Brooklyn Journal of Corporate, Financial & Commercial Law

Volume 2 | Issue 1 Article 2

2007

Against Shareholder Participation: A Treatment For McConvill's Psychonomicosis

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AGAINST SHAREHOLDER PARTICIPATION: A TREATMENT FOR MCCONVILL'S PSYCHONOMICOSIS

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I. INTRODUCTION

A current debate in corporate law and governance concerns how power should be allocated among directors, shareholders and management. Proposals to strengthen the power of shareholders include an American Bar Association proposal to amend the Model Business Corporation Act to require a majority vote for the election of directors,[1] a recent congressional initiative mandating advisory shareholder votes on executive pay plans[2] and Lucian Bebchuk's effort to vindicate undistorted shareholder choice in a takeover context.[3] Additionally,

> [t]he Delaware General Assembly has recently adopted an amendment to the Delaware General Corporation Law which provides that where shareholders have adopted a majority voting bylaw for corporate elections over the traditional plurality scheme, a corporation may not subsequently amend its bylaws to return to plurality voting without shareholder approval.[4]

While these initiatives may have little positive impact on stock prices,[5] various efforts to strengthen shareholders' power at the expense of insiders have gained wider support in the wake of Enron, WorldCom and the

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** Levy Fellow, George Mason University School of Law. Elizabeth McKay, Randall Clark, Lloyd Cohen, Peter Henning, Bruce Johnsen, Michael Krauss and Joshua Wright provided helpful comments on earlier drafts. The usual caveat applies. Our research was entirely supported by funds provided by the Law & Economics Center at George Mason University School of Law.

1. *See* Press Release, Am. Bar Ass'n, Corporate Laws Committee Releases Preliminary Report on Director Voting (Jan. 17, 2006), *available at* http://www.abanet.org/buslaw/committees/CL270000pub/directorvoting/20060117000000.pdf.

2. Rachel McTague, *Frank Urges Advisory Shareholder Vote on CEO Pay Gives Alternative to Divestiture*, 39 Sec. Reg. & L. Rep. (BNA) 377 (Mar. 12, 2007).

3. Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002) (explaining an undistorted shareholder choice approach to corporate takeovers).

4. John Verret, *Pandora's Ballot Box, or a Proxy with Moxie? The Majority Voting Amendment to Delaware Corporate Law* 1 (Bepress Legal Series, Working Paper No. 2015, 2007), *available at* http://law.bepress.com/expresso/eps/2015.

5. *See* William K. Sjostrom, Jr. & Young Sang Kim, Majority Voting for the Election of Directors (Feb. 24, 2007) (unpublished article), *available at* http://ssrn.com/abstract=962784 (offering an empirical study of market reaction to the adoption by firms of a majority voting requirement for the election of directors and showing that, at least when shareholders lack veto authority over candidates, these so-called reforms amount to little more than "smoke and mirrors").

Sarbanes-Oxley Act.[6] Given this environment and despite evidence that verifies stronger corporate governance rules do not "unambiguously show that corporate governance reduces the agency problems of moral hazard and adverse selection,"[7] much academic commentary supports such shareholder-empowering governance initiatives.[8] This is despite the probability that most (but not all)[9] initiatives ignore evidence showing that separation of ownership and control justifies the current regime of limited shareholder voting rights and director control as the default rule.[10]

Notwithstanding the blizzard of proposals aimed at strengthening shareholder power, it is widely recognized that neither the notion of shareholder ownership nor the assertion that stockholders are risk-bearing residual claimants provides a convincing ground for shareholder primacy.[11] "Active investor involvement in corporate decisionmaking seems likely to disrupt the very mechanism that makes the public corporation practicable: namely, the centralization of essentially non-reviewable decisionmaking authority in the board of directors."[12] The business judgment rule rightly effects a compromise between two competing values: authority and

6. *See, e.g.*, Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 WAKE FOREST L. REV. 1131, 1131 (2006).

7. Valentina G. Bruno & Stijn Claessens, *Corporate Governance and Regulation: Can There Be Too Much of a Good Thing?* 9 (Eur. Corp. Governance Inst., Finance Working Paper No. 142/2007, 2006), *available at* http://ssrn.com/abstract_id=956329. The authors further note that agency cost problems "can arise from reverse causality, that is, companies [may] improve their corporate governance practices . . . [as a commitment device] when raising new funds." Or alternatively they become more dependent on external financing, which may "trigger changes in [the] companies' corporate governance structures, in part . . . [because investors] require [such] changes." *Id.*

8. *See, e.g.*, Lucian Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 835, 847–50 (2005) (raising a number of proposals that might increase the power of shareholders). *But see*, Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 622–24 (2006) (pointing out the mechanical difficulties of achieving consensus among thousands of shareholders impede their active role). *See also* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) ("Chief among [the] pressures [for convergence in governance practices] is the recent dominance of a shareholder-centered ideology of corporate law . . . . It is only a matter of time before its influence is felt in the reform of corporate law as well.").

9. For an innovative reform proposal that might maintain directors' discretion in light of the separation of ownership and control, but which might also help more properly align directorial oversight, see Assaf Hamdani & Reinier Kraakman, *Rewarding Outside Directors* (Harvard John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 578, 2007), *available at* http://ssrn.com/abstract=959210.

10. *See, e.g.*, Stephen Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006).

11. Antoine Rebérioux, *Shareholder Primacy and Managerial Accountability* 1–2 (Comparative Research in Law & Political Econ., Research Paper No. 01, 2007), *available at* http://ssrn.com/abstract=961290 (suggesting, among other things, that "when contracts are incomplete, non-shareholder constituencies—and in particular workers investing in specific human capital—do bear risk").

12. Bainbridge, *supra* note 10, at 1749.

accountability.[13] This compromise favors the director primacy model as the best explanation of authority and disfavors (but does not necessarily eliminate) accountability of shareholders. This suggests that contemporary shareholder-empowerment initiatives unwisely endeavor to vindicate accountability fears at the expense of necessary authority.

Some corporate governance proposals aimed at enhancing shareholder participation appear to reflect discontent with traditional economics on the one hand and an apparent embrace of the emerging literature on happiness on the other.[14] "Whereas economics assumes that people's choices advance their well-being, the happiness literature suggests that, in many settings people make poor choices that undermine their happiness or subjective well-being."[15] Corporate law scholar James McConvill emphasizes that this emerging focus on happiness is simply a form of psychonomics.[16] McConvill supplies analysis that appears to substantiate the happiness literature's critique of traditional economic assumptions that inform typical corporate governance debates. His analysis serves to advance an ongoing effort to empower shareholders and diminish the power of directors. Instead of concentrating on economic return, McConvill proposes shareholder participation as a happiness-realization vehicle in order to create a new approach to corporate governance.

Far from endorsing the existing state of affairs, McConvill proposes a novel corporate governance approach that issues forth as an endless process of participation and self-discovery that forms a new normality: shareholder empowerment as end in itself.[17] While the satisfaction of selfish motives remains an unruffled objective, material gain as a maxim is exchanged for participatory experience. He disputes the judgment that "[a] business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end."[18]

In the traditional corporate model, shareholders have little room to originate action or participate in corporate decisionmaking. McConvill contests customary conceptions of rational choice analysis for shareholders,[19] and argues, "the perceived logic which encapsulates rational

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13. *See, e.g.*, Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 85–87 (2004) (arguing that the business judgment rule is designed to effect a compromise between two competing values: authority and accountability).

14. Mathew D. Adler & Eric Posner, *Happiness Research and Cost-Benefit Analysis* 1 (Univ. of Pa. Law Sch., Scholarship at Penn Law Paper No. 167, 2007) *available at* http://lsr.nellco.org/upenn/wps/papers/167 (providing background on happiness literature and cost-benefit analysis).

15. *Id.*

16. James McConvill, *Shareholder Empowerment As an End in Itself: A New Perspective on Allocation of Power in the Modern Corporation*, 33 OHIO N.U. L. REV. 1013, 1039–43 (2007).

17. *Id.* at 1015.

18. *See id.* at 1028 (quoting Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919)).

19. *Id.* at 1057–59.

choice theory fails to appreciate the non-financial benefits that can be derived from increasing shareholder power."[20] McConvill's fresh look requires explication and a critique.

In Part II, this article supplies comments regarding the authors' understanding of economics. It then discusses economics' limitations in explaining human behavior, and outlines the prevailing terms of the corporate governance debate. Part III supplies a general critique of McConvill's analysis. This Part examines McConvill's failure to provide empirical research that sustains his claim that shareholder empowerment is a necessary ideal.[21] This Part also examines the costs of increased shareholder participation, including the costs incurred in initiating and implementing changes to the current system and the related implications for corporate performance. The evidence destabilizes McConvill's contention that increased shareholder participation can ever be a cost-free good. The analysis concludes that social happiness through participation is an optimizing problem, not a maximizing problem, so that more participation is not necessarily better. This article is the first of a series of articles[22] offering critical analysis to vitiate McConvill's Panglossian conclusions.

II. EXAMINING THE BACKGROUND AND MCCONVILL'S PARADIGM

A. BACKGROUND: PROVIDING A FRAMEWORK FOR ANALYSIS

1. The Economic Cases For and Against Shareholder Passivity and Separation of Ownership and Control

In order to grapple with the ideas and currents that ripple through McConvill's essay, it is helpful to appreciate that his article echoes an emerging tension between active shareholder participation and passivity. Traditional economics and cost-benefit analysis makes a case for shareholder passivity in the face of organizational and transactional complexity. Most scholars, since "the days of Adolph Berle and Gardiner Means . . . have understood that in public corporations, shareholder 'ownership' does not mean shareholder control."[23] McConvill observes that separation of ownership and control "naturally developed through the simultaneous evolution of control in the hands of professional directors and

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20. *Id.* at 1057.

21. Instead of empirical evidence linked to shareholders, McConvill provides implicit analogies in the form of studies about participatory activities and their effects on human happiness. *See* discussion *infra* Part II.A.

22. *See, e.g.*, R. Sean Alley & Harry G. Hutchison, The High Costs of Shareholder Participation (Nov. 7, 2007) (unpublished manuscript, on file with author).

23. Lynn Stout, *The Shareholder as Ulysses: Some Empirical Evidence On Why Investors in Public Corporations Tolerate Board Governance*, 152 U. PA. L. REV. 667, 667–78 (2003).

diminished [the] status of ownership, resulting from control being removed as one of the characterizing features of property."[24] This trend was accelerated by the dispersion of ownership—the absence of a single shareholder with a large enough stake to exercise control—and accompanied by managers holding only a small stake in the enterprise.[25]

McConvill asserts that the position of shareholders has changed from an active to a passive role and shares of stock have become simple pieces of paper that contain certain financial expectations but provide little or no control over the physical property and the instruments of production of the enterprise.[26] The shares represent a financial interest in the affairs of the corporation while allowing the firm's directors and executives to get on with managing the firm.[27] Shareholders operate within a framework characterized by bounded rationality and complexity, are widely dispersed, have different time horizons and have difficulty reaching collective decisions.[28] Thus, typical corporate law scholarship implies that shareholders are rationally apathetic,[29] because they lack both the interest and the incentive to "devote much time to, or to acquire significant expertise in, the firm's affairs."[30] Evidently shareholders, aware of their own opportunity costs, decide not to trade their time for more corporate participation. They primarily desire material well-being, which directors, as platonic guardians, seek to maximize.[31]

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24. McConvill, *supra* note 16, at 1019.

25. *Id.*

26. *Id.* at 1020 (quoting ADOLPH A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 116 (rev. ed., 1967) (1932)).

27. *See id.* at 1021.

28. Harry G. Hutchison, *Director Primacy and Corporate Governance: Shareholder Voting Rights Captured by the Accountability/Authority Paradigm*, 36 LOY. U. CHI. L.J. 1111, 1201 (2005).

29. *See* Stout, *supra* note 23, at 673.

> The typical public firm has thousands or even hundreds of thousands of shareholders. How can these individuals reach a collective decision? Shareholder voting is slow, difficult and expensive, even with modern information technology. In contrast, a board of ten or twelve members can meet and vote on these issues relatively quickly, easily and cheaply. . . . Director voting offers other important advantages over shareholder voting as well. In the typical public firm, ownership is widely dispersed, with most investors holding only a relatively small portion of the firm's outstanding shares. As a result, few shareholders have the incentive to devote much time to, or to acquire significant expertise in, the firm's affairs.

Id. See also Bainbridge, *supra* note 8, at 622–24 (pointing out the mechanical difficulties of achieving consensus among thousands of shareholder impede their active role).

30. Stout, *supra* note 23, at 673; *see also* Hutchison, *supra* note 28, at 1201 ("The capability of shareholders (as a disparate group) to manage relatively large corporations is hindered by collective action problems tied to disparate preferences, different persuasive abilities, different time horizons, as well as differing capacities to digest pertinent financial, microeconomic and macroeconomic information even when widely available.").

31. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 560 (2003).

America's leading corporate jurisdiction has adopted a particular solution to accommodate separation of ownership and control. Delaware's General Corporation Law is grounded in the conclusion that "it is not feasible for shareholders, the owners of the corporation, to exercise day-to-day power over the company's business and affairs."[32] Although this version of shareholder primacy, coupled with management by directors, may be rooted in what Rebérioux calls the "philosophy of dispossession,"[33] one might argue that "boards can . . . retain power pursuant [to] a . . . corporate governance approach that allows contracting parties to agree in advance via the corporate charter to allow the board to entrench itself."[34] Thus understood, shareholders engage in a form of private ordering called "precommitment," where they bind themselves "ex ante, . . . to improve their collective position ex post."[35] However, board "[e]mpowerment has a cost—it risks entrenchment and self-interested behavior, which may reduce shareholder wealth. Hence, courts and shareholders are properly concerned about accountability."[36]

But accountability concerns alone cannot serve as the basis to empower shareholders. While it is possible that the director-primacy model risks increased agency costs[37] in exchange for more managerial freedom of initiative, leading to superior corporate performance,[38] the shareholder-primacy model, if viable, contributes to ex post and ex ante inefficiencies.[39] Stephen Bainbridge shows that the director primacy-based system of corporate governance, as explained by the model of rational choice, has served investors and society well.[40] "[T]his record of success has occurred not in spite of the separation of ownership and control, but *because* of that separation."[41] Limited shareholder power is consistent with an accurate

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32. UniSuper Ltd. v. News Corp., 2005 Del. Ch. LEXIS 205, at *25. (The Supreme Court of Delaware accepts the conclusion that shareholders are both the true owners and the true principals of the firm). *But see* Hutchison, *supra* note 28, at 1196–200 (disagreeing with this move because it delimits beneficial risk-taking by the board of directors).

33. Rebérioux, *supra* note 11, at 5 ("This situation has led to an exclusive focus on the question of control: how can the lost power be recovered?"); *see also* Hutchison, *supra* note 28, at 1175 (discussing the interplay between *Unocal* and *Blasius* and criticizing the validation of voting rights independent of the shareholders' contract rights because that might incorrectly imply stockholder control and shareholder-based authority as the null hypothesis).

34. Hutchison, *supra* note 28, at 1114.

35. Marcel Kahan & Edward B. Rock, *Precommitment and Managerial Incentives: Corporate Constitutionalism: Antitakeover Charter Provisions as Precommitment*, 152 U. PA. L. REV. 473, 522 (2003).

36. Hutchison, *supra* note 28, at 1201.

37. Lynn Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1200 (2002).

38. *See, e.g.*, Bruno & Claessens, *supra* note 7, at 6–7, 39–46 (providing empirical evidence on a cross-country basis indicating that optimal corporate governance does not imply either greater regulation or greater accountability).

39. *See* Stout, *supra* note 37, at 1200–01.

40. Bainbridge, *supra* note 8, at 636.

41. *Id.* (emphasis added).

description of how corporations work,[42] as well as the necessity of constraining accountability in order to preserve authority.[43]

This contractarian model is not without its critics. One scholar implies the contractarian model is deficient because it is based largely on the perfect-market assumption.[44] However, though the market may be imperfect and contract theory not flawless, similar or worse imperfections plague other theories of corporate governance without responding adequately to the authority-versus-accountability conflict. Contractarianism is grounded in the conclusion that individual preferences lead to decisions that denote the perceived preferences of the organizers and investors within the firm. Contractarian analysis is informed by the director primacy model and embraces shareholder weakness.[45] In spite of the problems, and critics such as Alchian and Demsetz,[46] most commentators remain contractarians,[47] animated by the belief in the necessity of fiat.[48]

Economic assumptions are embedded in the separation of ownership and control paradigm. Tension surfaces because law and economics, as a general rule, tend to produce distributive results that are not universally agreed upon. Typical corporate governance models operate as forms of private ordering that require hierarchs to make decisions. When directors

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42. Bainbridge, *supra* note 10, at 1735.

43. KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 78 (1974).

44. Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 781 (2006); *see also* Giulio Palermo, *Misconceptions of Power*: *From Alchian and Demsetz to Bowles and Gintis* (Univ. of Brescia, Dept. of Econ., Discussion Paper 05/10, 2005), *available at* http://www.unibs.it/on-line/dse/Home/Inevidenza/PaperdelDipartimento/articolo3483.html.

45. *See, e.g.*, Bainbridge, *supra* note 10, at 1735.

46. Alchian and Demsetz's property rights approach denies the existence of authority. For a summary, see Palermo, *supra* note **Error! Bookmark not defined.**, at 2–4; *see also* Armen A. Alchian & Harold Demsetz, *Production, Information Costs and Economic Organization*, 62 AMER. ECON. REV. 777 (1972).

> It is common to see the firm characterized by the power to settle issues by fiat, by authority, or by disciplinary action superior to that available in the conventional market. This is delusion. The firm does not own all its inputs. It has no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting between any two people.

Id. at 777. *But see* Oliver Williamson, *Efficiency, Power, Authority and Economic Organization*, *in* TRANSACTION COSTS ECONOMICS AND BEYOND 33 (John Groenewegen, ed., 1996) (suggesting that Alchian and Demsetz are wrong: "firms can and do exercise fiat that markets cannot").

47. We accept this description for purposes of corporate governance, but we do not necessarily accept, for example, the external derivation of ideals that culminates in John Rawls contractarianism. For an accessible discussion of these issues see NICHOLAS L. GEORGAKOPOULOS, PRINCIPLES AND METHODS OF LAW AND ECONOMICS: BASIC TOOLS FOR NORMATIVE REASONING 25–27 (2005).

48. *See, e g.*, William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1400 (1993) (acknowledging that contractarianism is the "dominant legal academic view"); *see also*, Stephen M. Bainbridge, *The Bishops and the Corporate Stakeholder Debate*, 4 VILL. J. L. & INVESTMENT MGMT. 3, 13 (2002).

make decisions that ostensibly benefit the firm and create shareholder wealth, they engage in trade-offs that are protected by the business judgment rule. However, corporate managers and the board often discover their interests are not completely aligned with shareholders', which raises the specter of agency costs.[49] This development is accompanied presumably by unfair distributions, undemocratic decision-making and inadequate control by capital holders. Thus, many observers challenge those economic assumptions underlying the customary default rule of director empowerment.

2. The Difficulty of Using Pure Economics to Explain Human Behavior

Uncertainties coupled with introspective and public dissatisfaction, have risen to prominence ever since Americans discovered that democracy and radical human autonomy yield less than they promised. Critics of the existing social and economic order, driven by social psychology or otherwise, seek non-market solutions or advance proposals that are disconnected with the price system in an effort to change the existing order. This move appears to be grounded in the inability of standard economics and market forces to justify a human life that appears, for all its contemporary advantages, nasty, brutish, unfair and beyond the control of individuals and, thus, without meaning. In other words, shareholders, like other partly rational human agents, lead incompletely explained and unfulfilled lives that conform to Aldous Huxley's perdurable perception of modern humanity.[50] An individual's sense of despair and unfairness and her craving for alternative doors of perception may correlate inversely with her sense of freedom.[51] Since an individual's sense of freedom and the definition of freedom itself are apt to vary across the population, the resultant disenchantment reflects the inability of any existing approach to solve all problems or justify the current allocations of resources and the current ends of economic institutions on terms that all will endorse.

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49. *See* Stout, *supra* note 37, at 1200.

50. ALDOUS HUXLEY, THE DOORS OF PERCEPTION 62 (Harper & Row 1970) (1954) ("Most men and women lead lives at the worst so painful, at the best so monotonous, poor and limited that the urge to escape, the longing to transcend themselves if only for a few moments, is and has always been one of the principal appetites of the soul.").

51. Sebastiano Bavetta et al., Autonomy Freedom and Preferences for Redistribution 2–3 (Jan. 23, 2007) (unpublished article), *available at* http://ssrn.com/abstract=958948.

> People who enjoy autonomy have, to a large extent, control over their achievements so, what they perceive as fair or unfair is likely to depend upon the degree of autonomy they enjoy. . . . [Thus] the higher is the extent of autonomy freedom perceived by an individual, the higher is the probability that he supports the view that larger income differences are needed as incentives for individual effort.

Id.

On one hand, classical economics implies that humans can be defined and human capability can be measured by the concept of rationality.[52] Rationality presupposes the capacity of individual choice.[53] On the other hand, notions of revealed preferences and rational utility maximization materialize potentially as an empty suit. The distributional consequences and the dissatisfying implications for human life in a postmodern age, where individuals are unable to experience the happiness that material goods and consumption once fostered, are troubling. The foundational notion of rational economic man and its implied norm, "wealth maximization," have come under attack. This assault persists despite the fact that rational choice implicates the fulfillment of *both* pecuniary and nonpecuniary wants.[54]

On one account, "[e]conomics can be distinguished from other social sciences by the belief that most . . . behavior can be explained by assuming that agents have stable, well-defined preferences and make rational choices consistent with those preferences in markets that (eventually) clear."[55] Additionally, "[e]conomics has assumed that all men pursue their private interest[s]."[56] That is to say, they aim to maximize something, but what that something is, is debatable.[57] The field of law and economics frequently explains outcomes via wealth maximization rather than social welfare maximization.[58] Others endeavor to diminish contractarian explanations of corporate law by invoking *trust*.[59] Intuitively, trust with its moral

52. Sandra J. Peart & David M. Levy, *Attitudes Towards Race, Hierarchy and Transformation in the 19th Century*, 47 HIST. ECON. THOUGHT 15, 18 (2005).

53. *Id.*

54. Bruce E. Kaufman, *Expanding the Behavioral Foundations of Labor Economics*, 52 INDUS. & LAB. REL. REV. 361, 363 (1999).

55. *Id.* at 364.

56. DENNIS C. MUELLER, PUBLIC CHOICE II, at 1 (1989).

57. Adam Smith may be the source of this debate. *See, e.g.*, ADAM SMITH, THE THEORY OF MORAL SENTIMENTS 1 (Dover Publications, Inc. 2006) (1759) ("However selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.").

58. Christine Jolls, *Behavioral Law and Economics* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 12879, 2007), *available at* http://www.nber.org/papers/w12879 (suggesting that the focus on the maximization of wealth rather than social welfare is driven by the conclusion that the distributional issues that bear on social welfare can be best addressed through the tax system). As an elementary matter of course,

> [t]he idea of a social welfare function is part of normative economics . . . [beginning] with the fundamental idea of utility as a conception or measure of the good. Economists may disagree about the nature of utility, the relationship of utility to social welfare, and the role of welfare in public policy, but most (if not all) economists would assent to the abstract proposition that ceteris paribus more utility is a good thing.

Lawrence Solum, *Legal Theory Lexicon*, http://lsolum.typepad.com/legaltheory/ (last visited Nov. 19, 2007).

59. *See, e.g.*, Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595 (1997).

underpinnings, provides non-pecuniary benefits and implicates richer normative values than monetary wealth-maximization.[60]

Disappointed perhaps by the debate over ordinal or cardinal utility[61] as well as the non-interpersonal comparability of such measures commentators conclude, "An important step in expanding the traditional analysis of individual rational choice is to incorporate into the theory a much richer class of attitudes, preferences, and calculations."[62] Dissatisfaction with the notion of revealed preference and rational utility maximization is grounded in the premise that people often do not know what is in their interest.[63] This development is related to the concepts of bounded rationality, bounded willpower and bounded self-interest.[64] Bounded rationality reflects the limited cognitive abilities that constrain human problem-solving. Bounded willpower captures the fact that people sometimes make choices that are not in their long-run interest. Bounded self-interest incorporates the fact that humans are often willing to sacrifice their own interests to help others.[65] Human irrationality thus presents an epistemological challenge to any pretensions of normative economic analysis,[66] including existing shareholder-participation rights.

While such critiques of normative economic analysis are valid, attempts to undermine the notion of the rational decision-maker must tackle an endogenicity problem: Unless they come from a different gene pool than the rest of us, the architects of such critiques face the risk that their analysis is tainted by their own irrationality.[67] Furthermore, while economics has

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60. *Id.* at 604.

61. For an explanation of cardinal and ordinal measurement, see, e.g., Ralph Byrns, *Cardinal Measures and Ordinal Measures*, http://www.unc.edu/depts/econ/byrns_web/Economicae/Essays/CardOrdinal.htm (Cardinal measurement of utility assumes satisfaction is measurable in absolute number. That is, it provides a constant and reasonably objective measure of utility. Ordinal measurement of utility assumes that "[s]atisfaction is not cardinally measurable. Instead, relative numbers provide rankings . . . .").

62. Kaufman, *supra* note 54, at 362 (internal quotation omitted).

63. For an incisive discussion of this issue and related ones, see Lloyd R. Cohen, *The Lure of the Lottery*, 36 WAKE FOREST L. REV. 705, 737–44 (2001).

64. *See* Sendhil Mullainathan & Richard H. Thaler, *Behavioral Economics* (Mass. Inst. of Tech. Dept. of Econ., Working Paper No. 00-27, 2000), *available at* http://www.economics.harvard.edu/faculty/mullainathan/papers/Encyclopedia.pdf.

65. *Id.* Indeed it appears "that [if] human consciousness has content and character and . . . it is not an empty box, there is no limit to the range of human activity that can be found wanting." Cohen, *supra* note 63, at 737. This includes such puzzles as why dozens of drivers bypass petroleum-based diesel stations for more expensive biodiesel at Dr. Dan's Alternative Fuel Werks, *see id.*, or why John Dober and David Nitschman, Moravian missionaries, were prepared to sell themselves into slavery *in order to reach* the slaves of the West Indies. *See* David Smithers, *Count Zinzendorf and the Moravians,* Awake and Go! Global Prayer Network, http://www.watchword.org/index.php?option=com_content&task=view&id=48&Itemid=48.

66. Cohen, *supra* note 63, at 737.

67. *See, e.g.*, Free Exchange: Problem or Solution?, ECONOMIST.COM, http://www.economist.com/debate/freeexchange/2007/02/problem_or_solution.cfm (discussing the issue of rational decision making within the context of government).

much to say about social welfare in a broad sense, it cannot explain all of life. Although some commentators imply that human self-interest can be explained simply as avaricious greed or monetary self-interest,[68] a more complete description of human rationality should admit a wider array of explanations for the choices humans make. Simple material gain supplies only "one of many motives propelling economic [and other] activity."[69] It seems that "a richer appreciation of self-interest helps to explain human behavior in the contemporary world."[70] Still, the controversy concerning the source and consequences of individual choice persists.

B. MCCONVILL'S CLAIMS

1. Shareholder Participation As The New Goal

In response to this controversy, new or hybrid fields have developed to fill perceived epistemic voids in the study of the distribution of goods and the provision of human welfare. These developments have led to social psychology, which in combination with economics, morphs into behavioral economics[71] or psychonomics. Commentators have expressed concern about the absence of active participation. Some have insisted that citizens must not be mere passive beneficiaries, but instead must be active participants in the control process.[72] The theory proceeds as follows: diminished participation leads to diminished happiness. In his effort to fill the perceived "happiness" void in western societies,[73] McConvill offers a rather open-ended form of shareholder participation as a fulfillment device.

The two most important institutions in America's politico-economic system, democracy and the market, make individual preferences decisive in the formation of policy and the allocation of resources.[74] In corporate law

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68. *Cf.* DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION 7 (1991) (implying that self-interest simply means avaricious greed in a simple monetary sense as opposed to ideological/nonmaterial considerations).

69. Harry G. Hutchison, *A Clearing in the Forest: Infusing the Labor Union Dues Dispute with First Amendment Values*, 14 WM. & MARY BILL RTS. J. 1309, 1312 (2006).

70. *Id*.

71. *See* Mullainathan & Thaler, *supra* note 64.

72. CHRISTOPHER SHANNON, CONSPICUOUS CRITICISM: TRADITION, THE INDIVIDUAL, AND CULTURE IN MODERN AMERICAN SOCIAL THOUGHT 121 (rev. ed., Univ. of Scranton Press 2006) (1996) (describing but not agreeing with this move).

73. *See* McConvill, *supra* note 16, at 1039–57.

74. Herbert Hovenkamp, *The Limits of Preference-Based Legal Policy*, 89 NW. U. L. REV. 4, 4 (1994). Hovenkamp asserts that there are two sub-disciplines within legal study that have come to reflect the importance of preferences in our governmental system: law and economics and the theory of public choice.

> Under neoclassical economics, the only human needs or wishes taken into account are those expressed through 'revealed preference,' or utility maximization, where 'utility' is understood as the individual's rank ordering of preferences. . . . [T]he theory of public choice . . . also applies economic theory, but this time to the behavior of voting, or political, markets. The model of public choice assumes that voters vote their

and prevailing modes of corporate governance, individual choice is reflected in contractarianism.[75] Typically, in large, publicly traded firms, the preferences that, under the contractarian model, drive corporate decisionmaking[76] yield governance structures where directors and managers, assisted by the business judgment rule,[77] direct and participate. Shareholders rarely initiate activity. There is a limited role for shareholders in ensuring that "corporate decisions are unbiased, informed, established in good faith, [and] made in the[ir] best interest."[78] This limited role is vindicated by shareholder ability to file derivative actions to redress alleged corporate injuries for breach of fiduciary duties.[79]

However, this limited role prompts dissatisfaction.[80] Commentators thus have engaged in a pressing search for alternative conceptions of corporate governance that would justify a more robust role for shareholders. This search has led to a "series of recent initiatives in the United States to increase the participatory rights, and hence the power, of shareholders,"[81] including McConvill's proposal.[82]

On one level McConvill appears to be a contractarian who accepts the possibility that the existing default rules may accord with the preferences of shareholders.[83] On another, he is dissatisfied with the customary outcome of this contractual exchange. He accepts the claim that greater personal happiness comes "when participating with other[s] . . . to build . . .

> preferences, or that elected representatives behave in a way that will maximize their chances for re-election or for some other enhancement of their position.

Id. at 4–5.

75. See *supra* Part II.A.1 for a brief discussion of contractarianism.

76. *Id.*

77. One argument in favor of the business judgment rule is that in its absence, "officers and directors would fail to make the risk-neutral business decisions desired by investors who can limit their overall investment risk through diversification." Jolls, *supra* note 58, at 27.

78. Harry G. Hutchison, *Presumptive Business Judgment, Substantive Good Faith, Litigation Control: Vindicating the Socioeconomic Meaning of Harhen v. Brown*, 26 J. CORP. L. 285, 286 (2001).

79. *Id.*

80. *See, e.g.*, scholars cited *infra* note 82.

81. McConvill, *supra* note 16, at 1013.

82. Other articles that advocate greater shareholder empowerment include Lucian Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 8; Bebchuk, *supra* note 3 (asserting that once undistorted shareholder choice is ensured by requiring the hostile bidder to win a shareholder vote, boards should not have a veto over takeover bids); Lucian Bebchuk, John Coates IV & Guhan Subramanian, *The Anti-Takeover Power of Classified Boards: Theory, Evidence and Policy*, 54 STAN. L. REV. 887 (2002) (the combination of poison pills and a staggered board that exists in a majority of publicly traded firms acts as a powerful anti-takeover device requiring correction in the form of shareholder empowerment). *But see* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 564 (2006) (challenging the claim of shareholder primacists that reapportioning corporate governance power away from boards of directors and toward shareholders will benefit shareholders as a class).

83. McConvill, *supra* note 16, at 1062 (suggesting that shareholders could change the terms of the contract).

'relational goods',"[84] and contends that the pursuit of happiness is the ultimate objective of human beings.[85] Thus, participation rather than passivity is the rational choice for shareholders.[86] He emphasizes that shareholders, in addition to purchasing a risk-adjusted economic return for their capital investment, should have the right to participate in the firm's governance and decision-making if they so wish. Dividing shareholder purchases into categories of material and experiential goods, participation rights become an experiential purchase leading to relational goods that augment the happiness and welfare of shareholders.[87] Consequently, shareholder participation ought to become an end in itself.

McConvill's paradigm asserts the right for shareholders to demand (and the obligation of corporations to accommodate) participation, wherein shareholders achieve enhanced happiness benefits in combination with undiminished material gains. He posits a floating nodal point of synthesis[88] between director and shareholder primacy. Theoretically, his proposal would allow ultimate control to remain in the hands of directors/managers as opposed to shareholders. But the centripetal tendency of his approach necessarily shrinks directorial *control* and insists on shareholder *participation* as the new ordering principle.

McConvill's model can be depicted by the following: Participation requires the interaction of others and happiness varies with the level of this interaction.[89]

> Even if active involvement in the corporation seems less desirable at the time [of purchase] than sitting back and collecting the dividend check, empirical findings . . . show that when looking back on the decision, shareholders, even in the largest of corporations, are likely to be happier by following the participation path.[90]

McConvill further contends that relational goods like investor participation can be purchased without any costs to either shareholders or the firm.[91] Hence, economic returns to the firm remain unaffected. McConvill emphasizes the argument that the value of participation has been either inappropriately or incompletely addressed.[92] He suggests that applied psychonomics favors shareholder participation.[93] Within the corporate governance debate, psychonomics theoretically reflects the disavowal of

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84. *Id.* at 1043.
85. *See id.* at 1039–43, 1059.
86. *Id.* at 1059.
87. *See id.* at 1053–56.
88. *See* SHANNON, *supra* note 72, at 166 (describing a perspective on social science).
89. *See* McConvill, *supra* note 16, at 1043.
90. *Id.* at 1059.
91. *Id.* at 1056.
92. *Id.* at 1013–17.
93. *Id.* at 1015.

individual preferences (narrowly described) in collective determination and the prescription of the appropriate governance regime. This rejection is premised on an imaginative conception that human cravings underlie psychological accounts of human wants. Whichever studies are used, psychonomics and happiness studies[94] imply that shareholders ought to enjoy greater, longer-lasting happiness by using their shares to create a participatory role in the corporation.[95] Eschewing the rational-choice model of the human agent, McConvill contests the conclusion that shareholders are rationally apathetic and introduces greater psychological complexity into the model of the human agent.[96] He concludes that "happiness theory" and psychonomics together imply that neither shareholder wealth maximization nor the protection of stakeholders' interest(s) ought to occupy the high ground in debates about corporate governance.[97]

While we agree that Enlightenment progress[98] can be illusory, this critique of human rationality is of a piece with Professor Gedicks' observation that contemporary attempts to overcome post-Enlightenment gloom reflect the postmodern conclusion that our world has fallen apart and that we live at the end of the neoclassical age as society struggles through the aftermath of confusion and helplessness wherein the real world, including the world of economics, lacks reality.[99] Manifestly influenced by this intuition, McConvill emphasizes this paradoxical claim: Society should move away from the self-referential world of economics and embrace a different kind of rationality that is *even* more enlightened and more considered as the axiomatic forces of neoclassicalism are placed on the run.[100] He offers a "new" paradigm of rationality. "Rather than a decision being rational because an economist thinks it is, a decision is rational because it is in [the] best interests of the decision-maker."[101] This fuels an inescapable question: Who ought to be the appropriate decision-maker—the shareholders or McConvill and the other members of the psychonomical community?

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94. Psychonomics may take many forms but appears to include exploring the intellectual interface between economics, psychology and other behavioral and social science disciplines. *See, e.g.*, Kaufman, *supra* note 54, at 361–62.

95. *See* McConvill, *supra* note 16, at 1039.

96. *Id.* at 1057–58.

97. *See id.* at 1015, 1061.

98. *See, e.g.*, SHANNON, *supra* note 72, at 196 (Among the Enlightenment fictions is the notion "that morality has an objective basis apart from any spiritual or ontological order. . . ." Therefore achieving progress in the "quest for a moral order initially saw its tasks as getting people to behave properly, but it has subsequently foundered on the problem of what precisely constitutes proper conduct.").

99. Fredrick Mark Gedicks, *Spirituality, Fundamentalism, Liberty: Religion at the End of Modernity*, 54 DEPAUL L. REV. 1197, 1197–98 (2006).

100. McConvill, *supra* note 16, at 1058.

101. *Id.*

2. McConvill as a Possible Third Option in the Shareholder Primacy/Director Primacy Debate?

If one can refrain from concluding that McConvill's theory is fatally counterintuitive and lacks persuasive evidence, one notes that many corporate law scholars are animated either by shareholder-primacy norms[102] or by director-primacy reality.[103] Assuming the soundness of McConvill's proposal, it may provide a "third way" forward by specifying a model that *simultaneously* achieves wealth maximization and provides an independent nonmaterial source of shareholder happiness.

Leading shareholder primacists concede the possibility, but reject the defensibility, of the "third way." Bebchuk states: "Some supporters of shareholder access have 'shareholder voice' and 'corporate democracy' as objectives. But the case for shareholder access does not depend on having such objectives."[104] Instead, he concentrates "on the sole objective of effective corporate governance that enhances corporate value."[105] Implicit in Bebchuk's approach is the affirmation that providing space for more robust shareholder activity and decision-making leads to value-enhancing corporate behavior.[106] In contrast, Bainbridge's director-primacy framework separates accountability from authority and contends that shareholders have, and ought to have, a very limited role in corporate governance and concludes that shareholder empowerment fails to offer the benefit of improved corporate performance.[107] Both Bebchuk's and Bainbridge's approaches provide testable hypotheses. Nevertheless, McConvill contests both claims by maintaining that shareholder participation can be accommodated "without unduly interfering with the traditional default rule of managerial authority [which is] the best guarantee of corporate performance."[108] He insists that any allegation that shareholders are rationally apathetic, and therefore, that shareholder empowerment is not

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102. *See, e.g.*, D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 278 (1998) ("[S]hareholders claim the corporation's heart. This shareholder-centric focus of corporate law is often referred to as shareholder primacy."). *See also* Bebchuk, *supra* note 3, at 974–77.

103. *See, e.g.*, Bainbridge, *supra* note 13, at 86.

> The director primacy model describes the corporation as a vehicle by which the board of directors hires various factors of production. The board of directors is not an agent of the shareholders; rather, the board is the embodiment of the corporate principal, serving as the nexus of the various contracts making up the corporation.

Id.

104. Lucian Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43, 44 (2003).

105. *Id.*

106. Consistent with Bebchuk's intuition but not necessarily his view, some cross-country empirical evidence derived from a large number of firms from different countries shows that appropriate corporate governance acts as a monitoring and discipline device, ensuring that management pursues value-maximizing goals. *See* Bruno & Claessens, *supra* note 7, at 1–5.

107. Bainbridge, *supra* note 10, at 1735, 1748–49.

108. McConvill, *supra* note 16, at 1057.

warranted, is an "intellectually lazy argument" because it rests on a simple, overly narrow assumption that shareholders are interested primarily in wealth maximization.[109]

III. A GENERAL CRITIQUE

There are a number of problems with McConvill's analysis. He avoids presenting any empirical evidence that substantiates the claim that shareholder empowerment is necessary, and refuses to deal with shareholders as they are—a disparate group with often inharmonious and incommensurable interests. He also fails to provide a convincing theory that delineates how material goods can be transformed into experiential ones. Hence, the debate is grounded in cloudy, if not conflicting, terms. McConvill also ignores the costs of shareholder participation, including coordination cost as well as the cost resulting from the search for private benefits.

A. THE ABSENCE OF EMPIRICAL EVIDENCE

McConvill presents more than twenty studies as references. However, none of the studies deal directly with whether shareholders desire McConvill's preferred outcome of shareholder participation. He does provide information derived from Tim Kasser's book, The High Price of Materialism;[110] Bruni & Stanca's study examining human acquisition of relational goods as opposed to watching television;[111] investigations derived from brain scans recording how certain events or sensations impact the parts of the brain that generate happiness or sorrow;[112] and discussions of positive psychology and the law, which suggest that a high degree of liberty, allowing individuals to pursue individual goals, is important for enabling individuals to pursue happiness.[113] While these studies provide descriptions of what makes people happy in general terms, they are entirely without any direct connection to shareholders as a group and the allocation-of-corporate power debate in particular. None of the studies show why providing participatory activities *within a corporate governance context* is essential. The evidence presented fails to support a defensible prescription for the allocation of power debate that favors shareholder empowerment.

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109. *Id.*

110. TIM KASSER, THE HIGH PRICE OF MATERIALISM (2002).

111. Luigino Bruni & Luca Stanca, *Watching Alone: Relational Goods, Television and Happiness* (Univ. of Biocca, Econ. Dept. Working Paper, 2005), *available at* http://dipeco.economia.unimib.it/pdf/pubblicazioni/wp90_05.pdf.

112. McConvill, *supra* note 16, at 1041.

113. *Id.* at 1041, 1043.

B. SHAREHOLDERS ARE A DISPARATE GROUP

Even if one finds evidence that shows that retail, institutional, short-term and long-term shareholders are captivated by the compulsion to participate, however, it is likely that some shareholders will view participation in different ways than others. This exposes McConvill's paradigm to interest divergence. Shareholders committed to happiness may have differing definitions of what happiness means for them, as well as differing ideas about how much and what type of participation is required in order to generate the happiness they seek. Participation by individual or institutional shareholders who are animated by divergent interests may have adverse implications for the community of shareholders. McConvill (like many shareholder primacists), ignores this fact and presumes that reapportioning corporate governance power away from boards of directors and toward shareholders will benefit shareholders as a class.[114]

Most shareholder primacists "contend that shareholders would like managers to maximize the long-term value of their shares, but that managers are unlikely to do so because their interests are insufficiently aligned with those of shareholders."[115] Solving this agency-cost problem requires increasing shareholder power[116] with the objective of maximizing shareholder value in some largely material sense.[117] McConvill supports shareholder empowerment, but not as a solution to the agency-cost question. In contrast to typical shareholder primacists, McConvill concentrates on shareholder empowerment for a different purpose: maximization of life experiences. Expanding shareholder power solves a different problem—the happiness void in western societies[118]—by providing necessary relational goods for shareholders. But his program suffers from the same error as that of other shareholder primacists': They all[119] underplay "deep rifts among the interests of large blockholders, those shareholders most likely to exercise shareholder power."[120] He also ignores differences between institutional and individual shareholders.

In addition, McConvill and other shareholder primacists refuse to recognize their theory's ignorance of interest divergence. The "case for increasing shareholder power assumes that shareholders would overcome

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114. *See* Anabtawi, *supra* note 82, at 561–99 (discussing this issue fully).

115. *Id.* at 562.

116. *Id.*

117. *Id.* at 564.

118. *See* discussion *supra* Part II.B.1.

119. *See, e.g.*, Bebchuk, *supra* note 8, at 891. Bebchuk, perhaps the leading shareholder primacist, argues that "shareholders are much more homogenous in their interests than are voters in the political system." *Id.*

120. Anabtawi, *supra* note 82, at 564. McConvill's unwillingness to recognize differences among shareholders is especially odd because he does recognize at least two groups of investors, those who would like to participate for happiness' sake and those who would not. *See* McConvill, *supra* note 16, at 1059 ("[P]articipation will, of course, not appeal to all shareholders.").

collective action problems to make use of the power being transferred to them."[121] Stephen Bainbridge clarifies:

> All organizations must have some mechanism for aggregating the preferences of the organization's constituencies and converting them into collective decisions. As Professor Kenneth Arrow explains such mechanisms fall out on a spectrum between "consensus" and "authority." Authority-based decisionmaking structures, which are characterized by a central agency empowered to make decisions binding on the firm as a whole, tend to arise when the firm's constituencies face information asymmetries and have differing interests. Because the corporation demonstrably satisfies those conditions, vesting the power of fiat in a central decisionmaker is the essential characteristic of its governance.[122]

Public corporations raise capital from widely dispersed or atomized shareholders.[123] Information asymmetry coupled with a diversity of perspectives presents difficulties for collective rationality and collective action. Collective action problems could be surmounted through coordination, but coordination generally is impractical to achieve in the context of widely dispersed ownership.[124] In publicly traded firms, it is only desirable for shareholders to attempt to discipline managers when it becomes collectively desirable to do so because the collective benefits exceed the costs.[125] Participation as a social good, jointly produced by a corporation and its shareholders, surfaces as a difficult proposition because of "the incommensurability and incomplete communicability of human wants and values."[126]

A further problem with realizing shareholders' "common" interests is the existence of significant private, or individual, interests.[127] For example, Bebchuk contends management may often trade shareholder premia in exchange for personal benefits that they can obtain by ending their filibuster against a takeover.[128] There is little reason to presume that shareholders, given the power to more fully participate in corporate decisions, would act differently. Like many shareholder primacists, McConvill overlooks the possibility that investors with "significant private interests" and sufficient incentives might "use any incremental power conferred upon them to pursue those interests to the detriment of shareholders as a class."[129] Enlarged shareholder power can be transformed into a vehicle to

121. Anabtawi, *supra* note 82, at 571.
122. Bainbridge, *supra* note 10, at 1745.
123. Anabtawi, *supra* note 82, at 572.
124. *Id.*
125. *Id.*
126. ARROW, *supra* note 43, at 24.
127. Anabtawi, *supra* note 82, at 564.
128. Bebchuk, *supra* note 8, at 899–900 (citing Jay Hartzell et al., *What's In It for Me? CEOs Whose Firms Are Acquired*, 17 REV. FIN. STUD. 37, 57 (2004)).
129. Anabtawi, *supra* note 82, at 564.

subordinate overall shareholder material welfare, as some shareholders increase their participation in order to secure private benefits. This quandary is sharpened in the presence of institutional investors driven by a supposed happiness objective. Participation yields private benefits which are not shared equally by all shareholders. This outcome may be the opposite of what McConvill predicts.[130]

The prospect of receiving a disproportionate share of returns (either material or psychological) provides an incentive for shareholders to overcome collective action problems through rent-seeking, which can take a financial or non-financial shape.[131] Disparate interests require a mediating structure that is capable of adjudicating among the potentially endless varieties of shareholder interests. McConvill simply ignores coordination issues and the existing role of directors in conciliating the conflicting interests of shareholders.[132] His scaffold, properly juxtaposed against the probability that selfish-motives can be transmuted into private benefits and collective costs, seems conspicuously fragile.

C. THE COSTS OF MCCONVILL'S PROGRAM

McConvill asserts that participation ought to be encouraged and accommodated because it makes people happy.[133] However, discovering the amount of participation that increases happiness the most is an optimizing problem, not a maximizing problem. *More* participation, therefore, is not necessarily *better*. Participation by shareholders or others is costly in many ways. It is unclear how McConvill would evaluate the happiness of different groups of shareholders. Compounding this issue are the costs of coordinating participation incurred by the investors and the firm itself. For example, participation by individual shareholders with divergent interests imposes costs on, and reduces the happiness of, the community of shareholders. Since these costs accumulate as the amount of participation increases, it stands to reason that, beyond some point at least, it makes sense to stop promoting it.

By way of example, imagine a very simple company, Widgets Transnational, with only two investors, person A and person B. Each investor has a utility function that determines how happy she is with her life. Assume A's and B's happiness is affected by only a few things, including participation. Then:

$U_A = f[\text{Wealth}_A\ (\text{Labor}_A, \text{Investments}_A\ (P_A, P_B)), \text{Health}_A, P_A, P_B]$; and

$U_B = f[\text{Wealth}_B\ (\text{Labor}_B, \text{Investments}_B\ (P_A, P_B)), \text{Health}_B, P_A, P_B]$,

130. *See id.* at 565.
131. *See, e.g.*, *id.* at 575–77.
132. *Id.* at 564.
133. McConvill, *supra* note 16, at 1043, 1059.

where U = utility, P = participation, and A's and B's participation agendas may differ. While participating in their own life experiences could be a positive factor for both A and B, it is not the only thing that promotes their respective happiness. Furthermore, the positive and negative effects of each one's participation are not fully internalized. A's utility is a function of her own wealth, health, participation, and of B's participation. A is happier when she is wealthier, healthier, and can participate more. A may or may not be happier due to B's participation, but it could affect her in some direct way (positively or negatively). More importantly, A's wealth is a function of her own labor and investments. Her investment returns are a function of her participation and the participation of B. Because participation is costly, any participation by A or B in A's investments may be negatively related to A's wealth, and thus, to her happiness.[134] So, B's participation affects A's happiness both directly, in whatever way A feels about B's participation, and indirectly by reducing the value of A's wealth (which reduces her happiness).

A related problem is that participation invites rent-seeking. Under a participatory scheme, shareholders and managers may strategically withhold information from one another.[135] There is also the risk that making divergent stakeholders privy to insider information leads to leaks of valuable private information to the workforce, competitors, or the public at large.[136] Such leaks can lower profits due to higher wages and strategic responses from competitors.[137] Also, activist shareholders can provoke companies to pay them to stop participating or to stop leaking information.[138] This raises the costs of doing business and[139] may also discourage stakeholders from transmitting information among themselves.[140] This, of course, has a negative feedback effect on other investors who invest solely for profit (most of them). It seems unlikely that McConvill would support this sort of extortive behavior, which is closely tied to his program.[141]

Acknowledging that most publicly traded corporations have thousands more investors than the simple company, it is likely that the overall transaction and coordination costs derived from the participation of large numbers of shareholders, as well as the rent-seeking encouraged thereby, reduce the happiness benefits that accrue to the community of shareholders. Shareholder participation is likely to be expensive to, among others, the

134. *See* Alley & Hutchison, *supra* note 22, at 3.
135. Bainbridge, *supra* note 8, at 607.
136. *Id.* at 609.
137. *Id.*
138. Bainbridge, *supra* note 10, at 1754.
139. Anabtawi, *supra* note 82, at 566.
140. Bainbridge, *supra* note 8, at 609.
141. *See generally* McConvill, *supra* note 16, at 1038–59.

participating investor, other investors, and the companies that allow participation.[142]

Investors as a class are made up of small- and medium-sized individual investors, public employee pension funds, unions, and others, all with differing time horizons, objectives and conceptions of happiness. Reconfiguring the purchase of stock as well as corporate governance to satisfy McConvill's stated preference for participatory activities would require the investment of scarce economic resources, including time, by shareholders and shareholder groups (mutual funds, unions, and pension funds) to gather information, deliberate and convey their views on corporate issues to management.[143] This would reduce the amount of time that they could spend on alternative participatory or nonparticipatory activities. As a rule, "shareholders lack incentives to gather the information necessary to actively participate in decisionmaking. A rational shareholder will expend the effort necessary to make informed decisions only if the expected benefits of doing so outweigh the costs."[144] McConvill's approach necessarily requires interpersonal utility comparisons and mandates the weighing of the happiness benefits against the costs of human suffering that necessarily accompany the implementation of this scheme. His failure to address this fact is a significant weakness in his theory.

Our intuition also suggests greater shareholder participation would negatively affect corporate performance. If true, this refutes McConvill's claim that shareholder wealth maximization remains unaffected.[145] McConvill argues investment of scarce economic/psychological resources by shareholders would not hinder economic returns, because increasing shareholder power emerges within a sustainable (material) wealth-maximization framework, within which shareholders (possibly risking happiness-inducing participatory experiences) decline to interfere unduly with the default rule of managerial/directorial authority.[146] Nonetheless, he contends this development fashions an appealing proposition that allows shareholders, "to have their cake, and help bake it too."[147] That is, they gain the psychological benefits of participation while retaining all of the expected material benefits that are derived from managerial/directorial fiat and the wealth maximization norm. This claim ignores the direct costs to shareholders, as well as the external costs of increased shareholder participation that are borne by the corporations who endure it. These costs are ultimately passed on to the participatory investor as well as all of the

142. Shareholder participation is likely to be costly for the economy at large as well as other institutions. *See id.*

143. *See supra* note 28 and accompanying text.

144. Bainbridge, *supra* note 8, at 623.

145. McConvill, *supra* note 16, at 1058–59.

146. *Id.* at 1053.

147. *Id.*

other shareholders of the corporation, necessarily, therefore, reducing their respective material gains.

There are other problems with McConvill's assertion that increased shareholder participation does not affect the bottom line. Potential creditors will not lend to firms with less accountable managers without compensation for the risks posed by the lack of accountability.[148] Investors are provided governance arrangements, and these arrangements are rolled into the price of the stock. If the arrangements are stacked against investors, the stock price will be discounted. Using governance terms preferred by investors reduces the firm's cost of capital by attracting a higher price for the securities.[149] In the face of participation, the cost of capital rises due to less favorable borrowing terms, and earnings fall. Another cost of participation is eternal surveillance. This requires the acquisition and digestion of information by dispersed and diverse individuals, which imposes costs on either participants or shareholders, and consequently reduces shareholder welfare.[150] Given the apparent unsupportability of McConvill's proposition, it seems unlikely that there is any place in corporate governance for increased shareholder power, if it does not aim to strengthen the bottom line, but instead aims at enhancing something else.

D. Other Difficulties

Other difficulties remain. First, McConvill's analysis lacks clarity with respect to *what* constitutes an appropriate conception of happiness. Second, he fails to untangle the impact of human choice and intent for purposes of ascertaining the goal associated with a given stock purchase. Finally, McConvill neglects to describe how one determines the constitutive components of an experiential good as opposed to a material one.

1. What Is (Or Should Be) "Happiness"?

In his pallid attempt to address what happiness consists of, McConvill asserts, "[i]n the normal scheme of things, law should be evaluated by one criterion: its capacity to promote human well-being, or 'happiness.'"[151] He contributes to the vagueness of this enterprise[152] by relying, ostensibly, on Aristotle's Nicomachean Ethics. McConvill claims that Aristotle favors happiness as a first principle that consists of virtuous activities.[153] This approach intimates that morality dictates that happiness is the primary objective of humans and leads to the conclusion that only virtuous activities

148. Bainbridge, *supra* note 10, at 1736.
149. *Id.* at 1739.
150. *See supra* note 28 and accompanying text.
151. McConvill, *supra* note 16, at 1039.
152. *Id.* at 1039–40 ("[H]appiness has always been viewed as being too vague and subjective to provide pointed answers regarding the things that are conducive to human flourishing.").
153. *Id.* at 1040.

have the capacity to produce happiness. Happiness-desiring humans, therefore, ought to prefer virtuous activities to less virtuous ones. Later, however, McConvill invokes a largely hedonic conception of utilitarianism: happiness consists of obtaining more pleasure with the absence of pain, where human satisfaction is tied to whatever goals an individual sets forward.[154] This statement suggests that happiness-desiring humans should maximize pleasure constrained only by the possible infliction of pain, regardless of virtuousness. McConvill asserts that though "individuals live their lives in a variety of different ways, these different pursuits have a common goal: the fulfillment of happiness. Each of us engages in different types of 'need expression', but our central or overriding need is to be happy."[155] He provides little reason why Americans committed to autonomy, or shareholders in particular, would favor his understanding rather than Mill's opinion that "happiness *cannot* result from seeking pleasure as an end in itself, but must result from the pursuit of higher goals."[156] McConvill fails to explain, however, whether he is driven by the necessity of finding and encouraging virtuous activities, or energized by utilitarianism as a wide-ranging theory that could include hedonic or other conceptions.

Second, McConvill insists the goals associated with the purchase of stock are defined exclusively by human choice and intent.[157] He asserts that individuals actually choose to structure their lives to pursue material goods when what they really should be doing is focusing their attention on building relational ones.[158] Bafflingly, he states that human choice/intent can transmute a material good into a relational one, while he simultaneously reprimands corporations that offer, and shareholders who accept, the "choice" of purchasing stock that primarily provides material benefits. McConvill's assertion that shareholders' "true" interests (happiness-producing activities) are missing in this contractual exchange model only contributes to this puzzle. McConvill's psychonomics are disjunctive, because if shareholders do not know their own interests, why will they have reason to choose participatory goods as an alternative to material ones, even assuming participatory goods are available?

Thirdly, McConvill focuses on the importance of experiential purchases as a key to happiness. He fails, however, to delineate a theory that describes clearly what constitutes an experiential as opposed to a material purchase. Whether a purchase is experiential or material "depends on the intention of

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154. *Id.* at 1058.
155. *Id.* at 1040.
156. Patrick Haden, *Introduction*, *in* JOHN STUART MILL, ON LIBERTY, *i*, *xii* (Dover Publications, Inc. 2002).
157. *See* McConvill, *supra* note 16, at 1049.
158. *Id.* at 1056.

the purchaser."[159] A purchase is experiential when the purchaser has the primary intention of acquiring a life experience through her purchase.[160] A particular purchase could be defined as an experiential activity by one person and as a material possession by another.[161] There is no way of knowing ex ante which purchases by which individuals will constitute an experiential purchase because we have no way of discerning intention until intention occurs. One's intention may remain fluid and can change ex post. A good acquired for one purpose can metamorphose into a good that achieves another. The acquisition of shares of stock could be primarily a material purchase animated by profits, but that does not rule out utilizing the shares as an experiential purchase later.[162]

Finally, McConvill does not explain why people will choose to take advantage of experiential/participatory goods if they are made available. He constructs his case for greater participation by relying (at least partially) on studies authored by Bruno Frey & Alois Stutzer,[163] which insinuate that people are dissatisfied with passive activities, and become happier as a result of participation. However, an additional study authored by Frey, Benesch & Stutzer suggests that when additional participatory activities are made available, humans generally fail to take advantage of them.[164] Why should we expect human behavior to be any different when additional experiential goods such as shareholder participation are made available when there is little evidence that humans take advantage of existing participatory activities? There are two far more persuasive alternative conclusions. First, in keeping with the premise that people know their own interests, participation in such activities simply yields less happiness than McConvill claims. Or possibly, putatively passive activities such as television-watching actually do contribute to participation and civic engagement in the United States, and constitute a break from more directly participatory activities.[165]

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159. *Id.* at 1052.
160. *Id.*
161. *Id.*
162. *Id.* at 1053.
163. McConvill, *supra* note 16, at 1047–48.
164. Bruno S. Frey, Christine Benesch & Alois Stutzer, *Does Watching TV Make Us Happy?* 4 (Inst. for Empirical Research in Econ., Univ. of Zurich, Working Paper No. 241, 2005), *available at* http://www.iew.unizh.ch/wp/iewwp241.pdf. This study's examination of passive activities by Americans shows that during the period 1965 to 1995 the average leisure time of adults rose by 6.2 hours per week while TV viewing time rose by almost the same amount, 6.0 hours. During that 40-year period, alternative participatory activities were doubtless available in contradistinction to passive ones. Sufficiently motivated Americans could have taken advantage of existing participatory opportunities. The evidence verifies that they have, thus far, failed to do so. *Id.*
165. Pippa Norris, *Does Television Erode Social Capital? A Reply to Putnam*, 29 POL. SCI. & POL. 474, 479 (1996).

IV. CONCLUSION

McConvill's shareholder participation framework relies on psychonomics.[166] Apparently, psychonomics heralds a certain kind of expert, a superior one. This new mode of expert, like former varieties, appears to be predisposed to disapprove of allowing the individual to make unfettered choices in the marketplace.[167] As Peart and Levy illustrate:

> As long as the expert maintains that he possesses insight into the sorts of preferences people "should" possess—if they only knew better—he must also accept, and may perhaps even demand, responsibility for directing those preferences until the subjects gain the sort of sophistication that he enjoys.[168]

It is possible that the ability of shareholders, boards and firms to reason, make judgments, and reach contractual agreements that empower directors and not shareholders, is not to be trusted unless directed by experts.[169] It is equally possible, but seemingly unlikely, that classical economists erred by believing that people make choices in response to incentives.[170] If the judgment of shareholders cannot be trusted, and if shareholders do not respond adequately to incentives, then it is possible to posit the necessity of transformative intervention by experts to ensure the achievement of a certain level of human status and happiness.[171] This argument, to the extent and in the manner in which McConvill presents it, is unconvincing.

McConvill's program commends participation leading to happiness, but cannot avoid an empty circularity. He offers the following conclusion: "Shareholder participation *should* be the end-game, recognising the direct benefits to shareholders through treating their shares as an experiential purchase."[172] If McConvill simply means that shareholders and firms should adopt his preferences for participatory, relational and experiential happiness as a possibility among a myriad others, it might be understandable. If, on the other hand, he wishes to convert his preferences into a universal ideal, it is less so, given the multiple problems with his theory's outcome. McConvill's approach seems to be a set of preferences just like any other

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> We get, from American television, a diversity of channels, programs and choices. If some choose [certain channels], they are likely to end up somewhat more interested in the complex problems and issues facing American government at the end of the twentieth century. . . . But compared with most democracies America is already high as nation of joiners, with a dense network of civic associations.

Id.

166. *See* McConvill, *supra* note 16 and accompanying text.
167. Peart & Levy, *supra* note 52, at 16.
168. *Id.*
169. *See id.* at 19.
170. *See id.* at 20.
171. *See id.*
172. McConvill, *supra* note 16, at 28 (emphasis added).

set. As preferences, they could "be part of any welfarist approach, but their weight and importance would be dramatically smaller than if they were believed to be universal ideals."[173]

Individuals and institutions that seize upon McConvill's thesis as a socially desirable approach to change the world will be disappointed. His attempt at universalization collapses into welfarism, wherein the proper locus of rational choice remains, as the price system implies, the self-interested individual. Hirschman shows,

> Two essential elements appear to characterize interest-propelled action: self-centredness [sic], that is, predominant attention of the actor to the consequences of any contemplated action for himself; and rational calculation, that is, a systematic attempt at evaluating prospective costs, benefits, satisfactions, and the like.[174]

In McConvill's world, by contrast, selfish motives are employed for two purposes: material gain *and* the opportunity to obtain relational goods providing experiential and happiness benefits to investors. McConvill constructs a system that mimics the price system but with a different metric of utility: experiential welfare instead of material wealth. Even if shareholders prefer participatory goods to material ones, McConvill fails to specify why they must have an opportunity to purchase an increased array of participatory goods as a constitutive component of corporate governance when alternative, highly participatory frameworks are already available. Investors who crave participatory experiences can choose from a rich stew of alternative activities that are readily available in both the profit and non-profit sectors. Investors who seek profits plus control can enjoy partnerships, LLC's and LLP's, as well sole proprietorships.

Additionally, McConvill appears to ignore the costs of implementing his program and the probable interest divergence among shareholders; these things taken together undermine his proposal. Despite its short-comings,[175] social science suggests that when humans act as citizens, "politicians,

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173. GEORGAKOPOULOS, *supra* note 47, at 33.

174. Albert O. Hirschman, *Interests*, *in* THE NEW PALGRAVE: THE INVISIBLE HAND 156, 157 (John Eatwell, Murray Milgate & Peter Newman eds., 1989) (emphasis omitted).

175. For a comprehensive examination of the short-comings of social science, see SHANNON, *supra* note 72. In sum, social science culminates the tradition of conspicuous criticism.

> [I]t demands that one approach self and society with no assumptions or preconceptions; that one accept no relation among people, or between people and their physical environment, as 'natural'; and that one engage in a rigorous process of inquiry that will issue in some 'new' perspective on self and society. . . . [I]t is capable of producing an infinite number of conflicting perspectives; that each perspective becomes obsolete upon formulation, . . . and offers no way of adjudicating between these perspective other than by engaging in a more rigorous version of the kind of inquiry that produces the chaos of perspectives it seeks to order.

Id. at 189.

managers, academics, professionals, . . . or factory workers, [they do so as] resourceful, evaluative maximizers" who respond creatively to optimize the opportunities the environment presents.[176] It is doubtful that McConvill's analysis has extended this research to investors in particularly useful ways.

John Dewey saw "the epochal developments of evolutionary biology as a model for immediate, constant, revolutionary social change,"[177] creating a new society comprised of new, non-conforming individuals.[178] This new society would be led by individuals who were enthralled by the new possibilities associated with collaborative and participatory activities. Professor Shannon shows that Dewey's metaphor of cellular growth as an alternative to stasis suggests not evolution so much as cancer.[179] As Shannon shows, this move in the hands of Dewey's intellectual heirs led not to order but to chaos.[180] McConvill formulates a "new normality," wherein participation issues forth as a fresh effort to expand human frontiers, enabling investors to continuously reinterpret relational experiences while liberating their personal strengths and virtues from confining constraints imposed by corporate hierarchs. In turn, this generates positive emotions for shareholders[181] and defies the status quo.[182] Not unlike Dewey's aspiration, McConvill creates a new corporate governance model that offers the give-and-take of participation as an effort to deepen the significance and satisfaction of human interaction. This evolutionary move, unconstrained by fiduciary duties, has no defined stopping point, and it appears to flounder. This is because social organisms populated by individuals and groups (including investors and fellow contractors) work to maintain existing structures or alternatively decide to exit the firm based on the prudential and normative assessments of their own interests. McConvill's shareholder happiness initiative is ephemeral. Instead of augmenting happiness, it is more likely to prove susceptible to infection in the form of rent-seeking, additional costs, and less material wealth. In light of this critique, the appropriate default rule for shareholder participation rights, as a general matter, is not to have any beyond the limits that the director primacy model prescribes. Properly understood, McConvill's contention that a strong case can be made for empowering shareholders as an end in itself is Panglossian.

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176. *See, e.g.*, Michael C. Jensen & William H. Meckling, *The Nature of Man*, 7 J. APPLIED CORP. FIN. 4, 19 (1994).
177. SHANNON, *supra* note 72, at 89–90.
178. *See, e.g.*, *id.* at 65–91.
179. *Id*. at 90.
180. *Id*. at 189.
181. McConvill, *supra* note 16, at 1049.
182. *Id.* at 1053.