The Failure of the Corporate Governance Market: A Reply to Bryce C. Tingle KC, "Returning Markets to the Center of Corporate Law"

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In *Returning Markets to the Center of Corporate Law*,[1] Professor Bryce Tingle offers an ambitious reset of corporate law practice, policy, and scholarship. More particularly, Professor Tingle seeks to reframe the *means* of corporate law by providing a pathway through the current debates about the *ends* of corporate law. In recent years, these debates have been centered on the question of whether wealth maximization should be part of the standard contract at the heart of the nexus of contracts that is the firm.[2] For Tingle, this is the wrong question. Rather than focusing on outcome-oriented questions like wealth maximization and governance efficiency, Tingle argues that regulators should concern themselves with "the impact of their prescriptions on the markets surrounding corporations."[3] Instead of arguing about what shareholders want and designing a governance system that builds in those preferences, Tingle argues that regulators should create market conditions that allow shareholders to express their own preferences.

This brief essay responds to Professor Tingle's reframing. The response first notes some of the key contributions of the article, including arguments for the social utility of markets and the role of government in sustaining markets. The response then seeks to isolate and emphasize questions raised by Tingle's thesis. Centrally, assuming that shareholder wealth maximization is and remains the dominant normative end for corporate law,[4] Tingle's article raises the question of why many shareholders seemingly choose to pursue other ends.

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1. Bryce C. Tingle KC, *Returning Markets to the Center of Corporate Law*, 48 J. Corp. L. 663 (2023).

2. *See, e.g.*, Stephen M. Bainbridge, The Profit Motive: Defending Shareholder Value Maximization 1 (2023) (arguing that shareholder wealth maximization is required by law) ("There are a lot of books on the market praising stakeholder capitalism. . . . This is not one of those books.").

3. Tingle, *supra* note 1, at 665.

4. This digital journal and its print counterpart have made recent contributions relating to shareholder wealth maximization theory and its lasting educational value. *See, e.g.*, Stephen M. Bainbridge, *Why We Should*

I. THE SOCIAL FUNCTION OF MARKETS

Tingle's analysis begins with a foundational question of why corporations exist. For Tingle, this teleological question receives a very practical response: "their very structure is designed to facilitate [commercial] activities, as well as to create markets in the ownership and management of the corporations themselves."[5] Tingle's approach does not make assumptions about human motivations for market participation; the end is simply a flourishing market in which individuals can express their own motivations through their market activity, rather than the law dictating a particular end through a default corporate purpose. A thriving market itself is a worthy end, and much of the foundational work in the article lies in its explanation and justification of markets as engines of human progress and welfare. Markets are sometimes portrayed as vehicles for rapacious individuals to take advantage of the naïve.[6] However, Tingle persuasively marshals evidence in support of the *doux commerce* thesis—that markets provide social and moral benefits beyond the economic interests afforded to their participants. Further, markets can produce benefits not only within societies, but among societies.[7]

Strong markets do not develop and flourish spontaneously, however, and Tingle highlights the importance of institutions to the functioning of markets. Markets are embedded within legal, political, and economic contexts, and cannot be merely transplanted to other systems. In a similar vein, Bernard Black has explained how this reality impacts the development of securities markets, and that strong markets cannot develop without adequate and credible protection of minority investors.[8] Note that this is not an argument that the substantive law itself is the crucial benefit offered by strong

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Keep Teaching Dodge v. Ford Motor Co., 48 J. CORP. L. 77, 79 (2022) ("[L]aw professors ought to keep teaching *Dodge* [and shareholder wealth maximization theory]); Robert T. Miller, *Delaware Law Requires Directors to Manage the Corporation for the Benefit of its Stockholders and the Absurdity of Denying It: Reflections on Professor Bainbridge's Why We Should Keep Teaching* Dodge v. Ford Motor Co., 48 J. CORP. L. DIGIT. 32 (2023) (endorsing the shareholder maximization and rebuking the stakeholder theory).

5. Tingle, *supra* note 1, at 664.

6. Classifying practices and markets as "predatory" is a common practice. *See, e.g.*, Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1257 (2002) ("Predatory lending—exploitative high-cost loans to naïve borrowers has dominated the headlines in recent years and has sent foreclosure rate soaring.").

7. Tingle, *supra* note 1, at 683 (noting that "private property and competitive market structures have a major impact of promoting peace between states"); *see also* PATRICK J. MCDONALD, THE INVISIBLE HAND OF PEACE: CAPITALISM, THE WAR MACHINE, AND INTERNATIONAL RELATIONS THEORY, at i, 77–110 (1st ed. 2009) ("[D]omestic institutions associated with capitalism, namely private property and competitive market structures, have promoted peace between states over the past two centuries.").

8. Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 783 (2001) (exploring how legal institutions contribute to capital formation and investor protection).

> A country's laws and related institutions must give minority shareholders: (1) good information about the value of a company's business; and (2) confidence that the company's insiders (its managers and controlling shareholders) won't cheat investors out of most or all of the value of their investment through "self-dealing" transactions (transactions between a company and its insiders or another firm that the insiders control) or even outright theft. If these two steps can be achieved, a country has the potential to develop a vibrant securities market that can provide capital to growing firms, though still no certainty of developing such a market.

Id. (footnote omitted).

institutions. Instead, the most important benefit of strong institutions is the offer of a framework that enables enforceable bargaining between parties. In the development of U.S. corporate law, this manifests itself as a fairly loose set of enabling rules, with very few mandatory requirements that form standard provisions in the corporation's contractual bargain outlined in corporate law statutes.[9] Corporate law's most important function (especially in the U.S. context) is to provide procedural rules that serve as a framework for bargaining, rather than to provide a standardized bargain in the form of substantive rules.

Politics inevitably shape the way in which the market is allowed to operate, and indeed the success of a market may depend on some government support. Tingle argues that markets are not a purely "private" sphere of action. Indeed, Tingle notes that markets and strong government tend to go hand in hand, while "the weaker the state and its regulatory apparatus, the weaker the markets in that country."[10] Government regulation is thus "demonstrably necessary for markets to exist," especially where the subject of the market—such as a corporation—is itself an artificial creation of a statute.[11] Further, markets may be destroyed by the actions of private actors operating without the occasional intervention of government. Why else would we be worried about monopolistic firms or predatory behavior by private actors, Tingle asks, if markets could only be left to private governance? Instead of framing markets as a choice between public and private governance, Tingle instead defines markets by "the presence of certain kinds of activities," including "experimentation, cooperation, competition, and bargaining."[12]

II. WHAT DRIVES MODERN CORPORATE GOVERNANCE?

The core of Professor Tingle's argument comes as he turns from general considerations of markets to the specific question of the market for corporate law and governance. An important feature of modern corporate governance (and a feature Tingle acknowledges and wrestles with) is that many of the corporate governance changes from the past couple of decades did not come through substantive regulation.[13] A paradox thus lies at the heart of the major shifts in corporate governance over the last several decades:

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9. John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1619–20 (1989). Coffee notes that:

> [A]n exclusive focus on economics ignores an important feature common to all forms of long-term relational contracts: namely, that courts have invariably played an active and indispensable role in monitoring and interpreting such agreements. Indeed, the feasibility of such contracting probably depends upon the parties' ability to rely upon the courts to play such a role. In this light, analogizing the corporation to a long-term contract may suggest not that the mandatory features of American corporate law are vestigial remnants of an earlier era that was hostile to private ordering, but rather that these provisions are analogous to similar legal rules that restrict opportunism in other areas of complex, long-term contracting.

Id. (footnote omitted).

10. Tingle, *supra* note 1, at 666. Tingle also notes, however, that "it is not the size of government that matters, but whether contracts and property rights are enforced and whether markets determine how resources are allocated." *Id.* at 679 (citing, *inter alia*, P. Graeff & G. Mehlkop, *The Impact of Economic Freedom on Corruption: Different Patterns for Rich and Poor Countries*, 19 EUR. J. POL. ECON. 605 (2003)).

11. Tingle, *supra* note 1, at 702–03 (exploring how government regulation is a necessity).

12. *Id.*

13. *Id.* at 700–03.

corporate *law* stays the same while corporate *governance* has changed considerably. Indeed, recent work by Robert Thompson has noted that corporate law has shifted very little from its last major evolution in response to the industrial age over a century ago.[14] Further, he anticipates that we are unlikely to see any major substantive shifts in corporate law rules. For 120 years, Delaware corporate law has followed a "director-centric structure" that allows for "ample room for private ordering and for key parties in the internal governance of the corporation to push back and forth among themselves about particular governance issues."[15] Does that then mean that all of the many governance changes were the result of private ordering through natural market forces? In other words, is the "hundred-year flood"[16] of corporate governance reform the result of ordinary shareholders determining that these governance innovations improve corporate performance, and consciously "selecting" these reforms through natural market interactions?[17]

There is good reason to be skeptical that this is the case. Some skepticism arises through simple observations about the structure of modern capital markets, and the potentially misaligned incentives of modern corporate voters and influencers. In contrast to earlier periods in which most companies were owned by widely dispersed retail investors,[18] today's markets are heavily intermediated. Institutional investors, such as mutual funds, pension funds, and endowment funds, now own most of the shares of publicly traded companies. As of 2017, about 78% of the Russell 3000 was controlled by

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14. As Thompson summarizes, corporate law shifted dramatically at the end of the 19th century:

> [T]he liberalizations of New Jersey's general incorporation act of 1896 provided no limit on a corporation's duration, permitted incorporation for any lawful purpose and to carry on business in other jurisdictions, authorized mergers and consolidations, and enabled director amendments of bylaws . . . This period also saw a decline in other traditional restrictions on corporations—the disappearance of ultra vires doctrine and quo warranto actions that had been used to limit corporation's acts—and a similar shriveling of state efforts to assert control over foreign corporations.
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> Here we see a wholesale state law abandonment of the prior regulatory approach to corporations in favor of a permissive director-centric approach with more room for private ordering that still characterizes American corporate law.

Robert B. Thompson, *Why New Corporate Law Arises: Implications for the Twenty-First Century*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? 3, 9–10 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019) (citations omitted).

15. *Id.* at 25.

16. Tingle, *supra* note 1, at 691 (citing Robert B. Thompson, *Delaware, the Feds, and the Stock Exchange: Challenges to the First State as First in Corporate Law*, 29 DEL. J. CORP. L. 779, 791 (2004)).

17. It is debatable, of course, whether all or even most shareholders consider wealth maximization to be the end of corporate governance. *Compare, e.g.*, Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power,* 53 UCLA L. REV. 561, 578–80 (2006) (characterizing shareholders as often pursuing heterogeneous interests), *with* George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97, 149 (2010) (arguing that "shareholders are remarkably united in their" wealth-maximizing goals). Professor Tingle does not wade into this debate but does note that "the influence of wealth maximization norms on academics and regulators in corporate law was instead largely directed into debates around various market interventions." Tingle, *supra* note 1, at 691.

18. Adolf Berle and Gardiner Means highlighted the governance concerns created by widely dispersed shareholders having little time, ability, or individual economic interest in monitoring firm managers. *See generally* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (rev. ed. 1967).

institutional investors, while about 80% of the S&P 500 was controlled by institutions.[19] Apple, one of the largest firms in the world by market capitalization, is over 85% owned by institutions, with investment titans Vanguard, State Street, and BlackRock the largest holders.[20] This ownership pattern introduces a new set of governance challenges, as retail investors now have two sets of agents—firm managers and investment managers—that might behave adversely to their interests as the ultimate investors in the firm.[21] But, of course, the promise of intermediation is that investment managers will take up the work of monitoring firm managers and will likely do it better than dispersed retail investors, given that they do not suffer from the kinds of collective action problems that Berle and Means identified as limiting investor-led governance initiatives and resulting in "a condition in which the individual interest of the shareholder is definitely subservient to the will of a controlling group of managers even though the capital is made up of the aggregated contributions of perhaps many thousands of individuals."[22] If the combined agency costs of intermediated ownership are less than the costs that Berle-Means observed in a market with dispersed retail investors, institutionalization should be viewed as a governance success rather than a complication. As Sharfman has argued, however, institutional investors' incentives are often at odds with those of the retail investors for whom they are fiduciaries.[23] BlackRock, for example, has different interests than the set of purely value-maximizing retail investors, as evidenced by BlackRock's marketing and engagement efforts;[24] BlackRock's marketing and engagement strategies are BlackRock-value maximizing, but not necessarily beneficial owner-wealth-maximizing.

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19. *80% of Equity Market Cap Held by Institutions*, PENSIONS & INVS. (Apr. 25, 2017), https://www.pionline.com/article/20170425/INTERACTIVE/170429926/80-of-equity-market-cap-held-by-institutions [https://perma.cc/8TUN-VLGS].

20. *Id.*

21. These agency costs have been defined by Jensen and Meckling as the costs of divergence between the interests of the principal and the agent:

> The principal can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs designed to limit the aberrant activities, of the agent. In addition, in some situations it will pay the agent to expend resources (bonding costs) to guarantee that he will not take certain actions which would harm the principal or to ensure that the principal will be compensated if he does take such actions.

Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (emphasis removed).

22. BERLE & MEANS, *supra* note 18, at 244.

23. *See* Bernard S. Sharfman, *The Conflict Between BlackRock's Shareholder Activism and ERISA's Fiduciary Duties*, 71 CASE W. RSRV. L. REV. 1241, 1246 (2021) [hereinafter Sharfman, *Conflict Between Activism and ERISA*] (discussing "the agency costs that may be created by the empty voting of investment advisers to index funds and how they can be mitigated so as to protect the value of private employee pension benefit plans"); *see also* Bernard S. Sharfman, *Opportunism in the Shareholder Voting and Engagement of the 'Big Three' Investment Advisers to Index Funds*, 48 J. CORP. L. 463, 467–69 (2023) [hereinafter Sharfman, *Opportunism in Shareholder Voting*] (extending this analysis to other Big Three asset managers); *see also* Roberto Tallarita, *The Limits of Portfolio Primacy*, 76 VAND. L. REV. 511 (2023) (describing potential conflicts arising from a portfolio primacy model of stewardship).

24. Sharfman, *Conflict Between Activism and ERISA*, *supra* note 23, at 1266–72. Sharfman notes, for example, that:

> BlackRock has an engagement strategy that focuses on benefiting various stakeholders who most appeal to millennials. These stakeholders, at least for the time being, are those who have been

Institutional investor power and influence may also help explain some—though perhaps not all—of the regulatory shifts from the most important federal corporate regulator: the Securities & Exchange Commission (SEC). As discussed in the following sections, some of these changes resulted from direct Congressional shaping of corporate governance through the SEC's ability to regulate publicly traded companies. Other regulations, including some of the most impactful, were indirect interventions that did not create substantive rules so much as put a thumb on the scale in favor of some market participants.

A. *Direct Market Interventions*

While corporate law is primarily state law, a series of federal interventions have slowly shrunk the scope of bargaining for public companies and their shareholders. While federal securities acts generally regulate through disclosure mandates rather than substantive governance rules, the Sarbanes-Oxley Act of 2002 nevertheless includes several substantive provisions. Sarbanes-Oxley directly impacted the core of corporate law—the board of directors—by requiring that public company audit committees be composed of independent directors, with at least one "financial expert" on the committee.[25] Sarbanes-Oxley also restricted the ability of public companies to purchase non-audit services from their outside auditors,[26] prohibited loans to corporate officers,[27] and required the chief executive officer and chief financial officer to certify the accuracy of their firm's financial statements.[28] Dodd-Frank also had lasting impacts on governance, most notably through its say-on-pay regulation, although it is debatable whether these regulations resulted in meaningful change or simply an annual performative ritual.[29]

> impacted by climate change, gender equality, global supply chains and operations impacted by Covid-19, and racial equity. BlackRock has the ability and willingness to enforce this engagement strategy by threatening to vote against management on various management and shareholder proposals. Based on its recent shareholder voting record, it appears to do so mainly by voting against management's nominees for board membership. Clearly, this strategy is not being done "solely in the interest of the participants and beneficiaries" and for the "exclusive purpose" of providing financial benefits.

Id. at 1267 (footnotes omitted) (quoting Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846, 72848 (Nov. 13, 2020) (to be codified at 29 C.F.R. pt. 2509, 2550)).

25. Sarbanes-Oxley Act of 2002, § 407, 15 U.S.C. § 7265.

26. *See id.* § 201, 15 U.S.C. § 78j-1(g).

27. *See id.* § 402, 15 U.S.C. § 78m(k).

28. *Id.* § 302, 15 U.S.C. § 7241. Roberta Romano notes that Sarbanes-Oxley overstepped the traditional (if not legal) bounds of its authority:

> In contrast to provisions in SOX entirely within the bounds of traditional federal securities regulation, such as the direction for increased disclosure of off-balance-sheet transactions, or outside the scope of issuer regulation, such as the creation of a new public board to oversee auditors, the substantive corporate governance provisions overstep the traditional division between federal and state jurisdiction, although they did not have to do so. They could have been formulated as disclosure mandates.

Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance,* 114 YALE L.J. 1521, 1527 (2005) (footnotes omitted).

29. Jill E. Fisch, Darius Palia & Steven Davidoff Solomon, *Is Say on Pay All About Pay? The Impact of Firm Performance*, 8 HAR. BUS. L. REV. 101, 129 (2018) (finding that "for under-performing firms, say on pay

Disclosure-based regulations may also impact governance, even if they do not impose substantive requirements on corporations. The SEC's recently enacted rules on cybersecurity risk management[30] and its proposed rules on climate risk[31] both require registrants to describe how their board oversees and manages those risks. This form of comply-or-explain regulation can have the same effect as a substantiative regulation. Since no company wants to explain why it does not have a rule that SEC regulations suggest should be a default governance structure for any publicly traded company, this is substantive regulation.

One feature of the SEC's governance interventions is that they typically work to reduce the scope of governance possibilities—a kind of ratchet effect that results in a progressive tightening of corporations' ability to innovate in governance. Bainbridge highlights this ratcheting effect when describing the impacts of the Dodd-Frank Act on corporate governance.[32] The phenomenon is not unique to corporate governance, but can be seen with government regulation generally: in response to a war or other major crisis, the federal government tends to grow in size, with "higher taxes, greater regulation, and loss of civil liberties."[33] After the crisis, government does not tend to revert to its smaller size; instead, "the interest groups that favored the changes now have an incentive to preserve the status quo as do the bureaucrats who gained new powers and prestige", and as a result "each crisis has the effect of ratcheting up the long-term size and scope of government."[34] Dodd-Frank produced such an effect, as "policy entrepreneurs favoring federalization" used the crisis as an opportunity to push their agendas.[35] Larry Ribstein,[36]

appears to be a useful tool for disciplining management. However, when firms perform well, shareholders do not seem to care about excess pay").

30. Standard Instructions for Filling Forms Under Securities Act of 1933, Securities Exchange Act of 1934 and Energy Policy and Conservation Act of 1975–Regulation S-K, 17 C.F.R. § 229.106(c) (2023) (explaining how registrants must describe the board's oversight of risks from cybersecurity threats).

31. The proposed rules would "require a registrant to disclose information concerning the board's oversight of climate-related risks as well as management's role in assessing and managing those risks" and "would require a registrant to disclose whether any member of its board of directors has expertise in climate-related matters and the processes and frequency by which the board discusses climate-related factors." The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334, 21431 (proposed Mar. 21, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, 249).

32. Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1820–21 (2011) ("The federal role in corporate governance . . . appears to be a case of . . . the ratchet effect.").

33. *Id.* at 1820 (citing ROBERT HIGGS, CRISIS AND LEVIATHAN: CRITICAL EPISODES IN THE GROWTH OF AMERICAN GOVERNMENT 73–74, 150–56 (1987)).

34. *Id.*

35. *Id.*

36. *See generally* Larry E. Ribstein, *Bubble Laws*, 40 HOUS. L. REV. 77, 77–78 (2003) ("[T]he recent [Enron] frauds are only the latest turn in a centuries-old cycle of capital market booms followed by busts and regulation.").

Stuart Banner,[37] and Roberta Romano[38] have also highlighted this ratchet effect as a longstanding feature of federal financial regulation.

Crucially, these scholars highlight how crises may create a particular set of conditions which ultimately erode the foundations of markets. Absent a crisis, markets tend to enjoy broad popular support. However, in dire financial times "deep-seated popular suspicion of speculation" dominates support for markets, "resulting in the expansion of regulation."[39] In Ribstein's explanation, in "normal or boom times" when consumers and investors are enjoying the benefits of a rising market, regulated entities enjoy enough political clout to defeat regulatory changes. Crashes "destabilize this interest group equilibrium" by weakening the financial and political position of regulated firms, while strengthening the position of "pro-regulatory forces" that "enlist new supporters by arguing that regulation would restore 'investor confidence'—code for more buyers and therefore higher prices."[40] But herein lies the irony: as Bainbridge emphasizes, such regulations tend not to improve the function of markets, but instead make them ultimately less competitive and effective.[41] Regulation may be necessary for the development of markets, but it can also impede the function of markets, and it tends to move in the direction of less freedom over time.

B. Indirect Governance Regulations

Instead of direct regulation of corporate governance matters, the SEC has occasionally shaped the market for corporate law and governance by empowering shareholders to push for changes directly. More specifically, the SEC has empowered a corporate governance industry to pressure corporations to make governance changes.[42] While this may appear to facilitate the development of a more robust and thriving corporate governance market, it has, in fact, had the opposite effect. The result is a shift in corporate governance "rules"

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37. *See generally* STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION: CULTURAL AND POLITICAL ROOTS, 1690–1860, at 161–249 (1998) (outlining, in various chapters, the responsive nature (to crashes and crises) of American securities regulation from 1789–1860).

38. Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1591–94 (2005) ("Stuart Banner's historical research suggests that these examples [crises] are not exceptions but rather are the template for financial regulation.").

39. *Id.* at 1593 (summarizing Banner). Romano notes:

> [F]inancial exigencies embolden critics of markets to push their regulatory agenda. They are able to play on the strand of popular opinion that is hostile to speculation and markets because the general public is more amenable to regulation after experiencing financial losses. A regulatory agenda, in short, does not generate popular support in a booming market. Due to greater sophistication in our understanding of market processes, there is far less popular suspicion of trading speculation today than in prior centuries. But we can still identify in Banner's formula for new regulation—the conjunction of the impact of a stock market downturn on public attitudes and the presence of political entrepreneurs with off-the shelf regulatory proposals (Banner's ever-present critics of free markets) . . . .

Id.

40. Ribstein, *supra* note 36, at 79.

41. Bainbridge, *supra* note 32, at 1788–91 (reviewing studies on the effects of Sarbanes-Oxley).

42. *See, e.g.*, The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334, 21431 (proposed Mar. 21, 2022) (to be codified at 17 C.F.R. 210, 229, 232, 239, 249) (proposing more stringent climate-related disclosures).

without the creation of actual rules, and a corporate governance industry developing a set of "best practices" that often have very little evidence to support their implementation.

Indeed, what is remarkable about the recent, dramatic shifts in corporate governance is that so few of them are the direct result of regulation. Many of the most important changes in corporate governance did not arise from explicit Delaware legislation or even from federal interventions in the state corporate law markets. Professor Tingle notes, among other governance changes:

> majority and then supermajority independent boards; board committees, then wholly independent board committees; pay-for-performance compensation structures; the use of equity incentives (originally stock options, then restricted share grants) to align managers with shareholders; say-on-pay votes (to further ensure alignment); majority voting on directors; eliminating staggered boards; separating the CEO and chair roles; increasing board independence by increasing diversity; restricting director "overboarding;" forbidding interlocking directorships; eliminating poison pills (or, more rarely, adopting them); prohibiting loans to insiders; adopting social responsibility measures; insisting that firms exclusively pursue either shareholder wealth maximization or constituency-maximizing outcomes, depending on political outlook; mandating employee representation on the board; banning stock buy-backs; increasing shareholder influence through proxy access; taking steps to reduce shareholder influence by restricting shareholder proposals; [and] mandatory voting by institutional shareholders.[43]

Of these, only a handful—board independence,[44] say-on-pay,[45] prohibiting loans to officers,[46] shareholder proposal requirement changes,[47] and mandatory voting by institutional investors[48]—were a result of legislative acts such as Sarbanes-Oxley and Dodd-Frank, direct SEC rulemaking, or as a result of national exchange listing standards (which require SEC approval).[49]

But of these direct and indirect legislative interventions, it is perhaps the mandatory institutional investor voting requirement that has been the most influential and adds to the explanation of how so many of these other changes came about. The history of the voting requirement dates to the "Avon Letter," in which the Department of Labor stated that "the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock."[50] Managers at ERISA-covered funds were, in essence, required to vote proxies even when the subject matter of the shareholder vote was not material to the interests of the fund's beneficiaries. The SEC enacted a similar rule in 2003 when it adopted Rule 206(4)-6 of the Investment Advisers

43. Tingle, *supra* note 1, at 688–90 (citations omitted).

44. Sarbanes-Oxley Act of 2002, §§ 301, 302, 15 U.S.C. §§ 78f, 7241 (requiring independent audit committees).

45. Dodd-Frank Wall Street Reform and Consumer Protection Act, § 951, 15 U.S.C. 78n (2010).

46. Sarbanes-Oxley Act of 2002, § 402, 15 U.S.C. § 78m(k).

47. 17 C.F.R. § 240.14a-8 (2023).

48. 17 C.F.R. § 275.206(4)-6 (2023).

49. 15 U.S.C. § 78s(b)(2).

50. Interpretive Bulletins Relating to the Employee Retirement Income Security Act of 1974, 59 Fed. Reg. 38860, 38863 (July 29, 1994) (providing a description of the "Avon letter").

Act of 1940.[51] Rule 206(4)-6 imposes a similar requirement on investment advisers to engage in proxy voting by framing the exercise of (or failure to exercise) voting authority with respect to client securities as a "fraudulent, deceptive, or manipulative act, practice or course of business" unless the adviser (1) "adopt[s] and implement[s] written policies and procedures that are reasonably designed to ensure [the adviser] vote[s] client securities in the best interest of clients," (2) "discloses to clients how they may obtain information from [the adviser] about how [the adviser] voted the[] securities," and (3) "describe[s] to clients [the adviser's] proxy voting policies and procedures and, upon request, furnish[es] a copy of the policies and procedures to the requesting client."[52] While not expressly requiring proxy voting, the linkage of proxy voting to fiduciary duty created a regulatory risk for investment advisers, and a corporate governance industry sprang up to help manage that risk.[53] The corporate governance industry is a very important factor in governance reform because the industry—which is dominated by two proxy advisory firms, Institutional Shareholder Services and Glass Lewis[54]—is able to resolve some of the collective action problems that impeded shareholder-led governance initiatives in the past. However, the good governance reforms suggested by proxy advisors have very little evidence that they result in better performance and stronger firm outcomes.[55] Instead, a corporate governance monoculture stifles the development of market forces that might ultimately result in stronger performance.

III. WHY PAY FOR LOW-QUALITY GOVERNANCE?

A central question raised by many of the corporate governance reforms of recent years is why institutional investors are willing to accept a monoculture corporate governance regime that doesn't result in better outcomes. The question is ironic in that, as Tingle points out, the idea of efficiency seems to be at the heart of modern corporate governance theory and practice; corporate governance structures are designed to reduce agency costs and ultimately increase the wealth of shareholders.[56] Are shareholders simply mistaken in their views and have failed to recognize the lack of evidence?

Several explanations for non-wealth-maximizing behavior have been offered, none of which are mutually exclusive. First, proxy advisors serve as a megaphone for institutional investors, but perhaps particularly for those seeking governance changes that are not tied to wealth creation. Proxy advisors' recommendations will ultimately be dictated by their

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51. 17 C.F.R. § 275.206(4)-6 (2023).

52. *Id.*

53. As the Government Accountability Office noted in a 2016 report, "some investment advisers determined that they could discharge their duty to vote their proxies and demonstrate that their vote was not a product of a conflict of interest if they voted based on the recommendations of a proxy advisory firm." U.S. GOV'T ACCOUNTABILITY OFF., GAO-17-47, CORPORATE SHAREHOLDER MEETINGS: PROXY ADVISORY FIRMS' ROLE IN VOTING AND CORPORATE GOVERNANCE PRACTICES 14–15 (2016).

54. *See* Jan Krahnen et al., *The Controversy over Proxy Voting: The Role of Asset Managers and Proxy Advisors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 30, 2023), https://corpgov.law.harvard.edu/2023/01/30/the-controversy-over-proxy-voting-the-role-of-asset-managers-and-proxy-advisors/#12b [https://perma.cc/8SR9-EEXX] ("[The] corporate governance . . . industry . . . is characterized by a limited number of voting advisory firms (ISS and Glass-Lewis) . . . .").

55. *See, e.g.*, Sharfman, *Opportunism in Shareholder Voting*, *supra* note 23, at 469, 472, 483 (critiquing the efficacy of various opportunistic voting topics, including a more specific analysis on gender diversity on boards).

56. Tingle, *supra* note 1, at 714–16.

clients. Index funds and other cost-focused and return-focused investors are less likely to invest in proxy voting advice, leaving the megaphone to other investors who may have investment preferences that reach beyond wealth maximization. These other investors may seek governance changes not because it improves the risk-adjusted performance of the company, but because such changes enable them to exert more influence over management. Rather than reducing agency costs, such a change may exacerbate "common agency" costs,[57] as "the action chosen by a particular individual [the common management agent] affects not just one, but *several* other parties (the principals), whose preferences for the various possible actions typically conflict."[58] Matsusaka and Shu argue that such conflicts are a feature of the proxy advisory market as proxy advisory firms will tend to cater to the preferences of "socially responsible investment . . . funds" that are not necessarily focused on wealth maximization, "even if [such] funds comprise only a small fraction of investors."[59]

A second explanation relies on the insights of behavioral economics, and the recognition that information costs surrounding corporate governance reforms are relatively high. As a result, shareholders willingly adopt measures that theoretically *seem* right, but in practice lack evidence that they produce better outcomes. Larry Ribstein noted that institutional investors might adopt such reforms as a kind of "criticism insurance."[60]

Finally, an institutional investor may prefer poor quality advice not because it helps them pursue some ulterior motive or because they are not aware that a particular governance structure has no supporting empirical evidence, but because a low-quality, noisy signal may "make it harder to hold them accountable for poor decision making or poor outcomes associated with those investment decisions."[61] Mason and Calomiris argue that institutional investors often have conflicted and sometimes perverse incentives driving their interest in "low-quality" corporate governance ratings:

> Why would institutional investors demand low-quality corporate governance analysis and ratings? Institutional investors enjoy private benefits from low-quality analysis and ratings, which can include: (1) avoiding legal liability for their decision making processes when selecting portfolio firms or voting firm shares, (2) avoiding accountability to their investors for poor firm performance, and (3) other potential private benefits that institutional investors gain at the expense of stockholders through their alliances with [Proxy Advisory Firms].[62]

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57. *See* Paul Rose, *Common Agency and the Public Corporation*, 63 VAND. L. REV. 1355 (2010) (describing common agency and the costs associated with such relationships).

58. B. Douglas Bernheim & Michael D. Whinston, *Common Agency*, 54 ECONOMETRICA 923, 923 (1986).

59. John G. Matsusaka & Chong Shu, A Theory of Proxy Advice Market when Investors Have Social Goals 2, 32 (Univ. S. Cal. Marshall Sch. of Bus. Rsch. Paper, 2021), https://ssrn.com/abstract=3547880 [https://perma.cc/F6YJ-DNUP].

60. Larry Ribstein, *Larry Ribstein on the Corporate Governance Industry*, CONGLOMERATE (June 12, 2006), http://www.theconglomerate.org/2006/06/the_corporate_g.html [https://perma.cc/T7FY-MP36].

61. Charles W. Calomiris & Joseph R. Mason, Conflicts of Interest, Low Quality Ratings, and Meaningful Reform of Credit and Corporate Governance Ratings 1, 12 (Apr. 14, 2010) (unpublished manuscript), https://www.aei.org/research-products/working-paper/conflicts-of-interest-low-quality-ratings-and-meaningful-reform-of-credit-and-corporate-governance-ratings [https://perma.cc/5V88-N3ER].

62. Joseph R. Mason, Comments on Securities & Exchange Commission Concept Release on the Proxy System 2–3 (Oct. 20, 2010), https://www.sec.gov/comments/s7-14-10/s71410-165.pdf [https://perma.cc/77Z5-LAF6].

All of these possibilities suggest a kind of failure at the heart of the market for corporate governance. Yet, these market failures did not arise because of a poorly functioning governance market,[63] but instead were the result of interventions in the market, and in particular the adoption of Rule 206(4)-6, which helped give rise to a powerful corporate governance industry that has in turn resulted in a corporate governance monoculture.

IV. CONCLUSION

Tingle's article will hopefully renew interest in the importance of a vital, open corporate governance market. The article is refreshingly agnostic about the ends of the corporate form and provides a counterpoint to the maximization-oriented debates that have dominated recent corporate law and governance scholarship. Tingle simply trusts the market to continually search for an equilibrium, without requiring a specific goal for the market. Arguably, however, current market regulation tips outcomes in favor of institutional investors at the expense of retail investors; institutional investor goals and preferences are driving governance changes. Concerns with the lack of retail investor voice have led scholars to suggest reforms designed to re-engage retail investors in governance markets. Jill Fisch, for example, has noted that "current voting outcomes do not reflect the preferences of all shareholders," and suggests the creation of an electronic platform that would facilitate retail investor voting.[64] Along with such changes, the SEC could also remove the structural interventions that currently impede the market for corporate governance, such as Rule 204(6)-4. As Tingle argues, such interventions may be not only harming the corporate governance market, but may be one of the primary reasons for the decline in public companies: "corporate managers are clear that one of the main reasons they try not to go public is to avoid the governance market we have created over the past thirty years."[65] The article compellingly contends that trusting market participants to devise their own solutions to agency problems—with less intermediation from the SEC and the corporate governance industry that tilts the market in favor of institutional investors—will result in more robust and vibrant corporate governance markets, and, ultimately, stronger capital markets as well.

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63. Admittedly, this is a debatable proposition. Certainly, the SEC thought that institutional investors—voting stock on behalf of beneficial owners—would not hold managers accountable and intervened in the corporate governance market by creating Rule 206(4)-6 in 2003. This cure, I argue, is worse than the disease.

64. Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 82 MINN. L. REV. 11, 14 (2017) (arguing that enhancing retail investor voting participation would "preserve the legitimacy of shareholder voting in reducing managerial agency costs and maintaining director accountability"); *see also* Christopher Gulinello, *The Retail-Investor Vote: Mobilizing Rationally Apathetic Shareholders to Preserve or Challenge the Board's Presumption of Authority*, 2010 UTAH L. REV. 547, 548–49 (promoting a new way of "robust and informed" shareholder voting); Yaron Nili & Megan Wischmeier Shaner, *Virtual Annual Meetings: A Path Toward Shareholder Democracy and Stakeholder Engagement*, 63 B.C. L. REV. 123, 126 (2022) (arguing virtual annual meetings would increase meaningful engagement among shareholders). One proposal even suggested that financial reporting changes (specifically to non-GAAP metrics) should be put to a shareholder vote to ensure the shareholders both understand and value the given metric. Israel Klein, *Voting on Reporting*, 48 J. CORP. L. 778, 810–11 (2023) (arguing how limiting non-GAAP reporting changes to those that pass a shareholder vote may pave the way towards a more effective reporting regime).

65. Tingle, *supra* note 1, at 711.