The End of Shareholder Wealth Maximization

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The shareholder wealth maximization ("SWM") doctrine requires the public corporation to pursue a single purpose to the exclusion of all others: increasing the wealth of shareholders by increasing the value of their shares, within the confines of the law. The doctrine excuses egregious corporate action as required for efficiency. It prohibits the corporation from forgoing even a dime of shareholder wealth to benefit the environment, charities, or the corporation's other stakeholders.

After reaching its zenith in the 1990s, SWM has been in decline — both in academia and the corporate world. Most scholars writing today oppose it. Corporations, in corporate social responsibility reports, advertising, and even corporate governance policies, proclaim their intention to consider the interests of other stakeholders.

The threat that abandoning SWM will somehow impair corporate efficiency remains the principal barrier to reconceptualizing the public corporation. This Article seeks to end SWM by debunking the six theories used to justify it: (1) corporate law requires SWM, (2) the shareholders own the corporation, (3) the shareholders are the corporation's residual owners, (4) the directors are the shareholders' agents, (5) the shareholders have an implied contract for SWM, and (6) SWM enables the shareholders to monitor the directors via the stock price. This Article's review of the literature shows that legal scholars have thoroughly discredited each of those theories.

Three circumstances assure that the threat of impaired efficiency is bogus. First, corporations not subject to the doctrine are competitive with U.S. corporations. They include European corporations formed in non-SWM jurisdictions and U.S. corporations formed in non-SWM states.

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Second, U.S. public companies are decreasing in number in recent decades, while foreign domestic corporations are increasing in number. Third, Delaware does not enforce its duty to SWM. Delaware directors are free to ignore it. Removing the fig leaf of law and norms purporting to require SWM and debunking the theory supporting it may be enough to finally end it.

TABLE OF CONTENTS

INTRODUCTION

The shareholder wealth maximization doctrine requires the public corporation to pursue a single purpose to the exclusion of all others: increasing the wealth of shareholders by increasing the value of their shares, within the confines of the law.[1] The doctrine encourages egregious corporate conduct from the burning of fossil fuels, to moving jobs offshore, price gouging on life-saving drugs, shifting liabilities to corporate shells, sourcing raw materials from human rights violators, and much more. The doctrine prohibits the corporation from forgoing profits to benefit the environment, charities, or the corporation's other stakeholders.[2] If shareholders can benefit from socially harmful but legal actions, the doctrine requires that the corporation take those actions.[3]

This Article will refer to both the noun, "shareholder wealth maximization," and the verb, "shareholder wealth maximize," as "SWM." The purpose is to make it easier for readers to distinguish those concepts from similar terms.

Some scholars argue that SWM is the law of Delaware, which would make it the governing law for most U.S. public corporations. Even more importantly, SWM is a norm embedded in the minds of many economists, law professors, businesspeople, and the public.

The doctrine is so extreme that few corporations espouse it. Courts rarely enforce it. Instead, the business judgment rule presumes that directors' actions — gifts to the managers' favorite charities, net-zero greenhouse gas campaigns, corporate jets, CEO compensation of hundreds of million dollars a year — are all for the purpose of maximizing long-run

1 Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 UC DAVIS L. REV. 705, 717 (2002) ("[T]he predominant position on corporate social responsibility suggests that a corporation's social responsibility is to maximize shareholder wealth within the confines of the law . . . .").

2 JOEL BAKAN, THE CORPORATION 60 (2004) ("The corporation . . . is compelled to cause harm when the benefits of doing so outweigh the costs."); Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 527 (2002) ("In Van Gorkom, as in Revlon and its progeny, the board's duty is to maximize shareholder value without regard to the interests of other corporate constituencies such as creditors or employees. . . . [L]ogic compels the conclusion that the board cannot pursue these interests at the expense of long-term shareholder value."); Paul Weitzel & Zachariah J. Rodgers, *Broad Shareholder Value and the Inevitable Role of Conscience*, 12 N.Y.U. J.L. & BUS. 35, 45 (2015) ("A course of action maximizes shareholder wealth if and only if no other course of action would have produced more shareholder wealth.").

3 *See supra* note 2 and accompanying text.

profits. Except when managers announce their lack of intention to SWM,[4] legal procedures prevent shareholders from rebutting the presumption, and the directors' actions stand.

Although legally unenforceable, the doctrine remains Delaware law. Directors can cheat. But law- or norm-abiding directors must SWM. Only cheaters can apply corporate assets for the benefit of anyone other than the shareholders. Taking advantage of the doctrine's unenforceability, most directors do not maximize shareholder wealth. As others before me have pointed out, SWM is a misleading description of how the public corporation operates.[5]

SWM persists due to a widely felt fear that abandoning SWM might impair corporate efficiency.[6] This Article is an effort to finally put the SWM doctrine to rest by examining the theory on which it is built. That examination reveals the lack of any plausible connection between corporate efficiency and the obligation to SWM. The arguments are either wrong or fail to connect with corporate financial performance.

Part I of this Article provides a quick review of the long-running debate over the purpose of public corporations. Part II explains the state of current SWM law. Parts III through VI present the arguments and refutations for SWM from ownership, residual ownership, agency implied contract, and shareholder monitoring theories. Part VII explains the lack of reason to believe that exorcising SWM would adversely affect corporate performance. Part VIII summarizes the arguments and concludes that abandoning SWM would reduce corporate externalizations and eliminate the hypocrisy of a policy that is neither followed nor enforced.

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[4] In the two leading cases, the managers did exactly that. *E.g.*, eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010) ("Jim and Craig did prove that they personally believe craigslist should not be about the business of stockholder wealth maximization, now or in the future."); Dodge v. Ford Motor Co., 170 N.W. 668, 683-84 (Mich. 1919) (Henry Ford's "testimony creates the impression, also, that he thinks the Ford Motor Company has made too much money, has had too large profits, and that, although large profits might be still earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken").

[5] LYNN STOUT, THE SHAREHOLDER VALUE MYTH 8 (2012) ("[S]hareholder value ideology is based on wishful thinking, not reality."); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1154-55 (1932) (describing managers as socially responsible).

[6] *Infra* notes 196–208 and accompanying text.

I. THE BERLE-DODD DEBATE

For almost a century, scholars have debated whether the purpose of the public company is SWM or service to the interests of all stakeholders. The modern debate began with three essays published in the Harvard Law Review in 1931 and 1932. In the first, Columbia Law Professor A.A. Berle argued that "all powers granted to a corporation . . . are . . . exercisable only for the ratable benefit of all the shareholders"[7] and "[n]o form of words inserted in a corporate charter can deny or defeat this fundamental control" because that would "defeat the very object and nature of the corporation itself."[8] Harvard Law Professor Merrick Dodd conceded that "the duty of the managers is to employ the funds of the corporate institution which they manage solely for . . . maximum stockholder profit."[9] He argued, nevertheless, that "public opinion, which ultimately makes law" was changing such that in the future "we may then properly modify our ideas as to the nature of . . . the corporation and hence as to the considerations which may properly influence the conduct of those who direct its activities."[10] Dodd continued,

> A sense of social responsibility toward employees, consumers, and the general public may thus come to be regarded as the appropriate attitude to be adopted by those who are engaged in business, with the result that those who own their own businesses and are free to do what they like may increasingly adopt such an attitude. . . .
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> [Regarding] the managers as representatives of the stockholding interest only . . . means in practice that there are no human beings who are in a position where they can lawfully accept for incorporated businesses those social responsibilities which public opinion is coming to expect.[11]

Berle responded that "you can not abandon . . . the view that business corporations exist for the sole purpose making profits for their

[7] A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931).
[8] *Id.* at 1074.
[9] Dodd, *supra* note 5, at 1161.
[10] *Id.* at 1163.
[11] *Id.* at 1160-62.

stockholders until such as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else."[12]

Since then, scholars have added hundreds of articles to the debate along with numerous schemes of responsibilities to someone else. During the 1980s and 1990s, academic opinion shifted in favor of SWM.[13] In 2001, Professors Henry Hansmann and Renier Kraakman declared "there is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."[14] Before the ink was dry on that epitaph, academic opinion had begun moving in the opposite direction. Although many corporate law academics continue to endorse SWM,[15] most now reject it.[16] More importantly, the arguments in favor of SWM all fail under close scrutiny.

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[12] A.A. Berle, Jr., *For Whom are Corporate Managers Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932).

[13] John Martin, William Petty & James Wallace, *Shareholder Value Maximization—Is There a Role for Corporate Social Responsibility?*, 21 J. APPLIED CORP. FIN. 110, 110 (2009) ("The 1990s can best be described as the decade of shareholder supremacy, with one company trying to outdo the next in its allegiance to shareholder value creation.").

[14] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001).

[15] Stephen M. Bainbridge, *Executive Compensation: Who Decides?*, 83 TEX. L. REV. 1615, 1616 (2005) ("The discretionary powers thus conferred on directors and officers, however, are to be directed towards a single end; namely, the maximization of shareholder wealth."); Sanjai Bhagat & Glenn Hubbard, *Rule of Law and Purpose of the Corporation*, 30 CORP. GOVERNANCE: AN INT'L REV. 10, 11 (2021) ("We conclude that the modern corporation should maximize shareholder value, while conforming to the law of the land."); George A. Mocsary, *Freedom of Corporate Purpose*, 2016 BYU L. REV. 1319, 1368 ("[S]hareholder wealth maximization is and should be the default strategic purpose in general corporations."); Pamela E. Queen, *Enlightened Shareholder Maximization: Is This Strategy Achievable?*, 127 J. BUS. ETHICS 683, 693 (2015) ("[S]hareholder value maximization should be the preferred corporate goal . . . ."); Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 955 (1984) ("[Profit maximization] is not simply the best, but it is the only operational decision rule that we currently have.").

[16] Barnali Choudhury, *Aligning Corporate and Community Interests: From Abominable to Symbiotic*, 2014 BYU L. REV. 257, 279 (advocating for an approach that "seeks to balance wealth maximization norms against community interest enhancement"); Jessica Chu, *Filling a Nonexistent Gap: Benefit Corporations and the Myth of Shareholder Wealth Maximization*, 22 S. CAL. INTERDISC. L.J. 155, 173 (2012) ("[C]orporations actually need to be able to endorse multiple purposes, not just shareholder wealth maximization."); Timothy L. Fort, *The Corporation as Mediating Institution: An Efficacious Synthesis of Stakeholder Theory and Corporate Constituency Statutes*, 73 NOTRE DAME L. REV. 173, 177 (1997) ("[This] Article argues that corporations ought to be operated for the primary benefit of all internal constituents."); Kent Greenfield, *Reclaiming Corporate Law in a New Gilded Age*, 2 HARV. L. & POL'Y REV. 1, 23 (2008) ("Almost certainly, if senior managers were required to consider the interests of the firm more broadly — to include the

Both sides in this debate agree that the objective is benefit to society as a whole, not merely to benefit corporations or their shareholders.[17] As Hansmann and Kraakman put it:

well-being of all investors, equity or non-equity — in their decisionmaking calculus, the firm would be more successful in satisfying the social goal of creating wealth, broadly defined."); Oliver Hart & Luigi Zingales, *The New Corporate Governance*, 1 U. CHI. BUS. L. REV. 195, 197 (2022) ("When externalities are important and at least some investors are prosocial, we argue that shareholders will want companies to pursue *shareholder welfare maximization* . . . not [SWM]."); Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 451 (2013) ("Delaware law should not mandate a narrow money-maximizing purpose."); Brett H. McDonnell & Matthew T. Bodie, *From Mandates to Governance: Restructuring the Employment Relationship*, 81 MD. L. REV. 887, 920 (2021) ("We agree with the move away from shareholder wealth maximization . . . ."); William Savitt & Aneil Kovvali, *On the Promise of Stakeholder Governance: A Response to Bebchuk and Tallarita*, 106 CORNELL L. REV. 1881, 1886 (2021) ("Stakeholder governance has emerged as the most appealing alternative to the failed shareholder primacy model."); George Shepherd, *Not Just Profits: The Duty of Corporate Leaders to the Public, Not Just Shareholders*, 23 U. PA. J. BUS. L. 823, 845 (2021) ("[T]he government should distribute [limited liability] to corporations only on the condition that corporations compensate the government for the valuable resource by operating in the public interest."); Malcolm Rogge, *Bringing Corporate Governance Down to Earth: From Culmination Outcomes to Comprehensive Outcomes in Shareholder and Stakeholder Capitalism*, 35 NOTRE DAME J.L. ETHICS & PUB. POL'Y 241, 299 (2021) ("[M]anagers . . . must not be constrained in their role by the formalistic construct of 'maximization.'"); David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKLEY BUS. L.J. 181, 226 (2014) [hereinafter *The Law of Corporate Purpose*] ("I do not believe [shareholder primacy] is desirable. The shareholder primacy norm is responsible for substantial suffering and political dysfunction in our society.").

[17] Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 778 (1997) ("Thus when the firm selects the monitoring level that maximizes its own profits it also maximizes social welfare."); Laura Lin, *Shift of Fiduciary Duty upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485, 1497 (1993) ("When a company is financially sound, profit maximization benefits all participants in the corporate venture and promotes societal welfare."); Robert J. Rhee, *Fiduciary Exemption for Public Necessity: Shareholder Profit, Public Good, and the Hobson's Choice During a National Crisis*, 17 GEO. MASON L. REV. 661, 727 (2010) ("The distributive principle of shareholder primacy is not the end of corporate law, but is instead a default setting because in most cases profit maximization nicely correlates to increased social wealth."); Frederick Tung, *The New Death of Contract: Creeping Corporate Fiduciary Duties for Creditors*, 57 EMORY L.J. 809, 819 (2008) ("[M]anagers should manage the firm with a view to maximizing shareholder value. This shareholder primacy norm harnesses the zest for private wealth maximization to serve the broader goal of social wealth maximization."); Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27, 62 (1996) ("[M]aximizing the present value of the corporation's earnings stream maximizes the total value of the corporation and, thus, maximizes the corporation's contribution to social wealth.").

> All thoughtful people believe that corporate enterprise should be organized and operated to serve the interests of society as a whole, and that the interests of shareholders deserve no greater weight in this social calculus than do the interests of any other members of society. The point is simply that now, as a consequence of both logic and experience, there is convergence on a consensus that the best means to this end (that is, the pursuit of aggregate social welfare) is to make corporate managers strongly accountable to shareholder interests and, at least in direct terms, only to those interests.[18]

The debate is a definitional quagmire. SWM is best defined as a corporation's effort to maximize the wealth of the corporation's shareholders.[19] Wealth is "the value of all the assets of worth owned by a person. . . . Wealth is determined by taking the total market value of all . . . assets owned, then subtracting all debts."[20] Some scholars use "shareholder value maximization" — or just "shareholder value" for short — as a synonym for SWM.[21] Some consider "shareholder primacy" to be synonymous with SWM[22] while others consider shareholder primacy not to necessarily include SWM.[23] SWM, not the version of shareholder

18 Hansmann & Kraakman, *supra* note 14, at 441.

19 Weitzel & Rodgers, *supra* note 2, at 45 ("A course of action maximizes shareholder wealth if and only if no other course of action would have produced more shareholder wealth.").

20 Robert C. Kelly & Pete Rathburn, *Understanding Wealth: How Is It Defined and Measured?*, INVESTOPEDIA, https://www.investopedia.com/terms/w/wealth.asp#:~:text=Wealth%20measures%20the%20value%20of,the%20accumulation%20of%20scarce%20resources (last updated July 10, 2022) [https://perma.cc/J3QR-QMS3].

21 *See, e.g.*, STOUT, *supra* note 5, at 2-3 (referring to the arguments that corporations should "maximize shareholders' wealth" as the "shareholder value ideology"); Andrew R. Roop, *Stakeholder Unrest, Denominational Theology, and Economic Veracity: Why the Shareholder Value Maximization Norm Should Remain Unchanged*, 45 J. CATH. LEGAL STUD. 195, 200 (2006) (referring to the "shareholder value maximization debate").

22 Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 637 (2006) ("The shareholder primacy norm defines the objective of the corporation as maximization of shareholder wealth."); David Min, *Balancing the Governance of Financial Institutions*, 40 SEATTLE U. L. REV. 743, 750 n.38 (2017) ("Many scholars use the term 'shareholder primacy' to refer to the norm or practice or legal requirement of prioritizing shareholder wealth maximization over other business interests.").

23 Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 574 (2003) [hereinafter *Director Primacy*] ("Although often used interchangeably, the terms 'shareholder primacy' and 'shareholder wealth maximization' express distinct concepts."). In their article, Lucian A. Bebchuk &

primacy that merely requires directors to serve primarily the interests of shareholders, is the target of this Article.

The debaters generally assume that the aggregate value of the stockholders' shares is equal to the net market value of the corporation's assets after deduction of the corporation's debt.[24] It follows that any increase in the value of the corporation's assets proportionally increases the value of its shares and the wealth of its shareholders. Because undistributed profits increase the value of the corporation's assets, some scholars consider profit maximization to be the equivalent of SWM.[25]

"Enlightened value maximization" is the view that directors should take the interests of all stakeholders into account in their decision making — to the extent doing so does not reduce shareholder wealth.[26]

Roberto Tallarita, *Will Corporations Deliver Value to All Stakeholders?*, 75 VAND. L. REV. 1031 (2022) [hereinafter *Will Corporations Deliver Value to Shareholders?*], Bebchuk and Tallarita classified policies that did not require SWM as "shareholder primacy" policies. *See infra* text accompanying notes 151–54.

[24] *But see* Fisch, *supra* note 22, at 673 ("Shareholder value is neither the equivalent of firm value nor a reasonable proxy for firm value, particularly when applied to the agency context upon which corporate law is focused."). Michael Jensen employs an idiosyncratic definition of "value maximization" that values the firm rather than the shares. Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 12 BUS. ETHICS Q. 235, 236 (2002) ("[V]alue maximization states that managers *should make all decisions so as to increase the total long-run market value of the firm*. Total value is the sum of the values of all financial claims on the firm — including equity, debt, preferred stock, and warrants.").

[25] ROBERT CHARLES CLARK, CORPORATE LAW 678 (1986) ("First, under appropriate conditions and definitions, different formulations of the thing to be maximized — 'profits,' "the company's net present value,' 'the market value of the company's common shares,' and 'shareholder wealth' — turn out to be equivalent to one another."); Ian B. Lee, *Corporate Law, Profit Maximization, and the "Responsible" Shareholder*, 10 STAN. J.L. BUS. & FIN. 31, 60-61 (2005) ("On one formulation of the stockholder profit maximization rule, management's responsibility is construed as an obligation to maximize the stock price."); James J. Park, *From Managers to Markets: Valuation and Shareholder Wealth Maximization*, 47 J. CORP. L. 435, 436 n.1 (2022) ("It is challenging to precisely define the concept of shareholder wealth maximization. A more abstract formulation is that a corporation maximizes shareholder wealth when it maximizes the present value of its earnings.").

[26] Jensen, *supra* note 24, at 235 ("Enlightened value maximization . . . accepts maximization of the long-run value of the firm as the criterion for making the requisite tradeoffs among its stakeholders, and specifies long-term value maximization or value seeking as the firm's objective."); *id.* at 236.

II. THE LAW ARGUMENT

The argument from law is that corporate law requires SWM, and corporate performance demonstrates SWM's effectiveness. In fact, the law is ambivalent about SWM. First, most states have rejected SWM. Second, even in Delaware, the most pro-SWM jurisdiction, the law is confused. Third, the business judgement rule renders any SWM mandate that exists unenforceable, enabling managers to ignore it.

A. Most States Reject SWM

At least thirty-five states have adopted statutes that authorize directors to consider the interests of constituencies other than shareholders in the director's decision making.[27] Those statutes are, to varying degrees, inconsistent with the idea that directors have a duty to maximize shareholder wealth.[28] Some specify that the directors' duty is to act in the best interests of the corporation, without mentioning the shareholders.[29] The existence of those statutes negates the idea that SWM is the essence of the corporation. To the contrary, the United States Supreme Court recently stated that "[w]hile it is certainly true that a central objective of for-profit corporations is to make money, modern corporate law does not require for-profit corporations to pursue profit at the expense of everything else, and many do not do so."[30] Courts in some states have stated in dicta

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[27] Matthew D. Cain, Stephen B. McKeon & Steven Davidoff Solomon, *Do Takeover Laws Matter? Evidence from Five Decades of Hostile Takeover*s, 124 J. FIN. ECON. 464, 469-70 (2017) (table showing the date each state adopted its statute).

[28] RESTATEMENT OF THE L. CORP. GOVERNANCE § 2.01 (AM. L. INST., Tentative Draft No. 1, 2022) [hereinafter DRAFT RESTATEMENT OF CORPORATE GOVERNANCE] ("These statutes generally provide the board with explicit discretion to consider the interests of nonshareholder stakeholders and vary as to the degree to which those interests may be elevated to the same level as the interests of shareholders as ends of corporate governance.").

[29] *E.g.*, OHIO REV. CODE ANN. § 1701.59(B) (2022) ("A director shall perform the director's duties . . . in a manner the director reasonably believes to be in or not opposed to the best interests of the corporation . . . .").

[30] Burwell v. Hobby Lobby Stores, Inc., 573 U.S. 682, 711-12 (2014) (internal citations omitted); Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?*, 99 TEX. L. REV. 1309, 1327 (2021) ("*Hobby Lobby* appears to stand for the proposition that a corporation can have an alternative purpose from profit maximization.").

that the corporation's purpose is to maximize shareholder wealth,[31] but no state legislature has imposed a duty to SWM.[32]

B. Delaware Law Is Confused

With respect to public corporations, Delaware's law is the most important because most public corporations are incorporated there.[33] Under the internal affairs doctrine, the law of the state of incorporation is generally assumed to determine whether SWM is required.[34]

Scholars sometimes describe the law of Delaware and some other states as requiring SWM.[35] Former Delaware Chief Justice Leo Strine has written:

> Delaware case law is clear that the board of directors of a for-profit corporation chartered under the Delaware General Corporation Law (DGCL) must, within the limits of its legal discretion, treat stockholder welfare as the only end, considering

[31] *E.g.*, Granada Invs., Inc. v. DWG Corp., 823 F. Supp. 448, 459 (N.D. Ohio 1993) (stating, without citing authority, that "the principle that a corporate officer's overriding duty is to maximize shareholder wealth remains intact").

[32] Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738 (2005) ("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.").

[33] About 55% of public companies are incorporated in Delaware. Lynn M. LoPucki, *Corporate Charter Competition*, 102 MINN. L. REV. 2101, 2129 (2018) (empirical finding). Courts and scholars seem to assume that the law of the state of incorporation governs purpose under the internal affairs doctrine, even though the effects of SWM are felt primarily outside the corporation.

[34] Courts and scholars seem to assume that the law of the state of incorporation governs purpose under the internal affairs doctrine, even though the effects of SWM are felt primarily outside the corporation. The unstated premise — that SWM addresses the relationship between directors and shareholders — is questionable. SWM principally addresses the relationship between the directors and other corporate stakeholders.

[35] Arnoud W.A. Boot & Jonathan R. Macey, *Monitoring Corporate Performance: The Role of Objectivity, Proximity, and Adaptability in Corporate Governance*, 89 CORNELL L. REV. 356, 363 n.21 (2004) ("[T]he business and affairs of a Delaware for profit, stock corporation are to be managed so as to maximize the value of the investment of one group and one group only, its stockholders." (citing Lawrence A. Hamermesh, *The Shareholder Rights By-Law: Doubts from Delaware*, 5 CORP. GOVERNANCE ADVISOR 9, 9 (1997))); *see* STEPHEN M. BAINBRIDGE, CORPORATE LAW 141 (2d ed. 2009) ("It is well-settled that directors have a duty to maximize shareholder wealth."); Stephen M. Bainbridge, *Making Sense of the Business Roundtable's Reversal on Corporate Purpose*, 46 J. CORP. L. 285, 301 (2021) ("[Delaware Chief Justice Strine and Delaware Chancellor William T. Allen] believed that directors had a duty to maximize the long-run interests of shareholders.").

> other interests only to the extent that doing so is rationally related to stockholder welfare.[36]

The fiduciary duty of loyalty under Delaware law, however, is not to the shareholders alone. The duty is to "the corporation and its shareholders."[37] That duty "mandates that directors *maximize the value of the corporation* over the long-term for the benefit of the providers of equity capital."[38] In a later case the Delaware Chancery Court explained:

> In the standard Delaware formulation, fiduciary duties run not only to the corporation, but rather "to the corporation and its shareholders" The conjunctive expression captures the foundational relationship in which directors owe duties to the corporation for the ultimate benefit of the entity's residual claimants. It is, of course, accepted that a corporation may take steps, such as giving charitable contributions or paying higher wages, that do not maximize corporate profits currently. They may do so, however, because such activities are rationalized as producing greater profits over the long-term. Decisions of this nature benefit the corporation as a whole, and by increasing the value of the corporation, the directors increase the quantum of value available for the residual claimants. Nevertheless, Delaware case law is clear that the board of directors of a for-profit corporation must, within the limits of its legal discretion, treat stockholder welfare as the only end, considering other interests only to the extent that doing so is rationally related to stockholder welfare.[39]

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[36] Leo E. Strine, Jr., *A Job Is Not a Hobby: The Judicial Revival of Corporate Paternalism and Its Problematic Implications*, 41 J. CORP. L. 71, 107 (2015); *see also* Frederick Hsu Living Tr. v. ODN Holding Corp., No. 12108-VCL, 2017 WL 1437308, at *18 (Del. Ch. Apr. 14, 2017), as corrected Apr. 24, 2017 ("[T]he fiduciary relationship requires that the directors . . . maximize the value of the corporation over the long-term for the benefit of the providers of presumptively permanent equity capital . . . ."); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010) ("I cannot accept as valid . . . a corporate policy that specifically, clearly, and admittedly seeks not to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders . . . ." (emphasis omitted)).

[37] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986) ("[T]he directors owe fiduciary duties of care and loyalty to the corporation and its shareholders.").

[38] *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 37 (Del. Ch. 2013) (emphasis added).

[39] *Frederick Hsu Living Tr.*, 2017 WL 1437308, at *17 (internal citations and quotations omitted).

Professor Christopher Bruner argues that this duty "'to the corporation and its stockholders' reflects deep-seated ambivalence regarding the degree to which shareholders' interests ought to dominate corporate decision-making."[40] Reading that language the same way, Professor Andrew Gold argues that that "because the interests of shareholders and the interests of the corporation will sometimes conflict, this amounts to an indeterminate standard."[41] Professor David Yosifon responds that no conflict between the interests of the corporation and its shareholders is possible, but he makes no effort to prove that.[42] Like Yosifon, I read the court's language as an assertion that no conflict is possible — the interests of the corporation are identical to the interests of the shareholders. In the official view, profit maximization maximizes the interests of the corporation and its shareholders, making conflicts between them impossible.

In reality, conflicts exist. Those conflicts are discussed in Part III.B.1. For now, the point is that Delaware's use of the phrase "the corporation and its shareholders"[43] and its insistence that maximizing the value of the corporation maximizes shareholder value leaves Delaware's law confused.

As others before me have noted,[44] *Unocal Corp. v. Mesa Petroleum* and other Delaware cases authorize directors to consider "the impact [of a transaction] on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[45] *Unocal* is important because the principal SWM cases are from lower courts. Perhaps in recognition of the dearth of authority in support of a SWM obligation, scholars often refer to SWM as a "norm."[46]

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40 Christopher M. Bruner, *Corporate Governance Reform in a Time of Crisis*, 36 J. CORP. L. 309, 325 (2011).

41 Andrew S. Gold, *Theories of the Firm and Judicial Uncertainty*, 35 SEATTLE U. L. REV. 1087, 1097 (2012).

42 Yosifon, *The Law of Corporate Purpose*, *supra* note 16, at 209 (refuting Andrew Gold's assertion that "the interests of the shareholders and the interests of the corporation will sometimes conflict").

43 *See supra* text accompanying note 37.

44 *See, e.g.*, STOUT, *supra* note 5, at 30-31 ("[S]ome [Delaware] cases explicitly state that directors can look beyond shareholder wealth in deciding what is best for 'the corporation.'"); Fisch, *supra* note 22, at 651 ("[E]ven in the takeover context, so long as the company has not entered the *Revlon* mode, Delaware law permits directors to consider the interests of 'creditors, customers, employees, and perhaps even the community generally.'").

45 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

46 Bernard S. Sharfman, *Shareholder Wealth Maximization and Its Implementation Under Corporate Law*, 66 FLA. L. REV. 389, 391 (2014) ("Shareholder wealth

C. SWM Law Is Unenforceable

Courts that have imposed a duty to SWM do not enforce it,[47] except in the rare cases in which managers volunteer that they are not maximizing shareholder wealth.[48] Scholars widely acknowledge the unenforceability of the SWM.[49] The result is that directors can take actions without a SWM intent, and not have to implausibly assert that they have one.

SWM is probably just a default rule from which directors and shareholders can opt out.[50] DGCL § 102(b)(1) provides that "the certificate

maximization is a norm of corporate governance that encourages a firm's board of directors to implement all major decisions such as compensation policy, new investments, dividend policy, strategic direction, and corporate strategy with only the interests of shareholders in mind."); D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277 (1998) (referring to shareholder primacy as a norm in the title); JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 2, 32-33 (Princeton Univ. Press ed., 2008) ("Corporations are almost universally conceived as economic entities that strive to maximize value for shareholders.").

47 STOUT, *supra* note 5, at 25 ("There is no solid legal support for the claim that directors and executives in U.S. public corporations have an enforceable legal duty to maximize shareholder wealth. The idea is a fable.").

48 *Supra* note 4 and accompanying text.

49 Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 778 (2006) ("While the law clearly establishes shareholder wealth maximization as one of the default contractual rights of shareholders, the business judgment rule effectively precludes courts from reviewing corporate decisions that allegedly further interests other than that of shareholder wealth maximization."); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 256 (1999) ("[T]he 'business judgment rule' . . . insulates directors from most claims of breach of the duty of care, even when they deliberately sacrifice shareholders' interests to serve other constituencies . . . ."); Jonathan R. Macey, *A Close Read of an Excellent Commentary on* Dodge v. Ford, 3 VA. L. & BUS. REV. 177, 180-81 (2008) ("[I]t simply is not possible or practical for courts to discern ex post when a company is maximizing value for shareholders and when the officers and directors are only pretending to do so."); *id.* at 181 ("The problem is not the lack of clarity of the rule. The problem is lack of enforceability."); Dalia T. Mitchell, *From* Dodge *to* eBay*: The Elusive Corporate Purpose*, 13 VA. L. & BUS. REV. 155, 210 (2019) ("Once the courts have begun to examine the corporation's purpose as an aspect of directors' and managers' fiduciary obligations, the presumption of the business judgment rule has guaranteed that the shareholders would not be able to force directors to fulfill the goal of wealth maximization.").

50 Justin Blount & Patricia Nunley, *Social Enterprise, Corporate Objectives, and the Corporate Governance Narrative*, 52 AM. BUS. L.J. 201, 242 n.192 (2015) ("While the shareholder wealth maximization language of *eBay Domestic Holdings* is quite strong, nothing in the case expressly rejects the contractarian argument that this objective is still only a default position that can be expressly modified by the parties."); Fisch & Solomon, *supra* note 30, at 1333 ("We believe, however, that corporations can voluntarily commit in their charters to prioritize stakeholder or societal interests and that such commitments would be legally enforceable."); Joan MacLeod Heminway, *Shareholder Wealth*

of incorporation may contain . . . [a]ny provision for the management of the business and for the conduct of the affairs of the corporation . . . if such provisions are not contrary to the laws of this State." If a certificate provision is challenged, "the court must determine, based on a careful, context-specific review . . . whether a particular certificate provision contravenes Delaware public policy, i.e., our law, whether it be in the form of statutory or common law." [51] That is, all Delaware corporate law rules are merely default rules unless they express a public policy. It cannot be the public policy of Delaware that corporations cannot seek both profit and public benefit pursuant to a certificate provision, because Subchapter XV of the Delaware General Corporation Law allows corporations to do precisely that by electing "benefit" status.[52] Nor can it be the public policy of Delaware that corporations can do so only by becoming public benefit corporations. Delaware's doctrine of independent legal significance provides that "action taken under one section of [the Delaware Corporation Law] is legally independent, and its validity is not dependent upon, nor to be tested by the requirements of other unrelated sections under which the same final result might be attained by different means."[53] To put it another way, public policies do not vary based on which section of the Delaware Corporation Law is invoked.

The business judgment rule makes it difficult for the default-rule issue to arise. The Draft ALI Restatement takes the position that "whether and to what extent corporation[s] may opt out of the economic objective by adopting a provision in its certificate of incorporation" is "an open

Maximization as a Function of Statutes, Decisional Law, and Organic Documents, 74 WASH. & LEE L. REV. 939, 958 (2017) ("The Delaware common law that has established shareholder primacy as the default governance rule for business corporations neither states nor implies any public policy indicating that the rule should be unalterable by charter provision." (quoting David G. Yosifon, *Opting out of Shareholder Primacy: Is the Public Benefit Corporation Trivial?*, 41 DEL. J. CORP. L. 461, 479 (2017)).

[51] Jones Apparel Grp., Inc. v. Maxwell Shoe Co., 883 A.2d 837, 848 (Del. Ch. 2004).

[52] *But see* Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 985 (1992) ("[S]tate law arguably does not permit corporate organic documents to redefine the directors' fiduciary duties. In general, a charter amendment may not derogate from common law rules if doing so conflicts with some settled public policy."); Jonathan R. Povilonis, *Contracting for ESG: Sustainability-Linked Bonds and a New Investor Paradigm*, 77 BUS. L. 625, 638-39 (2022) ("[P]arties of for-profit Delaware corporations do not have the freedom to opt out of the shareholder wealth maximization norm, unless they were to take the more drastic measure of changing their jurisdiction or organizational form.").

[53] Rothschild Int'l Corp. v. Liggett Grp. Inc., 474 A.2d 133, 136 (Del. 1984).

question."[54] Most scholars adhere to that wobbly view.[55] The ALI Draft does not assert that firm performance depends in any way on SWM.

Corporate law requiring SWM cannot be necessary to corporate financial performance. Such law does not exist, and, if it did, neither Delaware nor other states would enforce it.

III. THE PROPERTY ARGUMENT

The property-based arguments for SWM, ownership and residual ownership, each have two steps. At the first step, the argument is that shareholders own the corporation or are the corporation's residual owners. At the second step, the argument is that status entitles the shareholders to wealth maximization. The two statuses and their resulting entitlements are discussed separately.

A. Ownership

The first step in the ownership argument is that the shareholders own "the corporation." The law is clear that the shareholders own their shares and the corporation owns its property. The dispute at this first step is about who owns "the corporation." The arguments are abstract because the disputants do not say what they mean by "the corporation" in this context.

1. Shareholders Do Not Own the Corporation

Most scholars think the shareholders do not own the corporation.[56] They reach that conclusion by essentially three paths. First, contractarians

[54] DRAFT RESTATEMENT OF CORPORATE GOVERNANCE, *supra* note 28, at 37.

[55] Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, *supra* note 52, at 985 ("In light of the well-settled shareholder wealth maximization policy, nonmonetary factors charter amendments therefore appear vulnerable."); Mocsary, *supra* note 15, at 1331 ("[I]t is uncertain that courts would enforce a charter term opting out of shareholder wealth maximization.").

[56] John R. Boatright, *What's Wrong—and What's Right—with Stakeholder Management*, 21 J. PRIV. ENTER. 106, 113 (2006) ("Shareholders do not 'own' General Motors in the same way that a person owns a car or a house. Rather, shareholders have a certain bundle of rights that includes the right of control and the right to the profits of a firm." (citations omitted)); Richard A. Booth, *Who Owns a Corporation and Who Cares?*, 77 CHI.-KENT L. REV. 147, 150 (2001) ("So how good is the stockholder ownership theory as a theory? Not very. It does not describe the law very well, nor does it do a very good job as a normative matter."); Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 396 (1983) ("Shareholders are no more the 'owners' of the firm than are bondholders, other creditors, and employees (including managers) who devote specialized resources to the enterprise . . . ."); Jonathan R. Macey, *An Economic Analysis*

regard the corporation as a nexus of contracts in which the firm is "an aggregate of various inputs acting together to produce goods or services."[57] "[T]he nexus of contracts approach rejects the idea that shareholders hold property interests in the corporation, or that there are property interests in the corporation."[58] The shareholders are merely capital suppliers, not owners.[59]

That view is wrong. That prominent scholars choose to regard the corporation as a thing that cannot be owned, does not make it so. At the nexus of contracts is a business — a thing — that consists of both people and property.[60] One can, with some mental effort, regard the factory, machinery, and inventory as resources provided by shareholders and creditors against the labor provided by managers and employees under imaginary contracts, and therefore not the property of the corporation. But in legal reality, the factory, machinery, and inventory are the corporation's property.[61] Real, not imaginary, contracts exist. Under those contracts, the

of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties, 21 STETSON L. REV. 23, 26 (1991) ("[S]hareholders do not 'own' the modern, publicly held firm in any meaningful sense . . . ."); Julian Velasco, *Shareholder Ownership and Primacy*, 2010 U. ILL. L. REV. 897, 899 ("[T]here seems to be substantial agreement among legal scholars and others in the academy that shareholders do not own corporations.").

[57] STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 27 (2002).

[58] Robert Anderson IV, *A Property Theory of Corporate Law*, 2020 COLUM. BUS. L. REV. 1, 19; *see also* Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1427 (1993) [hereinafter *In Defense*] ("[O]wnership is not a meaningful concept in nexus of contracts theory. Someone owns each input, but no one owns the totality.").

[59] Bainbridge, *Director Primacy*, *supra* note 23, at 574 ("[T]he board of directors hires capital, not vice-versa."); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 290 (1980) ("Dispelling the tenacious notion that a firm is owned by its security holders is important because it is a first step toward understanding that control over a firm's decisions is not necessarily the province of security holders."); Steven H. Kropp, *Corporate Governance, Executive Compensation, Corporate Performance, and Worker Rights in Bankruptcy: Some Lessons from Game Theory*, 57 DEPAUL L. REV. 1, 9 (2007) ("Under this nexus of contracts approach, or contractarian model, shareholders are regarded not as owners but rather as suppliers of a particular form of capital: equity.").

[60] *But see* Stephen M. Bainbridge, *Who Owns the Corporation?*, PROFESSORBAINBRIDGE.COM (Jan. 13, 2006), https://www.professorbainbridge.com/professorbainbridgecom/2006/01/who-owns-the-corporation.html [https://perma.cc/6DJA-EBPG] ("[F]irms aren't things, they are simply a group of people for whom the law has provided an off-the-rack relationship we call the corporation. There simply is nothing there that can be owned.").

[61] *See* STOUT, *supra* note 5, at 59-60 ("[C]orporations *are* real, at least in [the] legal sense. *It is shareholders that are fictional*.").

shareholders and creditors do not contract with the managers and employees; the persons in all four groups contract with the corporation.[62]

Second, some scholars argue that under options theory, creditors and shareholders have equally valid claims to corporate ownership.[63] That argument is also wrong because the equality is only financial. The shareholders' ownership claim is stronger than the creditors' in all other respects. For example, shareholders have the right to voting control and to the residual upon dissolution; creditors do not. Shareholders can pay the creditors and own the entire value of the corporation. But creditors cannot pay the shareholders and own the entire value of the corporation.

Third, Professor Lynn Stout and two other scholars argue that the corporation owns itself.[64] In this conception, corporations "enter into contracts with shareholders exactly as they contract with debtholders, employees, and suppliers."[65] None of the three scholars explained how they reached that conclusion, but I suggest an explanation in the next Subsection.

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[62] *See, e.g.*, Bainbridge, *Director Primacy*, *supra* note 23, at 559-60 (explaining that the board of directors is the nexus of contracts).

[63] Theresa A. Gabaldon, *Like a Fish Needs a Bicycle: Public Corporations and Their Shareholders*, 65 MD. L. REV. 538, 541-42 (2006) ("According to [options] theory, once a firm has issued debt, debtholders and holders of equity both share contingent control and bear residual risk. Thus, it might be said either that the debtholders 'own' the firm and have sold a call option to the shareholders or that the shareholders 'own' the firm and have bought a put option from the debtholders."); *see also* Simone M. Sepe, *Directors' Duty to Creditors and the Debt Contract*, 1 J. BUS. & TECH. L. 553, 568 n.58 (2007) ("[T]he relationship between debtholders and shareholders can be recharacterized as one in which the former 'own' the right to the unlevered firm's cash flow . . . ."); Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1192 (2002) [hereinafter *Bad and Not-So-Bad*] ("[O]nce a firm has issued debt (as almost all firms do), it makes just as much sense to say that the debtholders 'own' the right to the corporation's cash flow but have sold a call option to the shareholder, as it does to say that the shareholder 'owns' the right to the corporation's cash flow but has bought a put option from the debtholders.").

[64] STOUT, *supra* note 5, at 37 ("*Corporations are independent legal entities that own themselves* . . . ."); David Ciepley, *The Corporation Is Always Already Government-Supported, and So Is Bankruptcy*, 11 GEO. J. L. & PUB. POL'Y 349, 351 (2013) ("[T]he corporation owns itself."); Daniel P. Schley, *Is Owning Stock an Abnormally Dangerous Activity? Shareholder Limited Liability in Tort*, 24 CHAP. L. REV. 55, 66 (2020) ("Because a corporation owns itself and is its own principal, it will be vicariously liable for its agents' actions in tort.").

[65] STOUT, *supra* note 5, at 38 ("Corporations own themselves and enter contracts with shareholders exactly as they contract with debtholders, employees, and suppliers.").

2. Shareholders Do Own the Corporation

A smaller group of scholars think the shareholders do own the corporation.[66] They reach that result on three theories. First, ownership is a social convention, and the prevailing convention — in and out of law — is to speak of the shareholders as owning corporations. The second is that shareholder rights — such as voting rights — constitute ownership of the corporation.[67] The third is that the shareholders are the beneficial owners of the corporation's property.[68]

Professor Melvin Eisenberg wrote that, "what constitutes property is to a significant extent a matter of social convention."[69] Professor Julian Velasco has shown that social convention regards shareholders as the owners of the corporation.[70] Businesspeople, lawyers, judges, and economists speak of shareholders as the owners of corporations.[71] That

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[66] Melvin A. Eisenberg, *The Conception that the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 825 (1999) ("On balance, however, the claim [that shareholders do not own the corporation] is unpersuasive."); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 883 n. 68 (1991) ("That shareholders 'own' the corporation is the *outcome* of economic analysis of corporate governance, not its premise."); Tom C.W. Lin, *CEOs and Presidents*, 47 UC DAVIS L. REV. 1351, 1370 (2014) ("Shareholders own the corporation . . . ."); Julian Velasco, *Shareholder Ownership and Primacy*, 2010 U. ILL. L. REV. 897, 897 ("According to the traditional view, the shareholders own the corporation.").

[67] *See* Anderson, *supra* note 58, at 8 ("[T]he property interests in the corporation are the residual governance rights that arise in the common stock directly from the relevant corporation statute — especially (but not uniquely) the plenary and residual voting rights.").

[68] *E.g.*, TONY HONORÉ, MAKING LAW BLIND: ESSAYS LEGAL AND PHILOSOPHICAL 188 (1987) (putting trusts and "incorporated companies" in the same class). That is, shareholders occupy the position in corporations analogous to the position beneficiaries occupy in trusts.

[69] Eisenberg, *supra* note 66, at 826.

[70] Velasco, *supra* note 66, seriatim.

[71] Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html [https://perma.cc/DMP2-W6UL] ("[T]he key point is that, in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation."); G. Mitu Gulati, William A. Klein & Eric M. Zolt, *Connected Contracts*, 47 UCLA L. REV. 887, 907 (2000) ("[C]orporate law conceives that equity is the owner."); Oliver Hart, *An Economist's Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757, 1773 (1989) ("Although owners (shareholders) typically retain some control rights, such as the right to replace the board of directors, in practice they delegate many others to management, at least on a day-to-day basis."); Arthur Levitt, Jr., *How to Boost Shareholder Democracy*, WALL ST. J., July 1,

includes Delaware and other state case law,[72] and the definition of "shares" in the Model Business Corporation Act.[73]

The second path to the conclusion that shareholders do own the corporation applies the definition of property. The definition that is currently most influential was proposed by Professor Tony Honoré in his famous essay "Ownership."[74] That essay identified the eleven "standard incidents of ownership: that is, those legal rights, duties and other incidents which apply, in the ordinary case, to the person who has the greatest interest in a thing admitted by a mature legal system."[75] The eleven incidents are (1) the right to possess, (2) the right to use, (3) the right to manage, (4) the right to income, (5) the right to the capital (which includes the right to consume, waste, or destroy it), (6) the right to remain an owner, (7) the right to bequeath it, (8) the absence of a term, (9) the duty to prevent the thing from harming others, (10) liability to execution, and (11) residuary character.

Shareholders lack seven of these eleven incidents (64%), including the most important ones. They cannot take possession of the property or use

2008, at A17 ("The principle that shareholders own the companies in which they invest — and are the ultimate bosses of those running them — is central to modern capitalism.").

[72] N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007).

> When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners.

Id.; Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998) ("The board of directors has the legal responsibility to manage the business of a corporation for the benefit of its shareholder owners."); Stahl v. Apple Bancorp, Inc., 579 A.2d 1115, 1124 (Del. Ch. 1990) ("[T]he prospect of losing a validly conducted shareholder vote cannot, in my opinion, constitute a legitimate threat to a corporate interest, at least if one accepts the traditional model of the nature of the corporation that sees shareholders as 'owners.'").

[73] MODEL BUSINESS CORPORATION ACT § 1.40 (2003) ("'Shares' means the units into which the proprietary interests in a domestic corporation or foreign corporation are divided."). For a definition of proprietary, see *Proprietary*, GOOGLE, https://www.google.com/search?q=proprietary&rlz=1C1GCEA_enUS1005US1005&oq=proprietary&aqs=chrome..69i57j0i433i512j0i512l3j0i433i512j0i512j0i433i512j0i512l2.3963j1j15&sourceid=chrome&ie=UTF-8 (last visited Feb. 15, 2023) [https://perma.cc/F8YH-LA4H] (defining "proprietary" as "relating to an owner or ownership").

[74] HONORÉ, *supra* note 68, at 161-92.

[75] *Id.* at 161.

it.[76] They cannot manage it.[77] They have no right to the income unless and until the directors declare a dividend. One might think of the income as in the corporation to be distributed to the shareholders upon dissolution, if not sooner. But dissolutions of public companies are rare; most are liquidated while insolvent with all or substantially all the distributions going to creditors.[78] Shareholders can neither consume, waste, nor destroy the corporate property. Controlling shareholders have the right to remain owners, but non-controlling shareholders can be cashed out over their objection through merger.[79] Shareholders have no duty to prevent the property from injuring third parties. Thus, on a literal reading of the incidents, the shareholders' claim to ownership is weak.

Honoré, however, regards the corporation as an example of "split ownership,"[80] meaning that the corporate property is split into two ownership interests: one held by the corporation and the other held by the shareholders.[81] The shareholders' interest is in part legal, for example, the right to vote, and in part beneficial, the right to income and capital upon dissolution.

Viewing Honoré's incidents in this manner, Professor Robert Anderson concludes that "shareholders do have the strongest claim of any claimant to the right to the income of the firm, the right to capital, the right to security, the right to transmissibility, the right to absence of term, and the incident of residuarity."[82] Eisenberg seems to agree.[83] Anderson also

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[76] Anderson, *supra* note 58, at 24 ("Shareholders typically lack the right to use corporation property, at least without authorization.").

[77] *Id.* at 24 ("[Shareholders] generally lack the right *qua* shareholders to manage, at least directly, especially when compared to the management rights of the board of directors."); *see* DEL. CODE ANN. tit. 8, § 141(a) (2022).

[78] *See, e.g.*, Andrew A. Wood, *The Decline of Unsecured Creditor and Shareholder Recoveries in Large Public Company Bankruptcies*, 85 AM. BANKR. L.J. 441 (2011) (finding shareholders received no recoveries or nominal recoveries in 90% of large, public company bankruptcies in 2009-10).

[79] LYNN M. LOPUCKI & ANDREW VERSTEIN, BUSINESS ASSOCIATIONS: A SYSTEMS APPROACH 228 (2021) ("Stock is property, and the person who wants to buy it ordinarily must negotiate with its owner. In mergers, however, shareholders who do not want to sell their shares may be forced to do so."); *see* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014) (upholding a cash-out merger).

[80] HONORÉ, *supra* note 68, at 188 ("[S]plitting may serve the purpose of specialization, by separating management from the enjoyment of income and/or right to dispose of capital. . . . In this . . . class fall . . . incorporated companies.").

[81] *Id.*

[82] Anderson, *supra* note 58, at 24.

[83] Eisenberg, *supra* note 66, at 825.

concludes that "shareholders as a whole do have all [eleven incidents], at least indirectly"[84] because they have the right to dissolve the corporation and "take hold of and use corporate property for any purpose."[85]

Anderson and Eisenberg overstate their cases. Ownership of the corporate assets are split between the corporation and the shareholders. But the corporation's claim is stronger than the shareholders' claim. Only the corporation has possession, the right to use the assets, the right to manage, and the right to the corporation's income. Even the shareholders acting unanimously cannot exercise these rights.[86] The shareholders might be able to remove the directors and elect their replacements. But replacement will not give the shareholders any of these incidents. They still cannot take possession of the assets, use them, manage the corporation's assets, or take its income. By dissolving the corporation, the shareholders can become the owners of its assets. But that does not make them the owners prior to dissolution. The corporation owns its assets until the corporation dissolves and the shareholders own the assets after dissolution.

Honoré recommends that "if the rules of a legal system demand an answer [to which of split owners should be considered the owner] it must be sought in positive law, in the comparative strength of competing

> As A. M. Honoré has pointed out, one way to determine the proper characterization of an interest is by comparing the incidents of the interest with the standard incidents of ownership, such as the rights to possess, use, and manage, and the rights to income and to capital. From this perspective, the body of shareholders appears to own the corporation.

Id.

[84] Anderson, *supra* note 58, at 25.

[85] *Id.* at 26.

> [I]n California and New York a majority of the shareholders can dissolve the corporation without the board's consent. Even Delaware allows dissolution without the board, though it requires a unanimous shareholder vote. Thus, shareholders in these states have the right to take hold of and use corporate property for any purpose, though that right may only be exercised collectively and indirectly. The MBCA has a different rule, requiring the concurrence of the board and shareholders to dissolve, but shareholders can always remove directors who disagree with their plan.

Id. at 25-26.

[86] For example, by delivering a signed consent to the corporation, shareholders can take only those actions that shareholders could take at a shareholder meeting. DEL. CODE ANN. tit. 8, § 228(a) (2022).

analogies."[87] I suggest that the closest analogy to the shareholders' relationship with the corporate assets is that of an option holder to the optioned property. By exercising its option — dissolving the corporation — the option holder can become the owner, but until exercise, the option holder is not the owner.[88] While the option remains unexercised, the option holder may consider itself enriched by increases in the property's value, but that consideration is warranted only if the increases remain part of the property at the time of exercise — that is, the time of dissolution.

The case for shareholder ownership is strongest regarding one-person corporations. An individual submits documents and fees to the Secretary of State, receives a corporate charter, and transfers the individual's business to the corporation. It might seem obvious that the individual, in his or her capacity as a shareholder, owns the corporation.[89] In presenting his case against SWM, Dodd began by conceding this point: After incorporation, he wrote, the "business is still a private enterprise existing for the profit of its owners, who are now the stockholders."[90]

But even in the one-person corporation case, ownership is far from clear under modern corporation law. The individual as shareholder does not have the right to order the corporation, its directors, or its employees what to do. The individual as shareholder must elect him or herself director and, in that capacity, decide what course of action the individual believes to be in the best interests of *the corporation and* the shareholder. If the individual does not comply with these requirements, that failure may be grounds for a court to disregard the corporate entity and hold the shareholder personally liable for corporate obligations.[91] Thus even in the strongest case for shareholder ownership of the corporation — the one-person corporation — shareholder ownership is unclear. Thus, at the first step, the argument from ownership is doubtful.

87 HONORÉ, *supra* note 68, at 164.

88 Gregory G. Gosfield, *A Primer on Real Estate Options*, 35 REAL PROP. PROB. & TR. J. 129, 138-39 (2000) ("[T]raditionally (though not uniformly), states have not considered options as interests in real estate, but as general intangibles . . . Of course, after exercising the option, the option holder also has all of the rights of an equitable owner of title.").

89 *See, e.g.*, Velasco, *supra* note 56, at 954 ("When a sole proprietor incorporates his business, no one doubts that he has control and remains the owner.").

90 Dodd, *supra* note 5, at 1146.

91 *E.g.*, Pae v. Chul Yoon, 838 N.Y.S.2d 172, 173 (App. Div. 2007) (holding sole owner of corporation liable for corporate debt because the sole owner of the corporation "dominated the corporation and was solely responsible for the wrongful failure of the corporation to pay the plaintiff"); *In re* Ma, 375 B.R. 387 (Bankr. N.D. Ohio 2007) (holding the sole owner liable for debt for under the same reasoning).

At the second step, the argument is that ownership entitles the shareholders to wealth maximization. SWM advocates reason that property owners are entitled to all of the property's benefits. SWM is one of those benefits, so the directors must SWM. The flaw in that reasoning is that, without justification, it treats SWM — something a corporation might do — as something a corporation must do.

If the ownership argument entitles shareholders to SWM, it is merely an entitlement to money. The ownership theory makes no claim that treating shareholders as owners improves the corporation's financial performance.[92] Thus the ownership argument does not suggest that corporate efficiency is at stake.

B. Residual Ownership

SWM advocates argue that SWM maximizes social wealth. The argument's premise is that shareholders are the corporations' residual owners.[93] The argument proceeds in four steps: (1) because the shareholders' status as residual owners gives them the strongest incentives to maximize corporate wealth, shareholders should control the corporation, but (2) shareholders cannot control the corporation, so (3) to maximize corporate wealth, the directors who control the corporation should SWM, and (4) that SWM will maximize both corporate wealth and social wealth.

1. The Definition of "Residual Owners"

SWM advocates define "residual owners" or "residual claimants" as the persons entitled to the corporation's profits.[94] Although no law entitles

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[92] Fisch, *supra* note 22, at 650 ("While ownership rights may be a consequence of shareholder primacy, they do not justify shareholder primacy.").

[93] *E.g.*, George S. Geis, *Shareholder Derivative Litigation and the Preclusion Problem*, 100 VA. L. REV. 261, 262 (2014) ("Shareholders are the residual owners of a company."); Michelle M. Harner, *Activist Distressed Debtholders: The New Barbarians at the Gate?*, 89 WASH. U. L. REV. 155, 171 (2011) ("Shareholders are the residual owners of the company.").

[94] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 67 (1991) ("[S]hareholders are the residual claimants to the firm's income. Creditors have fixed claims, and employees generally negotiate compensation schedules in advance of performance."); Bainbridge, *In Defense*, *supra* note 58, at 1434 ("[N]onshareholders . . . are paid first, but shareholders are entitled to whatever is left over after all of the formers' claims are satisfied."); Boatright, *supra* note 56, at 115 ("Just as customers buy a company's products, equity capital providers 'buy' the future profits of a firm."); Fisch, *supra* note 22, at 656 ("[In the standard economic literature] nonshareholder

shareholders to the corporation's profits, SWM advocates infer the entitlement on three bases. First, they consider it an implied term of the corporate contract. For example, Judge Frank Easterbrook wrote "for most firms the expectation is that the residual riskbearers have contracted for a promise to maximize long-run profits of the firm."[95] Second, SWM advocates infer the shareholder's entitlement to profits from the law governing corporate dissolution. That law provides for distribution of the corporation's assets first to the payment of debt with the remainder to shareholders.[96] Third, SWM advocates infer the shareholder's entitlement to profits from principles of accounting. "[U]nder the current corporate accounting system, shareholders are assumed to be the sole residual claimants, who are entitled to the whole amount of net income."[97] Profits not paid to the shareholders as dividends are recorded as retained earnings or in some similar category. Retained earnings appear in the equity section of the balance sheet, suggesting that they belong to the shareholders. "If a company retains its earnings instead of paying dividends, its stock price will increase, and this will benefit the shareholders."[98]

By this definition of residual owner, shareholders are the sole residual owners. I will refer to it as the "entitlement" definition to distinguish it from the "actually received" definition usually employed by SWM's opponents. Under the actually received definition, the residual owners or residual claimants are the persons who actually receive the marginal dollar of corporate revenues.[99] By this definition, nonshareholder stakeholders

stakeholders receive a fixed claim, while shareholders have a residual claim — they receive the surplus.").

95 Frank H. Easterbrook, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1446 (1989).

96 DEL. CODE ANN. tit. 8, § 281(a) (2022); Velasco, *supra* note 56, at 913 ("A residual claimant is one who is 'entitle[d] . . . to whatever remains after the firm has met its explicit obligations and paid its fixed claims.'").

97 Satoru Otaka, *Rethinking the Concept of Equity in Accounting: Origin and Attribution of Business Profit*, DE GRUYTER (July 22, 2020), https://www.degruyter.com/document/doi/10.1515/ael-2019-0018/html [https://perma.cc/HE3F-2GPB].

98 Velasco, *supra* note 56, at 913.

99 Fisch, *supra* note 22, at 658 ("Residual claimants are simply, by definition, those who receive a share of the firm's surplus."); George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CALIF. L. REV. 1073, 1100 (1995) (referring to the "residual claimants, who gain or lose at the margin from the actions of the firm"); Min Yan, *A Control-Accountability Analysis of Dual Class Share (DCS) Structures*, 45 DEL. J. CORP. L. 1, 6 (2020) ("As residual proprietary claimants, shareholders 'reap the marginal dollar' of corporate profits and "suffer the marginal dollar" of corporate losses.").

are often considered also to be residual owners.[100] For example, Stout observes that

> [S]hareholders are only one of several groups that can be described as "residual claimants" or "residual risk bearers," in the sense that they expect to enjoy benefits (and sometimes to endure burdens) beyond those provided in their explicit contracts. When the firm is doing well, for example, employees receive raises and enjoy greater job security, managers get use of a company jet, and bondholders enjoy increased protection from corporate insolvency. Conversely, these groups suffer along with shareholders when times are bad, as employees face "reductions in force," managers are told to fly coach, and debtholders face increased risk. Directors use their control over the firm to reward many groups with larger slices of the corporate pie when that pie is growing, and to spread the loss among many when the pie is shrinking.[101]

Velasco objects to the "actually-received" definition: "Although everyone's claim is at risk, not everyone is a *residual* claimant. A residual claimant is one who is 'entitled to whatever remains after the firm has met its explicit obligations and paid its fixed claims.'"[102]

The entitlement definition is not appropriate here, however, because the residual owner argument relies on the shareholders' incentives. The argument is that residual ownership aligns the shareholders' incentives with those of the corporation. But only actual receipts, not unrealized entitlements, generate incentives.

Most SWM advocates acknowledge that shareholders are not the sole residual claimants.[103] For example, Professor Eric Talley admits that "it no longer seems factually accurate to depict shareholders as the sole 'residual

[100] Fisch, *supra* note 22, at 658 ("[N]onshareholder stakeholders frequently have an explicit contractual claim on a portion of the surplus."); *cf.* McDonnell & Bodie, *supra* note 16, at 914 ("Employees are often significant residual claimants too, as the income and future prospects of employees depend upon their employer's profitability.").

[101] Stout, *Bad and Not-So-Bad*, *supra* note 63, at 1194-95.

[102] Velasco, *supra* note 56, at 913.

[103] Jonathan R. Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173, 175 ("[S]hareholders retain plenary authority to guide the fate of a corporate enterprise because . . . they have the greatest stake in the outcome of corporate decision-making."); Robert K. Rasmussen, *The Search for Hercules: Residual Owners, Directors, and Corporate Governance in Chapter 11*, 82 WASH. U. L.Q. 1445, 1451 (2004) ("[S]hareholders as residual claimants are good proxies for a sole owner.").

claimants' of a corporation."[104] Easterbrook and Professor Daniel Fischel acknowledged that from the beginning: "The shareholders receive *most* of the marginal gains and incur most of the marginal costs."[105]

Stout, who led the opposition to SWM in the years before her untimely death in 2016, also argued that shareholders did not have a legal entitlement to profits because the law does not require that dividends be paid.

> Outside of the bankruptcy context, it is grossly misleading to suggest that shareholders are somehow entitled to — much less actually receive — everything left over after a company's legal obligations have been met. To the contrary, shareholders cannot get any money out of a functioning public corporation unless two conditions are satisfied. First, under the standard rules of corporate law, a company's board of directors only has legal authority to declare dividends to shareholders when the company is doing well enough financially, as measured by whether it has (in accounting terms) sufficient "retained earnings" or "operating profits." Second, no dividend can be paid unless the board decides to actually exercise its authority by declaring a dividend.
>
> [N]either contingency is met *unless the board of directors wants it to be.*[106]

Shareholders share residual ownership with other stakeholder groups.

2. Shareholders' Incentives

At the residual ownership argument's first step, SWM advocates assert that shareholders should control the corporation because shareholders "have the right incentives to exercise discretion."[107] For example, Professor Robert K. Rasmussen argues that "in healthy corporations, shareholders as residual claimants are good proxies for a sole owner. This, at least in part, is the justification for the proposition that boards should seek to maximize shareholder wealth."[108]

[104] Eric Talley, *On the Demise of Shareholder Primacy (or, Murder on the James Trains Express)*, 75 S. CAL. L. REV. 1211, 1213 (2002).

[105] EASTERBROOK & FISCHEL, *supra* note 94, at 68 (emphasis added).

[106] STOUT, *supra* note 5, at 40.

[107] Easterbrook & Fischel, *supra* note 56, at 403-06.

[108] Rasmussen, *supra* note 103, at 1451. *But see* Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283, 304 (1998) ("There is nothing inherent in the nature of a residual claim that means that its holders' interest should be maximized above all others.").

Shareholders do not, however, have the right incentives. As partial residual claimants, shareholders' incentives are to increase the value of their interest in the firm. One way for the shareholders to increase the value of their interest is for the shareholders to appropriate the value of other stakeholders' interests. Professor Jill Fisch has noted this conflict between the interests of shareholders and other stakeholders:

> Even when a corporation is financially sound, increasing the level of risk to further the interests of shareholders may harm other stakeholders. Greater risk may reduce the creditworthiness of the firm and hence the value of its debt, or reduce job security, thereby reducing the value of the firm to its workers.[109]

SWM advocates fall back on the argument that despite the imperfection of the shareholders' incentives, the shareholders incentives are still better aligned with the corporation's interests than any other party's incentives.[110]

Stout responds that the *corporation's* incentives are perfectly aligned with corporation's interests. The corporation is a person entitled to its income — the residual — and capable of deciding how to spend it. "The corporation is its own residual claimant, and it is the board of directors that decides what to do with the corporation's residual."[111] No proxy for the corporation's interests is needed because the corporation can act for itself.

The second reason put forward to justify shareholder control is that shareholders "cannot be adequately protected by contract. Rather, to protect their interests, they must be given the right to control the firm."[112]

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[109] Fisch, *supra* note 22, at 660.

[110] KENT GREENFIELD, THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES 54 (2006) ("This argument is predicated on the assumption that the shareholders' interests and the interests of the enterprise as whole are more closely aligned than the interests of any other claimant and the firm."); Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *For Whom Corporate Leaders Bargain*, 94 S. CAL. L. REV. 1467, 1476 (2021) ("Although the interests of corporate leaders do not perfectly align with the interests of shareholders, the interests of corporate leaders and shareholders are substantially linked."); Michael S. Kang, *Shareholder Voting as Veto*, 88 IND. L.J. 1299, 1306 (2013) ("Shareholders are the residual owners of the company and at least putatively have interests most tightly aligned with the best long-term interests of the company.").

[111] STOUT, *supra* note 5, at 41.

[112] Boatright, *supra* note 56, at 115 ("If [shareholders'] return on the asset they provide, namely capital, is the residual earnings or profit of a firm, then this return is very insecure unless they can ensure that the firm is operated for maximum profit."); Hansmann & Kraakman, *supra* note 14, at 449 ("[I]n most circumstances, the interests of equity investors in the firm — the firm's residual claimants — cannot adequately be protected by contract.

That claim lacks credibility for two reasons. First, some shareholders do protect themselves by contract. Venture capitalists are an example. Second, the shareholders of most public companies invested despite having no ability to control the firm.[113] They impliedly contracted for the low levels of shareholder control currently in existence.

Thus, the residual ownership argument also fails at this first step. Shareholders are not the parties with the best incentives to control the corporation.

3. Shareholders' Inability to Control

Having decided that shareholders should control the corporation, the residual ownership argument immediately runs up against the fact that they cannot. Only about 9% of public corporations are "controlled," meaning that a single shareholder has enough voting power to elect a majority of the directors."[114] In most noncontrolled corporations, shareholders suffer from a collective action problem. "When many are entitled to vote, none of the voters expects his votes to decide the contest. Consequently, none of the voters has the appropriate incentive at the margin to study the firm's affairs and vote intelligently."[115] Corporate law addresses the problem by restricting shareholder decision making to electing and removing the board.[116] But in most corporations, shareholders are unable to exercise their power to elect and remove directors because the election rules are stacked against the shareholders.[117] The board can nominate directors and solicit proxies for their nominees at corporate

Rather, to protect their interests, they must be given the right to control the firm."); Macey, *supra* note 56, at 36 ("[S]hareholders face more daunting contracting problems than other constituencies.").

113 Fisch, *supra* note 22, at 657 ("Contract theory suggests that shareholders would not contribute capital unless operational decisions included a shareholder value objective, but, in practice, shareholders are more likely to be concerned with the level of return on their investment than their claim, relative to other stakeholders, to the firm's surplus.").

114 LoPucki & Verstein, *supra* note 79, at 586.

115 Easterbrook & Fischel, *supra* note 56, at 402.

116 Del. Code Ann. tit. 8, § 141(k) (2022) ("Any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors."); Brian R. Cheffins, *Corporate Governance and Countervailing Power*, 74 Bus. L. 1, 6 (2019) ("Under what has been referred to as 'the received legal model of the corporation,' 'the board of directors manages the corporation's business and makes policy; the officers act as agents of the board and execute its decisions; and the shareholders elect the board.'").

117 Bainbridge, *Director Primacy*, *supra* note 23, at 569 ("[S]hareholders lack both the de jure right and the de facto power to divest the board of its control.").

expense. If shareholders wish to nominate directors and solicit proxies in their favor, the shareholders must do it largely at their own expense and on the directors' timetable.[118] As a result, in the more than three thousand public companies in the United States, only about 6 proxy contests occur each year.[119]

Nor do the market for corporate control or activist investors provide the necessary shareholder control. The market for corporate control manifests as either a raider seeking control or directors' imaginings of what such a raider might want them to do. Persons actually seeking control are rare. When they take control, they are part of the 9% minority. Imaginings are not control. On average, activist shareholders are gone in a little over two years.[120] Thus, the residual ownership argument also fails at this second step.

4. Directors' Fiduciary Duties

Because shareholders cannot control the corporation, the residual owners' argument continues, the directors should manage in the shareholder's place and for the shareholders' benefit. That conclusion does not follow. The shareholders were chosen to govern despite their imperfect incentives because no party with perfect incentives was available. But if the directors will govern as proxies, the directors should emulate the ideal corporate interests, not the imperfect shareholder interests.

If the residual ownership argument had not failed at the first two steps, the correct conclusion to reach at this third step would have been that corporate wealth is best maximized by requiring director loyalty to the corporation. That is what Delaware does. By claiming that maximizing corporate wealth is the same as maximizing shareholder wealth, Delaware feeds a SWM narrative that Delaware does not follow.

[118] LoPucki & Verstein, *supra* note 79, at 237-40 (describing the rules for election and removal of directors); 17 C.F.R. § 240.14a-19 (2022) ("universal proxy" rule).

[119] LoPucki & Verstein, *supra* note 79, at 239. The number may increase because the SEC's universal proxy rules apply to director elections held after August 31, 2022. U.S. Sec. & Exch. Comm'n, Fact Sheet: Universal Proxy Rules for Director Elections, https://www.sec.gov/files/34-93596-fact-sheet.pdf (last visited Apr. 7, 2023) [https://perma.cc/2VJU-R849].

[120] Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 Colum. L. Rev. 1085, 1155 (2015) ("We note that the time difference between the initial 13D filing and the departure date in our database of activist interventions has a median of 539 days (about 1.5 years) and an average of 811 days (over two years).").

5. Social Wealth Maximization

Most SWM advocates do not consider SWM the ultimate goal. They endorse SWM on the incorrect theory that SWM maximizes both corporate wealth and social wealth.[121] The claim is that making shareholders wealthier not only makes corporations wealthier but also makes society as a whole wealthier.

Professor Michael Jensen famously asserted that "200 years' worth of work in economics and finance indicate that social welfare is maximized when all firms in an economy maximize total firm value."[122] He cited nothing in support of that proposition. Professors John Martin, William Petty, and James Wallace provide a clue as to the possible basis for Jensen's assertion. "This idea [that maximizing shareholder value maximizes social wealth] can be traced back to Adam Smith's concept of the invisible hand."[123] Smith wrote that "[b]y pursuing his own interest [the capitalist] frequently promotes that of the society more effectually than when he really intends to promote it."[124]

Most scholars do not believe that SWM maximizes social wealth.[125] The obvious problem with the SWM-maximizes-social-wealth claim is that corporations can increase their profits by externalizing their social costs.[126] As a result, corporations' "profit-seeking operations contribute to a wide

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121 *See* sources cited *supra* note 17 (listing scholars).

122 Jensen, *supra* note 24, at 239; *accord* Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27, 62 (1996) ("Therefore, maximizing the present value of the corporation's earnings stream maximizes the total value of the corporation and, thus, maximizes the corporation's contribution to social wealth."); Donald J. Kochan, *The Purpose of a Corporation Is to Seek Profits, Not Popularity*, HILL (Aug. 19, 2021, 2:30 PM ET), https://thehill.com/opinion/finance/568595-he-purpose-of-the-corporation-is-to-seek-profits-not-popularity/ [https://perma.cc/CWW4-QXQ5] ("As corporations and their shareholders maximize wealth, resources flow into the economy in ways that necessarily increase overall social welfare.").

123 John Martin, William Petty, and James Wallace, *Shareholder Value Maximization — Is There a Role for Corporate Social Responsibility?*, 21 J. APPLIED CORP. FIN. 110, 111 (2009).

124 ADAM SMITH, THE WEALTH OF NATIONS 423 (The Modern Library 1937).

125 *E.g.*, John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 104 (1986) ("Shareholder wealth and social wealth are not synonymous. The former can be enhanced in ways that do not increase, and may even decrease, the latter.").

126 JESSE H. CHOPER, JOHN C. COFFEE JR. & RONALD GILSON, CASES AND MATERIALS ON CORPORATIONS 40 (8th ed. 2013) ("Virtually everyone recognizes that corporate profit maximization can sometimes inflict a greater harm on society than the gain it creates for shareholders.").

array of society's problems and impose serious negative externalities on employees, communities, consumers, and the environment."[127] Jensen acknowledges as much by adding an exception to his assertion for "when monopolies or externalities exist" and listing "water and air pollution" as "classic examples" of externalities.[128] Other externalized social costs include the release of microplastics and other pathogens, the generation of financial crises, the social effects of child and slave labor, violations of human rights, the monopolization of the water supply, the movement of populations for temporary employment, the abandonment of older employees, and the release of greenhouse gases that may render the planet uninhabitable.[129]

SWM advocates assert, without stating reasons, that government should solve externalization problems through regulation.[130] Regulation is not,

[127] Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 168 (2020) [hereinafter *The Illusory Promise*]; *see also* Bakan, *supra* note 2, at 61 ("[T]he corporation's built-in compulsion to externalize its costs is at the root of many of the world's social and environmental ills.").

[128] Jensen, *supra* note 24, at 239 ("When monopolies or externalities exist, the value-maximizing criterion does not maximize social welfare. By externalities I mean situations in which the decision-maker does not bear the full cost or benefit consequences of his or her choices, water and air pollution are classic examples.").

[129] *See* Roy Shapira, *The Challenge of Holding Big Business Accountable*, 44 CARDOZO L. REV. 203, 233 (2022) ("Economist Luigi Zingales and I demonstrated that once you calculate the time value of money, the decision to pollute becomes rational from the point of view of shareholder wealth maximization.").

[130] Ilan Benshalom, *Who Should Decide Whether the Apple Is Rotten? Tax Disclosure and Corporate Political Agency*, 6 COLUM. J. TAX L. 86, 92 n.12 (2014) ("Goals other than wealth maximization are best promoted through the political arena.");

> Resolving externality and monopoly problems is the legitimate domain of the government in its rule-setting function. Those who care about resolving monopoly and externality issues will not succeed if they look to firms to resolve these issues voluntarily. Firms that try to do so either will be eliminated by competitors who choose not to be so civic minded or will survive only by consuming their economic rents in this manner.

Jensen, *supra* note 24, at 246; Edward B. Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. L. 363, 394-95 (2021) ("Finally, we should never forget that many of our problems require regulatory solutions and that we should not fool ourselves into thinking that tinkering with corporate objective can begin to substitute for regulation to control climate change, assure decent wages and working hours, and decent health care, as well as social insurance against the various downsides from competitive global markets."); Steven L. Schwarcz, *Misalignment: Corporate Risk-Taking and Public Duty*, 92 NOTRE DAME L. REV. 1, 21 (2016) ("[R]egulating substance generally should be superior to government interference with corporate governance to control externalities.");

however, a plausible solution. First, government regulation has not prevented the externalizations now under discussion. Refusing to address them through corporate governance means they will continue.[131] Second, in many instances, SWM caused the externalizations. That is, but for the SWM norm, the corporations would not have externalized the costs. Eliminating the norm would eliminate those externalizations. Third, remediation and clean-up are highly inefficient processes. In most cases, the government's clean-up costs greatly exceed the corporation's cost of pollution avoidance. Preventing the pollution by eliminating the SWM norm is the most efficient strategy for reducing clean-up costs. Lastly, SWM creates incentives for corporations to lobby against the adoption of the necessary regulations and corporations often do.[132] Thus, the argument from residual ownership cannot reach the conclusion that SWM maximizes social wealth.

IV. THE AGENCY ARGUMENT

In a frequently cited paper, Jensen and Professor William H. Meckling proposed an agency-cost theory of the public corporation.[133] They assumed that the shareholders owned the corporation and posited that (1) shareholders should be viewed as principals and managers as their agents, (2) the implied contract that creates the firm obligates managers to conduct the business to maximize the benefit to shareholders, and (3) the

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> Even where such problems emerge, however, the standard account insists that the solution does not reside in altering the shareholder primacy norm at the heart of firm governance. Instead, firms should be restrained from engaging in such exploitative conduct by external governmental regulation, such as labor laws, consumer protection statutes, and environmental codes.

David G. Yosifon, *The Public Choice Problem in Corporate Law: Corporate Social Responsibility After* Citizens United, 89 N.C. L. REV. 1197, 1202 (2011).

131 Part of the reason for regulation's failure is that corporations, as participants in the political process, resist regulation.

132 Shapira, *supra* note 129, at 266 ("[C]ompanies with political power to influence the rules can maximize shareholder wealth by externalizing greater costs on others in society."); Tim Wu, *The Goals of the Corporation and the Limits of the Law*, THE CLS BLUE SKY BLOG (Sept. 3, 2019), https://clsbluesky.law.columbia.edu/2019/09/03/the-goals-of-the-corporation-and-the-limits-of-the-law/ [https://perma.cc/D83Y-JM7Z] ("[T]he primacy model logically incentivizes corporations to prevent government from acting in ways that might be social welfare-maximizing.").

133 Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308-09 (1976).

problem was to induce the "agent" to "behave as if he were maximizing the 'principal's' welfare."[134]

Jensen and Meckling claimed that "the relationship between the stockholders and managers of a corporation fit the definition of a pure agency relationship."[135] They defined "agency" as "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent."[136]

In doing so, Jensen and Meckling demonstrated a profound misunderstanding of corporate and agency law. Corporations are created by law, not contract.[137] "Agency is the fiduciary" — not contractual — relationship in which the agent acts "subject the principal's control."[138] More specifically, the principal must have "the power to give interim instructions."[139] The relationship between the shareholders and the managers is not an agency relationship because the shareholders lack the right to control the managers and cannot give the managers interim instructions.[140] Statutes — not contracts — confer the authority to manage the corporation's affairs on the board of directors.[141] The shareholders — even acting unanimously — have no right to direct the managers' decisions.[142] They do have the right to remove and replace the directors,

[134] *Id.* at 309-10.

[135] *Id.* at 309.

[136] *Id.* at 308.

[137] *See, e.g.*, DEL. CODE ANN. tit. 8, § 106 (2022) ("Upon the filing with the Secretary of State of the certificate of incorporation . . . the incorporator or incorporators . . . shall, from the date of such filing, be and constitute a body corporate."); MODEL BUS. CORP. ACT § 2.03(a) (AM. BAR ASS'N 2021) ("[T]he corporate existence begins when the articles of incorporation are filed.").

[138] RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

[139] Johnson v. Priceline.com, Inc., 711 F.3d 271, 278 (2d Cir. 2013) ("The power to give interim instructions distinguishes principals in agency relationships from those who contract to receive services provided by persons who are not agents." (quoting RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006))).

[140] STOUT, *supra* note 5, at 42 ("[A] hallmark of agency is that the principal retains the right to control the agent's behavior.").

[141] *E.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2022) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . ."); Fisch, *supra* note 22, at 649 ("Corporate managers, unlike traditional agents, are not directly controlled by their principals in that the source of their power is largely statutory.").

[142] *See, e.g.*, CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 232 (Del. 2008) ("Indeed, it is well established that stockholders of a corporation subject to the DGCL may

but they can tell neither the directors nor their replacements what to do. When the shares are widely held, shareholders usually lack the practical ability to exercise their right to remove and replace. Together, these rules and circumstances confer on directors — not shareholders — the power to manage the corporation. The agency relationship about which Jensen and Meckling theorize bears no resemblance to the actual relationship between shareholders and directors in public corporations.[143]

Some corporate law scholars nevertheless promote the view that "corporate management is the agent of the shareholders and as such owes them a duty to maximize the return on their investments."[144] Professor David Millon refers to their view as "radical shareholders primacy" and identifies Easterbrook, Fischel, and Bebchuk as adherents.[145] Scholarship analyzing corporate governance in terms of "agency costs" is ubiquitous.[146]

Because directors are not the agents of shareholders in law or in reality, the agency argument for SWM fails. The agency argument provides no basis for the belief that directors should SWM or for the belief that abandoning SWM could impair corporate performance.

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not directly manage the business and affairs of the corporation, at least without specific authorization in either the statute or the certificate of incorporation.").

143 David Millon, *Radical Shareholder Primacy*, 10 U. ST. THOMAS L.J. 1013, 1022 (2013) ("In light of the corporate law's systematic disempowerment of shareholders, it makes no sense to describe their relationship to management in terms of agency because one of the essential attributes of an agency relationship is the principal's right of control over the actions of the agent.").

144 *Id.* at 1013-14. *But see* Bainbridge, *In Defense*, *supra* note 58, at 1426 n.8 ("[N]either legal nor economic theory bases the primacy of shareholder wealth upon the existence of an agency relationship between shareholders or managers.").

145 Millon, *supra* note 143, at 1026 ("First Fischel, and then Easterbrook and Fischel writing together, articulated the idea that management is the agent of the shareholders and then assumed its foundational relevance for their analysis of the entire field of corporate law."); *id.* at 1017-18 ("Professor Lucian Bebchuk's 'shareholder empowerment' agenda exemplifies the position [the radical version of shareholder primacy], taking for granted that shareholders should possess the ability to demand of management that it act according to their preferences.").

146 *E.g.*, Mark J. Roe, *Rents and Their Corporate Consequences*, 53 STAN. L. REV. 1463, 1465 (2001) ("Higher rents induce higher managerial agency costs for shareholders; higher agency costs induce shareholders to strengthen the inside-the-firm structures that keep higher agency costs within bounds."); James Cameron Spindler, *Vicarious Liability for Managerial Myopia*, 46 J. LEGAL STUD. 161, 161 (2017) ("In a principal-agent model, shareholders choose whether to award equity compensation to a myopic (short-termist) manager.").

V. THE IMPLIED CONTRACT ARGUMENT

Jensen and Meckling's second claim is that an implied contract between shareholders and directors requires directors to SWM. That claim fails because an implied contract must have a factual basis in the statements or conduct of the parties.[147] No factual basis exists for believing SWM is the intent of the parties to most corporations.

Rarely do provisions of corporate certificates, bylaws, or prospectuses suggest that directors will SWM. In 2020, the Business Roundtable claimed that its 1997 statement had "defined a corporation's principal purpose as maximizing shareholder return."[148] But in fact, the 1997 statement said merely that "the principal objective of a business enterprise is to generate economic returns to its owners."[149] It made no mention of SWM. The 2019 version removed the "principal objective" language and substituted a commitment "to deliver value to all of [our stakeholders], for the future success of our companies, our communities and our country."[150]

From their empirical study of the corporate governance policies of the companies whose CEOs signed the 2019 Business Roundtable Statement, Professors Lucian Bebchuk and Roberto Tallarita concluded that "a majority included an explicit statement in support of shareholder primacy."[151] But shareholder primacy as Bebchuk and Tallarita defined it is not SWM. Of the 128 corporate governance policies they studied, only three (2%) referred to maximization of profits, shareholder wealth, or

[147] Beth Isr. Med. Ctr. v. Horizon Blue Cross & Blue Shield of N.J., Inc., 448 F.3d 573, 582 (2d Cir. 2006) ("The terms of an implied-in-fact contract turn on the conduct of the parties."); No other kind of implied contract exists. RESTATEMENT (SECOND) OF CONTS. § 4 cmt. b (AM. L INST. 1981) ("As opposed to the inferred from fact ('implied in fact') contract, the 'implied in law' quasi-contract is no contract at all, but a form of the remedy of restitution.").

[148] *One Year Later: Purpose of a Corporation*, BUS. ROUNDTABLE, https://purpose.businessroundtable.org/ (last visited Jan. 8, 2023) [https://perma.cc/K788-DCBS].

[149] THE BUS. ROUNDTABLE, STATEMENT ON CORPORATE GOVERNANCE 1 (1997), https://cdn.theconversation.com/static_files/files/693/Statement_on_Corporate_Governance_Business-Roundtable-1997%281%29.pdf?1566830902 [https://perma.cc/4LTT-BXQJ] (stating that "the principal objective of a business enterprise is to generate economic returns to its owners").

[150] *Statement on the Purpose of a Corporation*, BUS. ROUNDTABLE (Aug. 19, 2019), https://system.businessroundtable.org/app/uploads/sites/5/2021/02/BRT-Statement-on-the-Purpose-of-a-Corporation-Feburary-2021-compressed.pdf [https://perma.cc/RG9B-H64Y].

[151] Bebchuk & Tallarita, *Will Corporations Deliver Value to Shareholders?*, *supra* note 23, at 1036.

shareholder value (in those or other words).[152] Most of the policies Bebchuk and Tallarita classified as supporting shareholder primacy merely said that the board's role was to represent or promote the interests of the corporation's shareholders. Nearly all the policies studied are consistent with an unstated board intention to also serve the interests of other stakeholders.[153] Two of the 128 companies (1.6%) expressly authorized the board to act in the interests of nonshareholder stakeholders.[154]

In another study, Bebchuk, Kastiel, and Tallarita provide persuasive evidence that directors protected shareholders and managers in sales of companies to private equity[155] and failed to protect employees, communities, and suppliers in those sales.[156] The sales studied included some governed by constituency statutes. From that evidence, Bebchuk and Tallarita infer that directors would not protect employees, communities, and suppliers in ongoing operations in a stakeholder governance regime.[157] That extension of their findings seems unwarranted. Directors' incentives to protect stakeholders are greater in ongoing operations because ongoing operations require the stakeholders' cooperation. Ongoing operations may not require the shareholders' cooperation — because the shareholders' capital is locked in. The opposite is true in a sale. Sale requires the shareholders' affirmative vote approving the sale,[158] and sale ordinarily does not require the other stakeholders' cooperation. Bebchuk and

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152 *Id.* at 1060 (The Home Depot); *id.* at 1055 (Eastman Chemical Company); S. CO., CORPORATE GOVERNANCE GUIDELINES (2019), https://s27.q4cdn.com/273397814/files/doc_downloads/2019-10-21-Governance-Guidelines.pdf [https://perma.cc/94C7-JTZY] ("[The Board's] role is to maximize long-term stockholder value.")

153 Duke Energy is the borderline case. Its policy requires that the board "act solely in the best interest of the Corporation's shareholders." Bebchuk & Tallarita, *Will Corporations Deliver Value to Shareholders?*, *supra* note 23, at 1055. I do not read that language as requiring maximization of shareholder value. It is consistent with an intention to also act solely in the best interest of the other stakeholders.

154 *Id.* at 1057 ("Finally, only two companies in the BRT Board Sample (Cummins and International Paper) fall within the category of stakeholderism.").

155 Bebchuk et al., *supra* note 110, at 1507-23.

156 *Id.* at 1519 ("Our findings indicate that . . . corporate leaders did not use their power to negotiate any protections for customers, suppliers, or creditors.").

157 *Id.* at 1534 ("[O]ngoing-concern decisions should not be expected to display more stakeholderist inclinations than final-period decisions."); *id.* at 1535 ("At a minimum, our findings should give stakeholderists pause and require them to examine the factors that caused the failure of constituency statutes in the cases we considered, and whether these factors would not similarly undermine stakeholderism more generally.").

158 DEL. CODE ANN. tit. 8, § 251(c) (2022) (shareholder vote on mergers); *id.* § 271(a) (shareholder vote on asset sales).

Tallarita miss this point in the section where they address the objection that "the validity of [their] conclusion is limited to the acquisition context and does not extend to ongoing-concern decisions."[159]

Consistent with Jensen and Meckling, Professor Stephen M. Bainbridge argues that SWM is a "bargained for right of the shareholders."[160] He asserts two bases for his conclusion. The first is that SWM "is not only the law, but is also a basic feature of corporate ideology." But none of the sources he cites in support of the proposition mention the concept of maximization.[161] Bainbridge's second basis is that directors' interests are often aligned with those of shareholders through compensation or reputational considerations.[162] That alignment does suggest that directors will work in the interests of shareholders, but suggests nothing about maximization.

Team production and stakeholder theory advocates argue persuasively that public companies provide stakeholders benefits that sometimes are substantially more or less than their legal entitlements.[163] If true, the stakeholders have implied contracts to receive those payments, and the shareholders do not have implied contracts for SWM.

VI. THE SHAREHOLDER MONITORING ARGUMENT

Corporate directors have fiduciary duties to serve the interests of the corporation and/or its shareholders.[164] SWM advocates argue that if directors are also permitted to serve the interests of other stakeholders, directors will use that discretion to serve their own interests.[165] Ironically,

[159] Bebchuk et al., *supra* note 110, at 1534.

[160] Bainbridge, *supra* note 23, at 574.

[161] *Id.* at 576.

[162] *Id.* at 576-77.

[163] *Supra* notes 101, 106, 109 and accompanying text.

[164] *Supra* Part III.B.4.

[165] Stephen M. Bainbridge, *The Bishops and the Corporate Stakeholder Debate*, 4 VILL. J.L. & INV. MGMT. 3, 21 (2002) [hereinafter *The Bishops*] ("There is a very real risk that directors and managers given discretion to consider interests other than shareholder wealth maximization will use stakeholder interests as a cloak for actions taken to advance their own selfish interests."); *see* Harry G. Hutchison, *Choice, Progressive Values, and Corporate Law: A Reply to Greenfield*, 35 DEL. J. CORP. L. 437, 462 (2010) ("[T]he claim that expanded stakeholder governance leads to diminished accountability of corporate managers is not new."); Jonathan R. Macey, *Corporate Law as Myth*, 93 S. CAL. L. REV. 923, 953 (2020) ("If corporate directors and corporate managers stop believing in the myth that they are supposed to maximize value for shareholders, there would be precious little, if anything, to constrain them from simply pursuing their own, idiosyncratic notions of

it appears that managers have already done so. CEO compensation in the U.S. is far higher than in other countries.[166] The solution, SWM advocates argue, is to require the corporations to SWM. The adoption of a single metric, they argue, is necessary to enable directors to make decisions,[167] for shareholders to monitor the directors' success,[168] and for the market to allocate resources efficiently.[169]

Jensen argued that directors could not make reasoned decisions without a command that they maximize something:

> It is logically impossible to maximize in more than one dimension at the same time unless the dimensions are monotone transformations of one another. Thus, telling a manager to maximize current profits, market share, future growth in profits,

what is 'best' for whatever group of corporate constituents they idiosyncratically and serendipitously happened to prefer at a particular moment in time.").

166 Statistica Rsch. Dep't, *Average Annual CEO Compensation Worldwide in 2017, by Country*, STATISTA (Aug. 5, 2022), https://www.statista.com/statistics/424154/average-annual-ceo-compensation-worldwide/ [https://perma.cc/2GSV-ZVBZ] (showing U.S. compensation at $14.25 million, nearly double the next highest country); *see* Gregory H. Shill & Matthew L. Strand, *Diversity, ESG, and Latent Board Power*, 46 DEL. J. CORP. L. 255, 322 (2022) ("[T]ensions between shareholder wealth maximization and top-of-market executive compensation are already clear."). *But see* Nuno Fernandes, Miguel A. Ferreira, Pedro Matos & Kevin J. Murphy, *Are U.S. CEOs Paid More? New International Evidence*, 26 REV. FIN. STUD. 323, 324 (2013) ("We find that the U.S. pay premium is economically modest: U.S. CEOs earn an average of 26% more than their foreign counterparts in 2006, far less than the 100% or 200% premiums documented in the (limited) academic research.").

167 Bainbridge, *Director Primacy*, *supra* note 23, at 581 ("[A]bsent the shareholder wealth maximization norm, the board would lack a determinate metric for assessing options. Because stakeholder decisionmaking models necessarily create a two masters problem, such models inevitably lead to indeterminate results."); Henry Hansmann, *How Close Is the End of History?*, 31 J. CORP. L. 745, 747 (2006) ("[I]mposing affirmative fiduciary duties on management to protect the interests of two or more groups simultaneously is unworkable.").

168 CLARK, *supra* note 25, at 679 ("A single, objective goal like profit maximization is more easily monitored than a multiple, vaguely defined goal like the fair and reasonable accommodation of all affected interests."); *see* Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1164-65 (1990) [hereinafter *Corporate Governance*] ("[M]anagement performance cannot readily be measured once stock price is no longer the lodestar."); Stefan J. Padfield, *Corporate Governance and the Omnipresent Specter of Political Bias*, 104 MARQ. L. REV. 47, 55 (2020) ("[A]llowing or requiring managers to consider impacts other than profit provides cover for self-dealing and exacerbates the agency problem.").

169 Romano, *Corporate Governance*, *supra* note 168, at 1165 ("Also, if corporations pursue objectives other than stock price maximization, the market's allocative efficiency will be compromised.").

> and anything else one pleases will leave that manager with no way to make a reasoned decision.[170]

Other SWM advocates agree.[171]

Stout responds "that perspective ignores the obvious human capacity to balance, albeit imperfectly, competing interests and responsibilities. . . . Balancing interests — decently satisfying several sometimes-competing objectives, rather than trying to 'maximize' only one — is the rule and not the exception in human affairs."[172]

Even accepting Jensen's limitation of a single objective, better alternatives than SWM exist. Jensen himself proposed maximizing "the total long-run market value of the firm" with the firm defined to include both equity and debt — thus extending board protection to creditors.[173] A better single objective would be to maximize production (without externalizing its costs). Production maximization without externalization would commit corporations directly to maximizing social wealth[174] — the goal most SWM maximization advocates claim to be pursuing already.[175]

Professors Oliver Hart and Luigi Zingles point out that efficiency requires shareholder *utility* maximization, not SWM.[176] To illustrate the importance of that distinction, assume that corporations made

[170] Jensen, *supra* note 24, at 238.

[171] EASTERBROOK & FISCHEL, *supra* note 94, at 36 ("[A] manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither."); Bainbridge, *The Bishops*, *supra* note 165, at 23 ("[A]bsent the shareholder wealth maximization norm, both boards and courts will lack a determinate metric for assessing options."); Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001) ("[A] stakeholder measure of managerial accountability could leave managers so much discretion that managers could easily pursue their own agenda, one that might maximize neither shareholder, employee, consumer, nor national wealth, but only their own.").

[172] STOUT, *supra* note 5, at 108.

[173] Jensen, *supra* note 24, at 236 ("[V]alue maximization states that managers should make all decisions so as to increase the total long-run market value of the firm. Total value is the sum of the values of all financial claims on the firm-including equity, debt, preferred stock, and warrants.").

[174] That is, they would be maximizing gross domestic product (GDP).

[175] *See supra* note 17 and accompanying text.

[176] Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 271 (2017) (arguing that "shareholder welfare maximization should replace market value maximization as the proper objective of companies"); Mocsary, *supra* note 15, at 1323 ("Although Professor Friedman is frequently quoted for his support of shareholder wealth maximization, his careful use of the word 'generally' suggests that, although it may not be commonplace, he apparently believed that shareholder ends need not be monetary.").

shareholders fabulously rich (SWM) while destroying the planet (a failure to maximize shareholder utility). Such wealth generation would be an obvious mistake.

Stout colorfully characterizes SWM advocates' choice to maximize wealth as "simply assuming — without explanation or justification — that the only shareholder whose interests count is the shareholder who is short-sighted, opportunistic, undiversified, and without a conscience."[177] In choosing to SWM, SWM advocates are choosing to maximize the wrong metric because it is the metric they think they can measure.

SWM advocates argue that "problems of incomplete contracts can only be resolved if there is an adequate mechanism for monitoring the behavior of managers."[178] Having already concluded that the shareholders should do that monitoring,[179] the advocates further conclude that directors should maximize shareholder wealth as measured by the stock price.[180] Professor Mitu Gulati explains:

> [A]ccording to the conventional model, a company's stockholders can get an accurate picture of managerial performance — albeit from an ex post perspective — by monitoring the market price of the company's securities. Under the strong or semistrong forms of efficient markets theory, a company's stock price reflects either all existing information or all public information about the company. Given the information content of stock prices, investors can monitor price movements as a proxy for managerial performance. Good management practices will result in higher

[177] STOUT, *supra* note 5, at 10.

[178] Boot & Macey, *supra* note 35, at 364.

[179] CLARK, *supra* note 25, at 389-90 ("[G]iving control to the residual claimants will place the power to monitor the performance of participants in the firm and the power to control shirking, waste, and so forth in the hands of those who have the best incentive to use the power.").

[180] Sean J. Griffith, *Opt-In Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority*, 98 TEX. L. REV. 983, 1007 (2020) ("Shareholder wealth maximization is reducible, essentially, to return on equity, which in efficient markets can be simplified even further to share price."); Romano, *Corporate Governance*, *supra* note 168, at 1164-65 ("[M]anagement performance cannot readily be measured once stock price is no longer the lodestar."). *Contra* CLARK, *supra* note 25, at 18 n.46 ("[M]anagers who attempt to maximize the market value of their company's common stock will take account of the probable long-range results of the company's activities as well as its bottom line in the current year.").

> stock prices; managerial failure to serve corporate interests will result in the market's devaluation of the company's securities.[181]

Stock prices are, however, a poor measure of managerial performance for at least three reasons. First, managerial performance is only one of many determinants of stock prices. Others include stock market conditions, product market conditions, labor market conditions, stakeholder cooperation, government policies, wars, path dependencies, and technological changes. Stock price analysts can and do attempt to control for determinants outside the directors' control. But monitoring directors through stock analysts would be far more complicated than monitoring stock prices.

Second, stock prices are not an accurate measure of the corporation's value.[182] In *Smith v. Van Gorkum*, the Delaware Supreme Court held it to be gross negligence for the Trans Union board to rely on the stock price in selling the company.[183] In 2004, Stout observed that "the evidence at this point does not support the close correlation between price and value predicted by orthodox efficient markets theory."[184] Famed economist Fisher Black attempted to quantify the correlation:

[181] Mitu Gulati, *When Corporate Managers Fear a Good Thing Is Coming to an End: The Case of Interim Nondisclosure*, 46 UCLA L. REV. 675, 692-93 (1999); *see* Lawrence E. Mitchell, *The Partner-Manager: Some Thoughts on Bebchuk and Fried*, 159 U. PA. L. REV. 57, 62 (2010) ("Stock price came to be the most easily accessed metric and — in an era in which markets were said to be highly efficient — appeared to serve as a reasonable proxy for corporate performance.").

[182] Fisch, *supra* note 22, at 672 ("[S]tock price is a poor measure of firm value. Even in a market that is relatively informationally efficient, it is unlikely that market prices reflect fundamental value."); *see* Paul H. Edelman, Randall S. Thomas & Robert B. Thompson, *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359, 1380 n.89 (2014) ("[W]e hear corporate boards routinely making the claim that long-term value is different from stock price value."); Jensen, *supra* note 24, at 246 ("The market is inevitably ignorant of many managerial actions and opportunities, at least in the short-run."); Jeff Schwartz, *De Facto Shareholder Primacy*, 79 MD. L. REV. 652, 666 (2020) ("The prediction of inaccurate stock prices is backed by a mountain of empirical evidence.").

[183] Smith v. Van Gorkom, 488 A.2d 858, 876 (Del. 1985), *overruled by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009) ("The parties do not dispute that a publicly-traded stock price is solely a measure of the value of a minority position and, thus, market price represents only the value of a single share. Nevertheless . . . the Board assessed the adequacy of the premium over market . . . solely by comparing it with Trans Union's current and historical stock price.").

[184] Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635, 667 (2003) [hereinafter *The Mechanisms of Market Inefficiency*].

> [W]e might define an efficient market as one in which price is within a factor of 2 of value, i.e., the price is more than half of value and less than twice value. The factor of 2 is arbitrary, of course. Intuitively, though, it seems reasonable to me, in the light of sources of uncertainty about value and the strength of the forces tending to cause price to return to value.[185]

That estimate finds support in stock market crashes in which prices fall by nearly half in the absence of significant changes in the firms and then quickly recover.[186]

Third, managers can and do manipulate stock prices.[187] The most obvious ways are by massive corporate trading in the corporation's own shares,[188] artificially increasing profits through "earnings management,"[189] misstating their profits,[190] exercising GAAP-permitted "judgment,"[191] and

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185 Fischer Black, *Noise*, 41 J. FIN. 529, 533 (1986).

186 *See* Faith Stevelman & Sarah C. Haan, *Boards in Information Governance*, 23 U. PA. J. BUS. L. 179, 208 (2020) ("The shocking drop and then stunning climb of stock market prices after the spring of 2020 has not enhanced faith in stock market efficiency."); Stout, *The Mechanisms of Market Inefficiency*, *supra* note 184, at 636 ("[I]n the Spring of 2000, the Standard & Poors 500 Index of 500 leading companies topped 1,500. By October 2002, the S&P Index was hovering near 775, a nearly fifty percent decline in value.").

187 STOUT, *supra* note 5, at 67-68 (arguing that managers can "raise share price without improving real economic performance"); Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders*, 124 YALE L.J. 1554, 1561 (2015) ("Short-term shareholders, on the other hand, may benefit when managers engage in what I call 'costly price-boosting manipulation' — actions that boost the short-term stock price at the expense of the pie generated over the long term."); Jensen, *supra* note 24, at 246 ("The market is inevitably ignorant of many managerial actions and opportunities, at least in the short-run.").

188 Fried, *supra* note 187, at 1561 ("Over any given five-year period, U.S. firms buy and sell stock equivalent in value to approximately 30% of their aggregate market capitalization.").

189 Park, *supra* note 25, at 477 ("Company managers that deliver predictable earnings prove that they can accurately forecast earnings growth and follow through on their plans. There is evidence that companies that meet market expectations are rewarded with a higher stock price."); *see* JOHN R. GRAHAM, CAMPBELL R. HARVEY & SHIVA RAJGOPAL, VALUE DESTRUCTION AND FINANCIAL REPORTING DECISIONS 8 (2006) ("80% of survey participants report that they would decrease discretionary spending on R&D, advertising and maintenance to meet an earnings target.").

190 Sharon Hannes & Avraham Tabbach, *Executive Stock Options: The Effects of Manipulation on Risk Taking*, 38 J. CORP. L. 533, 557 (2013) ("Inaccurate accounting and earnings management came at a huge cost to the firms involved and to the U.S. market as a whole.").

191 William O. Fisher, *Where Were the Counselors? Reflections on Advice Not Given and the Role of Attorneys in the Accounting Crisis*, 39 GONZ. L. REV. 29, 37-38 (2004) ("Indeed, two companies in the same industry can undergo virtually the same economic

taking "one-time" charges that analysts will ignore.[192] In light of managers' obvious ability to manipulate stock prices, SWM advocates and courts retreat to the position that shareholders should rely on "long-term profits" to evaluate managers.[193] But no separate stock price based on long-term profits exists.[194]

Under agency theory, the purpose of SWM was to enable shareholders — the people with their own money at stake — to monitor the directors' performance. However, as Bainbridge put it, "[i]n general, shareholders of public corporations have neither the legal right, the practical ability, nor the desire to exercise the kind of control necessary for meaningful monitoring of the corporation's agents."[195] Bainbridge proposed a director primacy theory of the corporation in which the duty of unmonitored directors is to SWM.[196]

The shareholder monitoring argument for SWM fails because directors don't need a single metric to make reasoned decisions, shareholder wealth

experience in a quarter yet report GAAP numbers that differ dramatically."); Richard C. Sauer, *Financial Statement Fraud: The Boundaries of Liability Under the Federal Securities Laws*, 57 BUS. L. 955, 979 (2002) ("[I]mprecise accounting standards in the hands of a clever practitioner can allow wide latitude for earnings management with limited legal consequences.").

[192] Fisher, *supra* note 191, at 38 ("For example, if you decide at some point to discontinue a particular line of business, you may take a "restructuring" charge to record, at the time the line is discontinued, the costs that you anticipate the discontinuation will create. This, too, is an estimate.").

[193] Bhagat & Hubbard, *supra* note 15, at 24 ("Corporate focus on long-term shareholder value maximization, remains the best way to enhance value and the broader corporate contribution to society."); Jensen, *supra* note 24, at 236 ("[V]alue maximization states that managers should make all decisions so as to increase the total long-run market value of the firm."); CLARK, *supra* note 25, at 678 ("[T]he profit-maximizing norm does *not* imply a commitment to short-run profits at the expense of long-run profits. All intelligent formulations of the norm, such as the 'net present value' or 'stock market value' ones, implicitly assume that a wealth-maximizing balance should be struck between long- and short-run profits.").

[194] M. Adetunji Babatunde & Olawoye Olaniran, *The Effects of Internal and External Mechanism on Governance and Performance of Corporate Firms in Nigeria*, 7 CORP. OWNERSHIP & CONTROL 330, 338 (2009) ("Jensen himself offers no clue on how to obtain an accurate measure of the long-term value of the firm, let alone offer an indication of how to assess the possible impact of an investment on that long term value."); *see* Fried, *supra* note 187, at 1568-69 ("Legal academics of a variety of persuasions have long believed that managers should ignore the short-term stock price and focus on maximizing long-term shareholder value.").

[195] Bainbridge, *Director Primacy*, *supra* note 23, at 568.

[196] *Id.* at 574 ("[D]irector primacy does not discard the concept of shareholder wealth maximization.").

is the wrong metric to maximize, shareholders can't use share price to evaluate directors because share price is not a valid measure of corporate financial performance, shareholders can't devote the necessary time and effort to evaluating directors, and shareholders' interests are in conflict with those of the corporation. Even if shareholders could evaluate directors, in most cases they lack the power to remove them.

VII. CORPORATE PERFORMANCE

Prominent defenders of SWM warn that ending the policy may adversely affect the corporation and the economy. Romano predicts that "if corporations pursue objectives other than stock price maximization, the market's allocative efficiency will be compromised."[197] Bainbridge cautions that "the basic rule that shareholder interests come first . . . has helped produce an economy that is dominated by public corporations, which in turn has produced the highest standard of living of any society in the history of the world."[198] Rock warns that "tinkering with the law of corporate purpose threatens to disrupt the coherence of the corporate form, a form that has been one of the great wealth generating innovations of the last 150 years."[199] Bebchuk and Tallarita claim that "[b]y making corporate leaders less accountable and more insulated from shareholder oversight, acceptance of stakeholderism would increase slack and hurt performance, reducing the economic pie available to shareholders and stakeholders."[200]

These warnings imply that the ending SWM threatens prosperity. At least four circumstances assure that it does not. First, foreign corporations not subject to the SWM norm are competitive with U.S. corporations. As Strine explains:

> Most European countries have corporate laws that expressly state that the corporation's managers have a duty to consider all the stakeholders of the corporation, not just stockholders, when managing the enterprise. For example, German corporate law directs managers to attend to the interests of shareholders, employees, and society as a whole. Likewise, in France, corporate managers are encouraged to consider the interests of all

[197] Romano, *Corporate Governance*, *supra* note 168, at 1165.

[198] Bainbridge, *In Defense*, *supra* note 58, at 1446.

[199] Edward B. Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. L. 363, 394 (2021).

[200] Bebchuk & Tallarita, *The Illusory Promise*, *supra* note 127, at 92.

> constituencies in running the corporation. The Netherlands takes a similar approach. Even in the United Kingdom, which is known for its non-frustration regime, the normative duty of corporate directors is to 'promote the success of the company,' which requires directors to take into account the interests of all constituencies. Additionally, E.U. 'harmonization laws' that provide for the creation of a "European Company" require such a company to take the interests of creditors, customers, and employees into account when making business decisions.[201]

That companies incorporated in those countries are competitive with U.S. corporations in numerous markets demonstrates that the absence of a legal duty to SWM is not fatal.

Second, American public companies have been declining in numbers over the past several decades,[202] while domestic[203] public companies worldwide have been increasing in numbers.[204] That suggests that companies most subject to the SWM norm may be less efficient than companies not subject to it. Of course, there may be explanations other than SWM.[205]

Third, a substantial minority of American public companies are incorporated in states with constituency statutes. As a result, their boards are not required to SWM and may consider the interests of non-shareholder stakeholders. Examples include Comcast and PNC Financial in Pennsylvania and Johnson & Johnson in New Jersey. As do foreign

[201] Leo E. Strine, Jr., *The Soviet Constitution Problem in Comparative Corporate Law: Testing the Proposition That European Corporate Law Is More Stockholder Focused than U.S. Corporate Law*, 89 S. CAL. L. REV. 1239, 1247-48 (2016); *accord* Roe, *supra* note 171, at 2072.

[202] Ruchir Sharma, *The Rescues Ruining Capitalism*, WALL ST. J. (July 24, 2020, 11:15 AM ET), https://www.wsj.com/articles/the-rescues-ruining-capitalism-11595603720 [https://perma.cc/B459-2MM5] ("Before the pandemic . . . the number of publicly traded U.S. companies had fallen by nearly half, to around 4,400, since the peak in 1996.").

[203] *Listed Domestic Companies*, *Total*, THE WORLD BANK, https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?page=1 (last visited Feb. 6, 2023, 10:29 AM PST) [https://perma.cc/2JBX-6BZQ] (choose "Details") ("A company is considered domestic when it is incorporated in the same country as where the exchange is located.").

[204] *Id.* (graph showing increase in numbers of listed domestic companies from about 15,000 in 1978 to about 44,000 in 2007 and 43,000 in 2019).

[205] *E.g.*, Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445 (2017) (arguing that public companies are declining in the U.S. because investors are choosing to invest in private equity).

corporations, those constituency-state corporations demonstrate the competitiveness of companies that are not required to SWM.[206]

Fourth, little evidence exists that U.S. companies actually SWM. Delaware law arguably requires corporate wealth maximization, but deliberately makes that requirement unenforceable. As a practical matter, directors can and do consider any interests they chose.[207] Corporations in all U.S. jurisdictions are pursuing objectives other than SWM, and the sky has not fallen.

Exorcising the SWM norm will have little effect on the substance of corporate decision making. Its principal effect may be to eliminate the hypocrisy of having a norm requiring SWM while directors do not SWM.

CONCLUSION

Once powerful, SWM has reached its end. The ALI Restatement of Corporate Governance draft rejects SWM, proposing instead that "the objective of a corporation is to enhance the economic value of the corporation."[208] SWM is not mentioned. This Article examined the arguments for SWM, finding that none plausibly led to the conclusion that SWM improved corporate performance.

The argument from law. The argument is that the law requires SWM, which has led to improved corporate performance. In fact, the law of most states rejects SWM, the law of Delaware requires *corporate* wealth maximization claiming it to be the equivalent of SWM, and SWM is not enforceable in any American jurisdiction. SWM cannot have improved corporate performance because SWM isn't in effect.

The ownership argument. The argument is that the shareholders own the corporation so the directors should SWM. Although shareholders are commonly referred to as the corporation's owners, most scholars do not think they are. But even conceding that the directors should treat the shareholders as owners, the ownership argument fails. Most business owners choose not to SWM, so SWM does not follow logically from ownership. Even assuming shareholders own the corporation and SWM should follow, the argument in no way suggests that the corporation would perform better as a result.

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[206] Whether constituency state corporations survive only because they SWM in the absence of a duty is irrelevant to the point made here. The point is that the absence of a legal duty to SWM is not fatal.

[207] Macey, *Corporate Law as Myth*, *supra* note 165, at 950 ("The reality is that directors essentially can do whatever they want.").

[208] DRAFT RESTATEMENT OF CORPORATE GOVERNANCE, *supra* note 28, at 25.

The residual ownership argument. The argument is that shareholders should manage because, as residual owners, they are the constituency with interests and incentives closest to those of the corporation.[209] By maximizing their own wealth, the managing shareholders would maximize corporate wealth. Because shareholders cannot manage the corporation, the directors should manage for the shareholders' benefit. In doing so, the directors should SWM because that is what the shareholders would have done. The argument contradicts itself by first recognizing that shareholders incentives are imperfect because they differ from the corporation's and then instructing the directors to SWM rather than corporate wealth maximize. The argument provides no basis for privileging shareholder interests over corporate interests.

The agency argument. The argument is that directors are the shareholders' agents, so the directors should maximize the shareholders' wealth. But corporate law requires that directors, not shareholders, manage the corporation and prohibits the directors from acting as the shareholders' agents.

The implied contract argument. The argument is that shareholders and directors have impliedly agreed to SWM. In fact, the corporate governance policies of a large majority of public corporations contain no evidence of a SWM policy. In those corporations, no factual basis exists for implying an agreement to SWM.

The shareholder monitoring argument. The argument is that directors must SWM to enable shareholders to monitor the directors' performance. The argument asserts that shareholders monitor the directors by observing the stock price and removing directors who perform poorly by that measure. In fact, stock prices are poor indicators of director performance and public corporation shareholders generally lack the power to remove directors.

The failure of any of the SWM arguments to connect with the corporation's productive capacity leaves us with no reason to believe abandoning SWM will adversely affect that capacity. Shareholders with their own money at stake are not calling the shots in any of the argument scenarios. The primary function of SWM today is to confuse.[210]

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209 Some consider residual ownership the leading argument for SWM. *See, e.g.*, McDonnell & Bodie, *supra* note 16, at 914 ("The leading scholarly argument favoring an exclusive focus on shareholder wealth maximization as the objective of corporate decision-making has been that shareholders are the residual claimants.").

210 *See* Bebchuk & Tallarita, *Will Corporations Deliver Value to Shareholders?*, *supra* note 23, at 1071 (quoting Caterpillar's statement referring to Caterpillar's "obligations under Delaware General Corporation Law to maximize shareholder value").

Removing the remaining legal and normative pressures to SWM would tend to reduce corporate externalization of social costs. It would also eliminate corporate law's hypocritical presumption that directors calculate the long-term profitability of each of their decisions when everyone knows they do not.

If Delaware clarified that SWM is optional, corporations like Home Depot, Eastman Chemical Company, Wal-Mart, and Caterpillar might continue to embrace it.[211] But SWM is so extreme a policy that most corporations have been unwilling to SWM even when SWM purports to be mandatory. Three decades after reaching its zenith, SWM is near its end.

[211] Those four corporations were the only ones in Bebchuk and Tallarita's 128-company data set stating policies of SWM. *Id.* at 1055-73 (stating Eastman, Home Depot, Caterpillar, and Walmart's mandatory SWM policies, respectively); *see also* S. CO., *supra* note 152 ("[The Board's] role is to maximize long-term stockholder value").