RESTORING TRUST IN CORPORATE AMERICA: TOWARD A REPUBLICAN THEORY OF CORPORATE LEGITIMACY

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I.
INTRODUCTION

Toward the end of his career, almost thirty years after co-authoring the classic work on the modern corporation, Adolf Berle was troubled by the question of corporate legitimacy. He thought that legitimacy, responsibility, and accountability were "essential to any power system if it is to endure . . . [as] they correspond to a deep human instinct."[1] But management's theoretical justification for possessing corporate power—election by shareholders—was a meaningless façade that concealed the reality that the directors, and hence management, chose their own successors. According to Berle, corporations were in fact governed by "an automatic self-perpetuating oligarchy"—"a string of bad words," he conceded[2]—and as a consequence, "these instrumentalities of tremendous power have the slenderest claim of legitimacy."[3] Nevertheless, Berle looked approvingly on what he called "the American economic republic."[4] A kind of legitimacy could be found in the relation between management and the elegant New Deal legislation that he had helped to create. Despite the anomalies of corporate structure, he considered that "the managers of American corporations . . . justify themselves by running their corporations well according to prevailing standards."[5]

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1. ADOLF A. BERLE, JR., ECONOMIC POWER AND THE FREE SOCIETY 16 (1958).

2. *Id.* at 9.

3. *Id.* at 16.

4. ADOLF A. BERLE, JR., THE AMERICAN ECONOMIC REPUBLIC (1965).

5. *Id.* at 43. Berle was a prominent member of the group of advisors, known as the "Brain Trust," in the early years of the Roosevelt administration. *See* H. W. BRANDS, TRAITOR TO HIS CLASS 250, 289 (2008).

Today, it is far more difficult to see an angle of repose between the instrumentalities of corporate governance and a compensating regulatory system. The SEC's regulatory system has grown vastly in complexity and intensity,[6] driven apparently by a slow erosion of public trust. Yet this growth did not prevent the Enron collapse, other recent mega-bankruptcies, nor the credit crisis of 2008. In fact, insider accounts of the Enron scandal reveal that government regulation was almost irrelevant to the processes of decision making; instead, regulatory compliance was a matter relegated to professionals with expertise in preparing the required documentation.[7] The Sarbanes-Oxley Act,[8] the legislative response to the scandals, has had a serious impact on corporate governance, but the compliance costs and myriad restrictions raise questions of unintended consequences.[9] In particular, the new scope of personal liability of directors threatens to discourage candidacies to the board, chill board deliberations, and put a premium on formal processes in decision-making.[10]

By seeking further external controls and expanded liability, the populist impulse for reform, conceals a despairing attitude toward the corporation as an institution. The call for reform is too often accompanied by a mindset that views the pathologies of the corporation as inherent characteristics of the corporate form.[11] The corporation is assumed *a priori* to

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6. *See* Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J. ON REG. 253, 253 (2007) (finding that regulatory intensity in the area of securities regulation is "strikingly higher" in the United States than in the United Kingdom and Germany).

7. *See* BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM, THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2003).

8. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

9. For a discussion of the recent literature on the Sarbanes-Oxley Act, *see* Steven A. Ramirez, *The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top*, 24 YALE J. ON REG. 313 (2007).

10. *See* Martin Lipton, *Twenty-Five Years After* Takeover Bids in the Target's Boardroom*: Old Battles, New Attacks and the Continuing War*, 60 BUS. LAW. 1369, 1379-1382 (2005).

11. *See, e.g.*, Jerry Mander, *The Rules of Corporate Behavior, in* THE CASE AGAINST THE GLOBAL ECONOMY AND FOR A TURN TOWARD THE LOCAL 309 (Jerry Mander & Edward Goldsmith eds., 1996) (an insightful account of corporate flaws which does not allow for the possibility that they can be remedied).

lack the capacity for legitimacy;[12] accordingly, it can only be restrained by governmental intervention. In effect, the objective must be to "control the beast." Ralph Nader's book, *Taming the Giant Corporation*, implicitly employs this metaphor.[13] The sentiment is fueled by a cultural current of books and films that portray senior managers as "ruthless, shallow and greedy, and large corporations as destructive and conspiratorial"[14] and by well-founded objections to the use of corporate wealth to support special interests and to fund ideological agendas, such as climate-change denial. Regardless of whether such books and films are justified, populist discontent diverts attention from the possibility of internal reform of the corporation.

A different kind of pessimism about the corporate institution, predicated on the need to discipline a feckless management, has spread from academic circles into public consciousness. In an article published after his untimely death, the brilliant British scholar, Sumantra Ghoshal, argues that business schools on both sides of the Atlantic have caused "the general delegitimization of companies as institutions and management as a profession."[15] He identifies three such management theories: the agency theory of corporate governance, which teaches that "managers cannot be trusted to do their jobs"; Williamson's theory of "opportunistic behavior" that favors "tight monitoring and control" of officers and employees; and Porter's "five forces framework" suggesting that "companies must compete not only with their competitors but also with their suppliers, customers, employees, and regulators."[16] Such ideas, he claims, "have been in the air, legitimizing some actions and behaviors and delegitimizing others." As managers conform to the normative order underlying such doctrines,

12. Martin Parker observes that "the anti-corporate protest movement is unconcerned with legitimizing management in any form" but rather is unified by "hostility to the corporation" and to management "in their limos." MARTIN PARKER, AGAINST MANAGEMENT 13, 168, 180 (2002).

13. RALPH NADER ET AL., TAMING THE GIANT CORPORATION (1976).

14. The phrases are taken from Parker's excellent chapter on "the culture industries and the demonology of big organizations." *See supra* note 12 at 135.

15. Sumantra Ghoshal, *Bad Management Theories Are Destroying Good Management Practices*, 4 ACAD. MGMT. LEARNING & EDUC. 75, 76 (2005).

16. *Id.* at 75.

they convert "our collective pessimism about managers into realized pathologies in management behavior."

Countering political hostility and academic pessimism, the business and legal communities have elaborated standards of corporate governance over the past several decades offering a measure of real substance. In 1992, the Principles of Corporate Governance of the American Law Institute—adopted after ten years of debate—proposed a board and committee structure designed to better hold executives accountable.[17] The Chief Reporter for the ALI project, Professor Melvin Eisenberg, expressed his hope that these reforms could maintain "the integrity and legitimacy of . . . the corporate system."[18] The Business Roundtable, an association of chief executive officers, has since issued more detailed and stringent guidelines for board conduct and structure.[19] Actual practice has, in significant respects, mirrored these reforms. For example, the nominating committee in the 1970s was an informal affair existing in a small minority of companies; today these committees are found in virtually all large publicly owned corporations and usually operate under charters with defined duties and membership requirements.[20] Most importantly, the rules of the New York and NASDAQ stock exchanges, adopted after the Sarbanes-Oxley Act, impose strict rules for directorial independence,[21] and in the case of the New York Stock Exchange, these rules require regularly scheduled executive sessions of independent directors.[22]

Nevertheless, the central problem that troubled Berle remains largely unchanged. The corporation is still governed by a self-perpetuating inner circle, subject to weak internal controls, which operates in a sphere detached from important seg-

17. AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE (1994).

18. Melvin Aron Eisenberg, *Corporate Legitimacy, Conduct, and Governance – Two Models of the Corporation*, 17 CREIGHTON L. REV. 1, 18 (1983) (commenting on the preliminary draft of the Principles of Corporate Governance).

19. BUSINESS ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERANCE 2005, http://www.businessroundtable.org/sites/default/files/CorporateGovPrinciples.pdf.

20. Michael E. Murphy, *The Nominating Process for Corporate Boards of Directors: A Decision-Making Analysis*, 5 BERKELEY BUS. L.J. 131, 146-148 (2008).

21. NYSE, Inc., Listed Company Manual, §§ 303A.01-02 (2008); NASDAQ, Inc., Stock Market Rules Manual, § 4350(c)(1) (2008).

22. NYSE, Inc., Listed Company Manual § 303A.03 (2008).

ments of society.[23] If it is no longer plausible to rely on the regulatory system to confer legitimacy, how can one address this central deficiency?

The former chancellor of the Delaware Chancery Court, William Allen, believes that the search for legitimacy is an unstated subtext underlying the burgeoning literature of corporate governance.[24] He explains that management decisions regarding the employment of corporate assets "involve the exercise of substantial power . . . over others—employees, customers, investors and others in the community."[25] While management may face competitive and regulatory restraints in these decisions, "the popular perception of [its] discretionary power is as much a social reality as the existence of power itself."[26] "This power—real or perceived— "requires a political or legal theory that legitimizes it."[27]

The term legitimacy, as it is employed by Berle, Eisenberg, and Allen, may have an academic character, but it is roughly interchangeable in the common currency of public discourse with the terms "trust" and "confidence" since legitimacy confers trust and confidence.[28] The frequent occurrence of these terms in business literature supports Allen's suggestion that public unease with respect to corporate legitimacy is a significant force driving corporate governance controversies.[29]

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23. The expression "inner circle" is taken from Useem's well known early work: MICHAEL USEEM, THE INNER CIRCLE: LARGE CORPORATIONS AND THE RISE OF BUSINESS POLITICAL ACTIVITY IN THE U.S. AND U.K. (1984).

24. William T. Allen, *The Mysterious Art of Corporate Governance*, 22 CORP. BOARD 1 (Sept./Oct. 2001).

25. *Id.* at 3.

26. *Id.*

27. *Id.* Allen argues that corporate law provides "a powerful legitimizing account of the exercise of corporate power."

28. *See* RICHARD C. BREEDEN, RESTORING TRUST: REPORT TO THE HON. JED S. RAKOFF, THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK ON CORPORATE GOVERNANCE FOR THE FUTURE OF MCI (2003); KATHY BLOOMGARDEN, TRUST: THE SECRET WEAPON OF EFFECTIVE BUSINESS LEADERS (2007); Eleanor Bloxham, *Seeking Trust?*, CHIEF EXECUTIVE, Jan. 29, 2007 at 57; MICHAEL S. MALONE, BILL & DAVE: HOW HEWLETT AND PACKARD BUILT THE WORLD'S GREATEST COMPANY 123-63, 192, 216-28 (2007).

29. Other comments on the contemporary significance of corporate legitimacy include: Cary Coglianese, *Legitimacy and Corporate Governance*, 32 DEL. J. CORP. L. 159 (2007); Guido Palazzo & Andreas Georg Scherer, *Corporate Legitimacy as Deliberation: A Communicative Framework*, 66 J. BUS. ETHICS 71 (2006); CONOR CRADDEN, REPOLITICIZING MANAGEMENT: A THEORY OF CORPO-

This Article seeks to bring the subtext of corporate legitimacy into the light of legal analysis, but it aspires only to present a contribution *toward* a theory of corporate legitimacy. It does not discuss the relationship between the corporation and its employees—a matter essential to any comprehensive theory of corporate legitimacy—and it does not explore the philosophical basis of the concept of legitimacy.[30] The Article focuses instead on the relation between the legitimacy of the large public corporation and the republican political heritage.[31]

Part II offers a description of the somewhat diverging concepts of legitimacy in sociology and social psychology, which provides a grounding for the discussion of the relevance of the republican tradition in Part III. In this section, I first describe the concept of liberty underlying the republican tradition, as it existed in the formative period of the United States. I then seek to show that elements of the republican tradition remain part of the discourse of legitimation to corporate governance debates today. I identify elements of corporate governance, as well as proposed reforms to corporate governance, that fall within five strands of the republican heritage: the rule of law, separation of power, contestatory democracy, deliberation, and citizenship. In part IV, I briefly sketch the reasons to believe that these republican features in existing or proposed corporate governance are compatible with effective economic performance and corporate self-regulation. I use the term self-

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RATE LEGITIMACY (2005); Roy Suddaby & Royston Greenwood, *Rhetorical Strategies of Legitimacy*, 50 ADMIN. SCI. Q. 35 (2005); Martin Parker, *Introduction: Ethics, Politics and Organizing*, 10 ORG. 187, 197 (2003) ("business is currently going through a substantial legitimation crisis"); Jackie Johnson & M.J. Holub, *Questioning Organizational Legitimacy: The Case of U.S. Expatriates*, 47 J. BUS. ETHICS 269 (2003).

30. Cradden develops a philosophically rigorous theory of corporate legitimacy with a focus on the employment relationship. CRADDEN, *see supra* note 29, at 120-46; *see also* JAMES J. BRUMMER, CORPORATE RESPONSIBILITY AND LEGITIMACY: AN INTERDISCIPLINARY ANALYSIS 73-97 (1991) (surveys theories of institutional legitimacy).

31. Other discussions of legitimacy in the context of corporate law include: Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565 (1993); Richard M. Buxbaum, *Corporate Legitimacy, Economic Theory, and Legal Doctrine*, 45 OHIO ST. L.J. 515 (1984): Eisenberg, *supra* note 18; JAMES W. HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780-1970 (1970).

regulation in the sense of the faculty for self-correction that is an essential element of institutional competence. The Article generally alludes to questions of praxis without entering into detail, seeking to tread a path between a level of generality that might lack concrete meaning and a discussion of practical issues that would burden the exposition of a republican perspective on corporate governance.

II.
THE CONCEPT OF LEGITIMACY

The significance of the term legitimacy is commonly taken for granted and seldom defined. As an institutional economist, Boulding explains that he uses "the term to cover a fairly wide range of social phenomena, all of which . . . center around the concept of acceptance of an institution or an organization as right, proper, justified and acceptable."[32] The dynamics of legitimacy, he maintains, are a profoundly important force in directing social change but still "very hard to explain and to trace."[33] No discipline has devoted more attention to legitimacy than sociology—the concept has been an essential component of sociological theory since it was first analyzed by Max Weber in his foundational work, Economy and Society.[34] I will insist only that sociological theory, directly or indirectly, supports a rather self-evident proposition: legitimacy resides in social evaluations of institutions based on commonly shared values and norms.[35] The discipline of experimental social psychology has less direct bearing on institutional issues but provides a firm empirical perspective. I argue that research in the field, as applied to corporations, supports

32. 2 KENNETH E. BOULDING, *The Legitimacy of Economics, in* COLLECTED PAPERS 417, 417 (1971). By the word "acceptable," which is on its face a tautological expression, Boulding presumably meant that the institution or organization is seen as being an unobjectionable part of a natural order of things—a reference to cognitive legitimacy. On the treatment of legitimacy in institutional economics, *see* Kenneth L. Avio, *A Modest Proposal for Institutional Economics*, 38 J. ECON. ISSUES 715, 720-30 (2004).

33. KENNETH E. BOULDING, THREE FACES OF POWER 113 (1989).

34. 1 MAX WEBER, ECONOMY AND SOCIETY 31-38, 212-99 (1968).

35. *See* Mark C. Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 ACAD. MGMT. REV. 571, 573 (1995) (reviews extensive sociological literature on legitimacy as of 1995).

a connection between legitimacy and a capacity for self-regulation, that is, a capacity for maintaining desired standards.

In a frequently cited formulation, Dowling and Pfeffer define legitimacy as "congruence between social values associated with or implied by [organizational] activities and the norms of acceptable behavior in the larger social system of which they are a part."[36] The definition draws on Weber's treatment of legitimacy as a non-rational expression of group or cultural values[37] and is very close to Parson's language describing legitimation as "the appraisal of action in terms of shared or common values."[38] Stated in such general terms, the concept embraces both scholarship ascribing legitimacy to cultural pressures largely beyond control of an organization as well as research treating it as a strategic objective, akin to reputation or community standing, which may be sought and defended by management.[39] In either case, sociological theory views the possession of legitimacy as giving an organization a claim on the resources of society. Ashforth and Gibbs write: "Legitimacy justifies the organization's role in the social system and helps attract resources and continued support of constituents. In this light, legitimacy is a resource."[40]

Some researchers distinguish legitimacy based on norms and values from other forms of legitimacy based on cognition or self-interest,[41] but these latter phenomena appear to be of secondary interest in our inquiry. Cognitive legitimacy exists

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36. John Dowling & Jeffrey Pfeffer, *Organizational Legitimacy: Social Values and Organizational Behavior*, 18 PAC. SOC. REV. 122, 122 (1975).

37. *See* PHILIP SELZNICK, THE MORAL COMMONWEALTH: SOCIAL THEORY AND THE PROMISE OF COMMUNITY 271 (1992).

38. TALCOTT PARSONS, STRUCTURE AND PROCESS IN MODERN SOCIETIES 175 (1960) (alteration in original).

39. *See* Suchman, *supra* note 35, at 572, 575-77. For the view of legitimacy as strategic objective, *see infra* note 46; for the alternative view, *see, e.g.*, John W. Meyer & Brian Rowan, *Institutionalized Organizations: Formal Structure as Myth & Ceremony*, *in* THE NEW INSTITUTIONALISM IN ORGANIZATIONAL ANALYSIS 41 (Walter W. Powell & Paul J. DiMaggio eds., 1991)

40. Blake E. Ashforth & Barrie W. Gibbs, *The Double-Edge of Organizational Legitimation*, 1 ORG. SCI. 177, 177 (1990); *see also, e.g.*, Ralph C. Hybels, *On Legitimacy, Legitimation, and Organizations: A Critical Review and Integrative Theoretical Model*, ACAD. MGMT. PROC., 1995, at 245 ("resource flows are among the best evidences of legitimation.").

41. *See* Suchman, *supra* note 35, at 577-85; W. RICHARD SCOTT, INSTITUTIONS AND ORGANIZATIONS 45-47 (1995) (views self-interest as exercised within regulated structures).

when an organization can offer a "common social 'account'" of a practice that places it in the normal and comprehensive order of things.[42] While, corporate governance does present such issues of cognitive legitimacy, they disappear when normative issues are addressed.[43] In this particular context, cognitive legitimacy appears to be an effect of normative factors rather than a phenomenon requiring separate analysis. An organization may also be thought to gain a kind of limited legitimacy when a broad coalition of suppliers, customers, etc., identifies their own interests with its activities, thereby enabling the organization to prosper.[44] But the admixture of self-interest does not detract from the significance of societal appraisals based on values and norms. Such moral evaluations, rooted in culture, are resistant to managerial manipulation and therefore have particular importance for institutional design.[45]

The literature of management science ordinarily views legitimacy through the lens of sociological theory, and it implicitly acknowledges the practical importance of the concept by analyzing the ways in which legitimacy is sought and defended by business enterprises.[46] Much of the literature departs from the high level of generality found in other areas of sociological

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42. *See* Ronald L. Jepperson, *Institutions, Institutional Effects, and Institutionalism, in* THE NEW INSTITUTIONALISM IN ORGANIZATIONAL ANALYSIS, *supra* note 40, at 143, 147. The trend in institutional theory appears to accord greater prominence to the idea of cognitive legitimacy. *See* Suchman, *supra* note 35, at 573, 575, 582-84; W. E. Douglas Creed et al., *Clothes Make the Person? The Tailoring of Legitimating Accounts and the Social Construction of Identity*, 13 ORG. SCI. 475 (2002).

43. For example, it may be difficult or impossible to give a socially acceptable explanation for the one-party slate in election of directors for corporate board, but the problem disappears with reform of the nominating process.

44. *See* JEFFREY PFEFFER & GERALD R. SALANCIK, THE EXTERNAL CONTROL OF ORGANIZATIONS: A RESOURCE DEPENDENT PERSPECTIVE 194 (Stanford Univ. Press) (1978); *see also* Suchman, *supra* note 35, at 578.

45. *See* Suchman, *supra* note 35, at 579, 585; Ashforth & Gibbs, *supra* note 40, at 186-190.

46. *See* Christine Oliver, *Strategic Responses to Institutional Processes*, 15 ACAD. MGMT. REV.145, 149-159 (1991); Ashforth & Gibbs, *supra* note 40, at 178-185; David L. Deephouse, *Does Isomorphism Legitimate?*, 39 ACAD. MGMT. J. 1024 (1996); Kimberly D. Elsbach, *Managing Organizational Legitimacy in the California Cattle Industry: The Construction and Effectiveness of Verbal Accounts*, 39 ADMIN. SCI. Q. 57 (1994); Eric H. Nielsen & M.V. Hayagreeva Rao, *The Strategy-Legitimacy Nexus: A Thick Description*, 12 ACAD. MGMT. REV. 523 (1987).

theory. While legitimacy in classical sociological theory applies to all institutions[47]—including practices, organizations, private enterprises, as well as the political system—the management science literature focuses on such matters as new entrants,[48] the foreign activities of multinational corporations,[49] and of course, the large corporation. As it increases in size, the corporation gains power over the lives of human beings and communities that invites scrutiny similar to that of political activities.[50] An early 1963 study found that the frequency of ethical statements in the annual reports increased dramatically with the size of private corporations.[51] Such statements were found in one fourth of the sample of 219 annual reports, but in over half of the reports of companies with assets over one billion dollars.[52] The ethical statements addressed how the corporation's activities affected shareholders, customers, employees, and the wider community[53]—apparently anticipating scrutiny of the corporation. The study confirms Selznick's observation that "[f]rom the standpoint of the larger community . . . the very size of the organization matters."[54]

Parsons observed that legitimacy plays a role in power systems "parallel to confidence in mutual acceptability and stabil-

47. On the concept of institution in sociology, *see* ROBERT N. BELLAH ET AL., THE GOOD SOCIETY 287-293 (1991).

48. *See* Suddaby & Greenwood, *supra* note 29; Howard E. Aldrich & C. Marlene Fiol, *Fools Rush In? The Institutional Context of Industry Creation*, 19 ACAD. MGMT. REV. 645 (1994); MICHAEL T. HANNAN & GLENN R. CARROLL, DYNAMICS OF ORGANIZATIONAL POPULATIONS 36 (1992); Sherrie E. Human & Keith G. Provan, *Legitimacy Building in the Evolution of Small-Firm Multilateral Networks: A Comparative Case Study of Success and Demise*, 45 ADMIN. SCI. Q. 327 (2000); M. Tina Dacin et al., *Institutional Theory & Institutional Change: Introduction to the Special Research Forum*, 45 ACAD. MGMT. J. 45, 47-48 (2002) (reviewing recent studies).

49. *See* Palazzo & Scherer, *supra* note 29; Johnson & Holub, *supra* note 29; Tatiana Kostova & Srilata Zaheer, *Organizational Legitimacy under Conditions of Complexity: the Case of the Multinational Enterprise*, 24 ACAD. MGMT. REV. 64 (1999); *see also* Eric W. Orts, *The Legitimacy of Multinational Corporations, in* PROGRESSIVE CORPORATE LAW, 247 (Lawrence E. Mitchell ed., 1995).

50. *See* ROBERT A. DAHL, TOWARD DEMOCRACY: A JOURNEY, REFLECTIONS 1940-1997, at 630 (1997).

51. Arthur Lentz & Harvey Tschirgi, *The Ethical Content of Annual Reports*, 36 J. BUS. U. CHICAGO 387, 392 (1963).

52. *Id.* at 390 tbl.2.

53. *Id.* at 388-89.

54. SELZNICK, *supra* note 37, at 238.

ity of the monetary unit in monetary systems."[55] As in the case of markets, the erosion of legitimacy may lead to a downward spiral as the public withdraws support and managers lose credibility.[56] The need to defend legitimacy is greatest when an institution ranks low in social esteem, but protestations of propriety are least likely to be accepted when an institution is already suspect. This lesson may be applied to the Business Roundtable when it claimed in 2002, after Enron and ensuing business scandals, that the U.S. had the best corporate governance system in the world. The statement spoke primarily of its desire to mollify a surge of anxiety about corporate accountability.[57] One consequence of a decline in legitimacy, as Parsons predicted decades earlier, is increased reliance on coercion as a means of securing compliance with desired norms[58]—a pattern confirmed by passage of the Sarbanes-Oxley Act.

Sociology, in general, derives theoretical concepts by a process of perceiving logical connections between abstract categories and then seeks to subject the concepts to empirical verification. The concept of legitimacy, however, has been "highly resistant to empirical specification."[59] For this reason, an analogous body of research in experimental social psychology is of great interest. The methodology of experimental social psychology *is* able to examine with empirical rigor the factors that prompt individuals to accept the exercise of authority. A widely acclaimed researcher, Tom Tyler, has spent much of his career examining this question as it arises from individuals' encounters with authorities, including not only government officials but also with parents, supervisors, and group leaders. Two articles deserve particular attention.[60] A 1992 ar-

55. TALCOTT PARSONS, SOCIOLOGICAL THEORY AND MODERN SOCIETY 309 (1967).

56. *See* Ashforth & Gibbs, *supra* note 40, at 186-91; Suchman, *supra* note 36, at 597-99.

57. THE BUSINESS ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE 2005, at 1 (noting 2002 version).

58. PARSONS, *supra* note 55, at 309.

59. Shirley Terreberry, *The Evolution of Organizational Environments*, 12 ADMIN. SCI. Q. 590, 608 (1968).

60. *See also, e.g.*, Tom R. Tyler, *Trust & Law Abidingness: A Proactive Model of Social Regulation*, 81 B.U. L. Rev. 361 (2001); Tom R. Tyler & Peter Degoey, *Collective Restraint in Social Dilemmas: Procedural Justice and Social Identification Effects on Support for Authorities*, 69 J. PERSONALITY & SOC. PSYCHOL. 482

ticle, which Tyler co-authored with Alan Lind, finds that the most potent reasons for individual willingness to "obey and voluntarily follow the decisions made by authorities" arise from judgments as to the legitimacy of the authorities.[61] A key factor determining legitimacy is "the person's evaluation of the fairness of the procedures used by the authorities in question."[62] The perception of procedural fairness in turn is affected by the factors of respectful treatment of the individual, neutrality, and trust.[63] The factor of trust, which involves beliefs as to the *intention* of the authority, may be defined broadly to embrace the other two factors since the desired intent involves a motivation to treat individuals impartially and with respect for their personal dignity.[64]

A later article, co-authored with Peter Degoey, examines the willingness of individuals to accept decisions by the San Francisco Public Utilities Commission, supervisors, and parents.[65] They find that the individuals' willingness to trust the authorities was influenced most "by their attributions of the motives of authorities."[66] The individuals did not base acceptance of authority on a calculation of the authorities' ability to provide favorable outcomes to them,[67] but instead sought to evaluate the authorities intent to treat them in an unbiased manner and with dignity and respect.[68] A striking feature of this finding is that individuals were most influenced by a cognitively difficult task—an effort to look beyond surface appearances and procedures to perceive the underlying intent or motivation of the authority.[69] The finding contradicts the common assumption that people are cognitively lazy and will

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(1995); TOM R. TYLER, WHY PEOPLE OBEY THE LAW (1990) (discusses legitimacy in chapters 3, 4, and 5).

61. Tom R. Tyler & E. Allan Lind, *A Relational Model of Authority in Groups*, 25 ADVANCES EXPERIMENTAL SOC. PSYCHOL. 115, 118 (1992).

62. *Id.* at 133.

63. *Id.* at 140-41. Tyler uses the more technical term "status recognition" to describe the conduct of respectful treatment.

64. *See* Tom R. Tyler & Peter Degoey, *Trust in Organizational Authorities: The Influence of Motive Attributions on Willingness to Accept Decisions*, *in* TRUST IN ORGANIZATIONS331, 342 (Roderick M. Kramer & Tom R. Tyler eds.,1996)

65. *Id.* at 334.

66. *Id.* at 332.

67. *Id.* at 337-39.

68. *Id.* at 342-43.

69. *Id.* at 336.

process their experiences in the easiest manner. Tyler calls for further research on the implications of his findings for an understanding of institutional legitimacy.[70] I suggest, however, that we are now justified in making certain inferences.

As applied to a corporation, the closest analogy to an attribution of motive or intent is a judgment as to the corporation's disposition to observe or fail to observe widely desired standards.[71] It may be naïve to suppose that the corporation has a character or "good heart,"[72] but corporations do have a demonstrated propensity to act in certain ways based on their culture and systems of internal controls. It may be inferred that a corporation that has adhered to a desired standard in the past may quite possibly possess a system of decision making that gives some measure of assurance that it will act similarly in the future. Suchman notes "organizations may stockpile goodwill and support. Generally, such stockpiles are dispositional in character, reflecting either pragmatic attributions (such as trust) or moral attributions (such as esteem)."[73] I would add that the inference of a corporation's disposition is entirely rational to the extent that it is based on a judgment as to the corporation's probable capacity for self-regulation in adhering to desired standards.

As an example of the potentially rational evaluation of a corporation's disposition, we may consider the wood products company, Stora Enso Corporation (annual sales $19.3 billion),[74] which has a record of maintaining a high environmental standard in its global operations, including its minority-owned investments in the United States.[75] The company has adopted internal practices providing assurance that these standards will continue to be observed. It includes a thorough environmental self-evaluation in its annual report and compares

70. *Id.* at 348-49.

71. Suchman, *supra* note 35, at 578-79.

72. *Id.*

73. *Id.* at 596.

74. Stora Enso Corp., Annual Report (Form 20-F), at 2 (Mar. 3, 2007) (data as of Dec. 31, 2006).

75. With regard to its North American operations, *see* STORA ENSO, 2007 ANNUAL REPORT 8, 57-61 (2007), http://www.storaenso.com/Documents/annual-reports-2007-eng.pdf; Michael E. Murphy, *Dispelling TINA's Ghost from the Post-Enron Corporate Governance Debate*, 43 SANTA CLARA L. REV. 63, 119-120 (2002).

actual performance against sustainability targets.[76] In addition, with a few exceptions, it discloses rigorous audits of plants in the European Union complying with the European Eco-Management and Audit Scheme and audits under the 13001 system of the International Organization for Standardization other operations.[77]

The social psychology research suggests another tentative conclusion. If the key factor is the disposition of the enterprise to act in desired way, legitimacy should not be regarded as an end point of a process of decision-making but rather to reside in *the nature of the process itself.*[78]

The view of legitimacy as pertaining to the enterprise's decision-making process brings us closer to the social thought of the great German social theorist, Jurgen Habermas—closer perhaps, but without any actual contact. Habermas describes the "colonization" of the ordinary sphere of social interaction (what he terms the "life world") by economic systems, but he appears to reject, or at least does not explore, the possibility of a reciprocal influence: the interpenetration of the economic systems by meaningful social interaction.[79] Nevertheless, it is worth noting that he analyzes legitimacy in terms of the processes of decision-making. He writes that the motive to conform to a decision making power lies in "the *expectation* that this power will be exercised in accordance with legitimate norms of action."[80] (Emphasis added.)

In other words, the processes of decision-making may themselves convey a measure of legitimacy if they display the qualities of accountability, openness, and responsiveness that bear an analogy to an individual's concern for fair and respectful treatment. If so, corporate legitimacy may depend on how the public engages in the cognitively difficult task of looking behind surface appearances to form an opinion about the in-

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76. *See* STORA ENSO, *supra* note 75, at 56-89.

77. *Id.* at 82-87.

78. In contrast, sociological literature often mentions legitimation as the process by which legitimacy is achieved or defended. *E.g.*, Alan J. Richardson, *Symbolic and Substantive Legitimation in Professional Practice*, 10 CANADIAN J. SOC. 139, 140 (1985).

79. For a discussion of Habermas' thought on legitimation, *see* CRADDEN, *supra* note 29, at 35, 37-99; THOMAS MCCARTHY, THE CRITICAL THEORY OF JURGEN HABERMAS 358-86 (1978).

80. JURGEN HABERMAS, LEGITIMATION CRISIS 43 (1973).

ternal processes of the corporation. Surely this possibility corresponds to commonly expressed criticisms of corporate actions. (The company is "heartless"; it doesn't "give a damn" for employees or community; it cares "only about the bottom line," etc). Even if one views these interpretations as somewhat speculative, one can at least say that the possession of legitimacy is linked to a corporate capacity for self-regulation to the extent that such self-regulation serves to assure future compliance with appropriate standards observed in the past.

This brief discussion suffices to guide our inquiry into the bearing of legitimacy on the structure of corporate governance, but it provides no more than a general orientation. I have not sought to survey for the breadth and complexity of the literature on legitimacy, and, in particular, I have bypassed the large subjects of political legitimacy,[81] as well as the relationship between institutional legitimacy and social integration.[82]

III.
THE REPUBLICAN HERITAGE AND CORPORATE GOVERNANCE

A. *The Relevance of Republicanism*

Much ink has been wasted on the futility of applying political models to corporate governance.[83] It is, of course, true that political models of self-government are ill adapted to the decision-making process of the large publicly owned corporation and would soon bring failure and discredit upon any corporation that sought to adopt them. However, we have seen that the concept of legitimacy rests on commonly accepted values and norms and, more speculatively, on a capacity for self-regulation. The concept calls upon us to seek a depository of ideas relevant to the exercise of corporate power. Since politi-

81. Most notably in Habermas' social theory.

82. *See* BOULDING, *supra* note 33; SELZNICK, *supra* note 37.

83. *See, e.g.*, Usha Rodrigues, *The Seductive Comparison of Shareholder and Civil Democracy*, 63 WASH. & LEE L. REV. 1389, 1389-90 (2005); Thomas W. Joo, *A Trip Through the Maze of "Corporate Democracy": Shareholder Voice and Management Composition*, 77 ST. JOHN'S L. REV. 735, 735 (2003); Henry G. Manne, *Citizen Donaldson*, WALL ST. J., Aug. 7, 2003, at A10 (Manne, dean emeritus of George Mason University School of Law, states: "the theory of corporate democracy . . . has long been a standing joke among sophisticated finance economists.").

cal traditions represent a culturally salient depository of ideas on the uses of power, the search for corporate legitimacy necessarily requires us to look for legitimizing concepts in political discourse that are relevant to the design of corporate governance.

The needed reservoir of legitimating concepts cannot be found in majoritarian democracy or in interest-group pluralism, which would saddle businesses with excessive costs of collective decision making.[84] But what of liberalism, a common source of reformist ideas? The difficulty is that the issues of corporate governance concern asymmetries of rights and power, either within the corporation or between the corporation and society. At the center of the liberal tradition is a concept of liberty as noninterference with individual autonomy, which provides no guidance as to these issues.[85] Liberalism can serve as a conceptual basis for corporate governance reform only if it is combined with independent evaluative criteria, such as justice, equality, welfare, or utility.[86] Such criteria may provide intellectually satisfying analyses but, with the exception of utility, they do not tap a culturally sanctioned discourse of legitimation applicable to corporate governance. The concept of utility does contribute to such an accepted discourse of legitimation if it is taken to refer to effective economic performance—there can be no doubt that people expect corporations to be efficient and well run.[87] Effective economic performance, as discussed later, must be regarded as the centrally important norm in corporate legitimacy. But is it sufficient? I hope to demonstrate the value of a richer source of legitimizing concepts and return to the question of effective economic performance at the end of this essay.

I argue that the oldest tradition of political liberty, republicanism, provides the needed lexicon of legitimation. A common tradition among the American colonies, republicanism

84. *See generally* Henry Hansmann, *When Does Worker Ownership Work? ESOPs, Law Firms, Codetermination, and Economic Democracy*, 99 YALE L. J. 1749 (1990).

85. *See* JEAN-FABIEN SPITZ, LA LIBERTE POLITIQUE 51, 169 (1995); MAURIZIO VIROLI, REPUBLICANISM 17, 54-58 (Antony Shugaar trans., Hill & Wang 2002); PHILIP PETTIT, REPUBLICANISM: A THEORY OF FREEDOM AND GOVERNMENT 9, 132 (1997).

86. *See id.* at 63.

87. *See* Allen, *supra* note 24.

drew on the political ideas of the English revolution of the mid-17th-century, leavened with legal and classical learning and the rhetoric of Whig opposition literature.[88] It is quite properly identified with the English idea of mixed government, which evolved into the system of separation of powers in the United States Constitution and later, under Jefferson's influence, gave birth to the Republican Party.[89] But it is the republican concept of liberty, underlying political ideas in this formative period, that is relevant to corporate governance. A constellation of ideas associated with the concept of liberty has generated a discourse of legitimation that, if *we look for it,* is actually present today in debates on corporate governance. I will first sketch the republican concept of liberty and then consider five corollaries of this concept arising in discussions of corporate governance: the rule of law, separation of powers, contestatory democracy, deliberation, and citizenship.

B. *The Genesis of Republicanism*

To understand the emergence of republican ideas, one must bear in mind that the education of the educated European elite in pre-modern times required literate persons to study in the original Latin the works of Cicero and the Roman historians of the late republican period. From these sources, the educated elite learned a narrative of the decline of republican institutions through the conspiracies and factions of ambitious individuals and their replacement with the despotism of imperial rule.[90] Imbued with classical learning, legal scholars found significance in the distinction between a slave and free man in Justinian's Digest: a slave was someone who lived subject to the dominion of someone else; it followed that a

88. I rely chiefly on the two classic studies of the ideological currents in late 18th-century America: *see* BERNARD BAILYN, THE IDEOLOGICAL ORIGINS OF THE AMERICAN REVOLUTION (1967); GORDON S. WOOD, THE CREATION OF THE AMERICAN REPUBLIC 1776-1787, 3-124, 593-615 (1969).

89. *See* LANCE BANNING, THE JEFFERSONIAN PERSUASION (1978).

90. *See, e.g.*, CICERO, SELECTED WORKS 35-57, 101-53 (Michael Grant trans., Penguin Books 1960); SALLUST, CATILINE'S WAR, THE JUGURTHINE WAR, HISTORIES 3-47, 144-48 (A.J. Woodman trans. 2007); TACITUS ON IMPERIAL ROME 29-32 (Michael Grant trans. 1956); LIVY, THE EARLY HISTORY OF ROME (Aubrey de Selincourt trans.1960).

free man was exempt from such dominion.[91] The republican concept of liberty, which emerged from these sources, identified freedom as a social condition enjoyed by citizens of a free state who were protected from the domination of a ruler, a ruling group, or their agents.[92]

Liberty was thus a quality of civic life enjoyed in a free polity.[93] Among the necessary conditions of liberty were the rule of law protecting individuals from arbitrary interference with their lives, a political system giving all citizens equal rights of control over the instrumentalities of government, and the moral capacity of citizens to put the common good over the interests of faction. Liberty was forfeited by dependence on the unconstrained will of a ruling group, regardless of how benign the group might be. The slave of a good master was still unfree. Hence, the measure of the loss of freedom was not actual coercion, or interference with choices a person was in a position to make, but instead, the power of ruling groups or other combinations of privilege and power to control such choices, even if such power was not exercised.[94]

Recent scholarship has revealed the prevalence of this neo-Roman view of liberty among the defenders of the English commonwealth, including James Harrington, Algernon Sidney, Marchamont Nedham, Henry Neville, and John Milton.[95]

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91. *See* Quentin Skinner, *States and the Freedom of Citizens, in* STATES AND CITIZENS, HISTORY,THEORY, PROSPECTS 12-13 (Quentin Skinner & Bo Strath eds., 2003); VIROLI, *supra* note 85, at 8.

92. *See* PETTIT, *supra* note 85, at 51-109.

93. *See* SPITZ, *supra* note 85, at 185-87.

94. *See id.* at 125-220; VIROLI, *supra* note 85, at 10, 25, 47-51, 69-78; PETTIT, *supra* note 85, at 52-58.

95. Quentin Skinner is perhaps the most distinguished member of this school of historical scholarship, which, departing from the great-man paradigm of intellectual history, has enabled us to see seventeenth century English republicanism as it was understood by contemporaries and passed on to later generations on both sides of the Atlantic. *See* Skinner, *supra* note 92 at 12, 13; QUENTIN SKINNER, LIBERTY BEFORE LIBERALISM (1998); Quentin Skinner, *Classical Liberty and the Coming of the English Civil War, in* 2 REPUBLICANISM: A SHARED EUROPEAN HERITAGE 6-13 (Quentin Skinner & Martin Van Gelderen eds., 2002). This scholarship owes much to Pocock's pioneering work. *See, e.g.*, J.G.A. POCOCK, THE MACHIAVELLIAN MOMENT: FLORENTINE POLITICAL THEORY AND THE ATLANTIC REPUBLICAN TRADITION (1975). Maurizio Viroli has brought Italian Renaissance republicanism to English readers, and Jean-Fabien Spitz has contributed illuminating studies of later French republican thought. *See, e.g.* MAURIZIO VIROLI, FROM POLITICS TO REASON OF STATE

Apart from classical sources, the commonwealth men were particularly conversant in the republican writings of Machiavelli who conveyed to the English a very similar variant of republicanism in his Discourses on Livy, which reflected the heritage of Italian renaissance humanism.[96] John Locke allied himself with the republicans of his time—and was understood by Americans as a republican—even though his theory of government contained the premises of a different concept of political liberty.[97]

The radical eighteenth century Whigs, such as Richard Price and the authors of Cato's Letters, maintained the idea of liberty as the absence of domination in writings that were avidly read by the American colonists.[98] This Whig literature responded to the colonists' detestation of royal governors and the favored circle of colonial magistrates who enjoyed the benefits of official appointments to the exclusion of other citizens. The governors and their sycophants possessed precisely the

(1992); JEAN-FABIEN SPITZ, LE MOMENT REPUBLICAIN EN FRANCE (2005); and SPITZ, *supra* note 85, at 311-490.

96. Niccolo Machiavelli is best known today for his advice to Italian princes on statecraft and the art of war, but he served as secretary of the Florentine republic and was imprisoned following its collapse in 1512. *See* MAURIZIO VIROLI, NICCOLO'S SMILE (1998). In his Discourse on Livy, he noted the early successes of republican Rome and Athens and commented: "This comes from nothing else than that governments by the people are better than those by princes." NICCOLO MACHIAVELLI, THE CHIEF WORKS AND OTHERS 316 (1965). His republican writings were a major influence on the political writers of the 17th-century English revolution and their successors. *See* FELIX RAAB: THE ENGLISH FACE OF MACHIAVELLI: A CHANGING INTERPRETATION 1500-1700, at 118-263 (1964); Skinner, *supra* note 95 at 47.

97. John Locke has an ambiguous relation to the republicanism. *See* John Dunn, *The Politics of John Locke in England and America, in* JOHN LOCKE, PROBLEMS & PERSPECTIVES 45 (1969). His contractual theory of political legitimacy, with its individualistic bias and emphasis on property rights, constitutes one of the seminal documents of liberal political thought. *See* JOHN LOCKE, TWO TREATISES OF GOVERNMENT 265-380 (1690). But he sided with contemporary republicans against their opponents. *See id., at* 67-68 *in* Peter Laslet, *Introduction.* He also employed republican rhetoric decrying arbitrary power, *id.* at 284, 412; advocated the rule of law, *id.* at 108, 113, 268, 324, and 355; and was clearly viewed through republican lens by the American colonists. *See* BAILYN, *supra* note 88, at 28; Dunn, *supra* note 97, at 59, 73-80.

98. *See* BAILYN, *supra* note 88, at 35-36, 132; WOOD, *supra* note 88, at 16, 396; Skinner, *supra* note 91, at 17; W. B. GWYN, THE MEANING OF THE SEPARATION OF POWERS 18-19 (1965). The authors of Cato's Letters were John Trenchard and Thomas Gordon.

kind of arbitrary and unchecked power that the colonists had come to view as being incompatible with civil liberty.[99] The intensity of this sentiment, as well as its classical sources, is revealed by the popular rhetoric of enslavement.[100] Oddly from our perspective, the colonists did not refer to racial oppression in inveighing against slavery but rather to the unchecked sway of British authority.[101] Bailyn notes that the Whig literature dwelt obsessively on the potential of political power to expand its influence to such fateful extremes as slavery, owing to the susceptibility of human nature to corruption and self-aggrandizement. Every encroachment on inherited freedoms thus carried the ominous prospect of further encroachments, if left unchecked.[102]

C. *The Rule of Law*

The enduring republican legacy can be seen today in a kind of fault line running through corporate governance debates, but the passionately expressed opinions of the formative republican period now appear as unspoken assumptions that clash with other assumptions derived from the later tradition of classic liberalism.

Viewing liberty as the ability of a citizen to live in society without fear of the arbitrary exercise of political power, the republicans saw the rule of law as not only a guaranty of liberty but also as actually constitutive of liberty.[103] There could be no liberty without the rule of law—the preservation of liberty, in Harrington's famous phrase, required an empire of laws, not of men. This formulation drew on Harrington's study of Machiavelli, who argued that the rule of law represented the

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99. *See* WOOD, *supra* note 88, at 75-82, 143-50.

100. *See* JOHN PHILLIP REID, THE CONCEPT OF LIBERTY IN THE AGE OF THE AMERICAN REVOLUTION 47-54 (1988).

101. For example, after passage of the Townsend duties, a Philadelphia grand jury complained, "For what slavery can be more complete, more miserable, more disgraceful, than that of a people, where justice is administered, government carried on and a standing army maintained at the expense of the people, and yet without the lease dependence upon them?" *Id.* at 50.

102. *See* BAILYN, *supra* note 88, at 55-60.

103. *See* VIROLI, *supra* note 85, at 9, 47-52; SPITZ, *supra* note 85, at 180-193; Pettit, *supra* note 85, at 35-41; Quentin Skinner, *Machiavelli on the Maintenance of Liberty*, 18 POLITICS, AUSTRALIAN POL. STUDIES ASS'N. J. 3, 8-10 (1983).

most reliable protection of a republican government. The phrase "empire of law" paraphrased language in Livy's account of the triumph of republicanism in the early history of Rome, part of the common classical learning of the time.[104]

On this issue, Locke was firmly in the republican camp. In an important passage he wrote:

> The end of Law is not to abolish or restrain but to preserve and enlarge Freedom. For in all the states of created beings capable of Laws, where there is no law, there is no Freedom. For Liberty is to be free from restraint and violence from others which cannot be where there is no Law. But Freedom is not . . . a Liberty for every man to do what he lists . . . [b]ut a liberty to dispose and order, as he lists, his Person, Actions, Possessions, and his whole Property within the Allowance of those Laws under which he is; and therein not to be subject to the arbitrary Will of another but freely follow his own.[105]

In 1762, before the conflicts with Britain that preceded the Revolutionary War, the Massachusetts House of Representatives articulated a similar view in its instructions to its agent in London:

> In General freedom of Men under Government, is to have standing fundamental Rules to live by, common to every one of that Society, and made by the legislative power erected in it, a Liberty to follow my own will in all things where that Rules prescribes and, and not to be subject to the inconstant, uncertain, unknown arbitrary will of another Man . . .[106]

The same devotion to law as a bulwark of freedom is evident in the charters, codes, and declarations adopted by the early settlers in the seventeenth century charters.[107] Bailyn explains that these documents "were, at the very least, efforts to abstract from the deep entanglements of English law and custom certain essentials—obligations, rights and prohibitions—by which liberty, as it was understood, might be preserved."[108]

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104. *See* SKINNER (1998), *supra* note 95, at 44-47, 75.
105. LOCKE, *supra* note 97, ch. VI. § 57, at 306.
106. REID, *supra* note 100, at 66.
107. *See* BAILYN, *supra* note 88, at 192-97.
108. *Id.* at 197.

An opponent of the American Revolution on the other side of the Atlantic, Jeremy Bentham, enunciated a contrasting idea of the role of law. In a letter to a friend in 1785, he wrote that he had made a discovery that formed the cornerstone of his philosophical system, "the idea of liberty, imported nothing in it that was positive: that it was merely a negative one; and that accordingly I defined it 'the absence of restraint.'"[109] As a corollary to his concept of liberty, Bentham maintained that "no law can ever be made but what trenches upon liberty" and, without more, "it is pure evil." Even if a law may produce good in the long run, "it is sure, in the first instance, to produce mischief."[110] Bentham's discovery was not actually new—it could be found in the writing of the seventeenth century authoritarian, Thomas Hobbes,[111] but it first gained traction through the writing of Bentham and other contemporaries and entered into the ideology of classic liberalism. It has had a long and varied history in the past two centuries, underlying the orthodoxies of a wide spectrum of political opinion.[112]

In the next two centuries, republicanism separated and blended with liberalism, as well as with offshoots of both traditions, such as pluralism, majoritarian democracy, and populism. It remained a pervasive presence in political discourse but lost any consistent identity. Without attempting to trace these complicated intellectual crosscurrents, I wish to indicate that the conflict between republicanism and classic liberalism is active today in corporate governance debates and was clearly illustrated by the controversy over the tentative draft of the Principles of Corporate Governance of the American Law Institute ("ALI").

The Chief Reporter of the ALI project, Melvin Eisenberg, defended the ALI draft in an important article on the structure of corporation law. He noted that the constitutive rules of the corporation were determined either by contract, private

109. PETTIT, *supra* note 85, at 44.

110. JEREMY BENTHAM, OF LAWS IN GENERAL 54 (H.L.A Hard ed., Athelone Press, 1970) (1782).

111. THOMAS HOBBES, LEVIATHAN, ch. 14, at 91 (Richard Tuck ed., Cambridge Univ. Press, 1991) (1651).

112. Berlin advanced an extremely influential defense of this concept of liberty as noninterference without addressing the republican alternative. *See* ISAIAH BERLIN, TWO CONCEPTS OF LIBERTY 7-16 (1958); *see* PETTIT, *supra* note 85, at 17-18, 25-50.

bureaucratic ordering (e.g. by-laws, stock rights, management orders), or by law. Laws in turn could be either enabling or mandatory.[113] While giving the largest scope for contract, private ordering, and enabling law, Eisenberg argued that mandatory rules were needed to govern conflicts of interest of top executives. He observed that top executives were not only subject to traditional conflicts of interest but also to "positional conflicts" because the executives "are legally and factually autonomous for many purposes."[114] The executives' position of relative autonomy enabled them to "enhance their positions, even at the shareholders' expense."[115] For example, they may "seek to increase corporate size as a way to maximize their power, prestige, and salary, even if an increase in corporate size does not increase shareholder wealth."[116] Since top managers have "little incentive to adopt rules that put constraints on their own positions,"[117] mandatory legal rules should determine the "core fiduciary and structural rules that put constraints on their own positions."[118] These core mandatory rules include those pertaining to the selection and composition of the board of directors, periodic disclosure of financial data and other material information, shareholder approval of transactions between managers and the corporation, appraisal rights in certain transactions, and fair election procedures.[119]

Though he did not mention the republican tradition, Eisenberg observed that the proposed scope of mandatory rules corresponded closely to existing state statutory law as well as federal regulatory law;[120] and, in an earlier article, he advanced an economic model of the corporation, conforming generally to the ALI proposals, as the basis for establishing corporate legitimacy.[121] The body of state and federal corporation law, reflecting something similar to his economic model, does indeed fall within the republican tradition by protecting

113. Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1471 (1989).
114. *Id.* at 1471-72.
115. *Id.*
116. *Id.*
117. *Id.* at 1473.
118. *Id.* at 1474.
119. *Id.* at 1480-81.
120. *Id.* at 1480-85.
121. *See* Eisenberg, *supra* note 18.

shareholders from the self-aggrandizing schemes of managers. In the republican view of a free society, the law should seek to reduce the spaces in social structure that permit the play of arbitrary power.[122] Accordingly, the ALI principles are justified to remedy the potential for abuse of power that arise from managers' traditional conflicts of interest and "positional conflicts," which Eisenberg described. Implicitly invoking this theme, the former Chancellor of the Delaware Chancery Court, William Allen, argues that corporation law, if properly understood, can provide a legitimizing narrative of the exercise of corporate power:

> The corporation law with its emphasis on shareholder rights of voting, on access to material information, and on a legally powerful board of directors that owes loyalty to the corporation and its shareholders, provides a powerful legitimizing account of the exercise of power. Corporate governance is the real world techniques and practices that drives this legitimizing theory.[123]

The views of Eisenberg were sharply contested in a comment of Fred McChesney, which clearly revealed the distinction between republican and classic liberal views of the role of law.[124] Describing himself as a contractarian and Eisenberg as a "coercionist," McChesney acknowledged that "the argument between contractarians and coercionists is essentially normative."[125] As an operative norm, contractarians regard interference with contractual freedom as "generally undesirable,"[126] while Eisenberg, as a coercionist, displayed an "oft-stated preference for coercive rules."[127] In this instance, McChesney contended, Eisenberg's "calls for legal coercion thus ring hollow,

122. SPITZ, *supra* note 85, at 6-7 ("In republican eyes, . . . the force of law is the only instrument capable of reducing to the highest degree the spaces of arbitrary action that the exercise of power recreates, destroying the social and civil fabric and engendering the kind of asymmetries that spell the death of a republic and of political participation as the common possession of all." (author's trans.)).

123. Allen, *supra* note 24, at 3.

124. Fred S. McChesney, *Economics, Law and Science in the Corporate Field: a Critique of Eisenberg*, 89 COLUM. L. REV. 1530, 1531 (1989).

125. *Id.* at 1536.

126. *Id.* at 1537.

127. *Id.* at 1530.

as Eisenberg never establishes that there are any actual problems requiring legal solutions."[128]

The normative analysis that McChesney espoused follows a tradition originating in the ideas of Bentham and Hobbes. He attributes a kind of *prima facie* legitimacy to a position avoiding interference with business decisions. The burden of persuasion, he seems to say, is on the drafters of the ALI draft to establish a need for legal restrictions by evidence of actual interference with shareholder interests. In contrast, the republican view, which ultimately prevailed, assumed the need for rules to protect shareholders from the exercise of power by executives acting out of conflicts of interest. A *prima facie* case could be made for such rules by showing that the executives were in a position to exercise power in such circumstances; the burden was then on opponents rebut the propriety of the rules.

The fault line that was so clearly exposed in the debate between Eisenberg and McChesney can be seen more obscurely in the arguments of other critics of the ALI draft,[129] and, I suggest, it can be traced through a wide swath of corporate governance literature. McChesney is unusual only for openly acknowledging his normative assumptions. By expressing an aversion to "coercive" rules of law, McChesney and other critics draw on a powerful discourse of legitimation arising from the tradition of classical liberalism. It is beyond the scope of this Article to pursue this tradition further. I mention this alternative discourse here only as a point of contrast with the republican tradition.

D. *Separation of Power*

The idea of separation of governmental power as a defense against domination by a despot or faction has a long gen-

128. *Id.* at 1531.

129. *See, e.g.*, Barry D. Baysinger & Henry N. Butler, *Revolution Versus Evolution in Corporation Law: the ALI's Project and the Independent Director*, 52 GEO. WASH. L. REV. 557, 559 (1984) (criticizes "intrusive changes"); Roberta S. Karmel, *The Independent Corporate Board: A Means to What End?*, 52 GEO. WASH. L. REV. 534, 556 (1989) (ALI drafts called for legislative action on matters best left to the market); Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1272 (1982) (sees strong presumption in favor of existing arrangements since "corporations are products of voluntary contractual agreements").

ealogy in political thought,[130] but it owes its central place in republican theory, and modern form, to Montesquieu's famous discussion of the English constitution. Montesquieu offered an idealized account of English mixed system of government—combining monarchy, aristocracy and democracy—and also reflecting the separation of government into three functions: executive, legislative, and judicial.[131] Today, the idea of separation of power is commonly associated with Madison's theory of checks and balances enunciated in the Federalist Papers.[132] Like his contemporaries, Madison was imbued with a conviction of the "encroaching spirit of power"[133] and feared the power of an aggressive faction to gain control of government to the detriment of other citizens.[134] The solution, he proposed, was to make "ambition . . . counteract ambition."[135] To avoid an elective despotism, "the powers of government should be so divided and balanced among several bodies of magistracy, and a fear of factions gaining control of the state, as that no one could transcend their legal limits."[136]

This concept of checks and balances, designed to pit "opposite and rival interests"[137] against each other, is obviously unsuited to corporate governance. In the realm of government, it has the benign effect of preventing the executive from manipulating the legislative and judicial branches.[138] However, the corporation thrives on strong, flexible, and adaptive leadership; indeed, it demands effective manipulation to operate successfully. If applied to the corporation, the Madisonian

130. *See* M. J. C. VILE, CONSTITUTIONALISM AND THE SEPARATION OF POWERS 21-75 (1967); GWYN, *supra* note 98, at 11.

131. *See* MONTESQUIEU, THE SPIRIT OF LAWS, b. XI, chap. 6, 201-02 (David Carrithers ed., Univ. Cal. Press 1977) (1748).

132. *See, e.g.*, THE FEDERALIST Nos. 48, 51 (James Madison). Madison's idea of checks and balances has its own genealogy and was closely mirrored in the contemporary writings of James Wilson. *See* VILE, *supra* note 130, at 158-59, 119-61 [generally]; GWYN, *supra* note 98, at 85-88; Bernard Manin, *Checks, Balances & Boundaries: the Separation of Powers in the Constitutional Debate of 1787, in* THE INVENTION OF THE MODERN REPUBLIC 27, 47 (Biancamaria Fontana ed., 1994).

133. THE FEDERALIST No. 48 (James Madison).

134. THE FEDERALIST Nos. 10, 43, 45 (James Madison).

135. THE FEDERALIST No. 51 (James Madison).

136. THE FEDERALIST No. 48 (James Madison).

137. THE FEDERALIST No. 51 (James Madison).

138. *See* PETTIT, *supra* note 85, at 173, 177-80.

concept would supply precisely the opposite outcome: a tendency to produce impasses in decision-making, which thwart effective leadership.

Nevertheless, if one examines the structure of the large corporation, one finds multiple separations of power.[139] At the apex of corporate governance, there is the division between management, the board of directors, and shareholders. Recent reforms have added the requirement of independent directors, executive sessions of these directors, and auditing committees composed of the independent directors with requisite qualifications.[140] At lower levels of the organization, one finds systems of internal auditing designed to assure auditor independence and systems of quality control and worker safety separated from production departments. Associations of lawyers, accountants, and occasionally other professions, such as actuaries and marine architects, play the role of gatekeepers.[141] Finally, the auditing of environmental and social conditions, as practiced widely in Europe, effectively transfers a degree of power to creditors, insurers, investors, and the general public.[142]

All these forms of separation of power are intended to serve a self-regulatory purpose by giving regulators the independence needed to perform their regulatory function effectively. For example, internal auditors may do their jobs better if they are accountable to a central controller rather than to divisional heads.[143] A broadly based safety committee with employee representatives may have more clout than a safety officer assigned to the production department.[144] Hence, it is not surprising that proposals for corporate governance reform typically build on existing separations of power by separating the positions of chairman of the board and CEO, by enhanc-

139. *See* John Braithwaite, *On Speaking Softly and Carrying Big Sticks: Neglected Dimensions of a Republican Separation of Powers*, 47 U. TORONTO L.J. 305, 326-44 (1997).

140. *See* NYSE, Inc. Listed Company Manual § 303A.01-03,.07(a) (2008); NASDAQ, Inc. Manual §§ 4350(c)(2), (d)(2)(A)-(B) (2008).

141. *See* Braithwaite, *supra* note 139, at 334-49.

142. For a perceptive account of the benefits, pitfalls, and excesses of auditing, *see* MICHAEL POWER, THE AUDIT SOCIETY: RITUALS OF VERIFICATION (1997).

143. *See* Braithwaite, *supra* note 139, at 346-48.

144. *Id.* at 350.

ing audit committee independence, or by allowing concerted shareholder action or shareholder participation in the nomination process for corporate director.

The function of these existing and proposed separations of power in corporate organizations corresponds closely to other rationales for separation of power articulated in the century and a half before Madison's writings. Gwyn has shown that the separation of power was sometimes advocated on the ground of efficiency, specifically that each branch of government could perform best without interference from the others.[145] Similarly, it was seen as a means of assuring impartial administration of justice and fair legislation; excessive meddling by the executive branch could lead to corruption.[146] And, most cogently, a separation of powers was regarded as a precondition for accountability. The executive, for example, could be accountable to the legislative branch only if it were not too deeply entangled in legislative processes.[147] The state constitutions adopted in 1776 were most concerned with shielding the legislative and judicial functions from the influence of royal governors, reflecting the impartiality and accountability rationales. The idea of checks and balances appears more often as an occasional element of rhetoric than as an operative principle.[148] Wood observes that in the new constitutions "governors' power of appointment was clipped and magisterial and administrative officials were prohibited from sitting in the legislatures, all in the name of Montesquieu's principle of separation of powers."[149]

Thus, if it is understood in a distinctly non-Madisonian sense, the idea of separation of power appears as a central theme in corporate self-regulation, carrying with it a discourse of legitimation with deep roots in the republican tradition. But as an element of self-regulation, it is linked to corporate legitimacy in a more profound way. As we have seen, social psychology research finds that acceptance of the exercise of authority is associated with perceptions of the intent of the person exercising authority. If extrapolated to the corporate setting, this

145. *See* GWYN, *supra* note 98, at 34.
146. *Id.* at 40.
147. *Id.* at 55, 127.
148. *See* VILE, *supra* note 130, at 133-141.
149. WOOD, *supra* note 88, at 449.

research suggests the importance of the perceived corporate disposition to adhere to desired norms, which in turn depends on the self-regulatory capacity of the corporation. Hence, the separation of power as a self-regulatory device appears likely to bolster public acceptance of corporate decision making.[150]

E. *Contestatory Democracy*

The republican concept of liberty as freedom from domination generated a complex set of institutions in the formative period of our country, which are now firmly associated with the idea of democracy. In addition to electoral institutions allowing citizens to participate in government, one finds other institutions empowering individuals to contest the improper exercise of power. For example, most of the state constitutions adopted in 1776 provided for the impeachment of odious officials enjoying royal appointments,[151] and the federal constitution, as Hamilton predicted in Federalist 78, would enable the federal judiciary to "pronounce legislative acts void, because contrary to the constitution."[152] These are, of course, only two examples out of many. A multiplicity of institutions now enable citizens, at least in some imperfect degree, to identify and oppose concentrations of power with the capacity to dominate sectors of social life, such as constitutional limitations on government, the protection of free speech, the right of association in civic organizations, and the procedures of administrative law.[153]

Pettit argues that it is helpful to distinguish between two dimensions of democracy—electoral democracy and contestatory democracy.[154] By giving people control over govern-

150. Aptly capturing the significance of separation of power as a widely accepted institutional norm, John Bogle, the founder of Vanguard Investments, writes: "The reality is that out modern-day corporations fail to follow a primary principle of good governance laid down by the founding fathers of our republic: the *separation of powers* . . . " John C. Bogle, *Democracy in Corporate America*, DAEDALUS 24, 26-27 (Summer 2007).

151. *See* WOOD, *supra* note 88, at 141.

152. THE FEDERALIST No. 78 (Alexander Hamilton).

153. *See* Philip Pettit, *Republican Theory and Contestatory Democratization*, DEMOCRACY'S VALUE 163, 178-185 (Ian Shapiro & Casiano Hacker-Cordon eds., 1999).

154. *See id.* at 183-200; Philip Petit, *Democracy, Electoral and Contestatory*, 42 NOMOS 105 (2000).

ment, electoral democracy aims to orient governmental actions toward the ideas and interests of the people; it serves a positive, generative function in defining and implementing policies. Contestatory democracy gives people the power to scrutinize governmental policies and object to those that allow the arbitrary exercise of power; it serves a negative function in examining and disallowing improper actions.[155] Electoral democracy involves collective processes, while contestatory democracy is usually associated with initiatives of individuals or groups. Electoral democracy operates through a central system of representation; in contrast, the institutions of contestatory democracy are diffuse, including the courts, civil institutions and the checks and balances of limited governments. Electoral democracy calls for active participation; contestatory democracy is satisfied when people possess the right to contest abuse, or threatened abuse, of power, even if the right is passively held in abeyance.[156]

The institutions of contestatory democracy are now universally associated with any government that deserves to be called democratic and are no longer the exclusive possession of republicanism.[157] The republican tradition, however, does emphasize a feature of contestatory democracy that is not always found elsewhere: the existence of consent to the exercise of power, as in a contractual agreement, is itself subject to scrutiny for evidence of domination.[158] Spitz argues that the republican tradition views a rule as being the product of duress, even if everyone consents to it, where it "has the effect of sanctioning relationships of domination and dependence."[159]

Corporate governance scholars have, to say the least, experienced difficulty in assimilating the idea of democracy. The notion of shareholder democracy is reflected in the formal structure of the corporation and expressed in the legislative history of the Exchange Act of 1934, but it is commonly regarded as the relic of an earlier age.[160] I suggest that the ap-

155. *Id.* at 105, 114-15.
156. *Id.* at 117, 124-27, 139.
157. *Id.* at 106, 124.
158. *See* PETTIT, *supra* note 85, at 62, 164-65.
159. SPITZ, *supra* note 85, at 362 (author's trans.); *see also id.* at 397-98.
160. *See, e.g.*, Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1347, 1351-68 (2005).

propriate role of democracy in corporate governance can be dramatically clarified by recognizing the distinction between electoral and contestatory democracy. In the field of corporate governance, shareholders have no general power of initiative.[161] The intended effects of existing forms of shareholder democracy—and the proposed effects of realistically conceived reforms—ordinarily fall within the category of contestatory democracy. In other words, they pertain to the scrutinize-and-disallow dimension of democratic processes.

The nominating procedure for board of directors might appear to offer a stark choice between electoral democracy or none at all. The inclusion of shareholder nominations in the management proxy opens the door to the election of shareholder candidates to the board, while the exclusion of shareholder candidates from the management proxy effectively precludes it, except in contests of control, because of the expense and practical difficulty of challenging a management nominee.[162] But serious proposals for reform of the nominating process are usually crafted to fit within the mold of contestatory democracy. In a 1953 article entitled, *Shareholder Nominations of Directors, A Program for Fair Corporate Suffrage,* Mortimer Caplin, who served as Commissioner of Internal Revenue under two presidents, called for revival of an SEC proposal for limited shareholder access to the management proxy.[163] His phrase "fair corporate suffrage" came from the legislative history of the Exchange Act of 1934.[164] He noted that the board of directors is charged with the ordinary business of the corpo-

161. There are two relatively inconsequential exceptions—the right to make nonbinding resolutions—and a problematic and disputed right to propose bylaw amendments. For shareholder resolutions, *see infra* notes 253-258 and accompanying text. On bylaw amendments, *see, e.g.,* John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?* 51 U. MIAMI L. REV. 605, 616-19 (1997); *Lawrence A. Hamermesh, Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?,* 73 TULANE L. REV. 409, 487 (1998); Brett H. McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills,* 3 BERKELEY BUS. L.J. 207, 224 (2005).

162. *See* Lucian Bebchuk, *Shareholder Access to the Ballot,* 59 BUS. LAW. 43, 44-46 (2003).

163. Mortimer M. Caplin, *Shareholder Nominations of Directors: A Program for Fair Corporate Suffrage,* 39 VA. L. REV. 141 (1953).

164. H.R. Rep. No. 73-1385, at 13 (1934); *see generally,* Patrick J. Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy* 23, GA. L. REV. 97, 123-146 (1988).

ration, but argued that fair corporate suffrage demanded that shareholders have some means of objecting to unsatisfactory performance of the board:

> Obviously, the very essence of such type of democratic economic organization is the availability to the shareholders of the untrammeled right of recall, at least on an annual basis, over managers whose records are not found to be satisfactory. And this is where corporate democracy fails to be realized today.[165]

Under this interpretation, fair corporate suffrage referred to the right to remove to incompetent or abusive leadership on the board, a matter within the scope of contestatory democracy. In 2003 the SEC proposed a very diluted version of the same concept, which would give shareholders a highly circumscribed right of access to the management proxy upon occurrence of a "triggering event."[166]

Other proposals for reform of the nominating process contemplate a continuing shareholder presence on the board, but still fall on the side of contestatory democracy. Commentators have called for direct shareholder participation in the nominating committee,[167] reserved shareholder seats on the board,[168] or some kind of limited shareholder access to the management proxy.[169] Similarly, the SEC has adopted disclosure provisions intended to encourage nominating commit-

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165. Caplin, *supra* note 163, at 151.

166. Security Holder Director Nominations, Exchange Act Release No. 48,626, 68 Fed. Reg. 205 (Oct. 23, 2003), *available at* http://www.sec.gov/rules/proposed/34-48626.pdf. Besides being a very weak reform, the SEC proposal appears to be perversely calculated to generate costly proxy contests. *See* Murphy, *supra* note 20, at 178-179.

167. *See id.*

168. LOUIS LOWENSTEIN, WHAT'S WRONG WITH WALL STREET, SHORT-TERM GAIN AND THE ABSENTEE SHAREHOLDER 210-216 (1988); Robert A. O. Monks & Allen Sykes, *Capitalism without owners will fail: A policymaker's guide to reform*, http://cegopp.cema.edu.ar/download/CapitalismOwnersFail.pdf.

169. William T. Allen, Jack B. Jacobs & Leo E. Strine, *The Great Takeover Debate: a Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1072-74, 1096-1100 (2002); Carol Goforth, *Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late*, 43 AM. U. L. REV. 379 (1994); Jayne W. Barnard, *Shareholder Access to the Proxy Revisited*, 40 CATH. U. L. REV. 37 (1990).

tees to consider shareholder recommendations for director.[170] A common objective of these proposals is to introduce an outsider's perspective, namely that of shareholders, into the internal controls of corporate governance. The shareholder presence is intended to serve as a check on the insularity of the board[171] and a source of negative feedback when things go wrong. This function again rests on the scrutinize-and-object function of contestatory democracy.

The term contestatory democracy, as outlined here, gives a specific meaning to the idea of democracy that lies outside common usage, but it has a long pedigree in republican tradition. Though narrower than more familiar meanings, it still calls for institutional structures with a recognizable connection with democratic practices. The phrase "fair corporate suffrage," as employed by Caplin, rings true because it gives shareholders what they are likely to want most—a check on failed executive performance.

Democracy is a powerful legitimating norm in our society. Management will battle against the current if it hopes to achieve corporate legitimacy without it. The practice of contestatory democracy is actually found in existing corporate institutions, though in a rather effete form; thus, shareholders have the power to confirm or disallow measures which management submits to them, though they cannot determine the timing or terms of the measures.[172] These practices of contestatory democracy can be expanded and strengthened in various ways, which include not only reform of the nominating

170. Disclosure Regarding Nominating Committee Functions, Exchange Act Release No. 48,825, 38 Fed. Reg. 238, at 69207-69208, 28-30 (Dec. 11, 2003). A Spencer Stuart survey recorded no shareholder nominations three years after the effective date of the disclosure rules. *Spencer Stuart Board Index: The Changing Profile of Directors*, at 14 (2006), http://content.spencerstuart.com/sswebsite/pdf/lib/SSBI-2006.pdf.

171. The phrase comes from: John Pound, *The Promise of the Governed Corporation*, HARV. BUS. REV. 89, 95 (1995).

172. *See, e.g.*, MODEL BUS. CORP. ACT ANN. § 8.01(4th ed. 2008) (board of directors charged with management of ordinary business of the corporation); *id.* § 8.63 (shareholder waiver of conflict of interest); *id.* §11.04 (plan of merger must be submitted to shareholders); *id.* § 12.02 (shareholder approval of disposition of assets); *id.* § 14.02 (shareholder approval of dissolution). Management, however, is notoriously in a position to manipulate the shareholder vote, thereby depriving shareholder approval of any value. *See* Eisenberg, *supra* note 113, at 1474-80.

procedure but a range of issues involving transparency and shareholder monitoring. An effective system of contestatory democracy can be thought of as a method of introducing negative feedback more efficiently into the processes of corporate decision-making. If it employed in this sense, the legitimizing norm of democracy can be applied more meaningfully to corporate governance.

F. *Deliberation*

The republican concept of liberty as the conduct of civic life in the absence of domination does not entail a particular view of justice; instead it affirms the ability of citizens with varying interests and ideas to draw on common loyalties to develop a mutually acceptable view of the good life.[173] As Skinner notes, a watchword of Renaissance humanism that accompanied the rebirth of republicanism was *audi alteram partem*, always listen to the other side.[174] Indeed, in a passage familiar to seventeenth century English readers, Machiavelli argued that the preservation of liberty in republican Rome was due to constant discord between the patricians and plebes.[175]

In political thought, this republican intuition uniting pluralism and dialogue is associated with the idea of deliberative decision-making.[176] As a political ideal in the American colonies, it competed with other offshoots of the republican tradition—the ideal of a moral commonwealth united in a common pursuit of virtue,[177] and later, the radical majoritarian democracy of the state constitutions of 1776, which held

173. In eloquent French, which I can only crudely translate, Spitz writes: "It is because the members of a community have a shared definition of what it means to be human, that is, they have a common notion of what is worthy and decent in human life, that they can develop their own concept of what is a good life, assisted by a mutual recognition of a common fund of humanity. SPITZ, *supra* note 85, at 125; *see also* Jean-Fabien Spitz, *The Concept of Liberty in 'A Theory of Justice' and its Republican Version*, 7 RATIO JURIS 331 (1994).

174. QUENTIN SKINNER, REASON AND RHETORIC IN THE PHILOSOPHY OF HOBBES 15-16 (1990).

175. NICCOLO MACHIAVELLI, *Discourse on Titus Livy*. Book 1, part 4, *in* 1 MACHIAVELLI, THE CHIEF WORKS AND OTHERS 202 (Allan Gilbert trans., 1965).

176. *See* SPITZ, *supra* note 85, at 221-36.

177. *See* WOOD, *supra* note 88, at 53-65.

representatives to be bound to constituents' instructions.[178] But in the debates over the Constitution[179] and Bill of Rights,[180] the concept of deliberation as a means of reaching a common sense of the public interest assumed a central role in political thought. In the Federalist Papers, Hamilton and Madison saw the wide range of interests embraced by a federal government as a positive factor encouraging an impartial consideration of the public interest. Thus, Hamilton wrote, "The difference of opinion, and jarring of parties in [the legislative branch] of the government, though they may sometimes obstruct salutary plans, yet often promote deliberation and circumspection . . . ."[181] To the same effect, Madison believed that the relatively small number of representatives in Congress would serve "to refine and enlarge the public views, by passing them through the medium of a chosen body of citizens, whose wisdom may best discern the true interests of their country . . . ."[182] Evidence of this intent to modify the effects of majoritarian democracy with the process of reasoned deliberation; can be seen throughout the Constitution: in the bicameral legislature, the relatively long terms of office (as compared to early state constitutions), the separation of powers,

178. *See* BAILYN, *supra* note 88, at 171; JOSEPH M. BESSETTE, THE MILD VOICE OF REASON, DELIBERATIVE DEMOCRACY AND AMERICAN NATIONAL GOVERNMENT 5-13 (1994).

179. The RECORDS OF THE FEDERAL CONVENTION OF 1787 at 479, (Max Farrand, ed., rev. ed. 1937)

180. In the first congress, Roger Sherman spoke against a proposal requiring representatives to follow instructions of constituents: "The words are calculated to mislead the people, by conveying an idea that they have a right to control the debates of the Legislature. This cannot be admitted to be just, because it would destroy the object of their meeting. I think, when the people have chosen a representative, it is his duty to meet others from the different parts of the Union, and consult, and agree with them on such acts as are for the general benefit of the whole community. If they were to be guided by instructions there would be no use in deliberation." Quoted in CASS SUNSTEIN, THE SECOND BILL OF RIGHTS 32 (2004).

181. THE FEDERALIST No. 70 (Alexander Hamilton); *see also* THE FEDERALIST No.1 (Hamilton) (virtue of deliberation) and No. 78 (Hamilton) (independence of judiciary).

182. THE FEDERALIST No. 10 at 66 (James Madison); *see also* THE FEDERALIST No. 37 (James Madison) (spirit of moderation), No. 55 (Madison) (trust in best human qualities), No. 57 (Madison) (attention to public good).

and the indirect election of senators by state legislatures and the president by the electoral collage.[183]

In twentieth-century America, the Founders' ideal of deliberation found a powerful rival—a concept of pluralism that calls for the resolution of differences by a process of self-interested bargaining.[184] As early as twenty-five years ago there was a dearth of literature on the subject of deliberation,[185] but recent years have witnessed a vigorous revival of interest in the concept of deliberation in political theory.[186] The most notable work is undoubtedly that of Gutman and Thompson, which, as they acknowledge, explores "a familiar theme in the American constitutional tradition."[187] "Deliberative democracy," they write, "asks citizens and officials to justify public policy by giving reasons that can be accepted by those who are bound by it."[188] As a first condition for meaningful deliberation, they propose the principle of reciprocity, a sense of mutuality required for productive dialogue. "The foundation of reciprocity is the capacity to seek fair terms of social cooperation for their own sake."[189] In this way, Gutman and Thompson come full circle back to the Renaissance principle of *audi alteram partem.*

In a trio of articles, a current vice-chancellor of the Delaware Chancery Court, Leo Strine, and two former chancery judges, Jack Jacobs and William Allen, link the term republic to deliberative decision making of elected representatives and argue that it is found in the existing structure of corporate

183. BESSETTE, *supra* note 178, at 13-25.

184. PETTIT, *supra* note 85, at 187-88, 202-05.

185. *See* BESSETTE, *supra* note 178, at xi.

186. *See, e.g.,* CASS R. SUNSTEIN, WHY SOCIETIES NEED DISSENT (2003); *id.,* THE PARTIAL CONSTITUTION 133-45 (1993); *id.,* DELIBERATIVE DEMOCRACY (Jon Elster ed., 1998); *id.,* DELIBERATIVE POLITICS: ESSAYS ON DEMOCRACY AND DISAGREEMENT (Stephen Macedo ed., 1999); John Ferejohn, *Instituting Deliberative Democracy,* in DESIGNING DEMOCRATIC INSTITUTIONS 75 (Ian Shapiro & Stephen Macedo eds., 2000); Joshua Cohen, *Deliberation and Democratic Legitimacy, in* THE GOOD POLITY: NORMATIVE ANALYSIS OF THE STATE 17 (Alan Hamlin & Philip Pettit eds., 1989).

187. AMY GUTMAN & DENNIS THOMPSON, DEMOCRACY AND DISAGREEMENT 12 (1996).

188. *Id.* at 52.

189. *Id.* at 52-53.

governance.[190] They state the thesis succinctly in a co-authored article: the "most compelling" defense of the existing corporate structure, they claim, "rests in [the] analogy of the corporation to a republic, in which managers are elected to make decisions independently, not to follow directions from the stockholders."[191]

Strine associates republican values with a "traditionalist perspective" in corporate law.[192] In an article entitled, *Toward a True Corporate Republic*, he writes: "This approach invests corporate managers with a great deal of authority to pursue business strategies through diverse means, subject to a few important constraints."[193] While these constraints, such as financial disclosure and annual election of directors, are vital, the traditionalist is most concerned with empowering "management to make and pursue risky business decisions."[194] The traditionalist "believes that, in a real sense, the institution is larger than any individual and that it is the corporation's ability as an organization to foster ongoing managerial excellence that ultimately determines how much wealth the corporation will deliver."[195]

A third article, co-authored by Allen and Strine, makes clear that the republican analogy rests on a broad interpretation of the business judgment rule.[196] The article, which is dedicated to the "enduring relevance" of corporate attorney, Martin Lipton, argues that Lipton "drew on principles of republican democracy" by advocating takeover defenses that protect management's ability to pursue "long-term growth strategies."[197] The business judgment rule, they argue, recognizes that "social wealth is created . . . within the corporation"

190. Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1777, 1783 (2006); William T. Allen & Leo E. Strine, Jr., *When the Existing Economic Order Deserves a Champion: The Enduring Relevance of Martin Lipton's Vision of the Corporate Law*, 50 BUS. LAW. 1383, 1386, 1389 (2005); Allen, Jacobs & Strine, *supra* note 169, at 1077, 1094-95.

191. Allen, Jacobs & Strine, *supra* note 169, at 1094.

192. Strine, *supra* note 190, at 1762.

193. *Id.*

194. *Id.* at 1763.

195. *Id.* at 1766.

196. Allen & Strine, *supra* note 190, at 1383, 1391.

197. *Id.* at 1386, 1389.

and, therefore, "these complex systems are hugely valuable and worthy of protection."[198]

These distinguished authors make a serious point. A decision-making process in an institutional setting that involves dialogue and explanatory rationale among managers and directors does bear an analogy to the republican concept of the sovereign deliberation of elected representatives.[199] To this extent, the existing corporate order, which the chancery judges defend, is open to republican modes of deliberation and offers a potential for republican reforms.[200] The judges, moreover, are on sound ground in opposing a "republican form of corporate governance"[201] to an influential school of thought that gives the influence of the capital markets priority over long-term strategic planning. This point of view, which the authors alternatively describe as the "finance view"[202] or the "property model,"[203] restricts the director's discretion to a process of attending to the market valuation of shares. It clearly lies outside the republican paradigm.

The defect in the chancellors' republican analogy lies in an aspect of the idea of deliberation that they do not address. Deliberation in the republican sense involves dialogue among people with varying perceptions of the public good.[204] When management decisions are based on limited sources of information, or, worse, on a process of group think,[205] any genuine deliberation will be absent. It has often been observed that the corporate board is typically a highly cohesive social group[206] comprised of members of a homogeneous elite—the "inner

198. *Id.* at 1388.

199. *See* VIROLI, *supra* note 85, at 4.

200. Strine appears to share this cautious assessment. His article is entitled significantly "*Toward* a True Corporate Republic" and concludes with a proposal to strengthen shareholder participation in the selection of directors. Strine, *supra* note 190, at 1777-79 (emphasis added).

201. Allen, Jacobs & Strine, *supra* note 169, at 1067.

202. Allen & Strine, *supra* note 190, at 1384.

203. Allen, Jacobs & Strine, *supra* note 169, at 1071. Strine's article, which is addressed to a proposal of Lucian Bebchuk, does not put a label on Bebchuk's proposals for increasing shareholder influence over management. Strine, *supra* note 190, at 1760-62.

204. *See* PETTIT, *supra* note 85, at 187-90.

205. *See* Murphy, *supra* note 20, at 157-158.

206. RAKESH KHURANA, SEARCHING FOR A CORPORATE SAVIOR 83 (2002); MYLES MACE, DIRECTORS: MYTH AND REALITY 52-61 (Harvard Business School

circle" as described by Useem.[207] In large measure, the board needs to be cohesive to carry out its complex tasks, and corporate leaders understandably put a high value on collegiality.[208]

Unfortunately, carrying social affinity further than needed, corporate boards typically draw from a homogeneous elite population which itself forms a distinct community. Khurana and Pick describe this community as being united in opposition to perceived adversaries:

> [I]n addition to being members of specific boards, directors are also members of the wider population of directors. This population is densely connected through interlocks, with most directors serving on several boards at the same time. The changing environment for corporate governance has made this community even tighter as it becomes more bounded by opposition to external parties that scrutinize and attempt to exert influence. The broader population of directors now has a visible and distinct out-group, comprised of legislators, shareholders activists, and various other critics, against which to position itself.[209]

As Khurana and Pick observe, the elite community of directors is afflicted by the profound and universal human tendency to form ingroup/outgroup orientations, which encourages redundant circulation of ideas, values, and information congenial to members and to suppress those emanating from outside groups, such as legislators, shareholder activists, and critics, that are viewed in an adversarial light.[210] The value of

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Press, 1986); JAY W. LORSCH & ELIZABETH MACIVER, PAWNS OR POTENTATES, THE REALITY OF AMERICA'S CORPORATE BOARDS 80-95 (1989).

207. MICHAEL USEEM, THE INNER CIRCLE: LARGE CORPORATIONS AND THE RISE OF BUSINESS POLITICAL ACTIVITY IN THE U.S. AND U.K. (1984); Rakesh Khurana & Katharina Pick, *The Social Nature of Boards*, 70 BROOK. L. REV. 1259, 1271 (2005).

208. *See* Murphy, supra note 20, at 168-170.

209. Khurana & Pick, *supra* note 207, at 1279.

210. *See, e.g.*, Nilanjana Dasgupta, *Implicit Ingroup Favoritism, Outgroup Favoritism, and Their Behavioral Manifestations*, 17 SOC. JUST. RES. 143 (2004); Marilynn B. Brewer, *In-Group Bias in the Minimal Intergroup Situation: A Cognitive-Motivational Analysis*, 986 PSYCHOL. BULL. 307, 319 (1979); Jacob M. Rabbie & Murray Horwitz, *Arousal of Ingroup-Outgroup Bias by a Chance Win or Loss*, 13 J. PERSONALITY & SOC. PSYCHOL. 269 (1986).

deliberation among directors and managers belonging to this community is necessarily diminished by the degree of intellectual and social homogeneity among its members and by the barriers that separate it from social environments that impinge on corporate performance.

The business elite of directors and managers, in short, forms a kind of enclave[211] in the broader society whose decision-making processes are affected by systemic distortions in communication.[212] Can corporate governance be designed to breach somewhat the walls of the enclave, allowing greater penetration of communication from outside? The question has implications for matters outside the scope of this essay, such as an appropriate employee role in decision-making functions,[213] but the existence of walls separating management from mass of shareholders very much pertains to our topic. The most important issue, which we have already discussed, is undoubtedly shareholder participation in the nominating process, which could significantly broaden the intellectual and social base of the governing elite. However, a closely related matter also deserves notice: equal shareholder representation.

An equal shareholder franchise has deep resonance in republican tradition[214] and responds to notions of fairness and respectful treatment of individuals. Several factors tend today

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211. I owe to Sunstein the concept of enclave deliberation. *See* Sunstein, *supra* note 186, at 158-61.

212. The concept of systemic distortions in communication has ramifications in social theory that are beyond the scope of this essay. *See* TERRY EAGLETON, IDEOLOGY: AN INTRODUCTION 129 (1991).

213. For example, the British Pension Act 1995 requires that one-third of the members of boards of pension trustees be employee representatives. Elsewhere, I have argued that a similar system of employee representation could be adopted in the United States, and if it were successful, it could be extended to certain other corporate functions. *See* Murphy, *infra* note 216, at 530.

214. *See* Philip Pettit, *The Freedom of the City: A Republican Ideal, in* THE GOOD POLITY, *supra* note 186, at 141 (arguing that equal franchise in a polity is an early and central republican idea). In an opinion of the Delaware Court of Chancery, Judge Allen calls the shareholder franchise the ideological underpinning of corporate legitimacy. Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) ("The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests . . . it is critical to the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property that they do not own").

to marginalize minority shareholder voices in corporate governance. First, the power of minority shareholders to exercise influence in election of directors proportionate to their share ownership depends on the privilege of cumulative voting; otherwise a majority of shareholders will always dominate. The practice of cumulative voting has now dwindled to a small fraction of its former importance in mid-twentieth century.[215] Second, a complex set of factors hobble the ability of pension funds to engage in corporate monitoring.[216] In a recent article, I discussed a series of ten inappropriate policies, unnecessary restrictions, and immobilizing conflicts of interest.[217]

A third marginalizing factor appeared, until recently, to be on its way out. The voting rights of shareholders are effectively diluted by the practice of allowing brokers to vote shares held in their name without instructions from beneficial owners. Since brokers typically vote for management, shareholders seeking to actively monitor management performance will find that the deck is stacked against them in annual shareholder meetings.[218] The New York Stock Exchange rule authorizing uninstructed broker voting is now subject to a list of exceptions[219] and a proposal to eliminate the rule for directorial elections was recently considered but appears stalled.[220]

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215. The practice of cumulative voting reached a high point in mid-twentieth century when 22 states had mandatory cumulative voting requirements and 40 percent of the largest 2900 corporations offered shareholders this right. *See* Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124, 142-46, 160 (1994).

216. Michael E. Murphy, *Pension Plans and the Prospects of Corporate Self-Regulation*, 5 DEPAUL BUS. & COM. L.J. 503 (2007).

217. *Id.*

218. A websearch reveals that estimates of the influence of uninstructed broker voting vary widely. The most conservative estimates are in the order of 15 percent of votes cast—enough to change the result of many elections. *See, e.g.*, TheCorporateCounsel.net Blog, http://www.thecorporatecounsel.net/blog/archieve/001487.html (last visited Mar. 5, 2009),

219. NYSE, Inc., Rule 452. The American Stock Exchange, Rule 577 mirrors the NYSE rule. The Nasdaq has no rule either allowing or disallowing such broker voting.

220. The Proxy Working Group of the Communication and Proxy Process Sub-Committee announced a proposed bar on uninstructed broker voting in a press release dated October 24, 2006; the proposal was amended on May 23, 2007 to exclude companies registered under the Investment Company Act. Press Release, New York Stock Exchange, NYSE Adopts Proxy Working Group Recommendation to Eliminate Broker Voting in 2008 (Oct. 24,

Even if adopted, some uninstructed broker voting would be allowed.

The most critical issue, however, is the right of corporations to adopt a bylaw ordering staggered elections for the selection of directors.[221] By putting up one third of its members for election each year, the board can effectively keep minority shareholders in a marginalized position.[222] Thus, one may logically conclude that the staggered board should be discouraged or prohibited. It is in fact under increasing attack by institutional investors.[223] But, at this point the well-meaning reformer will come under the mocking gaze of Nemesis, the mischievous fomenter of unintended consequences. The staggered board—when combined with the poison pill—is the most effective weapon available to boards to resist undesired takeover bids[224] and is therefore an essential factor in the relative equilibrium of the existing order. If it were eliminated without compensating measures, the republican ideal of deliberation would face a setback, since boards would be forced to respond to intensified pressure of current market valuation. For the republican, the issue of the staggered board represents a dilemma, which can only be resolved by devising better means of maintaining a desired equilibrium between internal governance and the external market for corporate control.

The republican concept of deliberation may be a technical subject of interest to historians and social theorists, but it is

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2006), *available at* http://www.nyse.com/press/1161166307645.html. As of the date of writing, Rule 452 remains unamended.

221. Typically the board will be divided into three classes, with one class subject to election to three-year terms each year. 59 percent of corporate boards in 1998 had a classified board. Lucian A. Bebchuk, John C. Coates IV & Guham Subramanian, *The Powerful Anti-Takeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 889, 893 (2002).

222. Strine proposes two systems of shareholder participation in the selection of directors, depending on whether a company has a staggered board. *See* Strine, *supra* note 190, at 1779.

223. *See* Bebchuk et al., *supra* note 221, at 891, 900.

224. By replacing only one-third of its members each year, the staggered board may force a bidder for corporate control to participate in two consecutive directorial elections to gain control of a majority of the board; meanwhile, the poison pill defense presents the bidder with the risk of having its shareholdings diluted by the exercise of warrants by other shareholders. *See* Allen, Jacobs & Strine, *supra* note 169, at 1095 n.85; Bebchuk et al., *supra* note 221, at 890, 904 (explaining that the poison pill defense made staggered boards important).

linked to other powerful legitimating concepts—the fairness of listening to the other side, equal shareholder franchise, and the use of the term republic itself. To the extent that it counsels consideration of different points of view, it also touches on the subject of the next section, corporate citizenship.

G. *Citizenship*

The recent popularity of the phrase "corporate citizenship" probably reflects a pairing of words that are redolent with positive political associations that and blend connotations of entitlement and obligation.[225] But the term citizenship also has a cultural resonance that owes something to its long history in the republican tradition.[226] A closer look at this tradition may allow us to speak more meaningfully of the implications of citizenship for corporations.

Liberty in the republican tradition is a quality of social life that exists in a polity that protects its members from the exercise of arbitrary power and relations of dependency.[227] In such a polity, the liberty of each individual is assured by a system of equal and reciprocal rights that guarantees the liberty of others. The liberty that I possess is secured by the liberty that you enjoy.[228] The preservation of liberty, republican writers insist, demands action in defense of the common interests of all members of the polity.[229] Thus, citizenship thus is not merely a

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225. *See* Jeanne M. Logsdon & Donna J. Wood, *Business Citizenship: From Domestic to Global Level of Analysis*, 12 BUS. ETHICS Q. 155, 155 (2002) ("language of corporate citizenship . . . appears to be replacing that of corporate social responsibility"); SANDRA WADDOCK, LEADING CORPORATE CITIZENS, VISION, VALUES, VALUE ADDED, at xii (global corporate citizenship popular topic in business press) *id.* at 193 (Boston College Center for Corporate Community Relations now renamed Center for Business Citizenship) (2005); Chris Marsden & Jorg Andriof, *Towards an Understanding of Corporate Citizenship and How to Influence It*, 2 CITIZENSHIP STUDIES 329 (1998).

226. *See* PETER RIESENBERG, CITIZENSHIP IN THE WESTERN TRADITION (1992); ADRIAN OLDFIELD, CITIZENSHIP AND COMMUNITY, CIVIC REPUBLICANISM AND THE MODERN WORLD (1990).

227. *See* SPITZ, *supra* note 85, at 143, 184-87; PETTIT, *supra* note 86, at 35-37.

228. *See* Spitz, *supra* note 173, at 336-40.

229. *See* VIROLI, *supra* note 85, at 11-17, 61-64; MAURIZIO VIROLI, FOR LOVE OF COUNTRY, AN ESSAY ON PATRIOTISM AND NATIONALISM 181-86 (1995); SPITZ, *supra* note 85, at 133, 143.

status of membership in a polity but an activity or practice of attending to public duties and responsibilities.[230]

The practice of republican citizenship does not require altruism or denial of self-interest; rather, it requires the capacity to work with others in pursuit of shared interests.[231] The classic phrase to describe this capacity is civic virtue, but today most people may feel more comfortable with Tocqueville's description of enlightened self-interest.[232] In the republican tradition, Viroli writes, "the common good is the good of all citizens who do not want to be oppressed and not desire to dominate."[233] All citizens gain from relations of mutual respect. The practice of citizenship, defined as the pursuit of common liberty, requires vigilant attention to the possibility of domination presented by concentrations of power in government, aggregations of private wealth, and alliances of the two. In particular, it calls for distrust of governing elites, which possess the power to manipulate public institutions for private benefit.[234]

Where does the corporation fit in this tradition of citizenship? For the public at large, the aggregations of wealth in corporate form represent a potential for effective action to serve shared interests but also a danger to common liberties.[235] The

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230. *See* OLDFIELD, *supra* note 226, at 5, 147-48; Cass R. Sunstein, *Beyond the Republican Revival,* 97 YALE L. J. 1539, 1557 (1988).

231. *See* OLDFIELD, *supra* note 225, at 139-46; *see also* ROBERT D. PUTNAM, MAKING DEMOCRACY WORK, CIVIC TRADITIONS IN MODERN ITALY 88-89 (1993) (discussing the republican heritage of citizenship in Northern Italy); MICHAEL WALZER, RADICAL PRINCIPLES 54-72 (1980) (describing the historical background and contemporary practice of citizenship in U.S.).

232. ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 498-99 (J. P. Mayer & Max Lerner eds., trans. George Lawrence, Harper & Row, 1966) (1835).

233. VIROLI, supra note 85, at 5. In political theory, republicanism may be distinguished from various forms of communitarianism, which put the interests of the community above that of the individual (*see* PETTIT, *supra* note 85, at 120-25) but republicanism may still be regarded as communitarian in the common usage of the term, that is, it affirms the value of social solidarity and devotion to public causes. *See* PUTNAM, *supra* note 231, at 87; OLDFIELD, *supra* note 226, at 145.

234. *See* VIROLI, note 85, at 12, 61, 66; SPITZ, *supra* note 85, at 133, 157, 164-65, 169.

235. Two recent articles discuss the positive potential and dangerous propensities of corporations propose opposing tacics strategies. *See* Kent Greenfeld, *Reclaiming Corporate Law in a New Gilded Age,* 2 HARV. L. & POL'Y REV. 1 (2008) (emphasizing dangers to common liberties and proposing

practice of citizenship may lead individuals to ally themselves with corporations to achieve public ends but also to work against concentrations of wealth and power in which corporations are embedded. For corporate managers, republican citizenship implies more than devotion to public causes; it also is served by the amenability of the corporation to regulation and to the influence of civic society. This does not mean that corporate citizenship calls for a self-imposed restraint. Instead, it requires relationships of reciprocity with those elements of society affected by corporate activities. The corporation itself stands to benefit, together with the rest of society, by a cooperative relationship, marked by trust and mutual respect, with its social and political environment.[236]

The American Law Institute ("ALI") had an opportunity to address corporate citizenship in drafting section 2.01 of the Principles of Corporate Governance, which defines "the objective and conduct of the business corporation," but, after much debate, it settled on a tentative draft that sought to balance the fundamental economic objective of the corporation with certain permissible public-spirited actions departing from this objective. It stated that corporate law

> should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain, except that, whether or not corporate profit and shareholder gain are thereby enhanced, the corporation . . . (a) is obliged . . . to act within the boundaries set by law, (b) may properly take into account ethical principles . . . and (c) may properly devote resources, within reasonable limits, to public welfare, humanitarian, educational, and philanthropic purposes.[237]

Commenting on a preliminary draft, Professor James White criticized section 2.01 for adopting a simplistic opposi-

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stakeholder governance); Aaron K. Chatterji & Barak D. Richman, *Understanding the "Corporate" in Corporate Responsibility*, 2 HARV. L. & POL'Y REV. 33 (2008) (advocating strategies to harness corporations specific competence in market).

236. *See* FRANCIS FUKUYAMA, TRUST, THE SOCIAL VIRTUES & THE CREATION OF PROSPERITY 5-11, 46-48, 355-62 (1995).

237. AM. L. INSTIT., PRINCIPLES OF CORPORATE GOVERNANCE, ANALYSIS AND RECOMMENDATIONS, Tentative Draft No. 2, at § 2.01 (Apr. 15, 1984).

tion between "making money" and "doing good" and called on the Institute to "integrate into a single view those elements of corporate life that the section places in false opposition to each other."[238] The appropriate concept, he argued, is citizenship:

> The corporation is and always has been a collective citizen. It serves not only its shareholders, but its bondholders and creditors of other kinds, as well as its employees and future employees, its suppliers and its customers. It has the proper aim not only of making money but of maintaining the conditions that make meaningful economic and social activity possible for itself and for others. It is a citizen, and I believe it should be spoken of as having both the responsibilities and benefits of that status.[239]

Professor White urged that the ALI adopt a very general statement to the effect that "the business corporation should always endeavor to act as a responsible citizen in its economic and other activities."[240] Such an open-ended statement, he argued, would establish the proper context for a productive public discourse,[241] while leaving it to the courts and other corporate actors to "give meaning to this standard as cases arise."[242] The ALI ultimately adopted section 2.01 in a form identical to the earlier draft, but added a Comment conceding something to Professor White's views.[243]

In other quarters, one also finds increasing acceptance of a broader definition of corporate objectives. In the *Unocal* decision, the Delaware Chancery Court construed the business

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238. James Boyd White, *How Should We Talk About Corporations? The Language of Economics and of Citizenship*, 94 YALE L. J. 1416, 1422 (1985).

239. *Id.* at 1418.

240. *Id.* at 1424.

241. *Id.* at 1424-25.

242. *Id.*

243. AM. L. INSTIT., PRINCIPLES OF CORPORATE GOVERNANCE, ANALYSIS AND RECOMMENDATIONS, § 2.01 (1994). Comment 9f on economic objective, however, was revised to recognize more explicitly the significance of corporate interdependencies with other elements of society: "The modern corporation by its nature creates interdependencies with a variety of groups with whom the corporation has a legitimate concern, such as employees, customers, suppliers, and members of the communities in which the corporation operates. The long-term profitability of the corporation generally depends on meeting the fair expectations of such groups."

judgment rule to allow consideration of the impact of a takeover bid on the network of relationships involved in the corporation's business activities. The board of directors, it held, may properly consider the "impact [of the bid] on the corporate enterprise," taking into account a range of factors, including "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[244] Over forty states have similarly enacted "other constituencies" statutes that allow the board of directors to consider the impact of an action on all constituencies of the corporation.[245]

Within the business community, the discussion of corporate citizenship frequently revolves around the maintenance of good relations with stakeholders, beginning with those necessary to business operations (i.e., shareholders, creditors, suppliers, customers) and extending outward to others who are affected by, or have the capacity to affect, corporate operations.[246] In its Principles of Corporate Governance, The Business Roundtable, an association of CEOs representing the business establishment, displays some deference to this point of view but insists on the "paramount [corporate] duty to optimize long-term shareholder value."[247] Obligations to stakeholders and society at large, in its view, may be viewed as part of this overriding duty:

> [S]hareholder value is enhanced when a corporation treats its employees well, serves its customers well, fos-

244. Unocal Corp. v. Mesa Petroleum Company, 493 A.2d 946, 955 (Del. Supr. 1985).

245. For a compilation of these statutes, *see* Ryan J. York, *Visages of Janus: The Heavy Burden of Other Constituency Anti-takeover Statutes on Shareholders and the Efficient Market for Corporate Control,* 38 WILLAMETTE L REV. 178, 189-90 (999). The Pennsylvania statute, for example, states that the board "may, in considering the best interests of the corporation, consider . . . [t]he effects of any action upon any or all groups affected by such action, including shareholders, members, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located." *See* 15 Pa.C.S.A. §515(a)(1).

246. *See, e.g.,* WADDOCK, *supra* note 225, at 4-14; James E. Post, *Global Corporate Citizenship: Principles to Live and Work By,* 12 BUS. ETHICS Q. 143, 149 (2002); Marsden & Andriof, *supra* note 225, at 329.

247. THE BUSINESS ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE 2005, at 31 (Nov. 2005), *available at* http://www.businessroundtable.org/search/index.aspy.

> ters good relationships with suppliers, maintains an effective compliance program and strong corporate governance practices, and has a reputation for civic responsibility.[248]

One may ask whether the definition of business purpose has much more than symbolic importance. It is true that issues relating to corporate purpose may sometimes enter into application of the business judgment rule, but it would be unwise for the courts or legislatures to venture beyond this narrow sphere of legal issues and attempt to translate standards of citizenship into affirmative fiduciary duties.[249] A vague fiduciary standard, which tries to serve multiple ends, will be difficult to enforce for any purpose.[250] I suggest, however, that corporate governance may indeed be designed in ways that are conducive to patterns of decision making that are more compatible with corporate citizenship. The republican ideas of contestatory democracy and deliberation both lead to relationships of reciprocity between management and corporate stakeholders, which are the hallmark of republican citizenship. Two other elements of corporate governance have particular relevance to citizenship: the shareholder resolution procedure and separation of power.

The shareholder resolution procedure is potentially a vehicle by which shareholders can bring social concerns to the attention of management, but it has generated polarization rather than dialogue. Ten years after passage of the Securities Exchange Act of 1934, the Securities and Exchange Commission ("SEC") first required the inclusion of shareholder proposals in the management proxy.[251] In the next fifty years, the procedure grew in complexity and cost. The regulations prescribe a series of thirteen, often vague and complex criteria for the appropriate subject matter of such proposals, together with requirements for eligibility and strict procedures in sub-

248. *Id.*

249. Among the states with other constituencies statutes, only Connecticut imposes an affirmative duty on the board of directors. *See* Conn. Gen. Stat. § 33-756(d) (1997); York, *supra* note 245, at 188. The statutes appear to be essentially symbolic since the business judgment rule gives managers wide discretion in any event. *See* Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2525-26 (2005).

250. *See* Murphy, *supra* note 75, at 116-17.

251. *See* Murphy, *supra* note 20, at 135-136.

mitting such proposals.[252] Yet management has consistently resisted such procedures, increasing costs for all concerned. A SEC study published in 1998 found that, on average, the companies surveyed spent $87,000 per year in processing proposals.[253]

In recent years, proposals directed at certain corporate governance reforms, such as anti-takeover defenses, have begun to gain widespread acceptance,[254] but proposals addressing the social or moral implications of management policies have had few successes.[255] A recent study revealed that while approximately 27 percent of shareholder proposals concerned social or environmental issues, such proposals seldom gained more than 20 percent of the shareholder vote.[256]

The ironic effect of the shareholder proposal procedure is to translate expressed social concerns, shared to varying degrees by the larger society, into costly and antagonistic procedural skirmishes. But in defense of management, it must be recognized that there are inherent problems in using the shareholder resolution procedure as a vehicle for such concerns. Although it may be easy to present a corporate governance issue, such as confidential voting, to a shareholder vote, suppose that a shareholder is concerned with employment practices that interfere with the child-rearing responsibilities

252. *See* LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1992-2060 (2000 rev.).

253. *See* Amendments to Rules on Shareholder Proposals, SEC Release No. 34-40018, 63 Fed. Reg. 29,106, 29,116 (May 28, 1998).

254. *See* Randall S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, 13 J. CORP. FIN. 368, 360, 375 (2007); GEORGESON, INC., ANNUAL CORPORATE GOVERNANCE REVIEW, *available at* http://www.georgesonshareholder.com (research and press releases).

255. In the 1990s the SEC also allowed proposals directed against employment discrimination. *See* LOSS & SELIGMAN, *supra* note 252, at 2041-42. During the Vietnam war era, the District of Columbia circuit allowed a proposal calling for the end of the manufacture of napalm. In memorable language, the court rejected "management's patently illegitimate claim of power to treat their vast resources as personal satrapies implementing personal political or moral predilections." Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 681 (D.C. Cir. 1979).

256. *See* Thomas & Cotter, *supra* note 254, at 374-75. The sample consisted of a survey of 875 firms from 2002-2004. The figure of 27 percent was calculated by adding the categories of environmental and social proposals and dividing by the total number of proposals.

of working parents or that the shareholder objects to corporate funding of organizations devoted to climate-change denial. It will be exceedingly difficult to address such complex social and environmental issues in a proposal that calls for a yes or no vote and is capable of effective implementation.

As applied to social and environmental proposals, the SEC regulations on shareholder proposals have no defenders, though critics may object to the procedure on contradictory grounds. Three reforms can be reasonably advocated: (1) exclude such proposals categorically to put an end to an unseemly and costly process that accomplishes nothing;[257] (2) lower the bar for such proposals to introduce a modicum of procedural fairness; or (3) devise an entirely different procedure to allow the public to engage in conversation with corporate management about complex issues of public importance. While, the literature on organizational dialogue[258] and internet applications may provide possibilities, a more old-fashioned approach might simply give eligible shareholder groups an opportunity to talk to a designated member of the board and to receive a written response.

The connection between separation of power and citizenship is by no means obvious, but in an article subtitled, *Neglected Dimensions of a Republican Separation of Power,*[259] the eminent sociologist, John Braithwaite, draws on a mass of empirical research to show that the separation of power within the business organization can facilitate an enlightened regulatory enforcement program. He first surveys the "deep practical difficulties in monitoring and deterring abuse of power."[260] In general, the more powerful the regulated actor may be, the greater the difficulties of successfully bringing an enforcement action. However, on the other hand, the worse the abusers may be, the more likely that many people are involved in their

257. A frequent position in legal literature. *See, e.g.*, Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation,* 45 ALA. L. REV. 879 (1994); George Dent, *SEC Rule 14(a)-8: A Study in Regulatory Failure,* 30 N.Y.L. SCH. L. REV. 1 (1985); Susan W. Liebeler, *A Proposal to Rescind the Shareholder Proposal Rule,* 18 GA. L. REV. 425 (1984).

258. *See, e.g.*, WILLIAM ISAACS, DIALOGUE AND THE ART OF THINKING TOGETHER (1999).

259. Braithwaite, *supra* note 139, at 305.

260. *Id.* at 308.

activities.[261] Many of these individuals may not benefit from the abuse but still have the power to prevent it, and some are likely to have internalized the values of a legitimate regulatory program to some degree. Such reluctant facilitators, who exist in every abusive organization, from the mafia to an exploitive insurance company, may be induced to participate in a dialogue that appeals to their public-spirited motivations or threatens to shame them for their role in the organization's activities.[262] An effective enforcement program, Braithewaite argues, relies on the first instance in the possibility of dialogue with potentially compliant individuals in the target organization. If this fails, various forms of deterrence can be employed, and lastly, there exists the remedy of incapacitation, i.e., putting the abuser out of business by injunction or license revocation.[263]

Effective business organizations, as we have seen, rely on internal control to detect and remedy deficient performance. These internal separations of power, though designed to assure accountability, also create opportunities for dialogue with an enforcement agency. For example, while serving as a commissioner in the Australian equivalent of the Federal Trade Commission, Braithwaite participated in an enforcement effort against a large carpet retailer employing deceptive marketing claims. The Commission offered a compliance program as a settlement, but it did not expect the company to accept the costly program. The retailer in fact capitulated and proposed its own rigorous compliance program. After learning of the marketing practices, the chairman of the board was outraged and emerged from semi-retirement to restore the company's reputation. Thus, the chairman's power served as an avenue for dialogue between the Commission and the company.[264]

This simple example suggests a more general pattern. Effective internal controls in a business organization create separations of power in the form of gatekeepers, auditors, monitors, and watchdog units of various kinds. Such plural

261. *Id.* at 324-26.

262. *Id.* at 326-40.

263. *Id.* at 333. In other studies, Braithwaite and colleagues have further developed this idea. *See, e.g.,* IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION, TRANSCENDING THE DEREGULATION DEBATE, 35-40 (1992); JOHN BRAITHWAITE ET AL, REGULATING AGED CARE, 276-80, 316-23 (2007).

264. Braithwaite, *supra* note 139, at 328.

separations of power multiply opportunities to appeal to the social responsibility of actors capable of preventing wrongdoing and permit reliance on dialogue as an initial approach to regulatory compliance. In contrast, a closed and autocratic organization is relatively impervious to dialogue as an enforcement tactic. The consequence is that the mechanisms of corporate accountability, even though devised for internal controls, serve the cause of corporate citizenship.

IV.
TWO OTHER CONSIDERATIONS

The central point of this essay is that ideas and values of the republican political tradition point to a plausible path toward corporate legitimacy. The republican elements of corporate government, which we have reviewed, can be seen more or less faintly in existing corporate structures and provide a basis for reform. But there are other possible strategies to advance the cause of corporate legitimacy. I have alluded in passing to powerful legitimating language of neo-liberalism originating in the ideas of Hobbes and Bentham. I will argue in the next two sections that republican elements in corporate government merit attention because they are broadly congruent with the goals of corporate self-regulation and effective economic performance—both legitimating features in themselves. My purpose is not to explore these fields in depth but only to sketch the reasons to see areas of congruence, and a general consistency, with the republican tradition.

A. *Self-Regulation*

The idea of self-regulation in the largest sense is linked to the architecture of life, which consists of self-organizing and interdependent systems.[265] Such a fundamental phenomenon of living systems can obviously be approached from many directions. Shann Turnbull, a corporate governance theorist with a background in electrical engineering, draws on the science of cybernetics to analyze the "information and control

265. *See, e.g.*, ENVIRONMENTAL LAW AND ECOLOGICAL RESPONSIBILITY: THE CONCEPT AND PRACTICE OF ECOLOGICAL SELF-ORGANIZATION (Gunther Teuber et al eds., 1994); John Mathews, *Holonic organizational architectures*, 15 HUM. SYS. MGMT. 27 (1996).

architecture" of the corporation."[266] He observes that the capacity of an institution to adhere to a desired standard through self-regulation always requires an independent control center, with access to a variety of information equal to the variety of its environment, and an ability to process information so as to generate corrective adjustments.[267]

The initial premises of Turnbull's cybernetic analysis rest solidly on common sense. A regulating center in an organization cannot maintain a desired standard unless it possesses the requisite independence to detect and correct deviations.[268] This independence may be assured by organizational structure, the possession of gate-keeping prerogatives, or it may be pursued by eliminating conflicts of interest that undermine independent decision-making. The kind of reforms indicated by the republican ideas of the rule of law and separation of power lead in this direction. Again, a self-regulating system will inevitably veer off course if it is not receptive to feedback from its environment.[269] In the context of corporate governance, this may occur as the result of systemic distortions of communication, adversarial relationships that block cooperative exchange of information, or ineffective feedback of information to the central governing centers. The republican ideas of contestatory democracy, deliberation, and citizenship all address aspects of these problems.

This cybernetic analysis, as proposed by Turnbull, tends to confirm that republican ideas do indeed take us on a course toward greater corporate self-regulation, but it is removed from the actual context of corporate governance. The unique feature of corporate governance from the perspective of self-regulation is that it consists of polycentric relationships that often take a predominantly tripartite form. The relationship among the auditing committee, the board of directors, and the shareholders represents such a tripartite relationship, but

266. Shann Turnbull, *Corporate Governance, Its Scope, Concerns, and Theories*, *in* 5 CORPORATE GOVERNANCE, at 415, 430 (2000).

267. Shann Turnbull, *Self-Regulation* 2-4 (July 6, 1997), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=630041.

268. Shann Turnbull, *Charters with Competitive Advantages*, 74 ST. JOHN'S L. REV. 89, 144 (2000); Shann Turnbull, *A New Way to Govern* 9-11 (New Economics Foundation, London, Working Paper no. 5, 2002).

269. *See* Turnbull, *supra* note 267, at 3-4; *see also* STAFFORD BEER, THE HEART OF ENTERPRISE 32, 89, 247, 272-344 (1979).

in reality it is more accurate to regard the auditing committee as part of a web of polycentric relationships involving management, independent board leadership, the independent auditor, legal counsel, shareholders, and government regulatory agencies.

Each of the relationships in this polycentric web presents the possibility of mutually beneficial cooperation of the kind that can sometimes emerge from repeated interactions of rational power-seeking individuals.[270] The introduction of a third party into these interactions may assist the emergence of cooperation in maintaining a desired standard—and thus serve a self-regulating function—because it allows each party to enhance their own power by facilitating cooperation between the other interacting parties.[271] But this scenario of cooperation can succeed only if the third party exerts some effective influence over others. The promise of polycentrism as a means of assuring adherence to a standard thus depends on empowerment of third parties, who are in a position to enhance cooperation between others and to further their own interest in doing so. It may therefore be promoted by endowing these third parties with sufficient power to enable them to promote cooperation among others adhering to the same standards of performance.[272]

An important, though not exclusive, focus of our discussion of republican values in corporate governance is the idea of enhancing shareholder influence. An empowered shareholder group may strengthen self-regulating polycentric relationships in two ways: it may *directly* monitor management performance, thus amplifying a very weak existing check in the polycentric structure of corporate governance; additionally, it may fortify the power of *other monitors* in the existing system of internal controls, such as the auditing committee, by giving these control centers a more independent power base.

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270. *See* ROBERT AXELROD, THE EVOLUTION OF COOPERATION (1984) (a seminal work in game theory demonstrating that stable cooperation can emerge from repeated interaction so long as both parties are sufficiently concerned about future payoffs). For an application of Axelrod's ideas to regulatory contexts, *see* John T. Scholz, *Cooperation, Deterrence, and the Ecology of Regulatory Enforcement*, 18 L. & SOC. REV. 179 (1984).

271. *See* AYRES & BRAITHWAITE, *supra* note 263, at 59, 71-78 (1992).

272. *Id.* at 84-86, 91-97.

The two strategies are, of course, complementary and may be mutually reinforcing; the pursuit of one form of shareholder empowerment in corporate governance, if successful, may stimulate interest in others. The pursuit of direct shareholder monitoring, however, must take into account the generally low level of shareholder interest in corporate governance. It is fair to say that the typical institutional shareholder, with diversified holdings, is content to remain a client of corporate shareholder relations departments, well removed from the centers of decision-making.[273] Only a few of the largest institutional shareholders have an interest in increasing stock value through corporate governance and the ability to gain the ear of top executives and directors.[274] This weak shareholder voice can be amplified and extended by reforms aimed at removing impediments to shareholder monitoring and increasing incentives for participation in corporate governance. But the ultimate degree of success of such reforms rests on many speculative considerations. Among other things, one may ask: what would be the shareholder response to removing restrictions on concerted action by shareholders in corporate governance? What is the effect of reforming the administrative structures of pension funds and investment companies that perpetuate passivity? To what extent is the problem of passivity self-correcting? In other words, will new avenues of shareholder influence, such as participation in the nominating process for board of directors, stimulate increased shareholder monitoring? Moreover, even if the shareholder voice can be significantly amplified, effective shareholder monitoring will

273. *See* MICHAEL USEEM, INVESTOR CAPITALISM: HOW MONEY MANAGERS ARE CHANGING THE FACE OF CORPORATE AMERICA, 168-207 (1996) (discussing corporate shareholder relations departments, middle-level departments that in effect carry out public relations with shareholders).

274. A 2004 survey of The Conference Board of the top twenty-five investors of the largest twenty-five publicly traded corporations provides a revealing look at the high degree of fragmentation of ownership that prevails. The two largest pension funds, CalPERS and TIAA-CREF, are among the institutional investors who actively engage in corporate governance issues, but, with one exception, they placed below the top ten in their stock holdings and usually held no more than 0.5 percent of the total stock of the corporation. *See* THE CONFERENCE BOARD, THE 2005 INSTITUTIONAL INVESTMENT REPORT 38-50 (2005). For the corporate governance policies of CalPERS and TIAA-CREF, http://www.calpers.ca.gov/index.jsp?bc=/about/press/news/invest-corp/home.xml.

necessarily be limited to the sphere of issues, such as the selection of an auditor, election of directors, and executive compensation, in which there is a rough parity of information between the shareholders and management. Diversified investors will seldom be able to exert a helpful monitoring influence over specialized business activities.

The uncertain potential of direct shareholder monitoring lends interest to the strategy of strengthening existing controls by linking them with the shareholder base. This strategy finds its most obvious application to the auditing function and board leadership. In the former, more direct shareholder links can relieve the problems of conflict of interest; in the latter, it may strengthen the leadership base of the board chair. A brief discussion of the existing weakness of these control centers may make my meaning more clear.

The institution of the independent auditor has always labored under a certain conflict of interest: accounting firms have an incentive to please the client who hires them, but they are expected to render independent opinions on financial statements that can be highly adverse to the client's desires.[275] The demise of Arthur Anderson revealed the increasing importance of practices that aggravate this inherent conflict of interest—a close long-term relationship with the client, the movement of personnel to and from the client and the accounting firm, and, in particular, the provision of profitable consulting services to client firms.[276] In 2003 the Sarbanes-Oxley Act responded to the accounting scandals with a series of measures that have been criticized as unduly harsh and costly, but it did not adequately address the core conflict of interest problem.[277]

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275. *See* Max Bazerman, Don Moore, Philip Tetlock & Lloyd Tanlu, *Reports of Solving the Conflicts of Interest in Auditing Are Highly Exaggerated*, 31 ACAD. MGMT. REV. 43 (2006).

276. Don A. Moore, Philip Tetlock, Lloyd Tanlu & Max Bazerman, *Conflicts of Interest and the Case of Auditor Independence: Moral Seduction and Strategic Issue Cycling*, 31 ACAD. MGMT REV 10, 15-16 (2006).

277. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002). For critical comment *see, e.g.*, MICHAEL F. HOLT, THE SARBANES-OXLEY ACT (2008); Robert A. Prentice & David B. Spence, *Sarbanes-Oxley as Quack Corporate Governance: How Wise is the Reserved Wisdom?*, 95 GEO. L. J. 1843 (2007); William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of "Going Private"*, 55 EMORY L. J. 141 (2006); Roberta Romano, *The*

Experimental social psychology indicates that conflicts of interest work powerfully at unconscious and unintended levels, even when deliberate fraud or deception is entirely absent. Moore et al., write: "Evidence on unconscious bias suggests that people are not very good at disregarding their own self-interest and evaluating information impartially, even when they try to do so."[278] People selectively rely on arguments and data serving their self-interest "without any awareness of this selectivity."[279] Research has shown that professionals are just as vulnerable to self-serving biases as layman, though they may sincerely believe themselves to be committed to high ethical standards.[280] Thus, Moore et al. conclude: "Once auditors learn and encode information from a partisan perspective, they are no longer able to objectively assess the data, and they view ambiguous data consistent with the preference of their clients."[281]

Without entering more deeply into the complex issues of auditor independence, I wish to point out only that corporate governance reforms offer ways to directly address the conflict-of-interest problem. By mitigating this core problem, it may be possible, by utilizing a series of other measures, to bring more closely within reach a more effective, and less costly, equilibrium than now exists. The Sarbanes-Oxley Act has in fact set the stage for such further reforms. The Act includes three constructive measures designed to shift the auditing firm's loyalty toward a relatively independent auditing committee: (1) the Act requires that the auditing committee, not the corporate management, hire the auditing firm;[282] (2) the auditing committee must consist solely of directors who meet formal criteria of independence from management;[283] and (3) the firm must make disclosures in financial reporting calculated to ensure that at least one member of the audit committee qualifies as a

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Sarbanes-Oxley Act and the Making of Quack Corporate Governance, 114 YALE L. J. 152 (2005).

278. Moore, et al. *supra* note 276, at 7; *see also* Max Bazerman, Kimberley Moran & George Loewenstein, *The Impossibility of Auditor Independence*, SLOAN MGMT. REV. 89, 91-93 (Summer 1997).

279. Moore, et al. *supra* note 276, at 7-8.

280. *Id.* at 8.

281. *Id.*

282. Sarbanes-Oxley Act of 2002 §§ 201(a), 202.

283. *Id.* § 301.

financial expert.[284] Though well conceived, these reforms are plainly weak because the financial expert can easily be co-opted, and the independent directors may be dominated by management or lack expertise to exert an independent influence. Nevertheless, the reforms might reach a threshold of genuine significance if combined with shareholder representation on the auditing committee.

The most viable proposals for shareholder participation in the nominating process for directorial elections contemplate a limited number of shareholder-nominated directors. Since the investment community has a depth of expertise in financial reporting, these shareholder-nominated directors might be expected to possess qualifications to serve on the audit committee, even if they lacked experience in other specialized business operations. There, they would be in a position to ally themselves with other more independent directors and to support a strong and experienced financial expert. In other words, it is reasonable to expect a synergism between the 2002 reforms and the representation of shareholder-nominated directors on the audit committee. The two reforms, both inadequate in themselves, could have a multiplicative effect in bolstering the committee's independence.

A shareholder right to propose the appointment of the outside auditor could add another degree of independence to the auditing function. Since the independent auditor in legal theory serves the interests of a corporation's shareholders,[285] it is anomalous that management has traditionally possessed effectively unchallenged power to select the auditor and secure a *pro forma* shareholder approval. This anomaly can be mitigated by giving major shareholders the power to propose the appointment of their own candidate for auditor through the management proxy. It may be objected auditors that need firm-specific knowledge, which could be lost by frequent changes in clients, and that contested nominations for auditor might result in costly proxy contests. Although both objections

284. *Id.* § 407.

285. As stated in United States v. Arthur Young & Co., 465 U.S. 805, 817-18 (1984), "[b]y certifying the public reports that collectively depict a corporation's financial status," the independent auditor "owes ultimate allegiance to the corporation's creditors and stockholders, as well as the investing public."

have some merit, it would be possible to calibrate a system of shareholder nominations of auditors to minimize such difficulties. A right of shareholder nomination could effectively enhance auditor independence even if it were normally kept in reserve by high procedural thresholds. Corporate management might hesitate to discharge an auditor giving a qualified opinion if it would risk a shareholder challenge, and accounting firms would know that an egregious restatement of financial condition or other sign of incompetence would risk arousing a shareholder challenge to their job.

As a second means to use the shareholder base to strengthen internal controls, we may consider the effect of enhanced shareholder power on the office of an independent board chair. Experience has shown that expanding the number of directors who meet a formulaic standard of independence is a weak and problematic reform. Directors who meet the standard of independence may turn out to be compliant or unprepared to monitor management. Conversely, the most active and competent directors may be within the CEO's circle of friends and associates.[286] The critical issues concern leadership of the independent board members. The NYSE and NASDAQ exchange rules, adopted in the wake of Sarbanes-Oxley, now require periodic executive sessions of independent directors[287] and corporations generally appoint a lead or presiding director to chair these executive sessions.[288] These measures, however, cannot supply the sort of ongoing and effective leadership that can be provided by an active board chair.

The practice of separating the offices of CEO and board chair has made slow progress in recent years. Today, only 10 percent of large corporations have a truly independent chair, though the number is larger if retiring CEOs and other non-independent categories are included.[289] The business literature reflects anxiety over the prospect that separation of the two offices can result in two rival leaders competing for influ-

286. *See* Murphy, *supra* note 20, 174-176.

287. NYSE, Inc., Listed Company Manual, § 303A.03 (2008); NASDQ Manual, Rule 4350(c)(2) (2008).

288. *See* SOC. CORP. SEC. & GOVERNANCE PROF'LS, INDEPENDENT BOARD LEADERSHIP: NON-EXECUTIVE CHAIRS, LEAD DIRECTORS AND PRESIDING DIRECTORS 5, 14 (2007).

289. *See* Stuart, *supra* note 170, at 20; THE CONFERENCE BOARD, CORPORATE GOVERNANCE HANDBOOK 2006, at 30-31 (2006).

ence with the board of directors.[290] However, the pitfalls of conflicting leadership roles can be avoided by giving the chair a distinct area of responsibility and a secure power base. A cooperative relationship between two power-seeking individuals, the CEO and the board chair, is most likely to evolve only when each enjoys sufficiently distinct and secure positions of power that they must work together to achieve common ends.[291]

Shareholder participation in corporate governance can help give the chair the independence necessary to carry out an effective leadership role. Shareholder-nominated directors will necessarily rely on the chair to secure access to information needed to discharge the monitoring duties that the shareholder base expects them to perform. Reforming the nomination process for directorships to include shareholder participation may thus serve to enhance the chair's position of influence on the board. Moreover, the chair is the logical person to preside over processes of communication with shareholders and the selection of shareholder representatives on the board.[292] The chair may thereby be able to cultivate relationships with major shareholders and newly appointed directors that will strengthen his or her position on the board. With links to the shareholder base, the chair will be better equipped to bring together all independent directors as a cohesive unit with a common commitment to effective monitoring of management performance.

This discussion of self-regulation began with general observations and led to a discussion of the auditing function and board leadership. My intention in discussing these areas of praxis has not been to narrow the republican perspective but rather to point to the feasibility of a central, stabilizing mechanism for a shareholder-based self-regulatory system. Other re-

290. *See, e.g.*, Charles M. Elson, *Separation Anxiety*, 82 HARV. BUS. REV. 10, 22 (Oct. 2004); Roberta S. Karmel, *Splitting the CEO & Chairman*, N. Y. L. J. (Dec. 23, 2004); Ben White, *Save the Chair for the Chief?*, THE WASH. POST, Feb. 7, 2003, at E1.

291. *See* Axelrod, *supra* note 270, at 170-73.

292. In the United Kingdom, the Combined Code on Corporate Governance, ¶ A.2.1 (June 2006), issued by the Financial Reporting Council, provides that the nominating committee is to be chaired by the board chairman or a non-executive director (who is presumably appointed by the chairman in most cases), *available at* http://www.frc.org.uk.

publican strategies, which may have a more oblique and limited self-regulatory effects, will find a more plausible context in an organization with strong central self-regulatory systems. Republican self-regulation thus may exhibit core systems of accountability with other features tending to assure added responsiveness to the social environment. In the end, as Philip Selznick observes, "What we can do is enlarge horizons and extend accountability."[293]

B. *Effective Economic Performance*

The idea of strengthening and extending the republican elements in corporate governance must ultimately meet the test of effective economic performance. It is an ambiguous test; there are always different paths toward a business objective, presenting a speculative range of outcomes, and the relative profitability of one or the other may be contingent on unpredictable circumstances and improvisations. But it is a decisive test; no reform will advance corporate legitimacy that does not satisfy the expectation of effective economic performance.

Without attempting to survey complex socio-economic issues, I wish to address merely how the pertinent questions regarding economic performance should be framed. It is commonly assumed that a price in terms of reduced economic performance must be paid for bringing political-social values into corporate decision-making. "The trick" Craden writes, "is to ensure that the price is not higher than is strictly necessary."[294] As applied to corporate governance reforms, the question then becomes what price in terms of economic performance should be paid for socially or politically oriented reforms.

While such a tension between social and economic goals may be frequently encountered in social policy issues, I suggest that it is not presented by republican elements in corporate governance. Emphasizing these elements in corporate governance offers an uncertain but distinctly realistic possibility of *improving* corporate economic performance. Any reform that disrupts established ways of doing things may, of course, have unforeseen consequences, leading to a different set of problems than those it addressed. But this possibility does not

293. SELZNICK, *supra* note 37, at 321.
294. CRADDEN, *supra* note 29, at 2.

pose the question of the appropriate price for republican reforms; it raises only the question of the risks entailed in a reform agenda. The question of the impact of reform on economic performance, if framed in terms of risk, is more amenable to an affirmative answer. It is far easier to advocate reforms having a range of possible outcomes, ranging from a net benefit to a net cost, than it is to argue that the price paid for social goals is justified by non–economic benefits. I will limit this brief comment to listing the reasons to suppose the republican reforms, if properly designed, may have a positive impact on corporate performance.

1. *Deregulation*

Accepting improved corporate self-regulation as a practical goal necessarily poses the question of possible deregulation. I suggest that there are three distinct issues: (a) the mitigation of back-end sanctions permitted by front-end improvements in the processes of decision making; (b) the introduction of schemes of mandated self-regulation that are more flexible and efficient than current controls; and (c) relief from the discipline imposed by the market for corporate control.

Ayres and Braithwaite observe that front-end participation of a public interest group in a regulatory system is more empowering than giving the group a back-end opportunity to challenge regulatory outcomes in the courts.[295] The same may be said of front-end improvements in the corporation's capacity for self-regulation. The back-end sanctions in this case consist of the draconian criminal penalties of the Sarbanes-Oxley Act[296] and extension of civil liability for misstatements in financial reporting.[297] These penalties have an array of undesirable side effects: they discourage qualified individuals from seeking positions on corporate boards; they waste executive and board time in formalistic procedures designed to insulate decisions from legal challenge; they shift attention from long-term, risk-taking corporate strategies; and they preserve out-

295. *See* AYRES & BRAITHWAITE, *supra* note 263, at 77-78.

296. Sarbanes-Oxley Act of 2002, §§ 3(b)(1).

297. *Id.* § 304. For a review of civil liabilities under the Exchange Act of 1934, *see* DIANE E. AMBLER, ET AL, SARBANES-OXLEY ACT: PLANNING AND COMPLIANCE § 2.02(13)(b), at 2-25 (2008).

moded hierarchical structures in business organizations by placing critical responsibility on top officers.[298] A range of front-end improvements in corporate self-regulation were suggested in our discussion of republican elements of corporate governance, with particular emphasis on enhanced shareholder participation.

While it may sometimes be desirable to dismantle a system of regulation,[299] the more plausible alternative at the level of corporate governance is to introduce a scheme of mandatory self-regulation. Regulatory agencies have long required private rule making on matters beyond their own competence. For instance, civil aviation authorities throughout the world require airlines to submit flight plans to a regulatory agency.[300] This mode of enforcement acquires teeth if (a) the private firm is required to submit its rules for agency approval and (b) sanctions are imposed for violations of the rules.[301] Under favorable circumstances, such mandated self-regulation can produce a tailor-made system of regulation that is more rational, flexible, and cost effective.[302] Accounting rules and procedures are amenable to such a scheme.[303] Section 404 of the Sarbanes-Oxley Act can in fact be read as mandating a form of

298. *See* Lipton, *supra* note 10, at 1379-81.

299. *See, e.g.*, JOHN BRAITHWAITE, TO PUNISH OR PERSUADE: ENFORCEMENT OF COAL MINE SAFETY 120-25 (1985); Murphy, *supra* note 216, at 529-531 (arguing that a reform of pension plan administration modeled after the British Pension Act 1995 would provide a strong argument for removing many of the administrative burdens of the Employee Retirement Income Security Act of 1974).

300. AYRES & BRAITHWAITE, *supra* note 264, at 116.

301. *Id.* at 101-08.

302. Mandated self-regulation can also be an excuse for regulatory inaction. A considerable literature explores the circumstances that call for self-regulation in the area of environmental and social welfare policies. *See, e.g.*, AYRES & BRAITHWAITE, *supra* note 263, at 101-132; JOSEPH V. REES, REFORMING THE WORKPLACE: A STUDY OF SELF-REGULATION IN OCCUPATIONAL SAFETY 9-10 (1988); EUGENE BARDACH & ROBERT A. KAGAN, GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS 217-42 (1982); Cary Coglianese & David Lazer, *Management-Based Regulation: Prescribing Private Management to Achieve Public Goals*, 37 LAW & SOC'Y REV. 691 (2003); Neil Gunningham & Joseph Rees, *Industry Self-Regulation: An Institutional Perspective*, 19 LAW & POL'Y 363, 365 (1997); Darren Sinclair, *Self-Regulation Versus Command and Control? Beyond False Dichotomies*, 19 LAW & POL'Y 529 (1997).

303. *See* John Braithwaite, *Enforced Self-Regulation: A New Strategy for Corporate Crime Control*, 80 MICH. L. REV. 1466, 1473-74 (1982).

self-regulation by requiring publicly traded companies to establish and maintain "adequate internal control structures and procedures for financial reporting."[304] The much criticized administrative burdens of this section might be eased, without any relaxation of regulatory standards, by borrowing from experience in mandated self-regulation in other fields.

The last option for deregulation—relief from the pressure of the market for corporate control—takes us beyond the pale of contemporary debates on corporate governance. The corporate critics and activists who have captured the mantle of reformers generally call for strengthening of this form of corporate discipline.[305] But whatever may be its beneficial effects may be, the costs of the contest for corporate control are well known: relentless pressure for short-term decision making, the disruption of employee communities, and the burdening of target firms with acquisition debt.[306] If corporate governance reforms should succeed in significantly strengthening internal checks on decision-making, the reforms should lead to changes in the decision-making processes affecting takeover bids to reflect the reduced need for this kind of external control.

2. *Decision-Making Research*

Progress toward deregulation in each of these modes may be expected to simplify decision-making processes and avoid expenses now associated with regulatory compliance. The more fundamental issue, however, concerns the impact of reforms on organizational competence, which alone can justify

304. Sarbanes-Oxley Act of 2002 § 404.

305. *See* GEORGESON, INC., 2008 ANNUAL CORPORATE GOVERNANCE REVIEW (2008) (documenting the annual assaults on classified boards and poison-pill defenses by activist shareholders), http://www.georgeson.com/usa/download/acgr2008.pdf. Professor Bebchuk is perhaps the most influential of these corporate critics. *See, e.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) (advocating shareholder right to change "rules of the game" so as to strengthen shareholder influence over management).

306. *See, e.g.*, Dean Baker & Archon Fung, *Collateral Damage: Do Pension Fund Investments Hurt Workers?*, *in* WORKING CAPITAL: THE POWER OF LABOR'S PENSIONS 13, 22-28 (Archon Fung, Tessa Hebb & Joel Rogers eds., 2001); MARY O'SULLIVAN, CONTESTS FOR CORPORATE CONTROL: CORPORATE GOVERNANCE AND ECONOMIC PERFORMANCE IN THE UNITED STATES AND GERMANY (2000).

deregulation.[307] Decision-making research in recent decades supports the desirability of organizational elements that turn out to be remarkably consistent with republican ideas. I have discussed this subject at length in a recent article and will briefly mention two considerations here: the value of an outsider perspective and the value of intellectual diversity.[308]

Research has revealed that humans are adapted to overcome obstacles and harbor benign illusions about their ability to do so. Optimism is the indicator of mental health and vigor, both in individuals and organizations.[309] In business planning, however, optimism can lead to foolish decisions, as evinced by the number of failed new products and business acquisitions. There are moments in the decision-making process, before important commitments are made, or when such commitments are assessed, when strict realism is needed. These occasions often involve a second decision-making bias: the tendency to follow commitments implied in earlier decisions. Though persistence is a virtue in the ordinary spheres of human life, the worst debacles in business are frequently caused by an inability to recognize and correct mistaken decisions that appeared quite reasonable when they were first made.[310]

These cognitive biases may be counteracted by injecting an outsider's perspective in decision-making. The republican ideas that we have reviewed all favor strategies to bring a broader perspective into corporate governance, but the central issues again concern the role of shareholders in corporate governance. In light of decision-making research, the relevant

307. In an essay linking self-regulation to a sociological theory of institutions, Selznick argues that "moral competence . . . must be built into the social structure of the enterprise" and that such moral competence "includes the capacity for self-regulation." PHILIP SELZNICK, *Self-Regulation and the Theory of Institutions, in* ENVIRONMENTAL LAW AND ECOLOGICAL RESPONSIBILITY: THE CONCEPT AND PRACTICE OF ECOLOGICAL SELF-ORGANIZATION, 395, 398 (Gunther Teubner, Lindsay Farmer & Declan Murphy eds., 1994).

308. *See* Murphy, *supra* note 20, at 156-160, 173-174. For an introduction to decision-making research relevant to corporate governance, *see* J. RICHARD HACKMAN, GROUP INFLUENCES ON INDIVIDUALS IN ORGANIZATIONS (1973); Khurana & Pick, *supra* note 207; MAX H. BAZERMAN, JUDGMENT IN MANAGERIAL DECISION MAKING (6th ed. 2006).

309. *See* SHELLEY E. TAYLOR, POSITIVE ILLUSIONS, CREATIVE SELF-DECEPTION AND THE HEALTHY MIND (1989) and sources cited in Murphy, *supra* note 20, at 159-160.

310. *See* sources cited in Murphy, *supra* note 20, at 161-163, 172-173.

consideration is that a shareholder voice has the potential of improving decision-making process by contributing an outsider's perspective, even if individual shareholder representatives are less well informed about core business operations than corporate insiders.[311]

The connection between intellectual diversity and successful decision making is by no means simple. In general, social cohesion is a measure of group effectiveness and may be absolutely essential in a group, such as the corporate board, that is faced with complex tasks and conflicting goals. But group cohesion can sometimes suppress dissenting views, leading to the phenomenon known as groupthink. Empirical research shows that the consideration of dissenting views in a decision-making process can lead to more robust decisions, even when those views are wrong. Other research reveals that creativity can be stimulated by contact with different ways of thinking either within or outside the decision-making group.[312]

This research suggests the need to somehow combine group cohesion with intellectual diversity.[313] The desideratum is to form a team—consisting of members' different views, talents, and backgrounds—that can work well together in pursuing a common goal. The critical variables lie in the quality of leadership and the corporate culture, but the design of corporate governance can make a contribution. By establishing "regularized forms of openness"[314] to the corporate environment, it can breach the inner circle of corporate insiders and bring an acceptance of diverse perspectives into the corporate culture.

3. *The Innovative Enterprise and Corporate Governance*

Theories of corporate governance have been closely linked to neo-classical ideas of efficient markets, but—without denying the importance of this body of scholarship—these theories do not address the element of innovation in economic systems.[315] In fact, a school of thought in economics

311. *See* Pound, *supra* note 171, at 95.

312. *See* sources cited in Murphy, *supra* note 20, at 158.

313. *See* Hackman, *supra* note 308, at 254.

314. The phrase is taken from Selznick, supra note 307, at 398.

315. Mary O'Sullivan, *The Innovative Enterprise and Corporate Governance*, 24 CAMBRIDGE J. ECON. 393, 394-402 (2000).

and management science maintains that innovation represents the most important dynamic in economic growth and business adaptation to changing conditions.[316] In this context, innovation is broadly understood as "the process through which productive resources are developed and utilized to generate higher quality and/or lower cost products than had previously been available."[317] Innovation is engendered within the social structure of an economic enterprise, rather than by competition. The products resulting from innovative processes establish the parameters of competition after they enter the market.

In an article in the Cambridge Journal of Economics, entitled "The innovative enterprise and corporate governance," Mary O'Sullivan explores the implications of the process of innovation for corporate governance. Economic research on innovation, she contends, "demonstrates the need to bring the analysis of innovative enterprise into the corporate governance debates."[318] She concludes, "Given the centrality of the process of innovation in the performance of dynamic economies, therefore, the types of corporate governance that will promote economic performance can only be determined within the conceptual framework that incorporates an analysis of the economics of innovation."[319]

O'Sullivan's challenge to give the economics of innovation its rightful place in discussions of corporate governance is one that students of the republican tradition will welcome. There is a broad consistency between the structures of the innovative enterprise, which she describes, and the elements of corporate governance answering to republican ideas. At the cost of oversimplifying her argument, I will highlight a few salient points in O'Sullivan's article and juxtapose them with strands in republican thought.

First, innovation involves a process of learning that unfolds over time. "What one learns changes how one conceives of the problem to be addressed, the possibilities for its solu-

316. *See, e.g.*, William Lazonick, *The Theory of the Market Economy and the Social Foundations of Innovative Enterprise*, 24 ECON. & INDUS. DEMOCRACY 9, 19-25 (2003); RICHARD NELSON, TECHNOLOGY, INSTITUTIONS, AND ECONOMIC GROWTH (2005); GEORG VON KROGH, KAZUO ICHIJO, & IKUJIRO NONAKA, ENABLING KNOWLEDGE CREATION (2005).

317. O'Sullivan, *supra* note 315, at 393.

318. *Id.* at 413.

319. *Id.* at 414.

tion, and the appropriate direction for further learning."[320] Accordingly, decision makers "require control to keep resources committed to the innovative strategy until the learning process has generated the high quality, lower cost products that enable the investment strategy to reap returns."[321] The republican idea of contestatory democracy lends itself to a self-regulatory mechanism that will identify and correct abuses without disrupting the organizational continuity that fosters innovation.

Second, for effective and strategic decision-making, decision makers need to be participants in the learning process: "When the basis for the generation and transmission of learning is an organizational process, strategic decision makers need to be integrated into the network of relations that underlie it; they must be insiders to the learning process to allow strategy and learning to interact in the process of innovation."[322] In a large organization, this principle will militate against hierarchical organization and in favor of the devolution of strategic responsibility to discrete organizational units—a concept consistent with a republican separation of power.

Third, innovation involves a process of organizational learning. "How work is integrated shapes the way in which people interact in the performance of their work and the working relationships that they establish with one another. The organization of work thus shapes the opportunities for the transmission and transformation of knowledge in a process of collective learning."[323] Effective interaction among employees will be facilitated by breaking down systemic distortions in the flow of information and broadening possibilities of contact between different spheres of activity—strategies corresponding to the republican idea of deliberation.

Fourth, the conditions for effective allocation of resources to generate innovation "support *organizational control* in contrast to *market control* over the critical inputs to the innovation process: knowledge and money."[324] The elements of corporate

320. *Id.* at 407.
321. *Id.* at 410.
322. *Id.* at 411.
323. *Id.* at 408.
324. *Id.* at 410.

governance that we have identified with the republican tradition tend to offer at least a partial alternative to the discipline of market control.

V.
AN ECONOMIC REPUBLIC?

My purpose has been only to survey the relevance of the republican tradition to corporate legitimacy. I do not wish to offer this essay as a distinct theory of corporate governance. Such a theory must be centered on the strongest norm: effective economic performance.[325] The essay seeks instead to demonstrate that legitimacy is an important criterion for evaluating corporate governance; that the republican political tradition lends itself to a theory of corporate legitimacy; and that a structure of corporate governance shaped by republican ideas is potentially compatible with self-regulation and effective economic performance.

Some caution, however, is called for in proposing new reforms for large, public corporations at a time when they are still adjusting to the impact of the Sarbanes-Oxley Act. This drastic legislative measure appears to have stimulated a trend toward privatization, though the causal relationships are debated.[326] Apparently, it has prompted a decline in listings by foreign companies on U.S. exchanges, an increase in foreign listings by U.S. companies, and a reduction in the U.S. share of the global IPO market.[327] Any reform program that would add another layer of unpopularity to the U.S. regulatory system would make U.S. capital markets less competitive and might even cause investors to assign a net negative value to corporations being publicly traded in the U.S.—a result that would unravel the objectives of reform. I have suggested the possibility of selective deregulation to minimize the chance of such adverse outcomes, but the problem cuts deeper. Any serious proposal to strengthen the internal governance of the large

325. *See* Eisenberg, *supra* note 18.

326. *See, e.g.*, Christian Leuz, *Was the Sarbanes-Oxley Act of 2002 Really This Costly?*, 44 J. ACCTG & EC. 146 (2007); William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: the Irony of 'Going Private,'"* 55 EMORY L. J. 141 (2006); Michael E. Lewitt, *The Market at Mid-Year*, TRUSTS & ESTATES, at 30 (June 2007).

327. *See* Holt, *supra* note 277, at 47-50, 75.

public corporation leads inevitably to questions, which are beyond the scope of this essay, concerning the appropriate balance between the market for corporate control and the institutional integrity of the publicly traded corporate sector.

The study of corporate governance has quite properly emphasized the empirical methods of the social sciences. The concept of legitimacy should also, so far as possible, be put to an empirical test. But the republican theory of corporate legitimacy, which I have presented, rests in part on corollaries of an idea of liberty that eludes empirical proof. The issues were revealed in 17th century debates between English republicans and their arch-adversary, Thomas Hobbes. Does liberty consist of the absence of interference? Or the absence of dependence or domination? Is the slave of a good master free? One may argue the point back and forth, but it will never be possible to prove one's position by a cost-benefit analysis. For this reason, the case I have presented will ultimately be persuasive only to those who place an intrinsic value on republican liberty.[328]

328. For a contrary view of republican liberty, *see* Bebchuk, *supra* note 305, at 842 (positing that there is no "intrinsic value" in shareholder democracy).