Digital Commons @ University of Georgia School of Law

Scholarly Works | Faculty Scholarship

10-21-2008

The Enduring Ambivalence of Corporate Law

Christopher M. Bruner
University of Georgia School of Law, christopher.bruner@uga.edu

Repository Citation

Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law* , 59 ALA. L. REV. 1385 (2008),
Available at: https://digitalcommons.law.uga.edu/fac_artchop/1140

This Article is brought to you for free and open access by the Faculty Scholarship at Digital Commons @ University of Georgia School of Law. It has been accepted for inclusion in Scholarly Works by an authorized administrator of Digital Commons @ University of Georgia School of Law. Please share how you have benefited from this access
For more information, please contact tstriepe@uga.edu.

THE ENDURING AMBIVALENCE OF CORPORATE LAW

Christopher M. Bruner[*]

INTRODUCTION 1385
I. THE CORPORATE SOUL 1387
II. PREVAILING THEORIES OF CORPORATE GOVERNANCE 1395
  A. *Board-centric Corporate Governance* 1396
    1. *Nexus of Contracts* 1397
    2. *Team Production* 1401
  B. *Shareholder-centric Corporate Governance* 1405
  C. *The State of Play* 1408
III. CORPORATIONS, MARKETS, AND MORAL THEORY 1408
  A. *Corporate Power and Shareholder Wealth* 1409
  B. *The Ambivalence of Corporate Law* 1421
    1. *Power Constituencies* 1422
    2. *Beneficiaries* 1424
    3. *The Social Good* 1427
IV. INSTITUTIONAL SHAREHOLDERS AND SOCIAL RESPONSIBILITY 1432
  A. *The Rise of Institutional Shareholders* 1432
  B. *Socially Responsible Investing* 1435
  C. *Institutional Activism* 1439
V. SHAREHOLDERS' BYLAW POWER AND THE FUTURE OF CORPORATE LAW 1442
VI. CONCLUSION 1448

INTRODUCTION

Despite the fact that corporations have existed for centuries in one form or another, broadly acceptable answers to some of the most fundamental questions of corporate law and theory continue to elude us today. Particularly in the case of widely held "public" corporations—in which the

* Assistant Professor of Law, Texas Tech University School of Law. A.B., University of Michigan; M.Phil., Oxford University; J.D., Harvard Law School. For thoughtful comments and suggestions, I would like to thank Stephen Bainbridge, Bryan Camp, William Casto, Susan Fortney, Lyman Johnson, Dean Pawlowic, and David Skeel. Thanks also to the editors of the *Alabama Law Review* for editorial assistance. Any errors are of course mine.

sheer complexity of governance, production, and social impact arguably exceeds the capacity of any single individual to comprehend it[1]—theoretical uncertainties regarding the nature and purpose of the entity remain exceptionally difficult to resolve in any comprehensive way. Who possesses ultimate corporate governance authority? For whose benefit are public corporations run? And what is corporate law's relationship to the achievement of the social good? These are the questions with which this Article will grapple.

Prevailing theories of corporate law have tended to advance strong claims regarding the corporate governance primacy and legitimacy of either the board or the shareholders, as the case may be. In this Article, I challenge the descriptive power of these theories and advance an alternative, arguing that corporate law is, and will remain, deeply ambivalent—both doctrinally and morally—with respect to each of three fundamental and related issues: the locus of ultimate corporate governance authority, the intended beneficiaries of corporate production, and the relationship between corporate law and the achievement of the social good. I describe corporate law as being "ambivalent" on each of these issues not to suggest self-contradiction, but rather a pragmatic balancing of "two contrary or parallel" sets of norms and interests in each case,[2] neither one of which can be wholeheartedly endorsed in light of the numerous and complex social and economic demands upon the modern public corporation.

Part I begins with a brief discussion of our long-standing misgivings regarding the status of the corporation as an entity, arguing that concerns regarding the potential negative consequences of permitting human beings to act behind the veil of a distinct legal person are as old as the corporate form itself. I then turn to an examination of the prevailing theories of corporate governance in Part II, arguing that they exhibit substantial shortcomings as descriptive theories due to their inability to account for the fundamental elements of corporate law as it actually exists. Based upon a re-examination of the roles and powers of shareholders and directors in the

1. This Article will focus on widely held public corporations, which raise the thorniest issues; close corporations, and corporations with controlling shareholders, for which ownership and control are largely synonymous, will not be addressed.

2. The modern corporation has been described elsewhere as "schizophrenic," *see* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 261 (1992), though I prefer "ambivalent" for the reason set out above. The term "schizophrenic," used colloquially, implies "mutually contradictory or inconsistent elements," whereas "ambivalent" can connote a more complex relation among ostensibly disparate ideas, in the sense of "having either or both of two contrary *or parallel* values, qualities or meanings." *See* OXFORD ENGLISH DICTIONARY ONLINE, schizophrenic, *a.* and *n.* (2d ed. 1989); *id.* ambivalent, *a.* (emphasis added); *see also* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1096 (2002) (describing Delaware law as "ambivalent" with respect to shareholder primacy). As I will argue below, corporate law is "ambivalent"—in the sense of maintaining "two contrary or parallel values"—with respect to each of the three issues I identify.

public corporation across various doctrinal contexts, I conclude in Part III that corporate law is, and will remain, fundamentally ambivalent. In so doing I draw upon utilitarianism—corporate law's implicit moral theory—to more clearly describe the nature and degree of corporate law's commitment to shareholder wealth maximization. Its weak utilitarian commitment to shareholder wealth maximization, I argue, reflects real, but incomplete, confidence in the consistency of shareholders' incentives and interests with those of the larger public—an uncertainty reinforced by the corporate form's lack of legitimacy or practical ability to articulate an authoritative conception of the "social good."

I then turn to the rise of institutional shareholders in part IV, assessing their effects on the issues discussed in this Article. Finally, in Part V I offer some brief reflections on the implications of my analysis for an important doctrinal debate cutting to the heart of corporate governance: the scope of the shareholders' authority to enact bylaws affecting the "business" and "affairs" of the corporation. Ultimately I suggest that corporate law's fundamental ambivalence represents a keen awareness of the limitations and pitfalls inevitably attendant upon this mode of human organization, and that awareness of this core characteristic ought to be brought to bear upon the corporate governance debate.

I. THE CORPORATE SOUL

For the early seventeenth century jurist Sir Edward Coke, the law of corporations flowed naturally from the fundamental nature of the corporate entity itself. In his famous report on *The Case of Sutton's Hospital*, published in 1614, Coke explained that "a corporation aggregate of many is invisible, immortal, and rests only in intendment and consideration of the law."[3] As an aggregation of real people into a single artificial legal person, the corporation met the need for a mechanism capable of ensuring the continuity of a given institution or enterprise for an indefinite time, notwithstanding the mortality of its constituents.[4] As the eighteenth century jurist Sir William Blackstone would express it, the corporation's constituents—past, present, and future—became "but one person in law, a person that never dies: in like manner as the river Thames is still the same river, though the parts which compose it are changing every instant."[5] Black-

3. EDWARD COKE, 5 THE REPORTS OF SIR EDWARD COKE, KNT. IN THIRTEEN PARTS pt. X, at *32b (photo. reprint 2002) (1826). The tenth part of Coke's Reports was originally published in 1614. *See* Steve Sheppard, *Coke's* Reports*: An Introduction to the 1826 Edition*, *in* 1 COKE, *supra*, at xi.

4. *See, e.g.*, WILLIAM BLACKSTONE, 1 COMMENTARIES *455. This account of the origin of the corporation is not specific to English common law. *See, e.g.*, MAX WEBER, MAX WEBER ON LAW IN ECONOMY AND SOCIETY 156-58 (Max Rheinstein ed., Edward Shils & Max Reinstein trans., Simon and Schuster 1967) (1925) (providing a similar explanation for the advent of legal entities on the Continent).

5. BLACKSTONE, *supra* note 4, at *456.

stone's contemporary, Sir Matthew Bacon, similarly employed the metaphor of the "Body Politick," the "Ligaments of which . . . are the Franchises and Liberties thereof, which bind and unite all its members together; and the whole Frame and Essence of the Corporation consist therein."[6]

What corporations could and could not do in seventeenth and eighteenth century England, then, was thought to turn directly on the qualities that distinguished them from their flesh-and-blood constituents—notably that they possessed neither bodies nor souls.[7] The passage from Coke quoted above, for example, goes on to explain that corporations "cannot commit treason, nor be outlawed, nor excommunicate, for they have no souls."[8] Neither could they "appear in person, but by attorney," nor "do fealty, for an invisible body can neither be in person, nor swear."[9] Blackstone similarly observed that corporations "can neither maintain, or be made defendant to, an action of battery or such like personal injuries; for a corporation can neither beat, nor be beaten, in it's body politic."[10] Likewise it "cannot be executor or administrator, or perform any personal duties; for it cannot take an oath for the due execution of the office"—and so forth in this manner of reasoning from the corporation's artificial nature.[11]

Speaking from the twentieth century jurisprudential point of view, H.L.A. Hart was clearly right to criticize the circularity of the old "fiction theory" of the corporation, which purported to "deduce" its capacities from conclusory statements about its inherent characteristics.[12] For Hart, the ontology was considerably simpler; *we* make the rules, and it is only by reference to those rules that the corporation can be said to "be" anything at all.[13] Perhaps the more interesting aspect of the writings of Hart's English forbears, however, is the simple fact that they felt the ontology of the corporation to be something that needed to be reckoned with. Numerous references to corporations lacking "souls," "bodies," and so forth, reflect an abiding puzzlement regarding the nature of the corporate enterprise, as well as its relationship to and effect upon its constituents.[14] Critically, why presume that corporations "have no souls," as Coke did? In a sense, this is a strange spiritual arithmetic: an aggregation of souls equals no soul. Why not conclude that the corporation possesses at least the sum

---

6. MATTHEW BACON, 1 A NEW ABRIDGMENT OF THE LAW *499-500.
7. COKE, *supra* note 3, at *32b.
8. *Id.*
9. *Id.* Fealty is defined as "the allegiance that a tenant or vassal owes to a lord" under feudal law. BLACK'S LAW DICTIONARY 642 (8th ed. 2004).
10. BLACKSTONE, *supra* note 4, at *464.
11. *Id.* at *464; *see also* BACON, *supra* note 6, at *506-09.
12. H.L.A. HART, ESSAYS IN JURISPRUDENCE AND PHILOSOPHY 44-47 (1983).
13. *Id.* at 23, 30, 39; *see also* Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565, 1571-74 (1993).
14. *See e.g.*, BLACKSTONE, *supra* note 4, at *464; COKE, *supra* note 3, at *32b.

of its souls, or better yet, a sort of "super-soul" greater than the sum (especially where the stated aim of the collective effort was charitable or humanitarian in nature)?[15] Put differently, why deny the humanity of what is, in essence, a collection of human actors?

This critical premise of the old English law arguably reflects deep misgivings about permitting real people—presumed to possess minds and souls guiding their actions—to organize themselves and act collectively behind the veil of a separate and distinct entity. There is an uneasiness, both ontological and moral, and perhaps even a certain creepiness, in such descriptions of the corporation. Indeed, the implication is that collective actions through these unnatural aggregations might differ markedly from the sum of the actions the individuals in question might have taken under the same circumstances. It is as if we were somehow meddling with the forces of nature, constructing and unleashing upon the world a sort of legal Frankenstein (composed of us, mind you), the capabilities and moral sensibilities of which could not be discerned, and the consequences of which could prove difficult to predict and contain.

Though we no longer think about corporate powers and capacities in such terms, and conceding that the entities that writers like Coke, Blackstone, and Bacon described as "corporations" bear only limited resemblance to the modern business corporation, such misgivings about distinct collective entities taking on lives of their own are hardly a thing of the distant past or foreign to American law.[16] The advent of general incorporation laws, limited liability for investors, free transferability of shares, and

---

15. In Blackstone's time corporations in fact took many forms, with important distinctions including those between "aggregate" and "sole" (the latter consisting of offices), "ecclesiastical" and "lay," as well as "civil" and "eleemosynary." *See* BLACKSTONE, *supra* note 4, at *457-59. It is corporations aggregate that are relevant to this discussion.

16. The mode of reasoning ascribed to these English commentators clearly carries over into early American jurisprudence. *See, e.g.*, Bank of Ithaca v. King, 12 Wend. 390, 391 (N.Y. Sup. Ct. 1834) (finding that a corporation cannot "be compelled to work on the highways" in part because it "has no corporeal body," is "incapable of performing labor, and therefore can not [sic] be compelled to perform an impossibility"). Early American cases involving corporations in fact note the lack of "body" and "soul" (discussing the views of Coke and Blackstone) in casting aspersion on corporations' regard for the social good. *See, e.g.*, Bloodgood v. Mohawk & Hudson R.R. Co., 18 Wend. 9, 43 (N.Y. 1837) ("Though corporations have no consciences, nor souls to commiserate the condition of others; though they are not far-famed for a ready willingness to dispense justice to those who may have claims upon their coffers, yet they are proverbial for their keenness and sagacity in amassing wealth, and not too unfrequently at the expense of others."); *see also* Trs. of the Antipoeda Baptist Church v. Mulford, 8 N.J.L. 182, 191-92 (N.J. 1825) (responding to Coke's statement that corporations lack souls, and Blackstone's statement that they lack bodies, in deciding that "assumpsit will lie against a corporation on an implied promise without the corporate seal"—an exception from the "general rule," attributed to Blackstone, motivated by concern that "corporations are now so multiplied that if they were not amenable to justice in some cases like natural persons . . . society could not tolerate the frauds in business that they would have the ability to commit"). For a nuanced discussion of Blackstone's influence on early American law, politics, and legal education, see generally Dennis R. Nolan, *Sir William Blackstone and the New American Republic: A Study of Intellectual Impact*, 51 N.Y.U. L. REV. 731 (1976).

the centralization of decision-making authority in the mid-nineteenth and early twentieth centuries[17] were not without controversy. Indeed, corporations were frequently referred to as "soulless" in nineteenth century debates over the future of the corporate form, reflecting concerns that they "could concentrate the worst urges of whole groups of men; the economic power of a corporation would not be tempered by the mentality of any one man, or by considerations of family or morality."[18] And as noteworthy scholars and jurists of the early twentieth century would observe of the emergence of "public" corporations—so called because they relied on enormous offerings of securities to an investing public to finance the capital-intensive projects of the industrial age[19]—"ownership" of these entities[20] seemed to have been severed from any effective means of controlling them.

By 1915, Louis Brandeis had concluded that public corporations were "not controlled through a majority of the stock," but rather "very largely by position," which he considered "an almost inevitable result of the wide distribution of stock."[21] Brandeis explained that "a wide distribution of the stock dissipates altogether the responsibility of stockholders, particularly of those with 5 shares, 10 shares, 15 shares, or 50 shares. They recognize that they have no influence in a corporation of hundreds of millions of dollars capital," and thus "consider it immaterial whatever they do, or

17. For accounts of the emergence of these core characteristics of the modern U.S. business corporation, see Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439-40 (2001); WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 83-109 (2d ed. 2007).

18. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 797-98 (2005) (quoting LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 171-72 (2d ed. 1985)) (internal quotation marks omitted). This is not to suggest, however, that evaluation of the moral dimensions of the modern business corporation has ever been a straightforward exercise. *See, e.g.*, David A. Skeel, Jr., *Christianity and the Large Scale Corporation* 6-13 (University of Pennsylvania Law School Public Law and Legal Theory Research Paper No. 07-45, 2007), *available at* http://ssrn.com/abstract=1025959 (discussing the range of Christian responses to the emergence of modern corporate characteristics in nineteenth century England and the United States).

19. A quintessential example was the emergence of the railroads, which catalyzed the development of global bond markets and credit rating agencies such as Standard & Poor's and Moody's, which initially rated only railroad debt. *See* Christopher M. Bruner & Rawi Abdelal, *To Judge Leviathan: Sovereign Credit Ratings, National Law, and the World Economy*, 25 J. PUB. POL'Y 191, 194 (2005). Today, of course, terms such as "public corporation" and "public company" more specifically denote having registered with the Securities and Exchange Commission pursuant to the Securities Act of 1933 in order to sell securities publicly, or having otherwise triggered disclosure obligations under the Securities Exchange Act of 1934. *See, e.g.*, STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 158-60 (2005).

20. By "ownership" these writers referred to the rights of equity holders. Challenges to this characterization are discussed below. *See infra* notes 63-64 and 120 and accompanying text.

21. LOUIS D. BRANDEIS, *On Industrial Relations*, *in* THE CURSE OF BIGNESS: MISCELLANEOUS PAPERS OF LOUIS D. BRANDEIS 70, 77 (Osmond K. Fraenkel ed., 1965) (testimony before the United States Commission on Industrial Relations, January 23, 1915).

omit to do"[22]—a phenomenon that economists would come to call "rational apathy."[23]

The definitive case for this view appeared with the 1932 publication by Adolph Berle and Gardiner Means of *The Modern Corporation and Private Property,* where they famously termed this development the "separation of ownership and control"[24] (certainly one of the most widely cited works, and turns of phrase, in the literature)[25]. Justice Brandeis, in 1933, built on the empirical case they set out, deriding acceptance of "the evils attendant upon the free and unrestricted use of the corporate mechanism" following the advent of general incorporation statutes, "as if these evils were the inescapable price of civilized life and, hence, to be borne with resignation."[26] In his view, availability of the corporate form for general business purposes had been restricted for centuries "because of fear."[27] Brandeis detected in the history "a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations," and interpreted the advent of general incorporation as a rejection of "favoritism" rather than an indication "that the apprehension of corporate domination had been overcome."[28] Observing the size to which corporations had grown, as well as their social and economic significance (and citing to Berle and Means' work) Brandeis argued that the separation of ownership and control had "removed many of the checks which formerly operated to curb the misuse of wealth and power."[29]

---

22. *Id.* As Stephen Bainbridge has observed, recognition of the separation of ownership and control in fact dates back at least to the late nineteenth century. *See* Stephen Bainbridge, *Cook's* The Corporation Problem*: There is Nothing New Under the Corporate Law Sun*, BUSINESSASSOCIATIONSBLOG.COM, July 31, 2007, http://www.businessassociationsblog.com/lawandbusiness/comments/cooks_the_corporation_problem_there_is_nothing_new_under_the_corporate_law_/ (dating this recognition to the early 1890s).

23. *See, e.g.*, ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 17, at 178.

24. ADOLPH A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 5 (1932).

25. As of June 25, 2007, searches of Lexis' "US & Canadian Law Reviews, Combined" database for the phrases "modern corporation and private property" and "separation of ownership and control" returned 920 and 1,061 results, respectively. For a discussion of historical trends resulting in the separation of ownership and control in early twentieth century public corporations, see Dalia Tsuk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE L. REV. 1503, 1519-24 (2006).

26. Louis K. Liggett Co. v. Lee, 288 U.S. 517, 548 (1933) (Brandeis, J., dissenting).

27. *Id.*

28. *Id.* at 549.

29. *Id.* at 564-65. *See also* William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and* The Modern Corporation 12 (Institute for Law & Economics, University of Pennsylvania Law School Research Paper No. 07-24, Georgetown Law Center Business, Economics & Regulatory Law Research Paper No. 1021273, 2007), *available at* http://ssrn.com/abstract=1021273 (indicating that Berle and Brandeis were in contact by 1932). It should be observed that Brandeis advocated disclosure not only to facilitate regulatory responses to manipulative market practices, but also as a means of enabling shareholders to impose discipline upon those controlling corporations. *See* Mitchell, *supra* note 25, at 1518-19.

Such descriptions of the modern public corporation reflect deep misgivings about the corporate form not unlike those identified in Coke's and Blackstone's writings. References to "absentee owners," "absentee stockholders," "absentee landlords,"[30] and the like often appeared in arguments that corporations were not sufficiently answerable to the public, be they consumers, employees, or communities, over whom they held enormous sway—and that stockholders were effectively enabling their activities by financing them, without accepting responsibility to monitor how, and to what ends, their money was being used. Merrick Dodd, in an influential 1932 article for the *Harvard Law Review*, characterized the separation of ownership and control primarily as a sort of ethical fragmentation, exemplified by shareholders deemed (by custom) to "own" something for which they accepted no responsibility, while corporate insiders were driven by fiduciary duties to pursue the maximization of profit to the exclusion of the interests of the public whose laws permitted the corporation to exist in the first place.[31] As Dodd saw it, the view that shareholder wealth maximization represents the principal goal of the corporation "means in practice that there are *no human beings* who are in a position where they can lawfully accept for incorporated business those social responsibilities which public opinion is coming to expect, and that these responsibilities must be imposed on corporations by legal compulsion."[32] It appeared as if each of what I will call the principal "power constituencies" within the public corporation—the board[33] and the shareholders—had ethical blinders placed over their eyes by the corporate structure itself, the former by fiduciary duties and the latter by rational apathy.

Concerns regarding the capacity of public corporations to conduct themselves consistent with the social good were widespread at the time of the Great Depression. However, it was far less clear what corporate law itself could or should do in response. For Dodd, the answer lay in remaining responsive to "public opinion, which ultimately makes law."[34] Dodd observed that business leaders felt, or at least said, that their responsibilities were broader than the maximization of shareholder wealth, and in this

30. *See, e.g.*, BRANDEIS, *supra* note 21, at 74, 77 ("absentee stockholdings" and "absentee landlordism"); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1153 (1932) ("absentee owners").

31. *See* Dodd, *supra* note 30, at 1160-63.

32. *Id.* at 1162 (emphasis added).

33. While large public corporations are, as a day-to-day matter, in fact run by officers—primarily the Chief Executive Officer (CEO)—I focus instead on the board as the body possessing actual statutory authority over the business and affairs of corporations. It should be observed that corporate statutes generally do not even mention the position of CEO, reflecting the fact that, notwithstanding practical problems faced by part-time directors in monitoring the activities of full-time officers, corporate officers' formal management authority is in fact derivative of the board's statutory mandate. *See* ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 17, at 103-07. My interest here being the fundamental fonts of power in corporate law, I therefore focus on the board and the shareholders.

34. *See, e.g.*, Dodd, *supra* note 30, at 1148, 1153, 1161.

light Dodd argued that the answer lay in fiduciary duties flowing not merely to shareholders, but to the corporate entity itself—a move permitting corporations to be run "with a sense of social responsibility without [boards and managers] thereby being guilty of a breach of trust."[35] Meanwhile, Adolph Berle, in a reply to Dodd, echoed his misgivings regarding the separation of ownership and control but worried that fiduciary accountability to multiple corporate constituencies on an equal footing would in practice mean accountability to none of them.[36] This, Berle argued, would simply enhance the power of corporate insiders and render them even less responsive to the public interest than they already were.[37]

This exchange framed a debate over the regulation of corporate governance that continues to animate corporate law scholarship and jurisprudence today.[38] Despite—or perhaps because of—the evolution of the corporation into the most consequential form of economic actor on the planet, uncertainties and misgivings about the moral capacities and social impacts of the corporation remain. Einer Elhauge, for example, has questioned the capacity of dispersed shareholders to engage in meaningful ethical assessment of corporate production at all.[39] The structure of the public corporation "insulates . . . shareholders from social and moral sanctions and processes," both by rendering them "largely anonymous" to the public, as well as by virtue of their "relative lack of information about how corporate operations may impact the public interest."[40] Consequently, he argues, shareholders could push all that much harder for profit maximization "untempered by social consequences," and a management team focused on their interests would indeed render the corporation "soulless" for lack of the "social and moral processes" that constrain individuals acting on their own.[41] Such concerns have taken on far greater urgency since the advent

35. *Id.* at 1161-63.

36. A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees*, 45 HARV. L. REV. 1365, 1368-72 (1932).

37. *Id.*

38. This said, as William Bratton and Michael Wachter point out, the Berle-Dodd debate differs markedly from the contemporary corporate governance debate in that both Berle and Dodd broadly accepted the prevailing "corporatism" of the day, under which "the corporation [was viewed] as an entity that operates as an organ of the state and assumes social responsibilities." Bratton & Wachter, *supra* note 29, at 6. Though Berle is often presented as "the supporter of modern shareholder primacy," and Dodd is often "interpreted in modern terms as a supporter of corporate social responsibility," Bratton and Wachter argue that "neither was supporting either position." Rather, "[b]oth were speaking to the politics of their day, defending different visions of the emerging corporatist state." *Id.* at 40-41.

39. Elhauge, *supra* note 18, at 796-99.

40. *Id.* at 798.

41. *Id.* at 799; *cf. id.* at 792-93 (observing that while a small percentage of investors invest in "socially conscious funds," political polls evidence strong support for consideration of other constituencies in corporate decision-making). Others have voiced similar concerns and advanced similar arguments. *See, e.g.*, Kent Greenfield, *Saving the World With Corporate Law?* 10-11 (Boston Coll. Law Sch., Legal Studies Research Paper No. 130, 2007), *available at* http://ssrn.com/abstract=978242 ("As an artificial entity, [the corporation] has no conscience of its own. And with the separation be-

of leveraged hostile tender offers in the 1980s, tempting shareholders with all-cash premium deals, while arguably leaving other stakeholders (including employees, creditors, and communities) to bear the costs as the acquired companies labored under high debt loads or were simply broken up to pay off the buyer's debts.[42] The rise of institutional investors like hedge funds—short-term investors more than happy to see companies take on substantial debt to fund dividend payments for the benefit of shareholders—have raised similar concerns.[43]

Simply observing such phenomena, however, does not answer the questions addressed in this Article, any more than it did in the day of Berle and Dodd. Again, who possesses ultimate corporate governance authority? For whose benefit are public corporations run? And what is corporate law's relationship to the achievement of the social good? Daniel Fischel, an influential proponent of the application of economic analysis to law, has similarly observed that, as "a legal fiction, a corporation is incapable of having social or moral obligations much in the same way that inanimate objects are incapable of having these obligations," but argued on this basis that corporate law is simply powerless to mandate the pursuit of anything other than shareholder wealth maximization.[44] For Fischel and others sharing this view, the best we can do is to try to contain corporate activity by legal means external to corporate law itself, notably by contract where possible and by regulatory laws where necessary.[45] Others, however, have emphasized that the all-important business judgment rule, which insulates the vast majority of business decisions from second-guessing by courts, already gives boards and managers (so inclined) substantial latitude to deviate from shareholder wealth maximization, so long as they are not blunt about it.[46] In this light, we encounter a puzzling ambiguity at the very heart of corporate law and corporate governance: corporate law cannot force boards to advance the interests of non-shareholders, but neither can it generally prevent them from doing so.[47]

---

tween the company and its investors, the conscience of those investors are not easily brought to bear.").

42. *See, e.g.*, DALE A. OESTERLE, THE LAW OF MERGERS AND ACQUISITIONS 660 (3d ed. 2005); Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 34-37, 46-54 (Alan J. Auerbach ed., 1988); *see also infra* Subpart III.A.

43. *See infra* Subpart IV.C.

44. *See* Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1273 (1982).

45. *See, e.g.*, *id.* at 1269-71; STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 421-29 (2002); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 37-39 (1991).

46. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 299-305 (1999).

47. *See* Elhauge, *supra* note 18, at 810-14.

As we will see, to the extent the corporation can be said to possess a "soul," it lies in our collective capacity to grapple with such fundamental tensions as these.

II. PREVAILING THEORIES OF CORPORATE GOVERNANCE

Corporate statutes and case law offer ample fodder for a range of views on the appropriate balance of board and shareholder power and accountability, and which of these power constituencies ultimately holds the upper hand is far from obvious. In Delaware (the jurisdiction of incorporation for most public companies in the United States)[48], the General Corporation Law (DGCL) gives boards sweeping authority to govern the "business and affairs of every corporation."[49] There are few decisions of any significance to the corporation that shareholders can take without the board's approval.[50] As Stephen Bainbridge aptly put it, in general "the board acts and shareholders, at most, react,"[51] leaving shareholders dissatisfied with firm governance with no (low-cost) option other than to sell their stock—the so-called "'Wall Street' Rule."[52] Yet, it is the shareholders who, under the statute, are granted the power to elect the board in the first place.[53] Thus, it is the shareholders to whom directors are ultimately answerable for their jobs—a reality leading one Delaware jurist to describe the "shareholder franchise" as "the ideological underpinning upon which the legitimacy of directorial power rests."[54] Moreover, the statute clearly contemplates some shareholder involvement in corporate governance by giving shareholders the unilateral right to "adopt, amend or repeal bylaws" relating to the corporation's "business" and "affairs"[55]—a relatively under-theorized form of authority teeing up a direct collision with the

48. "More than 800,000 business entities have their legal home in Delaware including more than 50% of all U.S. publicly-traded companies and 60% of the Fortune 500." State of Delaware Division of Corporations, Why Choose Delaware as Your Corporate Home?, http://www.corp.delaware.gov/ (last visited Mar. 11, 2008). Consequently I will focus on Delaware law, though I will turn to the law of other jurisdictions to illuminate discrete points throughout.

49. DEL. CODE ANN. tit. 8, § 141(a) (2001).

50. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 242(b), 251(b)-(c), 271(a) (2001 & Supp. 2006) (giving shareholders the power to approve, but not initiate, amendments to the certificate of incorporation, mergers, and sales of substantially all assets, respectively).

51. Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 603 (2006).

52. *See id.* at 619. Bainbridge further observes that board authority under state corporate law is reinforced by federal securities law, which discourages accumulation of large blocks of stock through the imposition of disclosure obligations, restrictive proxy rules, and the application of short-swing profit rules. *See id.* at 617-19.

53. *See* DEL. CODE ANN. tit. 8, § 211(b) (2001).

54. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) (Allen, C.); *see also* UniSuper Ltd. v. News Corp., No. 1699-N, 2005 Del. Ch. LEXIS 205, at *25 (Del. Ch. Dec. 20, 2005) (Chandler, C.) ("[T]he board's power . . . derives from the shareholders, who are the ultimate holders of power under Delaware law.").

55. DEL. CODE ANN. tit. 8, § 109(a) (2001).

board's own explicit statutory authority to govern the corporation's operations.[56]

Similar ambiguities attend the issue of whose interests are to be advanced. It is often said that the aim of the corporation is shareholder wealth maximization.[57] Yet, corporate statutes—even in Delaware—explicitly permit charitable donation of corporate assets,[58] and corporate statutes and case law have, in certain circumstances (most notably in the context of takeovers), explicitly endorsed the consideration of the interests of non-shareholder constituencies,[59] such as creditors, employees, and local communities.

So whose interests are corporate decision-makers to pursue? And who ultimately calls the shots? In the debate over the appropriate means and ends of corporate law, three theories have gained substantial traction: the "nexus of contracts" theory, the "team production" theory, and the "shareholder primacy" theory.[60] In this Part I briefly canvas these theories and the principal criticisms of them, and argue that each possesses only limited descriptive power and ultimately fails to account for fundamental elements of corporate law as it actually exists. Hence many of their principal claims remain, at best, normative and prescriptive aspirations.

A. Board-centric Corporate Governance

A number of prominent scholars have advanced theories of corporate governance that emphasize the board's superior decision-making capacities. However, these theories differ markedly in the policy justifications they offer for the primacy of boards in corporate governance, consequently advancing radically divergent claims regarding whose interests corporations are built to serve.

56. *See infra* Subpart III.B. and Part V.

57. *See, e.g.*, Hansmann & Kraakman, *supra* note 17, at 439 (arguing that there is "no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value").

58. *See, e.g.*, DEL. CODE ANN. tit. 8, § 122(9) (2001); *cf.* 26 U.S.C. § 170(b)(2) (2000) (permitting deduction of corporate charitable contributions up to 10 percent of taxable income).

59. *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153-54 (Del. 1990); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985); *see also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (observing that "*Unocal* permits consideration of other corporate constituencies" in the takeover context so long as "there are rationally related benefits accruing to the stockholders" and the independent existence of the corporation has not been abandoned).

60. *See infra* Subparts II.A.1 (nexus of contracts theory), II.A.2 (team production theory), and II.B (shareholder primacy theory).

1. Nexus of Contracts

Scholars associated with the "Law and Economics" movement generally view the corporation itself as a form of legal nexus through which various stakeholders enter into the complex of essentially private contractual relationships through which corporate production occurs. According to the classic statement of this "nexus of contracts" view of the corporation, set forth by Frank Easterbrook and Daniel Fischel in *The Economic Structure of Corporate Law*,[61] the claim is that while corporate stakeholders may never have actually negotiated the terms of their relationships, corporate law should—and typically does—arrive at what rational stakeholders would agree to if they had.[62]

Under this contractarian view of the corporation, shareholders cannot be said to "own" the corporation, as such. While they certainly own a claim to the corporation's residual profits and assets, they do not possess the full range of entitlements with respect to the corporation that we typically associate with the concept of ownership, and in any event the concept of ownership is simply inapposite to what is, on this view, just a legal fiction permitting lower-cost contracting.[63] Shareholders are, to be sure, the primary beneficiaries of decision-making in the nexus-of-contracts corporation, but only because rational investors, facing the prospect of a mere *residual* claim, would demand both the right to elect the board and fiduciary duties aligning the directors' interests with their own.[64] Deviations from shareholder wealth maximization remain permissible, but only where agreed upon ahead of time.[65]

These scholars explain substantial limitations on shareholder voting by reference to rational apathy and the heterogeneity of shareholders' interests,[66] and further point to the ability of shareholders to exert discipline

61. *See* EASTERBROOK & FISCHEL, *supra* note 45, at 12.

62. *Id.* at 14-15; *see also* Fischel, *supra* note 44, at 1261-65. Lyman Johnson observes that because "the positive and normative are largely congruent" in this formulation, "the need for legal reforms and government regulation goes out the window." The characterization of corporate law "as an adaptive, 'functional' response to social needs thus has an obvious conservative ideological thrust." Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215, 2222 (1992) (reviewing FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991) and ROBERT N. BELLAH ET AL., THE GOOD SOCIETY (1991)).

63. *See* Bainbridge, *supra* note 51, at 604.

64. *See* EASTERBROOK & FISCHEL, *supra* note 45, at 36-39, 92-93; Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U.L. REV. 547, 577-85 (2003); Hansmann & Kraakman, *supra* note 17, at 441.

65. *See* EASTERBROOK & FISCHEL, *supra* note 45, at 36. Investors in Ben & Jerry's, for example, could not fairly complain about the effect upon profits of a corporate philanthropy program well-publicized before the company went public because investors had the opportunity to bring the expectation of diminished future profits to bear upon the price they would pay for the stock in the offering. *See* Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 BUS. LAW. 681, 720 (2002).

66. *See, e.g.*, Bainbridge, *supra* note 51, at 607, 623.

through the sale of their stock in liquid capital markets, giving rise to a "market for corporate control."[67] Under this view, shareholder non-involvement in the corporation's governance is not merely an incident of the structure of corporate law, but one of its defining and efficiency-enhancing features, leading one prominent scholar to go so far as to depict the board as the very personification of the corporation itself—"a *sui generis* body" serving as "a sort of Platonic guardian," deriving its legitimacy not from shareholder endorsement, but by virtue of serving as the true nexus of contracts at the heart of the corporation.[68]

Other stakeholders, meanwhile, whose claims are not residual, and therefore would not be expected to value voting rights and fiduciary protections so highly as the shareholders would, are deemed best protected by contract where possible and external regulation where necessary. So-called "social concerns" raised by corporate production are treated similarly. Thus employees, for example, are deemed capable of bargaining for whatever protections they consider prudent in negotiating their employment agreements, and further enjoy the protections of labor laws; damage to the environment can be minimized through regulation imposing the costs of pollution on the corporation; and so on.[69]

While the nexus-of-contracts view provides a relatively solid theoretical description of board authority in the ordinary course of business for large public corporations, it nevertheless has a difficult time accounting for the law of corporate takeovers, and the absence of any clear mandate to maximize the wealth of shareholders under any but the most limited circumstances.[70] As noted above, economically oriented scholars typically argue that boards and management are adequately disciplined through the market for corporate control—the viability of which depends critically on the absence of substantial restraints on the transferability of shares—and that this justifies weak (or nonexistent) shareholder voting rights with respect to the vast majority of corporate actions. The availability of anti-takeover devices and statutes, however, tends to contradict this claim, as

---

67. *Id.* at 614; *see also* EASTERBROOK & FISCHEL, *supra* note 45, at 70-71.

68. Bainbridge, *supra* note 64, at 560. While built upon the contractarian view of the corporation as a nexus of contracts, Stephen Bainbridge's "director primacy" theory advances the claim that it is in fact the board of directors that constitutes the true nexus—a claim grounded in Ronald Coase's argument that the efficiency of firms resides in "command-and-control" governance structures eliminating costs of bargaining in markets, and Kenneth Arrow's argument that "authority"-based decisionmaking structures are superior to "consensus" procedures where stakeholders' interests and relative information differ. *See id.* at 554-59; Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 779-84 (2006).

69. *See* EASTERBROOK & FISCHEL, *supra* note 45, at 36-39; Bainbridge, *supra* note 64, at 587-91. Some have advocated supplemental protection for tort victims (who neither compose an organized group nor are capable of *ex ante* contracting) in the form of *pro rata* unlimited shareholder liability in tort. *See* Hansmann & Kraakman, *supra* note 17, at 466-67. However, such calls have not been embraced to date.

70. *See infra* Subparts II.A.2 and III.A.

Easterbrook and Fischel ultimately concede.[71] Poison pills[72] and other defensive measures, they note, "give [managers] substantial control over whether premium bids can succeed—that decrease the chance of receiving a bid and may prevent success if it is made,"[73] an opening seized upon by advocates for robust shareholder involvement in corporate governance.[74]

The very existence of *any* shareholder voting power inevitably proves problematic for those who identify the board as the very essence of the corporate enterprise. Bainbridge, for example, who depicts the board as a "*sui generis* body"[75] and "a sort of Platonic guardian,"[76] justifies giving voting power to shareholders by reference to the disciplinary effects of the market for corporate control (made possible by the transferability of their interests), but then proves amenable to "sharply constrain[ing]" the market for control through takeover defenses in favor of the efficiency of board governance[77]—an account that undercuts its own explanation for the existence of even minimal shareholder voting rights.

Bainbridge responds that "shareholder voting is properly understood not as an integral aspect of the corporate decision-making structure, but rather as an accountability device of last resort to be used sparingly, at best," and that corporate governance reflects the balancing of "two competing values"—"authority and accountability," which are "ultimately irreconcilable."[78] In the hostile tender offer context, then, Bainbridge acknowledges that takeover defenses cut against the disciplinary effects of the market for corporate control, but nevertheless defends Delaware's takeover jurisprudence as a "second best" solution on the logic that pre-

---

71. *See* EASTERBROOK & FISCHEL, *supra* note 45, at 205-06.

72. Poison pills, typically styled "shareholders' rights plans," provide a formidable defense through dilution of the would-be hostile acquirer. Such plans generally work by attaching rights to common stock permitting the holder to buy deeply discounted shares in the event that someone crosses a specified ownership threshold (often 15%) without the board's approval. Because the person triggering the rights is barred from exercising them, the effect of the poison pill is to dilute the holdings of the would-be hostile acquirer. For a concise description of the evolution of such plans, see ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 17, at 536-39.

73. EASTERBROOK & FISCHEL, *supra* note 45, at 205-06. *See also* Johnson, *supra* note 62, at 2245-46 (discussing this concession and observing that "[i]t is not often that halfway through a theoretical work the central thesis is undermined").

74. *See, e.g.*, Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 714-15 (2007).

75. Bainbridge, *supra* note 64, at 560.

76. *Id.*

77. Bainbridge, *supra* note 51, at 614 and n.33, 628 and n.74. Note that Delaware has explicitly rejected the characterization of directors as "Platonic masters" enjoying *sui generis* powers. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1988). Note also that Bainbridge's view on takeover defenses differs sharply from that of Easterbrook and Fischel. *See supra* text accompanying notes 72-74.

78. Stephen Bainbridge, *Bruner on Director Primacy and Other Pure Theories of Corporate Governance*, BUSINESSASSOCIATIONSBLOG.COM, Sept. 4, 2007, http://www.businessassociationsblog.com/lawandbusiness/comments/bruner_on_director_primacy_and_other_pure_theories_of_corporate_governance/ (commenting on the SSRN working paper version of this Article, and quoting from Bainbridge, *supra* note 51, at 627).

cluding such defenses would come at the cost of undermining board authority in other contexts, and ultimately sacrifice shareholder wealth.[79] In other words, jurisprudence endorsing powerful takeover defenses is "best explained as implicitly concluding that the benefits of preserving authority outweighs the costs of doing so."[80]

This account is problematic, however, in at least a couple of respects. Delaware's takeover jurisprudence is widely viewed as so very deferential to the board that it substantially undercuts market-for-control based explanations for the existence of voting rights[81]—a point that Bainbridge essentially concedes. As a consequence, then, one would have to have already accepted the strongest claims of the director primacy theory (or something very much like it) in order to accept the characterization of this jurisprudence as a "second best" approach. Indeed, more generally, stating the core tension of corporate law as being between "authority" and "accountability" makes sense *only* if one has already accepted the strongest claims of such a theory[82]—that is, that boards stand at the core of the corporate enterprise, that they wield *sui generis* powers (any deviation from which can then only be characterized as an "accountability" mechanism, rather than a legitimate exercise of "authority" in its own right), and that shareholder wealth maximization constitutes the defining goal of the corporation. However, Delaware courts quite clearly conceptualize board power as resting upon a shareholder-granted mandate, rejecting the notion that boards possess *sui generis* powers.[83] The claim that shareholder wealth maximization is the corporate end upon which the (hypothetically) negotiating parties would rationally agree is undercut by the fact that no state statute explicitly mandates the maximization of shareholder wealth.[84]

---

79. Bainbridge, *supra* note 68, at 827.

80. *Id.* at 827-28.

81. *See, e.g.*, Jeffrey N. Gordon, *"Just Say Never?" Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffett*, 19 CARDOZO L. REV. 511, 514-16 (1997); Mitchell, *supra* note 25, at 1564, 1572-73; Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261, 280-294 (2001); *see also infra* text accompanying notes 154-171.

82. While I agree with Bainbridge that corporate law is characterized by tension between differing fundamental principles and goals, I argue below that the core tension at the heart of corporate law actually arises out of uncertainty about the compatibility of shareholders' interests and incentives with the social good. *See infra* Part III.

83. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659, 663 (Del. Ch. 1988) (Allen, C.).

84. *See* Elhauge, *supra* note 18, at 738 ("None of the fifty states has a statute that imposes a duty to profit-maximize or that makes profit-maximization the sole purpose of the corporation."). Although Delaware case law mandates the maximization of the price received by shareholders once sale, break-up, or change of control of the company is "inevitable," *see* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 43, 46 (Del. 1994); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986), this is itself best understood as a deviation from the norm of permitting *de facto* deviations from shareholder wealth maximization, a doctrinal move described below by reference to the absence of any "long-term" stability interest to maintain once the company's fate is sealed. *See infra* Subpart III.A.

In fact, as described below, explicit endorsement of *deviations* from shareholder wealth maximization are common both in takeover law and with respect to charitable donations.[85] Additionally, a growing body of scholarship is exploring the degree to which the business judgment rule, coupled with a focus on the firm's "long-term" prospects, provides boards and managers with substantial discretion to deviate from the path of shareholder wealth maximization.[86] Whatever normative appeal such claims may have as a matter of policy, they do not contribute to a compelling descriptive theory of corporate law.

2. *Team Production*

An alternative model of corporate governance that has gained substantial traction over recent years is the "team production" theory developed by Margaret Blair and Lynn Stout. This theory describes fundamental elements of corporate law as a means of coaxing various stakeholder groups to make firm-specific investments in the corporation, notwithstanding the vulnerability to opportunism by other stakeholders that such investments inevitably involve.[87]

Blair and Stout define "team production" as "complex productive activity that requires multiple parties to make contributions that are to some extent both team specific and unverifiable to an outside party," resulting in "nonseparable" outputs that cannot be apportioned based on the parties' relative contributions.[88] Like the nexus-of-contracts view (and particularly Stephen Bainbridge's "director primacy" variant), team-production theory is highly board-centric with respect to governance authority,[89] although it predicates this authority on a very different conception of the board's purpose, consequently arriving at a radically different conception of the ends of corporate production. For Blair and Stout, the board acts as a "mediating hierarch," positioned and vested with the power to prevent other stakeholders from opportunistically exploiting one another.[90] The idea is that by creating a mechanism for the prevention of opportunism *ex post*, stakeholders have sufficient assurance *ex ante* to be comfortable making such

---

85. *See infra* Part III.

86. *See* Bainbridge, *supra* note 68, at 778 and n.43 (acknowledging that other constituency statutes "qualify" the "shareholder wealth maximization norm by allowing the board to make trade-offs between shareholder and stakeholder interests," and that "the business judgment rule effectively precludes courts from reviewing corporate decisions that allegedly further interests other than that of shareholder wealth maximization").

87. Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 418-20 (2001).

88. *Id.* at 419.

89. *See* Bainbridge, *supra* note 64, at 551-52 (observing this similarity).

90. *See* Blair & Stout, *supra* note 46, at 269-81; *cf.* Shleifer & Summers, *supra* note 42, at 37-41.

investments in the first place.[91] Reciprocally, then, the other parties—"including shareholders, employees, and perhaps other stakeholders such as creditors or the local community—enter into a '*pactum subjectionis*' under which they yield control over outputs and key inputs (time, intellectual skills, or financial capital) to the hierarchy" headed by the board.[92]

The team-production corporation thus appears quite similar to the nexus-of-contracts corporation in terms of governance authority, but the two in fact differ enormously in that team-production theory rejects shareholder wealth maximization as the principal goal of the corporation. Instead, for the board effectively to manage opportunism among stakeholders, directors must be deemed "trustees *for the corporation itself*."[93] In support of this view of the role of the board, Blair and Stout observe the lack of any clear articulation of a general duty to maximize profits in corporate statutes and case law, as well as the substantial latitude that the business judgment rule provides for boards to deviate from shareholder wealth maximization—latitude that Blair and Stout argue is critical to the board's capacity to manage tensions among stakeholder groups.[94] This room for maneuvering among the interests of various stakeholders, described by Blair and Stout as "play in the joints"[95] and by Einer Elhauge as "agency slack,"[96] is reinforced by courts' emphasis on the "long term" interests of shareholders—which, among other things, can rhetorically massage the sacrifice of shareholder wealth for the benefit of other constituencies.[97]

Through its emphasis on the interests of various stakeholders and the degree of freedom boards possess to weigh those interests in the balance, the team-production theory provides a good description of start-up and

---

91. *See* Blair & Stout, *supra* note 46, at 269-81.

92. *Id.* at 278. Note that even shareholders can be conceptualized as making firm-specific investments, notwithstanding ease of access to liquid capital markets, in that "when exploited shareholders try to sell en masse the result is a predictable loss of market value." Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 795 (2007).

93. Blair & Stout, *supra* note 46, at 281; *see also* Blair & Stout, *supra* note 87, at 424-25.

94. Blair & Stout, *supra* note 46, at 299-309; *cf.* Blair & Stout, *supra* note 87, at 437 (arguing that the relative unverifiability of inputs in the team-production corporation results in there being "no way to set a substantive judicial standard for gauging how good a job the board is doing," hence the business judgment rule); *see also* Elhauge, *supra* note 18, at 770-75; Ian B. Lee, *Corporate Law, Profit Maximization and the "Responsible Shareholder,"* 10 STAN. J.L. BUS. & FIN. 31, 44 (2005) ("In the final analysis, the debate is not so much about whether there should be limits on corporate profit maximization as about what form the limits should take."); D. Gordon Smith, *The Dystopian Potential of Corporate Law* 12-18 (Univ. of Wis. Law Sch., Legal Studies Research Paper No. 1040, 2007), *available at* http://ssrn.com/abstract_id=976742. Delaware describes the business judgment rule as "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

95. Blair & Stout, *supra* note 87, at 435.

96. Elhauge, *supra* note 18, *passim*.

97. *See, e.g.*, Blair & Stout, *supra* note 87, at 429.

certain initial public offering scenarios;[98] stakeholder-oriented takeover legislation and case law; and certain practical consequences of judicial (non)review under the business judgment rule—all of which are elements of corporate law that tend to elude the nexus-of-contracts theory.

The team-production theory itself falls short, however, of a complete descriptive theory of corporate law. First, and perhaps most critically, as David Millon has observed, for the board to function as an efficient mediating hierarch, corporate law would not merely have to permit deviations from shareholder wealth maximization, but in fact would have to mandate a stakeholder approach to prevent shareholder favoritism.[99] As Millon puts it, the "very discretion that allows corporate boards to pay attention to nonshareholder as well as shareholder interests also allows them to pursue shareholder value with relentless disregard for social costs"[100]—an outcome inconsistent with Blair and Stout's account of the board's purpose. As noted above, Blair and Stout argue that fiduciary duties are owed to the firm as a whole, not just shareholders.[101] But this is no answer to Millon's point that the board's dedication to its mediating hierarch role is no more policeable under the business judgment rule than would be a duty to maximize the wealth of shareholders.[102]

Millon's point in fact takes on added force in light of substantial market pressures to maximize current stock price. John Coates, for example, notes that the mediating hierarch approach to corporate governance cannot function where the board is dominated by any particular stakeholder (notably management or shareholders) and observes that despite its decline since the 1980s takeover wave, the market for corporate control still exists to some degree, and may be reinvigorated by institutional activism.[103]

98. *See, e.g.*, *id.* at 420-21 (employing the start-up example to illustrate team production dynamics); Blair & Stout, *supra* note 46, at 281 (observing that "the choice to 'go public' may be driven in part by team production considerations" where a closely held corporation controlled by an entrepreneur contemplates expansion requiring firm-specific investments by additional stakeholders). *But see* John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837, 863-64 (1999) (observing that while team production helps explain cases in which previously concentrated control is immediately dispersed among IPO investors, most IPOs do not in fact result in immediate dispersal of control in the market, leaving the post-IPO board under the thumb of a controlling shareholder).

99. David Millon, *New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001, 1022 (2000).

100. *Id.*; *see also* Bebchuk, *supra* note 74, at 730-31.

101. Blair & Stout, *supra* note 46, at 281.

102. Millon, *supra* note 99, at 1022.

103. *See* Coates, *supra* note 98, at 844, 859-60; Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1476 (2006) (arguing that the "hostile takeover has to some extent been replaced by substantial equity investments through hedge or other private equity funds," which have "added a significant disciplinary force"); Paul T. Schnell, *Fending off hostile activity now*, NAT'L L.J., June 25, 2007, at S1 (discussing the degree to which "activist" shareholdings facilitate hostile takeover activity); *see also* Millon, *supra* note 99, at 1008, 1023 (arguing that, at most, the team production theory provides normative support for board independence).

Blair and Stout, to be sure, acknowledge that their theory requires board independence, and that directors do "remain subject to equity market pressures," due not only to the market for corporate control (whatever its potency may be) but also to on-going financing needs and equity-based compensation.[104] Their response is that the board need only "provide *enough* of the firm's surplus to each residual claimant to keep her in the corporate team," and that otherwise "who gets exactly what share of [any] surplus will be determined by which groups best capture the board's attention, which groups argue most persuasively, and, perhaps, by what the directors had for breakfast the morning of the board meeting."[105] The response is inadequate, however, in so far as it simply assumes the happy circumstance in which there is "enough" to satisfy all stakeholders. It is precisely where this is not the case—the many circumstances where boards face difficult, zero-sum distributional questions—where equity market pressures become most relevant. In any event, like the nexus-of-contracts theory—and particularly its "director primacy" variant— the team-production theory provides no compelling explanation whatever for the existence of shareholders' statutory voting rights to elect the board, which—by any rational interpretation—can only have been intended to enhance the board's accountability to this single constituency.[106]

Finally, Blair and Stout's emphasis on fiduciary duties to the corporation as a whole fails to account for the general inability of non-shareholders to enforce them. Case law, at least in Delaware, has continually made clear that courts remain disinclined to extend fiduciary protections to non-shareholders in solvent firms. In *Gheewalla*, for example, the Delaware Supreme Court in 2007 emphasized that "directors owe their fiduciary obligations to the corporation *and* its shareholders."[107] While creditors may have *derivative* standing with respect to duties owed the corporation in insolvency (having replaced shareholders as the corporation's residual claimants), they do not enjoy such standing outside of that context, and never have *direct* standing to sue for fiduciary breaches[108]—a cabining of non-shareholder fiduciary protections at odds with the mediating hierarch conception of the board's role. Blair and Stout have argued that, as a practical matter, derivative standing rules limit such shareholder-initiated suits to those advancing the interests of all stakeholders.[109] As

104. Blair & Stout, *supra* note 87, at 435.
105. *Id.* at 435-36 (emphasis added).
106. *See supra* notes 78-83 and accompanying text.
107. N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007) (emphasis added).
108. *Id.* at 102-03 and n.43. While the Chancery Court had effectively expanded this concept to corporations "in the vicinity of insolvency," *see* Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., Civ. A. No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991), the *Gheewalla* court flatly rejected that notion. *See Gheewalla*, 930 A.2d at 101.
109. *See* Blair & Stout, *supra* note 46, at 293.

Millon observes, however, there is "no duty to bring suit in cases in which [shareholders] have no interest," and we could not reasonably expect them to do so where "they stand to gain nothing from the exercise."[110]

B. Shareholder-centric Corporate Governance

Another theory of corporate governance, in stark contrast with those considered above and premised largely on a property-based conception of the corporation, takes a far more shareholder-centric view. Whereas other theories of corporate governance query whether shareholders can sensibly be called "owners" of the corporation, given the significant limits on their control over corporate assets and the disputed nature of the corporation itself, some scholars view the corporation as the shareholders' property, and corporate governance as the hiring of help to administer it.[111]

In the classic statement of this shareholder-primacy view, published in the *New York Times Magazine* in 1970, economist Milton Friedman argued that "a corporate executive is an employee of the owners of the business," with "direct responsibility to his employers"—notably a "responsibility . . . to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society."[112] Permitting corporate boards and managers to advance any other goal would simply confuse the employee for the employer, and ought to be left to an institution with a legitimate mandate to address "social" issues—namely the government.[113] Shareholder-centric models of corporate governance have gained substantial traction in the new millennium, with calls for accountability to shareholders animated principally by dissatisfaction with perceived shirking and extraction of private benefits by insiders,[114] particularly once the meltdown of Enron and other notable bankruptcies called into question the efficacy of existing disciplinary mechanisms vis-à-vis boards and management.[115]

This view, like the nexus-of-contracts view, identifies the maximization of shareholder wealth as the proper metric of board performance and corporate success,[116] but unlike both theories outlined above, articulates a

---

110. Millon, *supra* note 99, at 1013.

111. Observe that whether such models explicitly treat shareholders as "owners," or merely emphasize "principal-agent" and "agency cost" dynamics vis-à-vis an ownership interest in a residual claim to corporate assets and profits, they nonetheless treat shareholders as "occupy[ing] a privileged position with ownership-like rights." Bainbridge, *supra* note 64, at 563-64.

112. Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business is to Increase Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 33.

113. *See id.* at 122.

114. *See, e.g.*, Bebchuk, *supra* note 74, at 678-82.

115. *See* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 568-69 (2006); *cf.* Schnell, *supra* note 103.

116. *See, e.g.*, Bebchuk, *supra* note 74, at 678; *see also* Stephen M. Bainbridge, *Executive Compensation: Who Decides?*, 83 TEX. L. REV. 1615, 1645 (2005) (reviewing LUCIAN BEBCHUK & JESSE

robust conception of shareholders' power in corporate governance. Lucian Bebchuk, for example, has emphasized that courts' willingness to abstain from substantive review of board decisions under the business judgment rule and to permit boards to block hostile tender offers has been premised in part on the shareholders' "power to replace the board," and that the practical significance of this capability is heightened by the shareholders' inability to initiate fundamental transactions like mergers.[117] Under this view, meaningful capability to elect and remove directors, above all else, is necessary to reduce "agency costs" in what is typically conceptualized as something akin to a principal-agent relationship[118]—"to provide directors with strong affirmative incentives to focus on shareholder interests."[119]

Strictly speaking, it would be somewhat unfair to criticize current shareholder-centric theories of corporate governance for their shortcomings as descriptive theories because many of their most important claims are in fact explicitly prescriptive.[120] The most prominent among them, Lucian Bebchuk's argument for the enablement of meaningful exercise of the shareholder franchise, readily acknowledges that the shareholder franchise remains in practical terms a "myth," and consciously styles itself a reform package—that is, a normatively favorable means of turning the myth "into a reality."[121] However, such calls for reform do build upon readings of the statute and case law claimed to favor significant shareholder involvement in corporate governance, thus making substantial descriptive claims about corporate law that are open to evaluation.

As mentioned above, Bebchuk emphasizes that courts' willingness to apply the deferential business judgment rule and to permit boards to impede tender offers has been premised in part on the shareholders' "power to replace the board," a statutorily provided capability the significance of which is heightened, he argues, by the shareholders' inability to initiate fundamental transactions.[122] He also emphasizes judicial language grounding the legitimate exercise of board power in the mandate granted through

---

FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004)) (observing that Bebchuk and Fried's shareholder primacy theory and Bainbridge's director primacy theory similarly identify shareholder wealth maximization as "the proper decisionmaking norm in corporate governance").

117. *See* Bebchuk, *supra* note 74, at 680-81.

118. *See, e.g.*, *id.* at 679. *But see* ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 17, at 100-01, 105 (observing that unlike officers, directors are not ordinarily subject to the will of the majority of shareholders and thus are not "agents" of the shareholders, strictly speaking).

119. Bebchuk, *supra* note 74, at 682.

120. In any event, the property-oriented view that shareholders literally "own" the corporation itself has been compellingly refuted by nexus-of-contracts and team-production scholars alike. *See supra* notes 63-64 and accompanying text; Blair & Stout, *supra* note 46, at 259-61.

121. *See* Bebchuk, *supra* note 74, at 677-79.

122. *See id.* at 680-81.

election by shareholders.[123] It should be observed, however, that Bebchuk's specific reforms relate not to the fact of the shareholder franchise itself, but instead to how it is effectuated—involving both state corporate law and federal securities law reforms, and focusing on liberalization of the proxy voting system and a strong interpretation of shareholders' bylaw authority.[124] And on this score—that is, the precise terms of governance within a given corporation—the situation remains a picture of perfect ambiguity. As discussed below, the relationship between the shareholders' authority to enact bylaws, on the one hand, and the board's broad authority to manage the business and affairs of the corporation, on the other, is left utterly unclear on the face of the statute.[125]

Perhaps more importantly, the shareholder primacist's claim that the purpose of the corporation is to maximize shareholder wealth[126] encounters the same descriptive problems that the nexus-of-contracts theory does: the absence of any such general duty, the explicit endorsement of deviations from it, and the relative insulation of tacit deviations from it under the business judgment rule. While Bebchuk, for example, rightly observes that the lack of a stakeholder mandate tends to contradict Blair and Stout's mediating hierarch conception of the board, his response to the relative insulation of boards from pressure to maximize shareholder wealth is primarily prescriptive, and he provides little evidence to support his claim that "[s]tandard board practices do not generally reflect a conception of boards as an agent for both stakeholders and shareholders."[127]

---

123. *See id.* at 676 (citing Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) (Allen, C.)). At the same time, however, *Blasius'* language regarding the shareholder franchise has itself been characterized as double-edged, in that it can be read to suggest that the shareholders' role is *merely* to legitimate board power. *See* Mitchell, *supra* note 25, at 1574.

124. *See* Bebchuk, *supra* note 74, at 683-711. An interesting development in the debate over shareholder involvement in corporate governance has arisen with the adoption of the North Dakota Public Company Act, which reads like a shareholder activist's wish list. *See* North Dakota Publicly Traded Corporations Act, N.D. CENT. CODE §§ 10-35-01 to -33 (Supp. 2007); Press Release, North Dakota Corporate Governance Council, North Dakota Enacts First Shareholder Friendly Corporation Law (Apr. 11, 2007), *available at* http://www.ndcgc.org/Reference/2007.04.11Release.pdf; *Anywhere but Delaware,* ECONOMIST.COM, Apr. 17, 2007, http://www.economist.com/business/displaystory.cfm?story_id=9028426&CFID=1869686&CFTOKEN=52050397. There is real reason to doubt, however, that such a statute could conceivably curtail Delaware's dominance via shareholder pressure to adopt it—not least because Delaware's statute already permits extraordinary latitude in terms of permissible governance structures, and corporations and their shareholders seldom diverge from the default allocation of power. *See* Lawrence A. Hamermesh, *The North Dakota Experiment: Bundle Up!*, THE HARVARD LAW SCHOOL CORPORATE GOVERNANCE BLOG, Apr. 26, 2007, http://blogs.law.harvard.edu/corpgov/2007/04/26/the-north-dakota-experiment-bundle-up/.

125. *See infra* Subpart III.B.1 and Part V. On the competing view of the policy merits, see, for example, Stout, *supra* note 92, at 799-801, which questions the empirical evidence that easing removal of directors would "improve corporate performance" in a piece responding to Bebchuk's reform proposals.

126. *See, e.g.*, Bebchuk, *supra* note 74, at 678.

127. *See id.* at 731 (citing the prevalence of equity-based compensation); *see also* notes 100-106 and accompanying text.

C. *The State of Play*

In sum, with respect to who holds the upper hand between the power constituencies of the corporation, the three dominant theories outlined above fall into two general camps—those premised on the board's authority to manage the business and affairs of the corporation under DGCL § 141, and those premised on the board's accountability to the shareholders who elect them under DGCL § 211. The former tend to emphasize the functional decision-making superiority of the board structure, giving short-shrift to the shareholder franchise as a (statutorily recognized) source of legitimacy, while the latter emphasize shareholder "ownership" type claims and vulnerability to "agency" type problems, giving short-shrift to the extraordinary limits the statutes place on shareholder voting, the pervasiveness of rational apathy in the capital markets, and the extraordinary breadth of the statute's grant of power to the board.

In seeking to describe the corporate form, each of these theories ultimately advocates a particular model or vision of "pure" corporate governance that, for better or worse, cannot be squared with fundamental tenets of corporate law as it in fact exists. The reason, I will argue in the next part, is that corporate law is fundamentally *ambivalent* with respect to the merits of board and shareholder power, respectively.[128]

III. CORPORATIONS, MARKETS, AND MORAL THEORY

Returning to Hart's observation that we cannot hope to describe what the corporation "is" other than by reference to the legal rules that give rise to and define its existence,[129] it appears that each of the theories canvassed in the preceding part exhibits substantial shortcomings as a descriptive theory. Indeed, Hart further observes how easily theories of corporate law—dealing with abstract legal entities lacking any "ordinary factual counterparts" to gratify the desire for easy definition—end up morphing into political claims regarding how and when certain types of rules or procedures ought to be applied.[130] This drama continues to play itself out in the corporate governance debate today.

---

128. As noted above, while the modern business corporation has been described elsewhere as "schizophrenic," I prefer "ambivalent" for its connotation of a complex relation among ostensibly disparate ideas, as opposed to self-contradiction. *See supra* note 2; *see also* Allen, Jacobs & Strine, *supra* note 2, at 1067, 1096 (describing Delaware law as "ambivalent" with respect to shareholder primacy, and observing that prevailing theories have been "content to advocate the pure form[s] of [their] position[s]").

129. *See supra* notes 12-13 and accompanying text; *see also* Orts, *supra* note 13, at 1571-74 (agreeing with Hart's observation that while "beginning study of [the corporation] by trying to define it may sound like common sense," it is in fact "not amenable to this approach").

130. *See* HART, *supra* note 12, at 25.

And so we have three prevailing theories, each of which has "dealt deadly blows to the other," as Hart might put it.[131] This part of the Article explores the ambivalence of corporate law with respect to three central issues and argues, contrary to the theories discussed above, that these manifestations of ambivalence themselves constitute the essence of corporate law, reflecting our uneasiness about the utilitarian bargain often said to underwrite it. First I will examine the doctrine in greater depth, focusing particularly on board power and the scope of the board's legal authority to deviate from the maximization of shareholder wealth. I will then argue that corporate law remains ambivalent regarding its power constituencies, its beneficiaries, and its relationship to the social good, respectively—three reflections of corporate law's structure that I consider in turn in order to illuminate the complex relationship between legal means and social ends. In so doing I will draw upon utilitarianism, the implicit moral theory of corporate law, to describe more fully the actual nature and degree of corporate law's commitment to shareholder wealth maximization, and ultimately the social indeterminacy of the widely held public corporation.

A. Corporate Power and Shareholder Wealth

In the modern public corporation, as a practical matter, retail shareholders—by which I mean living, breathing, individual shareholders—generally hand over their money and then check out.[132] The shareholders' money finances, and thus enables, corporate production. But as a day-to-day matter, shareholders generally do not monitor corporate boards and management in any meaningful sense due to rational apathy, limitations on their ability to initiate corporate actions, and restrictive voting procedures,[133] among other things. Recall the early-twentieth century characterization of shareholders as "absentee owners" and the like.[134] There may be good legal reason to query the characterization of shareholders as "owners" of the corporation, but there are no grounds for querying their characterization as "absentees." This, as we saw, struck scholars like Dodd as giving rise to a troubling ethical fragmentation at the heart of the public corporation; shareholders enable and profit from a form of production for

---

131. *Id.* at 24.

132. I describe here the typical investor holding a small amount of a public company's stock. The role of institutional shareholders, including their impact on the situation I describe here with respect to retail shareholders, is examined in Part IV.

133. *See, e.g.*, Bainbridge, *supra* note 51, at 603, 607, 616-19; Bebchuk, *supra* note 74, at 683-95 (highlighting the "considerable impediments to replacing boards").

134. *See supra* note 30 and accompanying text.

which they accept no responsibility—an "anomalous" situation in the law.[135]

Shareholders in the modern public corporation place themselves in a position in which virtually the only thing they can monitor with any efficacy is firm value, measured crudely by current stock price. In so doing they place massive market pressure on corporate boards to enhance their profits—even where those individual investors themselves, in the position of decision-maker, might have weighed other things into the balance.[136] They essentially enable corporate production by adopting a role that insulates them from substantial psychological awareness of, or feeling of responsibility for, the social consequences of that production.[137] Indeed, perhaps ironically, the very psychological dynamics that some have argued can account for board performance (in the absence of strong liability rules) reciprocally provide a compelling explanation for shareholders' moral disengagement in public corporations. Blair and Stout, for example, report that "trustworthy" conduct vis-à-vis some other person or group is associated, among other things, with proximity, group identity, and the capacity for direct communications, which they argue help to explain faithful conduct on the part of fiduciaries like corporate directors.[138] At the same time, however, we should observe the degree to which these very factors reinforce the disengagement of shareholders from the consequences of their own investment decisions; shareholders generally neither see, identify, nor communicate with, those affected by the corporate production they finance. Ian Lee has observed that "the geographic remoteness of the victims of corporate irresponsibility dulls our empathy in [the corporate] setting, while the opacity of the corporate world somehow tricks us into forgetting that the corporation's activities are undertaken for our benefit as shareholders"—dynamics to which Lee attributes what he calls the "bounded empathy" of shareholders.[139]

---

135. Dodd, *supra* note 30, at 1162.

136. *See* Lee, *supra* note 94, at 36-37.

137. *See supra* note 41 and accompanying text.

138. Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1768-75, 1780-98 (2001). David Sally, based on a meta-analysis of 37 prisoners' and social dilemma studies, found that defection was more likely where the temptation was great, the group size was large, and there was no money involved, whereas cooperation was more likely where participants could perceive that the group had much to gain through cooperation, they were instructed to cooperate, they could see the others, they could "select an affectively named choice," and they could speak with the others. *See* David Sally, *Conversation and Cooperation in Social Dilemmas: A Meta-Analysis of Experiments From 1958 to 1992*, 7 RATIONALITY & SOC'Y 58, 86-87 (1995). Interestingly, Sally also notes that economics students have been found less likely to cooperate than psychology students in such studies. *Id.* at 63, 78.

139. Lee, *supra* note 94, at 53; *cf.* Shleifer & Summers, *supra* note 42, at 37-43 (characterizing shareholders' acceptance of hostile tender offers as a breach of "trust" and "implicit contracts" with other stakeholders).

Shareholders do, of course, have the capacity to take consequential action in certain extraordinary circumstances discussed below,[140] and shareholder conduct may, to be sure, redound to the benefit of other stakeholders in a given circumstance—say, in litigation targeting disloyal directors, or in acceptance of a takeover bid that would, in fact, result in abler management. But as others have observed, this is largely a matter of coincidence.[141] Shareholders have no incentive to act in a manner beneficial to other stakeholders absent some personal interest in a given matter, and of course the shareholders' interests might well diverge from those of other stakeholders.[142]

And what of the other power constituency—the board? The perspective of the director is considerably more complex due to the interplay of market pressures, norms, and legal rules that affect how corporate directors exercise the decision-making power granted them by corporate law. There is clearly a general market understanding that directors labor to maximize current stock price, and there is correspondingly strong equity market pressure to do so. As a matter of corporate law, however, directors remain substantially unconstrained in this respect due to the protections of the business judgment rule.

While the business judgment rule certainly performs a number of functions, including ensuring that candidates have adequate incentive to take these jobs in the first place, notwithstanding the liability risks they would otherwise face,[143] it also undoubtedly functions to reinforce the distancing of shareholders from corporate production by rendering board decisionmaking all the more opaque. As the Delaware Supreme Court would explain in the midst of the Disney litigation regarding board approval of extraordinary pay and severance packages for former president Michael Ovitz:

> As for the plaintiffs' contention that the directors failed to exercise "substantive due care," we should note that such a concept is foreign to the business judgment rule. Courts do not measure, weigh or quantify directors' judgments. We do not even decide if they are reasonable in this context. Due care in the decisionmaking context is *process* due care only. Irrationality is the outer limit of the business judgment rule.[144]

---

140. *See infra* Parts III-V.

141. *See, e.g.*, Millon, *supra* note 99, at 1013.

142. *Id.*

143. *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 45, at 98-100; Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 WAKE FOREST L. REV. 1131, 1132-34 (2006).

144. Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000). On the Disney litigation generally, see

While courts will inquire as to the adequacy of the process followed by the board, the merits of the board's actual decision simply will not be second-guessed. The board, in this respect, is quite literally a "black box" in that its actual decision-making (as opposed to the formal procedures followed) generally is not open to the scrutiny of shareholders, judges, or anyone else.[145]

Indeed, setting aside equity market pressures for the moment, the outer limits that corporate law itself places upon the ability of boards to deviate from the maximization of shareholder wealth are relatively accommodating. They are, however, less than straightforward in their relation to one another. Therefore, for the sake of clarity, a visual representation is offered below (Figure 1), followed by an explanation of its components. In a nutshell, the board enjoys quite a range of discretion in day-to-day business matters, with considerable latitude to deviate (tacitly) from shareholder wealth maximization. Such latitude is modified only in narrow circumstances where the advancement of other stakeholders' interests is clearly barred, or clearly endorsed, as the case may be.[146]

Bruner, *supra* note 143, at 1153-54, 1162-73.

145. An interesting expression of these dynamics is the heavy reliance that drafters of minutes place upon the term "discussion ensued"—a perfect lawyerly blend of procedural specificity and substantive opacity. As one practitioners' guide explains, "[a]lthough all actions should be recorded in the minutes, the discussion surrounding the proposal is often better left omitted from the official minutes. Discussions that could potentially harm the interests of the company in the future should not be included." The corporate Secretary is urged to bear in mind that "the minutes will eventually constitute legal evidence of the actions that occur at the meeting," and that "although the Secretary is required to put together a true record of all of the corporate proceedings, she should take pains in drafting the minutes . . . to eliminate any language that could potentially be harmful to the company in a dispute or legal proceeding." Steven J. Gartner, *Form of Corporate Minutes*, 81 CORP. PRAC. SERIES (BNA) A-11, A-12 (Aug. 2007). As of July 1, 2007, a Google search for the phrase "discussion ensued" with the word "minutes" returned approximately 815,000 results.

146. Note that Figure 1 does not reflect true final period situations, most notably the application of *Revlon* duties where the sale, break-up, or change of control of the corporation has become "inevitable." On final period problems, see Bainbridge, *supra* note 68, at 789 ("In repeat transactions, the risk of self-dealing by one party is constrained by the threat that the other party will punish the cheating party in future transactions. In a final period transaction, this constraint—i.e., the threat of future punishment—disappears because the final period transaction is the last in the series.").

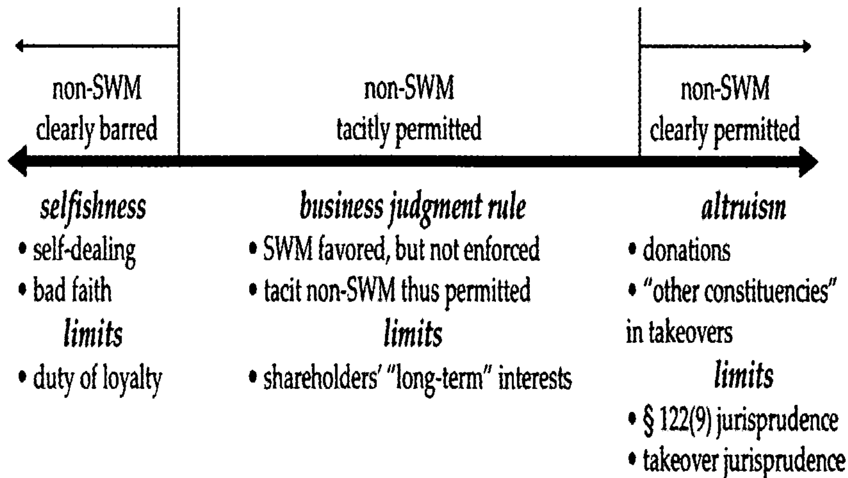

Figure 1. Deviations from Shareholder Wealth Maximization (SWM) by Delaware Boards

To begin with the more straightforward, at one extreme we have "selfish" conduct by the director. Quintessential examples of selfish director conduct include various forms of self-dealing, which obviously come at the expense of shareholders (and other stakeholders). However, corporate law reasonably conceptualizes "selfish" conduct more broadly as including bad faith departures from the pursuit of the corporation's interests—basically a form of shirking that also clearly hurts shareholders (and other stakeholders), and which the Delaware Supreme Court has clarified constitutes a violation of the duty of loyalty. The archetypal statement of the duty of loyalty was set forth in *Guth v. Loft*, in which the Delaware Supreme Court explained that:

> Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, *not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it,* or to en-

able it to make in the reasonable and lawful exercise of its powers.[147]

The dual nature of loyalty described in *Guth*—requiring both refraining from harming the corporation and its shareholders, and affirmatively working to advance their interests—was reinforced in *Stone v. Ritter* where the court finally held that "good faith" constitutes a component of loyalty.[148] So at this extreme of Figure 1, representing these differing forms of "selfish" conduct by directors, we find that courts have explicitly barred directors from advancing the relevant non-shareholder interests (namely their own). The fact that interested and bad faith decisions explicitly are not protected by the business judgment rule,[149] and that disloyal and bad faith conduct explicitly are not protected by Delaware's director exculpation statute,[150] give this limitation real teeth.

At the other extreme, then, we have what I term "altruistic" director conduct for the benefit of those typically lumped together as "other constituencies," such as creditors, employees, and broader communities. At this end of the spectrum, deviations from shareholder wealth maximization are clearly permitted, within constraints established by judicial interpretations of the corporate donation statute and takeover jurisprudence. DGCL § 122(9), for example, states that all corporations have the power to "[m]ake donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof."[151] Interestingly, this statute includes no explicit limit on the permissible scope of such donations, but courts interpreting the statute have applied a test of "reasonableness, a test in which the provisions of the Internal Revenue Code pertaining to charitable gifts by corporations furnish a helpful guide."[152]

---

147. Guth v. Loft, 5 A.2d 503, 510 (Del. 1939) (emphasis added).

148. Stone v. Ritter, 911 A.2d 362, 369-70 (Del. 2006); *see also* Bruner, *supra* note 143, at 1177-86 (arguing that good faith is best conceptualized as a subset of the duty of loyalty).

149. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

150. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2001). This section of the statute permits charter provisions limiting or eliminating directors' monetary liability for breaches of the fiduciary duty of care. *See* Bruner, *supra* note 143, at 1143-47.

151. DEL. CODE ANN. tit. 8, § 122(9).

152. Theodora Holding Corp. v. Henderson, 257 A.2d 398, 405 (Del. Ch. 1969); *see also* Kahn v. Sullivan, 594 A.2d 48, 61 (Del. 1991); 26 U.S.C. § 170(b)(2) (2000) (permitting deduction of corporate charitable contributions up to 10% of taxable income). The adequacy of legal and market-based constraints to contain corporate giving is evidenced by the fact that, notwithstanding such open grants of power under the statutes, corporate donations have averaged just 1 to 1.3% of corporate income, as compared with 1.9 to 2.2% for individuals. Elhauge, *supra* note 18, at 836-37. In *A.P. Smith Manufacturing Co. v. Barlow*, perhaps the best known case on corporate donations, the New Jersey Supreme Court took the view that modest corporate donations are generally consistent with the shareholders' own long-term interests, emphasizing that New Jersey's corporate donation statute simply confirmed a power that already existed absent the statute. 98 A.2d 581, 584-86, 590 (N.J. 1953).

Similarly, case law governing the board's response to a hostile takeover attempt explicitly permits consideration of the interests of non-shareholder constituencies, fixing the board's sights on the long-term in a context in which shareholders' sights can be expected to fix squarely on current stock price due to the lure of a premium bid.[153] Given the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders" when a hostile bid arises (i.e., to preserve their jobs), the Delaware Supreme Court has, since its 1985 *Unocal* opinion, applied "enhanced" scrutiny: the board in effect must earn the protections of the business judgment rule by demonstrating that there were "reasonable grounds for believing that a danger to corporate policy and effectiveness existed," and that any defensive measures were "reasonable in relation to the threat posed."[154] In so holding, the court explained that the proportionality inquiry requires the board to assess the effects of the bid on "the corporate enterprise," which analysis could include "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[155]

In general, the *Unocal* standard is not a terribly exacting one.[156] That virtually any type of defensive measure can be deemed proportionate was underscored in *Moran*, where the court held that a poison pill adopted preemptively, in response to the generalized threat of coercive tender offers in the market place, passed muster under *Unocal*, given the availability of the proxy contest as a means of dislodging the board itself.[157]

Elhauge similarly notes that corporate donations can ultimately redound to the benefit of shareholders, but observes that many early twentieth century cases had in fact held corporate donations to be *ultra vires* where not explicitly permitted by the charter. Elhauge, *supra* note 18, at 830. This suggests that the adoption of corporate donation statutes had less to do with long-term shareholder wealth maximization and more to do with enhancing management's ability to deviate from it, given management's greater awareness of corporations' dependence and impact upon the communities surrounding them. *Id.* at 830, 837-38.

153. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

154. *Id.* at 954-55. The Delaware Supreme Court has subsequently clarified that proportionality review under the second step of the *Unocal* test requires assessing whether the defensive measure was "preclusive" or "coercive," and if neither, whether it fell within a "range of reasonableness." Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387-88 (Del. 1995).

155. *Unocal*, 493 A.2d at 955. Other states have in fact gone further, enacting statutes explicitly endorsing the consideration of other constituencies as consistent with the discharge of fiduciary duties, though, with a single exception, such statutes do not *mandate* that other constituencies be considered. *See infra* note 186.

156. Thompson and Smith attribute the weakness of *Unocal* and its progeny as a means of policing the board to its reliance on fiduciary duties, requiring courts to "distinguish director-instituted takeover defenses that serve the interests of shareholders from those that merely entrench incumbent managers"—a task for which judges are poorly positioned in light of the fact that "every successful takeover defense has an entrenchment effect." Thompson & Smith, *supra* note 81, at 262; *see also id.* at 280-98.

157. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350, 1354 (Del. 1985).

While Delaware does require that the board maximize the price paid to shareholders in transactions in which the corporation will essentially be sold, the cases have established that the circumstances under which such a duty applies are exceedingly narrow. Where the corporation faces an "inevitable" sale, break-up, or change of control, the Delaware Supreme Court has reasoned (since its 1986 *Revlon* opinion) that the board "no longer face[s] threats to corporate policy and effectiveness,"[158] because there is no longer a long-term future for the corporation in which incumbent management's conception of appropriate policy could play out. In such a last-period scenario, then, the issue of defensive measures becomes "moot," and the "directors' role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[159] It is only in this narrow set of circumstances where Delaware courts speak of maximizing return to shareholders and will not permit boards to impede it out of regard for the interests of other constituencies.[160]

Indeed, Delaware courts have strictly limited the application of such *Revlon* duties to board-initiated transactions, reinforcing the *de facto* power of boards to deviate from shareholder wealth maximization, even in the context of hostile bids raising the prospect of enormous cash premia for shareholders.[161] In *Paramount v. Time*[162] the court held that—even in the face of an all-cash, all-shares bid at a 59% premium, where the board's alternative plan would leave the company laboring under up to $10 billion in new debt—the deferential *Unocal* standard remained applicable so long as the board's defensive measures did not represent "an abandonment of the corporation's continued existence."[163]

This holding starkly illustrates the extraordinary reach of the business judgment rule, even where the board's alternative plan appears downright ugly relative to the premium offer on the table. The court phrased the issue as being whether "Time's board, having developed a strategic plan of global expansion to be launched through a business combination with

158. *See* Revlon, Inc. v. MacAndrews & Forbes Holding, Inc., 506 A.2d 173, 182 (Del. 1986).
159. *Id.*; *see also* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 43-44 (Del. 1994) (stating that the *Revlon* test applies to "a sale of control").
160. *See* Blair & Stout, *supra* note 87, at 429-30; Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 913-15 (1990); *see also Revlon*, 506 A.2d at 182 (finding a breach of fiduciary duty in prioritizing the interests of creditors in connection with the "sale" of a corporation).
161. To be clear, I am not suggesting that the court intends to permit wholesale abandonment of shareholders' interests in the *Unocal* context. Indeed, *Revlon* makes clear that the board's "regard for various constituencies" under *Unocal* must be accompanied by "rationally related benefits accruing to the stockholders." *Revlon*, 506 A.2d at 182. The contention, rather, is that the focus on long-term performance, coupled with extraordinary deference to the board's judgment, renders deviations from shareholder wealth maximization effectively unpoliceable.
162. 571 A.2d 1140 (Del. 1990).
163. *Id.* at 1149-53.

Warner, [came] under a fiduciary duty to jettison its plan and put the corporation's future in the hands of its shareholders."[164] In answering in the negative, the court advanced rationales tending to reinforce the board's ability to deviate from shareholder wealth maximization. First, the court cited the *Unocal* language explicitly stating that boards can consider the effects on non-shareholder constituencies when evaluating takeover bids.[165] Second, it cited both the business judgment rule and the board's authority under § 141 as placing "the selection of a time frame for achievement of corporate goals" within the board's discretion, permitting the board to focus on "long-term" shareholder wealth maximization where it deems appropriate.[166] This move functioned to permit Time's board unilaterally to refuse to negotiate with Paramount (the hostile bidder) and to conclude for itself that its own plan offered long-term benefits to shareholders exceeding the benefits of the all-cash premium bid on the table—regardless of what shareholders themselves might conclude.[167]

As many have noted, the court's extension of business judgment deference to decisions regarding the time frame for the pursuit of corporate goals gives boards substantial latitude to deviate from shareholder wealth maximization in all but the narrowest circumstances.[168] As Blair and Stout have observed, the outcome in *Paramount v. Time* is tantamount to a conclusion that "a decision reducing the immediate market value of the Time shareholders' interests by thirty-five percent did not violate the directors' duties of loyalty or care."[169] To make explicit what has been implicit in my argument to this point: an adequate descriptive theory of corporate law cannot rest at citing the court's nominal commitment to long-term shareholder wealth maximization in such cases. It must also account for what this verbal formula translates into in concrete cases, and *Paramount v. Time* presents a supreme challenge for those who accept the "long-term" device as a means of squaring the cases with shareholder wealth maximization. As Lyman Johnson aptly put it, "the chief attraction of the long-run phantom is its marvelous ability to apparently harmonize management discretion with shareholder primacy while, in fact, sweeping the whole thing under the rug."[170] The emphasis on "long-term" shareholder interests, in practice, implicitly endorses board decision-making aimed at en-

164. *Id.* at 1149-50.
165. *Id.* at 1153.
166. *Id.* at 1153-54.
167. *Id.*; *see also* Gordon, *supra* note 81, at 523-25.
168. *See, e.g.*, Blair & Stout, *supra* note 87, at 428-29; Elhauge, *supra* note 18, at 819-20; Johnson, *supra* note 160, at 900-02; Allen, Jacobs & Strine, *supra* note 2, at 1079.
169. Blair & Stout, *supra* note 87, at 429.
170. Johnson, *supra* note 160, at 902.

suring the stability and sustainability of the corporation, redounding to the benefit of all stakeholders, even when the shareholders take a hit for it.[171]

This conception of the scope of business judgment deference brings us to the middle of the spectrum depicted in Figure 1, representing the vast majority of business decisions in which neither of the extremes of clear "selfishness" or "altruism" are implicated. As many have argued, the business judgment rule functions every day to insulate countless decisions from second-guessing of any sort, permitting corporate decision-makers to deviate from the path of shareholder wealth maximization without fear of judicial intervention or negative consequences--so long as they can come up with some form of rationalization phrased in terms of "long-term" shareholder interests.[172]

Even the famous *Dodge v. Ford Motor Co.*[173] case—often cited as the quintessential statement of a duty to maximize shareholder wealth[174]— is comprehensible in these terms. The litigation arose out of Henry Ford's refusal to pay dividends, notwithstanding available cash and cash equivalents exceeding $50 million, in favor of a business expansion plan and price reductions.[175] The Michigan Supreme Court's opinion did include a

171. On this point, it is interesting to observe that immediately following the quotation from *Unocal* endorsing consideration of other constituencies, the court rejects outright the notion of focusing on the type of mental exercise a shareholder, concerned solely with her own interests, might engage in—a comparison of the present discounted value of stock of the combined Time-Warner with the premium bid on the table. *See* Paramount Commc'ns v. Time Inc., 571 A.2d 1140, 1153 (Del. 1990). Implicit, then, in the court's analysis is a rejection of the idea that the market itself can efficiently bring to bear anticipated future value on present stock price. As Blair and Stout put it, "[t]he only way such a decision could be consistent with shareholder primacy and market efficiency is if the court believed that Time's directors had access to private information indicating that the Warner merger would soon produce tremendous benefits that eventually would be incorporated into the market price and raise it above the Paramount offer." Blair & Stout, *supra* note 87, at 429 n.73. Again, the claim is not that the court has formally divorced the doctrine from nominal focus on shareholders' interests, but that by placing this entirely within the board's discretion, it permits *de facto* (and in this case, apparently quite substantial) deviations from shareholder interests that cannot be effectively policed.

172. *See, e.g.*, Allen, *supra* note 2, at 272-73; Blair & Stout, *supra* note 87, at 428-29; Blair & Stout, *supra* note 46, at 299-305; Elhauge, *supra* note 18, at 770-71; Johnson, *supra* note 160, at 900-02; Lee, *supra* note 94, at 35; Orts, *supra* note 13, at 1599; *cf.* JOHN R. BOATRIGHT, ETHICS IN FINANCE 185, 189-94 (1999) (arguing that the inadequacy of shareholder wealth maximization as guidance for corporate decision-makers is in practice resolved by reference to the interests of non-shareholder constituencies); Robert N. Anthony, *The Trouble with Profit Maximization*, HARV. BUS. REV., Nov.-Dec. 1960, at 126-28 (arguing that business leaders in fact pursue a "satisfactory" return for shareholders due to practical and moral difficulties raised by attempting to "maximize" profits); Orts, *supra* note 13, at 1590-91 (observing that "everyday complexities of business management" render the concrete meaning of shareholder wealth maximization ambiguous); Douglas G. Baird & M. Todd Henderson, *Other People's Money* 15-19 (Univ. of Chi. Law Sch., John M. Olin Law & Econ. Working Paper No. 359, 2d series, 2007), *available at* http://ssrn.com/abstract_id=1017615 (observing that the business judgment rule effectively permits deviations from shareholder wealth maximization, but in so doing "invites circumlocution" in that "discussion becomes couched in terms that are somewhat tortured, but less likely to make waves" than would frank admission of the advancement of other stakeholders' interests).

173. 170 N.W. 668 (Mich. 1919).

174. *See, e.g.*, Bainbridge, *supra* note 68, at 777-78; Bainbridge, *supra* note 116, at 1616.

175. *Dodge*, 170 N.W. at 683.

strongly worded warning that corporations are not to be run "for the merely incidental benefit of shareholders and for the primary purpose of benefiting others."[176] It should, however, be observed that (1) the issue arose only because Henry Ford *actually said* that dividends were being withheld in order to advance the interests of non-shareholders (through expanded employment and reduced prices);[177] (2) the court explicitly did not question cases endorsing "incidental humanitarian expenditure" where the board was "acting for the best interests of the corporation";[178] and (3) even though the court ultimately ordered Ford to pay a dividend, it did so only after permitting the company's substantial business expansion plan to go ahead.[179] Notably, the court cited the lack of any indication that the expansion plan would "menace the interests of shareholders"—under the circumstances, presumably their long-term interests.[180] Put differently, the shareholders got their dividend, but only after enough cash had been set aside to fund the board's long-term plan. Like in the takeover context, the emphasis on the long-term implicitly endorses board decision-making aimed at ensuring firm stability and sustainability, even where that comes at the expense of shareholders.[181]

Later cases have emphasized such points in side-stepping the *Dodge* opinion's strong language regarding shareholder interests.[182] In the *Wrigley* case, for example, an Illinois court rejected a minority shareholder's challenge of Philip Wrigley's decision that the Chicago Cubs—unlike every other team in the majors—would eschew night baseball, a decision explicitly aimed not at the maximization of return to shareholders, but rather based on his conviction that baseball was and should remain a "daytime sport," and that "installation of lights and night baseball games [would] have a deteriorating effect upon the surrounding neighborhood."[183] The

176. *Id.* at 684.
177. *Id.* at 683-84.
178. *Id.* at 684.
179. *Id.* at 684-85.
180. *Id.* at 684.
181. *Cf.* ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 17, at 295 ("A board's decision today to use retained earnings to fund investments, price reductions, or even increased employee wages would easily be justified as a device to increase long-term corporate earnings and, as such, would be immune from shareholder attack."); Baird & Henderson, *supra* note 172, at 10, 32, 43-44 (arguing that current corporate law doctrine cannot be reconciled with the claim that the board owes a fiduciary duty to shareholders, advocating the elimination of fiduciary duties in favor of facilitation of more complete contracting, and suggesting that boards "should take from court decisions the simple maxim that they should do what is in the best interest of the firm, measured from the perspective of the ex ante bargain among investors"). Lynn Stout has in fact argued that "*Dodge v. Ford* is indeed bad law, at least when cited for the proposition that the corporate purpose is, or should be, maximizing shareholder wealth," and that consequently "instructors and scholars should stop teaching and citing" the case. Lynn Stout, *Why We Should Stop Teaching* Dodge v. Ford, *in* THE ICONIC CASES IN CORPORATE LAW 1, 2-3 (Jonathan R. Macey ed., 2008).
182. *See, e.g.*, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01, reporter's note para. 2 (2005) (identifying this development in subsequent case law).
183. Shlensky v. Wrigley, 237 N.E.2d 776, 777-78 (Ill. App. Ct. 1968) (internal quotation marks

plaintiff pointed to *Dodge*, but the *Wrigley* court, seizing on the *Dodge* court's acceptance of Ford's expansion plan for its arguable consistency with long-term shareholder interests, decided that Wrigley's own decision to reject night baseball could be squared with the "long run interest of the corporation" in maintaining the health of the neighborhood surrounding the ball park.[184] Similarly, in *A.P. Smith* the New Jersey Supreme Court bent over backward to find a donation to Princeton University acceptably connected with the shareholders' long-term interests, looking not only to the cultivation of an employee pool and good will in the community, but even to the maintenance of capitalism and the "free enterprise" system itself.[185]

The doctrinal approach established by case law on the business judgment rule and this emphasis on the long-run—which, again, applies to the vast majority of corporate decisions—has been reinforced in states with so-called "other constituency" statutes. By 2005 thirty states had adopted statutes explicitly permitting corporate managers to consider the interests of non-shareholder constituencies, and most of these statutes applied not only in the takeover context, but to all corporate decision-making.[186] Indiana's statutory fiduciary duty standard, for example, adds that a "director may, in considering the best interests of a corporation, consider the effects of any action on shareholders, employees, suppliers, and customers of the corporation, and communities in which offices or other facilities of the corporation are located, and any other factors the director considers pertinent."[187] Similarly, though considerably more broadly, the American Law Institute's Principles of Corporate Governance provide that "[e]ven if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business . . . [m]ay take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business."[188] Such statutes obviously eliminate any doubt as to the permissibility of bringing the interests of non-shareholders to bear

---

omitted).

184. *Id.* at 779-81.

185. *See* A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 583-86 (N.J. 1953). The court obliquely reveals Cold War-related concerns in applauding such corporations for "recogniz[ing] that we are faced with other, though nonetheless vicious, threats from abroad which must be withstood without impairing the vigor of our democratic institutions at home and that otherwise victory will be pyrrhic indeed." *Id.* at 586.

186. *See* Elhauge, *supra* note 18, at 763. Connecticut in fact goes further, stating that directors of public corporations considering fundamental transactions "shall consider" the "long-term" interests of the corporation and shareholders, "the interests of the corporation's employees, customers, creditors and suppliers," and "community and societal considerations." CONN. GEN. STAT. § 33-756(d) (2005).

187. IND. CODE § 23-1-35-1(d) (2005). Indiana's statute also explicitly—and pointedly—rejects Delaware's heightening of directors' duties in the sale-of-control context. *See id.* § 23-1-35-1(f).

188. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(b)(2) (2005); *see also id.* § 4.01 (including a strong version of the business judgment rule); Orts, *supra* note 13, at 1604-05.

on corporate decisions, and may even preclude corporations from creating an explicit duty to maximize shareholder wealth through their charters.[189]

B. The Ambivalence of Corporate Law

So to return to the questions posed at the outset, who possesses ultimate corporate governance authority? For whose benefit are public corporations run? And what is corporate law's relationship to the achievement of the social good? It would appear that corporate law remains deeply ambivalent on each score.

Again, for clarity and ease of reference, I set out in Figure 2 each of the fundamental issues to be addressed and the principal manifestations of corporate law's ambivalence with respect to each issue, and then proceed to describe them below.

Regarding:	**Manifestations:**
power constituencies	• § 141 (board authority) *v.* o § 211 (shareholder franchise) o transferability of shares (takeover jurisprudence) o § 109 (shareholder bylaws) • co-approval of fundamental transactions
beneficiaries	• shareholder wealth maximization *v.* o § 122(9) (donations) o takeover jurisprudence o business judgment rule • fiduciary duties owed to corporation *and* shareholders
social good	• weak utilitarian commitment to shareholder wealth maximization

Figure 2. Corporate Law's Ambivalence

189. *See* Elhauge, *supra* note 18, at 863-64; Johnson, *supra* note 160, at 870-71, 909-10.

1. *Power Constituencies*

Corporate law remains fundamentally ambivalent regarding the relative authority of what I have termed the corporation's power constituencies—the board and the shareholders. As discussed above, the board's claim to authority is rooted in DGCL § 141(a), which says that the "business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors"—a sweeping grant of power by any estimation.[190] However, the statute and case law also grant substantial power to shareholders, and in some instances employ language that is arguably just as broad as that in § 141(a). As we have seen, one clear counterbalance to board power under § 141(a) is the shareholders' right to elect the board under § 211(b)[191]—a right arguably suggesting that the board's power is simply derivative of, and therefore legitimated by, shareholder endorsement. This balance is arguably reinforced by the division of power between the board and shareholders over fundamental transactions. Although the fact that shareholders cannot initiate fundamental transactions has been cited as evidence of board supremacy, we might observe by the same token that the board cannot approve such transactions on its own. The statute in fact envisions co-approval, favoring neither power constituency in the critical context of fundamental transactions.[192] As the Delaware Supreme Court has put it, the DGCL "expressly provides for a balance of power between boards and stockholders which makes merger transactions a shared enterprise."[193]

Indeed, this form of power-sharing additionally renders more comprehensible the limits that Delaware courts have placed on the free transfer-

---

190. DEL. CODE ANN. tit. 8, § 141(a) (2001).

191. *Id.* § 211(b).

192. *See* DEL. CODE ANN. tit. 8, §§ 242(b), 251(b)-(c), 271(a) (2001 & Supp. 2006) (giving the board the power to initiate, and the shareholders the power to approve, charter amendments, mergers, and sales of substantially all assets, respectively); UniSuper Ltd. v. News Corp., No. 1699-N, 2005 Del. Ch. LEXIS 205, at *25 n.48 (Del. Ch. Dec. 20, 2005) (observing that board power is "constrained by . . . shareholders' right to vote" under these statutory provisions); *see also* Thompson & Smith, *supra* note 81, at 306 (identifying co-approval of fundamental transactions as recognizing "the space within which a well-functioning corporate-governance system requires shareholder action, the space where directors cannot have absolute authority"). It should be borne in mind that for those Delaware corporations listed on the New York Stock Exchange, shareholders have the right to approve an expanded list of transactions, notably including certain transactions involving the issuance of common stock equaling 20% of pre-transaction outstanding shares or voting power, and transactions involving a "change of control." *See* NYSE, Inc., Listed Company Manual § 312.03(c)-(d) (2007), *available at* http://www.nyse.com/Frameset.html?nyseref=http%3A//www.google.com/search%3Fhl%3Den%26q%3DListed+Company+Manual%26btnG%3DSearch&displayPage=/lcm/lcm_section.html. Other exchanges have similar rules. *See* OESTERLE, *supra* note 42, at 134-38.

193. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 930 (Del. 2003). Although this Article focuses on corporate law, it should be observed that similar expressions of ambivalence regarding the balance of power between boards and shareholders have been identified in the evolution of U.S. securities laws. *See generally* Mitchell, *supra* note 25.

ability of shares in the hostile tender offer context. While the omission from the statute of board authority to respond to tender offers is perhaps puzzling,[194] courts in any event have essentially analogized hostile tender offers to fundamental transactions like mergers (as opposed to, say, a series of one-off stock purchases from individual shareholders)[195] through the construction of a takeover jurisprudence achieving a similar balance between board and shareholder power.[196] As discussed above, Delaware's approach to defensive tactics walks a fine line between deference to board authority under § 141 and the business judgment rule, on the one hand, and limiting defensive measures to those that can be overcome indirectly through a proxy contest (and thus by vote-wielding shareholders) on the other.[197]

Another important reflection of this fundamental ambivalence regarding power constituencies is the statutory counter-balance between the board's authority under § 141 and the shareholders' authority to enact bylaws under § 109—a grant of power similarly sweeping in its terms. Under § 109, shareholders have the unilateral power to "adopt, amend or repeal bylaws," which "may contain any provision, not inconsistent with law or with the certificate of incorporation, *relating to the business of the corporation, the conduct of its affairs,* and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."[198] Like § 141(a), this grant of power to shareholders explicitly refers to the "business" and "affairs" of the corporation, and the only explicit limits regard-

194. *See, e.g.*, Allen, Jacobs & Strine, *supra* note 2, at 1086 (declining to take a position regarding whether omission of tender offers from the statute was deliberate, but "recogniz[ing] the cogency of the argument that if the statutory drafters had foreseen the impact of hostile tenders [sic] offers upon corporate governance, the board's role in approving such offers might have found its way explicitly into the statute").

195. *See, e.g.*, Bainbridge, *supra* note 68, at 811 ("The question has become whether unsolicited tender offers are more like secondary market trading or like mergers."); TW Services, Inc. v. SWT Acquisition Corp., 1989 Del. Ch. LEXIS 19, *33-*34 (Del. Ch. 1989) (Allen, C.) (observing that tender offers can resemble "change in control transactions that are functionally similar to merger transactions," yet at the same time "essentially represent the sale of shareholders' separate property").

196. *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1149-50, 1154 (Del. 1990) (declining to "put the corporation's future in the hands of its shareholders," in part by interpreting the board's authority under § 141(a) to include the selection of a time-frame for the achievement of corporate strategy).

197. *See, e.g.*, Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1379 (Del. 1995) (stating that where a hostile takeover attempt couples a proxy contest with a tender offer, courts "must recognize the special import of protecting the shareholders' franchise within *Unocal's* requirement that any defensive measure be proportionate" (citation and internal quotation marks omitted)); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1353-54 (Del. 1985) (finding that a preemptive poison pill did not preclude tender offers in part because shareholders could remove the board through a proxy contest); *cf.* Allen, Jacobs & Strine, *supra* note 2, at 1094-95 (observing that while "the realities of the corporate election process" generally limit its efficacy, the process yet "functions vigorously" when it "amounts to a referendum about a pending tender offer bid"). For conflicting views on the viability of the market for corporate control envisioned by such cases, see *supra* notes 103-105 and accompanying text.

198. DEL. CODE ANN. tit. 8, § 109(a)-(b) (2001) (emphasis added).

ing the substance of such bylaws are that they must be consistent with "law" and the certificate of incorporation.[199]

As a practical matter, the crucial question is obviously whether shareholders can unilaterally adopt bylaws substantially limiting the board's governance authority under § 141(a)—in particular, through a bylaw forcing the board to redeem or modify the corporation's poison pill. To the surprise of many students new to corporate law, this fundamental question remains open in Delaware.[200] Delaware corporate law firms "have opined that a mandatory bylaw would constitute an invalid intrusion by the shareholders into the realm protected by § 141(a)," but the matter remains unresolved.[201] This is an issue to which I will return below,[202] but for present purposes the critical point is simply the fact that the relationship between these two similarly worded grants of power has remained unclear for so long. Put differently, if any one of the prevailing theories of corporate law canvassed above were so clearly correct as their authors suggest, this would not present nearly so difficult a question.

2. *Beneficiaries*

Corporate law likewise remains deeply ambivalent regarding the intended beneficiaries of corporate production, and their relative priority under varying circumstances. Strong pressures to maximize stock price spring from the very capital market realities that have given rise to the widely held "public" corporation. As discussed above, in the modern public corporation we have a structure in which, regardless of their formal powers, retail shareholders generally remain rationally apathetic through much of the ordinary life of the corporation—a tendency reinforced by modern portfolio theory's emphasis on diversification, as discussed below.[203] In general, retail shareholders are both unaware of and unaffected by the realities of corporate production, and are thus freed from whatever constraints of conscience might have impacted their decisions, had they been directly involved (say, directly undertaking such business themselves). Boards, meanwhile, occupy a more complex position, both doctrinally and due to their direct and on-going involvement in the corporation's affairs. Boards face substantial equity market pressure to maximize current stock price by virtue of the fact that morally and socially insulated shareholders can single-mindedly focus on stock price and sell out of the in-

199. *See id.*

200. *See* Smith, *supra* note 94, at 6 n.28; Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409, 413-17 (1998) (observing the "critical dearth of precedent" in this area).

201. ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 17, at 623-24.

202. *See infra* Part V.

203. *See infra* Subpart IV.A.

vestment if they perceive it to be under-performing (the "Wall Street Rule").[204] This equity market pressure, then, is reinforced by the shareholders' privileged legal position within the corporate structure vis-à-vis other constituencies, reflected in their authority to elect the board, as well as the fact that fiduciary duties are owed to them directly, permitting shareholders to sue both directly and derivatively for breaches of fiduciary duty.

As we have seen, however, corporate law's commitment to shareholder wealth maximization remains far from clear and comprehensive. Recall that no state has imposed a clear duty to maximize shareholder wealth, and indeed that states have been all too ready to explicitly permit corporations to give away shareholder wealth through charitable donations. Likewise recall that statutes and case law permit boards to consider non-shareholder interests in discharging their fiduciary duties in various circumstances—notably the hostile takeover context. Even Delaware has made clear that "absent a limited set of circumstances" in which the corporation literally has no long-term future because its demise has become inevitable, "a board of directors . . . is not under any *per se* duty to maximize shareholder value in the short term."[205] And that this is equally true both within and without the takeover context only reinforces the board's substantial *de facto* discretion to deviate from shareholder wealth maximization in the day-to-day business of the corporation under the business judgment rule, so long as some plausible long-term benefit to the shareholders can be articulated.

Perhaps the clearest expression of corporate law's ambivalence regarding intended beneficiaries of corporate production, however, is the fact that corporate boards are deemed to owe fiduciary duties to shareholders and the corporation *simultaneously*. Recall that the Delaware Supreme Court, in its 1939 *Guth v. Loft* opinion, told us that corporate officers and directors "stand in a fiduciary relation to the corporation *and* its stockholders"[206]—a formulation to which the court remains committed.[207] Armed with this formulation of the relevant fiduciary relations, who would a newly minted director conclude the principal beneficiaries of her efforts were supposed to be? Lyman Johnson has suggested that this formulation may represent "a pragmatic doctrinal accommodation" of differing views of "corporate purpose"; rather than addressing the theoretical tension

204. *See, e.g.*, ROBERT CHARLES CLARK, CORPORATE LAW 680 (1986) (conceding that corporate managers possess discretion to deviate from "strict profit maximization," but arguing that "the evidence for the power of capital market controls on managerial behavior is very strong").

205. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1990).

206. Guth v. Loft, 5 A.2d 503, 510 (Del. 1939) (emphasis added).

207. *See* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007) (citing *Guth* and noting that "[i]t is well established that the directors owe their fiduciary obligations to the corporation and its shareholders").

forthrightly, corporate law "simply equivocated" and "bracketed" the problem (an approach that worked reasonably well until the hostile takeover wave hit).[208] Favored though the stockholders may be, relative to other constituencies, in the respects noted above, the very fact that corporate law has not seen fit to elevate either the "stockholders" or the "corporation" over the other suggests a deep ambivalence about the ultimate ends of corporate production (and an implicit rejection of both strict board-centric and strict shareholder-centric governance theories).

Indeed, in an article published by the *University of Chicago Law Review* in 2002, three highly respected Delaware jurists (one turned academic) argued that Delaware corporate law "remains ambivalent" as between shareholder wealth maximization, on the one hand, and what they described as "a partial commitment by the law to values in addition to implementing shareholder will," on the other.[209] Because the Delaware legislature itself has never clarified whether the corporation's primary purpose is to maximize the wealth of shareholders or the aggregate well-being of all its stakeholders, judges have inevitably been thrust into the middle of patently political questions.[210] "Most judges," they observe, do "worry about the legitimacy of their policymaking authority," and consequently engage in the practice only tentatively.[211] Lacking any "popular mandate," they find it "institutionally safer and more conforming with tradition to write judicial opinions in a way that obscures policy choices."[212] There being no greater policy issue in corporate law than to whose benefit corporate production is intended to redound, we ought not be surprised that this fundamental ambivalence regarding the primary beneficiaries of fiduciary duties has so endured.[213] The consequence is

---

208. Johnson, *supra* note 160, at 900 n. 133. *See also id.* at 923-24; TW Services, Inc. v. SWT Acquisition Corp., 1989 Del. Ch. LEXIS 19, *19 n.5, * 28 n.14 (Del. Ch. 1989) (Allen, C.) (observing that "this particular phrase masks the most fundamental issue" regarding the priority of short-term shareholder interests versus those of others, and that the issue "seems inescapably to involve normative questions").

209. Allen, Jacobs & Strine, *supra* note 2, at 1067; *see also* E. Norman Veasey, *Musings on the Dynamics of Corporate Governance Issues, Director Liability Concerns, Corporate Control Transactions, Ethics, and Federalism*, 152 U. PA. L. REV. 1007, 1015-16 (2003).

210. *See* Allen, Jacobs & Strine, *supra* note 2, at 1068-69; Johnson, *supra* note 160, at 887.

211. Allen, Jacobs & Strine, *supra* note 2, at 1070.

212. *Id.* at 1070-71; *see also id.* at 1078 (observing that the DGCL remains silent regarding when and how boards may impede a tender offer); Johnson, *supra* note 160, at 873-76, 887-90, 897.

213. Perhaps we ought not be any more surprised that Delaware jurists have chastised academics for "talking past each other," advancing extreme theoretical claims and proposed reforms so "otherworldly" as to "have no realistic chance for implementation." Allen, Jacobs & Strine, *supra* note 2, at 1072; *see also* Leo E. Strine, Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. CORP. L. 1, 3, 5 (2007) (criticizing the "so-called corporate governance debate" in which "[e]xaggeration is the norm; conversation the exception," and criticizing "corporate law scholars" and others "who profit in monetary and psychic ways from corporate governance tumult"); Veasey, *supra* note 209, at 1011 (describing the takeover debate as "an extraordinary symphony with half the orchestra playing in A major and the other half playing simultaneously in B-flat minor").

nominal commitment to shareholder wealth maximization while leaving boards ample room to bring the interests of other constituencies to bear upon their decisions.

3. *The Social Good*

Corporate law's ambivalence regarding power constituencies and beneficiaries together point toward a third form of fundamental ambivalence regarding corporate law's role in advancing the greater social good, to which corporate production is generally assumed to contribute.[214] To state the matter most simply, the degree to which corporate law itself may directly aim for the advancement of the social good depends on the consistency of the interests of the principal beneficiaries of corporate conduct with whatever the social good is thought to be—a calculus requiring not only some conception of the social good, but also a clear determination of which constituencies' claims upon the corporation take priority. In order, then, to illuminate further corporate law's conception of its role in the achievement of the social good, I turn briefly to the implicit moral theory of corporate law—utilitarianism—and examine the degree and nature of its commitment to shareholder wealth maximization through that lens.[215]

Given the degree of industrialization and specialization that typifies modern developed societies like ours, it is unsurprising that corporate law and capital markets—indeed, modern economics—would implicitly advance a relatively abstract, distant, and productivity-oriented moral theory.[216] As Mark Roe has observed, the "prevailing academic and business view in the United States is that shareholder wealth maximization fits with a utilitarian, greatest-good-for-the-greatest-number philosophy."[217] Roe summarizes the standard position as follows:

> The utilitarian justification is that this preference is the price paid for strong capital markets, and allocative efficiency and that these benefits are so powerful that they overwhelm the normative benefit of any distributional favoring of current employees over current shareholders. In the long run, the argument goes, employees and other stakeholders are overall better off with fluid and efficient capital markets, managers need a simple metric to follow, and both

214. *See, e.g.*, ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 17, at 2 ("In all events, the modern law of organizational forms—most notably corporation law—is premised on the idea that facilitating individuals' efforts to create wealth is wise public policy."); Mitchell, *supra* note 25, at 1560-63.

215. *See, e.g.*, Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001).

216. The rise of utilitarianism has generally been associated with the advent of industrialism. *See, e.g.*, RAYMOND WILLIAMS, CULTURE AND SOCIETY 55-56 (1958); WALTER E. HOUGHTON, THE VICTORIAN FRAME OF MIND, 1830-1870, at 110-12, 268-69 (1957).

217. *See* Roe, *supra* note 215, at 2065.

> wealth and, in the end, fairness are maximized by shareholders being the corporation's residual beneficiary, with the other claimants getting what they want via contract with the corporation. Current employees might be made worse off in some industries, but employees overall will have more opportunities, higher salaries, and better working conditions.[218]

Before we can say anything concrete about this, we must first clarify what type of "utilitarianism" this reflects. John Stuart Mill, one of the best known proponents of utilitarianism, explained that the "creed which accepts as the foundation of morals, Utility, or the Greatest-Happiness Principle, holds that actions are right in proportion as they tend to promote happiness, wrong as they tend to produce the reverse of happiness."[219] Over time such vocabulary has given way to "human welfare," "satisfaction of desires and preferences," and so on—through which formulations utilitarianism animates modern economic theory.[220] But in any event, operationalizing utilitarianism depends critically on how one actually calculates aggregate utility. Two distinct approaches have emerged. According to "act" utilitarians, the rightness of an action depends upon whether *that action in itself* would maximize utility.[221] According to "rule" utilitarians, on the other hand, the rightness of an action depends upon whether it is in accord with *a rule that, if generally accepted,* would maximize utility.[222] Thus an act utilitarian might excuse a lie told under specific circumstances where the truth would appear to do more harm than good, whereas a rule utilitarian might reject this conclusion, arguing that any lie is wrong because conformity with a rule of truth-telling maximizes utility over time.[223]

Armed solely with these concepts, we might be tempted to categorize the argument for shareholder wealth maximization, summarized by Roe, as "rule utilitarian" in that it focuses on the "long run" maximization of the welfare of all stakeholders through adherence to a practice. It is explicitly acknowledged that things might not pan out in specific instances for specific stakeholders—say, employees in a given company or industry—but nevertheless it is maintained that over time employees as a class across society "will have more opportunities, higher salaries, and better working conditions" if shareholder wealth maximization is uniformly pursued.[224]

---

218. *Id.* Roe argues, however, that this does not hold true in other countries "with mostly concentrated industry and weak product market competition." *Id.*; *cf.* Mark J. Roe, *Can Culture Constrain the Economic Model of Corporate Law?*, 69 U. CHI. L. REV. 1251 (2002).

219. JOHN STUART MILL, *Utilitarianism*, *in* ON LIBERTY AND UTILITARIANISM 144 (Bantam Books 1993) (1871).

220. *See* BOATRIGHT, *supra* note 172, at 55.

221. *See* DAVID LYONS, FORMS AND LIMITS OF UTILITARIANISM 119-21 (1965); BOATRIGHT, *supra* note 172, at 54.

222. *See* LYONS, *supra* note 221, at 119-21; BOATRIGHT, *supra* note 172, at 54.

223. LYONS, *supra* note 221, at 121-25; BOATRIGHT, *supra* note 172, at 54.

224. *See* Roe, *supra* note 215, at 2065.

Viewed in this light, however, we immediately encounter some significant problems with this account. As we have seen, (1) shareholder wealth maximization is not, in fact, a mandatory general rule; (2) even if it were, it would remain unenforceable in most day-to-day circumstances due to the business judgment rule; and (3) deviations are explicitly endorsed in certain circumstances in jurisdictions like Delaware, and across the board in many other jurisdictions. Thus it appears that this account of corporate law's "utilitarian" commitment to shareholder wealth maximization is—as a descriptive matter—oversimplified.[225]

An additional refinement of the nature and degree of corporate law's utilitarian commitment to shareholder wealth maximization may help to clarify the matter. Philosopher David Lyons has argued that act utilitarianism and rule utilitarianism, upon close inspection, are "extensionally equivalent" in that a rule justified by reference to a utilitarian principle can be rendered complete only through multiplication of exceptions and qualifications, presumably proportionate to the complexity of the decision-making context.[226] The purported "rule" in essence morphs into a presumption, and the inquiry simply becomes when one is justified in acting contrary to that presumption—an operation not materially different from application of the utilitarian principle directly to the acts in question.[227] Indeed, act utilitarians themselves, Lyons argues, are apt to accept such "rules," so construed, as "reliable guides to right action: they presumably represent and summarize or generalize upon centuries of mankind's experience regarding the usual utility of socially important types of acts."[228]

This is in fact the best that could be said of corporate law's utilitarian commitment to shareholder wealth maximization—a "guide[] to right action" that, due to the technical, social and moral complexity of the decision-making context, is riddled with exceptions and qualifications.[229] Shareholder wealth maximization is, at best, what Lyons would call a "*de facto* moral rule[]," a presumption easing the rigors of act-utilitarian application of a general utilitarian principle, not a true "rule" in the rule-utilitarian sense.[230] And as a consequence of its status as a *de facto* moral

---

225. Note that I speak here of corporate law's implicit moral theory, rather than applying an external moral theory—the point being that these legal realities tend to contradict the claim that corporate law itself in fact treats shareholder wealth maximization as a utility maximizing rule. On the distinction between applying rules that contain a utilitarian principle, on the one hand, and judging the utility of rules by reference to a utilitarian principle external to those rules, on the other, see LYONS, *supra* note 221, at 180-84.

226. *See id.* at 62-197.

227. *Id.* at 121-33.

228. *Id.* at 148.

229. *Id.*

230. *Id.* Regardless of whether one accepts Lyons' categorical claim regarding the extensional equivalence of rule utilitarianism and act utilitarianism, the complexity of the decision-making context faced by corporate directors renders the status of shareholder wealth maximization in corporate law particularly amenable to description by the terms he employs.

rule, "we must also adopt this escape clause: follow the rule[], indeed, but not when you know or are quite certain that breaking [it] will have better effects on the whole than keeping to it."[231] As a mere "practical approach towards maximizing utility"—a "way of deliberating and of effectively solving problems of conduct to best ensure conformity" to some underlying utilitarian principle[232]—corporate law expresses real confidence in the social utility of shareholder wealth maximization. But likewise corporate law remains highly skeptical of its strict application in numerous circumstances, and consequently remains unwilling to place all of our eggs in that basket.

Now, thinking back to the forms of ambivalence described above—ambivalence regarding power constituencies, regarding beneficiaries, and regarding the role of corporate law in ensuring consistency with the social good—the three are revealed to be distinct though related facets of an underlying problem in corporate law and theory. As Lyons ultimately observes in his book *Forms and Limits of Utilitarianism,* we often "seek to 'justify' or 'account for'" such *de facto* moral rules—in this case, shareholder wealth maximization—by simply "not[ing] that the rules are useful," without more.[233] The problem is that "this involves applying an unspecified 'principle of utility,'" evading the truly critical issues: "*how* useful a rule (or practice) must be if it is to be 'justified,'" and related to that, how we can know when the presumption may be overcome by reference to that underlying principle of utility itself—whatever it may be.[234]

At this point, we arrive at what is perhaps the defining paradox of the public corporation—as of industrial capitalism, of which it is a quintessential expression. *Through corporate law, we effectively outsource the pursuit of the social good to an entity lacking the legitimacy or the practical ability to articulate what the "social good" actually is.* In essence, this reality differs in no material respect from what Adam Smith perceived to be the essence of any market-based economy: the pursuit of self-interest, by which the market actor is thought to be "led by an invisible hand to promote an end which was no part of his intention."[235] As with industrial

231. *Id.*

232. *Id.* at 149.

233. *Id.* at 194.

234. *Id.*

235. The passage reads:

> By preferring the support of domestick [sic] to that of foreign industry, [the individual] intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.

ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 351-52 (J.C. Bullock ed., P.F. Collier & Son 1909) (1776).

capitalism generally, this paradox of the public corporation's social utility is irresolvable, and consequently the fundamental ambivalence of corporate law can be expected to endure. As then-Chancellor Allen has observed, within the public corporation "exists the tension that a dynamic market system creates between the desire to achieve increases in total wealth and the desire to avoid the losses and injuries . . . that a dynamic system inevitably engenders."[236] It is an "elemental tension" that he rightly identifies with industrial capitalism, "aris[ing] from the longing for stability and community in the liberal society." As a result, the corporation becomes "the locus of many conflicting claims," both economic and social, and "defining what we suppose a public corporation to be" becomes indistinguishable from "express[ing] our view of the nature and purpose of our social life."[237]

Ultimately, it appears that corporate law's ambivalence vis-à-vis shareholders—as power constituency, as beneficiaries, and as representatives of society's interests—reflects real but incomplete confidence in the consistency of shareholders' incentives and interests with those of the larger public. The consequence is a system of dual authority in which, ironically, neither power constituency generally possesses the practical ability to make strong, direct appeals to the social good within the ordinary life of the corporation.[238] To the extent we can identify an underlying "utilitar-

---

A few observations regarding the "invisible hand" are warranted here. First, notwithstanding its current prominence, this is literally the only reference to the concept in *The Wealth of Nations*. Second, as used here, the concept is likewise arguably best conceptualized as a *de facto* moral rule; as Smith words it, "[b]y pursuing his own interest he *frequently* promotes that of the society"—the implication being that this is not always or inevitably the case (emphasis added). Finally, there is an irony to the modern reader in that Smith himself employs the concept in arguing that we need not fear international trade because home-country bias—prompted by self-interest—could be expected to curb its excesses. That is, the "invisible hand" in Smith's example represents not the market liberalizing impulse, but the protectionist one. *See id.* at 351.

236. *See* Allen, *supra* note 2, at 280.

237. *Id.* at 280-81; *see also* Allen, Jacobs & Strine, *supra* note 2, at 1083-85; Orts, *supra* note 13, at 1612-23; Johnson, *supra* note 160, at 934; *cf.* Anthony, *supra* note 172, at 126-28 (arguing that business leaders in fact pursue a "satisfactory" return for shareholders due to practical and moral difficulties raised by attempting to "maximize" profits).

238. Corporate law's system of dual authority, among other things, has led some to analogize corporate governance—and post-Enron reforms, in particular—to the pursuit of "procedural legitimacy" in government. *See, e.g.*, Cary Coglianese, *Legitimacy and Corporate Governance*, 32 DEL. J. CORP. L. 159, 161-63; *cf.* Greenfield, *supra* note 41, at 5, 9 (drawing an analogy to government in arguing that "more pluralistic" group decision-making is generally superior). Employing a separation of powers to ensure legitimacy and to curb abuses is certainly not specific to government. As Federalist No. 51 itself suggests, "[t]his policy of supplying, by opposite and rival interests, the defect of better motives, might be traced through the whole system of human affairs, private as well as public." THE FEDERALIST NO. 51, at 320 (James Madison). While I acknowledge the descriptive force of such parallels with respect to the imposition of internal procedural checks on power, I nevertheless believe that such comparisons ought not be pushed too far—principally due to the radically differing postures and legitimacy of these institutions in articulating the social good and orienting their conduct toward it. *Cf.* Coglianese, *supra*, at 167 (arguing that the degree to which we ought to push for government-like "procedural legitimacy" in corporations is "the most important policy or normative question that lies ahead in corporate governance").

ian" principle guiding corporate governance, it appears to be that long-run firm *sustainability* is a good thing,[239] and correlatively, that excessive board or shareholder power is to be avoided. It should be observed, however, that in substance this is nothing more than a restatement of the assumption that corporate production benefits society, not an articulation of the precise ends toward which we strive or the acceptable means of getting there. We accept shareholder wealth maximization as a crude proxy for the achievement of an undefined "social good"—except when we do not.

IV. INSTITUTIONAL SHAREHOLDERS AND SOCIAL RESPONSIBILITY

A. *The Rise of Institutional Shareholders*

The picture of the public corporation set out above is stylized in its focus on retail shareholders—again, living, breathing, individual shareholders. Recent decades have, however, seen the emergence of "institutional shareholders" managing investments on behalf of others. This broad and diverse category of entities encompasses the likes of mutual funds; public, private, and union pensions; banks; insurance companies; and hedge funds. This part of the Article will assess the manner in which such market developments impact the analysis of the public corporation set out above, and particularly the degree to which they permit shareholders to assert greater authority in corporate governance—whether motivated by a conception of the social good or the shareholders' own interests.

The growth of assets under institutional management has been impressive, to say the least. Between 1995 and 2005, total assets under professional management in the United States rose from $7 trillion to $24.4 trillion.[240] According to the Investment Company Institute, as of 2005 U.S. registered investment companies alone managed $9.5 trillion in assets, of which 94% ($8.9 trillion) were in mutual funds—a figure representing about one-half of the world's mutual fund assets.[241] This represents an increase in U.S. mutual fund assets of over 60% since 1998.[242] As of 2005 there were over 15,000 investment companies, and over 500 financial intermediaries from countries around the world providing investment management services in the U.S. market.[243] According to the New York Stock

239. Hence the emphasis on board authority over the time frame for the achievement of corporate goals, the explicit endorsement of boards favoring long-term value over tender offer premia for shareholders, and so on. *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1149-54 (Del. 1990). As suggested above, I take long-term value maximization to be practically synonymous with actions aimed at firm "sustainability."

240. *See* SOC. INV. FORUM, 2005 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES iv (2006).

241. *See* INV. CO. INST., 2006 INVESTMENT COMPANY FACT BOOK 6, 12, 114 (46th ed. 2006).

242. *Id.* at 114.

243. *Id.* at 7, 9.

Exchange, by 2002 almost 50% of U.S. corporate equity securities were held by U.S. institutions—up from about 41% in 1990, 28% in 1970, and just 7% in 1950.[244] Almost one-half of U.S. households owned mutual funds in 2005, up from less than 6% in 1980.[245] U.S. retirement funds under management in 2005 totaled $14.3 trillion, of which mutual funds accounted for about 24%, with the rest under the management of pension funds, insurance companies, banks, and brokerage firms.[246] It is unsurprising, in light of such data, that indirect stock ownership by individuals has grown considerably faster than direct stock ownership.[247]

It is often suggested that the emergence of institutional investors has fundamentally altered the capital market landscape in a way that enables effective monitoring and thereby favors robust shareholder involvement in corporate governance.[248] But as a threshold matter, with respect to individual investors, observe that the growth of institutional investment actually amplifies and reinforces the dynamics discussed above. If investors are insulated from the consequences of corporate production in public corporations in which they own stock directly, then one might reasonably expect those same individuals to be even more insulated from what is going on in companies the stock of which they own only indirectly through mutual funds, pension funds, and the like. As Elhauge has observed, "they are [now] twice removed from knowledge and responsibility."[249] To the extent that indirect investing eclipses direct investing, the typical retail investor may not only not be aware of corporate actions and their own voting rights and responsibilities, but realistically may not know which companies (or industries) their money is backing—or even, according to one particularly depressing survey, which specific investment funds or accounts their money inhabits within a given institution.[250]

---

244. *See* NYSE, Inc., NYSE Fact Book, Holdings of Corporate Equities in the U.S. by Type of Institution, http://www.nysedata.com/factbook (follow "Institutional Investors" hyperlink, then follow "Holdings of corporate equities in the U.S. by type of institution" hyperlink) (last visited Apr. 28, 2008); NYSE, Inc., NYSE Fact Book, Holdings of Corporate Equities in the U.S. (end of period, $ in bils.), http://www.nysedata.com/factbook (follow "Institutional Investors" hyperlink, then follow "Holdings of corporate equities in the U.S. (end of period, $ in bils.)" hyperlink) (last visited Apr. 28, 2008).

245. *See* INV. CO. INST., *supra* note 241, at 46.

246. *Id.* at 56.

247. NYSE, Inc., NYSE Fact Book, Total Number of Sharehowners (mils.) (1989-1998), http://www.nysedata.com/factbook (follow "The Investing Public" hyperlink, then follow "Total number of shareholders (mils.) (1989-1998)" hyperlink) (last visited Apr. 28, 2008) (reporting that individuals owning stock directly only grew from 27.0% in 1989 to 33.8% in 1998, whereas individuals owning stock directly, through mutual funds, retirement savings accounts or defined pension plans grew from 52.3% to 84.0% over the same period).

248. *See, e.g.*, Allen, *supra* note 2, at 279-80; *see also* Anabtawi, *supra* note 115, at 573-74; William T. Allen, *Modern Corporate Governance and the Erosion of the Business Judgment Rule in Delaware Corporate Law* 9 (Comparative Research in Law & Political Economy Research Paper 06/2008, 2008), *available at* http://ssrn.com/abstract=1105591.

249. Elhauge, *supra* note 18, at 817.

250. *See* Memorandum from Greenberg Quinlan Rosner Research to Interested Parties regarding

Moreover, the insertion of an additional layer of fiduciaries into the equation can itself reinforce this distancing of retail investors from corporate realities, particularly in light of diversification goals. Historically, "institutional investors have focused on major issues in corporate governance and strategic direction and have avoided social issues," a tendency "dictated both by a fiduciary duty to increase bottom-line value for the funds' beneficiaries and by the difficulty of articulating a position on social issues" adequately representing the interests of a heterogeneous pool of beneficiaries.[251] These tendencies are greatly enhanced by modern portfolio theory's push to reduce firm-specific risks through diversification. Indeed the very purpose of mutual funds is to permit small investors to diversify,[252] and the Employee Retirement Income Security Act (ERISA) explicitly requires diversification of plan assets as a component of fiduciary duty.[253] Easterbrook and Fischel argue that investors ought not even care about the return from an individual corporation because diversification (e.g., through mutual funds) offers the opportunity for a portfolio representing "an investment in the economy as a whole," which in turn should lead investors to favor "whatever social or private governance rules maximize the value of all firms together"[254]—a logic provoking some concern about greater divergence between the interests of equity investors and other corporate stakeholders, as diversification augments risk tolerance of the former with respect to any single company.[255]

Thus there are good reasons to doubt that the greater prominence of institutional investors would, in and of itself, counteract the negative impacts of the corporate structure on investors' moral and social engagement. That said, however, the rise of institutions has been accompanied by the emergence of two trends perhaps justifying some optimism on the part

---

Socially Responsible Investing (SRI): An Understanding of How SRI is Viewed by TIAA-CREF Participants 4 (July 13, 2006), *available at* http://www.greenbergresearch.com/articles/1709/2082_SRI071306m.pdf (reporting survey results showing that 25% of CREF Social Choice Account participants "either do not know or deny that they have a CREF SCA account in the first place").

251. BOATRIGHT, *supra* note 172, at 116. Holders of mutual fund shares possess limited voting rights and are the beneficiaries of fiduciary duties. *See* INV. CO. INST., *supra* note 241, at 122; *see also* 15 U.S.C. § 80a-16(a) (2000) (regarding annual election of directors of registered investment company by holders of voting securities); *id.* § 80a-13(a) (requiring vote of securities holders, among other things, to change subclassification of registered investment company from "diversified" to "non-diversified" or to alter policies enumerated as "fundamental" in the registration statement pursuant to 15 U.S.C. § 80a-8(b)(3)); *id.* § 80a-35 (regarding civil actions for breach of fiduciary duty by investment advisers); *cf.* 29 *id.* § 1104 (establishing fiduciary duty standards in the retirement plan context).

252. *See* INV. CO. INST., *supra* note 241, at 116, 120, 123; *see also* 15 U.S.C. § 80a-12(d); *id.* § 80a-5(b). Note also that mutual funds can lose favorable "pass-through" tax treatment under the Internal Revenue Code if, among other things, they fail to meet "various investment diversification standards." INV. CO. INST., *supra* note 241, at 126 (internal quotation marks omitted).

253. *See* 29 U.S.C. § 1104(a)(1)(C).

254. EASTERBROOK & FISCHEL, *supra* note 45, at 29; *see also* Mitchell, *supra* note 25, at 1575.

255. *See, e.g.*, Orts, *supra* note 13, at 1588-89 (querying "whether this kind of increased risk-taking is desirable from a broader social perspective").

of those troubled by corporate law's fundamental ambivalence: "socially responsible investing," and "institutional activism," to which I now turn.

B. Socially Responsible Investing

It has been argued—from at least Brandeis' time to our own—that investors in public corporations have a moral obligation to ensure the consistency of corporate production with their values by virtue of the fact that they voluntarily enter investment relationships and accept benefits flowing from them.[256] "Socially responsible investing" (SRI) is an important reflection of this view.[257] Although dating back at least to the nineteenth century when religious groups "began screening their investments for activities they considered sinful," SRI became more common in the 1960s as a reflection of "growing opposition to the Vietnam War," and gathered momentum in the 1980s with the effort to avoid investment in companies operating in South Africa.[258] With the end of South African apartheid in 1993 some thought SRI might decline, but by 1997 SRI assets had reached $529 billion, and by 1999 had almost tripled to about $1.5 trillion.[259] By 2005, according to the Social Investment Forum, total U.S. investment assets upon which social concerns were brought to bear stood at approximately $2.3 trillion, with $1.685 trillion of that total taking the form of social screening (as opposed to shareholder advocacy or community investing). Socially screened accounts of institutional clients accounted for about $1.49 trillion of screened assets, with over 80% of those dollars representing public pensions.[260]

The term "SRI" is typically used to describe bringing both financial and ethical considerations to bear on investment decisions,[261] and as the data above indicate, works principally through screening out certain companies engaged in specified industries—so-called "sin stocks," such as tobacco, alcohol, and gambling—or that are deemed to have bad records in specified issue areas, such as labor relations and the environment.[262] In so far as the screens and evaluative principles used can differ substantially, the definition of SRI can vary quite widely in practice.[263]

---

256. *See, e.g.*, BRANDEIS, *supra* note 21, at 75; Lee, *supra* note 94, at 52.

257. *See* Knoll, *supra* note 65, at 682-83.

258. *Id.* at 684-85.

259. *Id.* at 685-86.

260. SOC. INV. FORUM, *supra* note 240, at iv-v, 1, 11-12.

261. *See id.* at 2; *see also* Knoll, *supra* note 65, at 689. In this Article I treat socially screened investment and shareholder activism separately to highlight the differing issues involved.

262. *See* SOC. INV. FORUM, *supra* note 240, at 7-8.

263. *See, e.g.*, BOATRIGHT, *supra* note 172, at 108-09; Robert Heinkel, Alan Kraus & Josef Zechner, *The Effect of Green Investment on Corporate Behavior*, 36 J. FIN. & QUANTITATIVE ANALYSIS 431, 431-32 (2001); Knoll, *supra* note 65, at 690.

The CREF "Social Choice Account" provides a useful (and to the academic reader, particularly relevant) example. As of March 2006, the account had "grown into the world's largest social screened investment fund for individual investors," exceeding $8 billion in assets.[264] The account's investment objective is a "favorable long-term rate of return that reflects the investment performance of the financial markets while giving special consideration to certain social criteria."[265] More specifically, for the roughly 60% of the account invested in equities, the "domestic equity portion attempts to track the return of the U.S. stock market as represented by the Russell 3000® Index," and the "foreign equity portion . . . attempts to track the return of developed foreign markets as represented by the MSCI EAFE® + Canada Index," but generally the account limits its investments to companies meeting specified social criteria.[266] Companies "currently excluded" include those deriving "any" revenues (or in some cases, "significant" revenues) from tobacco, alcohol, gambling, firearms/ammunition, military weaponry, and nuclear power.[267] Companies passing these screens, then, are "evaluated for their records in certain qualitative areas" including product safety, labor relations, human rights, corporate citizenship, corporate governance, environmental performance, and diversity.[268] Those investors who bother to read the prospectus are warned, however, that the social criteria are "non-fundamental investment policies," meaning that no vote of account participants would be required to change them.[269] Additionally, due to the exclusions, other holdings have to be adjusted in order to track the indexes. In light of such restrictions, one might intuitively predict significant high tech investments, and the account's top ten holdings as of March 2008 would appear consistent with that.[270]

The principal means by which it is hoped SRI may affect corporate conduct is downward stock price pressure,[271] and the optimistic detect

264. Press Release, TIAA-CREF, TIAA-CREF Forms New Social & Community Investing Department (May 30, 2006), *available at* http://www.tiaa-cref.org/about/press/about_us/releases/pressrelease177.html; *see also* TIAA-CREF, Retirement Annuity Accounts, CREF Social Choice Account (Mar. 31, 2008) (on file with the Alabama Law Review) [hereinafter TIAA-CREF, Social Choice Account] (reporting net assets of $8.71 billion as of March 31, 2008).

265. TIAA-CREF, PROSPECTUS, COLLEGE RETIREMENT EQUITIES FUND: INDIVIDUAL, GROUP AND TAX-DEFERRED VARIABLE ANNUITIES 27 (May 1, 2008) (on file with the Alabama Law Review).

266. *Id.* at 27-28.

267. *Id.* at 28.

268. *Id.* at 28-29.

269. *Id.* at 27; *see also* 15 U.S.C. § 80a-13(a) (2000) (requiring vote of securities holders, among other things, to alter policies enumerated as "fundamental" in the registration statement pursuant to 15 U.S.C. § 80a-8(b)(3)).

270. *See* TIAA-CREF, Social Choice Account, *supra* note 264. Note, however, that while the top ten holdings include Microsoft and AT&T, excluded stocks include Yahoo! Inc. *Id.*

271. *See, e.g.*, Heinkel, Kraus & Zechner, *supra* note 263, at 438; Knoll, *supra* note 65, at 702-04.

positive signs. Again, U.S. assets upon which social concerns were brought to bear in 2005 totaled $2.3 trillion, of which $1.685 trillion were socially screened—a lot of money, to be sure—and these assets have grown at a rate exceeding that of managed assets overall.[272] Moreover, SRI funds and accounts appear to stack up relatively well in terms of investment return. According to the Social Investment Forum, "when properly managed, risk-adjusted, and controlled for investment style, socially screened portfolios perform comparably to their unscreened peers."[273] Studies suggest that their "performance is, on the whole, no better and no worse than comparable stock portfolios."[274]

Notwithstanding such growth, however, SRI assets remain small relative to the enormity of U.S. capital markets. These assets represent about 9% of assets under professional management in the United States,[275] and studies indicate that there is little reason to think that they can affect corporate conduct through stock price pressure. The problem is simply that as fast as SRI investors can screen out a given stock, which would tend to push its price downward, non-SRI investors recognize that the stock in question is underpriced relative solely to expected returns and step in to buy—keeping the stock price where it was to begin with, thereby insulating boards from any substantial equity market pressure to alter their conduct.[276] This will remain the case "as long as the very large majority of investors in the market are 'socially indifferent.'"[277] It is thought that the number of investors interested in SRI would have to increase dramatically to affect corporate conduct through stock price pressure.[278] The growth of

272. *See* SOC. INV. FORUM, *supra* note 240, at iv; *see also* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1267-68 (1999) (observing the growth in interest in SRI since the 1970s).

273. *See* SOC. INV. FORUM, *supra* note 240, at 14.

274. BOATRIGHT, *supra* note 172, at 110; *see also* J. David Diltz, *The Private Cost of Socially Responsible Investing*, 5 APPLIED FIN. ECON. 69, 69 (1995) (finding that "ethical screening of firms has little impact on portfolio returns"); Heinkel, Kraus & Zechner, *supra* note 263, at 446 (citing studies finding "little difference" in the "stock market performance of green and neutral mutual funds"); Knoll, *supra* note 65, at 694-700 (arguing that while SRI does not reduce returns, it does increase risk by sacrificing diversification, though acknowledging that most of the benefits of diversification can be had with a relatively small number of stocks). *But see* Jeff Brown, *Investing With Your Conscience Has Its Rewards but May Affect Your Bottom Line*, WASH. POST, May 13, 2007, at F01 (citing data indicating that SRI funds "generally trail traditional competitors," but that the differential is less for SRI indexes). During the 1990s it appeared that SRI funds might even surpass their peers in performance, but following the tech boom and bust it became clear that this reflected relative weightings of tech stocks. *See* Knoll, *supra* note 65, at 699; Meir Statman, *Socially Responsible Indexes*, 32 J. PORTFOLIO MGMT. 100 (2006).

275. SOC. INV. FORUM, *supra* note 240, at 1.

276. *See, e.g.*, Siew Hong Teoh, Ivo Welch & C. Paul Wazzan, *The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott*, 72 J. BUS. 35 (1999); *see also* Elhauge, *supra* note 18, at 817-18; Knoll, *supra* note 65, at 707-10.

277. Lee, *supra* note 94, at 61 n.217.

278. Heinkel, Kraus & Zechner, *supra* note 263, at 445-47. Note that although investing in "clean energy" has picked up and prominent investment banks have issued "fat global-warming reports looking at stocks and industries likely to gain or lose," these and similar developments are generally unre-

funds like CREF's Social Choice Account may itself inspire optimism, though a recent survey indicates that even those who already participate are not terribly well informed; 25% of CREF Social Choice Account participants surveyed, for example, "either do not know or deny that they have a CREF SCA account in the first place," a finding contributing to the conclusion that "[e]ducation is the biggest challenge facing efforts to increase the investments in and commitment to socially responsible investing."[279] Meanwhile, the one constant remains that virtually everyone understands and prioritizes financial return.[280]

Such factors may help explain why socially screened assets have actually declined from $2.143 trillion in 2003 to $1.685 trillion in 2005, with socially screened separate accounts declining from $1.992 trillion to $1.506 trillion. According to the Social Investment Forum, while screened mutual fund assets have increased, these are dwarfed by screened separate account assets—again, mostly institutional—which have decreased "as single issue screening has waned and shareholder advocacy increased on the part of institutional investors."[281] The Social Investment Forum further notes that shareholder activism (of which more below), "whether through the proxy process or in direct dialogue with companies, produced tangible changes in corporate policies and practices"[282]—something that the studies above would tend to indicate could not be expected of socially screened investments (at least in the near term).

These trends do not prove, or even suggest, however, that SRI is entirely ineffective or without consequence. First, the very fact of public disapproval of certain forms of corporate activity, signaled through social screening of investments, could have some impact as part of a broader publicity campaign.[283] And second, there is clearly nothing wrong with—

---

lated to SRI as such. As one observer put it, "[y]ou go green by choice, to reflect your values. But there's nothing optional about global warming and what it might do to the bottom line." Jane Bryant Quinn, *How to Make a Buck Green*, NEWSWEEK, Apr. 23, 2007, at 63.

279. Greenberg Quinlan Rosner Research, *supra* note 250, at 4, 15.

280. *Id.* at 3 (reporting that 92% of Social Choice Account participants and 95% of non-participants surveyed agreed with the statement "My first priority in making investments is to have a secure retirement," and that 85% of participants and 91% of non-participants agreed with the statement "When making investment decisions, financial return is most important to me"); *cf.* INV. CO. INST., *supra* note 241, at 53 (observing that, "[r]eflecting the importance of performance in shaping shareholder opinion, mutual fund favorability rises and falls with stock market performance").

281. SOC. INV. FORUM, *supra* note 240, at v, fig.B, n.1.

282. *Id.* at v; *see also id.* at 11-12; *cf.* U.N. ENV'T PROGRAMME FIN. INITIATIVE & U.N. GLOBAL COMPACT, PRINCIPLES FOR RESPONSIBLE INVESTMENT 6 (2006) (initiating a worldwide, voluntary, principles-based approach "suggest[ing] a policy of engagement with companies rather than screening or avoiding stocks"—an approach "designed for large investors that are highly diversified and have large stakes in companies, often making divestment or avoidance impractical"); Press Release, U.N. Env't Programme Fin. Initiative & U.N. Global Compact, Principles for Responsible Investment Hit $8 Trillion Mark On First Year Anniversary (Apr. 29, 2007).

283. *See, e.g.*, SOC. INV. FORUM, *supra* note 240, at 15; *see also* Ribstein, *supra* note 103, at 1448-49; Williams, *supra* note 272, at 1293-96 (arguing that while "it seems unlikely that social investment per se will be able to influence" corporate conduct via stock price pressure, enhanced social

and per the analysis above, much that is admirable about—investors seeking to bring their investment behavior into focus with their own values. Indeed, there is reason to believe that this is in fact the principal impetus behind social screening of investments,[284] and this aim remains entirely legitimate regardless of the near-term prospects for social screening to impact corporate conduct directly via downward pressure on stock price.

C. *Institutional Activism*

Although institutional investors, with larger holdings and dedicated research staffs, would appear to offer a form of solution to the collective action problems that plague retail investors, historically institutions have remained relatively inactive themselves. Indeed, if anything, many institutions have strong incentives to cozy up to corporate management to maintain other lucrative business relationships—be they commercial lending relationships, insurance relationships, or pension management relationships. Banks, insurance companies, mutual funds, and private pension funds, then, are generally not well positioned to challenge management of public corporations.[285]

Consequently, most "activism" as such comes from union pension funds, public pension funds, and hedge funds—each of which typically has a distinct agenda, raising concerns about their relative capacities to bring broadly held shareholder concerns to bear on corporate decision-making. Union pension fund activism, not surprisingly, has sought to advance labor interests, and public pension fund activism, again not surprisingly, has been associated with the political goals of state officials pulling the strings.[286] Giving rise to far greater concerns, however, are hedge funds, which (like mutual funds) tend to have a distinctly short-term focus on maximization of current share price. Unlike insurance companies and pen-

---

disclosures "could act as an impetus for management to reduce those impacts that shareholders could interpret as negative").

284. *See, e.g.*, SOC. INV. FORUM, *supra* note 240, at 15 ("Socially screened mutual funds have experienced impressive asset growth, driven largely by individual investors who have discovered the power and relative ease of aligning their investments with their values."); Brown, *supra* note 274.

285. *See* Bainbridge, *supra* note 51, at 631 n.80; *see also* Bebchuk, *supra* note 74, at 706 (observing the "pro-incumbent bias of mutual funds that have a significant interest in obtaining business from public companies"). *But see* Kaja Whitehouse, *A Changing Story: How Funds Vote*, WALL ST. J., May 7, 2007, at R5 (reporting that mutual funds are devoting greater resources to proxy voting).

286. *See* Anabtawi, *supra* note 115, at 588-90; Bainbridge, *supra* note 51, at 634 n.88. One recent study concluded that "when a firm's main unionized employees change affiliation from the AFL-CIO to a different labor organization, the AFL-CIO funds become significantly more supportive of the firm's directors in subsequent board elections." Ashwini K. Agrawal, *Corporate Governance Objectives of Labor Union Shareholders: Evidence from Proxy Voting* 3 (working paper, Mar. 10, 2008), *available at* http://home.uchicago.edu/~aagrawal/AGRAWAL_paper.pdf. "The change in the AFL-CIO funds' voting behavior coupled with the lack of a similar response by other institutional investors suggests that firm-union labor relations have a causal effect on the director votes cast by the AFL-CIO funds." *Id.* at 4.

sion funds, which "are less concerned with quarterly or annual performance" and thus amenable to corporate plans and expenditures bringing longer-term benefits, hedge funds generally focus narrowly on short-term stock prices and have very high portfolio turnover rates.[287]

This has led many to oppose calls for reforming the shareholder franchise to enhance shareholders' ability to elect and remove directors of public corporations for fear that hedge funds will run roughshod over the concerns of non-shareholders and other shareholders alike. The credit rating agency Moody's, for example, has indicated that hedge fund activism would generally hurt a given corporation's credit rating, an unsurprising conclusion given the inclination of hedge funds to urge additional debt upon companies in order to facilitate greater short-term payouts to shareholders, hurting existing creditors by raising debt-to-equity ratios, thereby increasing the risk of default.[288] Some have argued that hedge funds could bring about beneficial governance changes,[289] but Moody's evidently concluded that for creditors, the negatives of hedge fund activism outweigh the positives.[290] Others have likewise observed that the short-term focus of hedge funds conflicts with the longer-term focus and interests of individual investors (often saving for the education of their children and their own retirement), managers, and labor alike, and queried whether empowering this short-term focus is really best for the corporate enterprise as a whole.[291]

---

287. *See* Anabtawi, *supra* note 115, at 579-81. Short-term pressures on mutual funds are attributable primarily to the liquidity they offer investors coupled with "widespread availability of information on fund performance," whereas for hedge funds such pressures are attributable primarily to their generally limited duration and on-going capital needs. *See id.* at 580.

There is "no precise legal or universally accepted definition" of a hedge fund, but the term generally refers to investment pools that are limited to a small number of relatively sophisticated investors, and thus avoid disclosure obligations and SEC examination under federal securities laws. Consequently, while their advisers remain subject to antifraud provisions of the securities laws, the SEC possesses relatively little information about them. Their advisers are typically compensated based on capital gains and appreciation, and generally retain substantial flexibility to alter investment strategies and "broad discretion in valuing the hedge fund's assets"—a source of concern for the SEC, given that "registered funds that invest their assets in hedge funds may lack access to information that enables them to 'fair value' their interests in hedge funds and therefore accurately calculate their net asset value." As of September 2003 there were thought to be 6,000—7,000 hedge funds active in the United States, managing assets of $600—$650 billion, though it was predicted that managed assets would "exceed $1 trillion" within five to ten years. *See* SEC, IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS vii-xi (2003), *available at* http://www.sec.gov/news/studies/hedgefunds0903.pdf.

288. *See* James Mackintosh, *Markets and Investing: Moody's Labels Activists a Threat to Credit Quality*, FIN. TIMES, June 13, 2007.

289. *See, e.g.*, Ribstein, *supra* note 103, at 1476-77. One practicing corporate lawyer backhandedly agreed, bemoaning hedge funds' facilitation of hostile takeovers, but advocating a remedy involving development and communication of "the best possible strategic plan to increase long-term value for shareholders"—which he concedes "companies should be doing . . . as a business matter anyhow." Schnell, *supra* note 103, at S1, S4-S5.

290. *See* Mackintosh, *supra* note 288.

291. Strine, *supra* note 213, at 5, 7; *see also* Anabtawi, *supra* note 115, at 583; Schnell, *supra* note 103, at S1, S4; Stout, *supra* note 92, at 794-95.

In evaluating all of this, however—and notably its impact on the analysis of the public corporation set out above—it is important to examine the actual mechanisms by which activist shareholders, like pension funds and hedge funds, bring pressure to bear on corporate management. Indeed, that management pay attention to the activists at all is perhaps curious in light of the fact that activists typically do not take majority stakes[292] and that shareholder proposals virtually never garner many votes at the ballot box.[293] The real power of activist shareholders would appear to lie in publicity, and the indirect benefits this brings them in influencing management. As the Social Investment Forum has observed, "[u]nlike in electoral politics, success in proxy voting is not measured solely through winning a majority vote."[294] Particularly in light of rational apathy and the tendency of some institutions "automatically [to] vote with management on shareholder proposals," management may interpret "even modest support for shareholder resolutions" as indicative of "genuine interest among shareholders, stakeholders, the public and the press," which "is often enough to compel management to enter into dialogue and to consider changing its practices and policies."[295] Indeed, for these reasons, many proposals can simply be withdrawn before any vote is even held.[296] Independent directors—upon whom we place increased regulatory reliance in the post-Enron world,[297] and who "derive important elements of their net worth from board service"—are particularly susceptible to activist pressure to give in to their demands in order to avoid a damaging "withhold authority" campaign in the next board election.[298]

As observed above, the use of ethical screens by "socially responsible investors" has fallen over recent years "as single issue screening has waned and shareholder advocacy increased on the part of institutional investors."[299] The Social Investment Forum attributes this development in part to convergence of the interests of "socially responsible investors" and "more traditional corporate-governance advocates," as "major institutional investors" like public pension funds "have increasingly come to recognize the potential impact of social, environmental, and ethical issues on long-term shareholder value."[300] As described above, however, empowerment of and activism by long-term oriented investors cannot easily be had without simultaneously empowering those ruthlessly focused on the short-term;

292. *See* Schnell, *supra* note 103, at S4.
293. *See* Lee, *supra* note 94, at 63.
294. SOC. INV. FORUM, *supra* note 240, at 18.
295. *Id.* at 18; *see also supra* note 103 and accompanying text (observing that some anticipate a reinvigoration of the market for corporate control due to increasing institutional activism).
296. SOC. INV. FORUM, *supra* note 240, at 21-22.
297. Bruner, *supra* note 143, at 1131-32.
298. Strine, *supra* note 213, at 8, 11-12.
299. SOC. INV. FORUM, *supra* note 240, at v, fig.B, n.1, 11-12.
300. *Id.* at 16.

after all, they are all shareholders, and as such this is a setting in which the sun truly shines, and the rain falls, on the good and the bad alike.

To return, then, to the issue with which this part of the Article is concerned: it would appear that, to date, the rise of institutional shareholders has not greatly increased the likelihood that individual retail investors will bring their own conceptions of the social good to bear on corporate management (via socially responsible investing), but has enhanced certain institutions' ability to pursue their own interests by boosting short-term returns (via institutional activism).[301] In this light, the rise of institutional shareholders has only reinforced the dynamics discussed above and heightened the stakes of the corporate governance debate.

V. SHAREHOLDERS' BYLAW POWER AND THE FUTURE OF CORPORATE LAW

The analysis presented above suggests that corporate law, for lack of a single animating vision of the social good, has refrained from articulating a clear hierarchy of beneficiaries of corporate production or fully endorsing the claims to corporate governance authority and legitimacy of either of its principal power constituencies. I conclude by observing briefly that corporate law's fundamental ambivalence ought to affect how we think about current doctrinal debates reflecting such dynamics—notably the debate over the scope of shareholders' bylaw authority, which brings corporate law's ambivalence to the foreground and cuts to the very heart of corporate governance.

The corporate governance debate has seen various proposals for reform arise over recent years—many requiring relatively fundamental changes to the statutory default rules governing the shareholder franchise.[302] The dynamics discussed in this Article suggest that the prospects for such reform are doubtful—at least in Delaware—and that the risks posed by excessively tilting the playing field to the benefit of short-term investors like hedge funds are very real. Recall that the ambivalence of Delaware corporate law is, first and foremost, a reflection of the fact that the legislature itself has never clearly established the primacy of either power constituency or any particular hierarchy of beneficiaries. I have argued that this state of affairs is inevitable given the complexities of public corporations. But in any event, as has long been recognized, the Delaware legislature has traditionally remained very cautious indeed when it

301. *See* Allen, *supra* note 2, at 279-80 (associating institutional investors with a push for shareholder-centric corporate governance).

302. *See, e.g.*, Allen, Jacobs & Strine, *supra* note 2, at 1097-1100 (floating a "thought experiment" involving triennial board elections to insulate directors from short-term pressures in exchange for "opening up the company's proxy machinery to all nominees having the support of a significant block of stock"); Bebchuk, *supra* note 74, at 694-711 (advocating various reforms along these lines).

comes to fundamental reform.[303] Thus in the near term we are likely left with the *status quo*—which, by the way, may not be such a bad thing. Former Chief Justice of the Delaware Supreme Court Norman Veasey, for example, observing that neither the shareholder-centrists nor the board-centrists are "fully satisfied" with the present state of the doctrine, has suggested that perhaps this means something approximating an appropriate balance has been struck. "Maybe that is good," he suggests, "like a settlement where there are no clear-cut winners or losers."[304] It would appear that shareholder advocates (particularly following Enron and other scandals) fear shirking and the extraction of private benefits by boards just as much as board advocates (and other corporate stakeholders, including long-term investors) fear increasingly potent hedge fund activism aimed at maximizing short-term returns.[305] Each power constituency believing the other is too powerful may itself simply be an inevitable reflection of corporate law's fundamental ambivalence—which, in the current political environment, has taken the form of a high degree of distrust of both agendas.[306] This is particularly likely to remain the case to the extent that we

303. *See, e.g.*, Lewis S. Black, Jr., *A National Law of Takeovers Evolves in Delaware*, LEGAL TIMES, Nov. 25, 1985, at 6 ("The national prominence of its corporation law is a source of pride (and revenue) to Delaware, and Delaware lawyers, judges, and legislators work to maintain the law's importance. The Delaware legislature considers proposed improvements from lawyers all over the country. The statute is fine-tuned frequently, but its clarity and predictability are carefully guarded. Major changes in direction are rare."); *see also* Veasey, *supra* note 209, at 1016 (observing that "as far as Delaware legislative activity is concerned, the general assembly is usually in a minimalist mode" in the area of takeovers, "largely because the Delaware Bar (consisting of advocates for both stockholders and directors) is in that mode").

304. Veasey, *supra* note 209, at 1015; *see also id.* at 1011-12 (taking the view of Delaware's takeover jurisprudence that Winston Churchill took of democracy—i.e., that it "may be inadequate—except when compared to all the alternatives"); *cf.* Schnell, *supra* note 103, at S1, S4-S5 (arguing that the best way for corporate boards and management to resist hedge fund pressures is to articulate compelling long-term business plans early and often). An interesting reflection of the dynamic identified by Veasey emerged out of an exchange between scholar J. Robert Brown, who wrote a blog post highlighting the five decisions from 2007 "that most show the anti-shareholder, anti-plaintiff nature of the Delaware courts," and Delaware practitioner Francis G.X. Pileggi, who responded with a blog post highlighting five decisions "that demonstrate that the Delaware courts take shareholder rights and the duties of directors very seriously." *Compare* J. Robert Brown, *Delaware's Top Five Worst Shareholder Decisions of 2007*, THERACETOTHEBOTTOM.ORG, Jan. 3, 2008, http://www.theracetothebottom.org/preemption-of-delaware-law/delawares-top-five-worst-shareholder-decisions-of-2007.html, *with* Francis G.X. Pileggi, *In Defense of Delaware Corporate Law Opinions*, DELAWARE CORPORATE AND COMMERCIAL LITIGATION BLOG, Jan. 4, 2008, http://www.delawarelitigation.com/2008/01/articles/chancery-court-updates/in-defense-of-delaware-corporate-law-opinions/index.html.

305. *Compare* Bebchuk, *supra* note 74, at 678-82, *with* Schnell, *supra* note 103, at S1, S4-S5, Anabtawi, *supra* note 115, at 579-83, 590-92, *and* Stout, *supra* note 92, at 794-95.

306. *See, e.g.*, Schnell, *supra* note 103, at S1 (bemoaning the perils of hedge fund activism, though acknowledging that their impact "may have a lot to do with one of the legacies of the Enron era of corporate scandals: the development of an environment in which directors and officers operate under a glare of skepticism, scrutiny and criticism from all directions, including shareholders, analysts, the media, courts and Congress"). *Cf.* Allen, *supra* note 248, at 17-18 (characterizing the contemporary corporate governance debate as "a contest" between corporate management and institutional investors "for the trust of the men and women of the country who have accumulated savings," and concluding

remain unable to predict and preemptively address whatever the next innovation by boards or shareholders may be to consolidate their own power and pursue private advantage vis-à-vis the corporation as a whole.

With respect to the scope of shareholders' bylaw authority, however, the nature of the issue differs markedly. The reality is that § 109 already appears in the DGCL; this is not a question of reform, but of interpreting and implementing a statutory structure the Delaware legislature has already put in place.[307] As discussed above, the statute thus tees up a perfect collision between § 141's grant of authority to the board to manage the "business and affairs" of the corporation and § 109's grant of authority to the shareholders to unilaterally adopt bylaws "relating to the business of the corporation" and "the conduct of its affairs"—one that the courts will inevitably have to sort out.[308]

This is an issue of enormous significance—both theoretically and practically—as bylaws "are about the only way that shareholders can initiate binding actions in corporate policy."[309] Although a full airing of the issues lies well beyond the scope of this Article, I would observe that the analysis of corporate law's fundamental ambivalence provided above strongly supports what I think can fairly be called moderate interpretations of § 109's scope, such as that advanced by Brett McDonnell.[310] As McDonnell succinctly observes, there are three possible readings of the two provisions' interaction.[311] Either (1) § 141 always beats § 109, precluding bylaws from treading in any way upon the board's governance authority; (2) § 109 always beats § 141, in which case the shareholders' ability to carve back *unilaterally*[312] at the board's governance authority knows no bounds; or (3) "one can split the difference so that section 109(b) does allow for some limitations on matters that otherwise would be subject to board authority, but section 141(a) limits how far such bylaw provisions can go."[313] McDonnell cites as principal support for the third reading (among other things) the canon of statutory construction that "we should read different

that "some balance of power" is desirable); Johnson, *supra* note 160, at 906-07 (arguing that non-shareholder constituencies' interests do not fit comfortably into the "binary world of corporate doctrine" in which shareholders and managers remain "the only two mainstays in the corporate-law world").

307. *See* Brett H. McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills*, 3 BERKELEY BUS. L.J. 205, 207 (2005) (observing that this basic collision of board and shareholder authority appears in every state's statute).

308. DEL. CODE ANN. tit. 8, §§ 109(a), 141(a) (2001).

309. McDonnell, *supra* note 307, at 210.

310. *See id.* at 263-64 ("[A]n expansive, although not unlimited, shareholder power to enact bylaws is both plausible under Delaware's statutory scheme and desirable as a policy matter.").

311. *Id.* at 214.

312. Recall that while shareholders can unilaterally adopt bylaws under § 109, amendments to the certificate of incorporation under § 242(b) must be proposed by the board and approved by shareholders.

313. McDonnell, *supra* note 307, at 214.

statutes together harmoniously, such that effect is given to all provisions"[314]—an eminently sensible approach ensuring that each of §§ 141 and 109 actually means something in reality. I would emphasize, however, that such a reading is substantially strengthened by the analysis of corporate law's larger structure provided above, indicating that corporate law in its essence reflects our historical unwillingness to grant complete control over the wheels of corporate governance to either power constituency alone—as either of the alternative modes of reading the statute would tend to do.

Commentators have voiced radically different views on the matter. Indeed, "[m]ost of the leading Delaware firms have opined that a mandatory bylaw would constitute an invalid intrusion by the shareholders into the realm protected by § 141(a),"[315] and Lawrence Hamermesh has argued that "it is preferable to read section 141(a) as an absolute preclusion against by-law limits on director management authority, in the absence of explicit statutory authority for such limits outside of section 109(b)"—notably to avoid the thorny judicial line-drawing problems that otherwise inevitably arise.[316] Yet even the most elemental issues regarding the relationship between §§ 141 and 109 remain to be settled by Delaware's courts.[317] From a practical standpoint, the most important questions relate to bylaws restricting the boards' powers with respect to poison pills, and bylaws mandating that shareholder nominees for board positions be included in the corporation's proxy materials under specific circumstances (notably where the shareholder meets certain ownership criteria). McDon-

314. *Id.*

315. ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 17, at 623; *see also The Bebchuk Bylaw: Devilish . . . but brilliant* [hereinafter *Bebchuk Bylaw*], 6:10 M&A J. 1, 4-8 (2006).

316. Hamermesh, *supra* note 200, at 444. As a matter of statutory interpretation, Hamermesh argues that "[w]hen section 141(a) refers to limitations on board authority 'provided in this chapter,' it does not refer to all by-laws that could conceivably be adopted pursuant to the general authority conferred by section 109(b)," but rather "is more naturally read to refer to statutes which address its specific subject matter—the allocation of managerial power to the board of directors—and which clearly and explicitly depart from that allocation by providing for management by persons other than directors." *Id.* at 430-31.

317. In July 2008, as this Article went to press, the Delaware Supreme Court issued an opinion addressing two questions of law on certification from the U.S. Securities and Exchange Commission (pursuant to a provision of the Delaware Constitution permitting such certification): (1) whether a proposed bylaw requiring reimbursement of proxy expenses under certain circumstances was "a proper subject for action by shareholders," and (2) whether the bylaw, if adopted, would cause the corporation, CA, "to violate any Delaware law to which it is subject." CA, Inc. v. AFSCME Employees Pension Plan, No. 329, 2008 at 2-4 (Del. July 17, 2008). The court rejected the notion that "*any* bylaw that in *any* respect might be viewed as limiting or restricting the power of the board of directors automatically falls outside the scope of permissible bylaws," and found that while there is no "bright line" indicating which bylaws may be unilaterally adopted by shareholders, the bylaw at issue was sufficiently focused on procedure to be a proper subject for shareholder action. *Id.* at 10-18. On the second question, however, the court found that the bylaw would cause CA to violate Delaware law because it could force the board to reimburse proxy expenses in violation of the board's fiduciary duties (e.g. "where the proxy contest is motivated by personal or petty concerns, or to promote interests that do not further, or are adverse to, those of the corporation"). *Id.* at 18-24.

nell argues that both should be permitted, though he concedes that proxy access bylaws are the more straightforward in that, among other things, no statutory provisions explicitly address proxy access, whereas the DGCL explicitly places the regulation of stock rights (the mechanism of the poison pill) within the certificate of incorporation.[318]

To date, these questions have yet to reach the Delaware courts in a justiciable form, but some clues regarding the courts' potential views nevertheless have emerged. In 2006 Lucian Bebchuk sought a declaratory judgment regarding the validity of a bylaw he proposed as shareholder of CA, Inc., which would have required that, in the absence of shareholder ratification, the board could adopt a poison pill or amend it to extend its term only by unanimous vote, and that the pill would automatically expire within one year of any such action.[319] The proposed bylaw could be repealed by the board, but again only by unanimous vote.[320] Because the case was "not yet ripe for consideration" (the bylaw not having been adopted by the shareholders), the court refused to rule and denied the request for declaratory relief,[321] but in so doing the court provided some tantalizing hints as to how it might assess a challenge to an enacted bylaw of this sort. Observing that its "review of the divergent authorities concerning the validity of stockholder bylaws which limit a board of director's exercise of one of its powers" showed the issue to be "fraught with tension," the court added that

> [f]rom a purely legal standpoint, it is not necessarily clear that a bylaw limiting the duration of a board-authorized rights plan to one year is either facially illegal as an unauthorized impingement upon the board's powers under the DGCL or an unreasonable intrusion into the board's exercise of its fiduciary duties.[322]

---

318. *See* McDonnell, *supra* note 307, at 223-25.

319. Bebchuk v. CA, Inc., 902 A.2d 737, 738-39 (Del. Ch. 2006).

320. *Id.* Note that under DGCL § 109(a), the board can be given the power in the certificate of incorporation (and thus by the shareholders, incidentally) to adopt, amend, and repeal bylaws as well. This raises another thorny question regarding the ability of the board to repeal shareholder-adopted bylaws aimed at curtailing the board's power. *See id.* at 743; Hamermesh, *supra* note 200, at 469-75.

321. *CA, Inc.*, 902 A.2d at 738. Ultimately the bylaw garnered 41% of the vote. ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 17, at 624.

322. *CA, Inc.*, 902 A.2d at 742-43; *cf.* UniSuper Ltd. v. News Corp., No. 1699-N, 2005 Del. Ch. LEXIS 205, at *22-33 (Del. Ch. Dec. 20, 2005) (rejecting arguments that contractual limitation of the board's ability to extend a poison pill beyond one year without shareholder approval constituted an unenforceable limitation on the board's § 141 authority or curtailment of the board's capacity to discharge its fiduciary duties). In the oral argument CA focused on the one-year limit, but did not contest the unanimity requirement in light of § 141(b)'s explicit provision for a bylaw requiring greater than a majority vote for board action. *See Bebchuk Bylaw*, *supra* note 315, at 10. Lawrence Hamermesh took the view that "[t]his is far more defensible than anything we've seen before," but that "[l]imiting the duration of the unanimously board-adopted pill to one year is where the proposal probably overreaches." *Id.* at 1, 7 (internal quotation marks omitted).

Put differently, the court appears open to the possibility that action squarely within the board's authority under the DGCL could be limited by a shareholder-enacted bylaw, though not to an unlimited degree[323]—signaling a desire to pursue a balanced approach ensuring that both §§ 141 and 109 can be brought to bear on the "business" and "affairs" of the corporation.[324]

Stephen Bainbridge has likened the search for "pure" theories of corporate governance to the search for a "unified field theory" in physics, and concluded that physicists' failure to identify any such theory "provides a strong cautionary tale for anyone seeking a unified field theory of social interactions among fallible humans, whose behavior is far harder to predict than is that of, say, an electron."[325] Thus even proponents of "pure" board-centric or shareholder-centric conceptions of corporate governance like Bainbridge may concede that the explanatory domain of any such theory is inevitably limited. "But so what?" he asks. "Elegant and parsimonious models are more important for economists than for lawyers. Instead, situation-specific mini-theories often are more useful for making legal decisions than a single unified theory."[326]

To be clear, my claim is not that a descriptive theory identifying a certain form of "ambivalence" as the core characteristic of corporate law permits us to predict any specific exercise of judicial line-drawing in this area. The description of corporate law's ambivalence in this Article seeks above all else to depict accurately corporate law's full complexity—a complexity that belies the sort of easy predictive correspondence between theory and future practice that might be available were any of the prevailing theories outlined above more descriptively compelling than they are. Yet, while I readily grant that "situation-specific mini-theories" may "often"

---

323. *See Bebchuk Bylaw*, *supra* note 315, at 14. Note that the court also emphasized the importance of the specific "factual context" of a given case, and added that "[h]ere, it is useful to remember, the proposed bylaw would allow the CA board to amend or repeal it by a unanimous vote." *CA, Inc.*, 902 A.2d at 742-43. Jeffrey Gordon has argued that the line should be drawn between bylaws reflecting shareholders' "residual" governance authority, which ought to be permitted, and those interfering with "discrete business decision[s]," which ought not to be permitted. Gordon, *supra* note 81, at 549-50 (arguing that shareholders should be permitted to adopt bylaws that "establish a shareholder mechanism as a precondition for the effectiveness of a pill, or for the amendment, repeal or waiver of an already existing pill"; that "forbid the creation of a pill altogether, or limit its possible terms . . . or prescribe conditions under which a pill could be implemented"; and that "force redemption of an already existing poison pill or amendment of its terms, except in connection with a specific transaction"). *See also supra* note 317.

324. *Cf. Bebchuk Bylaw*, *supra* note 315, at 14 (quoting an "experienced interpreter of [Delaware's] state courts," suggesting that "Delaware doesn't like bright lines," and that "when things get complicated they default back to the notion of whether it's reasonable" (internal quotation marks omitted)).

325. Bainbridge, *supra* note 116, at 1628. A unified field theory "would provide a single set of simple laws that explain the four interactions or forces that affect matter—i.e., the strong, electromagnetic, weak, and gravitational forces." *Id.*

326. Bainbridge, *supra* note 78 (responding to the SSRN working paper version of this Article).

serve, they most definitely will not serve in all instances. Crucially, the issues demanding a more holistic view of corporate law as a field will, I believe, tend to be those in which the stakes are highest. Such is the case in delineating the scope of the shareholders' bylaw authority, which—as we have seen—presents a clash of absolute and irreconcilable values at the very heart of corporate governance, with no guidance from the legislature as to how courts ought to resolve it.[327]

The upshot of my analysis is that some form of balancing of the corporation's power constituencies is inevitable if we are to remain consistent in this specific area with corporate law's larger structure—and correlatively, that the principal alternative position entirely subordinating shareholders' bylaw power to the board's management authority would sharply deviate from that larger structure. Although fundamental contours of this area of corporate law remain to be developed, there is at least some intimation that Delaware courts will remain cognizant of and consistent with corporate law's refusal to permit either power constituency entirely to dominate governance of the corporation[328]—a long-standing approach to corporate governance that I have argued is rooted in the fundamental nature and dynamics of the corporate structure itself.

VI. CONCLUSION

In assessing debates regarding the social merits of industrialism, John Stuart Mill wrote in 1840 "that the besetting danger is not so much of embracing falsehood for truth, as of mistaking part of the truth for the whole."[329] We might observe the same of contemporary corporate governance debates, which are no less complex or politically contentious.[330] Indeed, the latter are no more likely to produce broadly satisfactory resolu-

327. *Cf.* Gordon, *supra* note 81, at 547 ("The Delaware court needs a theory to explain the appropriate boundary between shareholder power and the board's authority—a theory presumably richer in normative appeal than 'management wins.'"); Thompson & Smith, *supra* note 81, at 319-23 (citing Gordon and concluding that "the plain words of the statute are too contradictory to be interpreted without employing external policy considerations").

328. It should be observed that these issues are closely bound up with issues arising under SEC Rule 14a-8, governing shareholder access to public corporations' proxy statements—notably because the rule permits management to exclude a shareholder proposal when, among other things, it is deemed "not a proper subject for action by shareholders" under state law, it "deals with a matter relating to the company's ordinary business operations," or it relates to an election. *See* 17 C.F.R. § 240.14a-8(i) (2007). For analysis of these issues, see McDonnell, *supra* note 307, at 252-64, and Bebchuk, *supra* note 74, at 707-09. For a nuanced history of the evolution of Rule 14a-8, itself reflecting ambivalence about the merits of shareholder versus board authority, see Mitchell, *supra* note 25, at 1551-60.

329. *See* WILLIAMS, *supra* note 216, at 50 (quoting Mill); *cf.* Baird & Henderson, *supra* note 172, at 1 ("Legal principles that are almost right are often more mischievous than those that are completely wrong."). For an argument that Mill himself sought to work out a "humanized utilitarianism," see WILLIAMS, *supra* note 216, at 49-70.

330. *See supra* note 213.

tions than the former because, as we have seen, the latter are themselves nothing other than reflections of the former.

Corporate law's ambivalence regarding power constituencies, regarding beneficiaries, and regarding the achievement of the social good, each reflect larger misgivings about the consistency of shareholders' interests and incentives with those of society at large. As then-Chancellor Allen suggested, "[i]t is perhaps asking too much to expect us as a people—or our law—to have a single view of the purpose of an institution so large, pervasive, and important as our public corporations."[331] Though surely right, I would add that, given the abuses to which excessive control by either power constituency can give rise, and our inability to ascribe to either of them a stronger identification with the social good, corporate law's ambivalence toward them may well represent a keen self-awareness and, as such, reflect its healthiest attribute.[332] We would do well to ensure that it remains its most enduring.

331. Allen, *supra* note 2, at 280; *see also* Orts, *supra* note 13, at 1612-23.

332. *Cf.* Allen, *supra* note 248, at 17-18 (advocating "some balance of power" between corporate management and institutional investors and urging "modesty and caution in making changes to facilitate one group or the other").