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Reconciling Corporate Interests with Broader Social Interests - Pursuit of Corporate Interests Beyond Shareholder Primacy

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RECONCILING CORPORATE INTERESTS WITH BROADER SOCIAL INTERESTS—PURSUIT OF CORPORATE INTERESTS BEYOND SHAREHOLDER PRIMACY

YONG-SHIK LEE*

ABSTRACT

A seminal case in corporate law, Dodge v. Ford Motor Co.*, set the cardinal principle that corporations must serve the interests of shareholders rather than the interests of employees, customers, or the community. This principle, referred to as "shareholder primacy," has been considered a tenet of the fiduciary duty owed by corporate directors. Scholars have disagreed on the current legal status of shareholder primacy. This Article examines the controversy in light of the current state legislation and case law. Regardless of its current legal status, shareholder primacy has influenced corporate behavior and encouraged short-term profit-seeking behavior with significant social ramifications. Corporations have been criticized for undermining the interests of employees, customers, and the community in the name of profit maximization. This Article argues that corporate interests and broader social interests, such as benefits to consumers and employees, are not mutually exclusive and can be reconciled by allowing corporate managers and majority shareholders to define corporate interests more broadly, beyond the narrow confines of shareholder primacy.*

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INTRODUCTION

Corporations, business entities that are granted a separate legal personality through incorporation, play a vital role in our society today.[1] Corporations create a majority of the jobs and produce most of the goods and services, but their influence goes well beyond the economic sphere: corporations, with their economic leverage, also affect social affairs and influence local, state, and national politics both domestically and internationally.[2] The world's largest corporations, those with international operations, called "multinational enterprises" (MNEs), have sales figures that are larger than entire economies of many sovereign states.[3] Corporate interests influence domestic legislative processes as well as bilateral and multilateral treaty negotiations, shaping the world in which we live.[4]

The substance of corporate interests, and the manner in which corporations promote them, greatly affects our economic, social, and political lives.[5] The widely accepted primary purpose

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[1] *See*, *e.g.*, DAMBISA MOYO, HOW BOARDS WORK 14–15 (2021); Phillip I. Blumberg, *The Role of the Corporation in Society Today*, 31 BUS. LAW. 1403, 1403 (1976). Throughout this Article, the terms "corporation," "company," and "firm" are treated synonymously. The terms "officer" and "manager" are also used interchangeably without distinction.

[2] Blumberg, *supra* note 1, at 1403; Alexander Hertel-Fernandez, *Who Passes Business's "Model Bills"? Policy Capacity and Corporate Influence in U.S. State Politics*, 12 PERSP. ON POL. 582, 582 (2014) (discussing corporation influence on state politics); Lenore Palladino, *The American Corporation is in Crisis—Let's Rethink It*, BOS. REV. (Oct. 1, 2019), https://bostonreview.net/forum/lenore palladino-rip-shareholder-primacy/ [https://perma.cc/6HHX-ZA25] (less than one percent of businesses employ over half of employees); Lou Pingeot, *Corporate Influence in the Post-2015 Process* 5, 8 (Global Policy Forum et al. Working Paper 2014), https://archive.globalpolicy.org/images/pdfs/GPFEurope/Corporate_influence_in_the_Post-2015_process_web.pdf [https://perma.cc/87V6-5H99].

[3] As of 2016, the world's 100 largest economies included 31 countries and 69 companies measured by gross domestic product (GDP) for countries and by the sales figures for companies. DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 23 (4th ed. 2020).

[4] *See* ADAM WINKLER, WE THE CORPORATIONS 70–71 (1st ed. 2018); Pingeot, *supra* note 2, at 5, 27; Knowledge at Wharton Staff, *Co-opting the Constitution: How Corporations Influence American Law*, KNOWLEDGE AT WHARTON (July 2, 2018), https://knowledge.wharton.upenn.edu/article/co-opting-the-constitution-how-corporations-influenced-american-law/ [https://perma.cc/CJY6-SAMT].

[5] *See* Pingeot, *supra* note 2, at 5.

of corporations is to maximize profit[6] or value to shareholders, otherwise known as "shareholder primacy."[7] Shareholder primacy represents not only the prevalent objective of corporations but also a norm: a seminal case in corporate law, *Dodge v. Ford Motor Co.*, set the cardinal principle that a corporation must serve the interests of shareholders rather than the interests of its employees, customers, or the community.[8] In this case, the Supreme Court of Michigan found that the corporation's decision not to distribute special dividends, so that the company could instead lower the prices of the automobiles it produced and increase employment, would serve the interests of consumers and employees but not the company.[9] The court held the decision violated the director's fiduciary duty owed to the shareholders.[10]

As further discussed in Part I, the court decision has set shareholder primacy as a legal obligation, not just a business objective, and created a distinction between corporate interests and the interests of other stakeholders such as employees, consumers, and the community at large.[11] This separation has considerable social ramifications because corporate interests and those other interests are closely intertwined: a majority of the population are employees of corporations and meet their economic needs

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[6] *See* Milton Friedman, *A Friedman doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970) [hereinafter *A Friedman doctrine*], https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html [https://perma.cc/JEA8-RMMU]. Reflecting this popular conception, Professor Lynn Stout observes, "To many people . . . corporations exist to make money for their shareholders. Maximizing shareholder wealth is the corporation's only true concern, its raison d'etre. Devoted corporate officers and directors should direct all their efforts toward this goal." Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 164, 164 (2008) [hereinafter Stout, *Stop Teaching* Dodge].

[7] Milton Friedman advanced the theory of shareholder primacy, the core of which is that the highest purpose of corporations is to maximize profits for their shareholders. MILTON FRIEDMAN, CAPITALISM AND FREEDOM (2020) [hereinafter CAPITALISM AND FREEDOM]; *see also* N. Craig Smith & David Rönnegard, *Shareholder Primacy, Corporate Social Responsibility, and the Role of Business Schools*, 134 J. BUS. ETHICS. 463, 464 (2016) (equating the Friedman doctrine with shareholder primacy).

[8] Dodge v. Ford Motor Co. (*Dodge v. Ford)*, 170 N.W. 668, 684 (Mich. 1919).

[9] *Id.*

[10] *Id.*

[11] *See* discussion *infra* Part I.

through the goods and services that corporations provide.[12] Considering the extent of corporate influence today, the pursuit of shareholder interests over the interests of other stakeholders can cause considerable adverse effects, such as inattention to social and environmental harms.[13]

The economic, social, and political powers of corporations today are incomparably stronger than those that existed at the time of the *Dodge* decision; thus, the economic and social impact of the decision upholding shareholder primacy would be significant, should the decision have a legal effect.[14] Academic views diverge: some scholars have argued that shareholder primacy is not the law and that the *Dodge* decision should not be considered relevant to current law,[15] while others are more cautious about refuting its legal status.[16] This Article assess the merits of these arguments in light of current state legislation and case law in Part II.[17] It is not at all clear whether lawyers can disregard shareholder primacy altogether in the face of shareholder challenges supported by this notion due to the variances in state legislation and the lack of clarity in case law.[18]

Shareholder primacy, regardless of its status as the law, has become a corporate norm[19]: shareholders' innate human desires to see their shares of profit maximized—what we call "market forces"—would only be a natural driver of shareholder primacy.[20]

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[12] *See* Blumberg, *supra* note 1 (corporations produce the majority of goods and services to the economy); Palladino, *supra* note 2 (less than one percent of businesses employ over half of employees).

[13] Benedict Sheehy, *Corporations and Social Costs: The Walmart Case Study*, 24 J.L. & COM. 1, 35–48 (2004); Grant Hayden & Matthew Bodie, *What Comes After Shareholder Primacy? Employee Empowerment*, CLS BLUE SKY BLOG (Sept. 16, 2019), https://clsbluesky.law.columbia.edu/2019/09/16/what-comes-after-shareholder-primacy-employee-empowerment/ [https://perma.cc/N8V5-9DZG].

[14] *See* Pingeot, *supra* note 2, at 5 (discussing how corporations have become more powerful over the past twenty-five years).

[15] *See* Stout, *Stop Teaching* Dodge, *supra* note 6 (refuting the legal status of Dodge v. Ford).

[16] Jonathan R. Macey, *A Close Read of an Excellent Commentary on* Dodge v. Ford, 3 VA. L. & BUS. REV. 177, 178 (2008).

[17] *See* discussion *infra* Part II.

[18] Macey, *supra* note 16, at 179.

[19] *See, e.g.*, Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 MINN. L. REV. 1951, 1953 (2008).

[20] *Id.* at 1952–53.

In addition to the cited market forces, corporate counsels, who have studied corporations in law school, would have covered *Dodge v. Ford* and would likely advise directors and officials to comply with the requirements of shareholder primacy.[21] The prevalent result from this powerful combination—i.e., recognition of shareholder primacy as a norm and its promotion under market pressure—is corporations' short-term profit seeking.[22] This has significant social ramifications, as the short-term profit seeking would justify behavior that might be contrary to the interests of society, such as cutting wages and customer support, but would improve profits for corporations in the short run.[23] To counter this type of corporate conduct, civil society has been emphasizing corporate social responsibility (CSR), putting corporations under considerable pressure to be more accountable to society,[24] but it is not clear whether these efforts are sufficient to contain the corporate activities adverse to social interests.[25] This Article analyzes these issues in Part III.[26]

Corporate interests, and the broader economic interests of society[27] are not mutually exclusive and can be reconciled by allowing corporate directors and managers to define corporate interests beyond shareholder primacy.[28] There is no compelling public policy ground for limiting corporate interests so narrowly; if the controlling majority of shareholders support a board decision to promote broader economic interests in society, perhaps at the expense of maximizing immediate profits, there seems to be no compelling reason for a court to find that such a decision violates the fiduciary duty owed to shareholders.[29]

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[21] Stout, *Stop Teaching* Dodge, *supra* note 6, at 164.

[22] *See* Lynn A. Stout, *The Toxic Side Effects of Shareholder Primacy*, 161 U. PA. L. REV. 2003, 2016–19 (2013) [hereinafter *Toxic Side Effects*].

[23] *Id.* at 2017.

[24] *See, e.g.*, Smith & Rönnegard, *supra* note 7, at 463.

[25] *Id.*

[26] *See* discussion *infra* Part III.

[27] The terms, "broader economic interests in society" and "social interests" are used interchangeably throughout this Article unless indicated otherwise. Also, "shareholder value" and "profit" are used interchangeably without distinction.

[28] Smith & Rönnegard, *supra* note 7, at 464.

[29] *Id.* If and when the majority shareholders do not support such board decisions, they can overturn the decision by changing the leadership of the

This approach may also promote corporations' and shareholders' long-term interests; by promoting broader economic interests, corporations may acquire goodwill from the public and reinforce their consumer base, which, in turn, will contribute to their future sales and profits.[30] As the shareholder primacy rule does not require immediate profit maximization but allows measures to increase long-term profits, which may well involve benefits to employees, customers, and the community, the separation between "corporate interests" and "social interests" is rather arbitrary and is subject only to a rhetorical distinction.[31] Shareholder primacy that purports to prioritize shareholders' interests over the interests of other stakeholders, for this reason, is not tenable in practice.[32] Also, shareholder interests are not uniform but varied, and shareholder primacy does not answer the question of *whose interests* should be prioritized.[33]

Corporations should not be compelled to resort to the argument of profit maximization to justify decisions that may appear contrary to shareholder primacy.[34] Dissatisfied shareholders have recourse, including the ability to sell their stocks on the open market or to negotiate with the corporation to buy their stocks on mutually agreeable terms.[35] This Article examines the flaws of shareholder primacy as the principle for corporate governance and discusses an alternative approach (the stakeholder approach) in Part IV.[36] It also discusses the necessity of a statutory adjustment and proposes legal reform to clarify the current ambiguity about the legal status of shareholder primacy.[37] The Article then draws conclusions in the final Part.[38]

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corporation. Alex Gorman, Note, *Exit vs. Voice: A Comparison of Divestment and Shareholder Engagement*, 72 N.Y.U. ANN. SURV. AM. L. 113, 133 (2017).

[30] *See* Smith & Rönnegard, *supra* note 7, at 470–71.

[31] *See* Macey, *supra* note 16, at 190.

[32] *See Toxic Side Effects*, *supra* note 22, at 2017.

[33] *Id.* at 2016–17.

[34] *See* Macey, *supra* note 16, at 190.

[35] Kevin Schott, *Executive Pay Does Not Need Its Day in Court*, 14 HOUS. BUS. & TAX L.J. 258, 268 (2014).

[36] *See* discussion *infra* Part IV.

[37] *See* discussion *infra* Part IV.

[38] *See* discussion *infra* Conclusion.

I. Arbitrary Determination of Corporate Interests

A. Shareholder Primacy Under Fiduciary Duty: Dodge v. Ford Motor Co.

1. Development of Shareholder Primacy

The notion of shareholder primacy, which assigns first priority to shareholders' interests, traces back to Adolf Berle and Gardiner Means' 1932 publication, *The Modern Corporation and Private Property*.[39] In this work, considered as setting the cornerstone for modern corporate governance, the authors argued that shareholders are the true owners of corporations who may establish and alter their directions.[40] They stated:

> We have the picture of a group of owners, necessarily delegating certain powers of management, protected in their property rights by a series of fixed rules under which the management had a relatively limited play. The management of the corporation indeed was thought of as a set of agents running a business for a set of owners; and while they could and did have wider powers than most agents, they were strictly accountable and were in a position to be governed in all matters of general policy by their owners. They occupied, in fact, a position analogous to that of the captain and officers of a ship at sea; in navigation their authority might be supreme; but the direction of the voyage, the alteration of the vessel, the character of the cargo, and the distribution of the profits and losses were settled ahead of time and altered only by the persons having the underlying property interest.[41]

While Berle and Means emphasized the primary position of shareholders, which has been reflected in modern corporate law that empowers shareholders to change corporate charters and elect and change directors,[42] a leading economist, Milton Friedman, defined the substance of shareholder primacy in an argument that the highest purpose of corporations is to *maximize profits*

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[39] ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 135 (The Legal Classics Libr. spec. ed., 1993) (1932).

[40] *Id.*

[41] *Id.*

[42] *See, e.g.*, DEL. CODE ANN. TIT. 8, §§ 141(k), 223, 242 (West 2022).

for their shareholders.[43] He opined, "[f]ew trends could so thoroughly undermine the very foundation of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible,"[44] emphasizing that social interests *should not* be a consideration for corporations.[45]

Shareholder primacy has been widely accepted by business leaders and policymakers as the primary objective of corporations as well as the "natural law of the market."[46] As further discussed in Part III, this sole emphasis on profit maximization for shareholders has harmed the other stakeholders, such as employees, consumers, and society at large, by justifying exploitative behavior of corporations in efforts to extract and maximize profits at the cost of the other stakeholders.[47] The negative social effect of shareholder primacy would only be reinforced if required under the terms of the fiduciary duty owed by corporate directors and officials.[48] In such cases, directors and officials would be not only *encouraged* to maximize profit for shareholders under market pressure but also *required* to do so, which might actually not be consistent with the preferences of the majority shareholders, as shown in *Dodge v. Ford*.[49]

2. Shareholder Primacy Under Fiduciary Duty

Fiduciary duty is the duty owed by an obligator (the fiduciary) to another (the beneficiary) to act in the interest of the latter.[50] Fiduciary duty is imposed on those who are in the position of trust and care vis-à-vis others due to their relationship to the beneficiary.[51] In the corporate context, directors and officials

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[43] CAPITALISM AND FREEDOM, *supra* note 7.

[44] *Id.* at 161.

[45] *Id.*

[46] *See*, *e.g.*, Palladino *supra* note 2 (discussing how Friedman's argument for shareholder primacy is widely accepted).

[47] *Id*.

[48] *Id.*

[49] Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

[50] *See Fiduciary Duty*, CORNELL L. SCH. LEGAL INFOR. INST., https://www.law.cornell.edu/wex/Fiduciary_Duty [https://perma.cc/M2EC-FRAG].

[51] *Id.*

owe certain fiduciary duties to the corporation and shareholders.[52] Under the duty of loyalty, for example, corporate directors and officials are required to act in the best interests of the corporation and its shareholders.[53]

The *Dodge* decision deemed shareholder primacy a tenet of the fiduciary duty owed by directors and officials.[54] The facts of the case are as follows. The Ford Motor Company was incorporated in 1903 and began manufacturing and selling motor vehicles.[55] Over the course of its first decade, and despite continually lowering the price of its cars, the company became increasingly profitable.[56] On top of annual dividends of $120,000, Ford paid more than ten million dollars in special dividends to the company's investors from 1913 to 1915.[57] In 1916, however, Ford's president and majority shareholder, Henry Ford, withheld special dividends from investors, insisting that future profits should be devoted to lowering the price of the product and growing the company.[58] Henry Ford had often made public statements about his intent to extend the benefits of the company to the greatest number of people and generally run the company in a manner that would benefit the overall community.[59] The Dodge brothers, who had recently started their own competing motor company and were minority shareholders in the Ford company, brought suit against Ford to reinstate the special dividends and to stop the company from building a new smelting plant.[60]

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[52] N. Am. Catholic Educ. Programming Found. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007) ("It is well established that the directors owe their fiduciary obligations to the corporation and its shareholders.").

[53] Peter A. Atkins, Marc S. Gerber & Edward B. Micheletti, *Directors' Fiduciary Duties: Back to Delaware Law Basics*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (Mar. 20, 2020), https://corpgov.law.harvard.edu/2020/03/10/directors-fiduciary-duties-back-to-delaware-law-basics/ [https://perma.cc/84C9-8ECH].

[54] *Dodge,* 170 N.W. at 684.

[55] *Id.* at 669.

[56] *Id.* at 670.

[57] *Id.*

[58] *Id.* at 671.

[59] *Id.* ("My ambition . . . is to 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. To do this, we are putting the greatest share of our profits back into the business.").

[60] *Id.* at 670–73.

The Dodge brothers argued that both the withholding of the special dividends to reinvest in the community as well as the construction of the smelting plant were at the expense of the shareholders and, therefore, the court should stop Ford from pursuing these courses of action.[61] The construction of a new smelting plant at this time, the Dodge brothers argued, would be nothing short of irresponsible:

> In the face of the increased labor and material cost and the uncertain conditions that will prevail in the business world at the termination of the present world war, the policy of said Henry Ford, in continuing the expansion of the business of said corporation, is reckless in the extreme and seriously jeopardizes the interest of your orators as stockholders in said corporation.[62]

The court held in favor of the Dodge brothers on the issue of reinstating the special dividends to shareholders but in favor of Ford Motors on the issue of establishing a new smelting plant.[63]

On the issue of special dividends, the court upheld the principle of shareholder primacy and stated:

> 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. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.[64]

Regarding the plans to open the smelting plant, the court gave deference to the company's decision, reasoning that since there was a valid business purpose for the plant, the court would not intervene with the proposed expansion of the business.[65] This decision indicates that the court, while finding for shareholder primacy, did not limit it to short-term profit maximization but allowed the manager to take into account long-term business interests, even at the expense of immediate profits that could be

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[61] *Id.* at 673.
[62] *Id.*
[63] *Id.* at 684.
[64] *Id.* (emphasis added).
[65] *Id.*

distributed to shareholders: the court recognized that plans must often be made for a long future, for expected competition, and for a continuing, as well as an immediately profitable, venture.[66] This raises the question why, then, such consideration could not be given to Ford's other interests, such as the benefits to consumers and employees, as well as to the community at large, considering that benefiting these stakeholders could also improve long-term business prospects for the company by, for example, improving the goodwill of future customers.[67] The *Dodge v. Ford* holding separates corporate interests from broader social interests,[68] and this separation has a degree of arbitrariness as further discussed in the next Section.[69]

B. Corporate Interests v. Broader Social Interests

The *Dodge* court defined corporate interests as the profits of shareholders,[70] which directors and officials are obligated to serve under their fiduciary duty.[71] Milton Friedman expounded that acceptance by directors of a social responsibility would be the undermining of "the very foundation of our free society."[72] However, this separation between corporate interests and broader social interests, such as benefits to consumers, employees, and the community, is arbitrary.[73] Despite Friedman's contention, the separation has an effect of restricting corporate interests to the predetermined substance that may not be consistent with the preferences of the majority shareholders.[74]

The *Dodge* court acknowledged the need for corporations to plan for the future, even if such a plan may incur immediate costs and a reduction in the profits to be distributed to shareholders.[75] Corporate actions affecting the interests of customers,

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[66] *Id.*
[67] *See id.* at 671.
[68] *Id.* at 684.
[69] *See, e.g.*, *id.*
[70] *Id.*
[71] *Id.*
[72] CAPITALISM AND FREEDOM, *supra* note 7, at 161.
[73] *Id.*
[74] *See, e.g.*, *Dodge,* 170 N.W. at 671.
[75] *Id.* at 684.

employees, and the community, regardless of whether these actions improve their immediate profit, are closely relevant to the goodwill of these other stakeholders who will, in turn, affect corporations' long-term business prospects as potential future customers.[76] Actions that seemingly benefit consumers, such as lowering prices, and benefit employees, such as increasing wages, could actually increase profits for the future by expanding the market share and retaining loyal and superior employees.[77] The outcome of this case would have likely been different had Ford argued that reducing the costs to consumers, increasing employment, and the resulting benefits to the community, would all contribute to the future business prospects of the company on account of the cited effects of such actions, because this argument would not qualitatively be different from one advocating for the investment in facilities to plan for the future (even if the latter may reduce the immediate profit for shareholders and would carry a risk of failure).[78]

Ford did not articulate his business purpose as such, stating instead that "[m]y ambition . . . is to 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. To do this, we are putting the greatest share of our profits back into the business."[79] The court found his motive philanthropic and, therefore, inconsistent with his duties as the company's president to serve the interests of shareholders.[80] It is, then, questionable why the identical action should be judged differently according to such articulation,[81] which, without such an arbitrary separation between corporate and social interests, would not be the case.[82]

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[76] *See* Chastity Heyward, *The Growing Importance of Social Responsibility in Business*, FORBES (Nov. 18, 2020), https://www.forbes.com/sites/forbesbusinesscouncil/2020/11/18/the-growing-importance-of-social-responsibility-in-business/?sh=4674d8a42283 [https://perma.cc/N6SF-E3KN].

[77] *Id.*

[78] *See Dodge*, 170 N.W. at 684.

[79] *Id.* at 671.

[80] *Id.* at 684.

[81] Professor Jonathan Macey aptly observes that "what mattered in this case was not what Mr. Ford did, but what he said he was doing." Macey, *supra* note 16, at 183.

[82] *See Dodge*, 170 N.W. at 684.

The distinction between corporate and social interests, as displayed by *Dodge v. Ford*, seems to be based on the presumption that corporations and their shareholders are primarily interested in profit,[83] distinguishable from the non-profit nature of social interests.[84] This presumption raises two issues. First, to the extent that the interests of the other stakeholders influence the future business prospects of the corporation, as discussed above, these social interests cannot be divorced from "for profit" corporate interests, even if corporations' primary interest is the profit of shareholders.[85] Second, majority shareholders may choose to support some social interests and be willing to identify them as corporate interests without distinction, regardless of their impact on the long-term business prospect of the corporation, as was the case in *Dodge v. Ford*.[86] The mandatory separation between corporate and social interests has the effect of undermining the preferences of the majority shareholders in the interest of the minority shareholders who may disagree on the corporation's direction.[87]

C. Must the Court Mandate Shareholder Primacy?

In *Dodge v. Ford*, the minority shareholders, the Dodge brothers, prevailed over the preference of the majority shareholders on the question of the special dividends, and this outcome was achieved because the court mandated shareholder primacy.[88] It is questionable whether it should be the role of the court to mandate shareholder primacy.[89] Under the business judgment rule, directors enjoy the benefit of the presumption that their business decisions are in the interest of the corporation.[90] This presumption serves well in the determination of corporate interests: the question of whether the promotion of certain social interests, as supported by the board and the majority shareholders, will be in the long-term interests of the corporation is a complex one

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[83] *Id.*
[84] *Id.*
[85] *See generally* Heyward, *supra* note 76.
[86] *Dodge*, 170 N.W. at 671.
[87] *Id.* at 670–71.
[88] *Id.* at 670, 684.
[89] *Id.* at 678.
[90] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

that arguably should be assessed by a corporate board rather than a court.[91]

Regardless of the court mandate, market forces are powerful enough to drive corporations and directors to seek profit maximization in most cases, albeit with varied term projections for its realization.[92] If, in rather unlikely circumstances where corporate directors decide to pursue social interests against the wishes of the majority shareholders, the shareholders have remedies that do not require judicial intervention: they are legally entitled to call for meetings, dismiss the directors in favor of such decisions, and overturn the decision.[93] If, on the other hand, a corporation wishes to pursue certain social interests with the support of the majority of shareholders, it is then a legitimate corporate interest even if minority shareholders, as in *Dodge v. Ford*, should be in disagreement.[94] Not all shareholders may support a corporate decision; in which case, a majority decision stands, protected by the business judgment rule.[95] It should be no different with a question of pursuing corporate interests: it would be unjust for the court to intervene and overturn a majority decision in the absence of other duty breaches, such as a conflict of interest.[96]

As discussed in the next Part, there is a controversy regarding whether shareholder primacy, supported by the *Dodge* decision, is the law.[97] Regardless of the final disposition on this question, courts imposing shareholder primacy on directors will restrain corporate freedom.[98] Friedman argued that acceptance of a social responsibility by corporate directors would undermine the foundations of a free society,[99] but mandating the opposite

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[91] *See generally Dodge*, 170 N.W. at 684.

[92] CAPITALISM AND FREEDOM, *supra* note 7, at 133.

[93] *See, e.g.*, DEL. CODE ANN. TIT. 8, §§ 141(k), 211(d), 223 (West 2022) (shareholders may call for a special meeting if authorized by the certificate of incorporation or by the bylaws); CAL. CORP. CODE § 600(d) (West 2022) (shareholders are entitled to cast not less than ten percent of the votes at the meeting may call for a special meeting).

[94] *See* Zipora Cohen, *Fiduciary Duties of Controlling Shareholders: A Comparative View*, 12 U. PA. J. INT'L BUS. L. 379, 387–88 (1991).

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

[96] *In re* eBay, Inc. S'holders Litig., No. C.A. 19988-NC, 2004 WL 253521, at *4 (Del. Ch. Jan. 23, 2004).

[97] *See infra* note 103.

[98] *See, e.g.*, Dodge v. Ford Motor Co., 170 N.W. 668, 685 (Mich. 1919).

[99] CAPITALISM AND FREEDOM, *supra* note 7, at 161.

would equally infringe upon the freedom of corporations that wish to broaden the scope of their corporate interests beyond shareholder primacy.[100] States have legislated for non-profit organizations and social purpose corporations (SPCs),[101] but there is no compelling policy reason to prevent regular corporations from pursuing social interests where the majority of shareholders support the decision to pursue social interests.[102]

II. IS SHAREHOLDER PRIMACY THE LAW?

Scholars disagree on the legal status of shareholder primacy.[103] Some argue that shareholder primacy is not the law, although it may well be a powerful norm supported by market forces, while others think it is the law, although they may not necessarily support it as "good" law.[104] The arguments begin with disagreements on the seminal case, *Dodge v. Ford*, a widely perceived legal authority for shareholder primacy.[105]

A. Rebuttal to Dodge v. Ford *as a Legal Authority for Shareholder Primacy*

1. Was Dodge v. Ford *a Mistake?*

Professor Lynn Stout, in her 2008 paper *Why We Should Stop Teaching Dodge v. Ford,*[106] questions the legal status of *Dodge v. Ford,* which she cites as the only legal authority for shareholder primacy.[107] Professor Stout argues:

> *Dodge v. Ford* is indeed bad law, at least when cited for the proposition that the corporate purpose is, or should be, maximizing shareholder wealth. *Dodge v. Ford* is a mistake, a judicial "sport," a doctrinal oddity largely irrelevant to corporate

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[100] *See, e.g.*, *Dodge*, 170 N.W. at 671.

[101] *See, e.g.*, CAL. CORP. CODE ANN. § 2500 (West 2019); DEL. CODE ANN. tit. 8, §§ 114, 361–68 (West 2022); FLA. STAT. ANN. § 607.501 (West 2021); WASH. REV. CODE ANN. § 23B.25.005 (West 2021).

[102] *See, e.g.*, *Dodge*, 170 N.W. at 671.

[103] *Compare* David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 226 (2014), *with* Stout, *Stop Teaching* Dodge, *supra* note 6, at 164.

[104] Yosifon, *supra* note 103, at 226.

[105] Stout, *Stop Teaching* Dodge, *supra* note 6, at 164.

[106] *Id.* at 165.

[107] *Id.*

> law and corporate practice. What is more, courts and legislatures alike treat it as irrelevant. In the past thirty years, the Delaware courts have cited *Dodge v. Ford* as authority in only one unpublished case, and then not on the subject of corporate purpose, but on another legal question entirely.[108]

Professor Stout urges legal instructors and scholars to stop teaching and citing *Dodge v. Ford*.[109] She cites the following as the grounds for impeachment: (i) the long passage of time (one hundred years since the case came out),[110] (ii) the marginal importance of the Supreme Court of Michigan as a legal authority for corporate issues (compared to the courts in Delaware, California, and New York),[111] and (iii) the relevant court statements as dicta; i.e., the decision was, according to her argument, made on the different and narrower legal grounds that Henry Ford, as a controlling shareholder, had breached his fiduciary duty of good faith to his minority investors.[112]

Professor Stout also argues that the *Dodge v. Ford* "dicta" does not represent a modern legal principle.[113] She observes that corporate charters virtually never mention shareholder primacy[114] and that a large majority of state codes explicitly authorize corporate boards to consider the interests of employees, customers,

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[108] *Id.* at 166 (footnote omitted).

[109] *Id.*

[110] *Id.*

[111] *Id.* at 166–67.

[112] *Id.* at 167. Professor Stout explains the grounds for the breach of financial duty as follows:

> As the majority shareholder in the Ford Motor Company, Henry Ford stood to reap a much greater economic benefit from any dividends the company paid than John and Horace Dodge did. Ford had other economic interests, however, directly at odds with those of the Dodge brothers. First, because the Dodge brothers wished to set up their own car company to compete with Ford (as they eventually did), Ford wanted to deprive them of liquid funds for investment. Second, Ford wanted to buy out the Dodge brothers' interest in the Ford Motor Company (as he eventually did) at the lowest price possible. Withholding dividends from the Dodge brothers was an excellent, if underhanded, strategy for accomplishing both objectives.

Id.

[113] *Id.* at 168.

[114] *Id.* at 169.

creditors, and the community, not just shareholders, in making business decisions.[115] She also concludes, after examining the court decisions in *Katz v. Oak Industries*,[116] *Unocal Corporation v. Mesa Petroleum Company*,[117] *Shlensky v. Wrigley*,[118] and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[119] that case law does not support shareholder primacy as the law and that the directors are permitted to serve the interests of stakeholders other than just shareholders (e.g., creditors, customers, employees, and the community generally).[120]

In Professor Stout's perception of corporations and their affairs, this disposition makes sense—after all, corporations are:

> extraordinarily intricate institutions that pursue complex, large-scale projects over periods of years or even decades. They have several directors, dozens of executives, hundreds or thousands of employees, thousands or hundreds of thousands of shareholders, and possibly millions of customers. Corporations resemble political nation-states with multiple constituencies that have different and conflicting interests, responsibilities, obligations, and powers. Indeed, the very largest corporations (such as Wal-Mart, ExxonMobil, or Microsoft) have greater economic power than many nation-states do. These are not institutions whose behavior can be accurately captured in a sound bite [such as "profit maximization"].[121]

2. Possible Misconception of Dodge v. Ford

Several scholars agree with Professor Stout that *Dodge v. Ford* is not a legal authority for shareholder primacy.[122] Professor Einer Elhauge points out that the court never stated that a director's "exclusive duty is to maximize shareholder profits"[123] but approved "implied powers to carry on with humanitarian

[115] *Id.* Professor Stout notes that the Delaware corporate code does not have such a provision, but it also does not specifically mandate shareholder primacy in the language of the code. *Id.*

[116] 508 A.2d 873, 879 (Del. Ch. 1986).

[117] 493 A.2d 946, 954–55 (Del. 1985).

[118] 237 N.E.2d 776, 779 (Ill. App. Ct. 1968).

[119] 506 A.2d 173, 181–82 (Del. 1986).

[120] Stout, *Stop Teaching* Dodge, *supra* note 6, at 170–71.

[121] *Id*. at 175 (explanation added).

[122] *See, e.g.*, Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005).

[123] *Id*. at 772–73.

motives such charitable works as are incidental to the main business of the corporation."[124] Professor Elhauge finds that the language of the court limits the degree of profit-sacrificing discretion rather than imposing a duty to maximize profit exclusively. Professor Elhauge also reasons that the court decided to strike the refusal to declare any special dividends, not because Ford had a public interest motive, but likely because he violated his fiduciary duty toward minority shareholders by using his corporate control to benefit himself financially at the expense of the minority shareholders.[125]

Professor Nathan Oman also opines that the language in judicial opinions, to the effect that corporations should operate in the interest of shareholders, is never meant to support shareholder primacy.[126] According to Professor Oman, the *Dodge* court never found a generalized duty by managers to maximize shareholder value, but prohibited the oppression of minority shareholders in the case of a closely held corporation.[127] Professor Oman considered that Ford's refusal to pay special dividends was a ploy to deny the Dodge brothers capital that they needed to start a competing automobile company and suppress the stock value so that he could take over the Dodge brothers' shares on the most favorable price terms as possible.[128] Thus, the Supreme Court of Michigan ruled for the Dodge brothers "not because of some generalized duty to maximize shareholder value, but rather, because of the right of dissenting minority shareholders to be free from unreasonable oppression."[129]

Professor M. Todd Henderson, after an extensive historical discussion of *Dodge v. Ford*, also concludes that *Dodge v. Ford* was misunderstood as setting the legal rule of shareholder primacy, which "was not and is not the law."[130] In the 1990s, Professor D. Gordon Smith also found that the shareholder primacy norm had become almost irrelevant with respect to conflicts of

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[124] *Id.* at 773 (citing Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919)).

[125] *Id.* at 774.

[126] Nathan Oman, *Corporations and Autonomy Theories of Contract: A Critique of the New* Lex Mercatoria, 83 DENV. L. REV. 101, 143 (2005).

[127] *Id.*

[128] *Id.*

[129] *Id.* at 43–44.

[130] M. Todd Henderson, *Everything Old Is New Again: Lessons from Dodge v. Ford Motor Company* 34 (U. Chi. Working Paper No. 373, 2007).

interest between shareholders and non-shareholders and had been outmoded with respect to conflicts of interest between shareholders.[131] He concluded that courts eventually replaced it with the more narrowly tailored doctrine of minority oppression.[132] Professor Gordon Smith opined that the *Dodge* court never intended to enunciate a major principle of corporate law—such as shareholder primacy—but thought it was only deciding a dispute between majority and minority shareholders in a closely held corporation.[133]

B. Response to the Rebuttal

1. The Legal Status of Dodge v. Ford

Professor Jonathan Macey challenges Professor Stout's view that *Dodge v. Ford* is a doctrinal oddity.[134] Professor Macey argues that the case has legal effect, citing the American Law Institute (ALI) *Principles of Corporate Governance* (Principles), which provides that "a corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain."[135] According to Professor Macey, the Principles specify that the goal of the corporation is shareholder wealth maximization and that "the only exceptions permitted to the shareholder wealth maximization norm are those necessary to ensure that corporations be given sufficient latitude to act like responsible community members by complying with the law and supporting charities and other worthy causes."[136]

Professor Macey also argues that the state statutes (state constituency statutes), which Professor Stout cited as authorizing corporate boards to consider the interests of other stakeholders, such as employees, customers, creditors, and the community, in business-making decisions, cannot be construed to permit managers to benefit non-shareholders at the expense of shareholders.[137] Professor Macey characterizes these statutes as merely "tie-breakers,

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[131] *See* D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 322 (1998).

[132] *Id.* at 323.

[133] *Id.* at 320.

[134] Macey, *supra* note 16, at 178.

[135] *Id.* (citing PRINCIPLES OF CORP. GOVERNANCE (Am. L. Inst. 1994)).

[136] *Id.* at 178–79.

[137] *Id.* at 179.

allowing managers to take the interests of non-shareholder constituencies into account when doing so does not harm shareholders in any demonstrable way."[138] Professor Macey explains that the shareholder maximization ideal actually drove the holding of the case and was not mere dicta.[139] Professor Macey also makes an interesting observation that *Dodge v. Ford* stands as the only authority for the rule:

> because CEOs who testify in depositions and trials are better coached and more willing to dissemble than Henry Ford was. If the other CEOs actually told the truth about how they put their own private interests ahead of those of shareholders, the case might not stand in such splendid isolation.[140]

Professor Macey concludes that shareholder wealth maximization is the law, not merely a "normative discourse,"[141] reiterating that shareholders are in the best position to maximize the overall value of the firm.[142]

2. Shareholder Primacy as the Law

Another powerful response has come from the Chief Justice of the Delaware Supreme Court,[143] generally perceived to be the highest authority for corporate law in the United States.[144] Chief Justice Leo Strine takes a structural approach to this question

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[138] *Id.*

[139] *Id.* at 180.

[140] *Id.*

[141] *Id.* at 181. Professor Macey adds that the problem is not the rule's lack of clarity, but rather its lack of enforceability; he states, "the rule of wealth maximization for shareholders is virtually impossible to enforce as a practical matter." *Id.* at 190.

[142] *Id.* at 189.

[143] *See generally* Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, U. PA. INST. FOR L. ECON., Research Paper No. 15-08 (2016), http://ssrn.com/abstract=2576389 [https://perma.cc/U86H-XJV3].

[144] *See, e.g.*, Yosifon, *supra* note 103, at 195. Sixty percent of publicly traded companies in the United States are incorporated in Delaware and subject to Delaware's corporate governance law. *See* John Armour et al., *Delaware's Balancing Act*, 87 IND. L.J. 1345, 1348 (2012).

by analyzing the Delaware General Corporation Law (DGCL): the Chief Justice finds the argument that corporate boards are free under Delaware law to make the welfare of constituencies other than stockholders "an equal end of corporate governance" flawed because it ignores the structure of the DGCL that gives only the stockholders the right to vote for directors, approve certificate amendments, amend the bylaws, approve certain transactions, such as mergers, enforce the DGCL's terms, and hold directors accountable for honoring fiduciary duties.[145] He draws justification for shareholder primacy from the exclusive statutory powers granted to shareholders but no one else.[146]

Chief Justice Strine also disagrees with the academic interpretations that assign only marginal importance to Delaware cases, which, in his view, have affirmed the requirement of shareholder primacy: according to the Chief Justice, *Revlon*, for example, which pronounced the board's duty to maximize shareholder wealth, is not a marginal decision but central in the discussion of the director's duty.[147] The Chief Justice points out that the court in *Revlon* clearly states that a board can only consider the interests of other constituencies if "rationally related benefits accru[e] to the stockholders."[148] According to the Chief Justice, commentators, such as Professor Stout and Professor Elhauge, do not properly account for this key statement,[149] failing to appreciate the importance of the Delaware court's decision affirming shareholder primacy.[150]

Professor Robert J. Rhee also characterizes shareholder primacy as a legal obligation.[151] Professor Rhee reviews rules of law that advance certain aspects of shareholder primacy on intersecurity conflicts, sale of corporate control, the market of corporate control, and executive pay,[152] and presents empirical data from federal and state cases that discuss the concept of shareholder

[145] Strine, *supra* note 143, at 5–6.
[146] *Id*. at 25–26.
[147] *Id*. at 7–8.
[148] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 173 (Del. 1986).
[149] Strine, *supra* note 143, at 7.
[150] *Id*. at 13–14.
[151] Rhee, *supra* note 19, at 2004.
[152] *Id*. at 1967–80.

profit maximization from 1900 to 2016.[153] Professor Rhee observes that parties have inundated courts with transactions and claims asserting shareholder profit maximization, particularly since the 1980s (as the economic and legal ideas of the theory of the firm and agency cost from the 1970s and the 1980s reinforced the theoretical foundation of shareholder primacy).[154] Professor Rhee finds that courts have embraced shareholder primacy for over thirty years and concludes that it has legal effect.[155]

Professor David G. Yosifon observes the ambiguity concerning the current state of law on shareholder primacy: despite the *Dodge v. Ford* decision, some of the field's most accomplished academics claimed that the law allows directors to serve the interests of non-shareholding stakeholders, including employees, consumers, and the general public, even when shareholder interests are in tension with such pursuits.[156] Professor Yosifon argues that shareholder primacy is the law, citing the *Revlon* opinion that boards can attend to the interests of non-shareholders when the board believes that doing so will ultimately serve shareholders.[157] Professor Yosifon reasons that the only permissible ground for considering the interests of the non-shareholder constituencies, as found in relevant cases, is their relationship to the shareholder interest.[158] Professors Mark J. Loewenstein and Jay Geyer also support the idea that Delaware case law, such as *Revlon,* affirms the shareholder primacy rule.[159]

C. Evaluation

As Professor Yosifon aptly points out, the controversy over the legal status of shareholder primacy, probably the most important doctrinal question in corporate law, needs to be settled.[160] Scholars may well disagree whether shareholder primacy *should* be the law, from a normative perspective, and debate the impact

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[153] *Id.* at 1981–2000.
[154] *Id.* at 1986.
[155] *Id.* at 2004.
[156] Yosifon, *supra* note 103, at 183.
[157] *Id.* at 192.
[158] *Id.*
[159] Mark J. Loewenstein & Jay Geyer, *Shareholder Primacy and the Moral Obligation of Directors*, 26 FORDHAM J. CORP. & FIN. L. 105, 127 (2021).
[160] Yosifon, *supra* note 103, at 183–84.

of corporate law and corporate governance;[161] but clarification on the current law will be essential to an informed and effective deliberation on these important issues.[162]

1. *Revisiting* Dodge v. Ford

Professor Stout raises questions about the legal status of *Dodge v. Ford*.[163] Considering the significance of this case as a dominant reference to shareholder primacy in corporate law—as demonstrated by thousands of citations in secondary literature[164]—it is important to understand precisely what this case is. Professor Stout discounts the case as "bad law" and the court's statements on shareholder primacy, such as one quoted earlier, as only dicta.[165] However, Professor Stout's position is incoherent—should shareholder primacy be mere dicta, as she argues, then shareholder primacy would *not* be the law at all, good or bad, that could be drawn from *Dodge v. Ford*.[166] Consequently, there would have been no reason for Professor Stout to criticize the case, as "a mistake, a judicial 'sport,' [or] a doctrinal oddity."[167] This contradiction suggests that shareholder primacy is indeed the holding, as Professor Macey also points out,[168] not merely dicta.

As discussed above, Professor Stout and other leading scholars, argue that the decision was made on different and narrower grounds: the breach of fiduciary duty owed by a controlling shareholder, Henry Ford, to the minority shareholders, the Dodge brothers.[169] The *Dodge* court recognized Henry Ford's position as the controlling shareholder[170] and the duties he owed to the minority shareholders.[171] However, the court never specifically stated that Henry Ford violated his fiduciary duty owed to the

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161 *Id*. at 183.

162 *Id*.

163 *See* discussion *supra* Section II.A.1.

164 *See, e.g.*, Williams v. Green Bay & W.R. Co., 326 U.S. 549, 558 (1946); Louis K. Liggett Co. v. Lee, 288 U.S. 517, 554 (1933).

165 Stout, *Stop Teaching* Dodge, *supra* note 6, at 166–67.

166 *Id*. at 167.

167 *Id*. at 166.

168 Macey, *supra* note 16, at 178.

169 *See* discussion *supra* Section I.A.1.

170 Dodge v. Ford Motor Co., 170 N.W. 668, 671 (Mich. 1919).

171 *Id*. at 684.

minority shareholders.[172] The court's reasoning for its decision is clearly articulated in the following passage:

> It is said by appellants that the motives of the board members are not material and will not be inquired into by the court so long as their acts are within their lawful powers. As we have pointed out, and the proposition does not require argument to sustain it, it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others, and no one will contend that, if the avowed purpose of the defendant directors was to sacrifice the interests of shareholders, it would not be the duty of the courts to interfere.[173]

Professor Stout and other critics introduce the "underlying motive" for Ford's refusal to declare special dividends: the Dodge brothers planned to compete with Ford by starting a new motor company, and Ford wanted to deny the Dodge brothers the funds that they needed to do this and to suppress the stock price so that he could take over the Dodge brothers' shares at the lowest possible price.[174] If this was the case, Ford indeed acted in breach of his fiduciary duty owed to the minority shareholders by profiting at their expense.[175] Persuasive as this story is, none of this was mentioned in the case and, therefore, cannot support the proposition that the court found in favor of the Dodge brothers because Ford breached his fiduciary duty owed to the minority shareholders.[176] The *Dodge* court did not state that Ford stood to gain personally as a controlling shareholder by refusing to declare special stipends, and the court could not have found him in breach of his fiduciary duty owed to minority shareholders without establishing Ford's personal benefit.[177]

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[172] *See generally id.*

[173] *Id.* at 684.

[174] *See* discussion *supra* Section II.A.2.

[175] *See* S. Pac. Co. v. Bogert, 250 U.S. 483, 487–88 (1919) ("The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors.").

[176] *Id.*

[177] *See* Zahn v. Transamerica Corp., 162 F.2d 36, 44 (3d Cir. 1947) ("[The] director represents all the stockholders in the capacity of trustee for them and cannot use his office as director for his personal benefit at the expense of the stockholders.").

This suggests that the main driver of the case was indeed shareholder primacy, not the alleged breach of Ford's fiduciary duty owed to the minority shareholders.[178]

2. Case Law

Dodge v. Ford, the authority for shareholder primacy, has been questioned on several grounds; i.e., the decision, which was rendered one hundred years ago, is too old, came from the court that has never been considered a great authority in the field, and attracted a relatively small number of cites over the years, particularly by the influential Delaware courts.[179] The cited weaknesses of *Dodge v. Ford* as the legal authority does not necessarily mean that shareholder primacy is not the law; i.e., courts may not cite this old Michigan case but may nevertheless apply the notion of shareholder primacy.[180] Notably, *Revlon*, a Delaware case, has affirmed shareholder supremacy.[181] Professor Stout argues that the Delaware Supreme Court has systematically reduced the situations in which *Revlon* may apply to the point that the value of the case is largely irrelevant to modern corporate law and practice.[182] However, as noted above, Professor Stout's interpretation has met objection from the Chief Justice of the Supreme Court of Delaware.[183] According to Chief Justice Strine,

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[178] *Id.*

[179] *See* Stout, *Stop Teaching* Dodge, *supra* note 6, at 166–67.

[180] *Id.*

[181] *Id.* at 172.

[182] *Id.* Legal professionals have also considered that there are conditions that "trigger" the *Revlon* duty (to take steps reasonably calculated to obtain the best price for the benefit of the stockholders), limiting the scope of its application. Such conditions include:

> (A) the company initiates an active bidding process seeking to sell itself or to effect a reorganization involving a clear break-up of the company; or (B) in response to an unsolicited bid, a company abandons its long-term strategy and seeks an alternative involving a break-up of the company; or (C) approval of a transaction would result in a sale or change of control.

J. Anthony Terrell, Revlon *in Review*, PILLSBURY 1, A-1 (May 11, 2016), https://www.pillsburylaw.com/images/content/1/0/104200.pdf [https://perma.cc/KN8L-6CGS].

[183] *See* Stout, *Stop Teaching* Dodge*, supra* note 6, at 166–67.

Revlon clarifies that a board can only consider the interests of other constituencies if "rationally related benefits accru[e] to the stockholders."[184] For the Chief Justice, *Revlon* is not marginal, but central, in the discussion of the director's duty to maximize shareholder wealth.[185]

An empirical study shows that courts have embraced the notion of shareholder primacy.[186] According to Professor Rhee's report, there were 212 federal and state cases that recited, outside the specific context of *Revlon*, the profit maximization rule from 1900 to 2016.[187] The number of such cases have shown significant increases in the last two decades, totaling sixty-four cases from 2000 to 2009 and sixty-two cases from 2010 to 2016, compared to thirty-two cases from 1990 to 1999 and thirty-one cases from 1980 to 1989.[188] These increases indicate a stronger acceptance of the shareholder primacy doctrine over time.[189] Professor Rhee assessed that over a quarter of such cases cited shareholder primacy as a rationale for a rule of corporate law or as a legal obligation in the last decade.[190] The latter types of cases include *Katz v. Oak Indus., Inc.* where the court stated:

> 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.[191]

In another of such case, *Virtus Capital L.P. v. Eastman Chemical Co.*, the court found:

> [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

184 Strine, *supra* note 143, at 7 n.18 (quoting Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 173 (Del. 1986)).
185 *Id.*
186 *See generally* Rhee, *supra* note 19.
187 *Id.* at 1987, Table 1.
188 *Id.*
189 *Id.*
190 *Id.*
191 Katz v. Oak Indus. Inc., 508 A.2d 873, 879 (Del. Ch. 1986).

> of maximizing the value of the corporation for the benefit of its residual claimants, *viz.,* the stockholders.[192]

As shown by these cases, courts have accommodated the notion of shareholder primacy, using it as a rationale for a rule of law or as a legal obligation.[193] However, Professor Rhee observes that this acceptance is not universal: that courts in jurisdictions with state constituency statutes (state codes authorizing corporate boards to consider the interests of employees, customers, creditors, and the community) are bound to reject the concept of shareholder primacy, and a few courts have also argued against profit maximization independent of constituency statutes.[194]

Professor Rhee's observation may be correct if shareholder primacy were to be equated with profit maximization for shareholders.[195] As mentioned earlier, the maximization of profit or value to shareholders has been labeled as shareholder primacy.[196] However, *Dodge v. Ford* did not mention profit maximization.[197] The court stated that a corporation is "organized and carried on *primarily* for the profit of the stockholders," not *exclusively* for the profit.[198] The court did not consider the incidental humanitarian expenditure of corporate funds in breach of the fiduciary duty and distinguished such spending from "a general purpose and plan to benefit mankind at the expense of others."[199] The ALI Principles also state "a corporation should have as its objective the conduct of business activities *with a view to enhancing corporate profit and shareholder gain*."[200]

Scholars, such as Milton Friedman, and the courts that cited shareholder primacy have used the term "profit maximization" to describe shareholder primacy.[201] However, if shareholder primacy

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[192] Virtus Cap. L.P. v. Eastman Chem. Co., No. 9808-VCL, 2015 WL 580553, at *16 (Del. Ch. Feb. 11, 2015).

[193] *See* Rhee, *supra* note 19, at 1991.

[194] *Id.* at 1984 n. 146.

[195] *See A Friedman doctrine*, *supra* note 6.

[196] *Id.*

[197] *See generally* Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

[198] *Id.* at 684.

[199] *Id.*

[200] Macey, *supra* note 16, at 178 (emphasis added) (quoting PRINCIPLES OF CORP. GOVERNANCE § 2.01 (Am. L. Inst. 1994)). Professor Macey interprets the Principles as mandating profit maximization, but with an exception for supporting charities and other worthy causes. *Id.* at 178–79.

[201] *See, e.g.*, Rhee, *supra* note 19, at 1989.

were to be understood as the "primary" (rather than "exclusive") pursuit of profit or value for shareholders, allowing incidental spending for social causes, as *Dodge v. Ford* and the Principles seem to authorize, shareholder primacy may not necessarily be in conflict with state constituency statutes, as further discussed in the next Subsection.[202] Herein lies a potential for ambiguity: Professor Rhee considers that, in its Principles, the ALI deliberately chose the word "enhancing," instead of "maximizing," to describe corporate profit and shareholder gain, revealing a reluctance to embrace a strong form of shareholder primacy represented by the term, "maximizing."[203]

This suggests a possible "spectrum" of shareholder primacy, from one that aims to enhance profit and value for shareholders as a corporation's primary objective ("the enhancement type") to one that "maximizes" profit with little or no allowance for social interests ("the maximization type").[204] Courts may use the term "maximizing" incoherently; i.e., courts that accept the enhancement type of shareholder primacy and allow incidental accommodation of social interests may still use this term "maximizing" without necessarily meaning to adopt the maximizing form of shareholder primacy.[205] Case law suggests that most courts accept the enhancement type of shareholder primacy because they do not readily strike a corporate decision on account of incidental spending for social interests, which were not proven to undermine shareholders' interest in any significant way.[206] The maximizing type of shareholder primacy is also conceivable, but courts bound by state constituency statutes would not likely be able to accommodate this type of shareholder primacy.[207]

3. State Statutes

All fifty states have a statute that governs the formation, operation, and dissolution of corporations, among which the DGCL has the prime position due to the jurisdiction's influence

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[202] *See, e.g.*, Macey, *supra* note 16, at 178–79.

[203] Rhee, *supra* note 19, at 1990.

[204] *See* LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC (1st ed. 2012).

[205] *See, e.g.*, Macey, *supra* note 16, at 178–79.

[206] *Id.*

[207] *Id.* at 179.

on American corporations.[208] On the question of shareholder primacy, these statutes, including the DGCL, do not specifically reference it in their provisions.[209] A majority of states, instead, have constituency statutes that authorize boards to consider the interests of non-shareholding stakeholders, such as employees, customers, creditors, and the community, in making business decisions.[210] Notably, Delaware is not among these states and does not have a constituency statute.[211]

Professor Macey contends that these constituency statutes do not preclude the application of shareholder primacy: they allow managers to take the interests of non-shareholder constituencies into account when it does not harm shareholders in any demonstrable way.[212] The actual language of the constituency statutes seem to support Professor Macey's point, at least

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[208] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citing the dominant influence of the jurisdiction of Delaware on American corporations).

[209] *See* Strine, *supra* note 143, at 30.

[210] The states with constituency statutes include: Arizona: ARIZ. REV. STAT. ANN. § 10-830 (West 2016); Connecticut: CONN. GEN. STAT. ANN. § 33-756(g) (West 2017); Florida: FLA. STAT. ANN. § 607.0830(6) (West 2020); Georgia: GA. CODE ANN. § 14-2-202(b)(5) (West 2021); Hawaii: HAW. REV. STAT. § 415-212(b) (West 2022); Idaho: IDAHO CODE § 30-1702 (West 2022); Illinois: 805 ILL. COMP. STAT. ANN. 5/8.85 (West 2022); Indiana: IND. CODE ANN. § 23-1-35-1(d) (West 2009); Kentucky: KY. REV. STAT. ANN. § 271B.12-210(4) (West 2021); Maine: ME. REV. STAT. tit. 13-C, § 831(6) (West 2007); Massachusetts: MASS. GEN. LAWS ANN. ch. 156B, § 65 (West 2022); Minnesota: MINN. STAT. ANN. § 302A.251(5) (West 2007); Mississippi: MISS. CODE ANN. § 79-4-8.30(f) (West 2022); Nebraska: NEB. REV. STAT. § 21-2,102(a)(1) (West 2022); New Jersey: N.J. STAT. ANN. § 14A:6-1(2) (West 1989); New Mexico: N. M. STAT. ANN. § 53-ll-35(D) (West 2022); Nevada: NEV. REV. STAT. ANN. § 78.138 (West 2021); New York: N.Y. BUS. CORP. LAW § 717(b) (McKinney Supp. 2022); North Dakota: N.D. CENT. CODE ANN. § 10-19.1-50 (West 2021); Ohio: OHIO REV. CODE ANN. § 1701.59F (West 2020); Oregon: OR. REV. STAT. § 60.357(5) (West 2022); Pennsylvania: 15 PA. CONS. STAT. ANN. § 1715(a) (West 2022); Rhode Island: R.I. GEN. LAWS § 7-5.2-8(a) (West 2022); South Dakota: S.D. CODIFIED LAWS ANN. § 47-33-4 (West 2022); Utah: UTAH CODE ANN. § 16-10a-840 (West 2022) ("applicable to changes or potential changes of control of the corporation"); Vermont: VT. STAT. ANN. tit. 11A, § 8.30 (West 2022); Wisconsin: WIS. STAT. ANN. § 180.0827 (West 2022); Wyoming: WYO. STAT. ANN. § 17-16-830(g) (West 2022).

[211] Francis J. Aquila, *Memorandum to the Board: Considering the Corporate Purpose*, SULLIVAN & CROMWELL LLP (2020), https://www.sullcrom.com/files/upload/PLJ_FebMar20_InTheBoardroom.pdf [https://perma.cc/E4DW-THTG].

[212] Macey, *supra* note 16, at 179.

for the enhancement type of shareholder primacy.[213] For example, Section 717(b) of New York Business Corporation Law provides in relevant part:

> In taking action, including, without limitation, action which may involve or relate to a change or potential change in the control of the corporation, a director shall be entitled to consider, without limitation, (1) both the long-term and the short-term interests of the corporation and its shareholders and (2) the effects that the corporation's actions may have in the short term or in the long term upon any of the following: (i) the prospects for potential growth, development, productivity and profitability of the corporation; (ii) the corporation's current employees; (iii) the corporation's retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation; (iv) the corporation's customers and creditors; and (v) the ability of the corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business.
>
> Nothing in this paragraph shall create any duties owed by any director to any person or entity to consider or afford any particular weight to any of the foregoing or abrogate any duty of the directors, either statutory or recognized by common law or court decisions.[214]

This New York constituency statute specifically authorizes directors to consider the interests of shareholders and certain non-shareholding stakeholders (employees, customers, creditors, and communities) without assigning any order of consideration or priority between shareholders and the other stakeholders.[215] Thus, it is unlikely that the maximization type of shareholder primacy, which allows little or no consideration for the interests of non-shareholding stakeholders, would be compatible with this statute.[216] As for the enhancement type of shareholder primacy, which aims to enhance profit or value for shareholders as a primary objective but allows incidental consideration of social interests, there is a scope for compatibility, as the statute does not "abrogate any duty of the directors, either statutory or recognized by

[213] N.Y. Bus. Corp. Law § 717(b) (McKinney 2022).
[214] N.Y. Bus. Corp. Law § 717(b) (McKinney 2022).
[215] *Id.*
[216] *Id.*

common law or court decisions."[217] Thus, if courts mandate the enhancement type of shareholder primacy, which allows directors and officials to take social interests into consideration, to the extent that it does not harm shareholder interests considerably, such a decision will not be in conflict with the constituency statute.[218] This reasoning is also applicable with respect to constituency statutes in other states because their contents do not vary from one another in any significant way.[219]

III. The Economic and Social Impact of Shareholder Primacy

A. Shareholder Primacy as a Norm

1. The Implementational Difficulty

The preceding discussion has shown that shareholder primacy, particularly the enhancement type, has been accepted by most courts and has legal status.[220] However, as Professor Macey describes, the rule is aspirational, rather than mandatory.[221] The difficulty with its enforceability is the inherent ambiguity of the concept,[222] as demonstrated by the following illustration.

Suppose that Company A produces computer parts and decides to spend an additional $10 million a year to increase employee wages. The board claims that this decision, which seemingly benefits employees, will help the Company recruit and retain superior employees, which will enhance productivity. Suppose that the Company also announces the reduction of its product price by ten percent, in response to its customer requests, resulting in the immediate loss of $10 million in revenue and claims that the price reduction benefits its loyal customers but will also benefit the Company by increasing its market share. The Company presents the following projections:

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[217] *Id.*
[218] *Id.*
[219] *See, e.g.*, KY. REV. STAT. ANN. § 271B.12-210(4) (West 2022); MINN. STAT. ANN. § 302A.251(5) (West 2007); IND. CODE ANN. § 23-1-35-1(d) (West 2009); WIS. STAT. ANN. § 180.0827 (West 2022); HAW. REV. STAT. ANN. § 414-221(b) (West 2022).
[220] *See supra* notes 187–92, 208–19 and accompanying text.
[221] Macey, *supra* note 16, at 179.
[222] *Id.* at 181.

TABLE 1
REVENUE PROJECTION BY YEAR (IN MILLIONS OF USD)[223]

Year	**Wage increase**	**Productivity increase**	**Price Reduction**	**Market share increase**	**Total revenue change**
Base year	0	0	0	0	0
Year 1	10	5	10	5	-10
Year 2	10	10	10	10	0
Year 3	10	15	10	15	+10
Year 4	10	15	10	15	+10
Year 5	10	15	10	15	+10

Dissimilar interests among shareholders create complexity.[224] For shareholders with a short-term investment plan, the proposed spending benefits the employees and the customers but does not enhance shareholder wealth at all; i.e., for one-year investors (shareholders), they only see the loss of $10 million, for two-year investors, a $5 million loss (the average of $10 million loss in the first year and no loss in the second), for three-year investors, no gain or loss, for four-year investors, an average of $2.5 million gain over the four-year period, and for five-year investors, an average of $5 million gain over the five-year period.[225]

Thus, the proposed action benefits shareholders who intend to stay with the Company for four years or more but no less.[226] So, whose shareholder interest must the company maximize or enhance? This is essentially a business decision that each corporation will have to make, not one that can be assessed and decided

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[223] This table is artificially crafted to illustrate this point, but there are other examples of costly investments that may reduce short-term profits but yield long-term profits. Purchasing costly equipment is such an example: the cost of the equipment and its maintenance will reduce profits in the short term but will increase profits in the long term if the improved revenue attributable to the new equipment exceeds the cost over a period of time. However, corporate management reportedly stays away from long-term, profitable investments out of concern that it may hurt the short-term profit. *See, e.g.*, Adam Brandenburger & Ben Polak, *When Managers Cover Their Posteriors: Making the Decisions the Market Wants to See*, 27 RAND J. ECON. 523, 523–24 (1996).

[224] *Id.*

[225] *See supra* Table 1.

[226] *See id.*

by a court.[227] The court, unable to reconcile varied interests among shareholders, has no choice but to take the directors' word at face value as long as they assert that they intend to enhance or maximize the interests of shareholders, whatever the projected period might be or however likely it is to be successful, "because it is impossible to refute these corporate officials' self-serving assertions about their motives."[228] The business judgment rule, which affords directors the discretion in business-making, reflects this reality.[229]

2. The Normative Influence of the Concept

Shareholder primacy is a rule of law that is not readily enforceable, except in odd cases.[230] It is more of an aspirational norm.[231] It is a "norm" because shareholder primacy imposes on directors and managers a sense of duty to behave in a certain way (to enhance or maximize profit for shareholders),[232] and the norm is "aspirational" because it is difficult to prescribe its exact content—e.g., whose interests among the varied shareholders, as illustrated in the above scenario, must directors serve—the question that must be left to the discretion of directors.[233] It is a directional aim, violation of which can only be confirmed by admission (as in *Dodge v. Ford*), and directors are not normally found in breach of their fiduciary duty on the grounds that they violated the shareholder primacy rule.[234] Despite its limited enforceability, however, shareholder primacy is a powerful norm that has been "fully internalized by American managers."[235]

The normative force of shareholder primacy, combined with market pressure, has driven directors and managers to focus on

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[227] Macey, *supra* note 16, at 190.

[228] *Id.*

[229] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); *see also* discussion *supra* Section I.C.

[230] Macey, *supra* note 16, at 179–80, 190.

[231] *Id.* at 190.

[232] *See* HANS KELSEN, GENERAL THEORY OF NORMS 133 (Michael Hartney trans., Clarendon Press 1991) (discussing the concept of a norm).

[233] *See supra* notes 219–22, 225–29.

[234] Macey, *supra* note 16, at 180–81, 190.

[235] Stephen M. Bainbridge, *Participatory Management Within a Theory of the Firm*, 21 J. CORP. L. 657, 717 (1996).

profit maximization over all other corporate goals, often at the expense of the interests of their own employees, customers, and the community.[236] Commentators observe that the prevalence of shareholder primacy in corporate governance is a result of the shift, which took place in the late 1990s, from the self-perceived notion that directors and executives of large corporations constitute "stewards of great economic institutions that should serve not only equity investors but also customers, creditors, employees, suppliers, and the broader society,"[237] to one that pushes for corporate profit and shareholder wealth.[238] Most public companies now embrace shareholder primacy as a key principle for good governance, which has, in turn, enhanced the position of shareholders, particularly institutional shareholders, in the governance of corporations today.[239]

The increased corporate focus on profit and stock prices, now justified as good corporate governance under the norm of shareholder primacy, has affected corporate behavior significantly, such as the emphasis on short-term corporate performance.[240] As discussed above, the varied interests among shareholders and the inherent uncertainty of long-term profit projection encourages directors and mangers to seek short-term profit, which will be more evident and likely more satisfactory to the largest group of shareholders than uncertain long-term profit projection[241] (if, for example, profit was to start generating in Year 1 instead of Year 3 in the preceding scenario, a larger group of shareholders would have been immediately happier).[242] This short-term profit seeking, as further discussed in the following Section, causes negative ramifications to the society, such as economic polarization.[243] The remainder of this Part examines these issues.[244]

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[236] *See, e.g.*, Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1923, 1940 (2013); *see also* GERALD F. DAVIS, MANAGED BY THE MARKETS: HOW FINANCE RESHAPED AMERICA 60–61 (2009).

[237] *Toxic Side Effects*, *supra* note 22, at 2004.

[238] *Id.* at 2003–04, 2010.

[239] *Id.* at 2004.

[240] *Id.* at 2016–18.

[241] *Id.*

[242] *See supra* notes 222–25 and accompanying text.

[243] *See infra* notes 261–68 and accompanying text.

[244] *See infra* Section III.B.1.

B. Encouraging Short-Term Profit Seeking

1. The Adverse Impact on Shareholders

The prevalence of shareholder primacy has encouraged directors and managers to seek short-term profit, which may not be conducive to the long-term prosperity of the corporation.[245] Myopic managerial decisions and strategies focusing on short-term goals may result in hasty decision-making and decisions influenced by short-term incentives and bonuses to meet certain targets.[246] Directors and managers seeking short-term profit deploy measures to increase the company's short-term profile, such as "cutting or minimizing reported expenses for employee salaries, customer support, or research and development" expense.[247] These types of strategies undermine the growth potential of the corporation by failing to retain quality employees due to wage cuts, losing customers because of inadequate customer support, or undermining product competitiveness on account of insufficient product research and development.[248] The adverse impact of such measures will be exacerbated over a period of time and might become irreversible due to the loss of reputation and confidence of the other stakeholders.[249]

It has been argued that raising a company's short-term share price while, at the same time, protecting its long-term prospects is not possible.[250] An outcome of an economic study comparing long-term performance between companies that practiced more short-term governance and those that focused on long-term goals supports

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[245] *Toxic Side Effects*, *supra* note 22, at 2016–17.

[246] *Id.* at 2017–19.

[247] *Id.* at 2017.

[248] See *id.*

[249] *See id.*

[250] *See* Jeremy C. Stein, *Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior*, 104 Q. J. ECON. 655, 668 (1989). *But see* Robert J. Rhee, *Corporate Short-termism and Intertemporal Choice*, 96 WASH. U. L. REV. 495, 498 (2018) (arguing, based on an asset valuation theory, that short-termism is not per se inefficient); Anne M. Tucker, *The Long and the Short: Portfolio Turnover Ratios & Mutual Fund Investment Time Horizons*, 43 J. CORP. L. 581, 634 (2018) (arguing the claim that institutional investors are increasingly short-term orientated and their short-term focus are forcing them to be more short-term is not supported by empirical evidence).

this point.[251] According to the study, the companies engaged in short-term governance exhibit weaker financial performance over time.[252] Between 2001 and 2014, the market capitalization of short-term focused companies grew an average of $7 billion less than that of other companies focused on long-term goals.[253] In addition, the total return to shareholders from the long-term focused companies was superior, with a fifty percent greater likelihood that they would be in the top decile or quartile by 2014.[254] Companies focusing on long-term goals were also able to create more jobs, had higher earnings growth, invested more in research and development, and exhibited superior market capitalization.[255]

Concerning is the attitude of directors and officials willing to undermine the corporation's long-term performance and the shareholders' long-term interests to improve the corporation's short-term performance.[256] According to a survey of 401 corporate finance officers, eighty percent reported that they would cut expenses, such as marketing or product development costs, if such a spending cut was necessary to meet their reported quarterly targets, at the risk of undermining the corporation's future performance.[257] Combined with powerful institutional shareholders, such as hedge funds that aim to reap short-term profits and dispose of their stocks in a year or two,[258] and CEOs, whose compensation depends on short-term performance, the current corporate governance systematically undermines the long-term interests of shareholders and the future of the corporation in the name of shareholder primacy.[259]

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[251] Dominic Barton et al., *Measuring the Economic Impact of Short-Termism*, MCKINSEY GLOB. INST. 1 (Feb. 2017), https://www.mckinsey.com/~/media/mckinsey/featured%20insights/long%20term%20capitalism/where%20companies%20with%20a%20long%20term%20view%20outperform%20their%20peers/mgi-measuring-the-economic-impact-of-short-termism.ashx [https://perma.cc/7F94-SD7H].

[252] *Id.* at 2.

[253] *Id.*

[254] *Id.* at 6.

[255] *Id.* at 1–2, 5.

[256] *See supra* notes 157–59 and accompanying text.

[257] John R. Graham et al., *Value Destruction and Financial Reporting Decisions*, 62 FIN. ANALYSTS J. 27, 31 fig.4 (2006).

[258] *Toxic Side Effects*, *supra* note 22, at 2017.

[259] *Id.* at 2017–20.

2. The Adverse Impact on Non-shareholding Stakeholders

The pursuit of short-term success encourages directors and managers to adopt measures that reduce costs, such as the suppression of payouts to employees, customer support, research and development spending, and community support (such as donations to non-profit entities), to maximize profit figures in the short term.[260] The preceding discussion examined the adverse impact such spending cuts have on the long-term prospects of the corporation, but such short-term action also has an immediate adverse impact on affected employees, customers, and the community.[261] Employees facing pay cuts will face an instant economic impact.[262] Customers without adequate customer support will, as a result, experience inconveniences.[263] Spending cuts on research and development will disrupt technological and product development.[264] When this type of short-term cut repeats periodically to improve quarterly targets, it causes disruption not only to the affected individuals and departments in the corporation but also to the community at large.[265]

The impact of short-term decisions on the community can indeed be serious.[266] For local communities relying on a particular company or a small number of companies in the region, the impact of a short-term decision would be greater and would cause a more serious disruption in the economic and social life of the

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[260] *See id.* at 2017.

[261] *See id.* at 2016–17.

[262] Whitney Airgood-Obrycki et al., *Renters' Responses to Financial Stress During the Pandemic*, HARV. UNIV., 1–3 (Apr. 2021), https://www.jchs.harvard.edu/sites/default/files/research/files/harvard_jchs_renter_responses_covid_airgood-obrycki_etal_2021.pdf [https://perma.cc/EQ7E-YYGX].

[263] Erin Hueffner, *5 Examples of Bad Customer Service (and How to Be Great Instead)*, ZENDESK BLOG (Mar. 12, 2022), https://www.zendesk.com/blog/what-is-bad-customer-service/ [https://perma.cc/L9V2-XZG4].

[264] William A. Galston, *The Consequences of Cutting Corporate R&D Budgets*, BROOKINGS (Sept. 30, 2015), https://www.brookings.edu/blog/fixgov/2015/09/30/the-consequences-of-cutting-corporate-rd-budgets/ [https://perma.cc/MDH5-S5T4].

[265] *See Toxic Side Effects*, *supra* note 22, at 2020–21.

[266] *See, e.g.*, Deborah Belle & Heather E. Bullock, *The Psychological Consequences of Unemployment*, SOC'Y FOR THE PSYCH. STUDY OF SOC. ISSUES, 3–4, https://www.spssi.org/index.cfm?fuseaction=page.viewpage&pageid=1457 [https://perma.cc/K8CU-MV4K].

communities.[267] Employee pay cuts, for example, will have a multiplying effect on the economy of the community through its impact on the local businesses.[268] Economic hardship from pay cuts or job losses can turn into social instability, often from an increase in crime rate and from population loss.[269] Reflecting this concern, the chief officers of 150 prominent U.S. public companies attended the 2019 Roundtable meeting where they pledged to act for all of their stakeholders.[270] It was said, "in the face of a pervasive and value destructive short-term culture, a more deliberate and permanent commitment to a long-term focus, ideally supported by stockholders, would send a strong and credible signal to both managers and the market of a purposeful shift in priorities away from the short-term."[271]

Indeed, a more balanced approach, with an eye to a long-term life for the corporation and caution against the predatory behavior of certain institutional shareholders, such as hedge funds seeking short-term profit, is necessary to protect the interests of all stakeholders.[272] Aside from short-term profit seeking, the pursuit of shareholder primacy has had a deeper impact on society, resulting in economic polarization, for example.[273] The next Section examines these issues.[274]

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[267] *Id.*

[268] *See* Airgood-Obrycki et al, *supra* note 262.

[269] Roger Tarling, *Unemployment and Crime*, 14 RSCH. BULL. 28, 32 (1982); Nate W. Kratzer, *Coal Mining and Population Loss in Appalachia*, 21 J. APPALACHIAN STUD. 173, 178–79 (2015); *see also* DAVID DOOLEY & JOANN PRAUSE, THE SOCIAL COSTS OF UNDEREMPLOYMENT: INADEQUATE EMPLOYMENT AS DISGUISED UNEMPLOYMENT (CAMBRIDGE UNIV. PRESS ed., 2004) (discussing the impact of unemployment on the community).

[270] Neil Whoriskey, *Outlaws of the Roundtable? Adopting a Long-Term Value Bylaw*, MONDAQ (Oct. 11, 2019), https://www.mondaq.com/unitedstates/CorporateCommercial-Law/855916/Outlaws-Of-The-Roundtable-Adopting-A-Long-Term-Value-Bylaw? [https://perma.cc/9BXD-8SWS].

[271] Neil Whoriskey, *Outlaws of the Roundtable? Adopting a Long-term Value Bylaw*, CLEARY GOTTLIEB (Oct. 11, 2019), https://www.clearymawatch.com/2019/10/outlaws-of-the-roundtable-adopting-a-long-term-value-bylaw/ [https://perma.cc/RXU9-XETW].

[272] *See id.*

[273] Thomas Clarke et al., *The Impact of Corporate Governance on Compounding Inequality: Maximising Shareholder Value and Inflating Executive Pay*, 63 CRITICAL PERSP. ACCT. 1, 2 (2017).

[274] *See* discussion *infra* Section III.C.

C. Social Ramifications

Thomas Piketty, in his seminal work, *Capital in the Twenty-First Century*, argues that the rate of capital return in developed countries is persistently higher than the rate of economic growth, causing income and wealth disparity.[275] Shareholders, as capital investors, are in a position to benefit from this higher return[276]; thus, shareholder primacy, which prioritizes shareholder profits, exacerbates the disparity.[277]

1. Economic Disparity

Scholars argue that shareholder primacy has contributed to economic polarization in society.[278] Thomas Clarke, Walter Jarvis, and Soheyla Gholamshahi observe:

> [C]ompanies have been subjected to the regimes of shareholder primacy and increasing rewards for CEOs has systemically intensified inequality, creating corporations apparently dedicated to serving the interests of a small elite of owners and managers. In this process the conception of property rights and reward systems are willfully distorted to compound the wealth of the privileged, and have dispossessed working people from sharing in the benefits of prosperity.[279]

In the United States, economic polarization has grown over the years.[280] Robert Gordon observes that the increasing share of the top ten percent of the income distribution has deprived the middle class of income growth.[281] The real incomes[282]

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[275] THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 1 (Arthur Goldhammer trans., 2014).

[276] See *id.* at 746.

[277] See *id.*

[278] *See* Clarke et al., *supra* note 273, at 1–2.

[279] *Id.* at 2.

[280] *See* COEN TEULINGS & RICHARD BALDWIN, SECULAR STAGNATION: FACTS, CAUSES, AND CURES 4 (Coen Teulings & Richard Baldwin eds., 2014) (ebook).

[281] *Id.*

[282] "Real GDP" refers to gross domestic product figures adjusted by inflation (calculated in fixed currency value). JOHN BLACK ET AL., *Real GDP*, A DICTIONARY OF ECONOMICS (Oxford Univ. Press 5th ed. 2017). Economic indicators in "real" terms, such as "real growth" and "real consumption," are also adjusted by inflation. JOHN BLACK ET AL., *Real Terms*, A DICTIONARY OF ECONOMICS (Oxford Univ. Press 5th ed. 2017).

of households in the low- to middle-income groups have stagnated, whereas the real incomes of households in the highest income group increased sharply.[283] The U.S. economy demonstrated an upward mobility from the 1950s until the 1970s, but it has been declining; and the increasing economic polarization has mostly affected the population with lower incomes since the turn of the century.[284] The percentage of middle-income households has decreased from around fifty-eight percent of all households in 1970 to forty-seven percentage in 2014, and the income share of the middle-income household has decreased from forty-seven percent in 1970 to thirty-five percent in 2014.[285]

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[283] Ali Alichi et al., *Income Polarization in the United States* 4 (IMF, Working Paper No. WP/16/121, 2016).

[284] *See id.* at 4, 8.

[285] *Id.* at 5, 8.

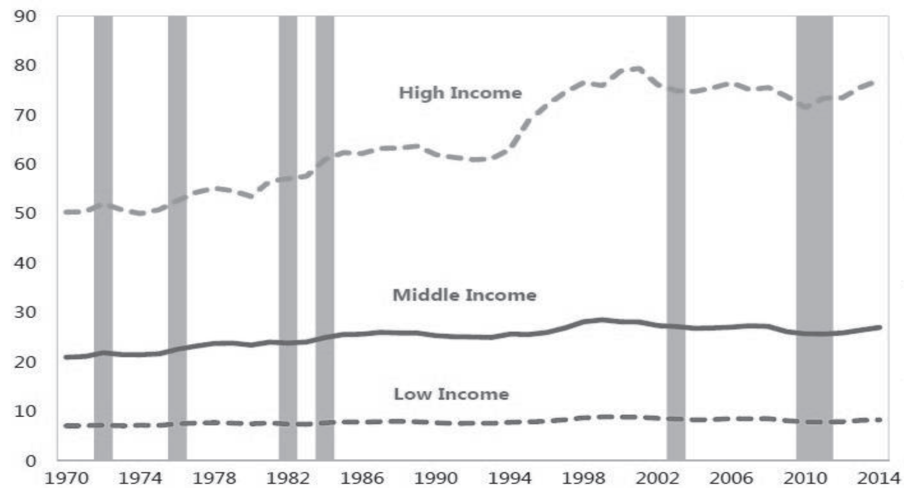

FIGURE 1. AVERAGE SCALED HOUSEHOLD INCOME, 1970–2014 (IN THOUSANDS OF 2005 USD)[286]

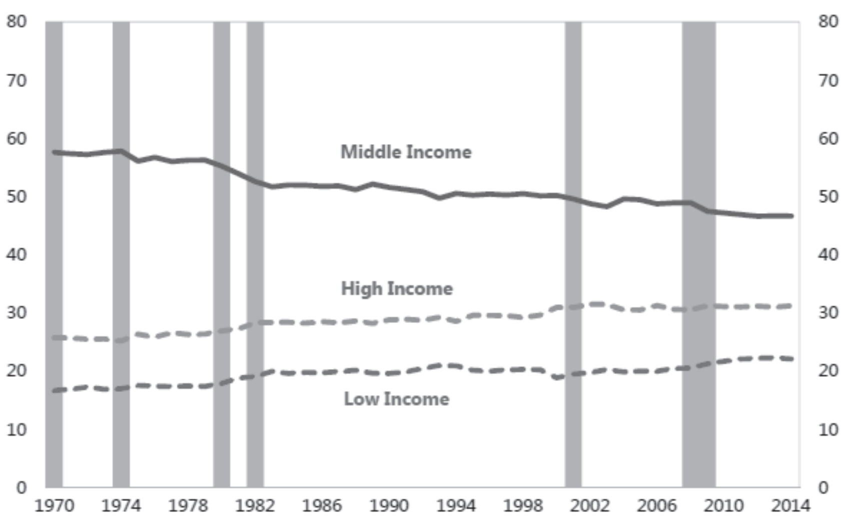

FIGURE 2. PERCENTAGE OF HOUSEHOLDS BY INCOME GROUP, 1970–2014[287]

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[286] The low-income group is comprised of households with less than 50% of the median income; the middle-income group is comprised of households with 50–150% of median income; and the high-income group is comprised of households with more than 150% of median income. *Id.* at 4. Household income is divided by its size using OECD's equivalence scale. *Id.* at 6.

[287] *Id.* at 5.

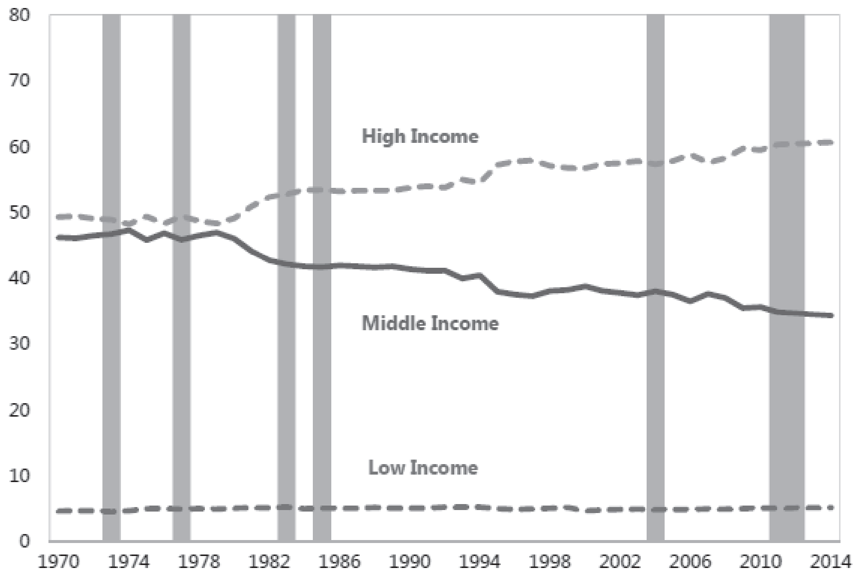

FIGURE 3. PERCENTAGE OF INCOME SHARES BY INCOME GROUP, 1970–2014[288]

The polarization has been deepening: more of the middle-income households moved into the high-income group, rather than the low-income group, from 1970 to 2000, but since 2000, only 0.25% of households have moved up to the high-income group compared to 3.25% of the middle-income households who have moved down to the low-income group.[289]

2. Shareholder Primacy as an Aggravating Factor

Corporate governance emphasizing shareholder primacy has affected economic polarization.[290] Giving shareholder value priority over all other corporate interests—and stock options and other compensation to encourage CEOs and other high-level corporate officials to serve this priority—has led to an obsessive emphasis on short-term financial performance, as discussed above.[291] Financial gains have not been reinvested to enhance

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[288] *Id.* at 8.
[289] *Id.* at 5.
[290] *See supra* Section III.C.1.
[291] *Id.*

corporate productive activity but distributed to shareholders in dividend payments and share buy-backs,[292] enriching a relatively small number of executives and shareholders while suppressing wages of the majority of workers (Figure 1). As shareholder primacy supported by agency theory[293] proliferates, corporate social responsibility diminishes[294] and economic polarization deepens.[295]

The adverse effect of shareholder primacy on economic polarization is also evident in the Gini coefficient comparison.[296] The Gini coefficient represents the degree of income distribution—the higher the Gini coefficient, the greater the income gap between the richest and the poorest.[297] The Gini coefficient is lower in countries where shareholder primacy is less prominent, such as France and Germany.[298] The following table shows the comparison.

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[292] *See* Natascha van der Zwan, *Making Sense of Financialization*, 12 SOCIO-ECON. REV. 99, 108 (2013).

[293] Agency theory explains the relationship between shareholders on one hand and directors and officials on the other. *See* Clarke et al., *supra* note 273, at 5. The theory describes the former as principals and the latter as agents who must act in the best interest of the former. *See id.; see also* Charles M. Elson & Craig K. Ferrere*, Surplus, Agency Theory, and the Hobbesian Corporation*, 48 WAKE FOREST L. REV. 721, 737 (2013).

[294] *See* Clarke et al., *supra* note 273, at 4.

[295] Shareholder primacy also adversely affected the 2007 financial crisis which resulted in millions becoming unemployed: major U.S. financial firms, many of which subsequently failed, had used up financial reserves to fund stock buy-backs for already overcompensated executives. *Id.* at 6.

[296] *See* Paddy Ireland, *Shareholder Primacy and the Distribution of Wealth*, 68 MOD. L. REV. 49, 72 (2005).

[297] *Gini Coefficient by Country 2021*, WORLD POPULATION REV., https://worldpopulationreview.com/country-rankings/gini-coefficient-by-country [https://perma.cc/95YX-5D5S].

[298] *See*, *e.g.*, Fabian Brandt & Konstantinos Georgiou, *Shareholders vs Stakeholders Capitalism*, *Comparative Corporate Governance & Financial Regulation*, U. PA. SCH. L. 4 (2016) ("Countries based on the Anglo-Saxon business model like the USA are in favor of a 'shareholder primacy' based system setting as their optimal goal the maximization of shareholder value. On the other hand, countries like Germany seem to have a stronger preference for a stakeholder based system."); *see also* Felix Hörisch, *The Macro-economic Effect of Codetermination on Income Equality*, 9 (Universität Mannheim, Working Paper 2012) (concluding that a stakeholder approach contributes to lesser income disparity in countries like Germany).

TABLE 2
GINI COEFFICIENT COMPARISON[299]

Country	United States	France	Germany
Gini coefficient	41.4 (2018)	32.4 (2018)	31.9 (2016)

Shareholder primacy is a device perpetuating economic polarization.[300] It involves "a shift in the internal social relationships within states in favor of creditor and rentier interests, with the subordination of productive sectors to financial sectors and with a drive to shift wealth and power and security away from the bulk of the working population."[301] Eliminating such polarization and income inequality requires corporate governance that is driven not by shareholder primacy but by stakeholder partnership that recognizes the contribution of the non-shareholding stakeholders, including employees, to corporate activities.[302] Deepening economic polarization is not likely to reverse without a change in corporate philosophy and governing principles away from shareholder primacy.[303]

IV. RECONCILING CORPORATE INTERESTS AND SOCIAL INTERESTS

A. Necessity for a Broader Approach

1. Shareholder Primacy as a Flawed Principle

Shareholder primacy is largely a flawed idea that is not implementable as a legal norm or as a governing principle for a corporation.[304] As discussed in the preceding Part, attempts to practice shareholder primacy have undermined the interests of non-shareholding stakeholders who are essential to the existence and continuation of a corporation including employees, customers, and suppliers, encouraged the short-term pursuit of profit at the

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[299] *Gini Coefficient by Country 2021*, *supra* note 297.
[300] Clarke et al., *supra* note 273, at 2.
[301] Ireland, *supra* note 296, at 78.
[302] *See* Hörisch, *supra* note 298, at 7, 9.
[303] *See* Clarke et al., *supra* note 273, at 15.
[304] *See id.*

expense of corporations' long-term performance, and inflicted harms on society, as shown by the economic polarization that resulted in social problems, such as rising crimes, deepening poverty, and loss of population from the affected communities.[305] While not all of these economic and social problems can be attributed to the prevalence of shareholder primacy alone, it is evident that shareholder primacy has caused significant economic and social problems.[306]

Shareholder primacy is an embodiment of neoliberalism that prioritizes capital and cautions against any consideration of social responsibility, as reflected in Milton Friedman's statement.[307] In the context of corporate governance, shareholder primacy prevailed "because it was thought to remedy the 'agency cost' problem of corporate managers neglecting shareholders' interests in order to serve their own."[308] However, as seen above, governance based on shareholder primacy actually works to enrich directors and managers who focus on short-term performance, often at the expense of employees, customers, and the community, and at the expense of the long-term performance of the corporation.[309] Shareholder primacy has not eliminated any significant divide between managers' and shareholders' interests—influential institutional shareholders may exert considerable influence on directors and managers, and many of them want to earn short-term profits within a year or two and dispose of their stocks after reaping profits, while other shareholders will have to face the long-term consequences: a class of shareholders might benefit from shareholder primacy, but not all of them.[310]

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[305] *See supra* Part III.

[306] *See Toxic Side Effects*, *supra* note 22, at 2.

[307] CAPITALISM AND FREEDOM, *supra* note 7, at 161 ("Few trends could so thoroughly undermine the very foundation of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible.").

[308] *Toxic Side Effects*, *supra* note 22, at 2004.

[309] *See* discussion *supra* Section III.B.

[310] Professor Gordon Smith observed that early courts created the shareholder primacy norm by employing rules that required directors to "act in the interests of *all* shareholders—not just the majority shareholders." Smith, *supra* note 131, at 279. Ironically, though, shareholder primacy tends to benefit a class of powerful, institutional shareholders at the expense of the

Another argument justifying shareholder primacy is that shareholders are the sole "residual claimants" in corporations.[311] According to this argument, maximizing the value of the shareholders' residual interest in the corporation is equivalent to maximizing the value of the corporation, which will consequently maximize social value because the interests of the claims of non-shareholders, such as creditors, employees, and taxing authorities, are fixed by contract or by law.[312] This assertion is not correct when the corporation is solvent.[313] Corporations, as a legal entity, have a legal right to profits, and shareholders are only legally entitled to whatever the board might decide to declare in dividend payments.[314] The interests of creditors, employees, suppliers, and taxing authorities are not fixed either: a corporate board, with broad discretion under the business judgment rule, may adjust employee salaries and benefits, retain earnings to provide creditors with a larger equity cushion, and may not pursue aggressive tax reduction or avoidance strategies.[315] Also, this residual claimant theory does not address the undermining of shareholders' long-term interests caused by the emphasis on short-term performance driven by shareholder primacy.[316]

Shareholder primacy, regardless of whether it is the enhancement type or the maximization type, has been turned into a device that serves the interests of a small group of shareholders, particularly influential institutional shareholders seeking short-term profits.[317] To the extent it benefits corporate directors and managers as well as the influential institutional shareholders,

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long-term interests of the other shareholders. *See* Ireland, *supra* note 296, at 78. Oliver Hart and Luigi Zingales also argue that company and asset managers should pursue policies consistent with the preference of their investors and proposes voting by shareholders on corporate policy. Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 260–61 (2017).

[311] *Toxic Side Effects*, *supra* note 22, at 2013.

[312] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 36 (1991).

[313] *See* Clarke et al., *supra* note 273, at 7.

[314] *See Toxic Side Effects*, *supra* note 22, at 2013.

[315] *See id.*

[316] *See id.* at 2017.

[317] *See id.*

with the support of the prominent mainstream economists,[318] shareholder primacy has become embedded in American corporate life and might not be amenable to change. The "financialization" of the American economy has also encouraged, and to some extent mandated, the prevalence of shareholder primacy.[319] Nonetheless, the extent of the economic and social harm caused by shareholder primacy requires consideration of an alternative approach.[320]

2. The Stakeholder Approach

A better corporate governance regime, which will remedy the problems caused by shareholder primacy, will have to take a broader approach and be more inclusive of the interests of non-shareholding stakeholders, such as employees, customers, suppliers, creditors, and the community at large.[321] The alternative "stakeholder approach" considers their interests independent of the shareholders' interests.[322] Thus, in the stakeholder approach, the performance of a corporation is measured using a broader spectrum of parameters, not just the value of the shares.[323] The stakeholder approach is distinguishable from CSR, as it is a strategic approach to business that aims to achieve the best possible economic outcome (by engaging with the stakeholders), rather than taking on a broader social responsibility issue.[324]

The stakeholder approach involves the identification of the legitimate stakeholders and the weighing and balancing of stakeholder interests.[325] This is a potentially complex task and also raises the risk of agency problems (e.g., easier to obfuscate management's selfish pursuits).[326] As for the latter problem,

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[318] *See, e.g., A Friedman doctrine*, *supra* note 6, at 7–8 (citing the Friedman doctrine).

[319] Clarke et al., *supra* note 273, at 3–4.

[320] *See id.* at 15.

[321] Brandt & Georgiou, *supra* note 298, at 7–8.

[322] *See id.* at 6.

[323] *Id.*

[324] *Id.* at 7.

[325] *Id.*

[326] Email from Professor Alex Lee, Professor of L., Northwestern Univ. Sch. of L., to Yong-Shik Lee, Dir. and Professorial Fellow, The L. and Dev. Inst., and Visiting Professor of L., Univ. of Nebraska Coll. of L. (Feb. 8, 2022) (on file with the author). However, Professors Margaret M. Blair and Lynn A.

however, an empirical observation suggests that the stakeholder approach may not necessarily be more problematic than shareholder primacy, which it was expected to alleviate[327]: according to a report, the ratio of CEO-to-worker compensation, which was 351-to-1 in 2020, drastically increased from 21-to-1 in 1965 to 61-to-1 in 1989.[328] From 1978 to 2020, CEO pay reportedly grew by 1,322%, substantially exceeding both the S&P stock market growth of 817% and top 0.1% earnings growth, which was 341% between 1978 and 2019.[329] In contrast, compensation of the typical worker grew by just 18.0% from 1978 to 2020.[330] These drastic CEO pay increases in recent decades arguably demonstrate that the prevalence of shareholder primacy has not deterred the pursuit of management's interests at the expense of other stakeholders, including shareholders, and that the agency problem does not represent a greater threat under the stakeholder approach.[331]

As for the identification of legitimate stakeholders, the instrumental approach suggests that only those with a direct economic connection to the corporation are to be considered.[332] According to this approach, stakeholders are defined as "constituents who have a legitimate claim on the firm . . . established through the existence of an exchange relationship" and who supply "the firm with critical resources . . . and in exchange [expect their] interests to be satisfied (by inducements)."[333] In contrast, Edward R.

Stout, in their 1999 landmark article, opine that the emphasis placed on principal agent problems in the corporate literature has been both excessive and misleading. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 328 (1999).

[327] *See* Rhee, *supra* note 19, at 1986.

[328] Lawrence Mishel & Jori Kandra, *CEO Pay Has Skyrocketed 1,322% Since 1978*, ECON. POL'Y INST. 9 (Aug. 10, 2021), https://files.epi.org/uploads/232540.pdf [https://perma.cc/BD3N-D32B].

[329] *See id.* at 6, 12 (noting information in Table 1 on page 6).

[330] *Id.* at 9.

[331] *See* Robert C. Bird & Stephen Kim Park, *Organic Corporate Governance*, 59 B.C. L. REV. 21, 24–25 (2018) (discussing that significant evidence exists that CEOs are commonly driven by self-interest and that boards often indulge CEOs).

[332] Andrew Crane and Trish Ruebottom explain that "stakeholders are predominantly defined solely by their generic economic function—to consume, invest, supply, and so on." Andrew Crane & Trish Ruebottom, *Stakeholder Theory and Social Identity: Rethinking Stakeholder Identification*, 102 J. BUS. ETHICS 77, 77 (2011).

[333] *Id.* at 79.

Freeman defines stakeholder more broadly as "any group or individual who can affect or is affected by the achievement of the firm's objectives."[334] This broader view encompasses a normative Kantian view under which stakeholders are not a means to a profitable end but an end in themselves.[335] However, this approach does not, arguably, alter the stakeholder classification significantly: while this approach may include the community at large, the latter is considered only a secondary stakeholder group, and the "main" stakeholders are identified based on their economic contribution to the corporation, typically including shareholders, employees, customers, suppliers, and creditors.[336]

In the stakeholder approach, management will have to assess how a specific management decision that favors a certain group of stakeholders, such as increasing employee wages or improving dividends for shareholders, affects the other groups.[337] Polonsky has described the stakeholder management process as a "tool designed to allow the firm to modify strategy to reflect the concerns of their various stakeholders."[338] This process is comprised of four basic steps:

> 1) identify the relevant stakeholder groups in relation to the issue being addressed; 2) determine the stake and importance of each stakeholder group; 3) determine how effectively the 'needs' or 'expectations' of each group is presently being met; and 4) modify corporate objectives and priorities to take into consideration stakeholder interests.[339]

This process has to be undertaken on a case-by-case basis with reference to the corporation's long-term interests.[340] For example, in the preceding illustration where a corporation decides to raise employee wages and reduce the product price,[341] the employees and the consumers are the groups of stakeholders

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[334] R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 25 (1984).

[335] Crane & Ruebottom, *supra* note 332, at 79.

[336] *Id.*

[337] *See* Bird & Park, *supra* note 331, at 32.

[338] Michael Polonsky, *Incorporating the Natural Environment in Corporate Strategy: A Stakeholder Approach*, 12 J. BUS. STRATEGIES 151, 153 (1995).

[339] *Id.*

[340] *Id.* at 153–54.

[341] *See supra* Table 1.

that immediately benefit from this decision.[342] This decision, however, reduces the corporation's short-term profits,[343] and management will have to assess the immediate benefits to employees and consumers against the short-term loss to the shareholders (and possibly other stakeholders) and the long-term prospects.[344]

The stakeholder approach does not prescribe a fixed formula or metric that ascertains, represents, and weighs the relative interests to be assigned to each identified stakeholder group; rather, it allows management to pursue long-term interests for the corporation, which will benefit shareholders as well as a broader range of stakeholders, because directors are no longer bound by the demands of a single group—a class of shareholders, such as the powerful institutional shareholders that seek short-term performance.[345] Under this approach, directors and managers do not predetermine a certain interest (e.g., a short-term stock price) to be more important than another, and they base their decisions on the consideration of all relevant interests and stakes,[346] although each management team may well have different assessments about the relative importance of each of these interests and stakes on a case-by-case basis.[347] Ostensibly, if the needs of one stakeholder group are currently being better satisfied, then the lesser-served group may take some precedence.[348] One conflict not too hard to imagine is a scenario in which the interests of a stakeholder group that is assigned more importance is at odds with the interests of a lesser group that is deemed to be currently underserved.[349] For example, management may find it necessary to deploy limited corporate resources to increase wages for employees at the time of labor shortage to retain able employees instead of using the resources to support underserved consumers.[350]

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[342] *See supra* Section III.A.1.

[343] *Id.*

[344] *See* Brandt & Georgiou, *supra* note 298, at 58–59.

[345] *See id.* at 56–59.

[346] *Id.* at 7–8.

[347] *See id.*

[348] *See* Polonsky, *supra* note 338, at 155.

[349] *Id.* at 151–52.

[350] *Cf. id.* at 155–56 (discussing how the modification of an environmental strategy to address the needs of a single "unsatisfied" stakeholder may alienate the stakeholders who find the firm's performance satisfactory).

The structure and conditions of deliberation will also affect the outcome.[351] Where managers must account corporate profits and losses to shareholders on a quarterly basis and where their reappointment and compensation packages depend on the short-term performance under the influence of dominant institutional shareholders, management decisions are likely to be more affected by the need to improve short-term corporate profits over the interests of other shareholders or long-term corporate interests.[352] The outcome may well be different where the interests of other stakeholders are better represented in the corporations' decision-making process, as exemplified by Germany's mandatory employee representation on corporate boards.[353] In the latter case, it is likely that management decisions will be more reflective of the interests of employees than otherwise.[354] Socioeconomic conditions on the ground may also affect the structure and conditions of deliberation[355]; i.e., in the United States where labor participation in management is not a norm among most corporations, the German-type labor representation on the board will not be feasible, and as a result the labor interests may not have the same degree of influence on management decisions.[356]

While the stakeholder approach is more reflective of social interests, it nevertheless does not allow for the consideration of social interests based on ethical considerations.[357] The approach is foremost a corporate governance strategy that aims to attain the best economic result for the corporation (e.g., the optimalization of long-term interests rather than short-term interests), but it is still a better approach than shareholder primacy, as this

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[351] *Id.*

[352] *See* Brandt & Georgiou, *supra* note 298, at 58–59.

[353] Germany's Codetermination Act of 1976 requires employee representation on the supervisory boards of large companies. The Act requires that employees must compose at least one-third of the supervisory board, which oversees and appoints the members of the management board, and must approve major business decisions when the company has at least 500 employees. *See* Hans-Joachim Mertens & Erich Schanze, *The German Codetermination Act of 1976*, 2 J. COMP. CORP. L. & SEC. REG. 75, 75 (1979) (discussing the elements of the Act).

[354] *See id.* at 83.

[355] *See id.*

[356] *See id.* at 76.

[357] *See* Brandt & Georgiou, *supra* note 298, at 7–8.

approach can prevent the harm caused by the prevalent short-term approaches encouraged by shareholder primacy and allows for the accommodation of social interests, to the extent that it is relevant to the interests of the corporation as a whole (not just shareholders).[358] The enhancement type of shareholder primacy also allows for the consideration of social interests, but the stakeholder approach is distinguishable from it because this type of shareholder primacy accommodates social interests only to the extent that they do not significantly undermine shareholder interests.[359] The stakeholder approach does not prioritize shareholders' interests; thus, consideration of the stakeholders' interests is not contingent upon shareholders' interests.[360]

The stakeholder approach has been more heavily adopted in Europe than the United States[361]: while corporate law in the United States does not require corporations to have employee representation on corporate boards (except small employee-owned companies), some European countries, such as Germany, as discussed above, do require employee representation on boards, which functions as a legally mandated channel to accommodate the non-shareholding stakeholders' (in this case employees') interests.[362] Such legally mandated channels, or procedures for the consideration of non-shareholding stakeholders' interests, are not available in the United States, and it is left to the discretion of the corporate management, again, to the extent allowed under the requirements of shareholder primacy.[363] A few states have enacted laws for SPCs, where directors and officers are authorized to consider social interests, and a majority of states have also enacted laws for "benefit corporations," where directors and officials are required to consider a specific benefit purpose.[364] However, SPCs and benefit corporations must be specifically formed for these purposes, and the provisions are not applied to general corporations, substantially limiting their scope of application.[365]

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[358] *See id.* at 58–59.
[359] *See id.* at 7–8.
[360] *See id.*
[361] *Id.* at 51.
[362] *See* Mertens & Schanze, *supra* note 353, at 78.
[363] *See* Brandt & Georgiou, *supra* note 298, at 51.
[364] *See, e.g.*, N.Y. Bus. Corp. Law § 1707(a)(1) (LexisNexis 2012).
[365] *See, e.g.*, § 1707(a).

The stakeholder approach is considered to have contributed to the lesser income disparity found in countries like Germany and France.[366] It enables a management regime that better accommodates social interests, including distributive justice in the form of a more equitable distribution of income, increasing employment and improving wages.[367] Despite the traditional inclination towards the stakeholder approach in Europe, the shareholder approach has gained appeal since the 1990s, due to the increased importance of institutional shareholders and capital markets in general, which has created pressure to meet the shareholders' demand of value creation in their favor.[368] However, this trend has been met with caution: the European Commission in its July 2020 report discussed problems created by short-term shareholder wealth maximization and warns that shareholder primacy "reduces the long-term economic, environmental and social sustainability of European businesses."[369]

B. The Role of Law

1. Necessity for Statutory Adjustment

The current legal status of shareholder primacy is uncertain and requires clarification, which will be best achieved through statutory adjustment.[370] To achieve such clarification, the role of the most prominent jurisdiction on corporate affairs, Delaware, will be essential.[371] This proposal for clarification may seem at odds with the published declaration of the Chief Justice of the Supreme Court of Delaware that shareholder primacy is the law.[372] However, disagreement on the legal status of shareholder primacy continues to exist among scholars.[373] As Professor Yosifon

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[366] *See supra* Table 2; *see also* Hörisch, *supra* note 298, at 14.

[367] *Id.* at 8.

[368] Brandt & Georgiou, *supra* note 298, at 16.

[369] ERNST & YOUNG, *Study on Directors' Duties and Sustainable Corporate Governance*, EUROPEAN COMM'N DIRECTORATE-GENERAL FOR JUST. AND CONSUMERS (July 2020), https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en [https://perma.cc/8RU8-37QW].

[370] *See* Brandt & Georgiou, *supra* note 298, at 40, 42, 71.

[371] *See id.* at 42–43.

[372] *See supra*, Section II.B.2.

[373] *See supra*, Sections II.A–B.

points out, the confusion on perhaps one of the most important questions in corporate law is not only embarrassing but also disempowering. [374] The current status of confusion about the legal status of shareholder primacy requires clarification.[375]

As Professor Macey explains, the shareholder primacy rule is aspirational and unenforceable in most cases.[376] This unenforceable rule creates confusion about the legal mandate of corporate governance and, along with market pressure, deters the adoption of a more inclusive and rational form of corporate governance.[377] A majority of states have enacted constituency statutes that authorize directors and officials to consider the interests of non-shareholding stakeholders,[378] but there is controversy regarding whether corporate directors may decide to pursue these interests independent of shareholder's interests when it may harm the latter interests in a significant way.[379] The shadow of shareholder primacy looms over the states that have adopted constituency statutes, and further statutory clarification is due.[380]

Irrespective of whether one supports shareholder primacy, its legal stipulation does not serve any useful purpose.[381] It is essentially a question that needs to be settled by corporations themselves, a question that belongs to the boardroom rather than the courtroom.[382] Right or wrong, there is considerable market pressure that pushes directors and officials, who are already motivated by large compensation packages per performance, to focus on short-term performance and to meet the interests of a class of powerful shareholders.[383] There is no need for a legal mandate, although it is even an aspirational one, to support this.[384]

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[374] Yosifon, *supra* note 103, at 183.

[375] *See id.*

[376] Macey, *supra* note 16, at 190.

[377] *See id.*

[378] *See supra* note 210 (listing state constituency codes).

[379] Professor Macey characterizes these statutes as merely "tie-breakers, allowing managers to take the interests of non-shareholder constituencies into account when doing so does not harm shareholders in any demonstrable way." Macey, *supra* note 16, at 179.

[380] Yosifon, *supra* note 103, at 183.

[381] Smith & Rönnegard, *supra* note 7, at 464.

[382] *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 811–12 (Del. 1984).

[383] Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

[384] Smith & Rönnegard, *supra* note 7, at 464.

In contrast, for corporations that wish to accommodate the interests of non-shareholding stakeholders and to seek long-term prosperity for the corporation, the current shareholder primacy norm is an impediment.[385] It might not be a substantial obstacle, because it is one that can be easily overcome by making an assertion that those interests somehow enhance profit for shareholders,[386] but there is no rational reason for imposing such an arbitrary requirement on the directors and officials who decide to promote the interests of stakeholders with the support of majority shareholders.[387] Corporations should be free to pursue any interest consistent with their charters, including the interests of non-shareholding stakeholders, without having to register as SPCs or public benefit corporations.[388]

The time has come to break away from the 100-year-old decision of *Dodge v. Ford*.[389] The *Dodge* court did not invent shareholder primacy *per se*, but the decision has permeated the minds of law students, lawyers, judges, policymakers, and businesspeople for generations, and created the present confusion and uncertainty about the legal status of shareholder primacy.[390] The amended law must clearly remove shareholder primacy by stipulating in the statutory text that, in acting for a corporation, directors and officials may, at their discretion, consider the interests of shareholders and non-shareholding stakeholders without any limitations and

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[385] *See, e.g.*, Macey, *supra* note 16, at 179.

[386] Commenting on *Dodge v. Ford*, Professor Macey makes an analogous observation:

> [H]ow easy it would have been for Mr. Ford to have won this case. Suppose Mr. Ford simply had gotten on the stand and testified (contrary to the truth, apparently) that he was keenly interested in maximizing value for shareholders. Suppose further that Mr. Ford took the position (as many CEOs have done) that, in his view, the best way to benefit the shareholders was to increase the market share of the business, and that reducing the price of cars was critical to his strategy of expanding the company. Also suppose that Mr. Ford took the eminently reasonable position that the company required loyal, experienced, and skilled workers to succeed, and that his plan to raise wages was necessary to accomplish this end.

Macey, *supra* note 16, at 179.

[387] Smith & Rönnegard, *supra* note 7, at 464.

[388] *See* discussion *supra* Conclusion.

[389] *See* discussion *infra* Conclusion.

[390] *See* discussion *supra* Sections II.A–B.

in any proportion that they deem appropriate without incurring any liability.[391] Considering the confusion, it will also be necessary to clarify in the statutory text that the interests of both shareholders and non-shareholding stakeholders are, in principle, equal and that one is not subordinate to the other.[392] As mentioned, it would be important for Delaware, given its prominent position in corporate practice, to take the lead and adjust the DGCL to this effect.[393]

2. From Ownership to Partnership

Corporations are not simplistic entities whose shareholders are the owners, to which the other stakeholders play a subsidiary role that serves the interests of shareholders.[394] Corporations are an entity of their own, not just a proxy for shareholder interests, with a plethora of formal contracts, informal relations, and permanent and provisional understandings with a number of stakeholders, including employees, customers, suppliers, business associates, and the general public as a whole.[395] It is a key institution in society with considerable privileges, rights, influences, and responsibilities that cannot be discharged simply by "maximizing shareholder value."[396] As already explained, dissimilar interests among shareholders render the identification of an action that maximizes all of their profits impossible.[397]

Considering the complexity and importance of non-shareholding stakeholders for the continuation and prosperity of corporations, "partnership" rather than "ownership" is a more appropriate description of the relationship among the various

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[391] *Cf.*, Accountable Capitalism Act, S. 3348, 115th Cong. § 4(a)(1)(A) (as introduced in Senate, Aug. 15, 2018) (bill, sponsored by Senator Elizabeth Warren, requiring that large companies with revenues over $1 billion be federally chartered); *Id.* § 5(a)(1), (b)(2) (imbuing federally chartered companies with "the purpose of creating a general public benefit"). The proposed statutory adjustment is distinguishable from this bill in that it *authorizes* directors and officials to consider stakeholder interests as well as shareholder interests, as opposed to imposing such duties on them. *Id.*

[392] *See* discussion *supra* Part III.

[393] *See* discussion *supra* Sections I.A.2., IV.B.

[394] *See* discussion *supra* Section IV.A.2.

[395] *See* discussion *supra* Section I.A.

[396] *Id.*

[397] *See* discussion *supra* Section III.A.

stakeholders.[398] Corporate governance in countries such as Canada, France, and Germany has better captured this important partnership aspect.[399] In Canada, the Business Corporation Act authorizes directors and officers to consider non-shareholding stakeholders.[400] It provides in relevant part:

> When acting with a view to the best interests of the corporation . . . the directors and officers of the corporation may consider but are not limited to . . . the interests of shareholders, employees, retirees and pensioners, creditors, consumers, and governments, the environment and, the long-term interests of the corporation.[401]

In France, under what they call, "the intérêt social," directors must comply with the interests of the corporation's stakeholders, including shareholders, employees, business affiliates, and the environment as combined corporate interests (i.e., no separation of shareholders' interests).[402] In Germany, corporations adopt the "stakeholder approach" as discussed earlier[403]: the approach considers the interests of non-shareholding stakeholders independent of shareholders' interests,[404] and corporate performance is measured using a broad spectrum of parameters, not just the value of the shares.[405]

Finally, a recent project, the Human Centered Business Model (HCBM),[406] which has been promoted by the World Bank's

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[398] *See, e.g.*, Forrest Alogna et al., *The Shareholder in France and the United States: A Comparative Analysis of Corporate Legal Priorities*, 17 L'ACTIONNAIRE 90, 94–95 (2020).

[399] *See infra* notes 400–05 and accompanying text.

[400] *See* Canada Business Corporations Act, R.S.C.,1985, c C-44 s.122.

[401] *Id.*

[402] Alogna et al., *supra* note 398, at 94–95.

[403] *See* discussion *supra* Section III.C.2.

[404] Brandt & Georgiou, *supra* note 298, at 6.

[405] *Id.* Professor Rhee has also conducted a comparative analysis of U.S. and South Korean corporate law. *See generally* Robert J. Rhee, *The Political Economy of Corporate Law and Governance: American and Korean Rules Under Different Endogenous Conditions and Forms of Capitalism*, 55 WAKE FOREST L. REV. 649 (2020). In that article, Professor Rhee discusses why South Korea does not have a strong version of that rule, in light of its internal conditions, whereas the United States has shareholder primacy. *See Id.*

[406] *The Human-Centered Business Model (HCBM): A Holistic Approach to a New Model for Doing Business*, GLOB. F. ON L., JUST., AND DEV. (Mar. 27, 2019), https://www.globalforumljd.com/sites/default/files/documents/events

Global Forum on Law, Justice, and Development (GFLJD), charts a future path toward cooperation and partnership among all stakeholders.[407] The GFLJD project points out the negative effects that profit maximization has had on social, environmental, ethical, and human rights principles[408] and aims to develop an innovative business model based on a common set of economic, social, environmental, and ethical rights-based principles.[409] The project is structured around six "pillars" "developing: (1) guiding principles, (2) the legal framework and corporate governance solutions, (3) financial mechanisms, (4) fiscal policy, (5) procurement policies, and (6) stakeholders' relationship techniques."[410] HCBM's corporate governance solution focuses on developing innovative techniques "to ensure more effective internalization of interests other than shareholder profit, including the interests of non-shareholder stakeholders."[411] It promotes a participatory, democratic, transparent, and accountable system of management, which includes the meaningful involvement of stakeholders.[412]

CONCLUSION

Over one hundred years have passed since *Dodge v. Ford*, one of the most cited cases in corporation textbooks and literature.[413] Still, controversy about its legal status persists.[414] Shareholder primacy, the principle of corporate governance upheld by this seminal case, has been accepted by most lawyers, judges, businesspeople, and policymakers as the operative concept for corporate governance in the United States.[415] Shareholder primacy

/HC BM%20Project%20Brief%20March%202019%20%28A%29.pdf [https://perma.cc/C5EU-AYFC].

[407] *See id.* at 3.

[408] *Id.*

[409] *Id.*

[410] *Id.*

[411] *Id.* at 4.

[412] *Id.*; *see also* Virginia Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59 (2010) (introducing another alternative approach for corporate governance, the "enlightened shareholder value" (ESV) approach).

[413] Stout, *Stop Teaching* Dodge, *supra* note 6, at 166.

[414] *See* discussion *supra* Part II.

[415] *See* discussion *supra* Section II.C.2.

had become prominent by the late 1990s, and it has shaped corporate behavior and affected the economy and society in fundamental ways.[416] For example, corporate directors and officers have focused on short-term performance to maximize shareholder value, often at the expense of non-shareholding stakeholders, causing adverse social effects as demonstrated by economic polarization.[417]

Shareholder primacy has legal status, as enunciated by the Chief Justice of the Supreme Court Delaware in his recent writing.[418] However, the rule is largely aspirational and unenforceable.[419] The interests of shareholders are not uniform but varied and, at times, in conflict with each other; thus, directors and officers will have to decide whose interests will be served, and not surprisingly, they tend to prioritize the interests of powerful institutional shareholders with short-term profit goals.[420] It is a myth that shareholder primacy enhances the corporate value: as an empirical study has revealed, it encourages directors and officers to focus on short-term performance at the expense of long-term performance[421] and, in the process, undermines the interests of non-shareholding stakeholders such as employees, customers, and the community.[422]

This Article proposes law reform in the form of statutory adjustment that specifically authorizes directors and officers to pursue the interests of non-shareholder stakeholders as well as shareholders and clarifies that one interest is not subordinate to another.[423] This is not necessarily an attempt to replace shareholder primacy with other types of corporate governance[424] despite

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[416] *See* discussion *supra* Section II.A.2.

[417] *See* discussion *supra* Section III.C.

[418] Strine, *supra* note 143, at 3–4.

[419] Macey, *supra* note 16, at 190.

[420] *Toxic Side Effects*, *supra* note 22, at 2004.

[421] Barton et al., *supra* note 251, at 1.

[422] *See* discussion *supra* Part III.

[423] *Id.*

[424] Lund and Pollman project that shareholder primacy is likely to remain a dominant norm. Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2630–31 (2021). They point out that "as the shareholder primacy viewpoint has become enmeshed in our cultural and institutional understanding of good governance and as multiple powerful players operate as gatekeepers for the shareholder primacy norm, it becomes difficult to move to another." *Id.* at 2630.

this author's personal preference for the stakeholder approach—but to allow each corporation to decide their own governance: if they wish to pursue the interests of non-shareholding stakeholders independent of shareholders' interests, they should be free to do so without having to register as SPCs or benefit corporations.[425]

Ultimately, corporations will have to comply with the wishes of the majority shareholders—shareholders can remove and replace any director who does not.[426] The question of corporate interests—whether they are primarily shareholders' interests or broader stakeholders' interests—must be left to each corporation, not to a court enforcing an alleged legal mandate.[427] The current situation is ambiguous: many believe shareholder primacy is the law, some do not; some think it is an effective law, and others believe it is just aspirational.[428] This state of confusion has remained unchanged for decades.[429] It is why legislatures, particularly that of Delaware—the most important jurisdiction on corporate affairs—should implement the proposed statutory clarification.[430]

[425] *See* discussion *supra* Conclusion.
[426] Smith & Rönnegard, *supra* note 7, at 464.
[427] *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 805 (Del. 1984)
[428] *See* discussion *supra* Sections I.A–B.
[429] *See* discussion *supra* Section I.B.
[430] *Id*.