THE SHAREHOLDER DEMOCRACY LIE

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Abstract

"Shareholder democracy" is frequently invoked, with companies, shareholder activists, mass media, and industry titans leveraging the term for their own benefits. But from its inception in the 1920s, the rhetoric has never been rooted in traditional notions of democracy such as principles of equity, equal opportunity, voice, and voting. By engaging in an historical analysis of share ownership and the development of proxy voting, this Article debunks the shareholder democracy rhetoric, brings to the forefront the structural failure of shareholder plumbing, and exposes the myths of equity and equal opportunity in shareholding. It explains why the rhetoric should be laid to rest.

As the word's etymology suggests, democracy means rule by the people or power of the people. But shareholder democracy is neither rule nor by the people. Especially now that most shares are held and voted by institutions rather than by individuals, shareholding does not provide power to the people. Rather, it concentrates the power in the hands of a few institutions -- the Big Three, other powerful funds, and proxy advisory firms. We expose the roots of uneven share ownership, and the current make up of share owners. It also reminds the reader that hegemonic powers hold up collective decision-making, impairing democratic processes.

Historically, access to shares was a prerogative of White people. Share ownership has been predominantly male. Discrimination in employment opportunities in the 20th Century caused selective access to share ownership across demographics. Employee stock ownership plans combined with discriminatory employment practices have contributed to keeping historically underrepresented groups out of the stock market.

Uneven access to shares has been compounded by institutionalization of investments along with the increasing power of proxy advisory services, which effectively govern a monstrous voting power without holding any stakes in the issuers. Preponderance of institutional investors over individual investors accompanied by the governance dominance of proxy advisory services disenfranchise human shareholders. Moreover, the current U.S. federal proxy regulation framework is rooted in a model designed to suit the governance infrastructure of past centuries. Despite being adopted under the guise of shareholder democracy, the current proxy system fails to provide a collective decision-making mechanism informed by a principle of equity and equal opportunity.

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As a result, people are driven away from voting even when they own shares directly, leaving little to no relevance to the role of the demos *in corporate governance.*

This Article connects the dots to reveal an uncomfortable reality: shareholder democracy is a lie told to appease citizens and investors while entrenching the power of the elite. A careful assessment of shareholding and its dynamics prevents scholars, professionals, and lay people from being captured by a rhetorical device that taints a fair and fruitful debate on the current corporate governance model and its features.

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INTRODUCTION

The term “shareholder democracy” is having a renaissance. Companies, activists, industry titans, and mass media all leverage the term.[1] Some have even claimed it as a consensus point

[1] *See, e.g.*, Betsy Atkins, *Musk Comp Overturned: Is Shareholder Democracy at Risk?* (Feb. 2, 2024), https://www.forbes.com/sites/betsyatkins/2024/02/02/is-shareholder-democracy-at-risk/ [https://perma.cc/MRA3-LVB4] (arguing Delaware Court of Chancery’s striking down of executive compensation plan authorized by

between shareholder primacy and stakeholderism.[2] But the term is used without careful definition or analysis. Shareholder democracy is neither democratic nor even shareholder centered. At best, it is mythical propaganda, at worst a lie.

Shareholder democracy refers to shareholder participation in corporate governance by being able to voice their opinions typically via shareholder proposals and voting on matters permitted under corporate law. Shareholder democracy inherently requires access to and ownership of shares which is the entry point for shareholders to have a voice and a vote in corporate elections and on other limited corporate matters. However, the historical roots of the term shareholder democracy reveal that from the beginning reliance on the term has been rhetorical. It was not truly about providing a broader individual access to company shares nor was it being used to develop the voice of shareholders in corporate governance. First popularized in the 1920s,[3] the term shareholder democracy attempts to legitimize a form of governance that defies ordinary democratic norms.[4] The true function of shareholder democracy was to limit calls for the radical reform of corporate law into a more representative or answerable form by encouraging investment by the masses.[5] The related term "corporate democracy" has a similar history and has been used in lieu of shareholder democracy since at least the 1930s to refer to shareholder participation in corporate governance.[6]

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overwhelming majority of shareholders "overturns the notion of shareholder democracy"); Meg James, *Disney slams proxy fight rival Nelson Peltz in political-style ad* (Mar. 11, 2024), https://www.latimes.com/entertainment-arts/business/story/2024-03-11/disney-slams-proxy-fight-rival-nelson-peltz-in-political-styled-ad [https://perma.cc/7EVF-U8NW] (quoting shareholder activist stating that classifying the activist as an "infiltrator" is "offensive and highly dismissive of shareholder democracy"); Kevin Crowley, *Exxon Vows to be 'Forceful Advocate' for Shareholder Democracy* (May 29, 2024), https://news.bloomberglaw.com/esg/exxon-shareholders-vote-with-board-on-all-proxy-proposals [https://perma.cc/T7SK-P5CH] (quoting Exxon Mobil CEO as stating, "[f]or shareholder democracy to thrive, abuses of the process must be addressed. You can count on us to do our part"); Jeff Sommer, *Millions of Fund Investors Are Getting a Voice*, N.Y. TIMES (Feb. 23, 2024) (stating "the growth of index funds has had the unintended consequence of diminishing shareholder democracy" and pass-through voting is "not true shareholder democracy, but it's progress."); Broadridge, *Pass-Through Voting* (last visited July 14, 2024), https://www.broadridge.com/article/wealth-management/pass-through-voting (arguing "advocates for shareholder democracy say that pass-through voting could be a great way to bring [retail] investors into the process"); *see also* Doron Levit, Nadya Malenko, & Ernst Maug, *Trading and Shareholder Democracy*, 79 J. FIN. 257, 262 (2024) (recognizing a "general movement to shareholder democracy").

[2] Peter Vanham & Nicholas Gordon, *Elon Musk and Larry Fink—ideological opposites—find common ground: the pursuit of shareholder democracy* (June 12, 2024), https://finance.yahoo.com/news/elon-musk-larry-fink-ideological-095224799.html [https://perma.cc/VCN9-UCC2].

[3] JULIA C. OTT, WHEN WALL STREET MET MAIN STREET: THE QUEST FOR AN INVESTORS' DEMOCRACY 5 (2011) ("By the end of the 1920s, one particular set of answers—an ideology of *shareholder democracy*—reigned supreme."). Some mistake the rise of the term "shareholder democracy" to have occurred later in the 20th Century. *See, e.g.*, Andrew Ross Sorkin, *How Shareholder Democracy Failed the People*, N.Y. TIMES (Aug. 20, 2019), https://www.nytimes.com/2019/08/20/business/dealbook/business-roundtable-corporate-responsibility.html (implying incorrectly that shareholder democracy arose in the 1970s).

[4] *See* OTT*, supra* note 3, at 5 (explaining that shareholder democracy was first perpetuated by the NYSE, large companies, and financial firms to meet their own goals but was quickly adopted by others seeking to "bring corporations in line with democratic political traditions").

[5] *See id.* (describing how Wall Street adopted shareholder democracy to fight government regulation and interference in corporate law).

[6] Franklin A. Gevurtz, *The Complex Dualisms of Corporations and Democracy*, 14 NORTHEAST. U. L. REV. 365, 372 (2022) (recognizing how shareholder democracy and corporate democracy is used interchangeably).

Proponents borrowed the term "democracy" from political democracy to convince shareholders that they had rights like those of the average citizen in a political setting.[7] But nothing could be further from the truth. Notwithstanding the close parallels between corporate and political governance, corporations and their governance have little in common with political democracy.[8] Democracy, in the modern era, is a device to allow people of varying moral and cultural commitments, values, religions, and ethnicities to live together in relative peace and without gross oppression.[9] It is defined by a commitment to treat the interests of all members of the governed population as constituting the interest of the state (or, the "general Welfare," in the language of the United States Constitution[10]). To serve these interests, political democracies typically employ a variety of processes.

These processes include mass voting, majority rule, and rotation in office; combined, these limit elite use of state violence as an enforcer of private power and exploitation.[11] Majority rule has an obvious appeal—better that more people be satisfied than fewer.[12] But a majority vote cannot transform wrong into right; majority oppression is only marginally better than minority oppression.[13] So, democracies are never merely based on majority rule; they also incorporate basic liberal individual freedoms from collective control and protections to assure the elections are not a one-and-done affair.

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[7] *See* OTT, *supra* note 3, at 4-7 (detailing the historical development of shareholder democracy).

[8] *See infra*, Part I.B; Leonard H. Axe, *Corporate Proxies*, 41 MICH. L. REV. 38, 39 (1942); John Morley, *The Common Law Corporation: The Power of The Trust in Anglo-American Business History*, 116 COLUM. L. REV. 2145, 2157-59 (2016); Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy*, 63 WASH. U. L. REV. 1389, 1397 (2006) ("[C]orporations and political states are marked by differences so fundamental that it is dangerous to extrapolate lessons from one realm to the other.")

[9] THE FEDERALIST NO. 51, at 352-53 (James Madison) (Jacob Ernest Cooke, ed., 1961) ("In the extended republic of the United States, and among the great variety of interests, parties, and sects which it embraces, a coalition of a majority of the whole society could seldom take place on any other principles than those of justice and the general good.").

[10] U.S. CONST., pmbl.; *see also* Jean Jacques Rousseau, *The Social Contract* (1762), *in* THE SOCIAL CONTRACT AND DISCOURSES 43-4 (G.D.H. Cole ed., 1923) (describing how society's preservation requires individuals to act in concert for the overall benefit of society).

[11] THE FEDERALIST NO. 10, at 56 (James Madison) (Jacob Ernest Cooke, ed., 1961) (arguing in favor of a larger republican structure and more widespread voting to combat elite influence and the probability of electioneering); *see* Rousseau, *supra* note 9, at 111 (outlining that more active participation in the political process, the more likely it is that the general will, will be highlighted); *see also* Cary Coglianese, *Democracy and Its Critics*, 88 MICH. L. REV. 1662, 1662 (1990).

[12] Brett W. King, *Wild Political Dreaming: Historical Context, Popular Sovereignty, and Supermajority Rules*, 2 U. PA. J. CONST. L. 609, 609 (2000); Daniel Wodak, *The Democratic Imperative to Make Margins Matter*, 82 MD. L. REV. 365, 372 (2023).

[13] *See* Wodak, *supra* note 11, at 372 ("The simplest argument for majority rule turns on the perversity of the alternative--minority rule."); *see also* Rousseau, *supra* note 9, at 53 ("It follows from what has gone before that the general will is always right and tends to the public advantage; but it does not follow that the deliberations of the people are always equally correct.").

Basic liberal freedoms are equally important to ensure majority rule.[14] First, that the stakes of politics are not so high as to cause losers to reject its legitimacy.[15] Second, to limit the ability of winners to use the powers of office to entrench themselves in office.[16] This entails certain basic freedoms and protections for all individuals that seek to limit the scope of politics while at the same time preserving the impermanence of victory.[17] Little of this is reflected in shareholder democracy. In sharp contrast to political democracy, corporate governance has little commitment to collective self-government, limits on the powers of incumbents, protections against incumbents' use of office to maintain power, freedom of criticism, or other basic liberal protections.[18]

The term democracy means rule by the people.[19] But corporate "democracy" is neither democratic nor rule.[20] Democratic participation is a farce when the infrastructure in place excludes people from taking part in decision-making, and barriers to entry limit participation to categories of people and undermine democratic endeavors at their core.[21] Centuries of discrimination with respect to who has the wealth, or the legal right to use their wealth, to invest in company shares, mean that share ownership reflects both past and present inequities, to the detriment of minorities and, indeed, people of ordinary or less wealth generally.[22] Discrimination in employment opportunities in the 20th Century with a corresponding lack of access to share ownership via employee stock ownership plans ("ESOPs") have contributed to keeping historically underrepresented groups out of the stock market.[23]

Even to the extent average citizens hold company stock, the ordinary human shareholder is practically disenfranchised.[24] The proxy system which has developed over the past 100 plus

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[14] Nelson Lund, *Rousseau and Direct Democracy (With a Note on the Supreme Court's Term Limits Decision)*, 16 J. CONTEMP. LEGAL ISSUES 459, 463-465 (outlining the primary tenants of liberal freedoms).
[15] Rousseau, *supra* note 9, at 107-08 (describing how to maintain a government's legitimacy).
[16] Daryl Levinson & Benjamin I. Sachs, *Political Entrenchment and Public Law*, 125 YALE L. J. 400, 402 (2015).
[17] *See* Jud Campbell, *Republicanism and Natural Rights at the* Founding, 32 CONST. COMMENT. 85, 92 (2017) ("Either when forming a political society or when constituting a government, the people might also recognize *fundamental positive rights* to limit governmental power . . . . like the rights of due process, habeas corpus, and confrontation."). Freedom of speech, regular elections, bars on political favoritism, nepotism and the spoils system, fair apportionment or proportional representation, protections for voting rights, bans on bribery and large campaign contributions, independent courts, and the like are all required to preserve the impermanence of victory. *See, e.g.*, THE FEDERALIST NO. 57 (Alexander Hamilton or James Madison) (Jacob Ernest Cooke, ed., 1961) (observing the need for frequent elections to prevent tyranny).
[18] Sergio Alberto Gramitto Ricci & Daniel J.H. Greenwood, *Total Governance*, 50 J. CORP. L. (*forthcoming* 2025) (on file with the authors).
[19] *Democracy*, MERRIAM-WEBSTER (retrieved June 25, 2024), https://www.merriam-webster.com/dictionary/democracy?src=search-dict-box [https://perma.cc/2F3Z-5A2Y; *see also* Coglianese, *supra* note 10, at 1662.
[20] *See infra*, Part I.B; *see also infra*, Part V.A.
[21] *See* Coglianese, *supra* note 10, at 1662-65 (observing that democracy is best protected by each individual person judges their own needs, and contributes to society's decision-making process, and "anything short of full participation," including berries to entry, stunts full consideration in the decision-making process).
[22] *See infra*, Part I-II.
[23] *See infra,* Part I.C.
[24] *See infra*, Part I.A; *see also* Paul Rose, *How Financial Institutions Disenfranchise Everyday Investors* (May 12, 2021), MANHATTAN INST., https://manhattan.institute/article/how-financial-institutions-disenfranchise-everyday-investors [https://perma.cc/C4FL-733B].

years, silences dissident shareholders and perpetuates the continuation of elite control.[25] As in a political democracy, shareholder voting has a long history of exclusion and partiality, with modern struggles to accommodate (or exclude) diverse groups and affluent White males benefitting from largely inherited privilege.[26] As the proxy system developed and as corporations grew, the system has disenfranchised shareholders and maintained elite control.

Over institutionalization of share ownership concentrates governance power in the hands of managers of a few funds and other institutions.[27] Common owners like BlackRock, Vanguard, and State Street as well as other financial institutions own and vote the bulk of company shares.[28] Further, institutional investors largely rely on the voting recommendations of proxy advisory services, effectively handing control to proxy advisory firms, which govern a high volume of votes without skin in the game.[29] Proxy advisory firms that do not have stakes in the issuers and are subject to market pressures which may or may not align their interests with the interests, let alone the views, of any corporate constituency.[30] So, shareholder governance is hijacked by institutional investors, which are, in turn, captured by proxy advisory firms that exert highly consequential voting power but have no stakes in the issuers.[31]

To expose the shareholder democracy lie, we consider three factors. First, the structure of a corporation profoundly diverges from that of a political democracy. Second, shareholder governance as it has developed over centuries and currently functions today is not democratic either. Third, share ownership is not democratic. The horizon of this Article is not a normative analysis of whether shareholders should have more power.[32] Nor is this Article about whether shareholders are best off with more power or whether corporate governance should be a branch of government that allows people to vote more granularly on political matters.[33] Rather, this Article exposes the mythological nature of shareholder democracy. Persuasive but inaccurate rhetoric leads to misconceptions and misunderstandings. The *pars destruens* that analytically debunks false rhetoric is often-times overlooked by literature borrows comfortably familiar but wrong concepts, thus further diffusing theoretical misunderstandings. This Article takes a different approach. It recognizes

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[25] *See infra*, Part I.A.
[26] *See infra,* Part I.B-C; *see also* Stout & Gramitto, *supra* note 22, 556-57.
[27] *See infra*, Part V.B.
[28] Zohar Goshen & Doron Levit, *Agents of Inequality: Common Ownership and the Decline of the American Worker*, 72 DUKE L. J. 1, 5 (2022).
[29] *See infra*, Part III.C; *see also* Goshen & Levit, *supra* note 28, at 65.
[30] *See infra*, Part III.C; *see also* Goshen & Levit, *supra* note 28, at 65.
[31] *See infra*, Part III.C; *see also* Goshen & Levit, *supra* note 28, at 65.
[32] Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675 (2007); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power,* 118 HARV. L. REV. 833 (2005). But see Lynn A. Stout, *Bad and Not-so-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189 (2002); Iman Anabtawi*, Some Skepticism About Increasing Shareholder Power,* 53 UCLA L. REV. 561, 577 (2006) (warning about risk of rent-seeking). To be sure, Lynn Stout co-authored an article and a book calling for the inclusion of virtually all individuals in shareholding and corporate governance. LYNN STOUT, SERGIO GRAMITTO, & TAMARA BELINFANTI, CITIZEN CAPITALISM: HOW A UNIVERSAL FUND CAN PROVIDE INFLUENCE AND INCOME TO ALL (2019); Stout & Gramitto, *supra* note 22.
[33] *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NORTHWESTERN U. L. REV. 547 (2003).

the essential importance of a careful *pars destruens* for sound legal and theoretical arguments. It lays out the foundation of an accurate understanding of shareholding, its features, and its structural failures.

This Article brings to the forefront salient facts about how shares are held and voted today. It debunks the narrative that shareholder democracy is informed by principles of equity and equal opportunity.[34] The Article sheds light on the mechanisms that ensure concentration of influence in the hands of a few people while effectively disenfranchising most.[35] It proceeds in five Parts. Part I provides example of recent uses of shareholder democracy rhetoric. It also rehearses some of the fundamental, inescapable, conflicts of any democratic system. Part II explores the development of proxy voting dating back to early modern English joint stock corporations as well as the U.S. federal proxy voting regulations. Part III examines the some of the origins of shareholder ownership inequality. Part IV details the de-retailization of company shares, the growth of institutional investors, and their reliance on proxy advisory services. Part V concludes.

I. THE CORPORATE AND SHAREHOLDER DEMOCRACY RHETORIC AND ITS LACK OF THEORETICAL JUSTIFICATION

A. Recent Use of Shareholder Democracy Rhetoric

The term shareholder democracy became popular in the late 1920s when Wall Street, particularly large corporations, investment firms, and the New York Stock Exchange relied upon the term to motivate investment by the masses.[36] The rhetoric was used to push back against government regulations, governmental provision of welfare, and labor union organization.[37] Shareholder democrats argued that acquiring corporate shares in an "*unregulated* securities markets could accomplish key social goals—individual security and opportunity, macroeconomic prosperity and stability—in a far more efficient matter and democratic manner" than the government could accomplish with regulations.[38] As Julia Ott has detailed, proponents of shareholder democracy argued that mass investment would provide "class harmony" but also sought to maintain the status quo with respect to who held and controlled "economic wealth and power."[39] Shareholder democracy than spread to others. For example, labor and consumer advocates seeking reform believed that "universal investment could bring corporations in line with democratic political traditions."[40] Still others used shareholder democracy as a way of garnering support for regulations to protect third party investors.[41] In the 1950s, shareholder democracy proponents like Frank Emerson and

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[34] *See infra*, Part III.
[35] *See infra*, Part IV.
[36] OTT, *supra* note 3, at 5.
[37] *Id.*
[38] *Id.*
[39] *Id.*
[40] *Id.*
[41] *Id.*

Franklin Latcham stressed the importance of individualism, the opportunity to exercise one's judgment, and a "rekindling" of "free discussion" among investors in corporations.[42]

Emerson and Latcham heralded the Securities and Exchange Commission (the "SEC") adoption of Rule 14a-8 providing a formal mechanism for shareholder voices to be heard. As will be detailed later in this Article, proponents of Rule 14a-8 heralded its adoption as the epitome of shareholder democracy while the management of many companies fought its adoption. The struggle between management and shareholders that prompted the adoption of Rule 14a-8 continues today. Both sides utilize shareholder democracy rhetoric to push their own agenda. The use of the rhetoric is not limited to battles between company management and their shareholders, mass media and industry titans also rely on the rhetoric to similarly push their agendas. This section briefly examines some recent uses of the shareholder democracy rhetoric.

In resisting a climate change shareholder proposal brought by Arjuna Capital and Follow This, a Dutch climate activist group, for the 2024 Exxon Mobil Corporation shareholder meeting, Darren Woods the CEO of Exxon argued that the proxy system was being hijacked and "abused by a coalition of activists masquerading as shareholders."[43] After a federal district court dismissed a case brought by Exxon against Arjuna, Exxon issued a press release stating in part, "We've heard a lot about shareholder rights, and our suit has always been about preserving those rights because shareholder democracy is only as strong as the rules that govern it. Making repeated proposals that garner a small minority of support doesn't serve anyone's interest, except the proponent's."[44] Arjuna also invoked shareholder democracy in a letter to ExxonMobil stating that Exxon's lawsuit "represent[ed] an assault on the system of shareholder democracy which has served both investors and companies well for decades."[45]

Exxon and Arjuna were not the only ones to invoke shareholder democracy recently. In Tesla's quest to have shareholders re-ratify Elon Musk's compensation plan which the Delaware Court of Chancery had struck down due to conflicts of interest, Tesla wrote in a letter to shareholders: "We don't agree with what the Delaware Court decided. So, we are giving stockholders the chance to make their voices heard. We believe in stockholder democracy. This important

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[42] FRANK D. EMERSON & FRANKLIN C. LATCHAM, SHAREHOLDER DEMOCRACY: A BROADER OUTLOOK FOR CORPORATIONS 9 (1954).

[43] Bloomberg, *Exxon Vows to Be 'Forceful Advocate' for Shareholder Democracy*, ENERGYCONNECTS (May 29, 2024), https://www.energyconnects.com/news/gas-lng/2024/may/exxon-vows-to-be-forceful-advocate-for-shareholder-democracy/.

[44] *Message from Darren Woods, ExxonMobil Chairman and CEO* (June 18, 2024), https://corporate.exxonmobil.com/news/corporate-news/message-from-the-chairman.

[45] *Exxon Mobil Corporation v. Arjuna Capital, LLC and Follow This*, No. 4:24-cv-00069-P, (N. TX), Arjuna Capital, LLC's Notice to Court of Letter to Exxon Mobil Corporation, (filed May 27, 2024), https://climatecasechart.com/wp-content/uploads/case-documents/2024/20240527_docket-424-cv-00069_notice.pdf. On the negative externalities on the corporate governance machinery of Exxon suing its shareholders, *see* Colleen Honigsberg and Robert J. Jackson, *Jr.Exxon's Suit Against Its Own Shareholders Threatens Valuable Bargaining*, Promarket (Jul. 16, 2024), https://www.promarket.org/2024/07/16/exxons-suit-against-its-own-shareholders-threatens-valuable-bargaining/

decision should be made by the owners of the Company: that's you."[46] It also leaned into the rhetoric in a shareholder presentation arguing that ratification of the compensation plan "protects stockholder democracy" and in its proxy it argued "ratification will restore Tesla's stockholder democracy."[47]

Shareholder democracy also was invoked in a 2024 proxy battle between Nelson Peltz of Trian Partners and Disney. As Peltz fought an ultimately losing battle for two Disney board seats, Disney launched a defensive. Trian responded, "To suggest that Nelson Peltz is an 'infiltrator' (he has been elected overwhelmingly by shareholders in 48 elections) is offensive and highly dismissive of shareholder democracy."[48] After Disney released the results of the shareholder vote early prior to the shareholder meeting, Bill Ackman, an activist hedge fund manager, criticized the release on X (formerly Twitter) stating, "It is time that we make an example of Disney here so that this bad practice does not continue to poison shareholder democracy."[49]

The reliance on shareholder democracy has not been limited to companies and activist investors. A year after BlackRock introduced pass-through voting to its funds, Larry Fink wrote to BlackRock clients and corporate CEOs heralding pass-through voting as creating "[t]he potential for a new era of shareholder democracy" and argued that "if widely adopted, [pass through voting] can enhance corporate governance by injecting new voices into shareholder democracy."[50] He concluded by saying, "[t]his revolution in shareholder democracy will take years to be fully realized, but it is one that, if executed correctly, can strengthen the very foundations of capitalism."[51]

Mass media also uses shareholder democracy to push their story lines. In September 2024, *The Financial Times* ran a story titled "*Vanguard experiment in shareholder democracy finds investors prefer to defer*" which described Vanguard's pass-through voting program.[52] The story explained that 45 percent of Vanguard shareholders chose to defer to Vanguard's default policy in how their shares would be voted.[53] The headline relying on shareholder democracy did not actually reflect the majority of Vanguard's shareholders and their desires. As an Op-Ed printed in response to *The Financial Times* article pointed out, more than half of Vanguard shareholders did not choose

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[46] Tesla, Tesla Letter to Stockholders (Apr. 17, 2024), https://www.votetesla.com/wp-content/uploads/2024/05/Tesla-Letter-to-Stockholders-April-17-2024-1.pdf.

[47] Tesla Investor Presentation (May 2024), https://www.votetesla.com/wp-content/uploads/2024/05/Tesla-Investor-Presentation-May-2024.pdf; Tesla, Inc., Proxy Statement on Schedule 14A (Apr. 17, 2024), https://www.sec.gov/ix?doc=/Archives/edgar/data/1318605/000110465924053333/tm2326076d15_def14a.htm

[48] Todd Spangler, *Disney Slams Activist Investor Peltz as 'Disruptive and Destructive,' Says His Proxy Fight 'Seems More About Vanity Than a Belief' in Company*, VARIETY (March 11, 2024), https://variety.com/2024/biz/news/disney-attacks-nelson-peltz-disruptive-destructive-vanity-1235938192/.

[49] Bill Ackman @BillAckman, X (Apr. 3, 2024, 12:14 AM), https://x.com/BillAckman/status/1775285586078707789?lang=en.

[50] Larry Fink, *The transformative power of choice in proxy voting*, BLACKROCK, https://www.blackrock.com/corporate/about-us/investment-stewardship/blackrock-voting-choice/proxy-voting-power-of-choice.

[51] *Id.*

[52] Madison Darbyshire, *Vanguard experiment in shareholder democracy finds investors prefer to defer*, FIN. TIMES (Sept. 17, 2024), https://www.ft.com/content/da59775c-c7f4-44c6-a625-2004ae9baeed.

[53] *Id.*

to passively vote in line with Vanguard's default policy.[54] The author of the Op-Ed stated that for most of the Vanguard shareholders who actively sought vote differently than Vanguard, it was likely the first time they had ever made any voting decisions with respect to their stock.[55] Although a majority of Vanguard shareholders may be choosing how to vote their stock, corporations are not democracies.

B. Corporations are Not Democracies

Corporate law as we know it does not create a government dedicated to the good of the governed. It lacks the basic political rights of equal votes, bicameralism, an independent internal judiciary, or any concept of due process. It does not guarantee, except to the extent that outside forces require it to do so, anti-discrimination principles or positions open to talent.[56] Indeed, standard corporate law still allows purchase of office (achieved by the purchase of shares), two centuries after the French revolution. Shareholders are effectively insurers rather than members, citizens, or owners. This, of course, is precisely the opposite of standard democratic theory, which contends that a state exists to serve its citizens,[57] not the reverse.[58]

1. Shareholder Democracy Is a Fake Rule

Whether shareholder democracy is "rule" at all is a critical issue. Beyond board elections and vetoing organic changes, as detailed previously, shareholders have limited rights. Precatory shareholder resolutions and say on executives' compensation plans are merely advisory in nature.[59] Whether board chooses to implement a shareholder proposal if it obtains the requisite number of affirmative votes is another matter.[60] Shareholders may have the power to enact corporate bylaws, although the board typically does as well.[61] Additionally, a limited number of board decisions are binding on the company only after shareholder ratification: decisions to sell, merge or otherwise

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[54] Georgia Stewart, *Letter: Vanguard pilot shows investors want say in voting their shares*, Op-Ed, FIN. TIMES (Oct. 16, 2024), https://www.ft.com/content/1ed14a04-5584-4f3b-a69c-0b51b022f1c5.
[55] *Id.*
[56] Max Weber, *Bureaucrac*y, *in* MAX WEBER, THE THEORY OF SOCIAL AND ECONOMIC ORGANIZATION (Talcott Parsons, ed.).
[57] *See, e.g.*, Declaration of Independence, July 4, 1776 ("We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness.--That to secure these rights, Governments are instituted among Men, deriving their just powers from the consent of the governed . . .").
[58] The idea that citizens, or subjects, exist to serve the state is generally understood to characterize anti-democratic fascist or totalitarian regimes. Democracies, in contrast, typically contend that the state ultimately exists to serve the citizens, while citizens ought to, as patriots, serve the country as well. *See, e.g.*, John F. Kennedy, Jr., Inaugural Address (January 20, 1961) ("Ask not what your country can do for you – ask what you can do for your country.").
[59] James C. Cox & Randall S. Thomas, *The SEC's Shareholder Proposal Rule: Creating A Corporate Public Square*, 2021 COLUM. BUS. L. REV. 1147, 1185 (2021) (recognizing the precatory nature of proposals).
[60] *Id.* ("Even though shareholder proposals are often technically advisory, boards often implement proposals that garner a majority of shareholder votes."); *c.f.* Yonca Ertimu, Fabrizio Ferri & Stephen R. Stubben, *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53, 54 (2010) (detailing a 2004 study in which 40% of proposals receiving a majority vote were not implemented).
[61] *See* Del. Code Ann. tit. 8, § 109 (2015) (describing power of shareholders to amend bylaws).

end the corporation's independent existence,[62] amendments to the corporation's articles of incorporation,[63] and a few similarly fundamental changes.

Under current law, the corporate board is the ultimate decisionmaker for the corporation; while directors are elected by share votes, they are barred from deferring to the views, or even interests, of the actual voters, let alone other corporate constituencies.[64] This is contrary to the general notion that representatives should represent the views of their electors. In fact, corporate directors are not representative of their electors. Rather, they are fiduciaries of the corporation, which is their principal as a separate legal entity. They must act in the interests of the corporation as the directors perceive them, in good faith.

Shareholders have no right to control the lobbying or political interventions funded by their investments as allocated by management. Indeed, incumbent corporate officers have virtually unlimited access to corporate funds and virtually unlimited power to direct corporate personnel to pursue their own views of the corporate good—even if others disagree. Corporate incumbents are permitted to use corporate resources to counter the efforts of shareholders willing to shake the board.[65] Incumbent officeholders are even allowed to use the full power of their office to defend their positions in contested elections – including financing their reelection campaigns with corporate funds (so long as they insist, even implausibly, that power struggles are over proposed policy rather than personality).[66] In the Disney-Peltz proxy battle, Disney is estimated to have spent $40 million defending the incumbent board seats while Peltz is estimated to have spent $25 million, making it by some estimates the most expensive proxy fights in history.[67] In the corporate sphere, we have no concept of a loyal opposition. For example, directors ordinarily are expected to support incumbent officials or resign, and common corporate governance parlance refers to dissident shareholders as "insurgents" or "barbarians at the gate" as if they were foreign invaders rather than legitimate participants in a democratic debate.

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[62] *See, e.g.*, DEL. CODE ANN. TIT. 8, § 251(c) (2020) (requiring shareholders of constituent corporations to a merger vote on the proposed merger); DEL. CODE ANN. TIT. 8, § 271(c) (2010) (requiring a shareholder vote for a sale of all or substantially all of the assets of a corporation).

[63] *See* DEL. CODE ANN. TIT. 8, § 242(b) (2023) (detailing amendments to the certificate of incorporation requiring a shareholder vote).

[64] Gramitto Ricci & Greenwood, *supra* note 17.

[65] Melvin Aron Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489, 1496 (1970)

[66] *Id.*

[67] *See* Brooks Barnes and Lauren Hirsch, *For Disney, Small Shareholders Loom Large in Boardroom Fight*, N.Y. TIMES (April 1, 2024), https://www.nytimes.com/2024/03/30/business/media/disney-shareholders-proxy-battle.html (citing costs of proxy fight); Kim Masters, *Bob Iger Bruised, But Not Broken, After Disney Fight*, THE HOLLYWOOD REPORTER (April 10, 2024), https://www.hollywoodreporter.com/business/business-news/bob-iger-nelson-peltz-disney-proxy-board-1235870436/ (stating the Disney-Peltz proxy battle was the most expensive in history).

2. Wealth Supremacy and the Limits of Shareholder Voting

Far from being "rule by the people (demos)," the corporate governance system is voting by investment, and therefore wealth.[68] Shareholders are not the "people" in any meaningful sense, in fact most shares are held and voted by institutions, not by individuals. Democratic governments are far more likely to take as their goal to "promote the welfare of the greatest possible number"[69] as opposed to preferring some ruling minority over others,[70] because they place ultimate control in the majority. Corporate governance, in contrast, allocates control according to shareholding size, giving ultimate control to the stock market, where shares are bought and sold, rather than to the people affected.

Shareholders vote per share, not per person.[71] Contrary to the basic notion that votes should not be for sale,[72] shares (along with the votes they carry) are freely bought and sold. Combined, these two rules mean that the system is far closer to plutocracy than democracy; the wealthy can buy the election. Indeed, as previously detailed, our publicly traded stocks—and their votes—are dominated by a handful of wealthy institutions. Moreover, individually held stocks are disproportionately in the hands of the ultra-wealthy.[73] Even below these extremes, income is quite skewed towards the top, wealth is far more unequally distributed than income,[74] and stock holding – direct or indirect – is far more unequal than wealth.[75] The logic that tells us that democratic rule is likely to promote the greatest good of the greatest number, suggests that shareholder voting will promote the interests of the wealthiest and most powerful.

The existing system effectively assures that publicly traded corporations remain subservient to the goal of shareholder profit maximization—regardless of the actual values and priorities

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[68] One share one vote is not legally required, and many corporations have shares with more than one vote, typically issued to founders to allow them to retain voting control after going public even as their percentage ownership of the shares drop. For a discussion of the merits of one share one vote from the perspective of maximizing long run returns to shareholders, *see, e.g.*, Lisa Fairfax, *Shareholder Democracy on Trial: International Perspective on the Effectiveness of Increased Shareholder Power*, 3 VA. L. & BUS. REV. 1, 16 (2008).

[69] ALEXIS DE TOCQUEVILLE, II DEMOCRACY IN AMERICA 238 (ED PHILIPS BRADLEY; TRANS HENRY REEVE, FRANCIS BOWEN) (1946).

[70] *Id.* at 241.

[71] *See* DEL. CODE ANN. TIT. 8, § 212 (2020) ("Unless otherwise provided in the certificate of incorporation . . . each stockholder shall be entitled to 1 vote for each share of capital stock held by such stockholder.").

[72] *See* Richard L. Hasen, *Vote Buying*, 88 CAL. L. REV. 1323, n.1 (2000) (setting forth the laws of all 50 states prohibiting vote buying).

[73] Robert Frank, *The Wealth of the 1% Just Hit a Record $44 Trillion*, CNBC (Mar. 28, 2024), https://www.cnbc.com/2024/03/28/wealth-of-the-1percent-hits-a-record-44-trillion.html#:~:text=The%20top%201%25%20own%20half,and%20home%20values%20than%20stocks (citing a Federal Reserve report and stating "[t]he top 1% own half of all individually held stocks").

[74] *See* Zia Qureshi, *Rising Inequality: A Major Issue of Our Time*, BROOKINGS (May 16, 2023) (explaining wealth inequality is generally significantly higher than income inequality).

[75] *See* Frank, *supra* note 70 (observing half of all individually held stocks are held by the top 1%). As of end of the fourth quarter of 2023, "[t]he top 1% accounted for 30% of the nation's wealth . . . while the top 10% accounted for 67% of all wealth." *Id.*

of corporate participants, including human shareholders.[76] Few actual human beings are so blinded by greed as to have no values other than shareholder profit.[77] Yet all those values tend to drop out in the current system, which effectively disenfranchise the majority of shareholders, who are human beings, because the majority of shares are held and voted by institutions. In fact, although the majority of shareholders are human beings, their values and concerns are typically overlooked, because their voting power and influence cannot counter the voting power and influence of institutional investors and proxy advisory firms.

II. ORIGINS AND APPEAL OF THE CORPORATE AND SHAREHOLDER DEMOCRACY RHETORIC

Some proponents of shareholder democracy in the early to mid-20th Century sought to replicate the corporate voting rights that existed and evolved beginning at least in the 1600s and 1700s with English joint-stock corporations. This section explores stock ownership and voting in early modern English companies which shaped American corporations. It also details the development of proxy voting regulations which now govern in Corporate America today.

A. History of Proxy Voting in Corporations

In the 1700s, English shareholders were typically known as proprietors.[78] General meetings of the proprietors were most often referred to as "general courts."[79] The general courts "corresponded to the legislative branch of the government of the kingdom."[80] The general courts elected the directors, who met in courts of directors functionally analogous to board meetings.[81] A so-called governor and sub-governor (sometimes referred to as a president and vice president) presided over the court of directors.[82] The directors summoned the general courts but typically occur multiple times a year with a minimum number set forth in the company's charter or articles of association.[83] For some companies courts "resemble[d] public gatherings."[84] According to Armand Budington Dubois, "[c]ausal spectators would wander into the meetings of the large companies of London, and would cheer for favorite directors as if the meeting were for entertainment instead of for business."[85] Not all companies and their directors welcomed such a public spectacle,

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[76] Robert G. Eccles & Jill E. Fisch, *The Politics of Values-Based Investing,* HARV. L. SCH. FORUM ON CORP. GOV., Sept. 7, 2022, https://corpgov.law.harvard.edu/2022/09/07/the-politics-of-values-based-investing/ (discussing the principles of values-based investing); Sergio Alberto Gramitto Ricci & Christina M. Sautter, *The Wireless Investor Movement*, U. CHI. BUS. L. REV.: ONLINE EDITION (2022). (arguing that new generations of investors use online communication to coordinate collective action aimed at steering corporations according to investors' generational values).

[77] Andreas Kokkinis & Konstantinos Sergakis, *Investor Personhood: The Case Against Paternalism and Welfarism in Corporate Law*, J. CORP. L. STUDS. 38 (July 18, 2024) (explaining individuals exercise both financial and non-financial values in their investing and voting decisions).

[78] ARMAND BUDINGTON DUBOIS, THE ENGLISH BUSINESS COMPANY AFTER THE BUBBLE ACT 1720-1800 314 n.38. (1938).

[79] *Id.* at 314 n.39. The terms "general assembly" and "general meeting" also were occasionally used. *Id.*

[80] *Id.* at 287.

[81] *Id.*

[82] *Id.* at 287, 314 n.40.

[83] *Id.* at 287.

[84] *Id.*

[85] *Id.*

and some companies took measures to limit attendance to only proprietors or proprietors capable of voting during a court.[86]

Generally, the ability to vote during a court in the 1700s in England was based on a proprietor's amount of holdings.[87] Voting ranges varied depending on the company but typically included a low cap on the total number of votes proprietors were able to cast.[88] For example, in 1723, the Chelsea Water Company had a tiered system in which proprietors with five shares had one vote, those with ten shares had two votes, and those with twenty shares had three votes and votes were also capped at three votes no matter how many shares above twenty a proprietor owned.[89] Notably, women represented a sizeable portion of investors in early modern English corporations and all indications are that women were permitted to exercise voting rights if they held the requisite number of shares needed to be able to vote.[90]

Interestingly, rates of female ownership of company shares in England were higher prior to 1750 than they were from the 1780s to the 1820s.[91] In the 1730s and 1740s, women represented a quarter to a third of investors in the Bank of England, the South Sea Company, East India Company, and the Mine Adventurers Company.[92] Froide notes that this was "twice the rate of female shareholding [than] in the 1780s."[93] In reviewing the records of early modern English companies, a distinction was not made based on gender on the ability to vote or hold office.[94] Hence, women were eligible to vote in company elections.[95] However, whether shareholders who were eligible to vote (either male or female) actually exercised their right to vote is unclear.[96] For example,

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[86] *Id.* at 289.
[87] *Id.* at 288.
[88] *Id.* For a discussion of the evolution of the one vote per shareholder rule to one vote per share in the United States, see Colleen A. Dunlavy, *From Citizens to Plutocrats: Nineteenth-century Shareholder Voting Rights and Theories of the Corporation*, *in* CONSTRUCTING CORPORATE AMERICA: HISTORY, POLITICS, CULTURE (Kenneth Lipartito & David B. Sicilia, eds. 2004), and Sarah C. Haan, *Voting Rights in Corporate Governance: History and Political Economy*, S. CAL. L. REV. (*forthcoming*), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4299462.
[89] DUBOIS, *supra* note 67, at 316 n.47. Other companies like the Scotch Mining Company in 1729 empowered even those with just one share the right to vote (one vote). *Id.* It also had a voting range with thirty shares having five votes and five votes being the maximum. *Id.* Other companies like the Warmley Copper Company in 1767 based its voting on the monetary value of stock owned. *Id.* Warmley permitted proprietors with £ 1,000 of stock one vote, £ 5,000 of company stock two votes, and £ 10,000 or more three votes. *Id.*
[90] AMY M. FROIDE, SILENT PARTNERS: WOMEN AS PUBLIC INVESTORS DURING BRITAIN'S FINANCIAL REVOLUTION, 1690-1750 198 (2017).
[91] *Id.* at 210. Looking back further to the 1600s and shareholding of the East India Company, scholars vary in their estimates of female share ownership. *Id.* at 8. For example, K.G. Davies estimated that women accounted for the ownership of between two and four percent of the company's shares in 1685 while Barbara Todd estimates a much higher number at thirteen percent in 1688. *Id.*
[92] *Id.* at 210.
[93] *Id.* at 210.
[94] *Id.* at 198.
[95] *Id.* at 198-99.
[96] *Id.* at 199.

between 1766 and 1773, only approximately eight to ten percent of shareholders entitled to attend general courts of the East India Company attended those meetings.[97]

Under English and American common law, proxy voting was not permitted without a special authorization.[98] The general inability to vote via proxy likely arose due to the historical political roots of the English corporate form.[99] More specifically, the English Crown issued charters pursuant to which individuals were designated as corporations, known a joint stock companies, and granted "sovereign power to exercise appropriate privileges."[100] Over time, the power to grant corporate charters passed from the Crown to Parliament.[101] Parliament passed special legislation establishing joint stock companies on a company-by-company basis until 1844, at which point they were formed by registering with the Registrar of Joint Stock Companies.[102] Early English corporations were "considered a part of the government" and followed political norms.[103] In the context of political elections, the right to vote was considered "so personal that it could not be delegated."[104] Because voting by proxy was prohibited in political voting, voting by proxy also was prohibited in corporate voting.[105] To vote via proxy, special authorization was required, which took various forms, including express charter or by-law provisions.[106] English companies included charter provisions allowing proxy voting as early as the beginning of the 1700s such that proxy voting was considered a "usual feature" of general courts during this time.[107] Typically, to act as another's proxy during a court, the proxy holder also had to be a proprietor.[108] English companies commonly allowed proxy voting for female shareholders as well as other categories of shareholders including those living a certain distance from the meeting location.[109] A couple of English companies required female shareholders to vote via proxy and did not allow them to attend shareholder meetings.[110] But those companies appear to have been in the minority and most allowed

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[97] *Id.*
[98] Axe, *supra* note 7, at 38-40.
[99] *Id.* at 39.
[100] *Id.* at 39.
[101] Morley, *supra* note 7, at 2157.
[102] *Id.*; Janette Rutterford, *The Forgotten Investors: Women Investors in England and Wales 1870 to 1935*, a. LVI QUADERNI STORICI 166 13, 15 (April 2021).
[103] Axe, *supra* note 7, at 39. For a discussion of the evolution of the one vote per shareholder rule to one vote per share, see Dunlavy, *supra* note 77 and Haan, *supra* note 84.
[104] EMERSON & LATCHAM, *supra* note 42, at 5. Frank Emerson and Franklin Latcham also noted, "[s]ometimes it is also explained that the English common law rule against voting by proxy at stockholder meetings was grounded on a similar ban applied in England under its common law to religious and municipal corporations." *Id.*
[105] Axe, *supra* note 7, at 39. However, as Emerson and Latcham pointed out in their 1954 book "Shareholder Democracy: A Broader Outlook for Corporations," citizens had the right to vote via absentee ballots in early modern England, which is like proxy voting. EMERSON & LATCHAM, *supra* note 93, at 5. Yet, under English common law, the prohibition against corporate proxy voting continued. *Id.* at 5.
[106] Axe, *supra* note 7, at 41-46.
[107] *Id.* at 41; DUBOIS, *supra* note 67, at 288.
[108] DUBOIS, *supra* note 67, at 288.
[109] Mark Freeman, Robin Pearson, & James Taylor, *'A doe in the city': Women shareholders in eighteenth-and early nineteenth-century Britain*, 16 ACCTG., BUS. FIN. HISTORY 265, 284 (2006).
[110] *Id.* DuBois notes the same pointing to two companies in the 1700s which did not permit women to attend general courts and stating that "most of the companies of the period drew no such distinction of sex." DUBOIS, *supra* note 67, at 319 n.55.

female shareholders to both attend shareholder meetings and to vote via proxy.[111] Moreover, female shareholders were permitted to act as another shareholder's proxy.[112]

Like in England, the power to incorporate early American corporations stemmed from special legislation via state legislatures after the United States gained independence from England.[113] To obtain a corporate charter, early incorporators had to petition a state legislature and a special bill had to be passed on a company-by-company basis.[114] Like the English system, the American system had a preference against proxy voting unless there was an express legislative, charter, or by-law provision providing otherwise.[115] This preference echoed a strong public policy in favor of a "democratic-style exchange of ideas" among shareholders.[116] Requiring legislatures to issue charters and also the general preference against proxy voting evolved over the 19th Century. In 1811, New York became the first state to enact legislation permitting the formation of manufacturing corporations via registration as opposed to requiring a special legislative act.[117] This legislation specifically provided that corporations formed pursuant to the statute would be managed by trustees who would be elected on a yearly basis "at such time and place" as set forth in the corporate by-laws by stockholders attending "either in person or by proxy."[118]

Over time, other states adopted similar statutes allowing for general incorporation and for voting by proxy. Pennsylvania's 1842 statute permitting the incorporation of manufacturing companies may best reflect the public policy for proxy voting at the time.[119] That statute was specifically enacted to "encourage manufacturing operations in [the] commonwealth" and allowed for stockholders to vote via proxy if they lived greater than 10 miles from the location of the annual meeting or were female.[120] By 1942, every state, except for Iowa and Texas, had statutes authorizing shareholders to vote via proxy.[121] Although Iowa and Texas did not have statutory authorization for corporate proxy voting, Iowa common law provided the right to vote via proxy if it was set forth within the charter or by-laws while Texas had a long-held custom of allowing shareholders to vote via proxy.[122]

Implicit in the statutes, common law, and customs in favor of proxy voting was a policy toward supporting shareholder participation. Sarah Haan explains that proxy voting facilitated voting by small shareholders who otherwise would be unable to participate in shareholder meetings

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[111] Freeman, Pearson, & Taylor, *supra* note 98, at 284.
[112] *Id.*
[113] Axe, *supra* note 7, at 46; *see also* Susan Pace Hamill, *From Special Privilege to General Utility: A Continuation of Willard Hurt's Study of Corporations*, 49 AM. U. L. REV. 81, 89 (1999).
[114] Hamill, *supra* note 102, at 89.
[115] Axe, *supra* note 7, at 38 n.1.
[116] Haan, *supra* note 84, at 6-7.
[117] LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 134 (3D ED. 2005).
[118] N.Y. Laws (1811), c. 67, p. 111, esp. sec. 3.
[119] Axe, *supra* note 7, at 48.
[120] *Id.* (internal quotations excluded).
[121] *Id.* at 46 & n.27.
[122] *Id.* at 46 n.27.

due to work obligations, family obligations, or their inability to travel.[123] She further notes that the growth of corporations and the related diversification and widespread dispersion of shareholders essentially necessitated proxy voting for corporations to meet quorum requirements for annual meetings.[124] As the Court of Chancery of New Jersey stated in 1931, "[i]t would be stupid indeed to assume that the 80,000 shareholders [of Bethlehem Steel Corporation] may possibly attend the meeting in person to hear the chairman account for his administration before voting, and thus remove the vice of the proxy vote."[125] Although, in theory, proxy voting enabled at least some shareholders to exercise their voting privileges who otherwise would have been disenfranchised, the proxy mechanism was exploited by others, particularly by corporate management.[126]

During the 19th and early 20th Centuries, corporate management often would solicit proxies to vote for their own purposes.[127] Complicating the situation for shareholders who did not attend shareholder meetings was the general lack of information made available to absentee shareholders. Corporate statutes did not require the provision of information generally nor did they require information to be provided prior to soliciting proxies.[128] Accordingly, the only venue for shareholders to obtain information regarding the corporation was via the shareholder meeting.[129] Thus, if one did not attend the shareholder meeting, one did not have access to information regarding the corporation's performance.[130] Also, as Sarah Haan has described, corporate management would leverage their status as well-respected and influential community members when soliciting proxies.[131] Additionally, management had total control over the form of the proxy. If management wanted a certain action to pass, they would make the "proxy as simple as possible, merely requesting that the [shareholder's] signature be affixed."[132] Conversely, if management wanted an action voted down, they would make completing the proxy complicated, including requiring "insertion of the number of shares and other details together with witness by a notary."[133] Additionally, in some instances, proxies were drafted so that they would be effective for several years. [134]

This widespread, unchecked proxy abuse caused Adolf Berle and Gardiner Means to famously write in 1932 that "[t]he proxy machinery has . . . become one of the principal instruments not by which a stockholder exercises power over the management of the enterprise, but by which his power is separated from him."[135] Five years earlier, Berle's mentor the economist William Ripley had observed that shareholder meetings were "routine" affairs and largely a matter of

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[123] Haan, *supra* note 84, at 8-10 (detailing the benefits of proxy voting in the 19th and early 20th Centuries).
[124] *Id.* at 10.
[125] Berendt et al. v. Bethlehem Steel Corporation et al., 154 A. 321, 322 (N.J. Chancery 1931).
[126] Haan, *supra* note 84, at 10.
[127] *Id.* at 10-11.
[128] *Id.*
[129] *Id.*
[130] *Id.*
[131] *Id.*
[132] WILLIAM ZEBINA RIPLEY, MAIN STREET AND WALL STREET 147 (1927).
[133] *Id.*
[134] EMERSON & LATCHAM, *supra* note 93, at 17.
[135] ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION & PRIVATE PROPERTY 129 (1932).

"form."[136] Ripley noted that "[t]he presence and participation of shareholders directly in such corporations has of course become a thing of the past."[137] Despite observing that shareholders were not participating in meetings and criticizing the proxy system, Berle, Means, and Ripley advocated for methods not to empower individual shareholder engagement but rather for individual shareholders to act as a check on corporate management.[138] Berle and Ripley in particular were concerned with protecting minority shareholders so that shareholders in turn would be able to limit the power of corporate management.[139]

A competing viewpoint to Berle, Means, and Ripley was focused not on using shareholders as a check on management but rather focused on the shareholder's position as part of the overall corporate hierarchy.[140] This view of shareholders led observers to inquire corporations could be internally structured so that shareholder voices could be heard.[141] But at the same time, those holding this view were also concerned with whether shareholders would participate and, if they participated, what decisions they would make.[142] Dalia Tsuk Mitchell summarized these different viewpoints regarding the role of shareholders in the early 20th Century, writing, "[t]hose viewing the shareholder as investor wanted to guarantee that the individual shareholder was informed, while those describing the shareholder as participant wanted to ensure that her (individual) voice was heard."[143]

This debate regarding the role of shareholders occurred as corporations had been heavily relying on democratic rhetoric to further goals ranging from building their shareholder and customer base, to resisting government regulation, to opposing labor unions. Corporations sought to portray themselves as akin to "'institutions' infused with all of the connotations of civic beneficence characteristic of other non-market entities, including hospitals, universities, foundations, and even government agencies."[144] For example, in 1936, the Chair of GE said that because the company was a "great public institution," it "had to accept 'more and more obligations for public discourse and public activities."[145] Similarly, the New York Stock Exchange and AT&T "declared themselves to be harbingers of a new era of shareholder democracy."[146] In 1919, AT&T leaned heavily into this rhetoric in an effort both to counteract arguments that the phone system should be nationalized and to deal with a defiant unionized employee base.[147] In particular, AT&T

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[136] RIPLEY, *supra* note 128, at 145.
[137] *Id.*
[138] Dalia Tusk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE L. REV. 1503, 1531, 1532, 1534 (2006).
[139] *Id.* at 1535.
[140] *Id.*
[141] *Id.* at 1509-10.
[142] *Id.* at 1510.
[143] *Id.* at 1535.
[144] Nelson Lichtenstein, *Two Cheers for Vertical Integration: Corporate Governance in a World of Global Supply Chain*, *in* CORPORATIONS AND AMERICAN DEMOCRACY 335 (NAOMI R. LAMOREAUX & WILLIAM J. NOVAK, EDS. 2017).
[145] *Id.* at 335.
[146] *Id.*
[147] OTT, *supra* note 2, at 153.

advertised itself as "a Democracy–of the people, by the people, for the people" and also a "democratic instrument of democracy."[148]

Despite this rhetoric, as Sarah Haan has written, large companies like AT&T employed "none of the mechanisms of real democracy."[149] It was against this backdrop that the federal securities laws, the Securities Act of 1933 (the "1933 Act") and the Securities Exchange Act of 1934 (the "1934 Act"), were enacted.

B. The Problem of the Proxy Paradigm

The right to participate in political debate, including by criticizing incumbent officeholders, is a core value of nearly every version of democracy. Indeed, thinkers as varied as Voltaire and Tom Tyler have argued that the right to speak and to be heard by decisionmakers is as important for a psychological sense of freedom, even if not for actual justice, as representation or even fair decision-making.

Within our large bureaucratic corporations, this core democratic value is strikingly absent: the norm, instead, is that critics are viewed as insubordinate or disruptive. Ordinarily, employment at will means that incumbent management has full authority to dismiss dissident employees. Moreover, it usually does so; our corporations have no equivalent to the loyal opposition, devil's advocate, ombudsman, or even a medieval joker. Similarly, board members who disagree with the board consensus (or incumbent management) are expected to resign.

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[148] *Id.* at 154.
[149] Sarah C. Haan, *The Corporation's Political Purpose*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 313 (ELIZABETH POLLMAN & ROBERT B. THOMPSON, EDS. 2021).

In contrast, managers at publicly traded corporations have no unilateral authority to exclude shareholders from the firm. Not coincidentally, shareholder disagreement is more common and perceived as more legitimate than dissent within the corporation's employee body or board. Still, since the origin of the modern large business corporation at the end of the nineteenth century, shareholder debate over the plans or purposes of a corporation has been sharply limited if not suppressed entirely. State corporate law gives shareholders no access to corporate information or to corporate decision-making except at the shareholders' meeting. And participation there is quite limited – management controls the agenda. Most importantly, shareholder meetings are physical events at a specific time and place: to participate, shareholders must appear in person or by proxy. From its inception the federal corporate proxy framework was presented as a pathway to foster individual shareholder engagement and participation in the corporate governance regime.[150] But a deeper examination of the development and implementation of the proxy system, as currently structured, reveals that the rhetoric of enabling the individual shareholder voice is a façade.[151]

Originally, the 1933 Act was enforced by the Federal Trade Commission (the "FTC").[152] As Congress considered the bill which would ultimately became the 1934 Act, a provision of the bill empowered the FTC to require corporations to hold corporate elections using mailed proxies which would comply with FTC regulations.[153] As it was described at the time, the rationale behind regulating proxies was because "proxies, as solicitations are made now, are a joke. The persons who control the proxy machinery for sending out the proxies, with practically no interest in the corporation, can simply keep other people from organizing [and] get enough proxies to run the Company."[154] Thus, from the start, the goal of proxy regulation was to prevent abuse of the proxy process which had become rampant; the goal was not to necessarily foster shareholder engagement.

As Frank Emerson and Franklin Latcham, proponents of increased shareholder power, wrote in 1954, it had become clear that for shareholders to be able to "express [their] desires as a legal owner, the proxy machinery [had to] more nearly approximate the early common law, individually attended, shareholders' meeting."[155] This meant that shareholders would need to become informed of the meeting agenda items and the company's finances and that there would need to be a mechanism pursuant to which shareholders would be able to provide clear instructions on how their votes should be cast.[156] Furthermore, shareholders other than management should have the ability to nominate individuals for directorships, to raise issues to be considered at shareholder meetings, and to have the "opportunity to communicate with other shareholders via the proxy

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[150] Mitchell, *supra* note 134, at 1506.
[151] *Id.*
[152] JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 57, 79 (3d. 2003) (noting the FTC enforced the 1933 Act during the first year of its existence and noting the FTC's request to create a special division within the FTC to enforce the 1933 Act).
[153] *Id.* at 87.
[154] *Id.* (original quotations omitted).
[155] EMERSON & LATCHAM, *supra* note 42, at 19.
[156] *Id.*

device."[157] These goals and the regulation of proxies were ultimately embodied in Section 14 of the 1934 Act. Among other things, the 1934 Act also created the SEC to enforce the Securities Acts, including Section 14.[158]

Section 14 authorized the SEC to promulgate rules relating to the solicitation of proxies of securities that were listed and registered on a national securities exchange.[159] In response to its broad grant of power, the SEC promulgated Rules LA1 through LA7 in 1935, which among other things required those soliciting proxies to provide a "'brief description' of the matters intended to be voted upon by the exercise of the shareholder's proxy" along with a statement indicating how the solicitor would vote.[160] They also required that management mail the shareholders relevant materials and prohibited materially false or misleading statements in the solicitation of proxies.[161] Although relatively barebones, the principles contained in Rules LA1 though LA7 laid the foundation guiding the SEC in its rule-making and continue to be reflected in present-day proxy rules. With the 1935 rules in place, the SEC then worked toward drafting a more complete set of rules which were released in 1938 and were known as "Regulation X-14."[162] Notably, Regulation X-14 introduced a "proxy statement" which was required to be mailed to shareholders in the context of director elections.[163] The SEC adopted multiple groups of amendments to Regulation X-14 over the succeeding years.[164] This early rulemaking reflected the SEC's perception of its role at the time. More specifically, as Jill Fisch has detailed, the SEC's initial understanding of its role was to tackle the issues raised by substituting in person attendance at shareholder meetings with proxy solicitations.[165] Hence, the SEC's early rulemaking was aimed at encouraging communications between management and shareholders and among shareholders.[166]

This relatively hands-off position by the SEC might have worked better had many companies not refused to incorporate shareholder proposed actions into shareholder meeting proxy materials.[167] This came to a head in 1939, when independent shareholder Lewis Gilbert made two proposals to Bethlehem Steel, which company management refused to include in the company's proxy materials: 1) that shareholders have the right to elect auditors and 2) that the annual meeting

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[157] *Id.*
[158] *Id.*; Robert B. Von Mehren and John C. McCarroll, *The Proxy Rules: A Case Study in the Administrative Process*, 29 LAW & CONTEMP. PROBS. 728, 728 (1964) (discussing formation of the SEC). For more information on the formation of the SEC, see MICHAEL E. PARRISH, SECURITIES REGULATION AND THE NEW DEAL 108-33 (1970).
[159] EMERSON & LATCHAM, *supra* note 42, at 19. Congress, when delegating power to the SEC to regulate proxy solicitation, expressed the concern that "too often proxies are solicited without explanation to the stockholder of the real nature of the matters for which authority to cast his vote is sought." S. REP. NO. 73-1455, at 74 (1934).
[160] EMERSON & LATCHAM, *supra* note 42, at 20-21.
[161] Von Mehren & McCarroll, *supra* note 154, at 736.
[162] *Id.*
[163] EMERSON & LATCHAM, *supra* note 42, at 21.
[164] *See id. at* 21-22 (1954) (describing amendments adopted in 1940, 1942, 1947, 1948, 1953, and 1954).
[165] Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1142-43 (1993).
[166] Mitchell, *supra* note 134, at 1548.
[167] *Id.* at 1548.

be held in New York City as opposed to Wilmington, Delaware.[168] This ultimately prompted the SEC to amend Regulation X-14 in 1942 to include shareholder proposals in proxy materials.[169] More specifically, under Rule X-14a-7 (now known as Rule 14a-8), management was required to include within the proxy statement a "100-word statement in support of any proposal of a security holder that it oppose[d]."[170] The rule was not without limits, however. In particular, the subject matter of the proposal had to be a proper one for shareholder action.[171] What was a proper action for shareholders was left undefined and was developed over time as shareholders began to use the proposal framework to address social issues of the day.[172]

The proposal rule was meant to restore to shareholders a right they had under state and common law corporate governance law which they previously had the ability to exercise in person via their attendance at shareholder meetings.[173] Supporters of Rule 14a-8 heralded it as the "the shareholders' Bill of Rights" while, in many cases, company managements' reactions were significantly less welcoming, to say the least, with many favoring repeal.[174] The proxy rules, generally, and Rule 14a-8, in particular, had been influenced greatly by President Franklin D. Roosevelt's New Deal and Roosevelt's desire for both political and economic democracy as "America's ideal."[175] As Dalia Tsuk Mitchell has written, "New Dealers wanted to recreate the traditional annual meeting, reminiscent, perhaps, of the democratic town meeting. They wanted to create a solid corporate foundation for the ideal of American democracy."[176] At the same time, Mitchell notes that New Dealers' "ideal of shareholder democracy was also meant to substantiate the absolute power of management to run the corporation."[177]

Emerson and Latcham favored the proposal rule as a way of enhancing shareholder democracy.[178] They discounted the fact that, like the majority of shareholder proposals today, most proposals in the 1940s and '50s did not garner a positive vote.[179] Instead, Emerson and Latcham focused on the ability of shareholders to exchange ideas by putting forth proposals.[180] They argued,

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[168] *See* LEWIS D. GILBERT, DIVIDENDS AND DEMOCRACY 41 (1956) (describing proposals and management's refusal to incorporate them); Mitchell, *supra* note 134, at 1506 (stating that Bethlehem Steel's refusal to incorporate Gilbert's proposals led the SEC to reconsider the SEC proxy rules).
[169] MARC I. STEINBERG, FEDERALIZATION OF CORPORATE GOVERNANCE 158 (2018).
[170] LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1939 (3d. 1990); *see* Securities Act Release No. 33-2887, Exchange Act Release No. 34-3347, Investment Company Act Release No. 35-3988, 1942 WL 34864 (Dec. 18, 1942).
[171] Securities Act Release No. 33-2887, Exchange Act Release No. 34-3347, Investment Company Act Release No. 35-3988, 1942 WL 34864 (Dec. 18, 1942).
[172] *See* Harwell Wells, *Shareholder Meetings and Freedom Rides: The Story of* Peck v. Greyhound, 45 SEATTLE L. REV. 1, 21 (2021).
[173] Fisch, *supra* note 161, at 1142.
[174] GILBERT, *supra* note 164, at 102-03.
[175] Joseph L. Weiner, *The New Deal and the Corporation*, 19 CHICAGO L. REV. 724, 729 (1952).
[176] Mitchell, *supra* note 134, at 1552.
[177] Dalia Tsuk Mitchell, *The End of Corporate Law*, 43 WAKE FOREST L. REV. 703, 718 (2009).
[178] Frank D. Emerson & Franklin C. Latcham, *The SEC Proxy Proposal Rule: The Corporate Gadfly*, 19 U. CHICAGO L. REV. 807, 835 (1952).
[179] *Id.* at 835.
[180] *Id.*

> The ideas contained in the proposals though controversial, far from being of the crack-pot variety, are at the least most stimulating, and, in fact, almost invariably had intrinsic substance. There is, therefore, no reason for immobilizing the gadfly. What is involved is basically the right of a minority to express itself and have an exchange of ideas-all in a business corporate context-but closely related to a fundamental freedom.[181]

Emerson and Latcham's reference to a "crack-pot variety" responds to a fear expressed during congressional hearings on the proposal rule that it would result in a "field day for crack-pots."[182] Despite the fact that many corporations used democracy as a marketing tool, they largely opposed the proxy framework, including the shareholder proposal rule, preferring to maintain the status quo of minimal shareholder participation.[183] They feared that the proposal rule would be a way for independent shareholders to "harass management."[184] Conversely, Emerson and Latcham believed that shareholder participation was crucial and actually benefited management by providing a "diversity of opinion and criticism so necessary for healthy growth."[185] For there to be shareholder participation leading to a diversity of opinion, individuals must own shares. The next Part of this Article details some of the barriers to owning shares which have led to a lack of diversity in shareholding.

III. Share Ownership is Not Democratic

Shareholding is not democratic: only a fraction of the American population holds company shares directly, and a minority of share owners vote their shares.[186] The make-up of share owners does not reflect the demographics of the increasingly diverse American population.[187] Share

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[181] *Id.*

[182] *Id.* at 835 n.153.

[183] Phil Nicolas Jr., *The Agency That Kept on Going: The Late New Deal SEC and Shareholder Democracy*, 16 J. of Policy His. 212, 225 (2004). Even more recently, corporations have continued to resist shareholder democracy efforts as detailed by Lisa Fairfax. *See* Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 Ohio St. L. J. 53 (2008).

[184] Nicholas, *supra* note 179, at 225.

[185] Emerson & Latcham, *supra* note 42, at 144.

[186] Sergio Alberto Gramitto Ricci, *The Vitruvian Shareholder*, Fla. L. Rev. Forum (2024); *Survey of Consumer Finances (SCF): Directly Held Stocks by All Families*, The Bd. of Governors of the Fed. Rsrv. Sys. [hereinafter *Survey of Consumer Finances (SCF)*], https://www.federalreserve.gov/econres/scf/dataviz/scf/table/#series:Directly_Held_Stocks;demographic:all;population:1;units:median (last visited July 9, 2024) (table showing only 21% of U.S. families own shares directly as of 2022); Alon Brav, Matthew Cain, & Jonathan Zytnick, *Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement, and Voting*, 144 J. Fin. Econ. 492, 500 (2022) (finding that only 32% of retail shares are voted representing 11% of retail accounts).

[187] *See* Jonathan Vespa, Lauren Medina, & David M. Armstrong, *Demographic Turning Points for the United States: Population Projections for 2020 to 20260*, Census.gov, 8 (Feb. 2020), https://www.census.gov/content/dam/Census/library/publications/2020/demo/p25-1144.pdf (projecting a decrease from 2016 to 2060 in non-Hispanic White children from one-half to one-third); Howard Hogan, Jennifer M. Ortman, & Sandra Colby, *Projecting Diversity: The Methods, Results, Assumptions and Limitations of the U.S. Census Bureau's Population Projections*, 117 W. Va. L. Rev. 1047, (2015) ("By 2044, the United States is projected to become a plurality nation, with no single race or ethnic group projected to have greater than a 50 percent share of the nation's total.").

owners are disproportionately White, old, male, and especially rich.[188] The uneven distribution of share ownership is rooted in centuries of inequality, racial and gender discrimination, slavery, a lack of access to education, and financial crises.[189] By its nature, a true shareholder democracy would require that individuals own shares; that shares be distributed relatively equitably; and that shareholders exercise the right to vote which accompany those shares. This has never been the case.[190]

The basis of democracy in the Western tradition is egalitarianism. Alexis De Tocqueville emphasizes that in a democracy "each individual forms an equal portion of the sovereign power and participates equally in the government of the state."[191] John Locke – whose personal fortune was deeply tied to plantation slavery – pushes this equality back into the dim past of the state of nature, contending that society only arises when individual men agree to give up equal natural rights for the greater benefits of society. A half century ago, both John Rawls and Robert Nozick began their descriptions of the just state by assuming similar initial equality, behind an imaginary veil of ignorance or an imaginary pre-state initial position.[192] For these theorists, democracy evokes the initial equality of Genesis 1:27 (humanity was created as one Adam so that no one may claim hereditary rights over others),[193] or Judges 17:6 ("In those days *there was* no king in Israel, *but* every man did *that which was* right in his own eyes"). But corporate governance knows no egalitarianism.

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[188] Jill E. Fisch, *GameStop and the Reemergence of the Retail Investor*, 102 B.U. L. Rev. 1799, 1827 (2022) (observing that the bulk of directly held stock is held by "rich white men"); Tim Smart, *Who Owns Stocks in America? Mostly, It's the Wealthy and White*, U.S. News (Mar. 15, 2021), https://www.usnews.com/news/national-news/articles/2021-03-15/who-owns-stocks-in-america-mostly-its-the-wealthy-and-white (explaining that "92% of those in the top 10% of the income ladder owned stock in 2019 compared to 56% of those considered middle class" while investors aged 65 and older owned 43% of the stock market in 2019); Drew Desilver, *A booming U.S. stock market doesn't benefit all racial and ethnic groups equally*, Pew Research Ctr. (Mar. 6, 2024), https://www.pewresearch.org/short-reads/2024/03/06/a-booming-us-stock-market-doesnt-benefit-all-racial-and-ethnic-groups-equally/ (explaining White families are more likely to own stock directly or indirectly with 66% of White families owning stock compared to 39% of Black families and 28% of Hispanic families); Jeffrey M. Jones, U.S. *Stock Ownership Down Among All but Older, Higher-Income*, Gallup (May 24, 2017), https://news.gallup.com/poll/211052/stock-ownership-down-among-older-higher-income.aspx (detailing results of a survey from 2008 to 2017 in which 56% of men and 52% of women said they owned stock either directly or indirectly).

[189] *See infra* this Part. *See also* Sergio Alberto Gramitto Ricci & Christina M. Sautter, *The Educated Retail Investor: A Response to "Regulating Democratized Investing*,*"* 83 OHIO ST. L.J. ONLINE 205 (2022).

[190] *See infra* Parts II & III.

[191] ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 108 (Eduardo Nolla, ed.; James T. Shchleifer, trans.) (2009).

[192] ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 25 (1974); JOHN RAWLS, A THEORY OF JUSTICE 118 (1971).

[193] Mishnah Sanhedrin 4:5 ("Adam was created alone so that no one might say to his/her fellow, 'my ancestor is greater than yours'."). Leading nineteenth century biologist and racist Louis Agassiz recognized the power of the Genesis myth by contending that it must refer only to the creation of White people (quoted in STEPHEN JAY GOULD, MISMEASURE OF MAN, ch 2 (1981)). For a different form of equality derived from the Genesis account, see, Leviticus Rabbah to Leviticus 12:2 (explaining that the meaning of "male and female He created him" is that the first Adam was androgynous, having both genders, until later split into male and female in Gen 2:12. A similar origin story appears in Plato's Symposium).

Individual disenfranchisement from investing and corporate voting both reflects and amplifies general inequality. The underprivileged, women, and minorities are disproportionately unlikely to own shares, so shareholder-centered debate necessarily fails to represent the diverse cultures and values in Corporate America.[194] Moreover, unrepresentative shareholding replicates itself, becoming a material factor in our growing racial wealth divide.[195]

A. *Share Ownership Inequality*

Most of the shares held by human investors are held by White men, typically older.[196] Most of these shares are or were held in retirement funds, so holdings are closely correlated with well-paying jobs – exacerbating socio-economic inequality and uneven access to opportunity. Deep roots of share ownership inequity tracing back to colonialism and slavery have markedly hindered access to opportunity to this day.[197] After slavery ended in the United States in the 1860's, African Americans remained economically oppressed through laws that stifled their ability to access equal jobs which could have provided them with a higher income and facilitated access to the stock market.[198]

In the United States, Black households generally rank last with respect to median household income. For example, in 2023, the U.S. Census Bureau estimated that median household income for Black households was $56,490 with the next lowest being Hispanic households who had a median of $65,540.[199] Black household income was significantly lower than the overall median household income of $80,610.[200] Lower income itself hindered Black Americans' ability to invest in equities as has unemployment.[201] To this day, Black people face a higher unemployment rate at every level of education.[202] Uneven access to employment opportunities has deprived Black individuals also of a chance to receive shares as part of their remuneration. As the saying goes, "it takes wealth to make wealth," but Black people have been excluded from intergenerational access to capital.[203] In fact, nearly 60 percent of Black individuals surveyed feel that racism impacts fair

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[194] LANI GUINIER & GERALD TORRES, THE MINER'S CANARY: ENLISTING RACE, RESISTING POWER, TRANSFORMING DEMOCRACY (2003) (arguing that minorities are overburdened by externalities).
[195] Rajashri Chakrabarti, Natalia Emanuel, & Ben Lahey, *Racial and Ethnic Inequalities in Household Wealth Persist*, FED. RES. BANK OF N.Y.: LIBERTY STREET ECON. (June 28, 2024), https://libertystreeteconomics.newyorkfed.org/2024/06/racial-and-ethnic-inequalities-in-household-wealth-persist/.
[196] *See infra* n.58; Stout & Gramitto, *supra* note 22, at 556-57.
[197] Michelle Singletary, *The Legacy of Slavery Made My Grandmother Fear Investing*, WASH. POST (Oct. 9, 2020), https://www.washingtonpost.com/business/2020/10/09/black-slavery-investment-stock-market/; *see also* Part I.E.
[198] Singletary, *supra* note 197.
[199] Gloria Guzman, *Median Household Income Increased in 2023 for First Time Since 2019*, United States Census (Sept. 10, 2024), https://www.census.gov/library/stories/2024/09/household-income-race-hispanic.html#:~:text=The%202023%20median%20incomes%20of,all%20race%20and%20ethnic%20groups.
[200] *Id.*
[201] Singletary, *supra* note 197.
[202] Samuel DuBois Cook Center on Social Equity Insight Center for Community Economic Development, *What We Get Wrong About Closing the Racial Wealth Gap*, 7 (2018), https://socialequity.duke.edu/wp-content/uploads/2019/10/what-we-get-wrong.pdf.
[203] *Id.* at 27.

investing opportunities which is a direct result of this exclusion from wealth accumulation over time.[204]

In the past century, becoming employee-shareholders was a traditional way to enter the stock market. The 1959 NYSE census that surveyed investors who acquired shares for the first time between 1956 and 1959 reported that a quarter of women who became share owners in that timeframe acquired the shares from their employers.[205] There was a clear correlation between becoming share owners and being employed in companies. So, any employment policies or practices that discriminated people of color hindered minorities' access to share ownership.[206] Numerous corporations only employed White people, depriving people of color of the possibility of becoming employee-shareholders in these companies.[207]

Discriminatory employment practices have had profound repercussions on minorities' access to the securities markets.[208] Uneven access to share ownership has had uneven intergenerational effects. Uneven access to company shares has familiarized many White families with securities, while at the same time often excluding non-White households from the stock market ecosystem. So, discriminatory hiring practices that deprived minorities of access to the stock market have intergenerational consequences. If your parents or grandparents obtained shares of stock as part of their pay packages, you hear about their experiences with equities, you get to learn what a share of stock is and what financial and economic rights it provides. You might also be introduced to a family broker or private banker who can guide you along your initiation to financial markets. However, if nobody in your family-or-community has ever owned shares of stock, equities could seem like obscure intangible financial instruments. This is not anecdotal. Studies have shown parents are the primary financial socialization agent and have a direct impact on their children's willingness to invest.[209] In fact, in his 2024 Letter to Investors, BlackRock's Larry Fink credited his father's investing habits and encouragement of Fink to invest in the markets as a primary motivation for his own investing.[210]

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[204] ARIEL INVESTMENTS 2015 BLACK INVESTOR SURVEY: SAVING AND INVESTING AMONG HIGHER INCOME AFRICAN-AMERICAN AND WHITE AMERICANS 7, 11 (2016).
[205] N.Y. STOCK EXCH., SHARE OWNERSHIP IN AMERICA: 1959, at 9 (1960); Sarah Haan, *Corporate Governance and the Feminization of Capital*, 74 STAN. L. REV. 515, 560 (2022).
[206] N.Y. STOCK EXCH., *supra* note 69, at 9.
[207] VICTOR PERLO, ECONOMICS OF RACISM U.S.A.: ROOTS OF BLACK INEQUALITY 134 (1975); Haan, *supra* note 201, at 569.
[208] Haan, *supra* note 201, at 567-68 ("Discrimination and related disparities significantly reduced the financial resources of nonwhite Americans to invest in securities."). For example, women shareholders were often customer-stockholders, rather than employee stockholders. *Id.* at 555.
[209] Crystal Hudson, John Young, & Sophia Anong, *Investment Behavior: Factors that Limit African Americans' Investment Behavior*, 9 J. FIN. THERAPY 21, 25 (2018).
[210] Larry Fink's 2024 Annual Chairman's Letter to Investors, https://www.blackrock.com/corporate/investor-relations/larry-fink-annual-chairmans-letter (last visited July 9, 2024). Specifically, he wrote:

> My dad had always been an enthusiastic investor. He encouraged me to buy my first stock (the DuPont chemical company) as a teenager. My dad invested because he knew that whatever money he put in the bond or stock markets would likely grow faster than in the bank. And he was right.

Id.

B. ESOPs and Access to Shares

ESOPs have played a key role in including everyday citizens in the stock market. Employee stock ownership became popular in the 1920s.[211] By 1927, roughly 400 American corporations had employee stock purchase plans, providing the ability to purchase stock at a discount and financing terms to facilitate the purchase.[212] The Great Depression, however, severely impacted employee investors—stock prices declined rapidly, wages decreased, and widespread layoffs occurred.[213] ESOPs rebounded in the 1950s.[214] Louis O. Kelso's economic theory and lobbying played a critical role in nurturing their success.[215] The rationale of Kelso's ESOPs consisted of providing employees with an opportunity to own equity in their corporate employer to supplement the provisions of their incomplete employment contract.[216]

In 1958, Kelso co-authored the book *The Capitalist Manifesto*, which promoted binary economics and referred to ESOPs as "Second Income Plans."[217] Kelso wrote that capital ownership was concentrated in too few hands, and that working people could not support themselves with just labor income and should have a second income from capital.[218] Kelso's ideas were largely not adopted by legislators and policymakers until 1973 when U.S. Senator Russell B. Long secured the inclusion of a provision sponsoring a study of employee share ownership in the Railroad Reorganization Act.[219] By August 1974, ESOPs were included in the Employee Retirement Income Security Act of 1974 (or "ERISA").[220] Then ESOPs were included in the Tax Reduction Act of 1975, which gave a tax credit to company contributions of stock to a qualifying ESOP, known as a TRASOP.[221] In the subsequent years, many companies have seen them, together with 401(k) styled defined contribution plans, as a cheaper alternative to traditional defined benefit plans, with the not-incidental benefit that they place large blocks of stock in friendly hands: employees are generally thought to be less likely to vote in favor of financially driven hostile takeovers. In any

[211] STEVEN M. BLOOM, EMPLOYEE OWNERSHIP AND FIRM PERFORMANCE 11 (1986).
[212] *Id.*
[213] *Id.* at 13.
[214] ANDREW W. STUMPFF, FIFTY YEARS OF UTOPIA: A HALF CENTURY AFTER LOUIS KELSO'S THE CAPITALIST MANIFESTO, A LOOK BACK AT THE WEIRD HISTORY OF THE ESOP 419 (2009); BLOOM, *supra* note 197, at 13-14. For example, in the 1950s, General Electric had two different employee compensation programs involving its own stock: the Incentive Compensation Plan and the Stock Option Plan. Internet Archive, General Electric Company Annual Reports 1892-2009, https://archive.org/details/generalelectriccompanyannualreports/generalelectric1955/page/n21/mode/2up. Under the Incentive Compensation Plan, compensation was awarded by a compensation committee to individually select positions supposedly determining the company's success. *Id.* With the Stock Option Plan, "key" employees were granted restricted stock options. *Id.*
[215] STUMPFF, *supra* note 200, at 419; BLOOM, *supra* note 197, 13-14.
[216] STUMPFF, *supra* note 200, at 419.
[217] *Id.* at 419-20.
[218] *Id.* at 422.
[219] *Id.* at 423-26.
[220] *Id.* at 426.
[221] *Id.* Shortly after ERISA, with the rise of hostile takeovers, many company managers determined that ESOPs could be a useful takeover defense, by placing large blocks of stock in the hands of employees (who often preferred known managers to newcomers). *Id.* ESOPs could be, and often were, structured to give corporate managers control over the votes associated with employee stock. *Id.*

event, many ESOPs allow the plan's managers (appointed by the company management) to vote the plans' shares, rather than passing votes through to employee beneficiaries.

C. *Minorities Double Jeopardy*

When employment practices and policies discriminate against minorities, minorities are deprived of a double opportunity. They are deprived of an employment opportunity, and they are deprived of an opportunity to become shareholders. We dub this phenomenon "minorities' double jeopardy." Minorities' double jeopardy has enduring ramifications on future generations' access to the stock market and more generally on socioeconomic inequality.[222]

Discriminatory hiring practices have played a key role excluding minorities from the stock market. With the diffusion of ESOPs, discriminatory employment practices deprived minorities of a double opportunity: employment and the opportunity to become share owners. Discriminatory practices were widely diffused, so the instances listed in this Article should not be considered isolated cases or examples of worst behaviors. Rather, they reflect relatively common practices in the past century, which still have enduring effects on the ability of minorities to participate in the stock market.

Between 1975 and 1979, General Motors granted stock ownership opportunities under its ESOP to salaried (but not hourly) employees.[223] However, General Motors apparently discriminated with respect to who could hold salaried positions. In 1975, General Motors was sued in a class action based on racial discrimination in employment.[224] Joe Stewart, as the spokesperson for the Concerned Black Workers at General Motors Parts Division, stated that GM denied Black employees opportunities for advancement to salaried positions:[225] when Black employees sought promotion to a salaried position, General Motors denied that any were available.[226] When salaried positions were available, General Motors allegedly ignored Black employee applications for the positions and even advised a Black employee to remain as a laborer or leave the company.[227] In addition to racial discrimination, it appears that General Motors discriminated against women as well.[228]

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[222] *See infra* Part I.D.
[223] *GM Workers Get ESOP Payments: General Motors*, L.A. TIMES (June 3, 1989), https://www.latimes.com/archives/la-xpm-1989-06-03-fi-965-story.html.
[224] Jojina Erwin, *Assail Bias at GM*, CHICAGO DEFENDER, 1 (June 13, 1973).
[225] *Id.* at 2.
[226] *Id.*
[227] *Id.*
[228] *DeGraffenreid v. Gen. Motors Assembly Div., St. Louis*, 558 F.2d 480, 482, 484 (8th Cir. 1977) (for example, until May 1, 1970, women were not allowed to work in the assembly line in St. Louis except when they could be sent home after nine hours without disrupting production). While assembly line workers presumably were hourly and therefore ineligible for the ESOP, this documented discrimination suggests that the company was discriminating elsewhere as well.

General Motors was not alone in discriminating in ways which potentially affected share ownership via ESOPs. For example, in 1977, AT&T announced the adoption of an ESOP pursuant to which each of its "927,000 employees would receive . . . an average of 1.6 shares of A.T.&T. stock free."[229] A year later, in 1978, the United States Supreme Court upheld "the largest and most impressive civil rights settlement in the history of this nation."[230] The settlement agreement, originally reached in 1973, ended a "long litigation" over many years of gender and racial discrimination both in hiring and in promotions.[231] Indeed, as of 1970, 7 percent of the EEOC's entire workload involved AT&T cases.[232] The EEOC stated that "the lingering effects of 'deliberate racial discrimination are readily apparent in both small numbers and types of jobs blacks hold.'"[233]

Boeing is another example. From its inception in 1917 through the beginning of World War II, Boeing did not hire African Americans at all.[234] Even in 1944, when Boeing employed 1,600 African American workers; however, it required African American workers to use segregated lunchrooms and bathrooms.[235] African American workers were often denied promotions or fired as retaliation for protesting discrimination.[236] Starting in 1996, Boeing provided all its employees with a stock ownership plan.[237] But there is evidence that Boeing was still discriminating against minorities and women in their compensation, and therefore in their ESOP participation as well.[238]

Famously, Ralston Purina offered unregistered shares of its stock to "key employees."[239] A "key employee" was broadly defined and included:

> an individual who is eligible for promotion, an individual who especially influences others or who advises others, a person whom the employees look to in some special way, an individual, of course, who carries some special responsibility, who is

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[229] Elizabeth M. Fowler, *A.T.&T. Joins Plan for Free Stock to Employees*, N.Y. TIMES (May 7, 1977), https://www.nytimes.com/1977/05/07/archives/att-joins-plan-for-free-stock-to-employees.html.
[230] Philip Shabecoff, *A.T.&T. Case Bekan With Appeal on Rate*, N.Y. TIMES (July 4, 1978), https://www.nytimes.com/1978/07/04/archives/att-case-began-with-appeal-on-rate-plan-for-intervention-back-pay.html (internal citations omitted).
[231] *Id.*
[232] *Id.*
[233] *Id.*
[234] Sarah Davenport, *Battle at Boeing African Americans and the Campaign for Jobs 1939-1942*, THE SEATTLE CIVIL RIGHTS & LABOR HISTORY PROJECT, https://depts.washington.edu/civilr/boeing_battle.htm (last visited May 26, 2024).
[235] *Id.*
[236] *Id.*
[237] Jeff Cole, Boeing Announces Stock Trust Plan for its Employees, WALL ST. J. (July 12, 1996), https://www.proquest.com/docview/398606034?parentSessionId=vkEzVb4%2FH7zYaTb2Ua%2FeD2HtnrVlWA-bUEHbOBqYfcnA%3D&pq-origsite=primo&accountid=6667&sourcetype=Newspapers.
[238] Laurence Zuckerman, *Boeing Agrees to Settle Case Charging Bias in Salaries*, N.Y. TIMES (Nov. 19, 1999), https://www.nytimes.com/1999/11/19/business/boeing-agrees-to-settle-case-charging-bias-in-salaries.html.
[239] *SEC v. Ralston Purina Co.*, 346 U.S. 119, 121 (1953).

> sympathetic to management and who is ambitious and who the management feels is likely to be promoted to a greater responsibility.[240]

There is limited information regarding discrimination of women and minorities in hiring and promoting practices done by Ralston Purina. However, the broad definition of "key employee" likely allowed room for preferences that could lead to discrimination in deciding who received shares of company stock.

Discriminatory hiring practices have undoubtedly had an impact on share ownership via ESOPs. An analysis of the 2002 to 2018 survey of U.S. employment stock ownership plans revealed that 22.9% of all adult men working in the U.S. participate in an ESOP while only 16.4% of adult women did the same.[241] The same analysis revealed that a total of 22.4% of White adult workers participated in an ESOP but the numbers were much lower for Black and Latinx adult workers, with only 14.3% Black workers and 17.3% of Latinx workers participating.[242]

D. Minorities and Unfriendly Financial Systems

The United States' and larger global banking and insurance system has long been tied to slavery.[243] New York Life, Aetna, and US Life (now a subsidiary of AIG) sold insurance policies to slave owners which permitted them to recoup three-quarters of the value of a slave upon their untimely death.[244] In 2005, J.P. Morgan Chase & Co. admitted that Citizens' Bank and Canal Bank in Louisiana, two of its predecessor banks, accepted slaves as collateral for loans to slave owners while Wells Fargo has made a similar admission.[245] Obtaining mortgages and other loans from banks facilitated the growth of sugar and cotton plantations, which in turn continued to grow the slave trade.[246] In the event of foreclosure, slaves who had been put up as collateral were sold, still furthering slavery.[247] The connection between slavery and the broader U.S. financial system was not confined to the American South.

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[240] *Id.* at 122.
[241] Democracy at Work Institute (US Federation of Worker Cooperatives), Economic Opportunities Program (The Aspen Institute), Rutgers School of Management and Labor Relations, *Race and Gender Wealth Equity and the Role of Employee Share Ownership*, THE ASPEN INSTITUTE (2021), https://www.aspeninstitute.org/wp-content/uploads/2021/03/Race-and-Gender-Wealth-Equity-and-the-Role-of-Employee-Share-Ownership.pdf
[242] *Id.*
[243] SHARON ANN MURPHY, BANKING ON SLAVERY: FINANCING SOUTHERN EXPANSION IN THE ANTEBELLUM UNITED STATES 21, 25 (2023) (stating that insurance policies on slaves were common and banking tied slavery to the U.S. financial system); Rachel L. Swarns, *Insurance Policies on Slaves: New York Life's Complicated Past*, N.Y. TIMES (Dec. 18, 2016), https://www.nytimes.com/2016/12/18/us/insurance-policies-on-slaves-new-york-lifes-complicated-past.html (detailing popularity of insurance policies on slaves).
[244] Swarns, *supra* note 112.
[245] L.A. Times Archives, *J.P. Morgan Says Two Precursor Banks Held Slaves*, L.A. TIMES (Jan. 21, 2005), https://www.latimes.com/archives/la-xpm-2005-jan-21-na-slavery21-story.html#:~:text=The%20bank%20estimated%20that%20the,March%201933%20during%20the%20Depression; Swarns, *supra* note 112; *see also generally* MURPHY, *supra* note 229 (detailing the involvement of banking in financing and supporting the slave trade).
[246] MURPHY, *supra* note 229, at 13.
[247] *Id.*

New York City, today's epicenter of the U.S. financial system, has had a long connection with slavery. It was not only was the site of the nation's largest cotton market but Wall Street was home to one of the nation's largest slave markets.[248] Ironically enough, Wall Street was once a physical wall built during the mid-1600's by slaves owned by the Dutch West India Company.[249] In the 1850s, New York City was also an epicenter for illegal slave trade after slavery had been abolished.[250] In all, American capitalism was founded on the backs of slaves which has created a deep-rooted distrust of the American financial system.[251] Fifty-nine percent of Black adults in a Pew Research Center survey say the legacy of slavery still "affects the situation of [B]lack people a great deal."[252] Slaves were "exploited twice" by having their freedom and labor stolen and their "captured 'economic value' leveraged by cutting edge financial instruments."[253]

As Mehrsa Baradaran details in her book *The Color of Money: Black Banks and the Racial Wealth Gap*, free Black Americans created their own financial system in the mid-to-late 1800's because they were essentially excluded from the mainstream, White financial system.[254] In 1865, the federal government created the Freedmen's Savings Bank and Trust Company (often called Freedmen's Bank) to teach former slaves, in the words of Frederick Douglass, "lessons of sobriety, wisdom, and economy, and to show them how to rise in the world."[255] In just ten years following its formation, Freedman's Bank had more than 75,000 depositors and handled more than $75 million in deposits.[256] However, as W. E. B. Du Bois once stated, Freedmen's Bank "not only ruine[d] thousands of colored men, but taught to thousands more a lesson of distrust which it will take them years to unlearn."[257]

Without any depositors' consent, deposits in the bank were used to fund the first postwar asset bubble, including railroads.[258] After the railroad investments failed in the Panic of 1873, the

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[248] Gavin Wright, *Slavery and the Rise of the Nineteenth-Century American Economy*, 36 J. ECON. PERSPECTIVES 123, 140 (2022); Zoe Thomas, *The Hidden Links Between Slavery and Wall Street*, BBC (Aug. 29, 2019), https://www.bbc.com/news/business-49476247.
[249] *White New Yorkers in Slave Times*, N.Y. HIS. SOC., 1, https://www.slavery-innewyork.org/PDFs/White_New_Yorkers.pdf (last visited July 10, 2024).
[250] Sylviane A. Diouf, *New York City's Slave Market*, N.Y. PUBLIC LIBRARY (June 29, 2015), https://www.nypl.org/blog/2015/06/29/slave-market.
[251] *See* Sven Beckert & Seth Rockman, *Introduction: Slavery's Capitalism*, *in* SLAVERY'S CAPITALISM: A NEW HISTORY OF AMERICAN ECONOMIC DEVELOPMENT 3 (SVEN BECKERT & SETH ROCKMAN, EDS., 2016) ("American slavery is necessarily imprinted on the DNA of American capitalism.").
[252] Juliana Menasce Horowitz, *Most Americans Say the Legacy of Slavery Still Affects Black People in the U.S. Today*, PEW RSCH. CTR. (June 17, 2019), https://www.pewresearch.org/short-reads/2019/06/17/most-americans-say-the-legacy-of-slavery-still-affects-black-people-in-the-u-s-today/.
[253] Phillip Roscoe, *How the Shadow of Slavery Still Hangs Over Global Finance*, THE CONVERSATION, (Aug. 21, 2020), https://theconversation.com/how-the-shadow-of-slavery-still-hangs-over-global-finance-144826.
[254] MEHRSA BARADARAN, THE COLOR OF MONEY: BLACK BANKS AND THE RACIAL WEALTH GAP, 12 (2017).
[255] Office of the Comptroller of the Currency, *The Freedman's Savings Bank: Good Intentions Were Not Enough; A Noble Experiment Goes Awry*, https://www.occ.treas.gov/about/who-we-are/history/1863-1865/1863-1865-freedmans-savings-bank.html (last visited July 14, 2024).
[256] BARADARAN, *supra* note 250, at 26.
[257] *Id.*
[258] *Id.* at 27.

bank lost more than $2 million of deposits.[259] Congress soon shut down the bank and left 61,144 depositors no access to almost $3 million.[260] More than half of Black wealth in the United States disappeared with the Freedman's Bank closure.[261] For more than thirty years, depositors and their descendants petitioned Congress to be reimbursed for losses.[262] This historical event led Black people to lose faith in the banking system and created financial trauma that has lasted generations.[263]

The distrust of the financial system is not limited to African Americans. Latinos tend to distrust the financial system because of several U.S. banks' tendencies to deny Latinos loans at a disproportionate rate.[264] Their suspicion of financial systems is compounded by the negative experiences their families have had in Latin America.[265] For example, inflation skyrocketed in Mexico after the peso was devalued in 1976, and political unrest plagued towns in the Dominican Republic in the mid 1980's when their peso was devalued by more than 300%.[266] These negative experiences result in suspicion not just of the banking system but of Wall Street as a whole.

E. The Lasting Consequences of Discrimination on Minorities and Access to the Stock Market

Slavery, Jim Crow laws in the wake of the abolition of slavery, redlining, and, more recently predatory payday loans, have had an enduring impact on Black individuals which has raised barriers to them investing in the stock market.[267] Studies have shown that Black Americans are generally less likely to get into contact with brokers and are generally less active in the stock market.[268] This has roots in the intergenerational ramifications that exclusion of minorities from ESOPs, career, and investing opportunities have caused. The lasting impacts are real as a young Black journalist described in a 2020 *Washington Post* article. She recalls how her grandmother taught her and other grandchildren to fear the stock market saying that the stock market was for "White folks . . . who can afford to lose money."[269] Fear drove her grandmother to save, but it also

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[259] *Id.* at 29.
[260] Office of the Comptroller of the Currency, *supra* note 123.
[261] BARADARAN, *supra* note 250, at 26.
[262] Reginald Washington, *The Freedman's Savings and Trust Company and African American Genealogical Research*, 29 FED. REC. AFR. AM. HIS. (1997), https://www.archives.gov/publications/prologue/1997/summer/freedmans-savings-and-trust.html.
[263] *Id.*
[264] Beatriz Acevedo & Jacqueline Martinez Garcel, *Op-Ed: How Previous Financial Trauma Keeps Latinos in the U.S. From Investing*, L.A. TIMES (June 3, 2022, 3:05 AM), https://www.latimes.com/opinion/story/2022-06-03/latino-investing-financial-trauma.
[265] *Id.*
[266] *Id.*
[267] *Id.* Black Americans tend to have more investments in homeownership. Samuel DuBois Cook Center on Social Equity Insight Center for Community Economic Development, *What We Get Wrong About Closing the Racial Wealth Gap*, 11 (2018), https://socialequity.duke.edu/wp-content/uploads/2019/10/what-we-get-wrong.pdf. Accordingly, the predominant form of wealth for Black Americans has been the equity accumulated in their homes. Andrew F. Brimmer, *Income, Wealth, and Investment Behavior in the Black Community*, AM. ECON. REV. 152, 152 (1988).
[268] Andrew F. Brimmer, *Income, Wealth, and Investment Behavior in the Black Community*, AM. ECON. REV. 152, 154 (1988).
[269] Singletary, *supra* note 197.

kept her from growing her money in the stock market viewing the stock market, including 401(k)'s, as gambling.[270] She needed to see and touch her wealth to know wholeheartedly it would not easily disappear from her grasp.[271] This grandmother ultimately opened a savings account saving $20,000 but eschewed even a short-term certificate of deposit for her savings.[272]

According to statistics, this journalist's grandmother is not alone. In 2021, 13% of Black adults were unbanked and 27% were underbanked.[273] In comparison, looking at U.S. adults, only 6% were unbanked and 16% were underbanked with 77% being fully banked.[274] Although Black adults have the highest numbers of unbanked and underbanked, the lack of participation in the financial system is not limited to Black Americans. Hispanic adults come in second with 11% being unbanked and 18% being underbanked.[275]

There are numerous reasons for individuals to be unbanked or underbanked, but academics often point to a lack of trust in the financial system.[276] In addition, like the journalist's grandmother, some Black Americans are concerned that using a bank can put their money or privacy at risk.[277] Like Black Americans, some Latinos are distrustful of banks regardless of their income status.[278] Some Latinos have a term called *colchón de emergencia* which means money under the mattress for emergencies, highlighting their distrust of institutional means of saving through banks.[279] They also use informal peer lending and saving clubs known as *tandas* that circulate money throughout Latino communities and pay interest to the lead organizer.[280] This pervasive feeling of distrust throughout the Latino community prevents them from making the leap to invest in stocks, mutual funds, exchange traded funds, or bonds because they lack money mentors—those

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[270] *Id.*
[271] *Id.*
[272] *Id.*
[273] USAFacts Team, *Who is the least likely to have a bank account in the US?*, USAFacts (Sept, 20, 2022), https://usafacts.org/articles/who-is-the-least-likely-to-have-a-bank-account-in-the-us/#:~:text=race%20or%20ethnicity.-,Black%20adults%20have%20the%20highest%20unbanked%20and,of%20any%20race%20or%20ethnicity.&text=Source%3A,among%20those%20with%20more%20education.
[274] *Report on the Economic Well-Being of U.S. Households in 2018-May 2019*, Fed. Res. (last visited Oct. 26, 2024), https://www.federalreserve.gov/publications/2019-economic-well-being-of-us-households-in-2018-banking-and-credit.htm#:~:text=In%20addition%2C%2016%20percent%20of,service%20product%20(figure%2014).&text=The%20remaining%2077%20percent%20of,use%20of%20alternative%20financial%20products.
[275] USAFacts Team, *supra* note 273.
[276] Daryl A. Carter, *Black and Brown Americans are chronically underbanked and unbanked.*, The Emancipator (Sept. 11, 2023), https://theemancipator.org/2023/09/11/topics/money/black-brown-americans-are-chronically-underbanked-unbanked-heres-why-that-matters/.
[277] *Id.*
[278] Luisa R. Blanco, Maria Ponce, Arturo Gongora, & O. Kenrik Duru, *A Qualitative Analysis of the Use of Financial Services and Saving Behavior Among Older African Americans and Latinos in the Los Angeles Area*, SAGE OPEN, 1, 8 (2015).
[279] Beatriz Acevedo & Jacqueline Martinez Garcel, *Op-Ed: How Previous Financial Trauma Keeps Latinos in the U.S. From Investing*, L.A. TIMES (June 3, 2022, 3:05 AM), https://www.latimes.com/opinion/story/2022-06-03/latino-investing-financial-trauma.
[280] *Id.*

who come from the same background and have made the leap to invest their hard-earned money in stocks and bonds.[281]

IV. OVER INSTITUTIONALIZATION, PROXY ADVISORY SERVICE, & THE NAIL IN THE COFFIN OF THE SHAREHOLDER DEMOCRACY MIRAGE

Institutional investors own about 70 percent of the shares in US public companies[282] and pack enough voting power to govern them.[283] Common owners like BlackRock, Vanguard, and State Street,[284] which are referred to as the Big Three,[285] "have hung an 'Under New Management' sign over publicly traded corporations."[286] In fact, the Big Three alone cast about one fourth of all the votes typically casted at S&P 500 companies' shareholder meetings.[287]

But the Big Three do not vote shares because voting is strategically important for their business model. Rather, they vote because mutual funds are required by law to vote the shares held

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[281] Louis Barajas, *Voices: Many Latinos Lack Investment Accounts. They Need Money Mentors.*, NBC NEWS (May 13, 2019 11:59 AM), https://www.nbcnews.com/news/latino/https-www-cnbc-com-2019-05-10-barajas-unbanked-latinos-.

[282] José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513, 1514 (2018); Germán Gutiérrez & Thomas Philippon, Investment-less Growth: An Empirical Investigation 15 fig.9 (Nat'l Bureau of Econ. Rsch., Working Paper No. 22897, 2016), https://www.nber.org/papers/w22897

[283] JOHN COATES, THE PROBLEM OF TWELVE: WHEN A FEW FINANCIAL INSTITUTIONS CONTROL EVERYTHING 32 (2023). The scale of and the risk associated with the concentration of share ownership and power of passive investors has been investigated extensively. John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve 2* (Harvard Pub. Law Working Paper, Paper No. 19-07, 2018); Jill E. Fisch, Assaf Hamdani, & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17, 65 (2019); Goshen & Levit, *supra* note 28, at 5.

[284] For an overview of the debate on common ownership, *see* Robert J. Jackson Jr., *Common Ownership: The Investor Protection Challenge of the 21st Century*, Testimony available at https://www.sec.gov/news/testimony/34ackson-testimony-ftc-120618#_ftn29

[285] *See* Stephen Choi, Jill Fisch, & Marcel Kahan, *Who Calls the Shots? How Mutual Funds Vote on Director Elections*, 3 HARV. BUS. L. REV. 35, 55 (2013) (discussing how the assets under management of BlackRock, Vanguard, and State Street outsize those of other mutual funds). The value of BlackRock's assets under management amounts to approximately $8.68 trillion. About BlackRock, BLACKROCK, https://www.blackrock.com/sg/en/about-us (reporting total as of Dec. 20, 2020). The value of Vanguard's assets under management amounts to approximately $8.1 trillion. Vanguard at a Glance: Facts and Figures, VANGUARD, https://corporate.vanguard.com/content/corporatesite/us/en/corp/who-we-are/sets-us-apart/facts-and-figures.html (reporting total as of Mar. 31, 2022). The value of Fidelity's assets under management amounts to approximately $4.28 trillion. Fidelity by the Numbers: Asset Management, FIDELITY, https://www.fidelity.com/about-fidelity/our-company/asset-management (reporting total as of Mar. 31, 2022). The value of State Street's assets under management amounts to approximately $4.02 trillion. Who We Are, STATE ST. GLOBAL ADVISORS, https://www.ssga.com/us/en/individual/mf/about-us/who-we-are (reporting total as of Mar. 31, 2022).

[286] Goshen & Levit, *supra* note 28, at 5.

[287] Lucian Bebchuk & Scott Hirst, *Big Three Power, and Why It Matters*, 102 B.U. L. Rev. 1547, 1599 (2022). Importantly, the voting power of the Big Three moves the needle in controversial matters. Caleb N. Griffin, *Margins: Estimating the Influence of the Big Three on Shareholder Proposals*, 73 SMU L. REV. 409, 442–43 (2020). According to Goshen and Levit, the concerns that the Big Three's *uber* power raise justify the breakup of these common owner when they exceed in size. Goshen & Levit, *supra* note 28, at 2.

in their portfolios.[288] Voting is essentially a transaction cost for most funds.[289] Passive investors largely compete on cost[290] (and lower advertised expenses), and any money spent on voting is a cost. The Big Three, for instance, vote shares in thousands of companies and their business model is designed around restraining costs, including costs associated with voting shares.[291]

The rise of ESG, with the flourishing of related shareholder proposals, and the 2010 Dodd-Frank Wall Street Reform and the Consumer Protection Act have exacerbated transaction costs associated with voting, since shareholder votes are both more common and more likely to be controversial. Researching proposals and items on a shareholder meeting agenda is an expense borne by the fund that does it. But any benefits deriving from careful voting are shared with competitors.[292] Moreover, benefits deriving from careful voting are speculative, especially if other funds, perhaps with larger investments in the stock of the same issuer, are not likely to vote similarly.

Against this backdrop, passive fund managers have had a quandary in their hands: satisfying regulatory requirements without overburdening their small stewardship teams.[293] The solution was to outsource voting to a new type of corporate governance player, specialized proxy advisory services. Proxy advisory firms help institutional investors, and their managers comply with their duty to vote shares held in the funds' portfolios. But proxy advisory services are also under intense market pressure to keep their prices, and therefore costs, down.[294] Taking unexpected or complex positions would result in higher costs for proxy advisory firms. They could also expose their clients to pushback by corporate executives, lobbyists, politicians, public opinion, and, of course, the funds' own investees.

Importantly, proxy advisory firms are not shareholders nor residual claimants.[295] To the extent that democratic theory prizes participation, not merely results, the advisory firms are peculiar pseudo-voters: they are neither shareholders nor corporate constituents. Proxy advisory firms have no financial or other interest in the corporations for which they advise.[296] Further, while they effectively act as agents of the funds (which are themselves agents of their investees), proxy advisory firms are not under the control of the investees nor they owe fiduciary duties to funds' investees.[297]

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[288] *See* Choi, Fisch, & Kahn, *supra* note 321, at 37 (describing Department of Labor release stating pension funds must vote to comply with fiduciary duties and SEC rule requiring disclosure of mutual funds' voting records and policies).
[289] Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 510–11 (2018).
[290] Fisch, Hamdani, & Davidoff Solomon, *supra* note 268, at 29; Aneil Kovvali, *Countercyclical Corporate Governance*, 101 N.C. L. REV. 141, 173 (2022).
[291] Dorothy S. Lund, *Asset Managers as Regulators*, 171 U. PA. L. REV. 77, 94–95 (2022).
[292] Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2056 (2019).
[293] The Big Three have small stewardship groups. Lund, *supra* note 327, at 94–95.
[294] Bernard S. Sharfman, *Opportunism in the Shareholder Voting and Engagement of the "Big Three" Investment Advisers to Index Funds*, 48 J. CORP. L. 463, 473–74 (2023); Bernard S. Sharfman, *Enhancing the Value of Shareholder Voting Recommendations*, 86 Tenn. L. Rev. 691, 712-14 (2019).
[295] Asaf Eckstein, *Skin in the Game for Credit Rating Agencies and Proxy Advisors: Reality Meets Theory*, 7 Harv. Bus. L. Rev. 221, 231 (2017).
[296] *Id.*
[297] *Id.*

In addition, proxy advisory services do not limit themselves to the low-margin business of recommending votes.[298] Institutional Shareholder Services ("ISS"), for example, also offers corporate governance consultancy services – advising managers on good governance practices.[299] To win lucrative consulting contracts, proxy advisory firms that provide governance advice must deal with incumbent management. Incumbent managers want shareholders to vote with management, and proxy advisory firms want lucrative jobs.[300]

So, proxy advisors' and common owners' incentives are not necessarily aligned with those of the human being who have their economic interests intermediated through funds[301] and their governance rights outsourced twice, first to funds and then to proxy advisory firms. As a result, increasing voting power governed by proxy advisory services equals increasing shareholder disenfranchisement.

A. Over-Institutionalization

The neologism *de-retailization*, introduced by Brian Cartwright, encapsulates the shift from individual to institutional share ownership.[302] The etymology of the word de-retailization emphasizes that individuals have gradually lost relevance in share ownership, extending Berle and Means's century-old point about their limited role in corporate governance. De-retailization can also be described as *institutionalization*.[303] The term institutionalization emphasizes that institutional investors such as the Big Three as well as pension funds, insurance companies, and hedge funds have increasingly achieved a hegemonic position with respect to both share ownership and corporate governance.[304] In 1965, institutional investors collectively held less than 15 percent of

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[298] Dan Daskal, *ISS and Other Proxy Advisory Firms' Conflicts of Interest: Analyzing the Insufficiency of New Securities and Exchange Commission Rules and Guidance*, 3 COLUM. BUS. REV. 1487 (2021); Tamara C. Belinfanti, *The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control*, 14 STAN. J. L. BUS. & FIN. 384, 406 (2009).
[299] Daskal, *supra* note 283, at 1507-09.
[300] *Id*; Tao Li, *Outsourcing Corporate Governance: Conflicts of Interest within the Proxy Advisory Industry,* 64 MGMT. SCI. 2951 (2018).
[301] Jill Fisch, *Promoting Corporate Diversity: The Uncertain Role of Institutional Investors*, 46 SEATTLE U. L. REV. 367, 383 (2023).
[302] Brian G. Cartwright, General Counsel, Sec. & Exch. Comm'n, The Future of Securities Regulation, Speech at the University Law School Institute for Law and Economics (Oct. 24, 2007); Donald Langevoort, *The SEC, Retail Investors, and the Institutionalization of Securities Markets*, VA. L. REV. 1025, 1026-27 (2009); Steven M. Davidoff, *Paradigm Shift: Federal Securities, Regulation in the New Millennium*, 2 BROOK. J. CORP. FIN. & COM. L. 339, 340 (2008).
[303] Cartwright, *supra* note 287; Langevoort, *supra* note 287, at 1026-27.
[304] On the various species of institutional investors *see* Peter Molk & Frank Partnoy, *Institutional Investors as Short Sellers*, 99 B.U. L. REV. 837, 844 (2019). On the use of the term *institutionalization*, *see* Cartwright, *supra* note 338; Langevoort, *supra* note 338, at 1026-27; Davidoff, *supra* note 338, at 340. *See also* Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1922–23 (2013).

the shares of US listed companies.[305] Starting in the 1980s, institutional investors' concentration of ownership has rapidly increased.[306] Institutional investors held 20 percent of the shares of listed public US companies in 1980.[307] But that number increased to 50 percent in 2015.[308] Today, as anticipated, institutional investors hold on more than 70 percent of US public company shares.[309]

The reasons for de-retailization and concomitant institutionalization are complex. Some reasons can be traced to labor regulation and market forces.[310] But the development and slow acceptance of portfolio theory beginning in the 1950s, which warns investors that chances of beating the the market by stock picking are thin, also played a role. Beginning in the 1960s, financial intermediaries began to offer mutual funds as a relatively low-cost way for investors with modest portfolios to obtain the benefits of diversification.

The financial industry began to take on its current form with Vanguard's introduction of the passive indexed fund, taking portfolio theory to its logical limit, in 1971. This change rapidly accelerated after the Employee Retirement Income and Security Act of 1974 (ERISA), which encouraged employers to abandon defined benefit pensions in favor of defined contribution plans[311] consisting of individual employee accounts centrally managed diversified funds,[312] creating a large new market of middle class investors.[313] Today, most employees in the upper half of the income distribution are invested in the stock market via employer sponsored defined contribution retirement plans. Moreover, this group includes a steadily increasing number of women, due to increasing gender equality and pressures on household income with the decline in unionization and the demise of the family wage.[314]

Over the past two decades, The Big Three have quadrupled their stake in the S&P 500 companies.[315] Today, collectively the Big Three are the largest shareholder in almost all of the

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[305] See John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837, 848 (1999); see also BD. GOVERNORS FED. RSRV. SYS., FINANCIAL ACCOUNTS OF THE UNITED STATES: HISTORICAL ANNUAL TABLES 1965–1974, at 95 tbl.L.213 (2014), http://www.federalreserve.gov/releases/z1/20140306/annuals/a1965-1974.pdf.
[306] Edward B. Rock, *Institutional Investors in Corporate Governance*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 363, 365–67 (JEFFREY N. GORDON & WOLF-GEORG RINGE EDS., 2018).
[307] James M. Poterba & Andrew A. Samwick, *Stock Ownership Patterns, Stock Market Fluctuations, and Consumption*, 1995 BROOKINGS PAPERS ON ECON. ACTIVITY 295, 313 tbl.5.
[308] Germán Gutiérrez & Thomas Philippon, *Investment-less Growth: An Empirical Investigation* 15 fig.9 (Nat'l Bureau of Econ. Rsch., Working Paper No. 22897, 2016), https://www.nber.org/papers/w22897.f
[309] José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513, 1514 (2018); Gutiérrez & Philippon, *supra* note 344, at 15 fig.9.
[310] Rock, *supra* note 342, at 363, 365–67.
[311] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 879 (2013).
[312] *Id.* at 880-81.
[313] *Id.* at 879-80.
[314] *See infra* Part I.G.
[315] Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B. U. L. REV. 721, 723-24.

S&P 500 corporations.[316] Lucian Bebchuk and Scott Hirst have warned that with the continued growth of institutional investors, the Big Three will soon become the "Giant Three."[317]

Institutional investors, including common owners like the Big Three, buy and vote equities using money obtained from their own investees.[318] When a person invests in a fund, the person receives shares in the fund in exchange for money. Institutional investors use that money to buy, hold, and trade assets that are held in their portfolios. When these assets are equities, institutional investors get to exercise the voting rights that the equities carry. As a result, institutional investors command an immense number of votes.[319] Although most recently the Big Three have adopted pass-through voting devices that allow investees to select among a very limited array of thematic voting models,[320] traditionally funds' employees vote the shares held the portfolio without any effective accountability to the investees in the funds.[321] Since over 90 percent of the shares held by institutional investors are voted,[322] the vast majority of shares in US public companies are voted by institutional investors' employees, who are not answerable to funds' investees.

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[316] Jan Fichtner, Eelke M. Heemskerk & Javier Garcia-Bernardo, HIDDEN POWER OF THE BIG THREE? PASSIVE INDEX FUNDS, RE-CONCENTRATION OF CORPORATE OWNERSHIP, AND NEW FINANCIAL RISK, 19 BUS. & POL. 298, 313 (2017) (finding that cumulatively the Big Three constitute the largest shareholder in 88 of the S&P 500 companies).

[317] Bebchuk & Hirst, *supra* note 300, at 723. More recently, growth rates at the big three have slowed; however, the overall percentage of publicly traded shares held institutionally continues to increase. Alon Brav, Dorothy S. Lund, & Lin Zhao, *Flows, Financing Decisions, and Institutional Ownership of the U.S. Equity Market*, (Jan. 13, 2024), http://ssrn.com/abstract_id=4693837

[318] Fisch, *supra* note 337, at 383.

[319] Molk & Partnoy, *supra* note 340, at 846; COATES, *supra* note 319, at 32.

[320] Caleb Griffin, *Open Proxy*, (on file with Authors) (warning that pass-through voting practices could be temporary devices to appease regulators, politicians, and investees). In 2022, BlackRock instituted a new practice of pass-through voting called Voting Choice to allow some investees to express their voting preferences. BlackRock, *Empowering Investors Through BlackRock Voting Choice*, https://www.blackrock.com/corporate/about-us/investment-stewardship/blackrock-voting-choice (last visited July 9, 2024). Vanguard and State Street soon followed suit adopting pass-through voting for various of their funds. Morningstar, *Proxy-Voting Insights: BlackRock, Vanguard, State Street: How differently do the Big Three vote on ESG resolutions?* (June 13, 2023), https://corpgov.law.harvard.edu/wp-content/uploads/2023/06/blackrock-vanguard-state-street-esg-proxy-voting-FINAL061223.pdf (discussing the roll-out of pass-through voting by the Big Three). Paradoxically, BlackRock and Vanguard have a relatively high proportion of institutional investees—so the pass through may do no more than shift the vote from one set of executives to another. Dorothy S. Lund & Adriana Robertson, *Giant Asset Managers, the Big Three, and Index Investing*, *in* BOARD SHAREHOLDER DIALOGUE: POLICY DEBATE, LEGAL CONSTRAINTS AND BEST PRACTICES (LUCA ENRIQUES & GIOVANNI STRAMPELLI EDS., *forthcoming*), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4406204.

[321] Lund & Robertson, *supra* note 356. John Coates warns against the risks associated with excessive power concentrated in the hands of a handful of people. COATES, *supra* note 319, at 32. FINANCIAL INSTITUTIONS CONTROL EVERYTHING 32 (2023); John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve 2* (Harvard Pub. Law Working Paper, Paper No. 19-07, 2018).

[322] Kate Dore, *Few individual investors participate in shareholder voting. Here's how that may be changing*, CNBC (Oct. 12, 2021), https://www.cnbc.com/2021/10/12/few-individuals-participate-in-shareholder-voting-but-that-may-change.html (reporting that 92% of shares held by institutional investors were voted in 2020).

The Big Three have stewardship groups tasked to vote the shares in their portfolios.[323] But the stewardship groups of the Big Three are surprisingly small.[324] So, a few dozen people are in charge of voting the largest blocs of the shares in nine out of ten S&P500 companies and many other US public companies.[325] These people are also demographically homogeneous.[326] Most of the fund managers are White men.[327] Almost eight fund managers out of ten are men and seven fund managers out of ten are White.[328]

Stewardship group employees' identities fail to reflect the demographics and cultures of the investees; this is particularly troublesome because, according to the literature, funds' votes diverge from how the human investees would vote their shares.[329] In fact, fund employees have incentives to pursue the interest of the funds, rather than the interests of the investees.[330] Most fund managers profit from increasing value of their assets under management rather than pursuing environmental or social goals.[331] The pay structure of many fund employees incentivizes them to commit as little time and resources as possible informing themselves about the items on shareholder meeting agendas and to heavily rely on the work of the two relevant proxy advisory services, ISS and Glass Lewis.[332] As a result, shares in our corporations, the mammoths of our economy, increasingly are voted by a small circle of individuals.[333]

B. Proxy Advisory Firms Vote without Stocks

In 1988, the Department of Labor issued the "Avon No Action Letter," setting out its position that the fiduciary duties of pension and health funds to their beneficiaries include voting

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[323] Bebchuk & Hirst, *supra* note 300, at 2077.
[324] *Id.* at 2076-77; Lund, *supra* note 327, at 94–95.
[325] Fichtner, Heemskerk & Garcia-Bernardo, *supra* note 352, at 313; Bebchuk & Hirst, *supra* note 300, at 2076-77.
[326] *Investment Fund Manager Demographics and Statistics in the US*, ZIPPIA THE CAREER EXPERT, https://www.zippia.com/investment-fund-manager-jobs/demographics/ (last visited July 14, 2024); Amrutha Alladi & Gabrielle Dibenedetto, *The Percentage of U.S. Female Fund Managers Is Exactly Where It Was in 2000*, MORNINGSTAR (Mar. 15, 2021), https://www.morningstar.com/funds/percentage-female-fund-managers-is-almost-exactly-where-it-was-20-years-ago.
[327] *Investment Fund Manager Demographics and Statistics in the US*, *supra* note 311; Alladi & Dibenedetto, *supra* note 311.
[328] *Investment Fund Manager Demographics and Statistics in the US*, *supra* note 311; Alladi & Dibenedetto, *supra* note 311.
[329] Jonathan Zytnick, *Do Mutual Funds Represent Individual Investors*?, (last revised Jun. 6, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3803690. *See also* Robert J. Jackson, Jr. & Jonathan Zytnick, *Individual Investor Ideology* (on file with Authors).
[330] Fisch, *supra* note 337, at 384; Sean J. Griffith, *Opt-in Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority*, 98 Tex. L. Rev. 983 (2020).
[331] *See* STOUT, GRAMITTO, & BELINFANTI, *supra* note 32; *see also* Alessio M. Pacces, *Sustainable Corporate Governance: The Role of the Law*, *in* SUSTAINABLE FINANCE IN EUROPE: CORPORATE GOVERNANCE, FINANCIAL STABILITY AND FINANCIAL MARKETS 156-160 (D. BUSCH, G. FERRARINI, & S. GRÜNEWALD, EDS., 2021).
[332] STOUT, GRAMITTO, & BELINFANTI, *supra* note 32; Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2594-97 (2021); Lund & Robertson, *supra* note 356.
[333] On the issues that the concentration of power in the hands of a small group of people, *see* John C. Coates*, The Future of Corporate Governance Part I: The Problem of Twelve; see also* STOUT, GRAMITTO, & BELINFANTI, *supra* note 32.

shares held in the portfolios with loyalty and care.[334] In 2003, the SEC solidified the regulatory requirement to vote shares in compliance with fiduciary duties by Rule 206(4)-6, which requires investment advisors, or institutional investors, to adopt written policies and procedures assuring that institutional investors vote proxies in the fund investees' best interest.[335] The accompanying adopting release made hiring an unconflicted proxy advisory firm a desirable practice in discharging the voting duties.[336] So, regulation has nurtured the development of proxy advisory services.

The regulatory favor for proxy advisory firms is compounded by Rule 14a-2(b)(1).[337] Rule 14a-2(b)(1) exempts most communications with shareholders from the proxy solicitation requirements of the Securities and Exchange Act of 1934 under Rule 14a-3, so long as the person making the communication did not seek authority to act as a proxy for the shareholders.[338] Accordingly, proxy advisory services that offer voting advice, recommendation, guidance and service are not subject to the disclosure requirements of the 1934 Act. Ironically, this means that the advisory services have more freedom to discuss voting with different shareholders and the issuer than do their clients, the institutional investors (or employees of the investors' stewardship departments). Consciously or otherwise, the two major advisory services can play a coordinating role among shareholders that would be barred to other market actors.

Markets and regulation boosted the central role of proxy advisory services in corporate voting. But this shift in power from shareholders to non-shareholders raise several issues. First, it hands critical voting power to entities that do not hold a stake in the issuers.[339] Second, it hands voting power to entities whose margins highly depend on keeping labor cost low.[340] This is particularly troublesome in consideration of the short time frame available to analyze and process information before the vote. Third, economy of scale and business models based on cost incentivize institutional investors to minimize the resources committed to voting and associated expenses, too.[341]

The Securities and Exchange Commission (the "SEC") expressed concerns about the power and risks associated with proxy advisory firms in 2010.[342] In seeking public comment on

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[334] Jill E. Fisch & Jeff Schwartz, *Corporate Democracy and the Intermediary Voting Dilemma* (Working Paper, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4360428
https://www.ecgi.global/sites/default/files/working_papers/documents/corporatedemocracyandtheintermediaryvotingdilemma.pdf

[335] SEC, *Proxy Voting by Investment Advisors*, Release No. IA-2106; File No. S7-38-02 (March 10, 2003), https://www.sec.gov/rules-regulations/2003/01/proxy-voting-investment-advisers.

[336] *Id.*

[337] 17 C.F.R. § 240.14a-2 (2022).

[338] *Id.*

[339] Asaf Eckstein, *Skin in the Game for Credit Rating Agencies and Proxy Advisors: Reality Meets Theory*, 7 HARV. BUS. L. REV. 221, 231 (2017).

[340] Bernard S. Sharfman, *Opportunism in the Shareholder Voting and Engagement of the "Big Three" Investment Advisers to Index Funds*, 48 J. CORP. L. 463, 473–74 (2023).

[341] Fisch, Hamdani, & Davidoff Solomon, *supra* note 319, at 29; Kovvali, *supra* note 275, at 173.

[342] *SEC Votes to Seek Public Comment on U.S. Proxy System*, SEC.GOV (July 14, 2010), https://www.sec.gov/news/press/2010/2010-122.htm.

the proxy system, the SEC stated that "proxy advisory firms may…fail to conduct adequate research and base [their] recommendations on erroneous or incomplete facts."[343] Since then, the power and in of proxy advisory firms has grown even further, to the point that they can be considered "quasi-regulators." Entities that have no-skin in the game, no equity interest in the issuers are able to sway as much as 30 percent of votes.

C. The End of the Matter

Separation of ownership from ownership—in other words, the agency problem that arises when fund managers and fund employees vote shares acquired with the money of the investees—has progressively insulated corporations from natural people. This phenomenon is made even more problematic by the mechanics of current corporate governance, which largely relies on the voting recommendations provided by the two relevant proxy advisory firms, ISS and Glass Lewis, and by the persuasive power of hedge funds.

The current share ownership model combined with the mechanics that control corporate governance have insulated corporations from the needs and concerns of the everyday person. They have also been hindering innovation, which would benefit society at large. They have been stagnating salaries.[344] They have been straining people from the corporate sector and capitalism.

Moreover, homogeneous demographics of fund managers further exacerbate the divide between society and the corporate sector by skewing representation of ethnicities, cultures, races, genders, life experiences, and weltanschauungs. This is particularly troublesome in consideration of the leverage on the corporate sector that voting shares grants. The role of proxy advisory firms, which raises concerns for potential conflicts of interests, further undermine the role of shareholders—individuals and institutions—willing to exercise their votes on the basis of a serious due diligence. Over reliance on the voting recommendations of proxy firms hands Corporate America to decision makers that do not have stakes (or skin in the game) in the issuers.[345] This is the nail in the coffin of the shareholder democracy mirage.

V. CONCLUSION

Shareholder democracy is a rhetorical device with no roots in reality. The distribution of share ownership is not democratic. Rather, it is the uneven result of unjust laws and practices. Only one household out of five owns company shares directly. So, only one household out of five has its voice heard in Corporate America, with the voice of some families overbearing all the others.

Shareholder governance is not democratic either: although the majority of shareholders are human beings, institutions (not individuals) have hegemonic voting powers and influence on business corporations. Hegemonic forces (not a plurality of views) have governed collective decision-

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[343] *Id.*
[344] Goshen & Levit, *supra* note 28.
[345] Tamara C. Belinfanti, *The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control,* 14 STAN. J. L. BUS. & FIN. 384, 406 (2009).

making since the Ancient Greek *ekklesia*. In shareholding, this pattern is further compounded by the one-share-one-vote paradigm. The one-share-one-vote paradigm overly rewards concentration of shares, held by common owners like the Big Three, accompanied by low-cost voting practices that rely on the recommendations of proxy advisory firms, which are entities with no stakes in the issuers.

Moreover, the structure and power-dynamics of business corporations are markedly different from those of political democracies. There is no space for loyal opposition in corporate law, and the incumbents are allowed to use corporate resources to perpetuate their power. Rather than through engagement, shareholders have their main form of protection through selling their shares and leaving the company. Different from civic engagement in political democracies, shareholders resort to an exit strategy that further empowers institutions and hegemonic forces.

There hardly is anything democratic in shareholding. This Article debunks the shareholder democracy myth and shows that it is time to put this rhetoric to rest. From its inception in the 1920s, shareholder democracy has been a lie, which has only been exacerbated over the past century. Shareholding has never been democratic in any sense of the word.