders to be apathetic, than to be active in relation to the affairs of the corporation. Sitting back and collecting dividend checks is seen to be the appropriate, and desirable, place of shareholders in the corporation, and over time this is what shareholders— especially in the large public corporations— have come to expect their role to be.

There is some important recent commentary explaining the theory of rational apathy, and why this theory justifies a limited participatory role for shareholders. Professors Stephen Bainbridge and Lynn Stout, both of the UCLA Law School, are leading proponents of the theory of rational apathy, and have given excellent accounts recently of this theory.

According to Stout:

The typical public firm has thousands or even hundreds of thousands of shareholders. How can these individuals reach a collective decision? Shareholder voting is slow, difficult, and expensive, even with modern information technology. In contrast, a board of ten or twelve members can meet and vote on these issues relatively quickly, easily and cheaply. ...

Director voting offers other important advantages over shareholder voting as well. In the typical public firm, ownership is widely dispersed, with most investors holding only a

¹⁹ *Id.* at 64. See also MARK J ROE, *STRONG MANAGERS, WEAK OWNERS* 6 (1994).

²⁰ BERLE & MEANS, *supra* note 11, at 116.

²¹ See B S Black, *Shareholder Passivity Re-examined*, 89 MICH. L. REV. 520, 522-4 (1990).

relatively small portion of the firm's outstanding shares. As a result, few shareholders have the incentive to devote much time to, or to acquire significant expertise in, the firm's affairs.²²

Professor Stephen Bainbridge's recent account of the theory of rational apathy is also excellent.²³ Bainbridge writes that:

As the number of decision makers increases, the number of communication channels within the firm increases as the square of the number of decision-makers....

[In such a corporation], the opportunity cost entailed in making informed decisions is ... high and, even more important, readily apparent. In contrast, the expected benefits of becoming informed are quite low, as an individual decision-maker's vote will not have a significant effect on the vote's outcome.²⁴

...

... shareholders lack incentives to gather the information necessary to actively participate in decision making. *A rational shareholder will expend the effort necessary to make informed decisions only if the expected benefits of doing so outweigh its costs.* Given the length and complexity of corporate disclosure documents, the opportunity cost entailed in making informed decisions is both high and apparent. In contrast, the expected benefits of becoming informed are quite low, as most shareholders' holdings are too small to have significant effect on the vote's outcome. ... *[C]orporate shareholders thus are rationally apathetic.*" (emphasis added).²⁵

I will return to discuss the theory of rational apathy in Part four below.

(b) *How the Law Allocates Corporate Power*

In his recent paper, *The Case for Limited Shareholder Voting Rights*, Professor Stephen Bainbridge, wrote that (with reference to Delaware's General Corporation Law):

In public corporations ...shareholder voting has very little to do with corporate decision making. To the contrary, the separation of ownership and control observed in such firms is inherent in the basic structure of the law of corporate governance. ...²⁶

The manner in which U.S. corporation law provides for the allocation of power in the public corporation both reflects and reinforces the long-standing separation of ownership and control. This is also the case in other developed jurisdictions.²⁷

²² Stout, *supra* note 7, at 673.

²³ Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, UCLA School of Law Research Paper, No. 05-15. Available online at: <www.ssrn.com>

²⁴ *Id.* at 7-8.

²⁵ *Id.* at 24. See also Julian Velasco, *The Fundamental Rights of the Shareholder*, Notre Dame Law School, Legal Studies Research Paper No. 05-16, at 11:

Because each individual shareholder owns only a very small percentage of the outstanding shares of a corporation, she does not have a stake sufficient to make monitoring worthwhile. After all, becoming informed is costly; it is also futile, because one shareholder's meagre vote is unlikely to affect the outcome. Thus, shareholders tend to be rationally apathetic and support the incumbent board on the theory that the directors are experts and have access to greater information.

Available online at: <www.ssrn.com>

²⁶ Bainbridge, *supra* note 23, at 4.

²⁷ See, for example, s 198A of Australia's Corporations Act, 2001 (Cth), which provides that the business of a company is to be managed by or under the direction of the directors. According to Simmons (Ralph Simmons, *Shareholder Democracy or a Banana Republic: The CASAC Proposals for Reform*, 7(4) MURDOCH UNIVERSITY ELECTRONIC JOURNAL OF LAW (2000). Available on-line at: <http://www.murdoch.edu.au/elaw/issues/v7n4/simmonds74.html>), this 'default rule' is understood 'as excluding the possibility of override by shareholder direction, but it is also subject to the assured role of the shareholders, of public companies at least, as stakeholders having the power at any time to remove directors, as well as appoint and remove

In understanding how power is allocated in public corporations in the U.S., the most common (and useful) place to start is s. 141(a) of Delaware's General Corporation Law.²⁸ Section 141(a) provides that:

The business and affairs of every organization 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.

In his paper, Professor Stephen Bainbridge discusses the effect of s 141(a), and equivalent 'default rule' provisions in other states, on governance arrangements in public corporations.

The vast majority of corporate decisions accordingly are made by the board of directors acting alone, or by persons to whom the board has properly delegated authority. Shareholders have virtually no right to initiate corporate action and, moreover, are entitled to approve or disapprove only a very few board actions. *The statutory decision-making model thus is one in which the board acts and shareholders, at most, react.*²⁹

Bainbridge goes on to say:

In U.S. corporation law, shareholder control rights in fact are so weak that they scarcely qualify as part of corporate governance.

...

Under the Delaware Code, for example, shareholder voting rights are essentially limited to the election of directors and approval of charter or bylaw amendments, mergers, sales of substantially all of the corporation's assets, and voluntary dissolution. As a formal matter, only the election of directors and amending the bylaws do not require approval before shareholder action is possible. In practice, of course, even the election of directors (absent a proxy contest) is predetermined by the existing board nominating the next year's board.³⁰

In a recent high-profile memorandum opinion of the Delaware Court of Chancery, *Unisuper Ltd et. al. v. News Corp*, handed down on 20 December 2005, Chancellor Chandler also gave an excellent overview of how Delaware law shapes the allocation of power in the large number of public corporations registered in that state. In his opinion, Chancellor Chandler writes:

Delaware's corporation law vests managerial power in the board of directors because it is not feasible for shareholders, the owners of the corporation, to exercise day-to-day power over the company's business and affairs. Nonetheless, when shareholders exercise their right to vote in order to assert control over the business and affairs of the corporation the board must give way.³¹

auditors, and to approve certain transactions with particular risks to corporate capital and certain fundamental changes in the company.' In the United Kingdom, Article 70 of Table A contained in the Companies Act, 1985 provides that (subject to the provisions of the Act, the memorandum and the articles and to any 'directions' given by 'special resolution'), the business of the company shall be managed by the directors who may exercise all the powers of the company.

²⁸ Section 8.01(b) of the Revised Model Business Corporations Act, the equivalent provision to s 141(a), provides that: 'All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation, or in an agreement authorized under [s] 7.32 [dealing with shareholders' agreements].'

²⁹ Bainbridge, *supra* note 23, at 4 (emphasis added).

³⁰ *Id.* at 17. See also Velasco, *supra* note 25, at 6 who says the rights of shareholders in the modern corporation can be divided into four categories: economic rights, control rights, information rights, and litigation rights. Also, at 5, Velasco comments that:

Although shareholders have many rights, there are two that are more important than any others: the right to elect directors and the right to sell shares. These rights should be considered "the fundamental rights of the shareholder" and, as such, should be afforded a great deal of respect and protection by law. Shareholder rights should not undermine the role of the director, but neither should director prerogative undermine the role of the shareholder. Whatever balance corporate governance may strike between them, it may not disregard the fundamental rights of the shareholder.

³¹ *Unisuper Ltd and others v. News Corp et. al.*, 20 Dec. 2005, at 15-16.

Chancellor Chandler also notes that:

Of course, the board of directors' managerial power is not unlimited; it is constrained by the directors' fiduciary duties and by shareholders' right to vote. The Delaware General Corporation Law gives shareholders an immutable right to **vote** on fundamental corporate changes. See s 242 (charter amendments), s 255 (merger), s 271 (sale of assets); s 275 (dissolution). In addition, the Delaware General Corporation Law vests shareholders with the power to **adopt**, amend or repeal bylaws relating to the business of the corporation and the conduct of its affairs- 8. Del. C.- s 109.³²

As to the limiting effect of fiduciary duties on the managerial authority of directors, Chandler also writes in his opinion:

Fiduciary duties exist in order to fill the gaps in the contractual relationship between the shareholders and directors of the corporation. Fiduciary duties cannot be used to silence shareholders and prevent them from specifying what the corporate contract is to say. ...

Once the corporate contract is made explicit on a particular issue, the directors must act in accordance with the amended corporate contract. There is no more need for the gap-filling role performed by fiduciary duty analysis.³³

It is often argued by opponents of greater shareholder empowerment that if shareholders really wanted more power, they could put forward an amendment to the corporation's charter and bylaws to shift responsibility from the board of directors to shareholders. The fact that this does not occur means that the standard 'default rule' of corporate governance, with the directors at the helm, works, or so the argument goes.

But in his 2005 article in the *Harvard Law Review*, Professor Bebchuk disputes this point. He argues that the law prevents shareholders in public corporations from intervening to reallocate power. The law, as it presently stands, ensures directors are insulated from shareholder revolt. According to Bebchuk:

...under U.S. corporate law, charter provisions that establish a regime in which the shareholder meeting has the power to make rules-of-the-game decisions are either impermissible or of uncertain validity. Although U.S. corporate law follows a clear and consistent "enabling" approach- allowing incorporators to opt out of many state law provisions and design their own tailored governance provisions- with respect to a wide range of issues, it does not follow this approach with respect to opting out of the principles of managerial insulation from shareholder intervention.³⁴

Bebchuk goes on to justify his view with reference to two key corporate law provisions. He first notes that under the American Bar Association's (ABA) Model Business Corporations Act, s. 7.32 authorizes shareholder agreements that are set forth in the articles of incorporation or bylaws to shift managerial power to shareholders. Section 7.32(d), however, provides that such agreements "cease to be effective when shares of [a] corporation are listed on a national securities exchange."

Bebchuk then refers to Delaware's General Corporation Law. He notes:

It might be argued that opting out of the statutory allocation of power is still permitted under the general provision of section 141(a) [of the Delaware Code]. This section allows companies to adopt charter provisions that confer the powers granted to the board on other "person or persons as shall be provided in the certificate of incorporation". A close look at the Delaware

³² *Id.* at fn 48 (emphasis added).

³³ *Id.* at 22.

³⁴ Bebchuk, *supra* note 1, at 888.

Code, however, suggests that it does not permit arrangements under which the general meeting may adopt a change in the charter (or a merger proposal or distribution decision) *without board involvement*.³⁵

With this overview of how power is allocated under U.S. corporation law, I now move on to explore the debate over allocation of power and how it has recently captured the imagination of those both for and against shareholder empowerment.

III The Allocation of Power Debate

It is quite clear that under U.S. corporation law, shareholders in public corporations have limited participatory rights. What is less clear, however, is whether shareholders should be given more power. The issue of how power is allocated in the public corporation has been debated for some time, but it has not been until relatively recently that it has become a central topic of discussion among corporate governance commentators.

As has already been explained, the impetus for the current debate on allocation of power was the series of proposals to enhance shareholder power that have recently been put forward by the corporate regulator, and by commentators.³⁶

There is a general consensus that the existing approach in which the board of directors and appointed executives hold responsibility for the operation and strategy of the business (the so-called ‘default rule’) works and should not be changed. But where opinion is divided is whether there is a positive, negative or neutral correlation between shareholder participation and company performance.

Given that this article ultimately contends that shareholder participation is virtuous in and of itself, and there should be an increase in shareholder power to be able to effectively capture the benefits of participation, it is necessary to paint a picture of where the debate on allocation of power sits at present. An appropriate way to do this is to outline the opposing views of the two main camps that have emerged: advocates of shareholder primacy, and advocates of director primacy.

(a) *The Shareholder Primacy Viewpoint*

To put things rather simply, shareholder primacy advocates believe that the ‘best interests of the corporation’ should be framed as ‘the best interests of shareholders’. According to D. Gordon Smith:

The structure of corporate law ensures that corporations generally operate in the interests of shareholders. Shareholders exercise control over corporations by electing directors, approving fundamental transactions, and bringing derivative suits on behalf of the corporation. Employees, creditors, suppliers, customers and others may possess contractual claims against a corporation, but shareholders claim the corporation’s heart. This shareholder-centric focus of corporate law is often referred to as shareholder primacy.³⁷

³⁵ *Id.* at 889 (emphasis added).

³⁶ See footnote 2 above for a discussion of proposals and sources.

³⁷ D Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 277 (1998). See also LEWIS D SOLOMON, DONALD E SHWARTZ, JEFFREY D BAUMAN & ELLIOTT J WEISS, *CORPORATIONS: LAW AND POLICY, CASES AND MATERIALS* 38 (4th ed, 1998): ‘shareholders are considered to be the corporation’s ultimate owners’.

Similarly, Easterbrook and Fischel have expressed the view that ‘the purpose of corporations law is to establish organizing principles under which shareholders may conduct the enterprise for their own benefit.’³⁸

Shareholder primacy is viewed very much in economic terms, with the concept of the best interests of the corporation tied in with maximising profits for distribution to shareholders. Thus, the shareholder primacy norm is often referred to as the ‘wealth maximisation norm’.³⁹ This strict economic view of shareholder primacy is exemplified by two classic statements. The first was by the Michigan Supreme Court in *Dodge v. Ford Motor Company*:

A business corporation is organized and carried on primarily for the profit of stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.⁴⁰

The second was not by a lawyer, but by Nobel laureate in economics, Milton Friedman. In an oft-cited piece written for *The New York Times*, Friedman argued that:

In a free-enterprise, private property system a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.⁴¹

Advocates of the shareholder primacy view of the corporation are naturally inclined to support greater shareholder empowerment. Given that shareholders are the ultimate owners of the corporation, and the corporation performs most effectively when focusing on the interests of shareholders, it makes sense to enhance the power of shareholders for those shareholders wishing to participate in the corporation.

According to the chief proponent of shareholder empowerment, Professor Bebchuk:

A central and well-settled principle of U.S. corporate law is that all major corporate decisions must be initiated by the board. Shareholders may not initiate any such decisions. The only way in which shareholders can attempt to introduce a new corporate decision is by replacing incumbent directors with a new team that is expected to make such a change. This feature of U.S. corporate law, which has profound implications for corporate governance, is often taken for granted. *Yet it is far from being an inherent corollary of the modern public corporation.*⁴²

In his 2005 article in the *Harvard Law Review*, Bebchuk not only provides an explanation of why he believes increasing shareholder power to be desirable, but also outlines a proposal for reform which would enable public corporation shareholders to intervene in the governance of the corporation, but without undermining the important managerial role of the directors.

³⁸ Cited in Martin Lipton & Stephen A Rosenblum, *A New System of Corporate Governance*, 58 U. CHI. L. REV. 187, 205 (1991) (they complain that this statement ‘assumes away the potential divergence’ between shareholder and corporate interests). For a contrary view, see Lawrence E Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263 (1992).

³⁹ See for example, Mark J Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063 (2001).

⁴⁰ 170 N.W. at 684. See also the famous article by Professor Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931), which outlined Professor Berle’s arguments as to why the corporation exists only to make money for its shareholders.

⁴¹ See Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, THE NEW YORK TIMES, Sep. 13, 1970, (Magazine) at 32-33, 122, 124, 126.

⁴² Bebchuk, *supra* note 1, at 836.

In a response to Bebchuk's article, to be published in the special edition of the *Harvard Law Review* in April 2006, Vice-Chancellor of the Delaware Court of Chancery, Leo E. Strine, provides the following useful overview of Bebchuk's proposal:

Bebchuk's basic proposal is that stockholders should be given the power to initiate changes in the equivalent of the corporate constitution: the certificate of incorporation or charter. Permeating Bebchuk's proposal is his belief that stockholders should have the affirmative power to set corporate policy in important areas, not simply the rights to veto major transactions (such as mergers) and to replace the board through the electoral process. He would not permit stockholders to amend the charter to demand that the board of directors make any specific business decision, such as merging with a particular corporation. But he would permit stockholders to establish "rules of the game" under which the board would be required to undertake certain actions — such as enabling stockholders to decide whether to accept a tender offer or requiring the board to pay a dividend — when triggering conditions in the charter are met. Likewise, Bebchuk would permit stockholders to amend the charter to repeal a staggered board or to establish a more open system of corporate elections.

To address the argument that important social institutions like public corporations should not have their policies dictated by transient stockholders whose interests might be inconsistent with the best interests of long-term investors concerned with the sound accretion of corporate wealth through fundamental economic growth, Bebchuk takes a page out of the Delaware Constitution's playbook by requiring stockholder-initiated charter amendments to receive support from a majority of the outstanding shares at two successive annual meetings. In other words, he contends that stockholders should have the option of retaining the current managers while changing the rules by which those managers govern the corporation. Bebchuk argues that granting stockholders this theoretical power will cause managers to bend frequently to the prevailing wind from stockholders and voluntarily adopt policy changes themselves, obviating the need for any actual electoral battle.

...

Through the reform he proposes, Bebchuk seeks to permit a majority of stockholders of a corporation that persists for two years to establish firm-specific rules limiting the board's ability to prevent stockholders from deciding whether to accept a premium offer. In Bebchuk's world, stockholders, not boards or even the corporate code or common law, would determine the extent to which directors can dictate their firms' options in the M&A marketplace. Bebchuk also expresses the view that stockholders might be well served by adopting rules of the game that prevent the board from acquiring other companies or assets without stockholder assent.⁴³ Thus, Bebchuk hopes to give stockholders the tools to police overpriced acquisitions, as well as those that conglomerate nonsynergistic assets for the sake of aggrandizing management rather than increasing investor returns. Overall, under Bebchuk's system shareholders would have the ability to establish rules of the game governing all corporate M&A transactions, regardless of whether the corporation was the pursuer or the target.⁴⁴

As was alluded to in the introduction to this article, the very interesting thing about Bebchuk's view, and the view of shareholder primacists more generally, is that shareholder participation is only ever a derivative goal— that is, a means to an end. Generally speaking, advocates of shareholder participation in the current allocation of power debate are not grand idealists or human rights flag-wavers. Consistent with the economic perspective on shares outlined above, shareholder empowerment is about one thing and one thing only: corporate performance. It is not about being touchy-feely towards shareholders, but rather making corporate governance more effective and improving the corporation's bottom line over time.

⁴³ *Id.* at 903–7.

⁴⁴ The working title of the draft article is *Towards a True Corporate Republic: A Traditionalist Response to Lucian's Solution for Improving Corporate America*. The draft was made available to the author in January 2006, and is not a final copy of the article. The quotes from the article are therefore subject to change before final publication in April. The quote is from page 3 of the draft.

In what is fast becoming one of the classic statements in corporate governance literature, and which was already quoted in the introduction, Bebchuk wrote in his *Harvard Law Review* that:

I ... stress ... that I do not view increasing shareholder power as an end in and of itself. Rather, effective corporate governance, which enhances shareholder and firm value, is the objective underlying my analysis. From this perspective, increased shareholder power would be desirable only if it would operate to improve corporate performance and value.⁴⁵

Other comments in Bebchuk's article highlight further his position:

In publicly traded companies with dispersed ownership, the interests of management do not fully overlap with those of shareholders, and management thus cannot be automatically counted on to take actions that would serve shareholder interests. As a result, agency costs that reduce shareholder value might arise. Without adequate constraints and incentives, management might divert resources through excessive pay, self-dealing, or other means; reject beneficial acquisition offers to maintain its independence and private benefits of control; ... engage in empire-building, and so forth.⁴⁶

And:

Introducing shareholder power to make rules-of-the-game decisions would operate over time to improve a wide range of corporate governance arrangements. It would provide a mechanism that could, without further regulatory intervention, address existing governance flaws as well as new governance problems that arise in the future.⁴⁷

With shareholder power seen merely as a corporate governance device to enhance the performance of corporation, ironically shareholder primacists and director primacists place the same value on shareholder power as being a means to an end rather than an end in itself. The only difference, as will be seen below, is that director primacists believe that greater empowerment of shareholders would not improve the performance of the corporation.

In the next section, a strong case is made for increasing shareholder power. This is based on a fresh take of shareholder participation as being an end in itself, rather than an end in itself. A goal worthy of pursuing, rather than just being of derivative status.

(b) *The Director Primacy Viewpoint*

According to the architect of the director primacy model of the corporation, Professor Stephen Bainbridge, the model: "describes the corporation as a vehicle by which the board of directors hires various factors of production. The board of directors is not an agent of the shareholders; rather, the board is the embodiment of the corporate principal, serving as the nexus of the various contracts making up the corporations."⁴⁸

⁴⁵ Bebchuk, *supra* note 1, at 842-3.

⁴⁶ *Id.* at 850.

⁴⁷ *Id.* at 913. As to this point about shareholder participation being seen as merely instrumental, as opposed to an end in itself, see also Lucian Bebchuk's earlier comments in, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43, 44 (2003), Bebchuk writes that:

Some supporters of shareholder access have "shareholder voice" and "corporate democracy" as objectives. But the case for shareholder access does not depend on having such. My analysis ... will focus on the sole objective of effective corporate governance that enhances corporate value.

Id. at 69:

... benefits from reduced insulation and increased accountability might well constitute the biggest payoff from the shareholder access reform.

⁴⁸ See Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 86 (2003).

The important point to note about the director primacy model is that shareholders are not given the status of owners of the corporation. This is because, according to the director primacy model, the corporation is not an entity that is capable of being owned. Rather, it is a mere fiction, an umbrella concept encompassing the interaction of contracts between the directors, shareholders, customers, suppliers, creditors and employees that goes on.

As a result, director primacists do not see any privileged role for shareholders, or consider that shareholder participation is a necessary component of a successful corporation. Shareholder participation only comes into the corporate governance equation, according to director primacists, when the shareholders negotiate with the directors for greater participatory rights as a condition of assuming the status of residual claimant (ie, the last to be paid out in the event of insolvency) that goes with buying shares in a corporation.⁴⁹ In other words, shareholder participation is only something to turn one's mind to if there is a relevant provision in the "corporate contract" to accommodate this.⁵⁰

In his response to Bebchuk to be published in 2006 in the *Harvard Law Review*,⁵¹ Bainbridge provides a useful explanation of the director primacy position on shareholder empowerment. According to Bainbridge:

If shareholder empowerment were as value-enhancing as Bebchuk claims, we should observe entrepreneurs taking a company public offering such rights either through appropriate provisions in the firm's organic documents or by lobbying state legislatures to provide such rights off the rack in the corporation code. Since we observe neither, we may reasonably conclude investors do not value these rights.

...

As Kenneth Arrow explained [in *THE LIMITS OF THE ORGANIZATION* 68-9 (1974)], such mechanisms [for aggregating the preferences of the organization's constituencies] fall out on a spectrum between "consensus" and "authority". Authority-based decision-making structures, which are characterized by the existence of a central agency empowered to make decisions binding on the firm as a whole, tend to arise when the firm's constituencies face information asymmetries and have differing interests. It is because the corporation demonstrably satisfies those conditions that vesting the power of fiat in a central decision-maker is the essential characteristic of its governance.⁵²

In the same article, Bainbridge also explains why in his view greater shareholder empowerment does not lead to improved corporate performance:

If shareholder empowerment is as value-enhancing as Bebchuk claims, why don't we already see it in the marketplace? Free markets typically produce only those goods people wish to purchase, after, which includes corporate governance terms.

...

... the substantial efficiency benefits that follow from the separation of ownership and control justify retaining the current regime of limited shareholder rights as, at the very least, the default rule. Nothing about the rise of institutional investors changes that analysis.⁵³

⁴⁹ See F L EASTERBROOK AND D R FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

⁵⁰ See, for example, Bainbridge, *supra* note 23, at 28:

[G]iven the significant virtues of discretion, one ought not lightly interfere with management or the board's decision-making authority in the name of accountability.

See also Stephen Bainbridge, *Shareholder Activism and Institutional Investors*, UCLA School of Law, Research Paper No. 05-20, at 8. Available online at: <www.ssrn.com> :

... agency costs are the inescapable result of placing ultimate decision-making authority in the hands of someone other than the residual claimant. We could substantially reduce agency costs by eliminating discretion. That we do not do so implies that discretion has substantial virtues.

⁵¹ Bainbridge, *supra* note 6.

⁵² *Id.*, at 21.

Consistent with the general position of shareholder primacists mentioned above, Bainbridge is also very clear that shareholder participation is judged as a means to an end, rather than an end in itself. In an earlier article, Bainbridge wrote that:

...shareholder voting is properly understood not as an integral aspect of the corporate decision-making structure, but rather as an accountability device of last resort to be used sparingly, at best.⁵⁴

Professor Bainbridge's UCLA colleague Lynn Stout also believes that the success of director primacy (although her label for this structural approach is 'team production'⁵⁵) warrants a limited role for shareholders in the modern corporation. Professor Stout believes that:

Obviously, weakening shareholder control sometimes works against shareholders' ex post interests. ... [H]owever, shareholders- like Ulysses- gain greater benefits from tying their own hands in this fashion. Diluting shareholder power- and with it, shareholders' ability to extract wealth from the firm- may ultimately benefit shareholders by enhancing the firm's ability to attract the firm-specific, sunk-cost investments of other important corporate "constituents", including creditors, executives, and rank-and-file employees.⁵⁶

In a recent article applying the director primacy model to explain why corporation law does, and should continue to, limit shareholder participatory rights, Professor Harry Hutchinson also made the following useful statement:

The capacity of shareholders (as a disparate group) to manage relatively large corporations is hindered by collective action problems tied to disparate preferences, different persuasive abilities, different time horizons, as well as differing capabilities to digest in pertinent financial, microeconomic and macroeconomic information (even when widely available). Directors are generally seen to be less likely to be blinkered by such collective action problems.⁵⁷

⁵³ *Id.* at 36.

⁵⁴ Bainbridge, *supra* note 23, at 28.

⁵⁵ In an co-authored article- Margaret Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999)- Stout, together with Professor Margaret Blair, outlined a new theory of the corporation based on economic analysis of team production. Blair and Stout's 'team production theory' has generated a great deal of interest in academic circles as it challenges the dominant view of shareholder primacy, by suggesting that the role of the corporation is not limited to maximising economic returns for shareholders, but rather is intended to resolve team production problems. As a result, neither shareholders nor other stakeholders are the primary concern, rather the corporation and the legal rules regulating corporations treat shareholders and stakeholders as a 'team', each contributing to the corporation in different ways.

Team production, and in particular the problems arising from team production, has been a popular area of research in economic literature for years, and this literature was the source of Blair and Stout's theory of the corporation. According to Blair and Stout, team production problems arise in situations where a productive activity requires the combined investment and coordinated effort of two or more individuals or groups. The problems arise because if the investment of members of this 'team' is firm-specific (meaning difficult to recover once committed to the project), and if output from the enterprise is non-separable (meaning that it is difficult to attribute any particular portion of the joint output to any particular member's output), it becomes very difficult to determine how any 'surpluses' generated by this production should be divided. This is because surpluses invite both 'shirking' (which essentially means free-riding off the efforts of others) and 'rent-seeking' (whereby individuals waste time and money competing for a share of a fixed amount of wealth). Blair and Stout suggest that as trying to prevent these team production problems through the mechanism of explicit contracts is next to impossible, this function can be achieved by the corporation as an 'institutional substitute' for explicit contracts. The corporation performs a 'mediating hierarchy' role, by which team members give up important rights (including property rights over the team's joint input) to the corporation (or more specifically its directors). At the top of this hierarchy is the board of directors, whose authority over the use of corporate assets is virtually absolute. Hence, the 'team production model' of the corporation takes shape. *See also* Margaret Blair & Lynn Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH & LEE. L. REV. 403 (2001).

⁵⁶ Stout, *supra* note 8 at 670. Another UCLA Law School, Iman Anabtawi, has also come out against shareholder empowerment recently. *See* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, UCLA School of Law, Research Paper No. 05-16, at 46. *Available online at* <<http://www.ssrn.com>>

The more diverse the interests of shareholders, the more likely it is that they will engage in costly rent-seeking behavior that generates new agency costs by distorting managerial decisions and wastes productive resources in the course of squabbling over whose private interests the firm will advance.

⁵⁷ *See* Harry H. Hutchinson, *Director Primacy and Corporate Governance: Shareholder Voting Rights Captured by the Accountability/Authority Paradigm*, 36 LOY. U. CHI. L.J. 1111, at 1191 (2005).

Leo E. Strine's response to Bebchuk in the *Harvard Law Review* is based on a similar account of U.S. corporation law as Bainbridge's "director primacy", however Strine labels this a "traditionalist" view of corporation law. Strine makes clear that this is not necessarily the view that he holds, but outlines what he sees as the position of the hypothetical traditionalist. According to Strine:

The perspective of the corporate law traditionalist is one that recognizes that there is great value to the American — that is, the Delaware — approach to corporation law. This approach invests corporate managers with a great deal of authority to pursue business strategies through diverse means, subject to a few important constraints. These constraints — that stockholders approve certain important transactions such as mergers, vote for directors annually, and have access to books and records; that stockholders can hold managers accountable for failing to fulfill their fiduciary duties; and that state and federal policies give independent directors the clout and duty to police corporate insiders — are vital. They provide assurance that managers will not abuse the powers granted to them, thereby instilling confidence in investors that capital may be safely entrusted to corporations run by centralized management. Importantly, potent federal laws requiring accurate accounting and periodic reporting of material financial information and subjecting corporate insiders to criminal and civil liability for fraud supplement state protections for public companies. The traditionalist recognizes the need for protections of this kind and the reality that developments in the business world might give rise to a need to strengthen or modify them.

But the traditionalist is as concerned, or more concerned, about protecting the core element of the Delaware way: the empowerment of centralized management to make and pursue risky business decisions through diverse means.⁵⁸

According to Strine, the traditionalist prefers a governance system characterised by strong managerial authority, and limited shareholder rights:

The ingenuity and skill of talented managers is what ultimately produces corporate wealth, and the law should facilitate their ability to make good-faith business decisions with the speed and efficiency modern commerce demands. Likewise, distractions from value-creating tasks should be minimized, so that managers can spend more time improving the company's products and services in order to increase profits.

...

The primary goal of corporate law, therefore, is not to prevent failure at each and every firm to the full extent possible, but to facilitate the maximum creation of durable societal wealth by all firms. The way to do that, the traditionalist believes, is to free up managers to manage. When that is done, over time, corporations will generate good returns for patient investors with diversified portfolios.⁵⁹

Importantly, Strine goes on to add that the 'traditionalist', like his 'director primacy' friend, and like his 'shareholder primacy' acquaintance, also considers shareholder participation to be a means to an end (corporate performance), as opposed to an end in itself. According to Strine:

In the context of political elections, the ability to express oneself freely at the ballot box has more than instrumental value. The chance to have a say, to speak one's mind, and to have a fair chance to persuade others to one's point of view about how to govern the community is a legitimate end in itself.

But the traditionalist knows that there is nothing sacred about the governance of corporate entities. The right to elect directors is an important tool for stockholders as it allows them to hold centralized management accountable, thereby contributing to the creation of stockholder

⁵⁸ Strine, *supra* note 44, at 4-5.(citations omitted) (draft).

⁵⁹ *Id.* at 5 (citations omitted) (draft).

wealth by checking agency costs. But the director election process is only one of the many methods by which accountability to stockholder interests is assured and its structure must be designed with efficiency in mind, lest it destroy more value than it protects.⁶⁰

So as we can see, there are mixed views as to whether shareholder power in the public corporation should be increased. Interestingly, the competing positions are the result of both sides of the debate holding the same view regarding the place of shareholder participation in the public corporation. Both camps see shareholder participation as merely instrumental, something that should or should not be embraced to achieve the “Holy Grail” of improved corporate performance. Shareholder primacists believe that participatory rights enhance corporate performance over time through ironing out the various costs resulting from a separation of ownership and control- ultimately contending that increased shareholder power, at least up to a point, is a good thing. Director primacists are comfortable with management at the helm, and shareholders with limited rights.

In the next section, the case is made for increasing shareholder power, but not with a view to simply enhancing corporate performance. Rather, it is argued, with the support of recent literature in the field of happiness studies and “psycho-economics”, that shareholder participation should be considered as an end in itself. With shareholder participation perceived in this fresh way, the objective of increasing shareholder power not only becomes more legitimate, but also more achievable.

IV Resolving the Allocation of Power Debate

(a) Introduction

As already explained, there is an important debate underway at present regarding the allocation of power between directors and shareholders in the public corporation. The debate has centred on whether the governance rights of shareholders should be increased.

Two clear sides have emerged, those who favour greater participatory rights for shareholders, and those who favour the existing governance approach in large corporations- with directors at the helm with the majority of power, and shareholders as essentially passive observers- holding very little power.

The interesting thing about the debate is that both the advocates and opponents of increasing shareholder power perceive shareholder participation in the same way. Rather than shareholder participation being associated with democratic values and being a noble cause in itself, the general view within both camps is that shareholder participation is a derivative goal: empowerment is perceived as a tool to be used to improve a corporation’s governance arrangements and overall corporation performance.

Even the most adamant supporters of shareholder participation do not put increasing shareholder power forward as a self-contained goal: for them, empowerment is also a means to an end, only they are convinced that increasing shareholder power is the most effective way to overcome recognised governance problems in large corporations, and to enhance corporate performance.

The reason for this commonality of views towards shareholder participation is that shares have been conventionally seen as strictly a material purchase. In other words, the one and only reason for buying shares, particularly in a large public corporation which are the focus of

⁶⁰ *Id.* at 18 (draft).

the allocation of power debate, is to make money. If individuals want to pursue other objectives in life, they should do so through activities other than holding shares, such as having a hit of baseball in the park or spending time with the kids.

Therefore, if corporations are performing successfully, with directors and executives running the show in terms of the operation and strategy of the corporation, and shareholders with limited rights, then the status quo should be maintained- indeed protected. What can be described as shareholder apathy is “rational”.

But what if empowering shareholders, lifting their governance role in the corporation above the status of insignificant, will actually resolve some of the governance problems in the corporation, and in doing so lead to an improvement in the corporation’s performance? In this situation, it is argued that shareholder participation should be put on the agenda. Director primacists contend that this will rarely if ever be the case.

Inherent in this restrictive view of shareholder participation is adherence to the traditional, economic perspective of shareholding. If something doesn’t enhance company performance and its share price, it is not worth pursuing. But just because the acquisition of shares may primarily be an economic decision pursued for material gain, does not rule out other considerations. As will be explained below, research outside of classical economics shows us that shareholder participation may have benefits totally removed from company performance.

Empirical literature in the emerging areas of happiness and psycho-economics highlight that there are important consequences, such as greater life satisfaction and improved happiness, by treating one’s shares as an “experiential” purchase and using one’s capacity as a shareholder in the modern corporation to build “relational goods”. From this perspective, shareholder participation becomes the rational choice, at least for those shareholders who decide to pursue that course.

Given that this section paints a fresh picture of shareholder participation and the corporation through drawing on research in the emerging area of happiness studies, what immediately follows is a brief introduction to this field of study, and an explanation of its relevance to the law.

(b) Introduction to the Happiness Movement

In the normal scheme of things, law should be evaluated by one criterion: its capacity to promote human well-being, or “happiness”. In a very crude manner this type of evaluation already occurs. Happiness or well-being are often not the precise words employed, however, when people state, as they often do, that a law is bad because it will adversely affect some members of the community, the connotation normally is that it is detrimental to happiness.

The capacity to persuasively critique laws on the basis of happiness has been severely curtailed over the ages for one reason: happiness has always been viewed as being too vague and subjective to provide pointed answers regarding the things that are conducive to human flourishing. While it is obvious that people need food, shelter, health care, education and a sense of personal security, beyond this the general view has been that the conditions that promote happiness vary from person to person. This is supported by the almost infinite number of activities and projects that people chose to pursue.

The richness and diversity of the human species seemingly militates against the idea that there is even approximate convergence concerning the things that are conducive to happiness.

Accordingly, as a self-contained concept, traditionally happiness failed to have any significant influence in the development of policy or regulation. This, however, is unsound given that happiness is our most fundamental objective as human beings.⁶¹

As Aristotle wrote in Book 1 of *The Nicomachean Ethics*,⁶² happiness is a first principle or ultimate starting point - everything we do we do for happiness. According to Aristotle:

Happiness is an activity; and activity plainly comes into being and is not present at the start like a piece of property . . . happiness is good activity, not amusement . . . for, in a word, everything that we choose we choose for the sake of something else--except happiness, which is an end . . . for happiness does not lie in such occupations, but, as we have said before, in virtuous activities . . . Happiness extends, then, just so far as contemplation does, and those to whom contemplation more fully belongs are more truly happy, not as a mere concomitant but in virtue of the contemplation; for this is in itself precious. Happiness, therefore, must be some form of contemplation.⁶³

According to US psychologist Tim Kasser in his book *The High Price of Materialism*,⁶⁴ while individuals live their lives in a variety of different ways, these different pursuits have a common goal: the fulfilment of happiness. Each of us engages in different types of 'need expression', but our central or overriding need is to be happy. According to Kasser:

Although needs provide a basic motivation to do something, they do not tell us exactly how to satisfy them. The way needs express themselves and the extent to which they are satisfied depend on a number of factors, including our personality, lifestyle, values, and the culture in which we live. For example, if I am hungry, my need for sustenance motivates me to eat. The way that I satisfy this need will vary depending on my personal tastes and on my environment. If I like sweet foods, I might seek out an orange or some candy; if I like salty foods, I might prefer pretzels or potato chips; if I live in Japan, I might eat sushi; if I live in Lebanon, I will be likely to eat hummus. Personality and societal context provide frameworks for need expression and satisfaction by suggesting particular pathways and behaviours we might follow.⁶⁵

Over the past decade, however, there has been an explosion in the amount of studies conducted into human happiness. Most recently, this has included conducting brain scans of individuals (using MRI technology) to record how certain events or sensations impact upon those parts of the brain that generate feelings of happiness or sorrow. While noting the diversity in the range of activities through which people choose to express themselves, what the happiness research to date has shown is that at the base we are not that different after all.

We can now confidently identify the things that make us happy. These include a high degree of liberty, so that we are free to pursue our individual goals; a sense of participation and control in the activities we engage in (which is examined more closely below given its relevance to the issue of shareholder empowerment); close personal relationships; good health and the pursuit of challenging projects and activities. We also know some things that do not make us happy. One of these, generally speaking, is money (beyond the satisfaction of basic needs)⁶⁶; another is engaging in passive forms of "activity" such as watching television.

In writing about the emerging science of happiness in his recent book, *Happiness: Lessons from a New Science*, Professor Richard Layard states:

⁶¹ According to John Stuart Mill in his classic work UTILITARIANISM (1863), we ought to pursue happiness because we do pursue happiness.

⁶² William David Ross, trans., 1908.

⁶³ *Id.*

⁶⁴ TIM KASSER, THE HIGH PRICE OF MATERIALISM (2002)

⁶⁵ *Id.* at 25-6.

⁶⁶ See Mirko Bagaric & James McConvill, *Goodbye Justice, Hello Happiness: Welcoming Positive Psychology to the Law*, 10 DEAKIN L. REV. 1, 16-18 (2005).

Happiness is an objective dimension of all our experience. And it can be measured. We can ask people how they feel. We can ask their friends or observers for an independent assessment. Also, remarkably, we can now take measurements of the electrical activity in the relevant parts of a person's brain. All of these different measurements give consistent answers about a person's happiness. With them we can trace the ups and downs of someone's experience, and we can also compare the happiness of different people. ...*so happiness is a real, objective phenomenon.*⁶⁷

Similarly, in *Making Happy People*, Paul Martin explains that:

Within the fairly recent past, scientists have begun to gaze at happiness and they are formulating tentative answers to questions about its nature and causes. ...[A] fair amount can now be said about happiness that is based on verifiable evidence rather than folklore or opinion.⁶⁸

In one of the most interesting and important books of the late 20th century, *The Pursuit of Happiness*,⁶⁹ David Myers collected the results of hundreds of surveys from across the world on human happiness to try and piece together some common variables about what make people happy.

The methodology used in most of the surveys reported in David Myers' book is the same as that adopted in relation to most scientific experiments: a hypothesis is developed and is then tested through experimentation involving a representative and a statistically significant number of respondents.⁷⁰ This method is far more accurate than haphazard sampling.⁷¹

To ascertain people's sense of well-being, people were asked to report their feelings of happiness or unhappiness along with their thoughts of how satisfying their lives were.⁷² The results show that people who feel happy also think their lives are satisfying. Sometimes this was probed according to a single measure, on other occasions researchers probed with multi-item measures. One method which was used to gauge the impact of suspected variables on happiness was to give two equivalent groups an experience that differed only in that factor. Thus, in order to determine if people are happier by finding money, participants were randomly assigned to either experience or not experience this factor.⁷³

In terms of how happiness is tested, happiness is obviously a state of mind and the ultimate and only judge is the individual. If you feel happy, you are happy. Despite this, there is obviously the problem that people may be disingenuous in their self-reporting of happiness. And indeed, there is a distinct tendency for people to over-report good feelings.⁷⁴ This does not, however, undermine the accuracy of the studies because happiness is a relative concept. According to Myers:

To discover who is happiest, and why, we need only assume that those who say they are 'very happy' or 'completely satisfied' do experience greater well-being than those who say they are unhappy or dissatisfied.⁷⁵

The overriding pursuit of happiness is now a psychological truism rather than a "heady" aspiration. Furthermore, there is now a dedicated international journal, the *Journal of Happiness Studies*, which is devoted to articles based on empirical studies of what makes

⁶⁷ RICHARD LAYARD, HAPPINESS: LESSONS FROM A NEW SCIENCE 224 (2005) (emphasis added).

⁶⁸ PAUL MARTIN, MAKING HAPPY PEOPLE: THE NATURE OF HAPPINESS AND ITS ORIGINS IN CHILDHOOD 3 (2005).

⁶⁹ DAVID MYERS, THE PURSUIT OF HAPPINESS (1992).

⁷⁰ In this regard he noted that 1,500 randomly sampled people provides an accurate snapshot of 100 million people. *Id.* at 17.

⁷¹ *Id.*

⁷² *Id.* at 24.

⁷³ *Id.* at 18-19.

⁷⁴ *Id.* at 27.

⁷⁵ *Id.* at 28.

people happy (or indeed unhappy). The study of happiness is thus becoming a discipline in itself, and one with great practical relevance for a number of other disciplines.⁷⁶

(c) *Participation and Building Relational Goods*

We seem to have been built in such a way that things requiring more effort yield more satisfaction. It's the old story: you get out what you put in.⁷⁷

One of the key findings emerging from happiness studies to date is that the more one is pursuing what life has on offer, the happier one is likely to be. Study after study shows that the active pursuit of goals and projects is a key ingredient for heightened, longer-lasting happiness.

More recently, empirical findings have become even more specific, showing that individuals are generally happier when participating with other individuals to build what are referred to as "relational goods", rather than remaining passive and being focused solely on individual-orientated, "material goods". These studies form part of a new field, associated with happiness studies, which has been labelled "psycho-economics"- discussed in further detail below.

Complimenting these empirical studies on participation and happiness, is a new movement that has recently come out of the University of Pennsylvania, known as "positive psychology". The architect of positive psychology, Professor Martin Seligman, strongly supports the idea that participating in what life has on offer makes for happier people.

(i) *Participation and Happiness*

In his ground-breaking book *Authentic Happiness*, Professor Martin Seligman outlines his case for a positive approach to psychology:

For the last half century, psychology has been consumed with a single topic only - mental illness - and has done fairly well with it. ... But this progress has come at a cost. Relieving the states that make life miserable, it seems, has made building the states that make life worth living less of a priority. But people want more than just to correct their weaknesses. They want lives imbued with meaning, and not just to fidget until they die.⁷⁸

Since coming onto the scene in the late 1990s, positive psychology has been important in shifting the attention of psychologists from a narrow minded focus on human weaknesses (through, for example, pathology, victimology and mental illness) towards personal strengths

⁷⁶ Indeed, two of America's leading psychologists, Ed Diener and Martin E P Seligman, in an article published recently in the journal, *Psychological Science in the Public Interest* believe our empirical understanding of happiness has now developed to such a point that policy decisions of government, private institutions and corporations should utilise so-called 'happiness indicators' to supplement traditional economic indicators. Diener and Seligman suggest that now is the appropriate time to replace mainstream economic indicators with a National Index of Well-Being (NIWB). The NIWB would measure the success of the nation according to so-called 'key well-being variables', including positive and negative emotions, engagement, purpose and meaning, optimism and trust, life satisfaction, as well as satisfaction with specific domains of life. See E Diener & MEP Seligman, *Toward an Economy of Well-Being*, 5 *PSYCHOLOGICAL SCIENCE IN THE PUBLIC INTEREST* 1 (2004).

⁷⁷ See Ross Gittins, *Activity is the Goods for True Satisfaction*, THE SYDNEY MORNING HERALD (Sydney, Australia), Feb. 18, 2004.

⁷⁸ MARTIN SELIGMAN, *AUTHENTIC HAPPINESS* 1 (2002). Seligman provides an even more succinct explanation in saying positive psychology '... seeks to cultivate human strengths, rather than focus on human weaknesses': see Martin Seligman, Paul R Verkuil & Terry H Kang, *Why Lawyers are Unhappy*, 23 *CARDOZO L. REV.* 33, 35 (2001). See also Martin E P Seligman & Mihaly Csikzentmihalyi, *Positive Psychology: An Introduction*, 55 *AMERICAN PSYCHOLOGIST* 5, 13 (2000):

The prevailing social sciences tend to view the authentic forces governing human behavior to be self-interest, aggressiveness, territoriality, class conflict, and the like. Such a science, even at its best, is by necessity incomplete.

Even if utopianly successful, it would then have to proceed to ask how humanity can achieve what is best in life.

On the nature and utility of positive psychology, see also C R SNYDER & SHANE J LOPEZ, *POSITIVE PSYCHOLOGY* (2005); the March 22, 2005 edition of the *JOURNAL OF POSITIVE BEHAVIOR INTERVENTIONS*; and *FLOURISHING: POSITIVE PSYCHOLOGY AND THE LIFE WELL-LIVED* (Corey L.M. Keyes & Jonathan Haidt, ed., 2002).

(so-called “signature strengths”) which can be nurtured through active participation and relationships.⁷⁹ In *Authentic Happiness*, Seligman explains that his positive psychology consists of “three pillars”:

First is the study of positive emotion. Second is the study of positive traits, foremost among them the strengths and virtues, but also the ‘abilities’ such as intelligence and athleticism. Third is the study of the positive institutions, such as democracy, strong families, and free inquiry, that support the virtues, which in turn support the positive emotions.⁸⁰

To demonstrate positive psychology’s ultimate position that active, rather than passive, behaviour contributes to personal happiness, in *Authentic Happiness* Seligman examines intensively the concept of happiness, and believes that it embraces two very ‘distinct kinds of things’: pleasures and gratifications.

“Pleasures” have very clear positive sensory and emotional components: ecstasy, thrills, orgasm, delight, mirth, exuberance, and comfort. They involve very little thinking, and thereby are essentially passive. In philosophy, these sensations are referred to as “raw feels”.

“Gratifications”, on the other hand, involve next to no raw feels, instead we become fully immersed and absorbed in the activity through having to use our personal strengths to meet the challenge of fulfilling the action. Examples given by Seligman are rock climbing, reading a book, dancing and making a slam dunk. According to Seligman, the ‘gratifications last longer than the pleasures, they involve quite a lot of thinking and interpretation, they do not habituate easily, and they are undergirded by our strengths and virtues.’⁸¹

Seligman goes on to explore the distinction between gratifications (long-term pleasures) and pleasures (short-term “treats”):

[Gratification] is part and parcel of right action. It cannot be derived from bodily pleasure, nor is it a state that can be chemically induced or attained by any shortcuts. It can only be had by activity consonant with noble purpose. ... The pleasures can be discovered, nurtured, and amplified ... but the gratifications cannot. The pleasures are about the senses and the emotions. The gratifications, in contrast, are about enacting personal strengths and weaknesses.^{82 83}

Based on this dichotomy, Seligman outlines the agenda and role of positive psychology:

The right question is the one Aristotle posed two thousand five hundred years ago: ‘What is the good life?’ My main purpose in marking the gratifications off from the pleasures is to ask this great question anew, then provide a fresh and scientifically grounded answer. My answer is tied up in the identification and the use of your signature strengths.⁸⁴

Importantly, to highlight the practical difference between gratifications and pleasures in terms of which is conducive to real happiness, Seligman refers to a study by Mike Csikzentmihalyi involving the experience sampling method (ESM).⁸⁵ ESM encompassed the provision of pagers to those being surveyed, which beeped during different times of the day and night.

⁷⁹ See WILLIAM COMPTON, INTRODUCTION TO POSITIVE PSYCHOLOGY (2004). See also CHRISTOPHER PETERSON & MARTIN SELIGMAN, CHARACTER STRENGTHS AND VIRTUES: A HANDBOOK AND CLASSIFICATION (2004). In this book, the authors report on the progress of a group of researchers who are part of the ‘Values-In-Action Classification Project’ (VIACP), which is undertaking a systematic classification and measurement of universal strengths. The VIACP is intended to reclaim the study of character as a legitimate psychological inquiry.

⁸⁰ See SELIGMAN, *supra* note 78, at xiii.

⁸¹ *Id.* at 102.

⁸² *Id.* at 112.

⁸³ The distinction between gratifications and pleasures seems to correlate with the distinction that JS Mill made between ‘lower pleasures’, and ‘higher pleasures’ (the latter being the pleasures of the intellect, of the feelings and imagination, and of the moral sentiments): See entry on ‘happiness’ in THE OXFORD COMPANION TO PHILOSOPHY 332 (Ted Honderich, ed., 1995).

⁸⁴ SELIGMAN, *supra* note 78, at 121.

⁸⁵ *Id.* at 117.

Each time the pager beeped, participants were asked to record what they were doing at that moment— what they were thinking, what emotions they were feeling, and how engaged they were. The overall finding from Csikzentmihalyi's study was that participants recorded a much higher level of psychological well-being (including self-esteem and engagement) from participating in active events, and mild depression when involved in more passive pursuits, such as watching television.

In *Authentic Happiness*, Seligman also considers the rise of depression in the United States and suggests that, contrary to other explanations for this development over the last few decades, the main reason for this depression is an increase in the amount of passive, as opposed to active, consumption by Americans— due to greater reliance on short term pleasures:

Depression is now ten times as prevalent as it was in 1960, and it strikes at a much younger age. ... This is a paradox, since every objective indicator of well-being- purchasing power, amount of education, availability of music, and nutrition- has been going north, while every indicator of subjective well-being has been going south. How is this epidemic to be explained?...

I have theorized that an ethos that builds unwarranted self-esteem, espouses victimology, and encourages rampant individualism has contributed to the subject ... [however] there is another factor that looms as a cause of the epidemic: the over-reliance on short-cuts to happiness. Every wealthy nation creates more and more shortcuts to pleasure: television, drugs, shopping, loveless sex, spectator sports, and chocolate to name but a few. ...

What would happen if my entire life were made up of such easy pleasures, never calling on my strengths, never presenting challenges? Such a life sets one up for depression. The strengths and virtues may wither during a life of taking shortcuts rather than choosing a life made full through the pursuit of gratifications.⁸⁶

When we engage in pleasures, we are perhaps just consuming. The smell of perfume, the taste of raspberries, and the sensuality of a scalp rub are all high momentary delights, but they do not build anything for the future. ...[P]leasure marks the achievement of biological satiation, whereas gratification marks the achievement of psychological growth.⁸⁷

As indicated, there have been numerous empirical studies over the past three decades that provide support for positive psychology's overriding contention that active participation is the key to greater happiness.⁸⁸

For example, in one famous study, Yale University psychologist Judith Rodin encouraged elderly patients in a nursing home to exercise more control, by way of participating in the making of decisions about their environment and policies for the nursing home. The result was that 93 per cent of patients became more alert, active and happy.⁸⁹ Further, in a more recent study, Gerry Veenstra found that: '... participation in clubs and associations was positively related to health among the elderly.'⁹⁰

⁸⁶ *Id.* at 117-8.

⁸⁷ *Id.* at 116-17 (emphasis added).

⁸⁸ See recently Bruce Mitchell, *Participatory Partnerships: Energy and Empowering to Enhance Environmental Management and Quality of Life*, 71 SOCIAL INDICATORS RESEARCH 123 (2005).

⁸⁹ See Judith Rodin, *Aging and Health: Effect of the Sense of Control*, 233 SCIENCE 1271 (1986). See also M J Graney, *Happiness and Social Participation in Aging*, 30 JOURNAL OF GERONTOLOGY 701 (1975), which reports on a 4 year longitudinal study of 60 elderly women. The study highlights a direct relationship between happiness and social activity among elderly people. Activity increments were associated with happiness, and decrements with unhappiness.

⁹⁰ Gerry Veenstra, *Social Capital, SES and Health: An Individual-Level Analysis*, 50 SOCIAL SCIENCE & MEDICINE 619 (2000).

A 1999 study by economists Bruno S. Frey and Alois Stutzer, titled *Happiness, Economy and Institutions*,⁹¹ is also important. It is particularly relevant when considering how more active shareholder participation could contribute to shareholder happiness. The study involved 6,000 residents in Switzerland, a country with strong direct democracy.⁹² Frey and Stutzer provided the following summary of their findings:

A cross-regional econometric analysis suggests that institutional factors in the form of direct democracy (via initiatives and referenda) and of federal structure (local autonomy), systematically and sizeably raise self-reported individual well-being.⁹³

They further go on to explain their findings:

There are two major reasons why a higher extent of direct political participation possibilities, or more strongly developed institutions of direct democracy (in particular via popular referenda and initiatives) can be expected to raise citizens' subjective well-being ... Firstly, due to the more active role of the citizens, (professional) politicians are better monitored and controlled. Government activity, ie public outlays, as well as the many other decisions by the government, are closer to the wishes of their citizenry. ... Secondly, the institutions of direct democracy extend the citizens' possibilities to get involved in the political process. *Experimental evidence ... suggests that this procedural effect is independent of the outcome of the political activity itself.*⁹⁴

More recent studies again emphasise a positive correlation between participation and happiness. For example, in an article published in the journal *Social Indicators Research* in 2005, Lindsey A. Baker, Lawrence P. Cahalin, Kerstin Gerst and Jeffrey A. Burr indicate, based on their research into older adults, that:

...[P]articipation in multiple productive activities should increase subjective well-being because these behaviours increase social integration and provide meaningful social roles.

... Our results provide support for the idea that engaging in productive activities is beneficial to older persons' well-being, implying confirmation of the role enhancement hypothesis and demonstrating the importance of social integration.⁹⁵

Empirical studies and proponents of positive psychology indicate a strong correlation between participation and happiness. But does this necessarily apply to shareholders and their relationship with the corporation? Isn't it the case that there are some things in life that are pursued purely for money? If shareholders traditionally have not actively participated in large corporations, can it be said that this demonstrates that shares are simply a material purchase?

⁹¹ Bruno S. Frey & Alois Stutzer, Working Paper No. 15, Institute for Empirical Research in Economics, University of Zurich, July 1999. Available on-line at: <http://e-collection.ethbib.ethz.ch/ecol-pool/incoll/incoll_529.pdf>

⁹² See also Bruno S. Frey & Alois Stutzer, *What Can Economists Learn from Happiness Research?*, XL JOURNAL OF ECONOMIC LITERATURE 402, 425 (2002):

... estimates reveal that the extent of direct democratic participation possibilities exert a statistically significant, robust and sizeable effect on happiness over and above the demographic and economic determinants normally taken into account. ...

... when individuals in the canton with the highest democratic index (Basel Land) are compared to citizens in the canton with the lowest participation rights (Geneva), the former state [experienced an] 11 percentage points higher probability that they are completely satisfied.

⁹³ Frey & Stutzer, *supra* note 91, at 2.

⁹⁴ *Id.* at 5. See also Bruno S. Frey & Alois Stutzer, *Happiness Prospers in Democracy*, 1 JOURNAL OF HAPPINESS STUDIES 79 (2000).

Citizens do not only gain utility from the outcome of the political process and its material consequences but also from the democratic process itself. Citizens value the possibility of engaging themselves directly with politically relevant issues, quite irrespective of the outcome.

⁹⁵ Lindsay A. Baker, Lawrence P. Cahalin, Kerstin Gerst & Jeffrey A. Burr, *Productive Activities and Subjective Well-Being Among Older Adults: The Influence of Number of Activities and Time Commitment*, 73 SOCIAL INDICATORS RESEARCH 431, 431 (2005).

If shareholders want greater happiness, they could ride a bike, go to the movies or help their kids with their homework. Isn't this enough participation in life for one person?

This may be true for some shareholders, but it does not mean we should rule out shareholder empowerment. As is explained below, even if we accept that shares are primarily acquired for materialistic reasons, they can still be used in other ways. While the corporation ticks over with directors at the helm, the stock price remains healthy and dividends continue to be paid, shareholders can achieve other ends. Indeed, based on empirical research, it is argued that shareholders should seriously accommodate these other ends. Those that do are likely to be happier.

(ii) *Happiness Through “Experiential” Purchases*

If the governance structure of corporations better facilitated shareholder participation, with shareholders thereby being given a real opportunity to have a sense of involvement in the corporation, shareholding could become an important source for facilitating gratifications and building up psychological capital for the future.

The corporation, through being a springboard for the positive interaction between shareholders and their stake in the corporation, would thus meet the description of the third pillar of positive psychology, a “positive institution” that supports shareholders’ personal strengths and virtues, and in turn generates positive emotions for shareholders.

I am not without precedent in applying positive psychology to other disciplines, even though the law has been slow to catch on. The theory and scientific studies which form the basis of positive psychology, and in particular the gratifications /pleasures dichotomy, have already been shown to be capable of application in other disciplines (notably economics).

In an article titled, ‘To Do or to Have? That is the Question’, published in the *Journal of Personality and Social Psychology*,⁹⁶ Dr Leaf Van Boven and Professor Thomas Gilovich outline the results of a nation-wide study of 1279 people between the ages of 21-69 they conducted.⁹⁷

The study showed that experiential purchases— ie those purchases that involve some kind of active component which people engage in to generate a life experience (ie, gratifications)— were far more conducive to personal happiness than material purchases (ie, those that involve buying tangible objects such as televisions, cars and jewellery). In follow-up laboratory experiments, participants also experienced more positive feelings after pondering an experiential purchase than after pondering a material purchase, and indicated that they were more likely to anticipate that experiences would make them happier than material purchases after adopting a temporally distant, versus a temporally proximate, perspective.

Van Boven and Gilovich build on the basic foundations of positive psychology by explaining that while material purchases can produce short-term pleasure, the activities that involve greater input and generate life experiences provide longer-lasting and deeper happiness— even though material possessions typically “last” longer from a physical perspective.

⁹⁶ 85 JOURNAL OF PERSONALITY AND SOCIAL PSYCHOLOGY 1193 (2003).

⁹⁷ For a summary of the results, see *id.* at 1193:

In two surveys, respondents from various demographic groups indicated that experiential purchases- those made with the primary intention of acquiring a life experience- made them happier than material purchases. In a follow-up laboratory experiment, participants experienced more positive feelings after providing an experiential purchase than after pondering a material purchase. In another experiment, participants were more likely to anticipate that experiences would make them happier than material purchases after adopting a temporally distant, versus a temporally proximate, perspective.

Why is this so? According to Van Boven and Gilovich, experiential purchases trigger more of our positive sensations. They state that there are several reasons for this:⁹⁸

(1) Experiences are more open to positive reinterpretation, whereas with material purchases, people quickly adapt to these purchases, ‘requiring continued increases to achieve the same level of satisfaction’.⁹⁹ We soon tire of our purchases, rather than continuing to experience satisfaction. Further, and more importantly, the researchers continue:

One reason ... for this difference is that experiences may have more favourable abstract, higher level features than material possessions. Visiting a museum, for example, may have more favourable higher level meanings (‘learning’, ‘becoming cultured’) than a new shirt, and these deeper meanings may figure more prominently in people’s construal of the museum over time. Indeed, people generally construe objects in terms of their central, higher level features when adopting a temporally distal perspective, but construe them in terms of peripheral, low-level features when adopting a temporally proximal perspective.

... Analogously, if experiences have more favourable abstract, high-level features than material possessions, but equally or less appealing peripheral, low-level features, then experiences should be relatively more desirable from a temporally distant perspective than from a temporally proximate one.¹⁰⁰

(2) Experiences are much more central to our personal identities:

A person’s life is quite literally the sum of his or her experiences. The accumulation of rich experiences thus creates a richer life. The same cannot be said of material possessions. As important and gratifying as they sometimes are, they usually remain ‘out there’, separate from the individual who attained them.¹⁰¹

(3) Experiences have enormous “social value”, as we can engage with our friends and family about our experiences more than about our possessions, thereby generating good relationships, with good relationships then being strongly associated with happiness.

In a follow up article published in 2005, Van Boven provides a very useful overview of the findings of his study with Gilovich:

...investing discretionary resources in life experiences makes people happier than investing discretionary resources in material possessions. Two lines of research support this thesis. First, dispositional materialism is negatively associated with subjective well-being and psychological health. Second, research from my own laboratory indicates that people in

⁹⁸ *Id.* at 1200.

⁹⁹ *Id.* at 1200. See also *id.* at 1199

A planned contrast revealed that participants in the two temporally distant conditions were significantly more likely to choose the experiences than participants in the near future condition. ...

These results suggest that experiences have particular appeal when construed from the higher level of abstraction that comes with temporal distance, implying that experiences are more open to favourable interpretations over time.

¹⁰⁰ *Id.* at 1199. In a follow up article, Van Boven provides another take on this part of his findings with Gilovich:

... As one forgets the incidental annoyances and distractions that detract from the online, monetary enjoyment of an experience, one’s memory of an experience can be sharpened, levelled, and “spun” so that the experience seems better in retrospect than it actually was ... It is hard to think of material possessions that can exhibit the same feature. One of the central conclusions of research on subjective well-being is that people adapt to material advances, and they fail to provide enduring pleasure.

See Leaf Van Boven, *Experientialism, Materialism and the Pursuit of Happiness*, 9 REVIEW OF GENERAL PSYCHOLOGY 132, 137 (2005).

¹⁰¹ *Id.* at 1200.

general are made happier by spending money with the intention of acquiring life experiences than by spending money with the intention of acquiring material possessions.¹⁰²

In this 2005 article, Van Boven also returns to consider the actual distinction between experiential and material purchases. He distinguishes between experiential and material purchases as follows:

Experiential purchases ...were defined with the *primary* intention of acquiring a life experience: an event or series of events that one encounters, lives through, and “consumes”. Material purchases were defined as those made with the *primary* intention of acquiring a material possession: a tangible object physically retained in one’s possession.¹⁰³

What is very important about the definitions provided above is the use of the word “primary”. What this means is that a purchase doesn’t necessarily need to be totally experiential or material to be described as an “experiential” or “material” purchase. Van Boven writes that whether a purchase is experiential, material (or both) *depends on the intention of the purchaser*.¹⁰⁴

A purchase can be primarily for experiential reasons, yet still have a material component, and vice versa. For this reason, Van Boven concedes that there will many occasions where it will not be clear-cut whether a purchase fits into the experiential or material purchase slot.

According to Van Boven, a particular purchase could be defined as an experience by one person (eg, being able to ride Colorado canyon roads) and as a material possession by another person (eg, adding to one’s collection of high-end Italian bicycles). A primary intention means that a predominantly (or even mostly) material purchase can still assume an experiential character through choice; same goes for experiential purchases (eg a lovely home could be bought primarily as an investment property, but also used on holidays for family activities and to be closer to the beach). What is clear, however, from Van Boven and Gilovich’s findings is that the experiential component is likely to be more conducive to a person’s long-term happiness than the material component.

This explanation of what is meant by an experiential and material purchase has important implications for the issue of shareholder empowerment, and how power should be allocated in the modern corporation. Even if one is to concede that the acquisition of shares is primarily a material purchase- to make a profit and/or to earn a sustained income through the receipt of dividends- does not rule out also utilising the shares as an experiential purchase.

If we appreciate that the primary objective of shareholders when buying shares in a corporation is to make money, and that managerial authority is the most effective approach to achieve improved company performance, shareholder governance rights should not unduly interfere with this model. That said, we need to appreciate that shareholders are likely to enjoy greater happiness over time through being able to utilise their shares as an experiential purchase, than by making money off their shares. Happiness studies consistently show a very weak correlation between material gain and happiness once basic needs are satisfied.

As discussed in Part two above, the rights of shareholders in public corporations are severely limited at present. Shareholders really are not given a chance to participate in the corporation. The task ahead is to increase shareholder power with this in mind.

Shareholder participation should be the end-game, recognising the direct benefits to shareholders through treating their shares as an experiential purchase. The objective is to

¹⁰² See Van Boven, *supra* note 100, at 132.

¹⁰³ *Id.* at 134.

¹⁰⁴ *Id.* at 134.

increase shareholder power as much as possible, without unduly interfering with the default rule of managerial authority.

Shareholders should be able to have their cake, and help bake it too!

This may very well best be achieved through a change of corporate culture, and the development of norms which are conducive to the goal of facilitating the use of shares as an effective experiential purchase, than through engaging in law reform. The task ahead for proponents of shareholder empowerment is to sell the idea that increasing shareholder power is important for shareholders, and can be accommodated without in any way sacrificing the bottom line.

Even if increasing shareholder power would not improve corporate performance, this is not a reason for clinging to the status quo. Increasing shareholder power would facilitate a more effective experiential purchase, opening up the possibility of greater happiness for shareholders, and should be pursued on this basis.

Similar findings discussed below on the correlation between building “relational”, rather than material, goods and one’s level of happiness provide further support for the view that the interests of shareholders would be best served by accommodating greater utilisation of shares as an experiential purchase. In other words, shareholders should be given greater participatory rights.

(iii) Relational Goods and Happiness

The findings above show that individuals experience greater happiness through participating in what life has on offer. In relation to the acquisition of shares, while shareholders typically buy in to a corporation for material gain, the research suggests that they would likely be happier if they also treated their shares as an experiential purchase. Participation rather than profits are more likely to put a smile on their dial- and an on-going smile at that.

The findings in relation to participation and happiness are backed up by recent findings on the relationship between so-called “relational goods” and happiness. Studies in the emerging area of “psycho-economics”¹⁰⁵ reaffirm that the path to greater happiness comes from building relational goods, rather than continuing to accumulate material goods.

In what has become the seminal article in this area, C J Uhlener defines a relational good as follows:

“relational goods ...arise as a function of a relationship with others ... only by mutual agreement”, [they] “cannot be acquired by an isolated individual” [and they] “are unlike private goods, which are enjoyed alone, and standard public goods, which can be enjoyed by any number”.¹⁰⁶

¹⁰⁵ See Maurizio Pugno, *The Happiness Paradox: A Formal Explanation from Psycho-Economics*, University of Trento, Working Paper, December 2004, at 23: “Psycho-economics” is a new line of inquiry by “employing crucial arguments from psychology within an economic approach”. This working paper is available on-line at: <<http://www.unitn.it/events/he/download/pugno.pdf>>

¹⁰⁶ See C J Uhlener, *Relational Goods and Participation: Incorporating Sociability into a Theory of Relational Goods*, 62 PUBLIC CHOICE 253, 254 (1988) [my interpolations]. See further, Benedetto Gui, *Beyond Transactions: On the Interpersonal Dilemma of Economic Reality*, 71 ANNALS OF PUBLIC AND COOPERATIVE ECONOMICS 139 (2000); also Lionel Prouteau & Francoii Charles Wolff, *Relational Goods and Associational Participation*, 75 ANNALS OF PUBLIC AND COOPERATIVE ECONOMICS 431 (2005); JAN E. LEIGHLEY, STRENGTH IN NUMBERS? THE POLITICAL MOBILIZATION OF RACIAL AND ETHNIC MINORITIES Ch 1 (2001):

Relational goods, as developed by Uhlener, refer to a set of incentives enjoyed by individuals as members of groups. These incentives- available only to group members- range from group identity to social interaction and recruitment, but the essential mechanism is again that of information provision: the group provides information that reduces the costs of participation.

Francis-Charles Wolff and Lionel Prouteau see relational goods as being:

[i]ntangible outputs of a communicative and affective nature, produced through interaction.¹⁰⁷

Another useful definition of relational goods has recently been provided by Angelo Antoci, Paolo Russu and Raola Vanin, in their study on relational goods and happiness:

Relational goods are goods that cannot be enjoyed alone, since they can only be produced and consumed by participating to some common activity with other agents.¹⁰⁸

The last few years has seen the publication of some important empirical research on the link between the building of relational goods, and one's level of happiness. While the research has not specifically related to building relational goods through participating as a shareholder in a public corporation, there is no reason to suggest the findings do not have relevance to shareholder participation.

One study that is particularly relevant to shareholder participation was undertaken by Luigino Bruni and Luca Stanca, and published as a working paper in June 2005.¹⁰⁹ In exploring the link between relationality and happiness, one area that gained the attention of researchers was the impact of participating in voluntary associations. The researchers' working paper contains some important commentary on relationality and happiness:

The existing literature, mainly outside the economic fields, recognizes both theoretically and empirically relationality as an important determinant of life satisfaction. In psychology, there is extensive evidence about the link between sociality and happiness.¹¹⁰

...

Further:

...psychological studies offer extensive evidence on the importance of relationality on happiness and life satisfaction. Within psychology there has been increasing appreciation of the fundamental importance of supportive interpersonal relationships for well-being and happiness. This dimension is so important that some theorists have defined "relatedness" as a basic human need that is essential for well-being.¹¹¹

Then, in exploring the empirical findings, the researchers' state:

Using individual data from the World Values Survey, we find a positive relationship between indicators of relationality and life satisfaction, and a negative relationship between television viewing and indicators of relationality.¹¹²

Focusing on the relational indicators, membership of a voluntary organization is associated to a statistically significant increase in life satisfaction (1.15 percentage points). Active participation to the activities of a voluntary organization is also positively and significantly associated to higher life satisfaction, and the increase is somewhat larger and more significant.¹¹³

¹⁰⁷ Wolff & Prouteau, *supra* note 106, at 406.

¹⁰⁸ See Angelo Antoci, Paolo Russu & Raola Vanin, *Relational Goods, Private Consumption and Social Poverty Traps in an Evolutionary Game*, Working Paper No. 25, December 2005, at 4. This working paper is available on-line at <<http://www.ecofo.unibo.it>>

¹⁰⁹ See Luigino Bruni & Luca Stanca, *Watching Alone: Relational Goods, Television and Happiness*, Working Paper, Economics Department, University of Bicocca, June 2005. Available online at: <http://dipeco.economia.unimib.it/pdf/publicazioni/wp90_05.pdf>

¹¹⁰ *Id.* at 3.

¹¹¹ *Id.*

¹¹² *Id.* at 4.

¹¹³ *Id.* at 13-4.

A relational good is very similar to the more established concept of “social capital”. Social capital is essentially the end-product for individuals within society building up relational goods. There have been some important findings over the years on the importance of building social capital, reinforcing more recent findings showing a positive correlation between building relational goods and personal happiness.

Many of these studies on social capital are discussed in Harvard professor of sociology Robert Putnam’s famous book on the topic, *Bowling Alone*.¹¹⁴ Putnam points to empirical research which consistently shows that improved health outcomes are achieved in US states which show heightened levels of social capital.¹¹⁵

Relational goods can certainly be obtained through one’s involvement as a shareholder in a public corporation. The above findings on participation in a similar type of organization- the voluntary association- provides support for this contention. Utilising the (limited) participatory rights that are available to shareholders, mainly confined at present to attending annual general meetings and voting on fundamental decisions affecting the corporation, provides shareholders with the opportunity to communicate and cooperate with shareholders and management, collectively building relational goods in the process. According to the findings above, greater happiness is on offer for those shareholders who decide to adopt a positive, broad-minded view of their shareholding.

Shareholder passivity in the public corporation is simply part of a general trend starting to be recognised in the social sciences. Even though building relational goods is the key to greater happiness, relational goods are in deterioration due to the pursuit of material goods. Individuals are structuring their lives with a view to accumulating material goods, when what they really should be doing is focus their attention on building relational goods.

In this sense, and as will be explored further below, an interesting issue arises. How can corporate lawyers and economists continue to back rational choice theory, essentially meaning a decision is rational if it maximises wealth, if the emerging evidence shows that greater longer-term happiness for individuals comes from doing basically the opposite- actively building relational goods rather than continuing to accumulate material goods.¹¹⁶

(iv) Redefining the Rational Choice for Shareholders

It was explained in Part two above that it is commonly agreed that the rational choice for public corporation shareholders is apathy. According to the theory of rational choice, increasing shareholder power is unnecessary because shareholders prefer to remain passive, and it is actually in their best interests to do so. The directors have the skill and experience to manage the corporation, and therefore should continue to do so. Given the size of the corporation and the number of shareholders, an individual shareholder is unlikely to hold much sway, and therefore the costs of participating in the corporation inevitably exceed any possible benefit that can be derived.

Put simply, a decision is rational if it contributes to the maximization of wealth. So long as the corporation buzzes along nicely with directors holding most of the power, and shareholders holding very limited power, there is no need to change the governance

¹¹⁴ ROBERT D.PUTNAM, *BOWLING ALONE: THE COLLAPSE AND REVIVAL OF AMERICAN COMMUNITY* (2000).

¹¹⁵ See also John F. Helliwell, *Social Capital, The Economy and Well-Being, The Review of Economic Performance and Progress in THE REVIEW OF ECONOMIC PERFORMANCE AND SOCIAL PROGRESS 2001: THE LONGEST DECADE: CANADA IN THE 1990S*, 43 (Andrew Sharpe, France St-Hilaire, & Keith Banting, eds., 2001).

¹¹⁶ See Pugno *supra* note 106, at 11:

All these results on deterioration and on the shifting away from relational goods appear puzzling for economists, who predict that the utility dynamics of optimising agents do not point to decline unless they are forced to do so by market failures.

arrangements in public corporations. If the corporation performs in the economic sense of an upward moving share price and healthy profits, there is simply no need to increase shareholder power. The best interests of the shareholders are being served, so the status quo is preferable.

But the perceived logic which encapsulates rational choice theory fails to appreciate the non-financial benefits that can be derived from increasing shareholder power. As we know now, shareholder empowerment can work towards enhancing the long-term happiness of shareholders. Even if shares are predominantly a material purchase, that is no reason to close off experiential aspects of the purchase.

Thus, without unduly interfering with the traditional default rule of managerial authority which is the best guarantee of corporate performance (which can go towards satisfying the primary material component of a higher share price), shareholder participation should be accommodated as an end in itself. The experiential component of shareholding should be accommodated up to the point where it is about to interfere with the material component of shareholding.

That shareholders are rationally apathetic, and thus shareholder empowerment is not warranted, is an intellectually lazy argument. It rests on the simple, overly-narrow assumption that a decision is rational only if it helps fill the pockets of the decision-maker. But it is quite obvious that there is more to a decision-maker than just their pockets, and that for most individuals, more is likely to be on their mind.¹¹⁷

Away from the self-referential world of economics, rationality is painted in a very different, much more considered, light. The axiomatic finally gets a run. Rather than a decision being rational because an economist thinks it is, a decision is rational because it is in best interests of the decision-maker.

Simply by embracing a “new” paradigm of rationality, with rationality based on what is truly in the best interests of the decision-maker, shareholder participation rather than shareholder passivity becomes the rational choice.

As long ago as in John Stuart Mill’s *Utilitarianism*, it was appreciated that “rationality” comes from choosing conduct which will enhance the satisfaction of whatever goals one sets forward. This is referred to by philosophers as “practical rationality”.¹¹⁸ For Mill, in *Utilitarianism* the rational goal was happiness- obtaining more pleasure with the absence of pain.

Thus, if a shareholder partly chooses to utilise their shares as an experiential purchase, exercising participatory rights with a view to building relational goods and achieving greater happiness, then this becomes a rational choice.¹¹⁹ It is rational because it contributes towards the satisfaction of the goal put forward by the shareholder.¹²⁰

¹¹⁷ See generally BRUNO S. FREY, NOT JUST FOR THE MONEY: AN ECONOMIC THEORY OF PERSONAL MOTIVATION (1997).

¹¹⁸ See further the entry on ‘Practical Reason’ in the STANFORD ENCYCLOPAEDIA OF PHILOSOPHY:

... practical rationality is a matter of consistency in action: people act rationally to the extent they do what is likely to bring about the best state of affairs, given both their preferences over the outcomes that may be brought about through their agency and their beliefs about the probability of those actions.

Available on-line at: <<http://setis.library.usyd.edu.au/stanford/entries/practical-reason/>>

Also see PRACTICAL RATIONALITY AND PREFERENCE: ESSAYS FOR DAVID GAUTHIER (Christopher W. Morris & Arthur Ripstein, eds., 2001), in which it is discussed how practical rationality is part of a broader field of ‘decision theory’; and the preface to MARK C. MURPHY, NATURAL LAW AND PRACTICAL RATIONALITY (2001): ‘Practical rationality aims to identify and characterise reasons for action and to explain how choice between actions worth performing can be appropriately governed by rational standards.’

¹¹⁹ See also the entry in Wikipedia, which defines ‘rationality’ as being the success of goal attainment, ‘whatever those goals may be’. Available on line at: <<http://en.wikipedia.org/wiki/Rationality>>

¹²⁰ See RATIONALITY AND HAPPINESS: FROM THE ANCIENTS TO THE EARLY MEDIEVALS (Jiyuan Yu and Jorge Gracia, eds., 2003), in particular the chapter by Donald Morrison, *Happiness, Rationality and Egoism in Plato’s Socrates*, chapter 1.

Remaining apathetic would make this goal impossible to achieve, and hence would be an irrational choice- regardless of the effect of the decision in terms of the decision-maker's wealth.

If we can accept that the concept of rationality is not confined to the meaning ascribed according to rational choice theory, then a major barrier to increasing shareholder power is removed. It is no longer enough to respond to a case for shareholder empowerment by arguing that shareholders are rationally apathetic. This will no longer wash. While it may still be accepted that shares are primarily a material purchase, and managerial authority is the most effective governance mechanism to enhance company performance, there is now a strong claim for shareholder participatory rights to be accommodated- so long as this does not unduly interfere with the management of the corporation.

V Conclusion and Recommendations

If we accept that greater personal happiness comes from participation, and the pursuit of happiness is the ultimate objective of human beings, then participation rather passivity becomes the rational choice for shareholders.

Even if active involvement in the corporation seems less desirable at the time than sitting back and collecting the dividend check, empirical findings presented in this article show that when looking back on the decision, shareholders, even in the largest of corporations, are likely to be happier by following the participation path.

Participation will, of course, not appeal to all shareholders. Many shareholders may simply not have the time or the inclination to get involved. But this should not form the basis for preventing other shareholders who want, or are encouraged, to get involved, doing so.

Given that shareholders at present have limited participatory rights, a strong case can be made for increasing shareholder power. It is argued that shareholders should be given real participatory rights, but not so as to unduly undermine or interfere with the day-to-day management of the corporation. The focus is shareholder happiness rather than shareholder autocracy.

Rather than imposing increased shareholder power on corporations through the process of law reform, for which there have been many proposals to do just this in recent years,¹²¹ I believe that the most effective way to build in a desirable level of shareholder empowerment within the corporation is through a change of corporate culture.

Directors may be more accommodating of an increased participatory role for shareholders if shareholder participation is appreciated as being an end in itself, an end not intended to interfere with the director's role of working to improve the corporation's performance.¹²² Regardless of whether or not such participation improves the corporation's bottom line, empirical studies demonstrate that participation is a key ingredient of greater, longer-lasting happiness, and is virtuous on that basis.

Rather than having their arms twisted to sacrifice managerial authority for the sake of accommodating increased shareholder power, directors could act *within* their authority to give

¹²¹ See footnote 2 above for a summary.

¹²² For a discussion of why the motivation and behavior of the overwhelming majority of directors and executives extends beyond narrow self-interest, see JAMES MCCONVILL, *THE FALSE PROMISE OF PAY FOR PERFORMANCE: EMBRACING A POSITIVE MODEL OF THE COMPANY EXECUTIVE* (2005).

shareholders more involvement in the corporation if shareholders wish to soak it up. Shareholder empowerment and managerial authority can go together hand in hand.¹²³

The authority of directors could be utilised to develop initiatives such as regular shareholder briefings about proposed strategies and operations and being able to provide input in relation to these proposals; the formation of shareholder committees to communicate with the board of directors and/or various board committees; welcoming shareholder nominations for election to the board; allocating time at the general meeting for a non-binding vote on a corporation's executive compensation arrangement (similar to what exists in the United Kingdom and Australia),¹²⁴ and possibly even giving shareholders the opportunity to intervene at times and put forward proposals for a change in the corporation's charter, or place of incorporation, or possibly requesting a takeover to proceed or staggered board arrangement to be unwound (along the lines proposed by Bebchuk in his 2005 *Harvard Law Review* article).

While it may sound somewhat opportunistic at present to say that directors will accommodate such shareholder participation if it is appreciated that participation has important non-financial benefits for shareholders, it is not beyond the realms of possibility.

At least as a matter of law, it is important to make clear that there is nothing standing in the way of directors vesting governance rights in shareholders, even if this was to limit the authority of the directors. Indeed, as Chancellor Chandler said in the recent Delaware Court of Chancery opinion, *Unisuper et. al. v. News Corp.*,¹²⁵ a director would be acting entirely within the authority given by s 141(a) of the Delaware General Corporation Law to cede power to shareholders when the shareholders vote to assert control over the business and affairs of the corporation.¹²⁶ Surely, then, it would be within a director's authority to give some powers to shareholders when this is the exercise of prudent discretion, rather than being forced through shareholder demand.¹²⁷ A contrary position would simply defy logic.

The only barrier standing in the way of greater shareholder participation therefore is corporate culture, and particularly the attitude of directors towards shareholder empowerment. Naturally, the bulk of directors assume the director primacist line in this regard.

If directors can begin to appreciate that increasing shareholder power in fact involves an important exercise of authority, rather than the sacrificing of authority, then I believe we are half way there. The remaining half will come through convincing directors that increasing shareholder power does not have to put at risk the corporation's financial performance. As was discussed in this article, shares are first and foremost a material purchase, and shares will

¹²³ As an example, during the 2005 proxy season, some corporations (notably Pfizer) volunteered to put forward a resolution to make it easier for shareholders to vote down nominees for directors that were selected by the board. Under the change, a nominee is rejected if a majority of votes cast express a "withheld" vote. This initiative was in response to calls from shareholder groups, and a proposal by the ABA, to change the system for electing directors so that a majority vote would be required, rather than the current "plurality" system where board-nominated directors can be elected with as little as one vote. See William Baue, *Majority-Vote Director Election Shareowner Resolutions to Top 100, Dominate Proxy*, SOCIAL FUNDS.COM, Jan. 10, 2006; William Baue, *Shareholder Empowerment is Alive and Well: A Preview of the 2006 Proxy Season*, SOCIAL FUNDS.COM, Nov. 16, 2005. Both articles are available online via: <<http://www.socialfunds.com/news>>

¹²⁴ See Larelle Chapple & Blake Christensen, *The Non-Binding Vote on Executive Pay: A Review of the CLERP 9 Reform*, 18 AUSTRALIAN JOURNAL OF CORPORATE LAW 263 (2005).

¹²⁵ *Unisuper Ltd et al. v. News Corp. Ltd. et al.*, Dec. 20, 2005. One of the central issues in this case, which will now proceed to trial, is whether an agreement by News Corp's directors to prohibit any extension of a poison pill beyond 12 months without obtaining shareholder approval first is valid. The directors of News Corp. departed from this agreement by extending the pill without the consent of shareholders. News Corp. argued that the agreement diminished the authority of the directors and hence was invalid pursuant to s 141(a) of the Delaware Code. Chancellor Chandler dismissed this argument.

¹²⁶ At p 17 of the memorandum opinion, Chancellor Chandler wrote that:

Delaware's corporation law vests managerial power in the board of directors because it is not feasible for shareholders, the owners of the corporation, to exercise day-to-day power over the company's business and affairs. Nonetheless, when shareholders exercise their right to vote in order to assert control over the business and affairs of the corporation, the board must give way. This is because the board's power- which that of an agent's with respect to its principal- derives from the shareholders, who are the ultimate holders of power under Delaware law.

¹²⁷ This would also apply in states outside Delaware who all have a default rule in their corporation statutes in substantially the same terms as s. 141(a).

inevitably want some return on their investment. Thus, shareholder empowerment only needs to be accommodated up to a point.

Given the important benefits that can be derived from shareholder participation, it should be facilitated up to a point close to where it may start to interfere with the day-to-day management of the corporation, and thus potentially undermine managerial authority. After this point, the concern for the primary material component of the share purchase kicks in, given that the corporation has already taken sufficient care of the experiential component. That said, the amount of power given to shareholders will ultimately depend on the culture inside each corporation, and the extent to which shareholders in that corporation are willing and able to participate.

Thus, it is not for this article to outline with precision what does and does not fit the bill of desirable shareholder empowerment, or to continue the recent trend in corporate governance commentary of coming up with new and innovative ways to increase shareholder power. The extent to which shareholders are empowered simply becomes a contractual issue to be negotiated between the shareholders and directors of the corporation.

I believe that this design for increasing shareholder power would be acceptable to both shareholder primacists and director primacists. For shareholder primacists, by embracing a new paradigm of rationality as to what is in the best interests of shareholders, increasing shareholder power would be acceptable given the positive correlation between participation and happiness highlighted in this article.

For director primacists, this design for increasing shareholder power would simply represent a change in the terms of the contract upon which shareholders agree to assume risk by buying shares in the corporation. Shareholders would contract with the directors for an experiential purchase, and not just a material purchase. Shareholder participation would be pursued as an end in itself up to the point that the directors and shareholders choose, and both shareholders and directors would keep in mind that shares are primarily a material purchase, and shareholders want the corporation to perform and perform well.

The mission going forward is to help educate directors, executives, shareholders, and corporate governance commentators about the non-financial benefits of increasing shareholder power. Shareholder empowerment should not come second fiddle to maintenance of the status quo, characterised by very little participatory rights, simply because the account books record that the corporation is performing well.