

CORPORATE HIERARCHY AND RACIAL JUSTICE

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I. RACIAL JUSTICE AND CORPORATIONS

What can advocates for racial justice learn from the study of corporate governance? The neoclassical economic analysis of law purportedly seeks to maximize social welfare. Yet mainstream corporate governance scholarship, which is dominated by neoclassical law-and-economics, tends to confine itself to maximizing shareholder welfare rather than social welfare generally. Not only do large business corporations' actions affect their shareholders, but they also have immense "external" effects on almost every aspect of society. Many of these externalities implicate racial issues. Most obviously, corporations employ and pay people, and thus affect the racial distribution of wealth, power, and prestige. Furthermore, diversity and fair treatment in the workplace are key elements of the social construction of race, because for many, if not most Americans, the workplace is the site of one's most significant interactions with people of other races. Outside the employment context, corporate practices influence racial disparities in such matters as health and environmental quality.

To the extent that scholarship on law and race has focused explicitly on the role of corporations, it has largely ignored business structures, business practices, and the corporate law

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regime that helps determine them. Instead, it has tended to focus on anti-discrimination laws and other forms of direct government intervention.¹ But it is unrealistic—at least for the foreseeable future—for diversity and anti-discrimination activists to expect the government to pursue new legal initiatives that explicitly address racial issues in the corporate context.² Corporate regulation has enjoyed recent, but probably short-lived, political popularity immediately following Enron, but the current political hostility to race-conscious remedial law shows no signs of changing in the immediate future.

Thus, strategies for racial justice in the corporate context should focus in the near term on understanding and using the corporate governance regime. This regime has two conflicting features: shareholder participation and management discretion.³ These two features suggest two approaches to initiating corporate change. I will refer to the first as “democratic

¹ See Cheryl L. Wade, *Attempting to Discuss Race in Business and Corporate Law Courses and Seminars*, 77 ST. JOHN'S L. REV. 901, 907 (2003) (stating that “if companies monitor their employees’ compliance with anti-discrimination law, they may begin to mitigate some of the economic effects of employment discrimination”).

² See Thomas W. Joo, *A Trip Through the Maze of “Corporate Democracy”: Shareholder Voice and Management Composition*, 77 ST. JOHN'S L. REV. 735, 736–37 (2003) (finding that “government-mandated quotas for business corporations” are an unlikely prospect). *But see* Steven A. Ramirez, *A Flaw in the Sarbanes-Oxley Reform: Can Diversity in the Boardroom Quell Corporate Corruption?*, 77 ST. JOHN'S L. REV. 837, 861–62 (2003) (arguing that post-Enron corporate regulators should mandate diversity on corporate boards to improve corporate decision-making).

³ Here, I use the term “management” to refer to the directors and executive officers of a corporation. Orthodox corporate legal scholarship has distinguished between directors and officers. In this view, officers have day-to-day power over the corporation, subject to monitoring by directors, who represent the interests of shareholders. More recently, commentators have tended to lump directors and executive officers together, contending that directors are, in fact, more closely aligned with executives than with shareholders. This assumption is now being disputed in current scholarship, and distinguishing between directors and officers is once again becoming prevalent, as boards of directors are increasingly being analyzed as independent centers of corporate power. *See, e.g.*, Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 573–74 (2002) (stating that “[s]hareholders exercise virtually no control over either day-to-day operations or long-term policy”); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 248, 251 (1999) (explaining that the power of American corporations “rests in the hands of its directors”). For present purposes, it is unnecessary to engage in the debate over whether officers or directors hold greater power in a corporation. Both directors and officers determine corporate policy, and the analysis herein applies to both, whether they constitute two classes or only one. To avoid this dispute, however, this Article will subsequently adopt the term “hierarchs” to refer to both directors and officers.

aspirationalism.” It seeks to influence corporate behavior through the mechanisms of “corporate democracy,” that is, through shareholders’ legal avenues of participation in corporate governance. In theory, shareholder participation can achieve both “substantive” reforms, such as increasing board diversity by voting for directors of color, and “procedural” ones, such as reforming a corporation’s internal governance rules to increase opportunities for future shareholder participation. A second approach, which I will call “hierarchical realism,” seeks corporate change with the understanding that notwithstanding the rhetoric of “corporate democracy,” the board of directors and the top executive officers, not shareholders, wield the real power in a corporation. I refer to the first approach as “aspirational” because it rests on an optimistic view of the democratic nature of corporate governance. The second approach is “realist” in that it is based on a more accurate, descriptive understanding of corporate law and management power.

Legal Realism has been criticized for its tendency to accept present legal conditions for what they are, rather than imagining new ones.⁴ Similarly, the hierarchical realist approach invites the criticism that it accepts the hierarchical nature of corporate governance and lacks the vision or courage to seek change.⁵ I accept that criticism in part. The hierarchical nature of corporate governance is simply unlikely to change in the near future, and a near-term reform strategy must accept that fact. But even assuming increased shareholder power were a possibility, I am skeptical that it would advance the cause of social justice, and particularly racial justice, in corporate affairs. The existing hierarchical system, for all its faults, may actually be superior for these purposes.

II. CORPORATION AS HIERARCHY

The democratic aspirationalist view relies on a traditional model of American corporate governance that Henry Hansmann and Reinier Kraakman have termed “the standard model.”⁶ Under this view, shareholders are the “owners” of a corporation

⁴ See, e.g., Gregory A. Mark, *The Personification of the Business Corporation in American Law*, 54 U. CHI. L. REV. 1441, 1482 (1987).

⁵ *Id.* at 1481.

⁶ Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001).

and corporate directors should be, and in fact are, their faithful agents.⁷ “[D]elegated management under a board structure” is a key characteristic of the standard model.⁸ Hansmann and Kraakman argue, however, that corporations should also be “strongly accountable to shareholder interests,”⁹ and are in fact, “strongly responsive to shareholder interests.”¹⁰

But while the American corporate governance model is an effective engine of wealth creation, debacles like Enron and WorldCom notwithstanding, it is “responsive” to shareholders only in a very abstract sense. That is, if we confine the definition of “shareholder interests” to the creation of wealth, then yes, corporate boards, and the officers they appoint, are “responsive to shareholder interests.” But boards and officers are not, and law does not require them to be, “responsive” to shareholders in the sense of accepting and responding to shareholders’ participation in governance. This is true with respect to shareholders’ expression of concerns about wealth creation issues, and doubly so with respect to their expression of concerns about social justice issues.

The corporate code of Delaware, the leading state of incorporation for large U.S. corporations, sums up the hierarchical nature of corporate governance under American law: “The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors”¹¹ Shareholders’ primary participation in setting corporate policy is indirect and passive—they may approve slates of director candidates who are normally nominated by incumbent directors.¹² At election time, the official corporate proxy (akin to a ballot), funded with corporate dollars and mailed out under the imprimatur of the corporation, includes only the names of the incumbent board’s nominees. Shareholders may vote for those nominees or “withhold” their votes, but they are not presented with options, nor may they cast a “no” vote. A corporation’s board has no obligation to list opposition candidates in the

⁷ *Id.* at 440–41 (highlighting protection of shareholder interests as an obligation of corporate management).

⁸ *Id.* at 440.

⁹ *Id.* at 441.

¹⁰ *Id.* at 440.

¹¹ DEL. CODE ANN. tit. 8, § 141(a) (2001).

¹² See Joo, *supra* note 2, at 744–45 (providing a discussion of the election process).

official corporate proxy materials.¹³

Active shareholder participation is largely limited to making and voting upon proposals for director consideration. As in the director nomination context, corporate law limits shareholders' access to the official corporate proxy mailing. The board may refuse to place proposals on the ballot.¹⁴ The securities law regime disfavors the making of such proposals unless they are made in nonbinding form,¹⁵ in which case management can simply ignore shareholder proposals. The brief flurry of post-Enron corporate reform has not increased shareholder voice in either the election or the proposal context.¹⁶

Shareholders who directly challenge management decisions through litigation are likely to be rebuffed by the principle of judicial deference to management discretion, known as the "business judgment rule."¹⁷ Under this rule, shareholders may not challenge management's business decisions unless they can show, despite strong presumptions to the contrary, that management did not act in good faith, on an informed basis, or in the best interests of the corporation.¹⁸ That is, disagreement about the substantive quality of a decision does not give shareholders grounds for a cause of action. Shareholders must allege corruption or conduct approaching recklessness in order to even state a claim challenging management actions.¹⁹ This principle of deference is not limited to decisions regarding "business," narrowly defined. Courts have applied business judgment deference to charitable and political spending on the ground that management may believe such decisions will indirectly advance the corporation's business.²⁰ Thus, corporate law puts few restrictions on management power. To the extent that shareholders exert influence over managers, it is in the capital marketplace and not in courts or corporate elections.

¹³ *Id.* at 758.

¹⁴ *Id.* at 758-59.

¹⁵ *See infra* note 29 and accompanying text. One possible exception to this rule is shareholders' power to initiate and approve binding amendments to corporate bylaws. *See Joo, supra* note 2, at 753.

¹⁶ *See infra* note 27-28 and accompanying text.

¹⁷ FRANKLIN A. GEVURTZ, *CORPORATION LAW* 278-79 (2000).

¹⁸ *See id.* at 278-80.

¹⁹ *See id.* at 283.

²⁰ *See, e.g., Marsili v. Pac. Gas & Elec. Co.*, 124 Cal. Rptr. 313, 320 (Ct. App. 1975) (discussing political spending); *Kahn v. Sullivan*, 594 A.2d 48, 59, 61 (Del. 1991) (discussing charitable spending).

Corporate commentators of many different stripes are coming to accept the above description and agree that shareholders do *not* hold the ultimate power in a corporation; rather, power is highly concentrated at the top of the corporate hierarchy.²¹ Despite the descriptive convergence, commentators remain divided over the normative implications of this fact. Some scholars see the concentration of power as undesirable. Many of these scholars agree with the normative vision of the standard model—that directors *should* be agents faithful and accountable to the shareholders who own the corporation, but argue that in practice, they tend to enrich and empower themselves or their senior executive cronies.²²

Other scholars, however, celebrate the fact that power resides in hierarchs rather than in shareholders. Stephen Bainbridge, for example, agrees with the assumption that a business corporation's purpose is to enrich shareholders, but argues that shareholder-centered corporate governance is not the best way to achieve this goal.²³ Rather, he asserts that corporate governance successfully pursues this end through "director primacy"—the concentration of power and discretion in directors.²⁴ Unlike Bainbridge, Margaret Blair and Lynn Stout believe that constituents other than shareholders, including employees and creditors, have equally legitimate interests in a

²¹ See, e.g., Bainbridge, *supra* note 3, at 547–49; Blair & Stout, *supra* note 3, at 251–52; Thomas W. Joo, *The Modern Corporation and Campaign Finance: Incorporating Corporate Governance Analysis into First Amendment Jurisprudence*, 79 WASH. U. L.Q. 1, 40–41 (2001).

²² See, e.g., Lucian Arye Bebchuk, Jesse M. Fried & David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 754 (2002); Charles M. Yablon, *Bonus Questions—Executive Compensation in the Era of Pay for Performance*, 75 NOTRE DAME L. REV. 271, 271–72 (1999).

The theory that directors and executives dominate the corporation to the detriment of shareholders is hardly new of course, though it fell out of favor in the 1970s and 80s. See William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1498–501 (1989). Over two centuries ago, Adam Smith warned that corporate directors could not be trusted with "other people's money." The modern version of this argument can be traced to Adolf Berle and Gardiner Means' 1932 book, *THE MODERN CORPORATION AND PRIVATE PROPERTY*, which argued that the dispersion of share ownership in large, publicly traded corporations made directors and officers unaccountable to shareholders.

²³ See Bainbridge, *supra* note 3, at 605–06.

²⁴ *Id.* at 550.

corporation.²⁵ But despite their sharply different view of the corporate purpose, Blair and Stout agree with Bainbridge that the corporate purpose is best served by concentrating power in the board. They argue that the competing claimants cede power to corporate directors and accept them as neutral “mediating hierarchs.”²⁶

III. SHAREHOLDER POWER AND RACIAL JUSTICE

Significant increases in shareholder participation are unlikely in the foreseeable future. The immediate post-Enron period, the best opportunity in many years for corporate governance reform, yielded no developments in this area. The only news of any note was a 2003 SEC rule proposal that would have allowed large shareholders to place director nominees on the corporate proxy under certain very restrictive conditions.²⁷ But by 2005, the SEC had abandoned this proposal, and the reform window opened by Enron appeared to have closed entirely.²⁸

In any case, even if shareholders' legal power were to increase, it would be unlikely to contribute to social justice, and particularly racial justice, in corporate affairs. As an example, assume the manufacturing processes of the hypothetical Tyrell Corporation generate a large quantity of legal, but noxious, waste. Tyrell's facilities are all located in low-income neighborhoods whose residents are overwhelmingly people of color. Technology to mitigate Tyrell's waste generation exists, but it would have a moderate negative effect on company profits. Residents and national civil rights organizations believe the placement of the facilities and the corporation's failure to mitigate the waste constitutes environmental racism. Under existing law, shareholders sympathetic to this view could make only *nonbinding* proposals asking Tyrell's board of directors to

²⁵ See Blair & Stout, *supra* note 3, at 250.

²⁶ See *id.* at 255, 280–81.

²⁷ See Security Holder Director Nominations, 68 Fed. Reg. 60,784 (proposed Oct. 23, 2003), available at <http://www.sec.gov/rules/proposed/34-48626.pdf>.

²⁸ See, e.g., Joseph Nocera, *Donaldson: The Exit Interview*, N.Y. TIMES, July 23, 2005 at C1 (“[The shareholder-nomination proposal] died because the commissioners disagreed on how, or whether, to carry out the idea.”); Kurt Eichenwald, *Reform Effort at Businesses Feels Pressures*, N.Y. TIMES, Jan. 14, 2005, at A1 (“The white-hot movement to overhaul corporate governance has cooled in recent months in Washington and beyond . . .”).

implement the waste-mitigation measures.²⁹ Shareholders could withhold their votes for directors who refused to mitigate the waste, but they would have great difficulty fielding an alternative slate of directors.

Now assume that SEC and state-law rule changes were to give shareholders expanded power to make binding proposals on the corporate ballot. Residents, who have purchased a small number of shares for this purpose, make a shareholder proposal that would require Tyrell to invest in waste-mitigation technology for its plants. Obviously, the value of the new shareholder power depends on the number of votes the proposal can attract. Some shareholders would certainly support the initiative. But not all of them would, particularly since it requires them to choose between profits and racial justice.³⁰ Indeed, it is likely that the majority of shares would not be voted in favor of the proposal. Note that corporate voting allocates votes per share, not per shareholder. Thus, the largest shareholders have the most votes, and unlike small shareholders, they would lose significant amounts of money under the proposal. Furthermore, as in political elections, the concerns of racial minorities are simply unlikely to command majorities or significant pluralities in corporate elections. Our political system

²⁹ Another potential avenue for active shareholder participation is through bylaws. Many state codes give shareholders the power to propose and enact corporate bylaws without board approval. It is unclear, however, whether shareholders can use this power in ways that would conflict with the fundamental rule that the board of directors shall manage a corporation. See, e.g., GEVURTZ, *supra* note 17, at 198; Joo, *supra* note 2, at 755. In the hypothetical, a shareholder-adopted bylaw requiring Tyrell management to implement waste-mitigation measures would obviously raise such a conflict.

³⁰ For the sake of the hypothetical, assume that there is a clear short-term negative effect on profits and no clear long-term positive effect. Some advocates of the resolution might argue that despite the immediate harm to profits, waste mitigation is good for long-term profits because it will generate public relations value and avoid future problems with regulators. Such arguments are easy to make; they are speculative and difficult, if not impossible, to prove, however. Cf. Thomas W. Joo, *Race, Corporate Law, and Shareholder Value*, 54 J. LEGAL EDUC. 351, 360 (2004) (contending that the argument for racial diversity in corporate America should not be based on its contribution to the bottom line, because diversity may increase profitability in some, but not all, contexts). *But see* Donald C. Langevoort, *Overcoming Resistance to Diversity in the Executive Suite: Grease, Grit, and the Corporate Promotion Tournament*, 61 WASH. & LEE L. REV. 1615, 1643 (2004) (arguing that profit-based rationales are a potentially effective way of garnering support for diversity policies, "whether or not the empirical reality clearly supports the inference").

depends heavily on the anti-majoritarian judiciary, rather than on majority rule, to decide questions of minority racial rights. This is particularly true in light of the fact that racial minorities, and especially economically disadvantaged racial minorities, are underrepresented in the ranks of shareholders.

Furthermore, even if a majority of shareholders valued racial justice highly enough to favor the Tyrell resolution, collective action problems and rational apathy could prevent them from acting. Most individual shareholders will probably not vote at all because their votes are unlikely to make a difference. Shareholder apathy toward participation in corporate governance is a common, and entirely rational, response to this powerlessness. Shareholders who strongly object to Tyrell's practices are likely to simply sell their shares rather than attempt to change company policy. Indeed, those shareholders who value racial justice very highly would be more rational to seek it through means other than the corporate governance system.

If avenues for communication among shareholders were improved along with shareholder decision-making power, it might become possible to unite shareholders into large voting blocs, thereby mitigating the apathy caused by dispersion. Even if such a possibility existed, however, most shareholders would still be unlikely to devote the necessary time to become informed, much less take action. Most shareholders are diversified: they have multiple investments and non-investment concerns that demand their time and attention. Shareholders are thus likely to lack the time to devote to any one issue in any one corporation.

Shareholders' lack of control further discourages them from pursuing reform by insulating them from the immediate legal consequences of corporate social irresponsibility. Their lack of participation in corporate decision making shields them from the threat of legal liability for corporate conduct. Their limited liability as shareholders largely shields them from the economic consequences of the corporation's culpability, especially if their holdings are small and/or diversified.

Einer Elhauge has pointed out that shareholders' lack of participation and control shields them from nonlegal sanctions as well.³¹ Society will not view an individual passive shareholder as

³¹ Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U.

responsible for a corporation's policy. Moreover, the less power a shareholder has to change corporate policy, the less likely he will feel guilt for passively owning shares of a corporation with objectionable policies.

Diversification exacerbates shareholder apathy and insulation.³² The more corporations a person owns shares of, the less time she has to inform herself, or even care, about the conduct and policies of any one of them, and the less she, her neighbors, or society at large will view her as a morally accountable "owner" of any one of those corporations. Many diversified investors own shares indirectly through mutual funds or other institutions. They are really investors in the funds, not the corporations, adding an additional layer of insulation between themselves and corporate conduct. Such a shareholder likely will not even know the *names* of all the corporations in which her money is invested, much less the nature of their policies with respect to race or any other issue. Furthermore, she does not even hold the power to vote the shares—the fund does. As large shareholders, these mutual funds and other institutional investors may have less reason to be apathetic. But note that they are by nature highly diversified. Furthermore, as profit-making organizations, they will tend to be more concerned with profits and governance practices than with social justice issues. Fund managers are not a particularly diverse lot. Nor are they subject to legal or nonlegal pressure, because society does not appear to hold institutional investors any more accountable than it does individual shareholders.³³

IV. CORPORATE HIERARCHY TO THE RESCUE?

Thus there is no reason to believe that shareholder "democracy," in its current form or in a hypothetical stronger form, will protect the interests of people of color or of any other disempowered minority groups. Perhaps surprisingly, the board-dominated hierarchy may offer a better alternative than

L. REV. 733, 749–55 (2005).

³² Lynne L. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors*, 76 TUL. L. REV. 1363, 1371 (2002).

³³ Some funds market themselves as "socially responsible" funds. However, the special name for these funds shows that demand for them is limited. "Socially responsible investing" is a niche product; it is not a general expectation of investors. Investors do not appear to punish the vast majority of funds that place no emphasis on "responsible" investment.

shareholder democracy. I do not mean to suggest that managers are inherently more enlightened or altruistic than the unwashed masses of shareholders. They are probably even less diverse than the shareholder class, and thus less likely to empathize with the concerns of people of color.³⁴ Further, they have only very limited legal accountability to shareholders, society, or anyone else.³⁵ Unlike shareholders, however, top corporate hierarchs have at least a modicum of legal accountability for a corporation's effect on society.

Unlike shareholders, directors and officers can be implicated in lawsuits that arise from corporate policy. Cheryl Wade has argued, for example, that a failure to implement compliance systems may constitute a breach of directors' duty of care and duty to monitor because racial discrimination is illegal and potentially costly.³⁶ Boards may nonetheless fail to invest sufficient resources to preventing and investigating workplace discrimination because majority white boards lack empathy for people of color. Wade argues that legal sanctions, such as adverse judgments in duty of care or discrimination suits, may wake up a board to its lack of empathy.³⁷

As noted above, adverse judgments against corporate hierarchs are highly unlikely in the absence of corrupt or reckless conduct.³⁸ But even if not found liable, indeed even if not named personally, directors will be directly inconvenienced by legal action against the corporation. In addition to the cost and annoyance of becoming enmeshed in legal proceedings, negative individual or corporate publicity can harm the personal and professional reputations of directors. Even if these direct and

³⁴ See Cheryl L. Wade, *Corporate Governance as Corporate Social Responsibility: Empathy and Race Discrimination*, 76 TUL. L. REV. 1461, 1481 (2002).

³⁵ See Joo, *supra* note 30, at 360, 362.

³⁶ Wade, *supra* note 34, at 1466, 1481.

³⁷ Wade believes it is unrealistic to expect boards to develop true cross-racial empathy. If directors recognize their lack of empathy, however, they may realize that it is preventing them from taking discrimination seriously, an oversight that can be costly in bottom line terms. *Id.*

³⁸ Statutes allowing full or partial exculpation of directors for personal liability for carelessness, as well as indemnification and insurance, further undermine directors' personal monetary liability. The recent Enron and WorldCom settlements involving personal monetary contributions by directors were notable precisely because such personal contributions are so rare. See Robert J. Jossen and Neil A. Steiner, *Taking a Close Look At Personal Liability of Outside Directors*, N.Y. L.J., August 22, 2005, at 8 (describing settlements).

collateral effects on directors are limited, shareholders experience virtually no such effects.

Corporate hierarchs, as the public personas of corporations, are also the individuals responsible for publicly justifying the immense power of the corporation in society. As corporate power grew to rival government power during the twentieth century, society began to demand that corporate power have greater moral legitimacy than the mere pursuit of profit.³⁹ Neil Mitchell has argued that corporations—or more specifically, their hierarchs—have thus felt pressure to use corporate wealth and power for the good of society generally in order to justify and maintain corporate power.⁴⁰ Robert W. Lundeen, chairman of Dow Corporation, explained his concern for corporate social responsibility as follows: “We found that if we were perceived as not running our business in the public interest, the public [would] get back at us with restrictive regulations and laws.”⁴¹ Since the 1980s, “shareholder value” has been a more prominent legitimating purpose for corporations, but social responsibility has not entirely lost its legitimating role.

The very fact that discretion and power are highly concentrated at the top of the corporate hierarchy concentrates nonlegal as well as legal accountability there. Directors are said to be “agents” of shareholders, but this agency is a metaphor, not a proper doctrinal description. A true agent is subject to the control of the principal, which is simply not true of the hierarch-shareholder relationship.⁴² Despite the rhetoric of hierarchs’ “duty” to maximize profits, there is no actionable duty to do so. The business judgment rule gives corporate hierarchs such wide latitude in making business decisions that directors can never honestly claim a legal obligation to make a specific morally distasteful decision for the sake of the bottom line. Thus, corporate hierarchs are not just “agents” of the allegedly profit-minded shareholder principals; they are also autonomous moral “agents.”⁴³ Unlike directors, however, shareholders evade

³⁹ See NEIL J. MITCHELL, *THE GENEROUS CORPORATION: A POLITICAL ANALYSIS OF ECONOMIC POWER* 6–7 (1989).

⁴⁰ *Id.*

⁴¹ *Id.* at 56 (quoting Philip Shabecoff, *Dow Stoops to Calm Congress and Public Opinion*, N.Y. TIMES, Jan. 2, 1985, at B8).

⁴² See Lawrence E. Mitchell & Theresa A. Gabaldon, *If I Only Had a Heart: Or, How Can We Identify a Corporate Morality*, 76 TUL. L. REV. 1645, 1666–67 (2002).

⁴³ *Cf. id.* at 1650 (“[H]uman actors, rather than the corporation itself, must be

accountability almost completely. Any individual shareholder can assure herself and her neighbors that she is simply powerless to affect corporate conduct and thus bears no responsibility.⁴⁴

As noted above, the legal sanctions on directors are fairly mild. But, as Melvin Eisenberg and others have pointed out, they are augmented by nonlegal sanctions, such as the disapprobation that accompanies the violation of social norms. The legal sanctions for a breach of the duty of loyalty, for example, are normally limited to disgorgement. Eisenberg argues that this is an inefficiently low penalty because breachers face no risk of loss.

The social norm of loyalty, however, adds the sanction of loss of reputation to the legal sanctions. Because the legal sanctions are set at an inefficiently low level, the increase in sanctions provided by the social norm is necessary if the total sanctions for breach of the duty of loyalty are to approximate an efficient level.⁴⁵

Elhauge points out that the business judgment rule's deference to directors' decisions underscores their room to act independently and morally, creating expectations that they do so.⁴⁶ Thus, he argues, nonlegal sanctions are more likely to induce socially responsible action from corporate hierarchs than from shareholders. In the eyes of the public, corporate directors and executive officers are a small, identifiable group, unlike the anonymous teeming masses of shareholders. The public imagination has identified Bill Gates very closely with Microsoft, Michael Eisner with Disney, and Rupert Murdoch with Fox and its parent NewsCorp.⁴⁷ And both the public and the hierarchs

morally accountable for the decisions and actions of a corporation."). Indeed, Mitchell and Gabaldon argue that directors should be even further insulated from accountability to shareholders—by longer terms of office or a specific "statutory disclaimer" of the shareholder wealth maximization norm—in order to increase their personal moral accountability for their decisions. *Id.* at 1668.

⁴⁴ Here, I merely mean to show that shareholders can easily rationalize their apathy and disclaim responsibility. I do not mean to address the thornier normative question of whether such justifications are morally or ethically sound.

⁴⁵ See Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1276 (1999).

⁴⁶ See Elhauge, *supra* note 31, at 805–07. *But cf.* Mitchell & Gabaldon, *supra* note 42, at 1663–64 (arguing that directors' morality is constrained by their role within the corporation).

⁴⁷ The media and the general public tend to focus on CEOs and Chairs, while academics tend to focus on boards. For example, Stephen Bainbridge argues "to the limited extent to which the corporation is properly understood as a real entity, it is

know that "corporate" decisions are made by the hierarchs as real human beings, not by shareholders and not by some abstraction known as "The Corporation." Therefore, at least relative to shareholders, hierarchs are more likely to be targeted by and responsive to public pressure and personal feelings of moral responsibility.

The concentration of moral responsibility on managers suggests that an expansion of shareholder decision-making power would have the potential to backfire on a social justice agenda. It would increase the power of justice-minded shareholder activists, but it would also empower profit-minded shareholders.⁴⁸ Thus, it might lead to demands—legally enforceable demands—for higher profits. Were that to occur, it would relieve management from both the power and the social-moral obligation to consider social justice.

V. PRACTICAL IMPLICATIONS

What does the above analysis suggest for activists seeking racial justice in corporate conduct?

A. *Legal Sanctions*

As noted above, the concentration of power in corporate hierarchs creates an opportunity to incentivize socially beneficial corporate behavior through individual legal sanctions. Because a few individuals control corporate decision-making, there is some potential to hold them legally responsible. As noted above, that potential is limited, but there seems to be a desire in the post-Enron era to impose greater individual liability on hierarchs for corporate behavior. The high-profile civil suits and criminal prosecutions against top executives in Enron, WorldCom, HealthSouth, Tyco, and other corporations are the most obvious examples.⁴⁹ The Sarbanes-Oxley Act also reflects greater personal accountability in its requirement that CEOs and CFOs personally certify the accuracy of a corporation's financial

the board of directors that personifies the corporate entity." Bainbridge, *supra* note 3, at 560.

⁴⁸ See, e.g., Elhauge, *supra* note 31, at 864 (noting that shareholders have ability to limit managerial power).

⁴⁹ See, e.g., Kurt Eichenwald, *A Guilty Verdict: Other Cases; When the Top Seat Is the Hot Seat*, N. Y. TIMES, Mar. 16, 2005, at C1 (discussing examples of former chief executives facing criminal charges).

reporting, subject to criminal penalties for knowingly false certifications.⁵⁰ However, it is too early to tell whether these developments signify merely a passing fit of Enron-inspired pique, or a real trend toward increased individual accountability and liability.

The use of legal sanctions comes with a caveat, however. In the current political climate, legal sanctions may sometimes have a perverse effect.⁵¹ Enron and related debacles notwithstanding, many Americans seem to agree that businesses are the victims of opportunistic litigants and plaintiffs' attorneys. This argument helped propel the Private Securities Litigation Reform Act of 1995, which subjected securities fraud lawsuits to numerous procedural barriers, as well as the Class Action Fairness Act of 2005, which moved class action lawsuits from state courts into federal courts on the theory that plaintiffs and attorneys would otherwise forum-shop for overly permissive class-action venues. Thus, in at least some instances, a corporate defendant and the public may attribute a complaint, and even an adverse judgment, to greedy lawyers rather than a need for corporate reform.⁵²

B. Nonlegal Sanctions

The need for corporate legitimacy and the concentration of accountability will contribute to corporate change only if activists apply constant public pressure. In certain situations and historical contexts, inflammatory anti-corporate rhetoric will be useful to attract the support of populist politicians. But that strategy is not usually welcomed. Even in the immediate post-Enron atmosphere, the legal response was more reformist than revolutionary. For the most part, activists should appeal to individual directors' consciences and their desire for good corporate and individual reputations. Activists should not focus on the potential bottom-line benefits of racial reform. While some corporate reforms, such as policing discriminatory conduct, may improve profitability in some cases, this will not always be

⁵⁰ See Sarbanes-Oxley Act of 2002 § 302, 15 U.S.C.A. § 7241 (West Supp. 2005); Sarbanes-Oxley Act of 2002 § 906, 18 U.S.C.A. § 1350 (West Supp. 2005).

⁵¹ See James D. Cox, *The Social Meaning of Shareholder Suits*, 65 BROOK. L. REV. 3, 6 (1999).

⁵² *Cf. id.* at 5 (arguing that the deterrence power of shareholder litigation depends on whether "shareholder litigation itself is viewed as a responsible actor" or as a rent-seeking nuisance).

the case. Moreover, justifying racial justice reform in bottom-line terms implies that the value of racial justice depends on its effect on share price.⁵³ In any case, corporate hierarchs are unlikely to give much weight to activists' assertions about improved profitability. After all, civil rights activists are not business experts. They may squander political capital by posing as such. They are more credible as a social and moral conscience than as experts on effective business practices. Even where bottom-line consequences are well-researched and documented, corporate hierarchs are simply unlikely to welcome unsolicited outside advice that encroaches on their area of control and presumptive expertise.

In bringing nonlegal sanctions to bear on directors, it is important to attribute actions to individual human beings. Decisions are not made by "corporations" but by individual human beings—directors and executive officers. Thus the rhetoric of corporate critique should criticize the moral choices of specific individuals, not the robotic acts of a faceless "corporation."⁵⁴ As noted above, corporate law gives directors and officers a great deal of autonomy to make corporate decisions. The critique of individual hierarchs then should squarely address and reject the mantra that "the shareholders made me do it."⁵⁵ Indeed, rather than bemoaning the supposed fact that the law imposes a "duty" to maximize shareholder wealth, activists should recognize and advertise the absence of such a duty—and demand that the resultant discretion be used in a moral way.

Underscoring the legal autonomy of directors may improve the morality of decision-making by requiring them to articulate moral justifications to the public, as well as to one another:

[W]e now provide a psychological "out" for bad behavior . . . by

⁵³ See Joo, *supra* note 30, at 359.

⁵⁴ Of course, tactics must be reasonably calculated to convince the public, and not simply to castigate. Like litigation, singling out individuals may backfire if it is perceived as harassing or unjustified. For example, members of People for the Ethical Treatment of Animals (PETA) may have done their cause more harm than good when they protested in front of the home of Petco's CEO based upon allegations of animal mistreatment at Petco stores. The protestors—including one dressed in a parrot costume—passed out fliers with the CEO's photo and the caption "Meet your neighbor. Please let him know how you feel about the suffering and deaths of countless animals in his Petco stores." Frank Green, *PETA Takes Protest into Exec's Home Turf*, SAN DIEGO UNION-TRIB., Jan. 17, 2004, at C3.

⁵⁵ See, e.g., Mitchell & Gabaldon, *supra* note 42, at 1655.

allowing managers to defend it on the grounds of profit maximization. If they did not have this excuse, they would have to supply their own reasons for bad behavior, and in our ideal world, they would have to supply them publicly, although we think that even the narrow process of having to justify it to each other in the boardroom and the executive suite would make a difference.⁵⁶

I have of course exaggerated the dichotomy between shareholder democracy and managerial hierarchy. For instance, I point out that mechanisms of "corporate democracy"—especially shareholder proposals—do not give shareholders the power to cause change directly. I do not mean to argue that they are useless. They may supplement the nonlegal sanctions on boards by educating the public about corporate practices. Indeed, nonbinding proposals, by publicly displaying shareholder dissatisfaction, can be seen as a kind of nonlegal sanction. But they operate as an appeal to hierarchs' power and consciences, not as a direct exercise of shareholder decision-making power.⁵⁷

Elhauge argues that managerial discretion combined with nonlegal sanctions will "move corporate behavior in the right direction, assuming our society's social and moral norms correctly identify which direction is right."⁵⁸ The question, of course, is whether our society's norms are "right." While I agree that the hierarchical system makes nonlegal sanctions more *effective* than they would be under diffuse shareholder control, I do not share Elhauge's optimism that the result will be "right"—that is, *efficient* for social utility as a whole. Racial justice advocates must compete with other causes for scarce management attention and corporate resources, just as, under public choice theory, they must compete for public resources.⁵⁹ Advocates for racial justice should see the hierarchical system as creating an opportunity, if not a duty, constantly to pressure and

⁵⁶ *Id.* at 1667.

⁵⁷ Furthermore, nonbinding proposals on diversity matters may backfire. As discussed above, the majority of shareholders are unlikely to value minority rights, and even if they do, shareholders simply tend not to vote in large numbers. Thus a proposal on a racial justice issue may receive a poor showing in an election, which management may take as a sign that shareholders, and perhaps society in general, do not value the issue.

⁵⁸ Elhauge, *supra* note 31, at 107.

⁵⁹ See, e.g., Daniel A. Farber & Philip P. Frickey, *The Jurisprudence of Public Choice*, 65 TEX. L. REV. 873, 878 (1987) (describing the fundamentals of public choice models of the legislative process).

educate corporate hierarchs with respect to racial issues. One way to view this role is to see racial justice advocates as potential "norm entrepreneurs":⁶⁰ those who try to change prevailing boardroom norms to include norms of racial justice.⁶¹ A more cynical way of viewing the advocate's role is to assume that the squeakiest activist wheels are likely to get the corporate grease—that is, that hierarchs respond to constituents' persistence, rather than to an activist's agenda's relationship to social norms or social utility.

C. Transparency

Cynthia Williams has argued that holding corporations accountable for their impact on society requires greater disclosure of their activities.⁶² Hillary Sale and Robert Thompson have argued that by requiring certain kinds of disclosures, the SEC, in effect, regulates substantive management conduct because inaction or inappropriate actions, once disclosed, must be justified.⁶³ Through such rules, "the Commission is regulating the conduct, not just what management says about the conduct. Through disclosure can come substance"⁶⁴

Increased federal disclosure may also benefit racial justice activists. SEC Regulation S-K sets forth specific items that corporate management must disclose periodically.⁶⁵ Item 303, known as "Management's Discussion and Analysis of Financial Condition and Results of Operations,"⁶⁶ or "MD&A," requires management to disclose events with potential to have a

⁶⁰ See Cass R. Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903, 929 (1996).

⁶¹ See *id.*

⁶² See Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1294–96 (1999).

⁶³ See Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance*, 56 VAND. L. REV. 859, 872–73 (2003). For example, while federal securities law does not directly regulate executive compensation, it arguably imposes some limits on compensation by requiring detailed disclosures. See 17 C.F.R. § 229.404(a) (2005). Sale and Thompson argue that some SEC rules also effectively impose a substantive duty of care. See Thompson & Sale, *supra*, at 873–74. For example, Regulation S-K requires disclosure of known trends that may threaten future liquidity, and to indicate how it proposes to respond. 17 C.F.R. § 229.303(a)(1).

⁶⁴ Thompson & Sale, *supra* note 63, at 874.

⁶⁵ 17 C.F.R. §§ 229.101–.1123.

⁶⁶ *Id.* § 229.303.

“material” effect on corporate liquidity.⁶⁷ Item 103 requires management to disclose “material” legal proceedings against the corporation.⁶⁸ “Materiality” in these contexts seems to refer to financial materiality.⁶⁹ Thus, for example, a number of small employment discrimination lawsuits against a corporation might escape the disclosure requirements.⁷⁰ Shareholder activists might consider pressing the SEC for an expansion of the meaning of “materiality.”⁷¹ In at least one other context, SEC rules recognize that issues with only minimal financial significance may still be relevant for securities regulation purposes on the basis of their social justice implications. The SEC limits shareholders’ right to put nonbinding proposals on the corporate ballot.⁷² To qualify for inclusion on the ballot, a shareholder proposal must have “relevance;”⁷³ that is, it must relate to operations accounting for at least five percent of the company’s assets or of its annual earnings or gross sales, or must be “otherwise significantly related to the company’s business.”⁷⁴ A federal court has held a proposal to be includable under the rule “in light of the ethical and social significance of [the] proposal and the fact that it implicates significant levels of sales.”⁷⁵ The proposal had “ethical and social significance” in that it requested a study to determine whether the production methods of one of the corporation’s suppliers involved cruelty to animals.⁷⁶ The “significant levels of sales” implicated amounted to a mere

⁶⁷ *Id.* § 229.303(a)(1).

⁶⁸ *Id.* § 229.103.

⁶⁹ *Cf.* SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150, at 45,151 & n.5 (1999) (noting that non-financial concerns will not be addressed in the bulletin’s examination of materiality of errors in financial statements).

⁷⁰ *See* 17 C.F.R. § 229.103 Instruction 2 (indicating that a lawsuit need not be reported if it “does not exceed 10 percent of the current assets of the” company). However, if there are pending or contemplated lawsuits based “in large degree [on] the same legal and factual issues,” the amounts involved in those proceedings should “be included in computing such percentage.” *Id.*

⁷¹ *See* Wade, *supra* note 1 at 911–13 (asking “whether the materiality requirement undermines the accomplishment of true environmental justice”). Expanding disclosure, while likely to be an uphill battle, is probably the most realistically achievable kind of reform in the near term.

⁷² *See* 17 C.F.R. § 240.14a-8 (listing rules for shareholder proposals).

⁷³ *See id.* § 240.14a-8(i)(5).

⁷⁴ *Id.*

⁷⁵ *Lovenheim v. Iroquois Brands, Ltd.*, 618 F. Supp. 554, 561 (D.D.C. 1985).

⁷⁶ *Id.* at 556. The supplier provided the corporation with *pâté de foie gras*, the production of which traditionally involves the prolonged force-feeding of geese. *Id.* & n.2.

\$79,000 out of \$141 million in total revenues.⁷⁷

Lawrence Mitchell and Theresa Gabaldon suggest that institutional reform may be able to increase individual moral responsibility in the corporate setting: "Demanding that corporations disclose their decision-making processes, that responsibility be clearly assigned within the organization, that justifications for corporate acts be explicit and traceable to those making the decisions, could go some way towards ensuring greater individual accountability and, hence, moral responsibility."⁷⁸

The theory that *individuals* at the top of the corporate hierarchy are subject to legal or nonlegal sanctions depends on public knowledge of their *individual* conduct. This requires not just disclosure of a *corporation's* record on racial issues, but internal "paper trails" giving us a better understanding of the role of the board and of *individual* board members and officers in setting particular policies.

Boards should be required to keep more detailed meeting minutes that show how individual directors voted on particular issues, just as voters have access to the voting records of their elected political representatives.⁷⁹ This proposal has practical viability because it is consistent with the existing corporate law principles: shareholders are already able to access board minutes and similar documents through their state-law right to corporate books and records.⁸⁰ Requiring corporations to maintain more detailed and meaningful records would further the purposes of this principle. Furthermore, such a reform would increase director accountability for "pure" business decisions as well as for "social" issues.

CONCLUSION

Shareholder empowerment holds little potential for

⁷⁷ *Id.* at 558. That is, the corporation had sold only \$79,000 of pâté in the most recent year. *Id.*

⁷⁸ Mitchell & Gabaldon, *supra* note 42, at 1656.

⁷⁹ *See, e.g.*, Project Vote Smart, <http://www.vote-smart.org> (last visited Oct. 14, 2005) (providing, inter alia, comprehensive voting records of elected officials nationwide).

⁸⁰ *E.g.*, DEL. CODE ANN. tit. 8, § 220 (2001). The Delaware courts have encouraged shareholder plaintiffs to exercise this right in order to craft specific allegations in complaints against directors. *See, e.g.*, Brehm v. Eisner, 746 A.2d 244, 266-67 (Del. 2000).

achieving racial justice in corporate conduct. Government intervention is also an unlikely solution, particularly given the ideological tendencies of our current federal government. Perhaps surprisingly, the existing system, which concentrates power and discretion in the board of directors and executive officers, holds greater potential than shareholder majoritarianism or government regulation. This is not to say that corporate hierarchs have a more developed sense of moral responsibility than lowly shareholders do. Nor does it mean that the existing corporate governance system is an ideal method of making corporations responsive to racial issues. Indeed, dependence on management discretion is probably the worst possible method—except for all the others.