

# THE YALE LAW JOURNAL POCKET PART

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## Critical Corporate Law, Colorblind Constitutional Law

Should minority status be a relevant datum for judicial decision?

That is the question motivating my essay, *Minorities, Shareholder and Otherwise*,<sup>1</sup> published five years ago in this journal. I am grateful to *The Yale Law Journal* for recalling the paper and inviting three of the nation's leading legal scholars to comment on it. Because my essay was published at the dawn of the Web 2.0 era when, alas, *The Pocket Part* was not yet available, the *Journal* has asked me to pen an introduction to this symposium to review that paper.

In *Minorities, Shareholder and Otherwise*, I demonstrate that corporate law recognizes the relevance of minority status, even while constitutional law more and more insists on minority-blindness. I argue that this is precisely backwards – that the constitutional domain should require greater judicial vigilance with respect to minority status than the corporate domain. The difficulty of exit from a polity and the inability to negotiate (or at least select among) terms of entry into a polity, not to mention a history of grave injustice, call for special attention to minorities in the constitutional context.

By juxtaposing the colorblind aspirations of current constitutional law doctrine with the minority-mindfulness of corporate law, I reveal a fundamental incoherence in the law.

I review my argument briefly here, beginning with my recharacterization of corporate law and then moving to my argument for extending the analysis to the constitutional plane.

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1. Anupam Chander, *Minorities, Shareholder and Otherwise*, 113 YALE L.J. 119 (2003).

## shareholder wealth distribution

Progressives have long sought to expand corporate values beyond shareholder wealth maximization. Corporations should, they suggest, heed stakeholders other than shareholders, such as workers, consumers, the neighborhood, and the environment. But *Minorities* suggests that corporate law's focus on shareholders is itself progressive at heart. Specifically, corporate law's determination to police the treatment of shareholders recognizes law's role as active guardian of the interests of those who may be susceptible to exploitation. *Minorities* uncovers this progressive premise of corporate law. Both in devising rules and in applying them to particular cases, corporate law takes minority status into careful account.

The canonical cases show this minority-mindfulness at work. In *Dodge v. Ford*, the court reminded Ford about “the duties which in law he and his codirectors owe to protesting, minority stockholders.”<sup>2</sup> While the case is often used to epitomize shareholder wealth maximization, the court is not motivated by a desire to protect all shareholders. Ford, after all, owned fifty eight percent of the company. The court was not concerned that Ford was not maximizing his own wealth – but rather that he was acting without regard to his minority co-venturers.

In *Joy v. North*, authored by Judge Ralph Winter, a major contributor to the modern theory of corporate law, the Second Circuit approved judicial scrutiny of a loan made by a corporation in a manner that might benefit the son of the corporation's CEO.<sup>3</sup> The court worried that the CEO “completely dominated” the board of directors and was still “deeply involved” even though he abstained from voting on the loan. Judge Winter here was following the wise counsel of Judge Cardozo, who would “probe beneath the surface” of corporate relations, recognizing that a “dominating influence may be exerted in other ways than by a vote.”<sup>4</sup>

I suggest that whether courts intervene in the battle for corporate control turns in large part on how minority shareholders will fare under the board's plan. The Delaware Supreme Court distinguished the proposed Time-Warner merger (which it approved<sup>5</sup>) from the Paramount-Viacom merger (which it did not approve) by noting that “Time would be owned by a fluid aggregation of unaffiliated stockholders both before and after the merger,” whereas the proposed Paramount merger would “shift control of

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2. 170 N.W. 668, 684 (Mich. 1919).

3. *Joy v. North*, 692 F.2d 880, 894 (2d Cir. 1982).

4. *Globe Woolen Co. v. Utica Gas & Elec. Co.*, 121 N.E. 378, 379-80 (N.Y. 1918).

5. *Paramount Commc'ns Inc. v. Time*, 571 A.2d 1140 (Del. 1989).

Paramount from the public stockholders to a controlling stockholder.”<sup>6</sup> The insertion of a controlling shareholder, where there had been none previously, threatened minority shareholders, necessitating judicial intervention.

These cases demonstrate that courts “are especially vigilant with regard to minority shareholders, both in the face of a controlling shareholder and, in the absence of a controlling shareholder, entrenched management.”<sup>7</sup> Vigilance should not, however, be mistaken for victory. Minority shareholders do not always get their way; one cannot predict the result of a case simply by identifying the side on which the minority shareholder sits. Rather, judicial concern is with fairness and care towards minority shareholders. Footnote four of *Carolene Products*,<sup>8</sup> which demands judicial protection for certain classes of minorities, lives on in corporate law, even if it is increasingly a relic in constitutional law.

The statutory realm reveals great concern for minority shareholders as well. Corporate law literally provides minority shareholders with a cause of action for “oppression.” Thus, a minority shareholder can bring an action against the majority for “conduct that substantially defeats the ‘reasonable expectations’ held by minority shareholders in committing their capital to the particular enterprise.”<sup>9</sup> At one time, many state laws and even state constitutions mandated cumulative voting, a device to help minority shareholders to see and be heard in a boardroom. Corporate codes also give minority shareholders in close corporations and, on occasion, public corporations the right to “force the corporation to buy their shares at a judicially determined price if they “disagree with certain fundamental changes” in the corporation.<sup>10</sup> For its part, securities regulation provides mandatory protections to shareholders, thus not obliging them to rely upon either contract breach or fraud to vindicate their rights. Such protections, I suggest, are largely designed to protect minority shareholders, not controlling ones.

To summarize: “Corporate law . . . seeks a much richer informational base [than contemporary constitutional law] upon which to form its

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6. *Paramount Commc’ns Inc. v. QVC Network Inc.* 637 A.2d 34, 46, 48 (Del. 1993).

7. Chander, *supra* note 1, at 141.

8. *United States v. Carolene Products Co.*, 304 U.S. 144, 152-53 n.4 (1938).

9. Douglas K. Moll, *Shareholder Oppression and “Fair Value”: Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 DUKE L.J. 293, 306-07 (2004) (quoting *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1179 (N.Y. 1984)).

10. *Pueblo Bancorporation v. Lindoe, Inc.*, 63 P.3d 353, 358 (Colo. 2003).

judgments. . . . It meticulously examines power, and learns from experience with power's operation."<sup>11</sup>

### drawing the analogy

In his magisterial book, *The Bill of Rights: Creation and Reconstruction*, Akhil Amar identifies a shift in the concerns of the Bill of Rights, from its foundational concern with agency costs — that is, the costs of governors whose interests vary from those of the governed — to the tyranny of the majority — that is, the oppression of minorities at the hands of those in control.<sup>12</sup> Since at least Jensen and Meckling, scholarship has sought to cast corporate law as largely concerned with the problem of agency costs.<sup>13</sup> But tyranny of the majority remains a significant concern of corporate law as well.<sup>14</sup> *Minorities* tells corporate law's story through this alternative lens. In this telling, both corporate law and constitutional law share a common problem: “the exercise of power by controlling groups to benefit themselves at the expense of minorities.”<sup>15</sup>

But just because minorities are protected in one domain does not mean that they should be protected in another. Perhaps the logic, the structure, the experience, the history, the dynamics, and the stakes in the two domains are different in ways that make minority status relevant in one, but not the other. In my essay, I consider four differences, though others can certainly be found: “(1) a special concern for protecting property rights; (2) the different American histories of corporations and of racism; (3) the difference in the exit option for shareholders and citizens; and (4) the notion that race-based dynamics, unlike corporate dynamics, are too amorphous to meet the strict demands of law.”<sup>16</sup>

Let me summarize my argument with respect to just one of these differences — the exit option, *vel non*: “While a shareholder in a publicly-

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11. Chander, *supra* note 1, at 169.

12. AKHIL REED AMAR, *THE BILL OF RIGHTS: CREATION AND RECONSTRUCTION*, at xiii (1998).

13. Lucian A. Bebchuck, *Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784, 1791 (2006) (“We often think about corporate governance as a mechanism for reducing the agency problem.”); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

14. See, e.g., Lynn A. Stout, *Takeovers in the Ivory Tower: How Academics are Learning Martin Lipton May Be Right*, 60 BUS. LAW. 1435, 1446 (2005) (“Shareholder voting is no solution: apart from being slow, cumbersome and costly, it risks of tyranny of the majority . . .”).

15. Chander, *supra* note 1, at 151.

16. Chander, *supra* note 1, at 159.

held corporation can leave easily by liquidating her position, a citizen has stronger ties that make exit far more difficult,”<sup>17</sup> a difference highlighted by Albert Hirschman.<sup>18</sup> Those without a viable exit option are more vulnerable to exploitation, a fact that should lead us to be especially vigilant about minorities in the constitutional context. Not only does a citizen face more difficulties upon exit, she faces great difficulties in entry. She cannot negotiate the terms of her entry into the polity or at least choose readily between various preset governing arrangements. Thus, she is unable to use her presence as leverage to ensure contractual arrangements against minority exploitation. The contractual devices for self-help available to minority shareholders are thus largely unavailable to minorities in an educational and employment context.

## applications

The last part of *Minorities* applies my analysis to three hot button issues: (1) the Supreme Court’s most recent decisions on affirmative action in higher education — *Grutter*<sup>19</sup> and *Gratz*<sup>20</sup>; (2) the Racial Blindness Initiative (then on the California ballot); and (3) the demographic shift to majority minority states (a turn that had already come to pass in California). With respect to the second issue, I suggest a tongue-in-cheek counterproposal: a “Shareholder Blindness Initiative,” where “Bill Gates, Warren Buffett, and the small pensioner are all rendered equal”<sup>21</sup> in the eyes of the law, even when it comes to considering relationships among shareholders and management. Such an initiative would rewrite corporate law.

## conclusion

Through *Minorities, Shareholder and Otherwise* I hope to spur students of the law to connect the subject of corporations to other legal subjects — to remove the artificial isolations required by both legal doctrine and the law school curriculum. We should ponder why state corporate law is a largely common law enterprise, a hotbed of judicial activism, leaving corporate insiders always looking over their shoulders for a shareholder suit

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17. Chander, *supra* note 1, at 160.

18. ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).

19. *Grutter v. Bollinger*, 539 U.S. 306 (2003).

20. *Gratz v. Bollinger*, 539 U.S. 244 (2003).

21. Chander, *supra* note 1, at 174.

complaining of unfair actions. In the corporate realm, we find courts calibrating fiduciary duties, even though the parties to whom these duties are owed might have insisted on such obligations in the corporate charter prior to placing an investment. But, in the constitutional sphere, law insists on an equal concern for minority and majority supplicants. *Minorities* identifies this puzzle, and suggests that corporate law has a grip on real world relations that constitutional law increasingly abjures.

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Preferred Citation: Anupam Chander, *Critical Corporate Law, Colorblind Constitutional Law*, 118 YALE L.J. POCKET PART TK (2008), <http://thepocketpart.org/2008/TK/TK/chander.html>.