Article

A Legal Theory of Shareholder Primacy

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INTRODUCTION

A foundational concept of corporate law and corporate governance is the principle of shareholder primacy. It expresses the idea that shareholders have the priority interest in both economics and governance of the corporation: shareholders are said to

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be the principal in a principal-agent relationship on whose behalf the corporate enterprise serves.[1] The debate over shareholder primacy is had over two broad matters: shareholder roles in governance and in corporate purpose. With respect to the latter, shareholder primacy instructs the board to manage the corporation for the purpose of maximizing shareholder wealth.

The shareholder-wealth-maximization norm is important because it goes to the most basic question in the field of corporate law: What is the purpose of the corporation and corporate law? The broad-canvas answer—corporations are wealth-producing socioeconomic legal constructs that should profit shareholders—is without controversy. Only when we examine the question deeper does it reveal important social implications.[2] Should shareholder profit be maximized at the expense of other interests? Are efficiency and equity irreconcilable? What about externalities and ethics? Are there social obligations on firms that operate in a complex democratic market system? Is there a causal link between maximization of shareholder profit and social inequity? These questions do not have easy normative answers. The debate is as old as the dawn of the modern corporation and has persisted over many generations of economic history and academic scholarship.[3] One side of the argument answers that the

1. *See* Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539, 545 (2000).

2. The debate on corporate purpose has modern constitutional and sociopolitical dimensions. *See, e.g.*, Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751 (2014) (debating the intersection of corporations and religious freedom); Citizens United v. FEC, 558 U.S. 310 (2010) (debating the intersection of corporations and political campaign finance).

3. As a representative sample, compare these debates in the 1930s, 1960s, and 1990s. *See* MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962) (arguing there is "only one social responsibility of business—to use its resources and engage in activities designed to increase its profits"); JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE 124–25 (1967) (stating that economists and businesspersons "have abandoned, however tacitly, their commitment to [profit] maximization"); Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1425 (1993) (defending shareholder primacy); A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (stating that managers should exercise power "only for the ratable benefit of all the shareholders"); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932) (stating that a corporation "has a social service as well as a profit-making function"); Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409, 1411 (1993) (proposing stakeholder theory).

sole obligation of a corporate manager is to maximize shareholder profit within the bounds of lawful activity.[4] Others disagree, arguing that shareholder profit need not always be prioritized over other interests or consideration.[5]

Despite persistent criticism, the idea of shareholder primacy has been widely accepted.[6] However, its legal status remains uncertain even today.[7] This is an unsatisfactory state of understanding, all the more conspicuous since the field of corporate law has been well developed in law and scholarship. Shareholder primacy is said to be a central tenet of corporate governance. Corporate law scholars almost universally describe it as a norm, and rarely as law.[8] Critics diminish it further to an ideology or dogma.[9] Even advocates consistently describe it as a norm.[10]

4. *See, e.g.*, Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 155, 171 (2012) (embracing Milton Friedman's idea and arguing "corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders"); Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, § 6 (Magazine), at 33 ("That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom."); *supra* note 3 (noting various scholars arguing for shareholder primacy).

5. *See, e.g.*, LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC *passim* (2012); William W. Bratton, *Framing a Purpose for Corporate Law*, 39 J. CORP. L. 713, 720–21 (2014); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 733 (2005); Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 638 (2006); David Millon, *Radical Shareholder Primacy*, 10 U. ST. THOMAS L.J. 1013, 1014 (2013); 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, 735–36 (2010); *supra* note 3 (noting various scholars arguing against shareholder primacy).

6. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) ("There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."); *infra* note 58.

7. *See infra* Part I.

8. *See infra* note 55.

9. STOUT, *supra* note 5, at 2 (labeling it an ideology); David Millon, *Shareholder Primacy in the Classroom After the Financial Crisis*, 8 J. BUS. & TECH. L. 191, 192 (2013) (labeling it a dogma).

10. *See, e.g.*, Bainbridge, *supra* note 3, at 1423; Jonathan R. Macey, *A Close Read of an Excellent Commentary on* Dodge v. Ford, 3 VA. L. & BUS. REV. 177, 179 (2008).

Other than undue and hackneyed debate around an old Michigan case,[11] we lack a legal theory of shareholder primacy. The debate on shareholder primacy is invariably had at the level of policy and economic rationale, advancing normative arguments for or against the idea.

This Article advances a coherent legal theory of shareholder primacy. It answers these basic questions: Is shareholder primacy law? If it is, how does the law work to achieve effective compliance? To answer these questions, this Article conducts the first empirical review of judicial discussion of shareholder profit maximization in the era of the modern corporation, 1900 to 2016. The data show that courts have pervasively embraced the concept that corporate managers should maximize shareholder wealth. This judicial embrace is a key part of the answer to these questions, but a coherent theory of shareholder primacy must answer how shareholder primacy works when judicial commentary on shareholder primacy is in the form of a nonenforceable rule.

This Article posits that shareholder primacy cannot be stated as a pithy rule of law and enforceable sanction. Law in this form would irreconcilably conflict with other foundational rules of corporate law and corporate governance. A basic aspect of corporate law as we know it—the separation of ownership and control—would become incoherent.[12] The inability to find a precise locus of law does not mean that the law does not exist. Shareholder primacy is not a social norm originating from a shared belief in the community, independent of legal origin or influence. It is law obligating managers to maximize value. It exists as a filament of the corporate system, weaving through

11. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

12. This comment simply notes the basic separation between shareholders and the board without delving into the ongoing debate as to the optimal distance of the separation between the two. *See* MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1126 (Del. 2003) ("The most fundamental principles of corporate governance are a function of the allocation of power within a corporation between its stockholders and its board of directors."); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 917 (2013) ("The net result [of the interaction between shareholder activists and institutional investors] is better monitoring and, perhaps, lower agency costs in the real economy."). *Compare* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) (arguing that shareholders should have increased power, such as the ability to alter the company charter or state of incorporation), *with* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U.L. REV. 547 (2003) (advocating for a director primacy model).

the architecture of the corporate system, its rules of law, corporate governance practices, and market mechanisms. Judicial recognition of the concept of shareholder primacy is an important facet of a greater legal and market architecture that has created a Hartian obligation.[13]

This Article does not advance a normative theory of shareholder wealth maximization or the idea that shareholder primacy promotes an equitable or ethical society. The normative arguments for and against have been well developed in legal, business, and economic scholarship. This Article presents a positive legal theory explaining the structure of a complex law. The question—*what is the law?*—has not received sufficient empirical or theoretical analyses. This Article contributes to the literature by presenting a complete, coherent theory of positive law of shareholder primacy. This theory explains why shareholder primacy must be in a form of law without sanctions and the precise mechanism by which the law effectively influences managerial behavior toward compliance.[14]

Before starting the analysis, this Article notes an important definitional distinction that is central to the theory advanced here. Although scholars sometimes use the terms *duty* and *obligation* interchangeably,[15] this Article distinguishes them. Duty

13. *See* H.L.A. HART, THE CONCEPT OF LAW 102 (3d ed. 2012) ("The use of unstated rules of recognition, by courts and others, in identifying particular rules of the system is characteristic of the internal point of view. Those who use them in this way thereby manifest their own acceptance of them as guiding rules . . . .").

14. *See* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1263 (1999) ("The process by which norms originate and are adopted as a result of changes in actors' belief-systems is extremely important generally, and is of special importance in explaining the origin and adoption of many norms that are significant in corporate law.") (internal citation omitted); Robert E. Scott, *The Limits of Behavioral Theories of Law and Social Norms*, 86 VA. L. REV. 1603, 1647 (2000) ("What are the mechanisms by which law influences behavior apart from the deterrent effect of state sanctions? That question remains a fertile area for further investigation.").

15. *E.g.*, Leslie Green, *Law and Obligations*, *in* THE OXFORD HANDBOOK OF JURISPRUDENCE & PHILOSOPHY OF LAW 514, 514 n.1 (Jules Coleman & Scott Shapiro eds., 2002). Some fields of law make a clear distinction. For example, noncorporate business-entity statutes distinguish duty and obligation, wherein duty refers to fiduciary duty and obligation refers to some other legal commitment. *See, e.g.*, UNIF. LTD. LIAB. CO. ACT § 409(a), (d) (Nat'l Conference of Comm'rs on Unif. State Laws 2013); UNIF. LTD. P'SHIP ACT § 408(a), (d) (Nat'l Conference of Comm'rs on Unif. State Laws 2013); UNIF. P'SHIP ACT § 404(a), (d) (Nat'l Conference of Comm'rs on Unif. State Laws 2013); s*ee also* Gerber v. Enter. Prods. Holdings, LLC, 67 A.3d 400, 418–19 (Del. 2013) (explaining the difference between fiduciary duty and the obligation of good faith and fair dealing).

is defined in the doctrinal sense of a cognizable fiduciary duty subjecting directors or others to potential legal sanction for breach.[16] Obligation is defined in the jurisprudential sense of a government prescription that is not attached to a sanction, though it is a form of law.[17] In short, the theory of law advanced here is that while there is no duty to maximize profit, courts have imposed an obligation to do so and this prescription is efficacious even though it is unenforceable. This obligation is the law of shareholder primacy. This Article unpacks how this law works in the practice of corporate governance.

This Article is organized into four Parts. Part I presents the current understanding of shareholder primacy as a social norm, and it explains the core tension between shareholder primacy and managerial authority in the structure of corporate law. Part II discusses rules of law that partially advance the effect of shareholder primacy, including the law's treatment of intersecurity conflicts, sale of corporate control, the market for corporate control, and executive pay. Part III presents empirical data from federal and state cases discussing the concept of shareholder profit maximization from 1900 to 2016. Part IV advances a complete and coherent theory of positive law, showing the precise mechanism by which courts and the legal system have created an obligation that, albeit unenforceable as a duty, is efficacious nonetheless.

I. THE PROBLEM OF LEGAL THEORY

Shareholder primacy is a legal enigma. It is said to be a fundamental tenet of corporate law.[18] Yet its legal authority seems strangely scant. In other fields of law, foundational laws are readily apparent in the primary sources of law. Every field has them.[19] The first statutes enacting a fundamental concept are

16. *See infra* note 39.

17. *See infra* Part IV.B. (presenting the theory of an obligation as law).

18. *See* Douglas R. Cole, *E-Proxies for Sale? Corporate Vote-Buying in the Internet Age*, 76 WASH. L. REV. 793, 831 n.192 (2001) ("This view of corporate law . . . is a central tenet of traditional corporate law."); Grant Hayden & Matthew Bodie, *Arrow's Theorem and the Exclusive Shareholder Franchise*, 62 VAND. L. REV. 1217, 1218 n.1 (2009) ("Shareholder primacy is generally viewed as the normative foundation for modern corporate law theory.").

19. *E.g.*, Civil Rights Act of 1964, Pub. L. 88-352, 78 Stat. 241 (1964) (codified as amended in various sections of the U.S. Code) (establishing the foundation for civil rights litigation); Securities Act of 1933, Pub. L. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. § 77a–77aa) (establishing the basis for securities regulation); Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837 (1984) (establishing standard of review for agency actions); Marbury v. Madison, 5 U.S.

modeled.[20] Progenitor cases are frequently cited and relied upon as authority.[21] Shareholder primacy is different. It is difficult to find the locus of law. There is no well-established body of case law or a statute commanding a duty to maximize profit. Due to this real legal ambiguity, shareholder primacy has been debated principally on policy grounds and, as discussed below, its legal status has been vigorously contested.

A. WHITHER THE LAW

The uncertain legal status is seen when one searches for legal authority in the traditional way that lawyers find the law: cases, statutes, and regulations stating a prescription, prohibition, or permission. Shareholder primacy seems to exist not as a pinpoint citation, but in the ether. It is real in that no one disputes the sense of obligation in the boardroom and executive suites, but finding the law's command is elusive. No corporation statute of the fifty states imposes a duty on the board to manage a business corporation to maximize shareholders' wealth. All corporation statutes simply provide that the corporation may engage in any lawful activity.[22] In fact, some statutes provide that the board may consider the interests of constituents beyond shareholders.[23]

Case law imposing a duty to maximize profit is so scant that there is hackneyed over-reliance on *Dodge v. Ford Motor Co.*[24]

(1 Cranch) 137 (1803) (establishing judicial review); Palsgraf v. Long Island R.R. Co., 162 N.E. 99 (N.Y. 1928) (establishing duty and proximate cause in tort law); Hadley v. Baxendale (1854) 156 Eng. Rep. 145; 9 Ex. 341 (establishing consequential damages in contract law).

20. For example, virtually every state has enacted a version of the uniform partnership laws. *See* UNIF. P'SHIP ACT (Nat'l Conference of Comm'rs on Unif. State Laws 2013); UNIF. P'SHIP ACT (Nat'l Conference of Comm'rs on Unif. State Laws 1914) (amended 2013).

21. For example, *Meinhard v. Salmon* has been cited 1158 times in federal and state court opinions according to Westlaw's KeyCite as of April 12, 2018. 164 N.E. 545 (N.Y. 1928) (stating the standard for a partner's fiduciary duty of loyalty).

22. *E.g.*, DEL. CODE ANN. tit. 8, § 101(b) (2017); MODEL BUS. CORP. ACT § 3.01(a) (2013). Most corporate charters track the statute and make no reference to profit maximization. *E.g.*, *Restated Certificate of Incorporation of Facebook, Inc.*, SEC (May 22, 2012), https://www.sec.gov/Archives/edgar/data/1326801/000119312512046715/d287954dex31.htm.

23. *E.g.*, FLA. STAT. § 607.0830(3) (2017); *see* Elhauge, *supra* note 5, at 737; D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 289 (1998); *infra* note 146 (citing cases where courts reject shareholder primacy on the basis of constituency statutes).

24. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

The case famously involved a dispute between Henry Ford and the Dodge brothers over whether Ford Motor Company, a close corporation that Ford controlled, should pay dividends to shareholders in light of enormous accumulation of capital surplus and whether the company should be permitted to make large capital investments.[25] Ford justified his business decisions on his philosophy that a corporation should "employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes."[26] The Michigan Supreme Court rejected his economic philosophy and rebuked Ford: "A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end."[27]

For a 1919 case from Michigan dealing with the legal issue of minority oppression, *Dodge* has assumed an outsized prominence in scholarship.[28] Its celebrity is due to two factors. First, Henry Ford and the Ford Motor Company, no less the Dodge brothers, are famed figures in American industry. Second, this history wraps the first judicial statement of shareholder primacy in crystalline form made in an inceptive era of industrialization, large corporate enterprises, and liberal corporate law. This second factor gives *Dodge* its celebrity in scholarship. The case is a polestar. There has not been another such unambiguous, unconditional embrace by a state supreme court. Despite its prominence as an iconic case for shareholder primacy,[29] it has not been

25. *Id.* at 669–79.

26. *Id.* at 671. In his autobiography, he reiterated this thought: "The true industrial idea is not to make money. The industrial idea is to express a serviceable idea, to duplicate a useful idea, by as many thousands as there are people who need it." HENRY FORD & SAMUEL CROWTHER, MY LIFE AND WORK 140 (1922).

27. *Dodge*, 170 N.W. at 684.

28. *See* STOUT, *supra* note 5, at 25 ("[O]versized effects of a single outdated and widely misunderstood judicial opinion."). The case has been cited in 1045 law review articles according to Westlaw's KeyCite as of April 12, 2018. It is also prominent in the business law curriculum of law schools. *See, e.g.*, JEFFREY D. BAUMAN, RUSSELL B. STEVENSON, JR. & ROBERT J. RHEE, BUSINESS ORGANIZATIONS LAW AND POLICY 160–65 (9th ed. 2017); CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS: CASES AND MATERIALS 270–73 (7th ed. 2014); M. Todd Henderson, *The Story of* Dodge v. Ford Motor Company*: Everything Old Is New Again*, *in* CORPORATE LAW STORIES 37 (J. Mark Ramseyer ed., 2009).

29. *See* THE ICONIC CASES IN CORPORATE LAW 2 (Jonathan R. Macey ed., 2008).

cited much.[30] In Delaware, it has only been cited three times for other propositions.[31] In almost one hundred years, only the West Virginia Supreme Court has restated *Dodge*'s iconic proposition, but it did so in the context of justifying broad authority to engage in corporate philanthropy, a concept that is at least in tension with maximizing shareholder profit.[32]

There is another anomalous case. In *eBay Domestic Holdings, Inc. v. Newmark*, the founders of Craigslist, a website created for users to list products and services for sale, adopted a poison pill plan to thwart eBay's attempt to acquire Craigslist.[33] They argued that the poison pill was necessary to protect Craigslist's social values and community-centric corporate cul-

30. The case is cited in forty-three state court opinions according to Westlaw's KeyCite as of April 12, 2018. Compare this to the 1156 citations to *Meinhard*. *Supra* note 21. Of the twenty-three non-Michigan cases, most cite *Dodge* for the proposition of rebutting the business judgment rule to compel dividends. *See* Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 278 (Alaska 1980); Hall v. John S. Isaacs & Sons Farms, Inc., 163 A.2d 288, 295 (Del. 1960); Blackwell v. Nixon, Civ. A. No. 9041, 1991 WL 194725, at *4 (Del. Ch. Sept. 26, 1991); Donahue v. Rodd Electrotype Co. of New England, Inc., 328 N.E.2d 505, 514 (Mass. 1975); Gordon v. Elliman, 119 N.E.2d 331, 334 (N.Y. 1954) (citing NY PA NJ Utils. Co. v. Pub. Serv. Comm'n of N.Y., 23 F. Supp. 313, 314 (S.D.N.Y. 1938)); City Bank Farmers' Tr. Co. v. Hewitt Realty Co., 177 N.E. 309, 311 (N.Y. 1931); Swinton v. W. J. Bush & Co., 102 N.Y.S.2d 994, 997 (Sup. Ct. 1951); City Bank Farmers' Tr. Co. v. Hewitt Realty Co., 245 N.Y.S. 782, 783 (App. Div. 1931) (Martin, J., dissenting); Jones v. Van Heusen Charles Co., 246 N.Y.S. 204, 208–09 (App. Div. 1930); Farmers' Loan & Tr. Co. v. Pierson, 222 N.Y.S. 532, 537 (Sup. Ct. 1927); Johnson v. Lamprecht, 15 N.E.2d 127, 131 (Ohio 1938); Ostlind v. Ostlind Valve, 165 P.2d 779, 789 (Or. 1946); Dodge v. Scripps, 37 P.2d 896, 902 (Wash. 1934); Meadows v. Bradshaw-Diehl Co., 81 S.E.2d 63, 69 (W. Va. 1954); Gesell v. Tomahawk Land Co., 200 N.W. 550, 556 (Wis. 1924). Several courts have cited *Dodge* for a proposition related to minority oppression by a majority shareholder, or a general statement of law regarding bad faith, fraud, or breach of fiduciary duty by a manager. Hill v. State Farm Mut. Auto. Ins. Co., 83 Cal. Rptr. 3d 651, 692 (Ct. App. 2008); Rogan v. Oliver, 110 So.3d 980, 983 (Fla. Dist. App. Ct. 2013); Shlensky v. Wrigley, 237 N.E.2d 776, 779–80 (Ill. App. Ct. 1968); Long v. Norwood Hills Corp., 380 S.W.2d 451, 476 (Mo. App. 1964); Zidell v. Zidell, Inc., 560 P.2d 1086, 1089 (Or. 1977). Three cases cite *Dodge* for propositions related to corporate philanthropy. *See* E. I. Du Pont De Nemours & Co. v. Clark, 88 A.2d 436, 444 (Del. 1952) (Tunnell, J., dissenting); A. P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 584 (N.J. 1953); Gilbert v. Northfolk & W. Ry. Co., 171 S.E. 814, 815 (W. Va. 1933).

31. *See supra* note 30.

32. *See Gilbert*, 171 S.E. at 815.

33. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 15–16 (Del. Ch. 2010). Delaware has legitimized the use of poison pills. Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356–57 (Del. 1985). A defensive measure must be a reasonable response to the threat posed to the corporation. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985).

ture, which would be threatened by the acquisition by the corporate giant eBay.[34] The Delaware Chancery Court rejected the argument and its reasoning echoed the *Dodge* proclamation:

> 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. . . . I cannot accept as valid for the purposes of implementing the Rights Plan 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 . . . . Directors of a for-profit Delaware corporation cannot deploy a rights plan to defend a business strategy that openly eschews stockholder wealth maximization—at least not consistently with the directors' fiduciary duties under Delaware law.[35]

This statement strongly embraces shareholder primacy. It is a trial court opinion of a single judge, but of course an influential court. If *Dodge* is a polestar, *Newmark* is a sign of the season, a trade wind blowing toward shareholder-centrism.

The point still stands: case law is scant. In the over one hundred years of the modern era of corporations and in light of a well-developed corporate law, there does not seem to be a weight of case law establishing a duty on boards to maximize shareholder profit in managing a going concern. In this respect, *Dodge* and *Newmark* could just as well be characterized as outliers rather than crystalline examples of existing principle. In light of the disconnection between *Dodge*'s prominence and its actual influence on corporate law, some commentators have dismissed the case as irrelevant.[36]

B. CONFLICT WITH MANAGERIAL AUTHORITY

Corporate law vests the board of directors with managerial authority.[37] A fiduciary duty to maximize profit, subjecting the board's decision to judicial review, would impose a framework of a rule and enforceable sanction (hereinafter "rule-sanction"). In jurisprudence, such law is said to be Austinian, in the sense of

34. *eBay*, 16 A.3d at 32.

35. *Id.* at 34–35.

36. *See* STOUT, *supra* note 5, at 25–29; Millon, *supra* note 5, at 1023; Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163, 168–74 (2008); *see also* Smith, *supra* note 23, at 322 (arguing that due to the business judgment rule "the shareholder primacy norm is nearly irrelevant").

37. *E.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2017); MODEL BUS. CORP. ACT. § 8.01(a) (2013).

an order backed by the threat of government power.[38] Fiduciary duties in corporate law are liability rules; the breach of the duty of care or loyalty may result in legal liability for various parties subject to the liability scheme.[39] The basic tenets of corporate law are the separation of ownership and control[40] and the primacy of managerial authority.[41] As a conceptual matter, a rule-sanction framework of a duty to maximize profit presents an irreconcilable conflict between authority and accountability because profit-seeking is the core managerial function in a business corporation.[42]

Shareholder primacy is clearly unenforceable on its own terms because the business judgment rule would defeat any claims based on a failure to maximize profit.[43] Corporate managers formulate business strategy. A rule-sanction is antithetical to the core concept of the business judgment rule. No court has ever imposed liability for breach of fiduciary duty on the specific reason that the board, in managing operational matters, failed to maximize shareholder profit, though it made the decision informedly, disinterestedly, and in good faith.[44] In fact,

38. *See* HART, *supra* note 13, at 16–17 (discussing Austin's concept of law in JOHN AUSTIN, THE PROVINCE OF JURISPRUDENCE DETERMINED (1832)).

39. *See, e.g.*, RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 857 (Del. 2015); Gantler v. Stephens, 965 A.2d 695, 699 (Del. 2009); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 368 (Del. 1993); Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985); Weinberger v. UOP, Inc., 457 A.2d 701, 712–13 (Del. 1983); Guth v. Loft, 5 A.2d 503, 514–15 (Del. 1939); *In re* Rural Metro Corp., 88 A.3d 54, 110 (Del. Ch. 2014).

40. N. Am. Catholic Educ. Prog. Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007); Malone v. Brincat, 722, A.2d 5, 9 (Del. 1998); Randy J. Holland, *Delaware's Business Courts: Litigation Leadership*, 34 J. CORP. L. 771, 779 (2009).

41. Tit. 8, § 141(a); MODEL BUS. CORP. ACT. § 8.01(a) (2013); Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1154 (Del. 1990); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984).

42. *See* Bainbridge, *supra* note 12, at 604–05 (noting the conflict between authority of managers and accountability to shareholders); Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 BUS. LAW. 503, 522 (1989) ("The power to hold to account is the power to interfere and, ultimately, the power to decide.").

43. STOUT, *supra* note 5, at 29; Macey, *supra* note 10, at 180–81; Smith, *supra* note 23, at 286; D. Gordon Smith, *Response: The Dystopian Potential of Corporate Law*, 57 EMORY L.J. 985, 1002 (2008); *see* Bratton, *supra* note 5, at 716 ("A legal mandate to maximize makes no sense in a dynamic economy.").

44. *See* Fisch, *supra* note 5, at 651 ("Although *Dodge v. Ford* is frequently cited, no modern court has struck down an operational decision on the ground that it favors stakeholder interests over shareholder interests.").

many cases hold the opposite. Courts have held that shareholders cannot challenge a board's decision on the specific reasons that, for example, the company paid its employees too much;[45] it failed to pursue a profit opportunity;[46] it did not maximize the settlement amount in a negotiation;[47] or it failed to lawfully avoid taxes.[48] Textbook cases show that courts have rejected shareholders' attempts to interfere with the board's decisions on the argument that their views of business or strategy would have maximized corporate value.[49]

A rule-sanction would be difficult and inefficient to implement through a liability rule. Commanding a board to maximize profit upon pain of sanction does not inform how a manager should do so. Such a command is different from instructing a person not to drive negligently. Profit is a score, not a strategy. In many cases, an indeterminate set of potential business strategies, each subject to unique business risk, must be reviewed and second-guessed through the litigation system.[50] In concrete terms, there may be no way to tell how profits can be maximized for the *New York Times* as between, for example, two strategies: reducing the number of reporters and thereby cutting employee costs, or increasing the number and thereby incurring more costs. A corporate action may be motivated by profit maximization, but such motive does not yield a deterministic end. The profit motive may often result in stochastic corporate actions.[51]

45. *See, e.g.*, *In re* Walt Disney Co. Deriv. Litig., 906 A.2d 27, 56 (Del. 2006); *In re* The Goldman Sachs Grp., Inc. S'holder Litig., No. 5215-VCG, 2011 WL 4826104, at *14–16 (Del. Ch. Oct. 12, 2014).

46. *See, e.g.*, Shlensky v. Wrigley, 237 N.E.2d 776, 778–80 (Ill. App. 1968).

47. *See, e.g.*, Carlton Invs. v. TLC Beatrice Int'l Holdings., Inc., No. CIV. A. 13950, 1997 WL 305829, at *18 (Del. Ch. May 30, 1997).

48. *See, e.g.*, Gregory v. Helvering, 293 U.S. 465, 469 (1935) (holding that taxpayers have a right to pursue lawful tax avoidance strategies); Kamin v. Am. Express Co., 387 N.Y.S.2d 807, 812–13 (Sup. Ct. 1976); s*ee also* Freedman v. Adams, C.A. No. 4199-VCN, 2012 WL 1345638, at *13 (Del. Ch. Mar. 30, 2012) (emphasizing that there is no fiduciary duty under corporate law to avoid taxes); Seinfeld v. Slager, No. 6462-VCG, 2012 WL 2501105, at *3 (Del. Ch. June 29, 2012) (same).

49. *See, e.g.*, *Shlensky*, 237 N.E.2d at 779–80; *Kamin*, 383 N.Y.S.2d at 815.

50. *See In re* Pure Res., Inc. S'holder Litig., 808 A.2d 421, 34–35 (Del. Ch. 2002); E. Norman Veasey, *Should Corporate Law Inform Aspirations for Good Corporate Governance Practice—or Vice Versa?*, 149 U. PA. L. REV. 2179, 2184–85 (2001).

51. *See* Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 12 BUS. ETHICS Q. 235, 245 (2002) ("[V]alue maximizing says nothing about how to create a superior vision or strategy."); Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2072 (2001) (noting that corporate law's

If courts impose an enforceable duty, they will struggle over the proper allocation of authority and accountability for business actions and profits. They must provide some generalizable instructions on how to maximize profit. Any new division between deference and judicial review would require some judicial determination of whether profit has been maximized. Foundational rules of corporate law, such as the separation of ownership and control and the business judgment rule, would be tested in a conceptual shift. This conflict would ultimately be inefficient and incoherent.

Neither *Dodge* nor *Newmark* conflicts with this analysis. Their specific holdings did not rest on or establish an independent fiduciary duty to maximize profit, enforceable by sanctions. The holding in *Dodge* rested on an abuse of discretion in Ford's dividend decision in the context of a minority freeze out.[52] The holding in *eBay* rested on the court's application of the *Unocal* enhanced standard of review applicable to corporate defensive measures.[53] As a doctrinal matter, neither case can fairly be read to establish a cognizable duty to maximize profit, though clearly the admitted failure to maximize profit by the controlling shareholders in both cases was a significant, if not dispositive, factor in the holdings resting on other doctrines of corporate law.

C. ACADEMIC DISCOURSE AND CONSENSUS

In light of the seemingly scant law and the doctrinal problem of a rule-sanction framework, academic discourse on shareholder primacy has been had on theoretical and policy grounds (after the usual obligatory discussion of *Dodge*).[54] Legal scholarship almost always describes shareholder primacy as a social

instructions to managers to enhance shareholder profit do not "determine what they do").

52. Dodge v. Ford Motor Co., 170 N.W. 668, 682–85 (Mich. 1919); *see* STOUT, *supra* note 5, at 26–27 (noting that the holding relates specifically to minority oppression by withholding dividends); Smith, *supra* note 23, at 315 (same).

53. Unocal v. Mesa, 16 A.3d 1, 28–35 (Del. Ch. 2010).

54. The rise of shareholder primacy as an idea has been well described in legal scholarship. *See* STOUT, *supra* note 5, at 18–19; Fisch, *supra* note 5, at 656–61; Millon, *supra* note 9, at 1025–34; Robert J. Rhee, *Corporate Ethics, Agency, and the Theory of the Firm*, 3 J. BUS. & TECH. L. 309, 310–14 (2008). In brief, shareholder primacy arose from theoretical work by economists in the 1970s and 1980s, resulting in subsequent law and economic conception of corporate law. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1996); Eugene Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 289 (1980); Michael C.

norm.[55] This description is significant because a social norm is generally not considered law and is not subject to legal sanction.[56] Academic discourse reveals the unclear legal status of shareholder primacy.

In an influential essay, Henry Hansmann and Reinier Kraakman argue that, as an observed matter, corporate law has reached an ultimate consensus: "[t]he 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."[57] This standard model reflects an internalization of shareholder-centric ideology by a broad consensus of business, government, and legal elites.[58] Absent in the analysis was discussion of law and its relationship to observed internalization of shareholder primacy.[59]

In an article specifically analyzing *Dodge*, Jonathan Macey argues that the case has "legal effect" and is a "positive account of what corporate law actually is,"[60] but also notes the limited evidence of law in the form of a rule-sanction. We rarely see cases like *Dodge*, Macey explains, because managers are better

Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Capital Structure*, 3 J. FIN. ECON. 305, 305–12 (1976).

55. A Westlaw search of the terms "shareholder primacy norm" and "shareholder wealth maximization norm" shows that a total of 110 articles used one of the two terms as of February 19, 2018. *See, e.g.*, Bainbridge, *supra* note 12, at 573; Bratton, *supra* note 5, at 720; Fisch, *supra* note 5, at 637; Hansmann & Kraakman, *supra* note 6, 465–66 n.41; James D. Nelson, *The Freedom of Business Association*, 115 COLUM. L. REV. 461, 502 (2015); Roe, *supra* note 51, at 2064; Smith, *supra* note 23, at 277.

56. *See infra* notes 207–10 and accompanying text.

57. Hansmann & Kraakman, *supra* note 6, at 441.

58. *Id.* at 439; *see* STOUT, *supra* note 5, at 4 (claiming that it is "accepted as a truth" by business and policy elites); Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 798 n.35 (2002) ("[M]ost corporate law scholars embrace some variant of shareholder primacy."); Fisch, *supra* note 5, at 640 (stating that it is "overwhelmingly embraced" by scholars); Nelson, *supra* note 55, at 501–02 ("[W]idely accepted social norm among business leaders."); Smith, *supra* note 23, at 278 (explaining that it is fully internalized by managers); s*ee also* Edwards v. Morrow, 725 S.E.2d 366, 370 (N.C. App. 2012) ("From an economics standpoint, it is considered a given that the primary aim of a for-profit entity is profit maximization.").

59. The article cited no primary legal authority, except a minor citation to *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983). Hansmann & Kraakman, *supra* note 6, at 456 n.28.

60. Macey, *supra* note 10, at 178, 180.

coached and are more willing to dissemble than Ford was to get business judgment deference.[61] Shareholder primacy is "the law on the books, if not in practice."[62] The concept is like a street sign that clearly posts a speed limit. The problem is not the lack of clarity of the rule, but the lack of enforceability.[63] Shareholder primacy is unenforceable because managers can hide behind the business judgment rule as long as they do not reveal their motive, as Ford did.[64] Thus Macey suggests that, on the one hand, profit maximization "actually is" corporate law, but at the same time calls it a "norm."[65]

In a recent essay, Leo Strine, the chief justice of the Delaware Supreme Court, defends shareholder primacy from a normative perspective.[66] This essay is notable in two respects. First, invoking Milton Friedman's famous manifesto on profit maximization,[67] Strine states that "corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders."[68] The linkage of shareholder wealth maximization and the duty of loyalty is a serious matter in the practice of corporate law because money damages against a director for a breach cannot be exculpated.[69] With that said, Strine conditions his statement by reciting the primacy of managerial authority: "The directors, of course, retain substantial discretion, outside the context of a change of control, to decide how best to achieve that goal and the appropriate time frame for delivering those returns."[70] This comment implicitly concedes the incoherence of subjecting managerial authority to a rule-sanction for the failure to maximize profit.[71] Second, like

61. *Id.* at 180.

62. *Id.* at 181.

63. *Id.*

64. *See supra* notes 36, 43–44.

65. Macey, *supra* note 10, at 179; *see* George A. Mocsary, *Freedom of Corporate Purpose*, 2016 B.Y.U. L. REV. 1319, 1342 (calling it both law and norm).

66. Strine, *supra* note 4.

67. *See* Friedman, *supra* note 4.

68. Strine, *supra* note 4, at 155, 171. Strine further echoes Milton Friedman when he suggests that profit maximization promotes "the public interest." *Id.* at 135–36.

69. DEL. CODE ANN. tit. 8, § 102(b)(7) (2017); Malpiede v. Townson, 780 A.2d 1075, 1094 (Del. 2001); McMullin v. Beran, 765 A.2d 910, 926 (Del. 2000).

70. Strine, *supra* note 4, at 155.

71. Delaware jurists have suggested that shareholder primacy is "a matter of principle," but stopped short of calling it law. William T. Allen et al., *The*

Hansmann and Kraakman's earlier essay, Strine's essay is notable in that he did not make a sustained legal argument for shareholder primacy. He cites and discusses *Dodge* and *eBay*, but this discussion punctuates a policy-laden argument supported by academic literature on shareholder primacy.[72]

Lastly, the contestability of the legal status of shareholder primacy is evident in a recent popular media editorial debate between Lynn Stout and Stephen Bainbridge. Stout argues that corporate law does not mandate "a legal duty" to maximize profit.[73] But Bainbridge argues that shareholder primacy has been "the law" since *Dodge*.[74] On the basic question of stating the positive law, the positions of these two eminent corporate law scholars at first glance seem contradictory. The seeming contradiction reveals the problem.

The above review of literature is not a criticism, but simply confirms the earlier point that pinpointing the law of shareholder primacy has been elusive. Without a positive legal theory, the academic discourse does not rely on the law in the doctrinal and practical sense so much as it defaults to normative arguments to suggest what law or corporate governance norm is and

Great Takeover Debate: A Meditation on Bridging the Conceptual Divide, 69 U. CHI. L. REV. 1067, 1079 (2002).

72. *See* Strine, *supra* note 4, at 145–55. In another article, Strine argues that shareholder primacy is a logical conclusion in light of the structure of corporate law and the rights held by shareholders therein. Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 453–54 (2014). However he acknowledges the possibility that shareholder primacy is not law: "But regardless of whether that is so as a matter of law, this allocation of power has a profound effect as a matter of fact on how directors govern for-profit corporations." *Id.* at 454–55. He further suggests that "as a practical matter" *Revlon* settled the issue. *Id.* at 454 n.16. This suggestion elides the issue because the *Revlon* rule is limited in its scope to a particular type of M&A transaction, and the unresolved question is whether the principle in *Revlon* applies outside of the doctrinal scope of *Revlon*.

73. Lynn Stout writes: "There is a common belief that corporate directors have a legal duty to maximize corporate profits and 'shareholder value'—even if this means skirting ethical rules, damaging the environment or harming employees. But this belief is utterly false." Lynn Stout, *Corporations Don't Have to Maximize Profits*, N.Y. TIMES (Apr. 16, 2015), https://www.nytimes.com/roomfordebate/2015/04/16/what-are-corporations-obligations-to-shareholders/corporations-dont-have-to-maximize-profits.

74. Stephen Bainbridge writes: "Despite contrary claims by some academics and Occupy-Wall-Street-type partisans, [*Dodge v. Ford Motor Co.*] remains the law today." Stephen Bainbridge, *A Duty to Shareholder Value*, N.Y. TIMES (Apr. 16, 2015), https://www.nytimes.com/roomfordebate/2015/04/16/what-are-corporations-obligations-to-shareholders/a-duty-to-shareholder-value.

should be. The implicit assumption is that the suasion of normative theory, manifesting in a social norm, is the root cause of managerial internalization and behavior.

The legal status of a fundamental concept of corporate law is uncertain and contestable. The legal theory advanced in this Article shows that both Stout and Bainbridge, and other commentators discussed above, are correct in their precise positions: shareholder primacy is not a duty, but is law; the rule of law is unenforceable, but is broadly obeyed and thus efficacious. Advocates and critics of shareholder primacy are not as far apart as they seem to be. The apparent conflict in their positions on a positive theory is attributable to two factors: first, an incomplete theory of law resulting in an assumption that the rule of law must take the form of an independent fiduciary duty; second, an underappreciation of the role of courts in recognizing and advancing a legal obligation beyond the statements of several well-known cases. A coherent legal theory can bridge the divide in conflicting positions and advance a better understanding of one of the most important rules of corporate law.

II. PARTIAL SHAREHOLDER PRIMACY

Shareholder primacy does not exist as a single locus rule-sanction in the form of an enforceable fiduciary duty, but instead weaves through a series of rules of corporate law and the architecture of the corporate and market systems. Corporate law *partially* achieves the end of shareholder primacy through three discrete pathways. First, in the realm of corporate finance, when there is an intersecurity conflict of interest among capital providers involving common stock, corporate law mandates that the value of common stock must be maximized over other securities. Second, in the realm of takeovers, corporate law imposes a duty to maximize common stock value when the corporation is selling control. Third, in the vast realm of day-to-day managerial decision making in a going concern, there is not a single locus, easily identifiable rule of law that mandates profit maximization, but the corporate and market systems, based on a foundation of the legal system, steer managers toward the end of shareholder primacy even when corporate law empowers the primacy of managerial authority.

A. INTERSECURITY PRIORITY

Shareholder primacy is clearly evident in the realm of corporate finance. Among securityholders, common stockholders

are owed fiduciary duty and are preferred over other securityholders. Although the variety of securities is limited only by the freedom of contract, there are three principal classes of securities: debt, preferred stock, and common stock. These financial instruments often present intersecurity conflicts among securityholders.

Consider the relative positions of creditors and common stockholders. The interests of creditors and shareholders can conflict because managers, in the pursuit of shareholder wealth, can make decisions that externalize risk to creditors, a form of opportunism that enriches shareholders at the cost of creditors.[75] Although corporate law provides some protection to creditors,[76] the creditor's principal protection is the ability to negotiate for the terms of credit through contract law.[77] Outside of insolvency, creditors are not owed fiduciary duty,[78] but common stockholders are.[79] This rule makes economic sense, since creditors have priority rights to corporate income and assets and thus take less financial risk than common stockholders.[80]

The primacy of shareholders over creditors is seen in several doctrines. Creditors invoke the doctrine of the implied covenant of good faith and fair dealing when the issuer corporation takes an action that benefits shareholders at their expense and there are no express contractual protections in the credit contract.

75. *See generally* Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907 (2013) (explaining the potential conflict between creditors and shareholders).

76. *See* DEL. CODE ANN. tit. 8, § 160(a) (2017); MOD. BUS. CORP. ACT § 6.40(c); Klang v. Smith's Food & Drug Ctrs., Inc., 702 A.2d 150, 154–56 (Del. 1997).

77. Mann v. Oppenheimer & Co., 517 A.2d 1056, 1061 (Del. 1986); Prod. Res. Grp. v. NCT Grp., Inc., 863 A.2d 772, 790 (Del. Ch. 2004); AM. BAR FOUND., COMMENTARIES ON INDENTURES 2 (1971).

78. N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99, 101–02 (Del. 2007); Katz v. Oak Indus., Inc., 508 A.2d 873, 879 (Del. Ch. 1986); *see* Simons v. Cogan, 549 A.2d 300, 303 (Del.1988) ("[A] convertible debenture represents a contractual entitlement to the repayment of a debt and does not represent an equitable interest in the issuing corporation necessary for the imposition of a trust relationship with concomitant fiduciary duties."); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) ("[T]he Revlon board could not make the requisite showing of [fiduciary] good faith by preferring the noteholders and ignoring its duty of loyalty to the shareholders. The rights of the former already were fixed by contract.").

79. Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998).

80. *See* RICHARD BREALEY ET AL., THE PRINCIPLES OF CORPORATE FINANCE 493 n.12 (11th ed. 2013).

Courts have limited the application of this contract doctrine, essentially rejecting an independent cause of action for bad-faith action against creditors. Absent an identifiable connection to a bargained-for term in the contract, courts generally reject these claims.[81]

The primacy of common stock over debt is more directly seen in an important Delaware case on coercion and exit consents. In *Katz v. Oak Industries Inc.*, bondholders objected to a coercive exchange offer that was conditioned on the tendering bondholders providing the company exit consents to amend the indenture.[82] The corporation extended the exchange offer as a part of a restructuring, which required removing protections that hindered the restructuring. The complaining bondholders argued that the exchange offer was coercive and that the amendment was designed to strip nontendering bondholders of their protective covenants. They averred that "the purpose and effect of the Exchange Offers is to benefit Oak's common stockholders at the expense of the Holders of its debt."[83] The court held that the exchange offer was in fact coercive, but not wrongfully so.[84]

> It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders; that they may sometimes do so "at the expense" of others (even assuming that a transaction which one may refuse to enter into can meaningfully be said to be at his expense) does not for that reason constitute a breach of duty. It seems likely that corporate restructurings designed to maximize shareholder values may in some instances have the effect of requiring bondholders to bear greater risk of loss and thus in effect transfer economic value from bondholders to stockholders.[85]

The issuer corporation must respect the legal duties to creditors under contract law, but otherwise the board has a duty to prefer the interest of shareholders over creditors. When a board benefits common stockholders through the intentional infliction of economic loss on creditors (e.g., through risk shifting, as seen in *Katz*), absent an impairment of capital or fraudulent conveyance, the board must act pursuant to its duty to shareholders.

81. *See, e.g.*, Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1520 (S.D.N.Y. 1989) ("The sort of unbounded and one-sided elasticity urged by plaintiffs would interfere with and destabilize the market."); Winshall v. Viacom Int'l, Inc., 76 A.3d 808, 816 (Del. 2013) ("Rather, a party may only invoke the protections of the covenant when it is clear from the underlying contract that the contracting parties would have agreed to proscribe the act later complained of . . . had they thought to negotiate with respect to that matter.").

82. *Katz*, 508 A.2d at 875.

83. *Id.* at 879.

84. *Id.* at 880–82.

85. *Id.* at 879 (emphasis added).

Consider next the relative positions among preferred stockholders and common stockholders. The priority of interest is more nuanced since both are stockholders, but ultimately Delaware law has evolved to clearly prefer the interest of common stockholders.

At common law, unless preferences are found in the certificate of incorporation, all shares of stock are equal, and thus courts did not recognize a preference in forms of stock.[86] Contractual preferences provide preferred stockholders benefits and also limitations. The typical preferences are priorities over dividend and liquidation and a limitation on participation beyond the fixed dividend.[87] When the right asserted is not a preference, fiduciary duties are owed to preferred stockholders as well.[88] Delaware cases followed this common law rule,[89] but over time it evolved in favor of common stockholders. Rather than viewing preferred stock as a form of stock with contractually negotiated preferences but otherwise standing in equal dignity to common stock, Delaware courts emphasized the contractual nature of preferred stock, thus treating preferred stock more like debt than common stock.[90]

In *Equity-Linked Investors, L.P. v. Adams*, preferred stockholders (early venture-capital investors in a struggling public

86. Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 593–94 (Del. Ch. 1986); Shanghai Power Co. v. Delaware Tr. Co., 316 A.2d 589, 593 (Del. Ch. 1974), *aff'd in part, rev'd in part sub nom.* Judah v. Delaware Tr. Co., 378 A.2d 624 (Del. 1977); *see* MCG Capital Corp. v. Maginn, No. 4521-CC, 2010 WL 1782271, at *6 (Del. Ch. May 5, 2010) ("I begin with the proposition that all stock is created equal. By this I mean that all classes of stock enjoy the same rights and privileges unless an affirmative expression alters those rights.").

87. ROBERT J. RHEE, CORPORATE FINANCE 312–13 (2016).

88. *See MCG Capital Corp.*, 2010 WL 1782271, at *6 (holding that preferred stockholders have standing to bring derivative actions); *Jedwab*, 509 A.2d at 594 (stating that where there is no stated preference "the existence of such right and the scope of the correlative duty may be measured by equitable as well as legal standards").

89. *See, e.g.*, Orban v. Field, No. 12820, 1997 WL 153831, at *8–10 (Del. Ch. Apr. 1, 1997); *In re* FLS Holdings Inc. S'holder Litig., 1993 WL 104562, at *4 (Del. Ch. Apr. 21, 1993); Eisenberg v. Chicago Milwaukee Corp., 537 A.2d 1051, 1057 (Del. Ch. 1987); *Jedwab*, 509 A.2d at 591; Dalton v. Am. Inv. Co., 490 A.2d 574, 579 (Del. Ch. 1985).

90. Preferred stock is a hybrid instrument that has the features of both debt and equity. *See* RHEE, *supra* note 87, at 311–12. *See generally* Richard M. Buxbaum, *Preferred Stock—Law and Draftsmanship*, 42 CAL. L. REV. 243 (1954) (discussing the contractual nature of preferred stock and why courts treat preferred stock more like debt than common stock).

company) desired to liquidate the company and common stockholders sought to continue the enterprise by seeking new capital funding.[91] In light of Delaware's evident policy preference in favor of business decisions promoting the continuation of a going concern,[92] the court's ruling in favor of common stockholders is not so remarkable. However, the justification for its ruling is revealing:

> While the facts out of which this dispute arises indisputably entail the imposition by the board of (or continuation of) economic risks upon the preferred stock which the holders of the preferred did not want, and while this board action was taken for the benefit largely of the common stock, those facts do not constitute a breach of duty. . . . The special protections offered to the preferred are contractual in nature. The corporation is, of course, required to respect those legal rights. But, aside from the insolvency point just alluded to, generally *it will be the duty of the board, where discretionary judgment is to be exercised, to prefer the interests of common stock . . . to the interests . . . of preferred stock, where there is a conflict. See Katz v. Oak Industries, Inc.*[93]

This passage departs from the traditional understanding under common law that, if a preference is not stated, stocks are considered equal.[94] Under *Equity-Linked Investors*, absent a special preference in the corporate contract, the interest of common stockholders may be elevated over the interest of preferred stockholders. Also, by citing *Katz* as authority and analogizing the permissibility of transferring risk from common stockholders to other securityholders, the court pushes the analysis of preferred stock toward the same analytical framework applicable to credit contracts.

In *In re Trados Inc. Shareholder Litigation*, the board pursued a merger in which virtually all of the merger consideration would go the preferred stockholders due to the triggering of a

91. Equity-Linked Inv'rs, L.P. v. Adams, 705 A.2d 1040, 1041 (Del. Ch. 1997).

92. *See, e.g.*, Orban v. Field, 1997 WL 153831, at *9; Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., Civ. A. No. 12150, 1991 WL 277613, at *33 (Del. Ch. Dec. 30, 1991); Katz v. Oak Indus., Inc., 508 A.2d 873, 879 (Del. Ch. 1986).

93. *Equity-Linked*, 705 A.2d at 1042 (emphasis added).

94. The following passage provides a summary of the earlier rule, which emphasized equality of stock.

> At common law and in the absence of an agreement to the contrary all shares of stock are equal . . . . [W]here however the right asserted is not to a preference as against the common stock but rather a right shared equally with the common, the existence of such right and the scope of the correlative duty may be measured by equitable as well as legal standards.

Jedwab, 509 A.2d at 593–94.

liquidation preference.[95] Common stockholders got nothing. The plaintiff common stockholder averred that the board, comprised mostly of directors elected by preferred stockholders, breached its fiduciary duty to them. The court noted: "in circumstances where the interests of the common stockholders diverge from those of the preferred stockholders, it is *possible* that a director could breach her duty by improperly favoring the interests of the preferred stockholders over those of the common stockholders."[96] The court set forth a principle that, unless a preference is expressly provided in the corporate contract, where the interests of preferred and common stockholders conflict, the latter's interest is preferred.[97] This proposition—stated in both *Equity-Linked* and *Trados*—turns the original rule in common law upside down, because under traditional common law all stocks are treated equally unless there is a stated preference right or limitation therefrom.[98]

In *LC Capital Master Fund, Ltd. v. James*, the issue again involved the allocation of merger consideration between convertible preferred and common stockholders.[99] The certificate did not set a contractual merger price to be paid to the preferred stockholders. The preferred stockholders argued that the fair allocation should exceed the as-converted value of their stock due to the unique features of the stock and the circumstance of the preferred stockholders.[100] The court rejected this argument, reasoning that the contractual right of conversion determines the duty

95. *In re* Trados Inc. S'holder Litig., No. 1512-CC, 2009 WL 2225958, at *1 (Del. Ch. July 24, 2009).

96. *Id.* at *7.

97. In a subsequent proceeding, the chancery court ultimately held that, under the entire fairness standard, the merger consideration to the common stockholder was fair. *In re* Trados S'holder Litig., 73 A.3d 17 (Del. Ch. 2013). The court emphasized in the analysis:

> To reiterate, the standard of conduct for directors requires that they strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm's value, not for the benefit of its contractual claimants. In light of this obligation, "it is the duty of directors to pursue the best interests of the corporation and its common stockholders, if that can be done faithfully with the contractual promises owed to the preferred."

Id. at 41–42 (quoting LC Capital Master Fund, Ltd. v. James, 990 A.2d 435, 452 (Del. Ch. 2010)).

98. *See supra* note 86.

99. *LC Capital*, 990 A.2d at 435.

100. Previously, Delaware courts have considered the unique features of the preferred stock and the circumstance of their holders when considering the fairness of the merger consideration. *See, e.g.*, *In re* FLS Holdings, Inc. S'holders

owed by the board to the preferred stockholders. The board "was entitled to favor the interests of the common stockholders."[101] The court acknowledged that recent decisions discussing fiduciary duties to preferred stockholders conflict with earlier cases.[102] The court attempted to harmonize the conflict. When the rights of the preferred are found in the contract, the board must honor them, but it does not otherwise owe "unspecified fiduciary beneficence on the preferred at the expense of the common."[103] When, however, there is no contractual basis for treatment of the preferred, the board must engage in gap-filling and attempt to fairly reconcile the competing interests of the common and preferred. Echoing *Equity-Linked* and *Trados*, the court stated the rule "that it is the duty of directors to pursue the best interests of the corporation and its common stockholders, if that can be done faithfully with the contractual promises owed to the preferred."[104]

Scholars have analyzed this line of Delaware cases. William Bratton and Michael Wachter observe that preferred stock is subject to the tug and pull of conflicting analytical paradigms of corporate law and contract law.[105] Courts seemingly apply these paradigms without a coherent theory.[106] But any apparent inconsistency is dispelled by judicial outcome preference: "[s]till, we are left with corporate treatment when corporate treatment benefits the common and contract treatment when contract treatment benefits the common."[107] Why do "the preferred always lose?"[108] Delaware courts ultimately are driven by the "common stock-value maximization norm."[109] This Article agrees

Litig., 1993 WL 104562 (Del. Ch. Apr. 2, 1993); Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584 (Del. Ch. 1986).

101. *LC Capital*, 990 A.2d at 438.

102. *Id.* at 446–47 (citing apparent tension in recent cases such as *In re Trados Inc.*, 2009 WL 2225958, with older cases such as *In re FLS Holdings, Inc.*, 1993 WL 104562, and *Jedwab*, 509 A.2d 584).

103. *LC Capital*, 990 A.2d at 448–49 (relying on the reasoning set forth in HB Korenvaes Invs., L.P. v. Marriott Corp., No. 12922, 1993 WL 205040, at *1–7 (Del. Ch. June 9, 1993)).

104. *Id.* at 452. The trend toward protecting common stockholders has continued. *See* Carsanaro v. Bloodhound Techs., Inc., 65 A.3d 618 (Del. Ch. 2013).

105. William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. PA. L. REV. 1815, 1821, 1900–01 (2013).

106. *Id.* at 1901.

107. *Id.* at 1902.

108. *Id.* at 1901.

109. *Id.* at 1816, 1823–24, 1877, 1882, 1905. "The court's disposition to favor the common is unsurprising: Delaware sells a product, the buyers of which tend

with Bratton and Wachter's cogent analysis and conclusion. In the realm of stockholder class conflicts, corporate law mandates a priority duty to common stockholders. The opinions in *Equity-Linked*, *Trados*, and *LC Capital* clearly state so.

The law of corporate finance shows that, in the absence of bargained-for contractual protections, there is a clear preference for the interest of common shareholders over other capital providers. This observation is now trivially obvious with respect to creditors. Corporate law has also recently treated preferred stock more like debt and less like stock by emphasizing contractual rights. This trend has left common stock as the clearly preferred securityholder among capital providers. In the realm of intersecurity conflicts, the law mandates that boards must maximize the wealth of common stockholders.

B. *REVLON* DUTY

In the realm of takeovers, a board ordinarily has significant control of decisions.[110] A manager's discretion includes consideration of "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[111] However, under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, a board has a duty to maximize shareholder profit once the object is no longer "to protect or maintain the corporate enterprise but to sell it to the highest bidder."[112] The directors' role changes from "defenders of the corporate bastion to auctioneers charged with getting the best price

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to be holders of common stock or their management representatives." *Id.* at 1901.

110. *See* Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277, 3286 (2013); Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 974–75 (2002).

111. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985); *see* Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989) ("[A]bsent a limited set of circumstances as defined under *Revlon*, a board of directors, while always required to act in an informed manner, is not under any *per se* duty to maximize shareholder value in the short term, even in the context of a takeover.").

112. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986). The *Revlon* duty is not a separate duty independent of the duty of care and loyalty, but is an "application in a specific context of the board's fiduciary duties of care, good faith, and loyalty." RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 858 (Del. 2015) (quoting Malpiede v. Townson, 780 A.2d 1075, 1086 (Del. 2001)).

for the stockholders at a sale of the company."[113] In other words, once the board no longer has a future duty to manage the business, its present duty is to maximize value for shareholders.[114]

Beyond an all cash sale of the target,[115] there are three scenarios when *Revlon* applies: (1) a corporation initiates an active bidding process for sale or breakup of the company; (2) a target abandons its long-term strategy and acquiesces to a sale of the company to a bidder; and (3) a transaction results in a change of control.[116] These situations are contextual, and scholars have debated the scope of the *Revlon* duty.[117] The precise contours of the duty are not within the scope of this Article. The relevance of *Revlon* here is that in a specific transaction zone, the terminal business decision for the target board, *Revlon* provides a rule-sanction framework mandating shareholder wealth maximization.

Although *Revlon* is an enforceable rule, it also illustrates the tension between the enforcement of shareholder primacy and the law of managerial authority. Courts do not provide a judicial

113. *Revlon*, 506 A.2d at 182; *see* McGowan v. Ferro, 859 A.2d 1012, 1032 (Del. Ch. 2004); Equity-Linked Investors, L.P. v. Adams, 705 A.2d 1040, 1054–55 (Del. Ch. 1997).

114. *See* TW Servs., Inc. v. SWT Acquisition Corp., CIV. A. Nos. 10427, 10298, 1989 WL 20290, at *7 (Del. Ch. Mar. 2, 1989) ("In such a setting, for the present shareholders, there is no long run.").

115. Equity-Linked Inv'rs, L.P. v. Adams, 705 A.2d 1040, 1058 (Del. Ch. 1997). An all cash deal is not a precondition to triggering *Revlon*. *See, e.g.*, C & J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Tr., 107 A.3d 1049, 1053, 1061 (Del. 2014) (assuming without deciding that a transaction involving a share exchange in which acquirer shareholders owned fifty-three percent and target shareholders forty-seven percent of the post-merger company triggered *Revlon*); *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 725, 730–31 (Del. Ch. 1999) (triggering *Revlon* in a mixed cash and stock consideration deal).

116. Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1289–90 (Del. 1994).

117. *See* Bainbridge, *supra* note 110, at 3337–38 (providing three circumstances in which *Revlon* duty is triggered); Christopher M. Bruner, *Conceptions of Corporate Purpose in Post-Crisis Financial Firms*, 36 SEATTLE U. L. REV. 527, 531 (2013) (suggesting that the *Revlon* duty "is in fact quite limited"); Fisch, *supra* note 5, at 651 ("The *Revlon* decision . . . applies to an extremely small set of cases."); Lyman Johnson & Robert Ricca, *The Dwindling of* Revlon, 71 WASH. & LEE L. REV. 167, 172 (2014) (characterizing *Revlon* as a "narrow, silo-like doctrinal isolation"); Mohsen Manesh, *Defined by Dictum: The Geography of* Revlon*-Land in Cash and Mixed Consideration Transactions*, 59 VILL. L. REV. 1, 33 (2014) ("The boundaries of *Revlon*-land have never been clearly defined . . . ."); Millon, *supra* note 5, at 1035 ("The *Revlon* duty . . . arises only in a narrow range of circumstances . . . ."); Stout, *supra* note 36, at 172 ("The case has become nearly a dead letter.").

blueprint for boards to follow.[118] The application of *Revlon* is not algorithmic. "No court can tell directors exactly how to accomplish that goal, because they will be facing a unique combination of circumstances, many of which will be outside their control."[119] Courts apply a heightened scrutiny for reasonableness under which "directors are generally free to select the path to value maximization."[120] Thus, *Revlon* imposes a rule-sanction framework, but courts still accept, with a watchful eye, the primacy of managerial authority as a pragmatic constraint on the assessment of breach and liability.

C. Market and Architecture

The duties associated with intersecurity conflicts and takeovers under *Revlon* are specific transactional situations. The vast majority of managerial decisions in the day-to-day management of a going concern are not subject to a rule-sanction framework.[121] Instead, boards have the authority to manage the business and affairs of the corporation and their decisions are protected by the business judgment rule. For example, if a board decides that the corporation should pay its employees above-market wages or incur exceptional cost to surpass regulatory safety standards on the reason that it would be in "the best interests of the corporation and its shareholders,"[122] this incantation would cloak the board in the shield of the business judgment

118. *C & J Energy Servs., Inc.*, 107 A.3d at 1067; Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989); *see* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1373–74 (Del. 1995) ("[E]nhanced judicial scrutiny . . . is not intended to lead to a structured, mechanistic, mathematical exercise. . . . [It is] a flexible paradigm that jurists can apply to the myriad of 'fact scenarios' that confront corporate boards.").

119. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242 (Del. 2009).

120. *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 595–96 (Del. Ch. 2010); *see In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1000 (Del. Ch. 2005) ("[T]he enhanced judicial review *Revlon* requires is not a license for law-trained courts to second-guess reasonable, but debatable, tactical choices that directors have made in good faith.").

121. *See supra* Part I.B.

122. *See* Rhee, *supra* note 5, at 699 ("[W]ith the incantation of 'long-term interest of the corporation and shareholders,' the threat of liability is whisked away by the spirit of plausible good faith."); *see also* King v. VeriFone Holdings, Inc., 12 A.3d 1140, 1151 (Del. 2011); Gentile v. Rossette, 906 A.2d 91, 103 n.30 (Del. 2006); *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 66 (Del. 2006); *Unitrin*, 651 A.2d at 1373 n.10; Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1287 (Del. 1988); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985); Unocal v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

rule. It would be irrelevant that a plaintiff can demonstrate the demerit of the business decision.[123]

In theory, the law does not seem to hold managers accountable for not pursuing the end of shareholder primacy. Commentators have argued that shareholder primacy is irrelevant in actual business management.[124] The point is correct insofar as a corporate manager has broad authority so long as it acts informedly, disinterestedly, and in good faith.[125] Any rational decision can be justified on some abstract benefit to the long-run interest of the corporation and shareholders.[126] However, the logical end of expansive managerial authority does not diminish shareholder primacy to a social norm of the business community.

The legal system has conceived a better way of achieving the end of shareholder primacy without the complexity and cost of a rule-sanction framework. Let's assume for argument's sake only that shareholder primacy is the desired policy end. Corporate law is founded on the principle of the separation of ownership and control and the primacy of managerial authority. How can the law influence managerial behavior toward the end of shareholder primacy?

123. The fiduciary duty of care in corporate law is an artful concept, under which substantively poor actions are not a breach of care. *See, e.g.*, Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) ("Due care in the decisionmaking context is process due care only."); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) ("[A] decision substantively wrong, or degrees of wrong extending through 'stupid' to 'egregious' or 'irrational,' provides no ground for director liability . . . ."). *See generally* Robert J. Rhee, *The Tort Foundation of Duty of Care and Business Judgment*, 88 NOTRE DAME L. REV. 1139 (2013) (examining how the principles of tort law apply to the liability scheme of fiduciary duty).

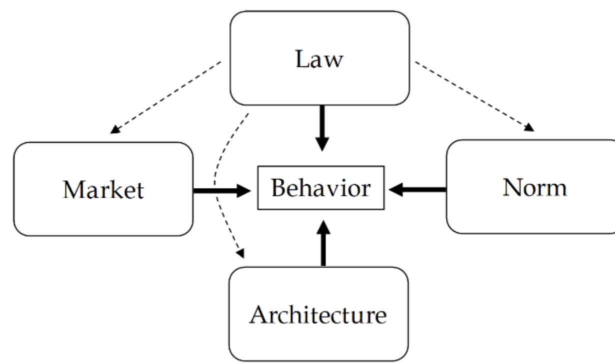
124. *See supra* notes 36, 43–44, 52 and accompanying text.

125. *See* STOUT, *supra* note 5, at 31 ("The business judgment rule thus allows directors in public corporations . . . a remarkably wide range of autonomy in deciding what to do with the corporation's earnings and assets.").

126. *See* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 272–73 (1992) ("The law 'papered over' the conflict in our conception of the corporation by invoking a murky distinction between long-term profit maximization and short-term profit maximization. . . . There is a utility in this long-term/short-term device. Though employment of this distinction is subject to obvious manipulation, it can nevertheless resolve the tension between these differing conceptions of the corporation in a way that offers the possibility of some judicial protection to shareholders, while affording substantial room to the multi-constituency, social entity conception to operate.").

Lawrence Lessig provides a helpful way to think about the general problem of affecting behavior toward a desired outcome.[127] He suggests that behavior can be regulated by four mechanisms: (1) law in the Austinian sense of a rule backed by the threat of government sanction; (2) social norms through non-legal community enforcement; (3) markets through the device of price; and (4) architecture, which he defines as any feature of the world as it is found or made.[128] These four mechanisms affecting behavior are not independent. The law can affect the efficacy of each of the other mechanisms.[129]

Figure 1: Law and Mechanisms Inducing Behavior



For example, the social norm against smoking can be influenced by laws against cigarette advertisements and designation of cordoned smoking spaces. The market for insurance can be used to incentivize seat-belt use through subsidization of insurance rates for safe behavior. The architecture of discrimination against the physically handicapped can be diminished by building codes that mandate accessibility. Thus the law can influence the efficacy of other mechanisms.

This model provides a helpful framework for understanding how corporate law influences managerial behavior toward shareholder primacy. The unstated assumption in labeling shareholder primacy as a norm is that a *law* of shareholder primacy must be in Austinian form, such as fiduciary duty. Because

127. Lawrence Lessig, *The New Chicago School*, 27 J. LEGAL STUD. 661, 661 (1998).

128. *Id.* at 662–63.

129. *Id.* at 667–69.

shareholder primacy cannot be in such form without irreconcilable conflict with managerial authority, it is reduced to the mechanism of norms. This assumed belief is incorrect.

By calling shareholder primacy a norm, we are simply stating the observation that managerial behavior in the practice of corporate governance is consistent with shareholder wealth maximization. *Something* is influencing observed behavior, and since a legal duty does not exist, we assume, erroneously, that the cause must be a social norm. The thesis of this Article is that the principal cause of inducing conforming behavior is not through the mechanism of a norm, but instead through the mechanisms of law, market, and architecture (the latter two being enabled and influenced by corporate law and the legal system writ large). The workings of these three mechanisms, then, legitimizes and reinforces an existing norm of the business community.[130]

With respect to the architecture of markets, shareholder primacy tends to be more robust when product competition in the market is strong, as is the case of American markets.[131] An efficient market limits the agency cost of broad managerial control because stock prices would incorporate such cost into valuation. When corporations operate within a liquid capital market, two forms of direct incentives influence managers; the legal system creates (1) a market for corporate control; and (2) it incentivizes executive pay that is substantially linked to share price.

First, the market for corporate control provides the incentive to increase and maintain share price.[132] The laws relating to mergers and acquisitions advance shareholder primacy and directly affect board and managerial incentives and conduct. In a liquid capital market, share price is directly connected to shareholder profit maximization. To avoid an unsolicited threat of takeover, managers are incentivized to maximize share price. The pricing mechanism of the market, a feature of architecture supported by law, enforces shareholder primacy.[133] To be sure,

130. *See* Robert C. Ellickson, *The Market for Social Norms*, 3 AM. L. & ECON. REV. 1, 38–42 (2001) (explaining ways in which the government affects norms); Cass R. Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903, 907 (1996) (suggesting that "government deserves to have, and in any case inevitably does have, a large role in norm management").

131. Roe, *supra* note 55, at 2063.

132. *See* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112–13 (1965).

133. "Hostile takeovers were, and despite the rise of the poison pill still are, an engine of shareholder wealth maximization." Roe, *supra* note 55, at 2074.

there are takeover defenses that mitigate the possibility of a successful hostile takeover, such as the poison pill and staggered boards,[134] but obviously the effect of share price can induce takeovers under some form of coercion or felt need outside of a classic hostile takeover.

Second, executive compensation has moved toward a "pay-for-performance" model that is linked to share price.[135] The state of executive compensation today has been influenced by law.[136] The current incentive system is linked to shareholder wealth. The phenomenal rise of executive compensation over the past several decades corresponds temporally to the rise of shareholder primacy.[137] As flawed as it currently is,[138] executive compensation is a pricing mechanism for managerial talent and outcomes. The law and the legal system link the stock value of shareholders and the architecture of the corporate system and

134. *See* DEL. CODE ANN. tit. 8, § 141(d) (2017) (permitting staggered boards); Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182 (Del. 2010) (upholding a staggered board provision in the charter); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (validating poison pill).

135. *See* Michael C. Jensen & Kevin J. Murphy, *Performance Pay and Top-Management Incentives*, 98 J. POL. ECON. 225 (1990) (discussing connections between CEO compensation and company performance); Michael C. Jensen & Kevin J. Murphy, *CEO Incentive—It's Not How Much You Pay, But How*, HARV. BUS. REV., May–June 1990, at 138 (discussing data that indicated CEO pay did not consistently reflect performance).

136. The tax code incentivizes pay-for-performance. *See* I.R.C. § 162(m) (2012) (limiting deductibility of executive compensation to one million dollars unless it is a qualified performance-based compensation). Absent a breach of duty, corporate law does not review the amount of compensation awarded. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006); *In re* Goldman Sachs Grp., Inc. S'holder Litig., No. 5215-VCG, 2011 WL 4826104 (Del. Ch. Oct. 12, 2014).

137. *See* Rock, *supra* note 75, at 1917 ("The biggest development since the 1980s is that CEOs now have large amounts of equity and equity-linked compensation."). *Compare infra* Part III.B and Charts 2 & 3 (showing rise of shareholder primacy in courts since the 1980s), *with* Robert J. Rhee, *Intrafirm Monitoring of Executive Compensation*, 69 VAND. L. REV. 695, 703 (2016) (showing rise of executive compensation since the 1980s).

138. A legion of scholarship has been critical of executive compensation based on either the amount of compensation paid or the decoupling of pay and performance. *See, e.g.*, LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004); Gregg D. Polsky, *Controlling Executive Compensation Through the Tax Code*, 64 WASH. & LEE L. REV. 877 (2007); Rhee, *supra* note 137; *see also* THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 271–303 (Arthur Goldhammer trans., 2013) (showing how the rise of "supermanagers" has become a major factor of social inequity in the United States).

capital markets. These linkages clearly affect managerial incentive to maximize profit.[139]

If shareholder primacy is only a consensus among managers, shareholders, and academics, and subject only to community reprobation, then the most accurate description would be a social norm. However, the market and the architecture of the corporate system constrain the otherwise expansive legal discretion afforded to corporate managers and steer, partially at least, managerial decisions toward the end of shareholder wealth maximization.[140]

III. SHAREHOLDER PRIMACY IN COURTS 1900 TO 2016

The above rules and aspects of the legal system are parts of a multifaceted mechanism through which shareholder primacy works—through enforceable rules of corporate law in specific transactional spaces and through law-facilitated negative and positive incentives in the corporate system. These facets only partially explain the legal mechanism of shareholder primacy. A complete, coherent legal theory, which is set forth in Part IV, must explain the law's effect on the entire spectrum of managerial conduct. Central to this explanation is the role of courts in advancing shareholder primacy as a rule of law.

This Part provides the results of an empirical survey of judicial opinions discussing shareholder wealth maximization in the period 1900 to 2016. It shows that since the 1980s, there has been a marked increase in discussion of shareholder profit maximization in judicial opinions. This phenomenon raises the questions: (1) How did courts respond to the wave of shareholder-centric consciousness in the business and academic communities? (2) Did the responding judicial discussion, rhetoric, and expectation affect the legal obligations of boards?

139. *See* STOUT, *supra* note 5, at 71–72 (discussing how managing shareholder value drives CEOs to different actions); Kent Greenfield, *Reclaiming Corporate Law in a New Gilded Age*, 2 HARV. L. & POL'Y REV. 1, 14–15 (2008) (discussing how the CEO of Home Depot had to leave when the stock price stagnated); Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 884 (2002) (discussing the rising use of stock options in CEO compensation).

140. *See* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 911 (2013) ("Hostile takeovers and, later, equity-based executive compensation, began to emerge as the new forces creating incentives for managers to focus on share value.").

A. METHODOLOGY AND RAW DATA

This Article surveys judicial opinions discussing the concept of maximizing or increasing shareholder profit in the period from 1900 to 2016, the era of modern corporations and liberal corporate law.[141] A broad search term was used to systematically capture cases that discuss, at some level, enhancing shareholder economic interest.[142] This Article does not claim that the search process identified all judicial decisions discussing the concept of shareholder primacy. The search term is not perfect.[143] Rather, the claim here is that the search process systematically captured a large volume of data over a long period, and the data show distinct patterns of judicial discussion, analysis, and rhetoric throughout the modern era of corporations.

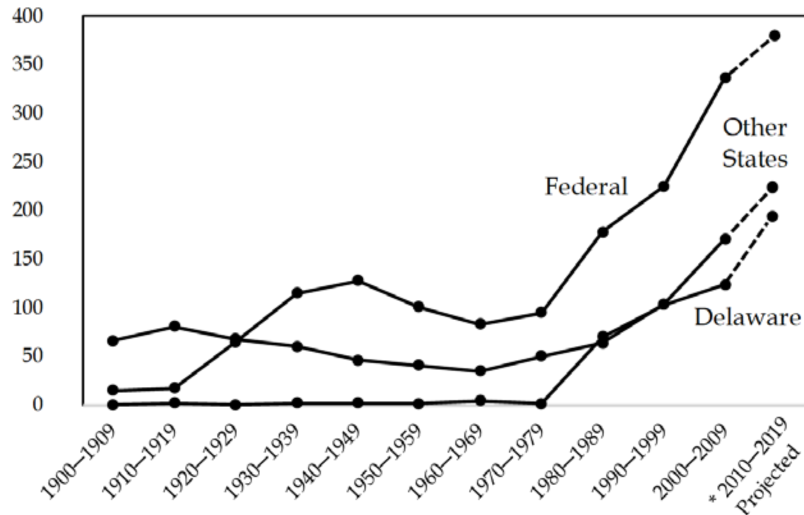
The search criteria produced a raw dataset of 3034 cases. Even the raw, unfiltered data show a distinct pattern. The raw data, shown in Chart 1, suggest that courts have increasingly discussed the idea of maximizing shareholder profit since the 1980s. (Charts showing data for the decade 2010 to 2019 present actual data for the seven-year period 2010 to 2016 and linear extrapolations for the remaining three-year period 2017 to 2019.)

141. The New Jersey Incorporation Act of 1896 was probably the first liberal corporation statute. Stephen B. Presser & Richard E. Simpson, *Adjusting to the Managerial Revolution: The Law of Corporations in the Federal Courts of Delaware 1900–1941*, 23 WM. & MARY L. REV. 725, 730 (1982). In 1899, Delaware enacted its own liberal corporation statute. *Id.* at 732.

142. The Westlaw state and federal case law directories were searched using this search term: (maximiz! or enhanc! or increas!) /15 (shareholder! or stockholder!) /15 (profit! or wealth! or valu!). The search term was devised to capture statements like this: "Business corporations must engage the political process in instrumental terms if they are to *maximize shareholder value*." Citizens United v. FEC, 558 U.S. 310, 454 (2010) (Stevens, J., concurring and dissenting in part) (emphasis added). As of the time of the searches in late 2016 and early 2017, no federal or state court opinion has ever used the term "shareholder primacy" independently.

143. This search term did not capture *Dodge v. Ford Motor Co.* because the key discussion did not meet the Boolean search criterion: "A business corporation is organized and carried on primarily for the *profit* of the *stockholders*. The powers of the directors are to be employed for that end." 170 N.W. 668, 684 (Mich. 1919) (emphasis added). The missing term is the word derivative "maximize!" or "increase!" or "enhance!" This miss does not undermine the validity of the search criterion. The search term captured many important law cases discussing shareholder primacy. *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1989); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010); Katz v. Oak Indus., Inc., 508 A.2d 873 (Del. Ch. 1986).

Chart 1: Raw Data of All Judicial Opinions



The search term, of course, produced many false positives. Two types of false positive cases were identified and discarded: (1) irrelevant cases that are just random hits from the Boolean search term;[144] and (2) cases where the idea of maximizing shareholder wealth was raised by a party or was a point of fact, such as a statement in a press release or proxy, but the court did not directly engage this assertion with its own voice.[145] This second type of case could be relevant to some broader analysis of shareholder primacy, but recitations of facts do not reveal judi-

144. *See, e.g.*, ev3, Inc. v. Lesh, 114 A.3d 527 (Del. 2014) ("[T]he selling *shareholders* argued that the buyer had breached the implied covenant of good faith and fair dealing by failing to take discretionary action that would have *maximized* earn-out payments to the selling shareholders. Because the conduct the selling shareholders complained about involved the potential *profits* for a product in which the selling shareholders had no contractual expectation, and the buyer did not take any action to reduce the earn-out payments that the selling shareholders could have reasonably expected, the Court of Chancery found for the buyer." (emphasis added)).

145. *See, e.g.*, Bank of N.Y. Mellon Tr. Co. v. Liberty Media Corp., 29 A.3d 225, 231–32 (Del. 2011) (quoting the company's CEO: "That's what we continuously look for . . . opportunities to carve out if necessary other businesses that can go off and be part of a consolidation in their space, gain market power, improve profitability, appropriately use debt leverage, shelter taxes, or avoid corporate level taxes, and go on down the road in terms of *maximizing shareholder value* . . . ." (emphasis added)).

cial thinking. Thus, under the method here, they are strictly irrelevant cases.

Although the second type of false positives were discarded, they yield three general observations. First, not surprisingly, corporate litigants, both shareholders and managers, routinely invoke the concept of profit maximization when advancing a complaint or a defense. This type of case was far more numerous than random hits. Since the 1980s, parties have inundated courts with transactions and claims asserting shareholder profit maximization. Second, again not surprisingly, courts do not reproach corporate litigants for advancing facts or arguments based on shareholder wealth maximization.[146] At minimum, courts have not found the concept objectionable or inconsistent with corporate law; more likely, when they have been silent in face of facts, they have tacitly accepted the principle as an orthodoxy of corporate law and governance.[147] Third, the case law reveals that the lexicon of maximizing shareholder wealth, vis-à-vis increasing or enhancing, is ubiquitous among courts and corporate litigants. This clearly preferred linguistic choice expresses the maximand as the corporate purpose.[148]

B. Rise of Shareholder Primacy in Courts

The culling of false positives produced a list of relevant cases where courts discussed in their own voice the concept of shareholder primacy. These relevant cases were further sorted into two broad categories: cases invoking the *Revlon* rule and those that do not. Because *Revlon* mandates an enforceable duty to maximize shareholder wealth, *Revlon* rule-invoking cases are

146. When courts explicitly rejected the concept, they were bound by state constituency statutes. *See* Dixon v. Ladish Co., 785 F. Supp. 2d 746, 753 (E.D. Wis. 2011) (Wisconsin statute); Stilwell Value Partners I, L.P. v. Prudential Mut. Holding Co., No. 06-4432, 2008 WL 1900945, at *13 (E.D. Pa. Apr. 24, 2008) (Pennsylvania statute); *In re* Guidant Corp. S'holders Derivative Litig., No. 1:03 CV 955 SEB WTL, 2006 WL 290524, at *7–8 (S.D. Ind. Feb. 6, 2006) (Indiana statute); Shepard v. Meridian Ins. Grp., Inc., 137 F. Supp. 2d 1096, 1113 (S.D. Ind. 2001) (Indiana statute); *In re* PHLCORP, No. 88 Civ. 0306 (PNL), 1992 WL 85013, at *9 (S.D.N.Y. Apr. 10, 1992) (Pennsylvania statute); Murray v. Conseco, Inc., 766 N.E.2d 38, 44 (Ind. App. 2002) (Indiana statute). Only a few courts or judges have argued against profit maximization independent of constituency statutes. *See* Day v. Staples, Inc., 555 F.3d 42, 56 (1st Cir. 2009); Flamm v. Eberstadt, 814 F.2d 1169, 1182 (7th Cir. 1987) (Cudahy, J., concurring in judgment and in part); Bonoff v. Troy, 589 N.Y.S.2d 340, 341 (App. Div. 1992).

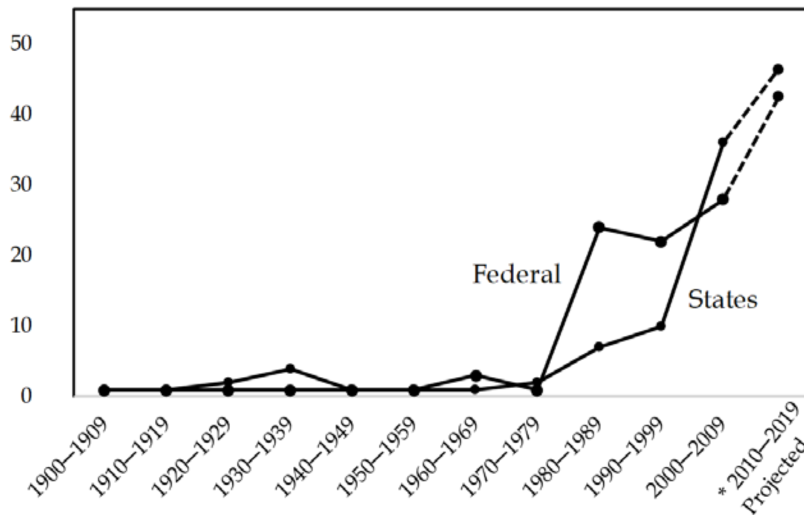
147. This point is addressed in greater detail in Part IV *infra*.

148. *See infra* Part III.B and Chart 4.

uninteresting, in the sense that they recite the profit maximization rule as a matter of *stare decisis* even if a court ultimately determined that *Revlon* did not apply to the transaction.[149] Non-*Revlon* cases are cases where courts are speaking outside of the specific context of the *Revlon* rule of shareholder value maximization. These cases are more revealing because any comment by the court, speaking in its own voice, reveals its thought process on shareholder wealth maximization when it is not required to do so under the *Revlon* rule.

Like the pattern of the raw data, the refined data show that judicial discussion of shareholder-centric concepts have figured prominently in corporate litigation starting in the 1980s. The chart below shows federal and state non-*Revlon* cases, a total of 212 cases.

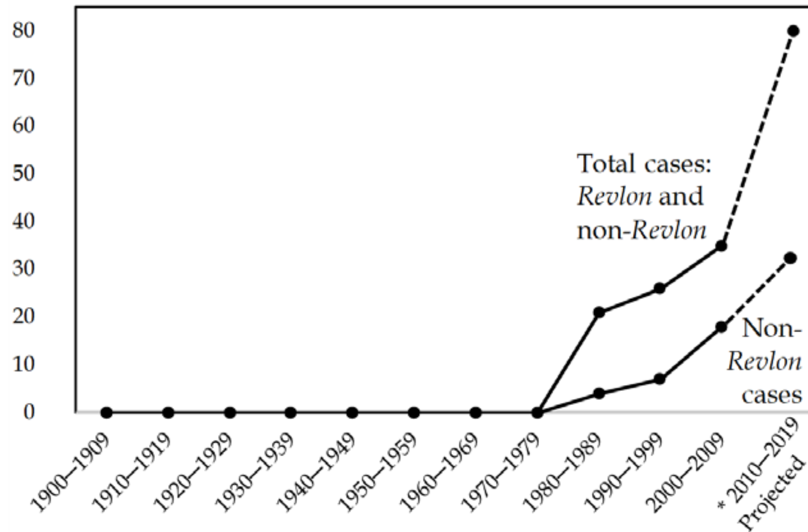
Chart 2: Non-*Revlon* Federal and State Cases



149. Only cases specifically reciting *Revlon*'s rule of shareholder value maximization were excluded. When *Revlon* was cited for other propositions, such as a discussion of Delaware's enhanced scrutiny under *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), it was not excluded. *See, e.g.*, Larkin v. Shah, No. 10918-VCS, 2016 WL 4485447, *12 n.69 (Del. Ch. Aug. 25, 2016); *In re* Appraisal of Dell Inc., No. 9322-VCL, 2016 WL 3186538, at *26–27 (Del. Ch. May 31, 2016); *In re* Orchard Enterprises, Inc. Stockholder Litig., 88 A.3d 1, 35 n.22 (Del. Ch. 2014); *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 44 (Del. Ch. 2013).

The Delaware experience is consistent with the above data. Delaware cases show that judicial discussion of shareholder-centric concepts have figured prominently in corporate litigation starting in the 1980s. The table and the chart below provide the data, categorized into *Revlon*-invoking and non-*Revlon* cases.

Chart 3: Delaware Cases



Charts 2 and 3 show that in the period 1900 to 1979, courts were virtually silent on the concept of shareholder primacy. The hockey-stick pattern of cases is not surprising in light of well-known economic, business, and intellectual histories. It is confirming. The increased discussion of maximizing shareholder profit is associated with economic and legal ideas on the theory of the firm and agency cost from the 1970s and 1980s, which provided the theoretical foundation of shareholder primacy.[150] The 1980s brought forth "tectonic forces" in the form of hostile takeovers, innovations in junk-bond financing, economic globalization, and sustained economic arguments in the business and academic communities for profit maximization.[151] The case law,

150. *See supra* note 54.

151. In the twentieth century, there were two competing conceptions of the corporation: the property conception, which views the corporation as the shareholder's private property, and the society-entity conception, which views the corporation as a social entity endowed with a social purpose. ADOLF A. BERLE,

reflecting the collective judicial thinking, reveals these developments. The table below tracks the number of cases by decades, a total of 212 cases.

Table 1: Non-*Revlon* cases from 1900 to 2016

Period	Delaware	Other States	Federal
1900–1909	0	1	1
1910–1919	0	1	1
1920–1929	0	2	1
1930–1939	0	4	1
1940–1949	0	1	1
1950–1959	0	1	1
1960–1969	0	1	3
1970–1979	0	2	1
1980–1989	4	3	24
1990–1999	7	3	22
2000–2009	18	18	28
2010–2016	22	10	30

The rise of shareholder primacy in courts can be pinpointed further to a specific period in the 1980s. The years 1980–1984 were unremarkable and looked very similar to the 1970s in the number of cases. In the time period 1900 to 1984, the search criteria produced no Delaware case that discussed shareholder primacy in its own voice.[152] The first case in Delaware was in 1985,

POWER 206 (1969); William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 266–72 (1992). These two conceptions have coexisted in an uneasy détente for much of the twentieth century. BERLE, *supra* at 206; Allen, *supra*, at 264–65. The 1980s brought to the surface the underlying tensions between the two conceptions of the corporation.

> The dynamic forces in corporation law are easy to identify. The evolution of the junk bond market and takeover entrepreneurs, the growth of institutional investors, and the striking emergence of a global economy came together in the 1980s to force massive change in the private sector of our economy. In that process, tensions and antinomies in corporation law theory that had been lying beneath the surface for a very long time, were forced out into the open. As a result, during the 1980s corporation law became not boring and marginal, but important, even fascinating. Articles on corporate theory found their way into leading journals. Basic questions excited argument, and the most basic questions—What is a corporation? What purpose does it serve?—became the stuff of wide discussion and of statutory activity. Everything old became new again.

Allen, *supra*, at 263–64.

152. Prior to 1985, only one case could be read as dealing with profit maximization. In *Warshaw v. Calhoun*, 213 A.2d 539 (Del. Ch. 1965), a minority

the seminal decision by the Delaware Supreme Court in *Moran v. Household International, Inc.* where the court validated the poison pill.[153] The court also decided several other landmark cases in the takeover realm.[154] In 1986, portending the new era of shareholder-centrism, Delaware courts decided two seminal cases in corporate law, which partially but substantially advanced shareholder primacy in specific transactional contexts: *Katz v. Oak Industries, Inc.* and *Revlon v. MacAndrews & Forbes Holdings, Inc.*[155] The table below tracks the number of cases in each year of the decade.

Table 2: Non-*Revlon* Cases in the 1980s

Year	Delaware	Other States	Federal
1980	0	0	3
1981	0	0	2
1982	0	0	0
1983	0	0	0
1984	0	1	1
1985	1	1	0
1986	1	1	8
1987	0	0	1
1988	1	0	6
1989	1	0	3

During the leverage-financed-merger boom of the late 1980s and early 1990s, the debate on profit maximization was had largely in the takeover arena.[156] The years 1985–1986 mark an

shareholder of a personal holding company complained that the controlling shareholder was depressing the stock value of the company by maintaining too large of an investment stake in a portfolio company. The court held that the board was not required to reduce its investment stake. *Id.* at 542–43. Thus *Warshaw* unremarkably upholds managerial authority over a shareholder's assertion of a strategy to maximize profit.

153. Moran v. Household Int'l, Inc., 490 A.2d 1059 (Del. 1985). "The very fact that the director wants to enhance corporate profits is in part attributable to his desire to keep shareholders satisfied so that they will not oust him." *Id.* at 1074.

154. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955–56 (Del. 1985) (discussing when a board may try to prevent a takeover); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (finding a board liable even after allowing for business judgment).

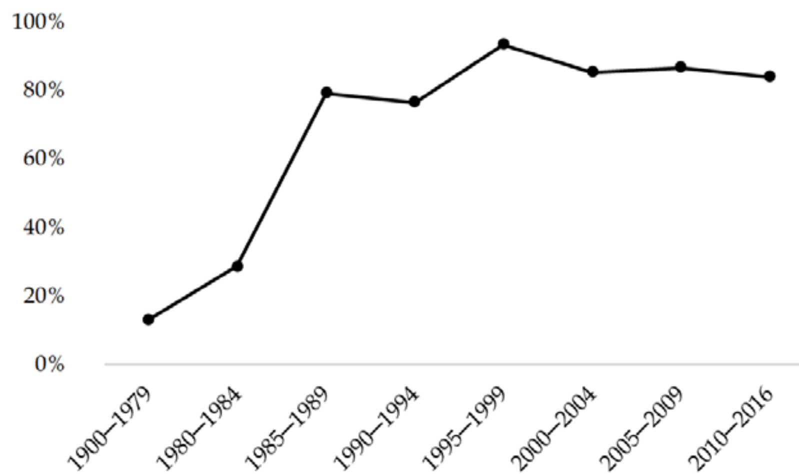
155. *See supra* Parts II.A, II.B.

156. The takeover arena has continued to be the focus of the debate on the purpose of the corporation and shareholder wealth maximization. *See* Para-

inflection point, at which time courts began to opine on shareholder primacy and the trend has been unabated since then. Although Delaware is the leading corporate law jurisdiction, it cannot be said, as deduced from the above, that it led the rise of shareholder primacy. The trend is seen across all jurisdictions, and Delaware, though prominent, is a part of the pack.

The rise of shareholder primacy is also marked by a significant shift in lexicon. Before the mid-1980s, when courts discussed shareholder profit, they tended to use the word choice increasing or enhancing profit, indicating an obligation to make a profit without stating a maximand or prioritizing the purpose of a corporation. Since 1985, the word choice of maximizing profit became the dominant term in the conversation in corporate transactions and litigation.[157] Chart 4 tracks the use of the term maximize in federal and state judicial opinions from the period 1900 to 2016 as a percentage of total cases per time period indicating an obligation to increase, enhance, or maximize shareholder profit.

Chart 4: Percentage of "Maximization" Lexicon



mount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 48 (Del. 1994); Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1990); Allen, *supra* note 151, at 263 (describing the evolution of the corporate law discussion); William T. Allen et al., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1071 (2002) ("Delaware law has yet to make a definitive choice between the two basic models of the corporation . . . .").

157. The term profit maximization has long been in public and academic discussion. *See, e.g.*, GALBRAITH, *supra* note 3, at 112–13.

The shift in rhetoric is definitionally and legally significant. Enhance is defined as an increase.[158] Maximize is defined as an increase to a maximum,[159] and it connotes the economic concept of a maximand. The word choice has legal significance. Corporate-law statutes and the Model Business Corporation Act do not mandate the purpose of the business corporation. However, the American Law Institute's *Principles of Corporate Governance* addresses the issue: "a corporation . . . should have as its objective the conduct of business activities with a view to *enhancing* corporate profit and shareholder gain."[160] The ALI's choice of term enhancing, instead of maximizing, was deliberate. It reveals a reluctance to embrace a strong form of shareholder primacy; or stated more strongly, it rejects economic efficiency as *the* purpose of the corporation.[161] The choice of enhancing (or increasing) and maximizing is meaningful. The sudden shift in the judicial choice of terms in the mid-1980s reveals an awareness and embrace of the concept of maximand.

C. INTEGRATION AND DUTIFICATION

The nature of the judicial discussion has evolved with judicial embrace of the concept of shareholder primacy becoming stronger over time. To show this phenomenon, this Article categorizes non-*Revlon* cases into four types of cases reflecting various degrees of judicial embrace. *Recognition* indicates cases where the court states as a point of fact or observation that directors or shareholders seek to maximize profit, thus recognizing shareholder primacy at the factual level of business practice.[162] *Application* indicates cases where the court applies the concept of shareholder primacy in the process of reasoning toward the case holding or issue resolution, thus applying the concept in the decision analysis.[163] *Integration* indicates cases where the court

158. *Enhance*, WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY (1991).

159. *Maximize*, WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY (1991).

160. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 (Am. Law Inst. 1994) (emphasis added).

161. Bratton, *supra* note 5, at 714; *see* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, *supra* note 160, § 2.01(b)(2)–(3) (discussing ethical implications of shareholder primacy).

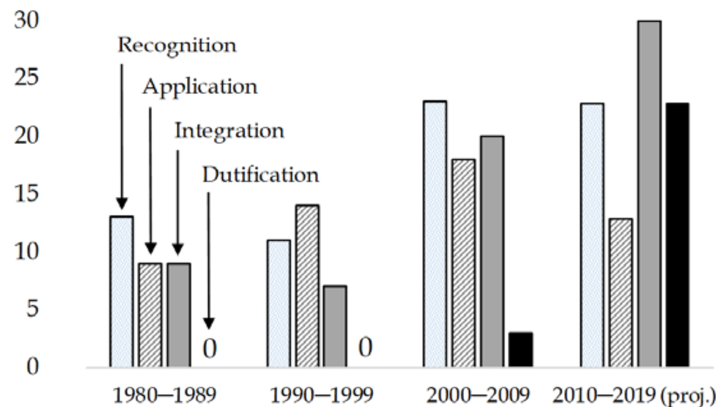
162. *See, e.g.*, *In re* Dunkin' Donuts S'holder Litig., Civ. A. No. 10825, 1990 WL 189120, at *9 (Del. Ch. Nov. 27, 1990) ("Stockholders, on the other hand, do not care if the bidder gets a 'good deal,' they want the most compensation available for their holding in the company. As recent cases in this Court illustrate, maximization of shareholder value is often achieved through an auction of a target company.").

163. *See, e.g.*, IXC Commc'ns, Inc. v. Cincinnati Bell, Inc., No. C.A. 17324,

cites the concept as a rationale for another principle or rule of corporate law, thus integrating the concept into the rule of law.[164] *Dutification* indicates cases where the court prescribes profit maximization as a managerial obligation, thus clearly expressing shareholder primacy as a legal obligation.[165]

These four categories represent an increasing spectrum of judicial endorsement of shareholder primacy: from embracing the concept at the factual level to incorporating the principle at the level of law and legal obligation. Chart 5 provides the number of cases by these four categories in the period 1980 to 2019 (projected).

Chart 5: State and Federal Non-*Revlon* Cases



C.A. 17334, 1999 WL 1009174, at *5 (Del. Ch. Oct. 27, 1999) ("It seems that at this preliminary stage that, absent a complete review of the facts, that the IXC board's judgments about what deals and offers might have been more or less viable than others reflect a vigorous process for maximizing shareholder value. I have not been presented facts that would allow me to conclude that the IXC board did not exercise its best judgment in deciding which suitors merited serious consideration and which ones perhaps did not.").

164. *See, e.g.*, Katz v. Oak Indus., Inc., 508 A.2d 873, 879 (Del. Ch. 1986) ("It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders; that they may sometimes do so 'at the expense' of others (even assuming that a transaction which one may refuse to enter into can meaningfully be said to be at his expense) does not for that reason constitute a breach of duty.").

165. *See, e.g.*, Virtus Capital L.P. v. Eastman Chem. Co., C.A. No. 9808-VCL, 2015 WL 580553, at *16 (Del. Ch. Feb. 11, 2015) ("[Directors] owe fiduciary duties of loyalty and care to the corporation, which require that the directors exercise their managerial authority on an informed basis in the good faith pursuit of maximizing the value of the corporation for the benefit of its residual claimants, *viz.*, the stockholders.").

The number of total cases is increasing with time.[166] Integration and dutification cases, representing the highest level of judicial embrace, are increasing both in terms of numbers and relative percentage. These combined cases as a percentage of total cases are by decades: twenty-nine percent (1980s), twenty-two percent (1990s), thirty-six percent (2000s), sixty percent (2010s projected). Dutification cases are a recent phenomenon, and since 2000 their numbers have increased significantly, from five percent of all cases in the decade 2000 to 2009 to twenty-six percent in the decade 2010 to 2019 (projected).

The concept of shareholder primacy has been integrated into a number of legal principles and rules of law. An example of integration is seen in *In re Pure Resources, Inc. Shareholders Litigation*.[167] The controlling shareholder there made a tender offer to minority shareholders with an intended backend short-form merger.[168] There were two plausible options for the standard of judicial review, the choice of which would be critical to the outcome of any corporate litigation.[169] The Delaware Chancery Court discussed the underlying policy and principle guiding the choice of rule:

> Much of the judicial carpentry in the corporate law occurs in this context, in which judges must supplement the broadly enabling features of statutory corporation law with equitable principles sufficient to protect against abuse and unfairness, but not so rigid as to stifle useful transactions that could increase the shareholder and societal wealth generated by the corporate form.
>
> In building the common law, judges forced to balance these concerns cannot escape making normative choices, based on imperfect information about the world. This reality clearly pervades the area of corporate law implicated by this case. When a transaction to buy out the minority is proposed, is it more important to the development of strong capital markets to hold controlling stockholders and target boards to very strict (and litigation-intensive) standards of fiduciary

166. The following are the number of state and federal non-*Revlon* cases by decades noted in parenthesis (1980s, 1990s, 2000s, 2010s projected) and categories: Recognition (cases by decades: 13, 11, 23, 23), Application (cases by decades: 9, 14, 18, 13), Integration (cases by decades: 9, 7, 20, 30), Dutification (cases by decades: 0, 0, 3, 23).

167. *In re* Pure Res., Inc. S'holder Litig., 808 A.2d 421, 424 (Del. Ch. 2002) (Strine, V.C.).

168. *Id.* at 428–29.

169. *Id.* at 433. *Compare* Kahn v. Lynch Commc'ns Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994) (holding that entire fairness is the standard of review for a cash-out merger by a controlling shareholder), *with* Solomon v. Pathe Commc'ns Corp., 672 A.2d 35, 39–40 (Del. 1996) (holding that courts do not impose any right of shareholders to receive a particular price in a voluntary, non-coercive tender offer by a controlling shareholder).

> conduct? Or is more stockholder wealth generated if less rigorous protections are adopted, which permit acquisitions to proceed so long as the majority has not misled or strong-armed the minority?[170]

The court adopted the rule of law that advanced the policy consideration in favor of profit maximization.[171]

The number of integration cases is significant and increasing. Many corporate law doctrines, as well as doctrines from other fields of law, such as securities regulation, contracts, bankruptcy, and ERISA, have been explicitly justified on the rationale of shareholder wealth maximization. The following discussion provides examples.

1. Difference in Duties Between Nonprofit and For-Profit Corporations

Courts have applied different rules to nonprofit and for-profit corporations. These rules are justified on the rationale that nonprofit and for-profit corporations have different purposes.[172] Managers of a business corporation are "guided by their duty to maximize long term profit for the benefit of the corporation and the shareholders."[173] But a nonprofit corporation's purpose is not to generate a profit and instead the board's duty of loyalty is to pursue the charitable or public benefit mission.[174]

2. Fiduciary Duty

A foundational rule in corporate law is that the board owes fiduciary duty "to the corporation and its shareholders."[175] Courts have interpreted this formulation as not a horizontal relationship between the corporation and its shareholders as dual obligees of duty, but instead as a vertical relationship in which the shareholder's interest is at the apex. "This formulation captures the foundational relationship in which directors owe duties

170. *In re Pure Res. Inc.*, 808 A.2d at 434–35 (emphasis added).

171. *Id.* at 444 (adopting the *Solomon* standard).

172. Summers v. Cherokee Children & Family Servs., Inc., 112 S.W.3d 486, 503–04 (Tenn. Ct. App. 2002); *accord* State *ex rel.* Little People's Child Dev. Ctr., Inc. v. Little People's Child Dev. Ctr., Inc., No. M2007-00345-COA-R3-CV, 2009 WL 103509, at *7 (Tenn. Ct. App. Jan. 9, 2009).

173. *Summers*, 112 S.W.3d at 504.

174. *Id.* at 503–04.

175. N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989); Polk v. Good, 507 A.2d 531, 536 (Del. 1986).

to the corporation for the ultimate benefit of the entity's residual claimants."[176]

3. Business Judgment Rule

A foundational rule in corporate law is the business judgment rule. The business judgment rule has been justified on the rationale of stockholder wealth: to mitigate the debilitating fear of personal liability for the company's losses. "Delaware law encourages corporate fiduciaries to attempt to increase stockholder wealth by engaging in those risks that, in their business judgment, are in the best interest of the corporation."[177]

4. Corporate Charter

Courts have noted that corporate charters permit corporations to pursue profit maximization in diverse ways, subject to the requirement that the corporation engage in "lawful business" and "lawful acts."[178]

5. Shareholder Voting Rights

A foundational rule in corporate law is that shareholders have governance rights through voting. This rule has been justified on the rationale: "What legitimizes the stockholder vote as a decision-making mechanism is the premise that stockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization."[179]

176. *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 36–37 (Del. Ch. 2013); *accord In re* Rural Metro Corp., 88 A.3d 54, 80 (Del. Ch. 2014); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010); N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007).

177. *In re* Goldman Sachs Grp., Inc. S'holder Litig., Civ. Action No. 5215-VCG, 2011 WL 4826104, at *23 (Del. Ch. Oct. 12, 2011)); *accord* Panter v. Marshall Field & Co., 646 F.2d 271, 294 (7th Cir. 1981); Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980); Granada Invs., Inc. v. DWG Corp., 823 F. Supp. 448, 454 (N.D. Ohio 1993); Crouse-Hinds Co. v. InterNorth, Inc., 518 F. Supp. 390, 407 (N.D.N.Y. 1980); *In re* Ambac Fin. Grp., Inc., 457 B.R. 299, 305 (Bankr. S.D.N.Y. 2011); *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 139 (Del. Ch. 2009).

178. *In re* Massey Energy Co., C.A. No. 5430-VCS, 2011 WL 2176479, at *20 & n.144 (Del. Ch. May 31, 2011) (citing ROBERT CHARLES CLARK, CORPORATE LAW 17–18 (1986)) (stating that a corporation's purpose is to "maximize the value of the company's shares, subject to the constraint that the corporation must meet all its legal obligations to others who are related to or affected by it.").

179. Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010); *accord In re* CNX Gas Corp. S'holder Litig., 4 A.3d 397, 416 (Del. Ch. 2010);

6. Derivative Suits

A foundational rule in corporate law is that shareholders may bring a derivative suit on behalf of the corporation. This form of action has been justified on the rationale that shareholders can "pursue monitoring activities that are wealth increasing for the collectivity (the corporation or the body of its shareholders)."[180] Additionally, instrumental aspects of derivative suits such as attorney fees[181] and the demand requirement[182] have been justified on the rationale of shareholder wealth.

7. Shareholder Inspection Rights

All corporation statutes permit shareholders certain inspection rights. However, courts have limited this right by requiring shareholders to show a credible basis for showing mismanagement, waste, or wrongdoing to compel an inspection of the books and records.[183] This rule has been justified on the rationale that it "maximizes stockholder value by limiting the range of permitted stockholder inspections to those that might have merit."[184]

8. Creditor's Standing to Bring Derivative Suit

A well-established rule in corporate law is that creditors have standing to bring derivative suits for a breach of fiduciary duty when a corporation is insolvent. This rule has been justified on the rationale that it comports with the "directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it."[185]

Kurz v. Holbrook, 989 A.2d 140, 178–79 (Del. Ch. 2010).

180. *In re* Activision Blizzard, Inc., 86 A.3d 531, 548 (Del. Ch. 2014) (quoting Bird v. Lida, Inc., 681 A.2d 399, 403 (Del. Ch. 1996)); *accord* Case Fin., Inc. v. Alden, Civ. Action No. 1184-VLP, 2009 WL 2581873, at *7 n.41 (Del. Ch. Aug. 21, 2009); Keller v. Estate of McRedmond, 495 S.W.3d 852, 868 (Tenn. 2016).

181. *In re* Del Monte Foods Co. S'holder Litig., C.A. No. 6027-VCL, 2011 WL 2535256, at *14 n.5 (Del. Ch. June 27, 2011); *In re* Sauer-Danfoss Inc. S'holder Litig., 65 A.3d 1116, 1140 n.7 (Del. Ch. 2011).

182. Johnson v. Glassman, 950 A.2d 215, 220 (N.J. Super. Ct. App. Div. 2008).

183. Seinfeld v. Verizon Commc'ns, Inc. 909 A.2d 117, 122–23 (Del. 2006).

184. *Id.* at 125.

185. N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 103 (Del. 2007); *accord* Official Comm. of Bond Holders of Metricom, Inc. v. Derrickson, No. C 02-04756 JF, 2004 WL 2151336, at *3 (N.D. Cal. Feb. 25, 2004); *In re* AWTR Liquidation Inc., 548 B.R. 300, 328 n.12 (Bankr. C.D. Cal. 2016); *In re* Grace Manor Health Care Facility, Inc., Bankr. No. 09-11456 B., 2012 WL 1021036, at *2 (Bankr. W.D.N.Y. Mar. 9, 2012); *In re* RSL COM PRIMECALL, Inc., Nos. 01-11457 (ALG), 2003 WL 22989669, at *8 (Bankr. S.D.N.Y. Dec. 11, 2003); Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.,

9. Maximization of Residual Value

A related concept is the rule that requires a manager or trustee to maximize firm value in insolvency, including value for shareholders. This rule has been justified on the rationale that managers should "strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm's value."[186] This rationale is the same one that supports profit maximization as the economically efficient goal, which is the maximization of a firm's residual value. Outside of insolvency, the residual value in assets and earnings belongs to shareholders.

10. Priority Rule in Bankruptcy

A fundamental concept in bankruptcy and corporate law is that creditors must be paid before shareholders. In bankruptcy, under the rule of absolute priority, creditors are first in the order of seniority. In corporate law, under the rule of limited liability, the claims of creditors are protected ahead of shareholder interest in the corporation. These rules are justified on the rationale that "unlike creditors and depositors, stockholders stand to gain a share of corporate profits, stockholders should take the primary risk of the enterprise failing. This scheme of priorities is consistent with the economic theory of corporations."[187]

11. Debt Restructuring and Exchange Offers

In a restructuring or in other corporate transactions, the economic value of debt instruments may be diminished to enhance shareholder value. Such transactions are justified on the rationale: "It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's

863 A.2d 772, 777, 787, 790–91 (Del. Ch. 2004); Caulfield v. Packer Grp., Inc., 56 N.E.3d 509, 518 (Ill. App. Ct. 2016); Lichtenstein v. Willkie Farr & Gallagher LLP, 120 A.D.3d 1095, 1097 (N.Y. App. Div. 2014); Sanford v. Waugh & Co., 328 S.W.3d 836, 845 (Tenn. 2010).

186. Quadrant Structured Prods. Co. v. Vertin, 102 A.3d 155, 172, 176 (Del. Ch. 2014) (quoting *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 40–41 (Del. Ch. 2013)); *accord In re* C.W. Mining Co., 636 F.3d 1257, 1264–65 (10th Cir. 2011); Terrydale Liquidating Tr. v. Barness, 846 F.2d 845, 847–48 (2d Cir. 1988); *In re* JL Building, LLC, 452 B.R. 854, 862 (Bankr. D. Utah 2011); Mukamal v. Bakes, 383 B.R. 798, 826 (Bankr. S.D. Fla. 2007); *In re* Amcast Indus. Corp., 365 B.R. 91, 104 n.6, 107 n.7 (Bankr. S.D. Ohio 2007); *In re* Hechinger Inv. Co. of Del., 274 B.R. 71, 89 (Bankr. D. Del. 2002); Badii ex rel. Badii v. Metro. Hospice, Inc., C.A. No. 6192-VLP, 2012 WL 764961, at *9 (Del. Ch. Mar. 12, 2012).

187. Gaff v. Fed. Deposit Ins. Corp., 919 F.2d 384, 392 (6th Cir. 1990).

stockholders; that they may sometimes do so 'at the expense' of others . . . does not for that reason constitute a breach of duty."[188]

12. Controlling Shareholder's Right to Sell

A controlling shareholder, such as a parent corporation, "has a right to sell . . . stock and in the ordinary case owes no duty in that connection to other shareholders when acting in good faith."[189] This rule is based on the perceived alignment of interest: "as the owner of a majority share, the controlling shareholder's interest in maximizing value is directly aligned with that of the minority."[190]

13. Mergers and Acquisitions

The poison pill has long been used as a takeover defense. Courts have noted that the poison pill may have value-maximizing uses.[191] The poison pill has been justified on the rationale that it is "plausibly related to the goal of stockholder wealth maximization."[192] Various other issues and rules in the takeover context have been justified on the rationale of shareholder profit maximization.[193]

188. Katz v. Oak Indus. Inc., 508 A.2d 873, 879 (Del. Ch. 1986); *accord* U.S. Bank N.A. v. Stanley, 297 S.W.3d 815, 820 (Tex. App. 2009) (quoting *Katz*, 508 A.2d at 879).

189. Harris v. Carter, 582 A.2d 222, 234 (Del. Ch. 1990); *accord In re* CompuCom Sys., Inc. S'holder Litig., No. Civ. A. 499-N, 2005 WL 2481325, at *6 (Del. Ch. Sept. 29, 2005); *cf.* McMullin v. Beran, 765 A.2d 910, 919 (Del. 2000) (holding that "the directors are obliged to make an informed and deliberate judgment, in good faith, about whether the sale to a third party that is being proposed by the majority shareholder will result in a maximization of value for the minority shareholders.").

190. *In re CompuCom*, 2005 WL 2481325, at *6.

191. Moore Corp. v. Wallace Computer Servs., Inc., 907 F. Supp. 1545, 1557 (D. Del. 1995)).

192. Cooperstock v. Pennwalt Corp., 820 F. Supp. 921, 924 (E.D. Pa. 1993); *accord* Dynamics Corp. of Am. v. CTS Corp., 805 F.2d 705, 708 (7th Cir. 1986); Desert Partners, L.P. v. USG Corp., 686 F. Supp. 1289, 1297 (N.D. Ill. 1988).

193. *See* Blanchard v. Edgemark Fin. Corp., No. 94 C. 1890, 2000 WL 33223385, at *3 (N.D. Ill. May 22, 2000) ("Secrecy maximizes shareholder wealth in the context of public corporations by encouraging potential bidders to offer their most aggressive price on a deal."); Avon Prods., Inc. v. Chartwell Assocs. L.P., 738 F. Supp. 686, 689 & n.2 (S.D.N.Y. 1990) (explaining certain statutory merger rules as presumably "an effort to maximize stockholder value"); Terrydale Liquidating Tr. v. Barness, 642 F. Supp. 917, 923 n.5 (S.D.N.Y. 1986) (indicating that defensive tactics should have "a plausible measure for maximizing shareholder wealth" (quoting Dynamics Corp. v. CTS Corp., 794 F.2d 250, 257 (7th Cir. 1986)); Alessi v. Beracha, 849 A.2d 939, 947 (Del. Ch. 2004) (discussing the idea that "secrecy increases shareholder wealth" in the context of sale of the company); Fulk v. Washington Serv. Assocs., Inc., No.

14. Shareholder Proxy

A recent prominent case decided the validity of a proxy rule proposed by the SEC related to the direct nomination and election of directors by shareholders. In striking down the proposed rule, the court reasoned that the rule did not establish a connection to "the goal of maximizing shareholder value."[194]

15. Contract Privilege

In some states, corporate officers are privileged to interfere with contracts. This rule is justified on the rationale that the "privilege maximizes firm value by incentivizing officers to prioritize the interests of shareholders over those of contract creditors. . . . [T]he privilege also leaves corporate officers freer to exercise their business judgment in their shareholders' best interests."[195]

16. ERISA

Courts can circumscribe the exercise of discretion of an ERISA plan administrator and engage in judicial review of the administrator's conduct. This rule is justified on the rationale that "as the insurer, [it] reaps the financial rewards of its claims decisions, and, as a subsidiary of a publicly held and traded cor-

Civ. A. 17747-NC, 2002 WL 1402273, at *7 (Del. Ch. June 21, 2002) (noting "the larger question—how best to maximize value for the shareholders in a sale of the Company" in a dissolution and liquidation); ACE Ltd. v. Capital Re Corp., 747 A.2d 95, 104–05 (Del. Ch. 1999) (noting that "the Delaware law of mergers and acquisitions has given primacy to the interests of stockholders in being free to maximize value from their ownership of stock without improper compulsion from executory contracts entered into by boards"); Emp'r Teamsters Local Nos. 175 & 505 Pension Tr. Fund v. Caspersen, 2006 WL 435289, at *8 (N.J. Sup. Ct. App. Div. Feb. 24, 2006) (discussing directors' duty to inform in a merger and "maximize the value obtained for their shareholders"); Alpert v. 28 Williams St. Corp., 473 N.E.2d 19, 28 (N.Y. 1984) (explaining that a freeze-out merger must "ultimately seek to increase the individual wealth of the remaining shareholders."); Marcoux v. Prim, No. 04 CVS 920, 2004 WL 830393, at *13 (N.C. Super. Ct. Apr. 16, 2004) ("This Court must balance protecting shareholder rights with preserving the freedom of shareholders to approve or block a proposed merger according to their own economic interests. A standard that is too lenient in either direction can have adverse repercussions on both shareholder rights and maximizing shareholder value.").

194. Bus. Roundtable v. SEC, 647 F.3d 1144, 1152 (D.C. Cir. 2011).

195. Serv. By Air, Inc. v. Phoenix Cartage & Air Freight, LLC, 78 F. Supp. 3d 852, 864 (N.D. Ill. 2015).

poration, has a conflicting fiduciary obligation to maximize profits for the benefit of shareholders."[196]

* * * * *

The above examples of integration cases show that shareholder primacy is a filamentary principle that weaves through many important rules of corporate law and the corporate system. As an organizing principle, it provides structural coherence and form to the body of law. Courts have recognized that shareholder profit is the rationale for many important or foundational rules of corporate law.

In addition to integration cases, the case law shows the beginning, perhaps, of an explicit rule of law emerging in the form of an unconditional obligation to maximize shareholder wealth. This is a recent phenomenon. Before 2000, there were no dutification cases. In the period 2000 to 2009, there were a handful of dutification cases.[197] In the period 2010 to 2016, such cases have increased significantly, both in Delaware and other jurisdictions; and courts have prescribed the obligation to maximize shareholder profit in various contexts and legal issues.[198] The 2010

196. O'Bryhim v. Reliance Standard Life Ins., No. 98-1472, 1999 WL 617891, at *7 (4th Cir. Aug. 16, 1999).

197. *See, e.g.*, E*TRADE Fin. Corp. v. Deutsche Bank AG, 631 F. Supp. 2d 313, 377 (S.D.N.Y. 2009); Kreinberg v. Dow Chem. Co., No. 07-13235-BC, 2007 WL 2782060, at *4 (E.D. Mich. Sept. 24, 2007); Jasinover v. Rouse Co., No. 13-C-04-59594, 2004 WL 3135516, at *9 (Md. Cir. Ct. Nov. 4, 2004); Rodriguez v. Loudeye Corp., 189 P.3d 168, 174–75 (Wash. Ct. App. 2008).

198. *Delaware cases*: Virtus Capital L.P. v. Eastman Chem. Co., C.A. No. 9808-VCL, 2015 WL 580553, at *16 & n.5 (Del. Ch. Feb. 11, 2015) (Laster, V.C.) (holding that the court had personal jurisdiction over directors and controlling shareholders of entities under equitable principles); Allen v. El Paso Pipeline GP Co., L.L.C., 113 A.3d 167, 179–80 (Del. Ch. 2014) (Laster, V.C.) (holding that a master limited partnership agreement provided the standard for determining whether a transaction was in good faith and distinguishing the fiduciary duties of a director of a corporation and a general partner's duties under a partnership agreement when they have been subject to contracting); *In re* Orchard Enters., Inc. S'holder Litig., 88 A.3d 1, 37–38 (Del. Ch. 2014) (Laster, V.C.) (holding that triable issues on the fairness of a merger existed); *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 20, 37 (Del. Ch. 2013) (Laster, V.C.) (holding that a merger was fair to common stockholders; stating the obligation in the context of discussing the nature of a board's fiduciary duties); Feeley v. NHAOCG, LLC, 62 A.3d 649, 668 (Del. Ch. 2012) (Laster, V.C.) (holding that a controlling owner of an entity can be held liable for a breach of fiduciary duty arising from the entity's acts under equitable principles); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34–35 (Del. Ch. 2010) (Chandler, C.) (holding that a poison pill plan was improper).

Delaware Chancery Court opinion in *eBay Domestic Holdings, Inc. v. Newmark* seems to have ushered a new period in which courts have become comfortable with explicitly linking shareholder wealth maximization to a generalized judicial statement of a board's obligation.[199] Notably, excepting *Revlon*-invoked cases, explicit statements about shareholder profit maximization and the conception of corporate purpose tied to the private-

Other jurisdictions: Nakkhumpun v. Taylor, Civ. Action No. 12-CV-01038-CMA-CBS, 2014 WL 321156, at *5 (D. Colo. Jan. 23, 2014) (holding that disclosures did not raise a strong inference that defendants knew or were recklessly indifferent to the possibility of misleading shareholders); KD Gretna Props., LLC v. Decatur Realty Corp., Civ. Action No. 13-218, 2013 WL 1288048, at *5, *8 (E.D. La. Mar. 26, 2013) (holding that a minority shareholder's complaint failed to plead gross negligence or reckless disregard for the interest of the corporation in a self-dealing context); Giles v. ICG, Inc., 789 F. Supp. 2d 706, 714–15 (S.D.W. Va. 2011) (holding that Delaware is the appropriate forum for the consolidation of class action fiduciary claims arising under Delaware law); Akanthos Capital Mgmt., LLC v. CompuCredit Holdings Corp., 770 F. Supp. 2d 1315, 1333–34 (N.D. Ga. 2011) (holding that creditors sufficiently pleaded an action for fraudulent transfer); *In re* Celestica Inc. Sec. Litig., No. 07 CV 312 (GBD), 2010 WL 4159587, at *5–6 (S.D.N.Y. Oct. 14, 2010) (holding that the complaint in a securities fraud case failed to adequately plead scienter under the heightened pleading standard), *rev'd*, New Orleans Emps. Ret. Sys. v. Celestica, Inc., 455 Fed. App'x 10 (2d Cir. 2011); Nucor Corp. v. United States, 675 F. Supp. 2d 1340, 1348–50 (Ct. Int'l Trade 2010) (upholding an agency revocation of orders related to antidumping countervailing duty orders); *In re* Gulf Fleet Holdings, Inc., Bankr. Nos. 10-50713, 2014 WL 4560441, at *13 (Bankr. W.D. La. Apr. 2, 2014) (recommending that motion to dismiss claims for breach of fiduciary duty be denied); *In re* Gulf Fleet Holdings, Inc., 491 B.R. 747, 776–81 (Bankr. W.D. La. 2013) (holding that breach of fiduciary duty allegations were sufficiently pled with respect to some defendants and discussing fiduciaries duties for directors of solvent and insolvent companies, for controlling shareholders, and for managers of LLCs); IBEW Local No. 129 Benefit Fund v. Tucci, Nos. 2015-3130-BLS-1, 2015 WL 9275480, at *5 (Mass. Super. Ct. Dec. 7, 2015) (holding that a challenge to a board's recommendation for a merger for inadequate consideration was a derivative claim); Stilwell Value Partners, IV, L.P. v. Cavanaugh, No. 653011/2011, 2015 WL 6499500, at *3–4 (N.Y. Sup. Ct. Oct. 23, 2015) (holding that a trial was necessary to determine whether a board breached its fiduciary duty under the entire fairness standard when it refused to proceed with a second step in a transaction), *rev'd*, 27 N.Y.S.3d 553 (Sup. Ct. App. Div. 2016).

199. The specific language of profit maximization in *eBay* has been favorably cited in a number of cases. *See In re Gulf Fleet Holdings, Inc.*, 2014 WL 4560441, at *12; *In re Gulf Fleet Holdings, Inc.*, 491 B.R. at 776; OptimisCorp v. Waite, C.A. No. 8773-VCP, 2015 WL 5147038, at *61 n.520 (Del. Ch. Aug. 26, 2015) (Parsons, V.C.); *Virtus Capital L.P.*, 2015 WL 580553, at *16 n.5 (Laster, V.C.); *Allen*, 113 A.3d at 179 n.1 (Laster, V.C.); Quadrant Structured Prods. Co. v. Vertin, 102 A.3d 155, 187 n.11 (Del. Ch. 2014) (Laster, V.C.); *In re* Rural/Metro Corp. S'holder Litig., 102 A.3d 205, 253 n.27 (Del. Ch. 2014) (Laster, V.C.); *In re Trados Inc.*, 73 A.3d at 36 n.3 (Laster, V.C.); Klaassen v. Allegro Dev. Corp., C.A. Case No. 8628-VCL, 2013 WL 5967028, at *11 (Del. Ch. Nov. 7, 2013) (Laster, V.C.); *Feeley*, 62 A.3d at 668 (Laster, V.C.).

property model of the corporation were largely absent in the prior decades.[200]

Two facts condition the number of dutification cases. First, all post-2009 cases are trial court opinions.[201] Second, although Delaware has seen a sharp increase in cases after *eBay*, all cases are attributable to a single vice chancellor.[202] However, he is not alone in the Delaware judiciary in his explicit embrace of the idea. Chief Justice Strine has written in a recent law review article that "corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders."[203] Of course, it is an additional step to go from authoring a law review article to announcing a rule in the majority opinion of a state supreme court. Thus far a duty to maximize profit has not been announced by the Delaware Supreme Court, but its chief justice saying so publicly is important. That said, we are unlikely to see courts impose a legal duty.[204]

IV. THE LEGAL MECHANISM OF SHAREHOLDER PRIMACY

The empirical evidence in Part III shows that shareholder primacy is not independent of law. It has a legal foundation in broad judicial embrace. In much of social interaction, law per prescription, proscription, or permission is a driving force of behavior. Yet shareholder primacy clearly does not, and cannot, work doctrinally through a rule-sanction of duty.[205] Academically, *Dodge v. Ford Motor Co.* may be iconic, but doctrinally, the case has been irrelevant to the larger movement, other than serving as a focal point for academic debate. It is farfetched to believe that a rarely cited, one-hundred-year-old case from Michigan actually influenced business and economic history to its current state. When juxtaposed with the empirical data, the hypothesis tells a story that *Dodge* remained dormant and ineffective

200. Not that long ago, Delaware jurists were writing that there were competing models of the corporation with different views on the purpose of the corporation. *See* Allen, *supra* note 151, at 264–66; Allen et al., *supra* note 156, at 1074–77. Allen, Jacobs, and Strine suggested that Delaware corporate law was equivocal and did not strongly embrace either the property or entity models. Allen et al., *supra* note 156, at 1078–79.

201. *See supra* note 198.

202. *See supra* note 198 (citing opinions written by Vice Chancellor Travis Laster).

203. Strine, *supra* note 4, at 155.

204. *See supra* Part I.B.

205. *See supra* Part I.B.

for the first sixty years since its publication in 1919 only to have suddenly become prophetic in the past thirty years, though it has never been cited much outside of law review articles. The narrative of its impact does not make sense. In truth, appellate courts have not imposed a duty to maximize profit, the breach of which would subject a board to a cognizable derivative action, judicial review of substantive business decisions, and potential liability. Courts have not embraced this form of law. It bears repeating that no court has ever imposed liability on a board for a breach of fiduciary duty on the independent ground that the board demonstrably failed to maximize profit.

In spite of the abundant evidence of judicial embrace of the idea, a positive legal theory must still answer: Is shareholder primacy law in light of the nonexistence of a duty? If so, how does the law work?

A. Defining Norm

Corporate-law scholarship almost always refers to shareholder primacy as a norm. This moniker is shorthand for conveying the idea that a rule-sanction framework does not exist; accordingly, the concept, it is thought, must work as a social norm. The subject of social norms has generated significant scholarship.[206] For the purpose of this Article, Richard Posner provides a workable, generally accepted definition, which serves as a starting point of the analysis here:

> A norm is a social rule that does not depend on government for either promulgation or enforcement. . . . Laws are promulgated by public institutions, such as legislatures, regulatory agencies, and courts, after well-defined deliberative procedures, and are enforced by the police power of the state, which ultimately means by threat of violence. Norms are not necessarily promulgated at all. If they are, it is not by the state. Often a norm will result from (and crystallize) the gradual emergence of a consensus.[207]

206. *See generally* ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1991) (analyzing the way social norms play into the resolution of common disputes); SOCIAL NORMS, NONLEGAL SANCTIONS, AND THE LAW (Eric A. Posner ed., 2007). Scholars have studied norms at work in commercial law. *See, e.g.*, Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992) (detailing how the diamond industry polices itself not through laws, but through carefully crafted norms); Eisenberg, *supra* note 14.

207. Richard A. Posner & Eric B. Rasmusen, *Creating and Enforcing Norms, with Special Reference to Sanctions*, 19 INT'L REV. L. & ECON. 369, 369–70 (1999).

There are other definitions of a norm,[208] such as the philosophical concept of "ought" and the mathematical concept of probabilistically consistent behavior,[209] but many scholars in the study of law and social norms define norms as a community-prescribed behavior enforced through some means other than the threat of governmental sanction.[210]

The labeling of shareholder primacy as a norm is consistent with the above definition. Shareholder primacy is said to be a "principle,"[211] "belief system,"[212] or "ideology"[213] that has broad community support for its normative content.[214] It is not enforceable by law through statute or judicial order.[215] Its legitimacy, it is believed, is based on a norm, originated from the persuasiveness of economic theories and policy arguments, internalized by the business community, and, presumably like other norms, enforced through nonstate censure.[216]

This widely perceived account is inaccurate because the notion of a norm diminishes the role of courts and the centrality of law in imposing a legal obligation on managers. Logic alone suggests this; if corporate governance is founded on law, we should expect one of its fundamental tenets to be also founded on the

208. *See* Marcel Kahan, *The Limited Significance of Norms for Corporate Governance*, 149 U. PA. L. REV. 1869, 1871 (2001) ("Since there appears to be no norm for the definition of 'norms,' the 'norms' terminology does not add much conceptual clarity.").

209. Robert Cooter, *Normative Failure Theory of Law*, 82 CORNELL L. REV. 947, 954 (1997); *see also* HART, *supra* note 13, at 44, 55 (discussing customs and habits as distinct from obligations); Green, *supra* note 15, at 517 ("Not all practice rules are obligation-imposing, however; most are just ordinary customs and conventions.").

210. *See* John C. Coffee, Jr., *Do Norms Matter? A Cross-Country Evaluation*, 149 U. PA. L. REV. 2151, 2171–72 (2001) (honor and reputation); Robert Cooter, *Do Good Laws Make Good Citizens? An Economic Analysis of Internalized Norms*, 86 VA. L. REV. 1577, 1579–80 (2000) (nonlegal sanctions such as criticism or blame); Cooter, *supra* note 209, at 950 (efficiency); Ellickson, *supra* note 130, at 3 (external, informal third parties); Oliver Hart, *Norms and the Theory of the Firm*, 149 U. PA. L. REV. 1701, 1702 (2001) (contractual completeness); Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1623 (2001) (business judgment rule); Sunstein, *supra* note 130, at 915 (intuitive behavior).

211. Allen et al., *supra* note 156, at 1079.

212. Matthew T. Bodie, *AOL Time Warner and the False God of Shareholder Primacy*, 31 J. CORP. L. 975, 977 (2006).

213. STOUT, *supra* note 5, at 2.

214. *See supra* notes 6, 58 and accompanying text.

215. *See supra* Part I.A.

216. *See supra* note 58 and accompanying text.

law and the legal system. Experience confirms this; courts have embraced shareholder primacy over a thirty-year period. This fact is not without legal effect. Shareholder primacy is not just a social norm—such as taking off one's hat in a house of worship or rising for the national anthem—conduct that is widely observed, not because of a legal obligation but because of social pressure and internalization of custom. Shareholder primacy ultimately derives its legitimacy from judicial acceptance and that the obligation it creates demands compliance.

The missing idea in a positive legal theory of shareholder primacy is that law can be expressed by the government as an obligation without formal sanction if the application of such police power would undermine other important rules and a sanction is not needed to achieve efficacy of the law's prescription.

B. SHAREHOLDER PRIMACY AS OBLIGATION

Shareholder primacy is not a legal duty, but is instead a legal obligation.[217] H.L.A. Hart's *The Concept of Law* provides an insight into obligations that rise to law.[218] In theorizing the jurisprudential question "what is law?" he critiqued Austin's idea of law as a general command backed by the coercive force of the threat of government enforcement.[219] The Austinian form of law aptly describes fields such as criminal law, torts, and regulated industries, which are constructed on the idea of duty, breach, and sanction.[220] Fiduciary duties of corporate managers, being liability rules, are also in this form of duty-based rules enforceable through sanction.[221]

Some laws are not in Austinian form. A law can be either unenforceable or simply enabling. A particularly relevant example in the field of business organizations is laws that "confer legal powers on private individuals."[222] Corporate law is said to be

217. *See supra* notes 15–17 and accompanying text.

218. HART, *supra* note 13.

219. *Id.* at 18–25; *see* Green, *supra* note 15, at 517 (arguing that "sanction theories are now nearly friendless").

220. HART, *supra* note 13, at 27.

221. *See supra* note 39 (collecting cases finding liability for breach of fiduciary duties).

222. HART, *supra* note 13, at 28. These laws include contracts, wills, and marriages. *Id.* at 27. They also include the laws of noncorporate entities that provide greater contractual flexibility than the corporate form. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-1101(b) (2017) ("It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."); LARRY E. RIBSTEIN, THE RISE OF THE

enabling, characterized in large parts by its power to enable a set of privately ordered legal and economic relationships among corporate constituents.[223] Thus the Austinian concept of law does not fully describe other forms of law.[224]

According to Hart, a rule imposes an obligation when the general demand for conformity is insistent and the social pressure brought to bear upon those who deviate is great.[225] Social customs and obligations differ on the degree of social pressure: "What is important is that the insistence on importance or *seriousness* of social pressure behind the rules is the primary factor determining whether they are thought of as giving rise to obligations."[226] An obligation is supported not only by a general demand for compliance and social pressure, but also such demand for compliance is considered a legitimate response to deviations.[227] An obligation is mandatory, which distinguishes it from other norms.[228]

UNCORPORATION 37 (2010) (suggesting that LLCs "have real contracts" unlike corporations).

223. *See* Shintom Co., Ltd. v. Audiovox Corp., 888 A.2d 225, 227 (Del. 2005) ("The Delaware General Corporation Law is an enabling statute . . . ."); Williams v. Geier, 671 A.2d 1368, 1381 (Del. 1996) ("At its core, the Delaware General Corporation Law is a broad enabling act which leaves latitude for substantial private ordering, provided the statutory parameters and judicially imposed principles of fiduciary duty are honored."); William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1400 (1993) ("United States corporate law is thus chiefly enabling in character, not regulatory."). The idea of enabling contractual relationships in a firm is seen in economic theories of the firm, which form the basic ideas of law and the economic conception of corporate law. *See* R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 391 (1937); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 290 (1980); Jensen & Meckling, *supra* note 54.

224. HART, *supra* note 13, at 79–81.

225. *Id.* at 86–87. Other scholars have been influenced by Hart's idea of an effective obligation. *See* Cooter, *supra* note 209, at 955.

226. HART, *supra* note 13, at 87.

227. *See* H.L.A. Hart, *Answers to Eight Questions*, *in* READING HLA HART'S THE CONCEPT OF LAW 283 (Luís Duarte D'Almeida et al. eds., 2013). Elaborating, Hart says:

> What is necessary is that there should be a critical reflective attitude to certain patterns of behaviour as a common standard, and that this should display itself in criticism (including self-criticism), demands for conformity, and in acknowledgments that such criticism and demands are justified, all of which find their characteristic expression in the normative terminology of 'ought', 'must', and 'should', 'right' and 'wrong'.

HART, *supra* note 13, at 57; *see id.* at 90 (explaining that "the violation of a rule is not merely a basis for the prediction that a hostile reaction will follow but a *reason* for hostility").

228. Kenneth Einar Himma, *A Comprehensive Hartian Theory of Legal Ob-*

In a legal system, the government applies rules of recognition to determine obligations, such as when common law courts determine the rule of law. Courts may observe general characteristics possessed by an obligation and its "relation to judicial decisions."[229] Courts do not always state the rule applied to recognize an obligation, but instead the decision frequently reveals the rule: thus "when courts reach a particular conclusion on the footing that a particular rule has been correctly identified as law, what they say has a special authoritative status conferred on it by other rules."[230] When courts identify a rule in the legal system, they validate the obligation.[231] The validity of a rule differs from its efficacy.[232] If law is more than the Austinian concept, it requires a dissociation of validity from efficacy because some laws are not sanctionable and thus enforceable.[233]

Viewed through this jurisprudential prism, shareholder primacy is more than a social custom or social norm. It is a legal obligation in the Hartian tradition: shareholder primacy is an important rule imbued with a "seriousness of social pressure,"[234] though it is not enforceable; it is recognized and institutionalized by courts;[235] it is said to be foundational to corporate law and governance.[236] The reprobation directed at one who deviates from the rule would be considered legitimate. This social pressure may be inconsistent with the corporate manager's own value system, but nevertheless she may feel compelled to obey

ligation: Social Pressure, Coercive Enforcement, and the Legal Obligation of Citizens, *in* PHILOSOPHICAL FOUNDATIONS OF THE NATURE OF LAW 162, 166 (Wil Waluchow & Stefan Sciaraffa eds., 2013).

229. HART, *supra* note 13, at 95.

230. *Id.* at 101–02.

231. *Id.* at 103; *see* Roscoe E. Hill, *Legal Validity and Legal Obligation*, 80 YALE L.J. 47, 51 (1970) ("In Hart's system, therefore, a legal rule of obligation (imposing legal obligation) is created whenever the relevant officials make the appropriate manipulations under the secondary rules of the legal system.").

232. HART, *supra* note 13, at 103.

233. *Id.* at 217–18.

234. *Id.* at 87.

235. *See supra* notes 162–65 and accompanying text.

236. *See supra* note 54.

the rule.[237] Thus outlier cases like *Dodge* and *eBay* are insubstantial at the instrumental level of doctrine;[238] their significance is at the expressive level. They legitimize shareholder primacy through a judicial rebuke of perceived deviations from the legal obligation.[239] The opinions are consistent with the large body of judicial literature across many jurisdictions and over several decades. Furthermore, the recent rise of dutification cases in lower court opinions is not a signal of a move toward an enforceable duty.[240] Instead, they unambiguously express the judicial expectation of the obligation. They function at the level of expressive value.[241] The rule of law and the legal system writ large, not social norm, have resulted in today's strongly shareholder-centric economic orientation in corporate governance.

Shareholder primacy also has both external and internal aspects. The volume of judicial literature over several decades clearly shows that courts have recognized shareholder primacy.[242] Courts accept arguments based on shareholder primacy; they embrace the concept as a part of the reasoning process toward judicial outcomes; they incorporate the concept in

237. Hart adds two other characteristics of an obligation: (1) the obligation is thought to be important "because they are believed to be necessary to the maintenance of social life or some highly prized feature of it"; and (2) the obligation, while benefiting others, may "conflict with what the person who owes the duty may wish to do" and thus it is "thought of as characteristically involving sacrifice or renunciation." HART, *supra* note 13, at 87; *see* Green, *supra* note 15, at 517. In this sense, an obligation demands compliance. *See* Himma, *supra* note 228.

238. As categorized in the empirical analysis here, these cases are the application cases. *See supra* note 163 and accompanying text. The courts applied the concept of shareholder primacy in the process of reasoning toward the case holding with respect to the distribution of dividends and the application of a poison pill defense.

239. For example, Ford's honest confession of an altruistic motive earned the court's rebuke. *See* Macey, *supra* note 10, at 183; Strine, *supra* note 4, at 148.

240. *See supra* Part III.C & Chart 5.

241. *See* Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649, 1650–51 (2000) ("The thesis is that law influences behavior independent of the sanctions it threatens to impose, that law works by what it says in addition to what it does."); *id.* at 1651 n.2 (describing expressive law as the "claim that law influences behavior independently of sanctions"); Sunstein, *supra* note 130, at 964 ("Many laws have an expressive function. They 'make a statement' about how much, and how, a good or bad should be valued. They are an effort to constitute and to affect social meanings, social norms, and social roles.").

242. *See supra* Part II.

other principles and rules of corporate law.[243] The rule of shareholder primacy is not simply a pronouncement by a few courts or even important courts such as Delaware's.[244] It is not simply the occasional dictum of judicial rumination on best practices, which would not rise to the level of a rule of law.[245] Courts have embraced the obligation pervasively, across many jurisdictions,[246] and consistently over several decades.[247] The weight and seriousness of the concept is apparent. These collective judicial actions have recognized a legal obligation. This obligation has been internalized by managers and shareholders.[248] By recognizing the rule, courts have focused the business community's internalization toward a single common objective.[249]

Enforceability is not a precondition of efficacy.[250] Unenforceability does not inevitably result in inefficacy, and thus possibly delegitimization.[251] Most commentators, including critics, conclude that shareholder primacy has been internalized by a consensus of all relevant constituents.[252] This fact predicts significant compliance without the need for enforcement. Not all laws are coupled with a meaningful sanction.[253] Examples from other

243. *See supra* Part III.

244. *See, e.g.*, Summers v. Cherokee Children & Family Servs., Inc., 112 S.W.3d 486, 503–04 (Tenn. App. 2002); *see also supra* note 198 and accompanying text.

245. *See supra* Part III.C.

246. *See supra* note 198 and accompanying text.

247. *See supra* Part III.

248. *See supra* Parts III.B, III.C.

249. "[L]aw facilitates coordination by making a particular outcome salient; law's requirements focus individuals' attention on one way to coordinate, channeling their behavior in that direction." RICHARD H. MCADAMS, THE EXPRESSIVE POWERS OF LAW 22 (2015). In corporate law theory, the idea of a single objective is prominent. Coordination to a single objective is consistent with agency cost theory of the firm, which says that an agent must be given a single objective, lest the agent will pursue his own interest and agency cost will increase. EASTERBROOK & FISCHEL, *supra* note 54, at 38; Jensen, *supra* note 51, at 238. Thus, shareholder primacy can be seen as a legal focal point that coordinates the behavior of managers toward a single goal.

250. The internalization of a rule as a legal obligation presupposes the truth of a legal system that is "generally efficacious." HART, *supra* note 13, at 104.

251. *See supra* notes 208–16 and accompanying text.

252. *See supra* note 6.

253. For example, states have legislated a duty to rescue, which is contrary to the common law of torts. *See, e.g.*, Yania v. Bigan, 155 A.2d 343, 346 (Pa. 1959). However, the sanctions are so light that these laws are best understood as having an expressive function. *See* MINN. STAT. § 604A.01(1) (2017) (petty misdemeanor); VT. STAT. ANN. tit. 12, § 519 (2018) (fine of not more than one hundred dollars); WISC. STAT. § 940.34 (2018) (Class C misdemeanor). Likewise, there are laws against cursing in public with de minimis penalties. *See* MICH.

laws show that law may work through expressive value.[254] The suggestion here is not that regulatory rules without sanctions are a standard form of law. Most regulations work through the stick of enforcement. Although much of corporate law is said to enable the private ordering of economic actors,[255] shareholder primacy—to the extent that it prescribes specific managerial behavior through the rule of law—is regulatory in character.[256] Unlike most regulatory frameworks that work through enforcement, shareholder primacy as a regulation cannot take the form of a rule-sanction. Such form of law would be internally incoherent with the structure of corporate law.[257] Nevertheless, efficacy does not require this form of law. A rule-no-sanction form is seen in law when a rule can still achieve compliance through other means.[258]

COMP. LAWS § 750.103 (2013) (misdemeanor with a five-day statute of limitations); R.I. GEN. LAWS § 11-11-5 (2013) (fine of not more than five dollars). Additionally, federal statute prohibits disrespect of the flag, but provides no penalty. 4 U.S.C. § 8(h) (2012). Finally, the entire field of international law must generally contend with obligations without sanctions. *See generally* Kenneth W. Abbott & Duncan Snidal, *Hard and Soft Law in International Governance*, 54 INT'L ORG. 421, 440 (2000); Andrew T. Guzman & Timothy L. Meyer, *International Soft Law*, 2 J. LEGAL ANALYSIS 171, 182 (2010).

254. *See supra* note 241.

255. *See supra* note 223.

256. On this point, there is apparent tension in corporate law. Statutory corporate law is enabling, in that it allows a corporation to pursue any lawful activity. *See supra* notes 22 and 223. On the other hand, case law is regulatory in that shareholder primacy obligates managers through law to pursue profit maximization. *See supra* note 146 and accompanying text; *supra* text accompanying note 147. This tension is resolved if the statute is read as prohibiting a corporation from pursuing unlawful activities. *See In re* Massey Energy Co., C.A. No. 5430-VCS, 2011 WL 2176479, at *20 (Del. Ch. May 31, 2011) ("Delaware law allows corporations to pursue diverse means to make a profit, subject to a critical statutory floor, which is the requirement that Delaware corporations only pursue 'lawful business' by 'lawful acts.'"); Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 650 (2010) ("For a corporate director knowingly to cause the corporation to engage in unlawful acts or activities or enter an unlawful business is disloyal in the most fundamental of senses."). Assuming that the corporation's activity is lawful and thus complying with statutory proscription, the corporation has an obligation to maximize profit under judicial prescription. In this respect, it is clear that corporate law is regulatory.

257. *See supra* note 42 and accompanying text.

258. Leslie Green, *Introduction* to HART, *supra* note 13, at 30.

C. COMPLETE SHAREHOLDER PRIMACY

Courts have imposed the obligation of shareholder primacy on the entire spectrum of managerial decisions.[259] Although this obligation is unenforceable, it exerts serious social pressure to comply. But we are still left with the questions: How exactly is the pressure applied since an unenforceable rule can be seen as a paper tiger? Why do managers obey a rule that cannot be enforced against them?

We start with the basic premise: shareholder primacy and primacy of managerial authority cannot coexist in a rule-sanction form.[260] This is the fundamental tension that has been the source of much disagreement and tension in the academic debate.[261] The legal mechanism of shareholder primacy must solve a doctrinal puzzle: (1) the primacy of managerial authority is a rule-sanction, and as such, it is a first-order rule in that it has independent dignity; (2) shareholder primacy is a rule-no-sanction, and as such, it is a second-order rule in that it is subordinate to any first-order rule in a conflict at the level of enforcement;[262] (3) however, the purpose of the first-order rule is to serve the second-order rule at the level of prescription and substantive content, and as such, the latter must be efficacious in spite of the former. When the doctrinal and jurisprudential problem is framed in this way, we see why the legal status of shareholder primacy has been opaque and contestable for so long. Each side of the debate can point to substantial evidence, argument, and elements of truth, for their respective positions.[263]

As a matter of the practice of corporate governance and the theory of corporation law, the law of shareholder primacy only works as a coupling of first-order and second-order rules. The legal mechanism of shareholder primacy resolves the tension between the two rules. It enables the second-order rule to exert a conditional obligation on the first-order rule and do so efficaciously.[264] Compliance without sanction achieves two important functions: (1) it is efficient because there are no additional liti-

259. *See supra* notes 172–96 and accompanying text.

260. *See supra* Part I.B.

261. *See supra* Part I.C.

262. Given a choice between enforcing shareholder primacy or managerial authority, courts will select the latter. *See supra* notes 43–49 and accompanying text.

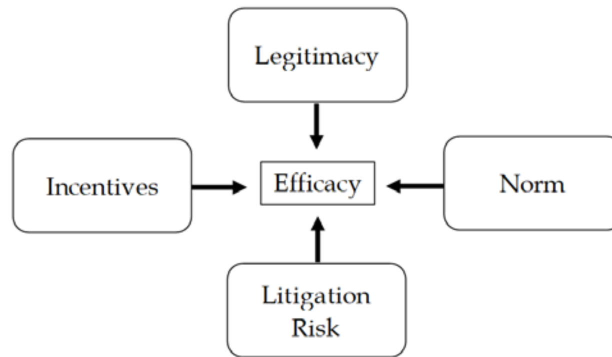
263. *See supra* Part I.C.

264. *See supra* Part IV.A.

gation costs; and (2) it preserves the rule of managerial authority, and thus, the coherence of the basic structure of corporate law.

The law and the legal system writ large achieve broad compliance through the following pathways: (1) legitimacy of obligation; (2) positive and negative incentives on managers; (3) litigation risk imposed on managers; and (4) social norm in the business community.

Figure 2: Complete Shareholder Primacy



1. Legitimacy

Empirical evidence shows that courts have pervasively and over a long period embraced shareholder primacy.[265] Courts have used the concept of shareholder wealth maximization both at the factual and legal levels of analysis.[266] This judicial embrace has legitimized shareholder primacy and given it the cloak of legal authority.

2. Incentives

Corporate law and the legal system advance shareholder primacy as a legal obligation through positive and negative incentives inherent in performance-based executive compensation and the market for corporate control, as well as by the imposition of duties toward shareholders in the *Revlon*-zone and intersecurity conflicts.[267] Also, whether a manager has complied with

265. *See supra* Part III.B.
266. *Supra* Part III.C.
267. *Supra* Part II.

shareholder primacy is a factor in determining liability under other rules of corporate law.[268] The combination of these laws motivates managers to comply with shareholder wealth maximization.

3. Litigation Risk

Judicial recognition of an obligation creates legal uncertainty and litigation risk for corporate managers.[269] The incentive, then, is to comply with the rule even though the obligation cannot be enforced as an independent duty. Courts weigh whether a manager has complied with shareholder primacy in the analysis of whether other rules were violated or not.[270] Compliance is simply the path of least resistance given the negative incentives. The grant of fiduciary duty only to shareholders ensures that only unsatisfied shareholders can bring a derivative suit against managers when they fail to maximize profit.[271]

4. Norm

Obligations can legitimize and strengthen norms.[272] This institutionalization of a social rule through a judicially announced obligation is critical to the need to obey and actual compliance.[273] Courts have validated the normative policy rationale for shareholder primacy held by the academic,[274] policy,[275] and business communities.[276] Thus, alongside the legal obligation, there is a norm in the community, and its strength is measured by the degree of compliance with the principle of wealth maximization,[277]

268. *See supra* text accompanying note 164; *see also supra* notes 172–96 and accompanying text.

269. *See supra* text accompanying note 50.

270. *See supra* note 163 and accompanying text.

271. *See supra* text accompanying note 179.

272. *See supra* Part IV.B.

273. Leslie Green argues that an account of obedience to law is grounded in part on the law's institutionalization.

> First, law is *institutionalized*: it is the product not only of human thought and action and in that sense a social construction; it is more significantly the product of institutionalized thought and action. Nothing is law that is not in some way connected with the activities of institutions such as legislatures, courts, administrators, police, and so on. Neither ideal social norms nor general social customs, but only an institutionally relevant subset of these, count as law.

Green, *supra* note 15, at 523.

274. *See supra* note 55 and accompanying text.

275. *See supra* text accompanying notes 170–71.

276. *See supra* notes 4 and 58.

277. *See supra* note 6 and accompanying text.

even if there is little risk of a sanction for business decisions falling within the business judgment rule.[278]

When the above four factors are considered in the totality of effect, we see the completeness of the legal mechanism of shareholder primacy. Corporate law achieves a harmonization of the first-order and second-order rules. A board manages the business and affairs of the corporation, and it has vast discretion under the business judgment rule to consider the balance of interests among shareholders and other constituents.[279] The primacy of managerial authority is enforceable in court, and courts frequently enforce it in favor of management when shareholders seek to encroach upon the board's authority to manage.[280] Such enforcements in favor of management and against shareholders are unremarkable, and the number of cases is legion.[281] Yet managerial behavior and actions are nonetheless steered toward shareholder primacy through multiple rules, incentives, and justifications provided by courts and the legal system.[282] The two rules exist not in conflict but in a harmonized pair. Both have independent dignity and are efficacious as to purpose.

The realm of all management decisions can be broadly categorized into decisions relating to takeovers, financing, and operational decisions of a going concern. In takeovers and financings, *Revlon* and intersecurity priority doctrines partially enforce shareholder primacy in the form of rule-sanction.[283] Because these transactions typically involve significant sums, the chance of avoiding detection and escaping judicial review is slim.[284] The threat of sanction is direct and real, which applies negative incentives.

Takeovers and financings are specific transactions. The vast majority of managerial decisions are operational decisions made in the context of a going concern.[285] In this realm, managers have great discretion under the first-order rule of managerial authority to comply with the obligation of shareholder primacy or not,

278. *See supra* notes 43–49 and accompanying text.

279. *See supra* notes 36, 43–44 and accompanying text.

280. *See supra* notes 43–49 and accompanying text (discussing the business judgment rule).

281. *See supra* note 58 and accompanying text.

282. *See supra* Parts IV.B and IV.C.

283. *See supra* Parts II.A and II.B.

284. *See* Jensen & Meckling, *supra* note 54, at 313 (explaining the costs of corporate financing and the resulting tendency of minority shareholders to monitor managerial behavior).

285. *See supra* text accompanying note 121.

depending on their preference or personal value—a situation that fits the classic agency cost problem.[286] Managers are generally safe from sanction since there is no enforceable duty.[287] However, there are many nonsanction checks that constrain a manager's virtually unfettered discretion under the first-order rule. The legal system provides managers carrot-and-stick incentives. Executive compensation and the market for corporate control provide complementary incentives and align shareholder and manager economic interests.[288] In light of normative arguments and the business community's acceptance of them, the path of least resistance—laid by courts—is also the internalized norm of most managers.[289] These combined factors push managers toward compliance with the rule of law.[290]

Although there is no duty to maximize profit, the threat of real sanction exists, albeit indirectly. Managers understand that *other rules* of corporate law exist in a rule-sanction form.[291] Those rules are connected to the principle of shareholder primacy. For example, *Revlon* applies only in a change of control context, but the context may be open-textured and the precise geography of *Revlon* remains uncertain.[292] In any takeover transaction where a change of control is arguable, corporate managers are incentivized to maximize shareholder profit.[293] The decisions in *Dodge* and *eBay* are prime examples of indirect sanction through other enforceable rules, since it is clear in both cases that the court rebuked the controlling shareholders' rejection of the profit motive.[294]

286. *See supra* note Part I.B.

287. *See supra* note 43 and accompanying text.

288. *See supra* notes 135–39 and accompanying text.

289. *See* Rock, *supra* note 75, at 1988 ("Managers now largely think and act like shareholders.").

290. *See generally* LAWRENCE M. FRIEDMAN, IMPACT: HOW LAW AFFECTS BEHAVIOR 5, 96–217 (2016) (arguing that law affects behavior through three principal factors: positive and negative incentives, peer pressure, and internalization of rules).

291. *See supra* Part II.

292. *See supra* notes 72 and 117.

293. *See supra* notes 113–16 and accompanying text.

294. *See* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34–35 (Del. Ch. 2010); Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919); *see also* Bernard S. Sharfman, *Shareholder Wealth Maximization and Its Implementation under Corporate Law*, 66 FLA. L. REV. 389, 425–28 (2014) (discussing the *eBay* and *Dodge* holdings and their relation to the primacy of shareholder wealth maximization); *supra* notes 238–39 and accompanying text.

Courts have applied and integrated the concept into the legal-reasoning process and rule justification.[295] It would be reasonably apparent to a board, typically advised by sophisticated corporate lawyers, that shareholder primacy may be a factor in the liability determination of these rules. When the boundaries of a rule are uncertain and the law is applied in an open-ended and potentially ex-ante indeterminate manner,[296] law and economic literature has shown that the uncertainty can lead to overcompliance as parties may be incentivized to take additional precautions.[297] Thus there is always the threat of indirect liability, even though the legal form is a second-order rule.

Finally, to understand the role of courts in creating the obligation of shareholder wealth maximization, consider this counterfactual: what if, over the period 1980 to 2016, courts had pervasively rejected or softened the idea of shareholder primacy? This alternative world is not so farfetched. Courts may be willing to contradict shareholder primacy when such statement suits specific analytical needs. In *Burwell v. Hobby Lobby Stores, Inc.*, the Supreme Court majority claimed that while "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."[298] Of course, it is not too cynical to believe that this liberal-sounding statement from a conservative majority was a convenient and instrumental rationale, unique to the case and the issue of corporate religious liberty at hand.[299] But

295. *See supra* Part III.C.

296. Delaware law is contextual and open-ended, and thus indeterminate in outcomes. *See* William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 29–30 (2009); Hansmann & Kraakman, *supra* note 6, at 459; Mohsen Manesh, *Delaware and the Market for LLC Law: A Theory of Contractibility and Legal Indeterminacy*, 52 B.C. L. REV. 189, 223–24 (2011).

297. *See* John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965, 966 (1984); Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J.L. ECON. & ORG. 279, 280 (1986). If uncertainty is distributed normally around the optimal standard of care, the legal rule will have an over-deterrence effect because a cost-benefit analysis may militate taking more precaution at the margin to comply. Robert J. Rhee, *On Duopoly and Compensation Games in the Credit Rating Industry*, 108 NW. U. L. REV. 85, 132 (2013).

298. Burwell v. Hobby Lobby Stores, Inc., 134 S.Ct. 2751, 2771 (2014).

299. The Supreme Court has been trending toward a probusiness bias for several decades. Lee Epstein, William M. Landes & Richard A. Posner, *How Business Fares in the Supreme Court*, 97 MINN. L. REV. 1431, 1449, 1470–71 (2013). From the perspective of corporate law, the above quoted language in

in a counterfactual world, what if courts across the land had consistently, pervasively, and over a long period admonished shareholders and managers that "modern corporate law does not require for-profit corporations to pursue profit at the expense of everything else"[300] and had reasoned through and decided cases based on this organizing principle? There would not have been a legal obligation to maximize profit. Corporate governance and perceptions of legal obligations are products of corporate law, and courts have the power to create or validate a rule of law.[301] Since law can legitimize or delegitimize social norms, there would not even have been a strong norm in the business community. There would have been only schools of intellectual thought in the academic community.[302]

CONCLUSION

Shareholder primacy is law, and not just a social norm. It does not arise out of statute but has been prescribed through the common law. Case law since the 1980s shows that courts have embraced the concept. The legal mechanism of shareholder primacy is not a single locus rule-sanction in the form of an enforceable fiduciary duty. It is in the form of a legal obligation. Courts have legitimized and imposed the obligation to maximize shareholder profit across the entire spectrum of managerial decision making. The principle weaves through a series of corporate law rules and the architecture of the corporate and market systems. A legal obligation is the only form of law that is coherent in light

Hobby Lobby, if interpreted in isolation, sounds liberal in its rejection of a singular profit motive and seeming adoption of a stakeholder theory, but the case is unquestionably a probusiness decision as applied to closely held firms because it expands corporate personhood and rights. All five Justices in the majority in *Hobby Lobby* (Alito, Roberts, Scalia, Kennedy, and Thomas) are ranked in the top ten probusiness Supreme Court Justices for the period 1946 to 2011; the opinion author (Alito) is ranked first in this list followed by Roberts who is second. *Id.* at 1451. *Citizens United* and *Hobby Lobby* challenge the traditional conservative theory of corporation law based on profit maximization. Leo E. Strine & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 363–65 (2015). The two cases also challenge the conventional concept of corporate separateness. Brief for Corporate and Criminal Law Professors as Amicus Curiae Supporting Petitioners at 3–13, Sebelius v. Hobby Lobby Stores, Inc., 723 F.3d 1114 (2014), 2014 WL 333899.

300. *Hobby Lobby*, 134 S.Ct. at 2771.

301. *See* HART, *supra* note 13, at 103; *see also supra* notes 229–31 and accompanying text.

302. *See supra* notes 239–41 and accompanying text.

of the primacy of managerial authority. By legitimizing shareholder primacy without creating a duty, courts have harmonized the conflict between authority and accountability.

The legal mechanism that begets and advances the idea of shareholder wealth maximization is complex, efficacious, and efficient. It is complex because it must harmonize the coupling of first-order and second-order rules that is unique to corporate law while respecting the independent dignity of both rules. It is efficacious because the rule of law has been internalized without the coercion of sanctions. It is efficient because the rule achieves compliance at systematic, predictable levels at minimal cost. Whether the rule is socially efficient, equitable, or ethical—all contestable points—is in the domain of a normative theory of shareholder primacy. However, the normative debate and policy prescription must be informed by a positive theory of law. Whether law exists or not matters in our understanding. The cause and effect of shareholder primacy rests on a legal foundation, and not some general notion of collective social belief that perhaps can change with enough suasion or argument. Any policy prescription from a normative theory must contend with the fact that there is a law of shareholder primacy.