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**The Dangers of Denial:
The Need for a Clear-Eyed Understanding of
the Power and Accountability Structure
Established by the Delaware General
Corporation Law**

Leo E. Strine, Jr.

***GOVERNMENT OF THE STATE OF DELAWARE - SUPREME COURT OF DELAWARE;
HARVARD LAW SCHOOL; UNIVERSITY OF PENNSYLVANIA LAW SCHOOL***

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**The Dangers of Denial: The Need for a Clear-Eyed Understanding
of the Power and Accountability Structure Established by the
Delaware General Corporation Law**

**Honorable Leo E. Strine, Jr.* **
Chief Justice
Delaware Supreme Court**

* Leo E. Strine, Jr. is Chief Justice of the Delaware Supreme Court; Austin Wakeman Scott Lecturer on Law and Senior Fellow, Program on Corporate Governance, Harvard Law School; Adjunct Professor of Law, University of Pennsylvania Law School and Vanderbilt University Law School; and Henry Crown Fellow, Aspen Institute.

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I. Introduction

There are, as in any intellectual and political tradition, different strands of thought on the center-left of American politics, as well as different approaches to looking at the world. I confess that the one I most admire is clear-eyed, and attempts to make things better by acknowledging how things in fact are, and not how I would wish them to be.

In the area that this essay addresses, Adolf Berle stands as one example of someone who confronted the world as it was and advanced ideas to improve it.¹ James

¹ In a famous debate with E. Merrick Dodd, Jr., Adolf Berle contended that if corporate managers were allowed to consider the interests of all constituencies, without being legally bound to any, those fiduciaries would be free from accountability. Adolf A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932) (“When the fiduciary obligation of the corporate management and ‘control’ to stockholders is weakened or eliminated, the management and ‘control’ become for all practical purposes absolute.”). Berle was not entirely opposed to a regime that would allow managers to consider a broader set of interests, but argued that it would be imprudent to deviate from the status quo until a system of binding legal regulation emerged that would safeguard against managerial self-interest:

Now I submit that you can not abandon emphasis on ‘the view that business corporations exist for the sole purpose of making profits for their stockholders’ until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else. . . . Either you have a system based on individual ownership of property or you do not. If not—and there are at the moment plenty of reasons why capitalism does not seem ideal—it becomes necessary to present a system (none has been presented) of law or government, or both, by which responsibility for control of national wealth and income is so apportioned and enforced that the community as a whole, or at least the great bulk of it, is properly taken care of. Otherwise the economic power now mobilized and massed under the corporate form, in the hands of a few thousand directors, and the few hundred individuals holding ‘control,’ is simply handed over, weakly, to the present administrators with a pious wish that something nice will come out of it all.

Id. at 1367-68. For his entire career, Berle argued that those with economic power had to be subject to genuine regulation to ensure that they used their power in a way consistent with the public interest. Most famously, Berle was a leading academic at the core of President Roosevelt’s “Brains Trust” and drafted his famous “Commonwealth Club Address,” a speech that sketched a philosophical foundation for the New Deal. See William W. Bratton & Michael L. Wachter, *Shareholder Primacy’s Corporatist Origins: Adolf Berle and the Modern*

Madison, Alexander Hamilton,² Abraham Lincoln,³ Theodore Roosevelt,⁴ and Franklin Delano Roosevelt⁵ are other notable examples. Internationally, George Orwell⁶ might be counted among the ranks.

Corporation, 34 J. CORP. L. 99, 110 (2008). In his debate with Berle, Dodd postured himself as a champion of social responsibility, but Berle saw Dodd as naively asking the nation to just trust managers to absorb the lessons of the Great Depression and act more responsibly to protect workers and society. *Id.* at 125 (“Dodd believed that the corporatist policy for the United States should be based on the presumption that the managerial elite, given the appropriate mandate, would act as trustees for the community and use their corporations to resolve the economic and social problems of the Great Depression. Extensive regulation would be unnecessary, and ‘[t]he principal object of legal compulsion might then be to keep those who failed to catch the new spirit up to the standards which their more enlightened competitors would desire to adopt voluntarily.’” (quoting E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932))). Berle wanted managers to operate within a binding accountability structure that demonstrated adequate regard for those affected by corporate conduct and that would therefore help managers act more in keeping with the better angels of their nature.

² The Federalist Papers authored by Alexander Hamilton and James Madison reveal a keen understanding of the contours of the world and of human nature, and the need to consider governance in light of these realities. *E.g.*, Federalist No. 51, *available at* <http://www.foundingfathers.info/federalistpapers/fed51.htm> (“It may be a reflection on human nature, that such devices should be necessary to control the abuses of government. But what is government itself, but the greatest of all reflections on human nature? If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself. A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions.”).

³ As an example, President Lincoln continued to seek further legal protection for emancipated slaves even after issuing the Emancipation Proclamation. He explained his reason for doing so with an anecdote: a lawyer had “tried to establish that a calf had five legs by calling the tail a leg. ‘But,’ said the President, ‘the decision of the judge was that *calling* the tail a leg, did not make it a leg, and the calf had but four legs after all.’ So, he reminded his guests, ‘proclaiming slaves free did not make them free.’” DAVID HERBERT DONALD, *LINCOLN* 396 (1995).

⁴ *See, e.g.*, President Theodore Roosevelt, First Annual Message to Congress, (Dec. 3, 1901), *available at* <http://www.presidency.ucsb.edu/ws/?pid=29542> (“There is a widespread conviction in the minds of the American people that the . . . trusts are in certain of their features and tendencies hurtful to the general welfare. . . . It is based upon sincere conviction that combination and concentration should be, not prohibited, but supervised and within reasonable limits controlled; and in my judgment this conviction is right.”).

⁵ *See, e.g.*, Joseph S. Nye Jr., *Toward a Liberal Realist Foreign Policy*, Harvard Magazine, Apr. 2008, *available at* <http://harvardmagazine.com/2008/03/toward-a-liberal-realist.html> (noting that

In current corporate law scholarship, there is a tendency among those who believe that corporations should be more socially responsible to avoid the more difficult and important task of advocating for externality regulation of corporations in a globalizing economy and encouraging institutional investors to exercise their power as stockholders responsibly. Instead, these advocates for corporate social responsibility pretend that directors do not have to make stockholder welfare the sole end of corporate governance within the limits of their legal discretion, under the law of the most important American jurisdiction – Delaware.⁷ I say stockholder welfare for a reason. To the extent that these

Franklin Roosevelt excelled at balancing ideals with capabilities and that his “*effective* visions combine[d] feasibility with the inspiration” (emphasis in original)).

⁶ Orwell “saw the class system as a system of oppression,” but nonetheless authored several unsparing critiques of communism and was a life-long advocate of democratic socialism. See Louis Menand, *Honest, Decent, Wrong: The Invention of George Orwell*, THE NEW YORKER, Jan. 27, 2013, available at <http://www.newyorker.com/magazine/2003/01/27/honest-decent-wrong> (observing that, “the works for which [Orwell] is most celebrated, ‘Animal Farm,’ ‘1984,’ and the essay ‘Politics and the English Language,’ were attacks on people who purported to share his political views”).

⁷ See, e.g., LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 30-31 (2012) (arguing that *Revlon* is the “exception that proves the rule” and “it is only when a public corporation is about to stop being a public corporation that directors lose the protection of the business judgment rule and must embrace shareholder wealth as their only goal”); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 308 (1999) (arguing that *Unocal* espouses the general rule in Delaware that directors are permitted to consider how a threat to the corporate entity would impact creditors, customers, employees, and even the general community); Christopher M. Bruner, *Corporate Governance in a Time of Crisis*, 36 J. CORP. L. 309, 325 (2011) (citing Delaware cases for the proposition that “U.S. boards generally . . . have explicit latitude to consider the interests of other stakeholders, such as employees and creditors, in deciding how to respond to a hostile bid.”); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 763–69 (2005) (arguing that corporate managers have the discretion to sacrifice corporate profits in favor of the public interest under Delaware law); Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 432 (2013) (arguing that Delaware law is unsettled on the question of whether corporations are required to advance the long-term interests of stockholders); Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163, 169-171 (2008) (arguing that the Michigan Supreme Court’s statement that “[a]

commentators argue that directors are generally empowered to manage the corporation in a way that is not dictated by what will best maximize the corporation's current stock price, they are correct.⁸ But their claim, as I understand it, is a more fundamental one: they contend that directors may subordinate what they believe is best for stockholder welfare to other interests, such as those of the company's workers or society generally. That is, they do not argue simply that directors may choose to forsake a higher short-term profit if they believe that course of action will best advance the interests of stockholders in the long run. Rather, these commentators argue that directors have no legal obligation to make – within the constraints of other positive law – the promotion of stockholder welfare their end.⁹

business corporation is organized and carried on primarily for the profit of the stockholders" is not a legal requirement under Delaware law nor is it normatively desirable); Darrell West, *The Purpose of the Corporation in Business and Law School Curricula*, Governance Studies at Brookings, July 19, 2011, available at http://www.brookings.edu/~media/research/files/papers/2011/7/19%20corporation%20west/0719_corporation_west.pdf (contending that "many courts, including those in Delaware where numerous corporations are based, have not ruled that maximizing shareholder value is the sole purpose of the corporation"); see also *Unpacking Corporate Purpose: A Report on the Beliefs of Executives, Investors and Scholars*, Aspen Institute Business & Society Program, May 2014, available at <http://www.aspeninstitute.org/sites/default/files/content/upload/Unpacking%20Corporate%20Purpose%20May%202014.pdf> (describing the results of interviews on the role of the corporation in society, revealing disparate points of view on the idea of shareholder primacy).

⁸ See *Paramount Communications, Inc. v. Time Incorporated*, TW, 571 A.2d 1140, 1150 (Del. 1989) ("[A]bsent a limited set of circumstances as defined under *Revlon*, a board of directors, while always required to act in an informed manner, is not under any *per se* duty to maximize shareholder value in the short term, even in the context of a takeover."); *Air Products and Chemicals, Inc. v. Airgas, Inc.*, 16 A.3d 48, 112 (Del. Ch. 2011) ("When a company is not in *Revlon* mode, a board of directors is not under any *per se* duty to maximize shareholder value in the short term. . . .") (internal quotation omitted).

⁹ *E.g.*, STOUT, *supra* note 2, at 32; Elhauge, *supra* note 2, at 738 (2005) ("Corporate managers have never had an enforceable legal duty to maximize corporate profits."); Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefit Corps.*, 25 REGENT U. L. REV. 269, 274 (2012-2013) ("[T]he positive law cited in support of a shareholder wealth maximization

According to these commentators, if only corporate directors recognized that the stockholders are just one of many ends they can legally pursue, the world would be a better place.¹⁰ Corporate directors, under this rosy view, may consider any or all of the following to be ends as important or even more important than the economic well-being

structure is remarkably thin and highly ambiguous.”); Mohsen Manesh, *Nearing 30, Is Revlon Showing Its Age?*, 71 WASH. & LEE L. REV. ONLINE 107, 197-99 (2014) (“In reality, beyond *Revlon*’s narrow scope – covering only ‘sale or change in control’ transactions – the business judgment rule affords corporate directors ample discretion to make decisions that serve the interests of non-shareholder stakeholders. If directors myopically focus on the interests of shareholders, then it is not because corporate law requires it, but because shareholders demand it.”); West, *supra* note 2, at 18 (“It appears that some law and business professors mistakenly are training future lawyers and corporate leaders that corporations have no authority to do good or benefit society other than its shareholders.”); Lynn Stout, *The Problem of Corporate Purpose*, BROOKINGS INSTITUTION, ISSUES IN GOVERNANCE STUDIES, at 4 (June 2012), available at http://www.brookings.edu/~media/research/files/papers/2012/6/18%20corporate%20stout/stout_corporate%20issues.pdf (“[The perception that directors of public companies are required to maximize shareholder wealth] lacks any solid basis in actual corporate law. The corporate code of Delaware, where the majority of Fortune 500 businesses are incorporated, states that corporations can be formed for any lawful purpose. Similarly, the typical public company charter broadly defines the company’s purpose as ‘anything lawful.’ . . . This leaves advocates of shareholder primacy in something of a bind. Where, exactly, can the supposed legal requirement that directors maximize shareholder value be found?”); M. Todd Henderson, *The Story of Dodge v. Ford Motor Company: Everything Old is New Again*, in CORPORATE LAW STORIES 37, 49 (J. Mark Ramseyer ed., 2009) (“[Shareholder wealth maximization] was not and is not the law.”).

¹⁰ E.g., Judd F. Sneirson, *The Sustainable Corporation and Shareholder Profits*, 46 WAKE FOREST L. REV. 541, 548 (2011) (“Why aren’t there more sustainable businesses and why are mainstream businesses seemingly unable to move beyond a profit focus and deepen their commitments to sustainability? The answer to both of these questions lies in the conventional view in law and business that corporations are to be managed for the sole purpose of maximizing shareholder profits.”); Steven Pearlstein, *How the Cult of Shareholder Value Wrecked American Business*, WASHINGTON POST, Sept. 9, 2013, available at http://www.washingtonpost.com/blogs/wonkblog/wp/2013/09/09/how-the-cult-of-shareholder-value-wrecked-american-business/?tid=pm_business_pop; Grace Wallack, *Steven Pearlstein on Charlie Rose: Our Mistaken Obsession with Maximizing Shareholder Value*, Brookings Blog, Feb 21, 2014, available at <http://www.brookings.edu/blogs/fixgov/posts/2014/02/21-pearlstein-charlie-rose-maximize-shareholder-value-wallack> (“Pearlstein argues that the dominance of the shareholder-value mentality blinds us to the variety of other things business can maximize—the quality of their products or services, customer satisfaction, providing good jobs, and creating long-term market value. Promoting these things in tandem creates thriving, sustainable businesses; and the role of a good CEO, Pearlstein suggests, is balancing them adequately to ensure the long term health of a business.”).

of the corporation's stockholders: the employees, the customers of the corporation, the environment, charitable causes, the communities within which the corporation operates, and society generally.

These well-meaning commentators, of course, ignore certain structural features of corporation law that folks like Madison and Hamilton would have thought important. For example, one of the most important flaws in 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 is that it ignores that the law generates focus on those persons subject to its authority in many ways. For corporate law in particular, that focus is important. Even if § 101(b) of the DGCL, which allows a corporation to pursue “any lawful purpose,” represented an expression of Delaware’s commitment to a constituency-based approach, the provision does not exist in a vacuum, and the contention that it proves directors are free to promote interests other than those of stockholders ignores the many ways in which the DGCL focuses corporate managers on stockholder welfare by allocating power only to a single constituency, the stockholders. Under the DGCL, only stockholders have the right to vote for directors;¹¹ approve certificate amendments;¹² amend the bylaws;¹³ approve certain other transactions such as mergers,¹⁴ certain asset sales and leases;¹⁵ and enforce the DGCL’s terms and to hold directors accountable for

¹¹ DEL. C. ANN. tit. viii, § 211(b) (2009).

¹² *Id.* § 242.

¹³ *Id.* § 109.

¹⁴ *Id.* § 251.

¹⁵ *Id.* § 271.

honoring their fiduciary duties.¹⁶ In the corporate republic, no constituency other than stockholders is given any power.

Slighting this rather important signal of what the end of corporate law is in Delaware, these commentators argue that the business judgment rule is cloaking a system of law giving directors the ability to act for any reason they deem appropriate. These commentators argue that cases with contrary holdings have simply been misinterpreted and misunderstood. For example, these scholars argue that one of the most important cases in Delaware law history, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,¹⁷ is really a marginally important decision, and that it has been misinterpreted.¹⁸ Indeed,

¹⁶ *Id.* § 327.

¹⁷ 506 A.2d 173, 182 (Del. 1986).

¹⁸ See, e.g., STOUT, *supra* note 2, at 30-31 (“[*Revlon* is] the exception that proves the rule . . . [and] it is only when a public corporation is about to stop being a public corporation that directors lose the protection of the business judgment rule and must embrace shareholder wealth as their only goal.”); Elhauge, *supra* note 2, at 849-50 (“To be sure, some of the *Revlon* language suggests that the Delaware Supreme Court thought that normally nonshareholder interests could be considered only when rationally related to shareholder interests, and was pointing out that such a rational relationship could no longer exist when shareholders were being cashed out. But this language apparently just reflects the incomplete waning of the prior incompletely theorized agreement, for . . . Delaware case law in fact does not make shareholder interests controlling and thus allows consideration of nonshareholder interests other than just when that happens to maximize shareholder value.”); Franklin Gevurtz, *Removing Revlon*, 70 WASH. & LEE L. REV. 1485, 1485 (2013) (“The narrow holding of [*Revlon*] stands for the common sense proposition that if directors decide to sell their corporation by choosing between two bids, both of which will pay all of the shareholders cash for all of their shares, the directors should pick the bid that pays the most cash. The problems arose when Delaware courts assumed that the case had something to say about situations in which the directors were not choosing between two all-cash all-shares bids.”); Lyman Johnson & Robert Ricca, *The Dwindling of Revlon*, 71 WASH. & LEE L. REV. 167 (2014) (arguing that corporate law has evolved so as to diminish the importance of *Revlon*).

But in the discussion of what directors must focus on as their central goal, within the limits of their legal discretion, *Revlon* is central, and clearly states a board can only consider the interests of other constituencies if “rationally related benefits accru[e] to the stockholders.” *Revlon*, 506 A.2d at 173. Professor Elhauge gives little weight to this key statement, and Professor Stout does not quote it in her influential book on this subject. See STOUT, *supra* note 2.

these commentators essentially argue that Delaware judges do not understand the very law they are applying, and the Delaware General Assembly does not understand the law it has created.¹⁹

It is not only hollow but also injurious to social welfare to declare that directors can and should do the right thing by promoting interests other than stockholder interests. This argument does not pressure those with the ability to make sure that other constituencies are protected to do so, such as by giving them rights to protect other interests. Instead, it alleviates this pressure. It is the “trust those in power” move of Merrick Dodd, not the “regulate and channel power” approach advanced by Adolf Berle and other New Dealers.²⁰

States that have adopted so-called constituency statutes, which allow directors to promote interests other than stockholder interests, have done little, if anything, to make corporations more socially responsible or more respectful of their workers’ or communities’ interests.²¹ That should not be surprising, because declaring that directors

¹⁹ See, e.g., Johnson & Ricca, *supra* note 13; Mohsen Manesh, *supra* note 4, at 144 (contending that Delaware’s benefit corporation statute emerged from a misunderstanding of the law: because *Revlon* does not require directors to “myopically focus on shareholder interests,” the statute is not necessary).

²⁰ In his debate with Adolf Berle, Dodd argued that society could trust corporate managers to exercise their power in a socially responsible way if public opinion so demanded. E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1153 (1932). Berle disagreed, cautioning that such an approach would allow managers to pursue their own self-interest if it was not backed by strong legal requirements to act in the public interest. See Berle, *supra* note 1.

²¹ See Jonathan D. Springer, *Corporate Constituency Statutes: Hollow Hopes and False Fears*, 1999 ANN. SURV. AM. L. 85, 123 (1999) (“Proponents of constituency statutes would better serve the interests they seek to advance by focusing on other measures. Constituency statutes arguably detract attention from more promising measures of change such as measures with potential to

may consider other interests without giving those interests voting or enforcement rights, or any real leverage to influence decision-making is more an exercise in feeling good than in doing good. In fact, it largely shifts power to the directors to couch their own actions in whatever guise they find convenient, without making them more accountable to any interest.

If we wish to make the corporation more socially responsible, we must do it the proper way. If we believe that other constituencies should be given more protection within corporation law itself, then statutes should be adopted giving those constituencies enforceable rights that they can wield. But a more effective and direct way to protect interests such as the environment, workers, and consumers would be to revive externality regulation. We must also address the incentives and duties of institutional investors – who act as the direct stockholders of most public companies – so that these investors behave in a manner more consistent with the longer-term investment horizon of the human beings whose capital they control.

But lecturing others to do the right thing without acknowledging the actual rules that apply to their behavior, and the actual power dynamics to which they are subject, is not a responsible path to social progress. Rather, it provides an excuse for avoiding the tougher policy challenges that must be overcome if we are to make sure that for-profit corporations become vehicles for responsible, sustainable, long-term wealth creation.

change not only whose interests may be legally considered, but who also makes corporate decisions.”); Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 463-64 (2006) (noting that because most constituency statutes are limited in scope, are permissive and do not require the board to give weight to outside interests, and do not give stockholders enforceable rights, “history has proven such statutes to be rather insignificant”).

II. A Clear-Eyed Look at Delaware Common Law

Despite attempts to muddy the doctrinal waters, a clear-eyed look at the law of corporations in Delaware reveals that, within the limits of their discretion, directors must make stockholder welfare their sole end, and that other interests may be taken into consideration only as a means of promoting stockholder welfare.

The Delaware Supreme Court first grappled explicitly with the question of the ends of corporate law in the case of *Unocal v. Mesa Petroleum Co.* In that case, the Supreme Court considered the notion that when a board of directors evaluated a takeover bid, the board could give weight to factors such as the impact on corporate constituencies other than stockholders as ends, and not just as instruments of stockholder welfare:

If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. *Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on “constituencies” other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of securities being offered in the exchange.* While not a controlling factor, it also seems to us that a board may reasonably consider the basic stockholder interests at stake, including those of short term speculators, whose actions may have fueled the coercive aspect of the offer at the expense of the long term investor.²²

By floating this possibility, the Delaware Supreme Court gave heart to advocates such as Marty Lipton who argued that corporate law left directors free to treat various constituencies as proper ends of corporate governance equal to or even more important

²² 493 A.2d 946, 955-56 (Del. 1985) (internal citation omitted) (emphasis added).

than stockholders.²³ Ultimately, what weight to give to any constituency as an end was, in Lipton's view, a matter of business judgment.

In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, the question of whether other constituencies could be considered as ends in themselves was squarely addressed.²⁴ In the takeover contest, the directors of Revlon had encouraged their stockholders to accept senior subordinated notes of \$47.50 principal at 11.75% interest in exchange for some of their stock, up to a maximum of 10 million Revlon shares.²⁵ Over 87% of the Revlon stockholders tendered and the full 10 million shares were exchanged for subordinate notes on a pro rata basis.²⁶ Revlon promised that the new debt securities would have certain guarantees of value that could only be waived by the independent directors.²⁷ A few weeks later, the Revlon directors made a deal with a "white knight" bidder, Theodore Forstmann, in part because Forstmann promised to provide price protection for the senior noteholders.²⁸ In responding to the argument that the Revlon directors had breached their fiduciary duties by preferring Forstmann's bid and not pursuing a bid from Ronald Perelman that was potentially more valuable to the equity holders, the Revlon directors argued that it was proper for them to consider the interests of the senior noteholders under the Supreme Court's recent ruling in *Unocal*. At public

²³ See, e.g., Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979); Martin Lipton & Andrew R. Brownstein, *Takeover Responses and Director Responsibilities: An Update*, A.B.A. NAT'L INST. ON THE DYNAMICS OF CORP. CONTROL 7 (Dec. 8, 1983) (unpublished).

²⁴ 506 A.2d 173 (Del. 1986).

²⁵ *Id.* at 177.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.* at 179.

sessions at both Harvard and Penn Law Schools, the lawyer who argued for the directors, A. Gilchrist Sparks, III, indicated that this argument was quickly dispensed with by the Justices at oral argument, when Justice Moore said in words or substance that *Unocal* did not mean that. When the written decision came down, his statement at argument became Delaware law:

[T]he Revlon board could not make the requisite showing of good faith by preferring the noteholders and ignoring its duty of loyalty to the shareholders. The rights of the former already were fixed by contract. The noteholders required no further protection, and when the Revlon board entered into an auction-ending lock-up agreement with Forstmann on the basis of impermissible considerations at the expense of the shareholders, the directors breached their primary duty of loyalty.²⁹

The Revlon board had argued that it acted in good faith in protecting the noteholders because *Unocal* permits consideration of other corporate constituencies. But the Supreme Court rejected this argument:

A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders. However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder. . . . [A]ny such duties [to consider the noteholders] are limited to the principle that one may not interfere with contractual relationships by improper actions. Here, the rights of the noteholders were fixed by agreement, and there is nothing of substance to suggest that any of those terms were violated. The Notes covenants specifically contemplated a waiver to permit sale of the company at a fair price. The Notes were accepted by the holders on that basis, including the risk of an adverse market effect stemming from a waiver. Thus, nothing remained for Revlon to legitimately protect, and no rationally related benefit thereby accrued to the stockholders. Under such circumstances we must conclude that the

²⁹ *Revlon*, 506 A.2d at 182 (internal citation omitted).

merger agreement with Forstmann was unreasonable in relation to the threat posed.³⁰

Thus, the Court gave the back of its hand to the argument that the senior noteholders – who received their notes just weeks before as part of the takeover defense itself and who likely remained Revlon noteholders – deserved any protection, even though part of their contractual protections was that the price support covenants could only be waived by the independent directors. If ever there were a sympathetic constituency, it would seem to be the Revlon noteholders, but the Supreme Court emphatically held that once the Revlon board decided to sell the company, the only end within the limits of its legal discretion was getting the highest price for the equity holders *qua* equity holders.

Lest it be thought that this holding was incidental and not central to the Supreme Court’s reasoning, the beginning of the decision bears quoting. In that introduction, the court made clear that it was “address[ing] for the first time the extent to which a corporation may consider the impact of a threat on constituencies other than shareholders.”³¹ The Court then gave its answer: “[W]hile concern for various constituencies is proper when addressing a takeover threat, that principle is limited by the requirement that there be some rationally related benefits accruing to the stockholders.”³²

The understanding in Delaware is that *Revlon* could not have been more clear that directors of a for-profit corporation must at all times pursue the best interests of the

³⁰ *Id.* at 182-83 (emphasis added).

³¹ *Id.* at 176.

³² *Id.*

corporation's stockholders, and that it highlighted the instrumental nature of other constituencies and interests. Non-stockholder constituencies and interests can be considered, but only instrumentally, in other words, when giving consideration to them can be justified as benefiting the stockholders. In fact, after the *Revlon* decision was issued, there was vocal criticism of the Delaware Supreme Court for its ruling,³³ and a movement for the adoption of constituency statutes accelerated.³⁴ These statutes, which were eventually adopted by a majority of U.S. states,³⁵ gave directors the discretion to consider interests other than stockholder welfare in responding to a takeover. But Delaware did not adopt a statute of this kind.

Shortly after *Revlon* was issued, the finest corporate law judge of his era – and arguably the finest overall trial judge of his era – Chancellor William T. Allen, had a chance to reflect on *Revlon* in the important, but often overlooked, case of *TW Services*,

³³ William Meyers, *Showdown in Delaware: The Battle to Shape Takeover Law*, INSTITUTIONAL INVESTOR, Feb. 1989, at 64; see also Martin Lipton, *Pills, Polls, and Professors: A Reply to Professor Gilson*, 27 J. CORP. L. 1, 16 n.36 (2002).

³⁴ See, e.g., Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 993-94 (1992) (explaining that Indiana's constituency statute was "obviously drafted in response to a pair of Seventh Circuit decisions" agreeing with *Revlon*).

³⁵ See Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 DEL. J. CORP. L. 649, 702 (2004) ("Today, twenty-nine states have statutes that permit, or in one instance requires, the directors and officers of corporations chartered within their states to consider the interests of the standard other constituencies beyond the corporations' shareholders, at least in certain situations (particularly in connection with a change of control). Delaware never adopted a constituency statute of this type."); John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425, 1540-45 (1991) (appendices summarizing constituency statutes in twenty-nine states).

*Inc. v. SWT Acquisition Corp.*³⁶ His distillation of its meaning deserves extended quotation:

I take it as non-controversial that, under established and conventional conceptions, directors owe duties of loyalty to the corporation and to the shareholders; that this conjunctive expression is not usually problematic because the interests of the shareholders as a class are seen as congruent with those of the corporation in the long run; that directors, in managing the business and affairs of the corporation, may find it prudent (and are authorized) to make decisions that are expected to promote corporate (and shareholder) long run interests, even if short run share value can be expected to be negatively affected, and thus directors in pursuit of long run corporate (and shareholder) value may be sensitive to the claims of other “corporate constituencies.” Thus, broadly, directors may be said to owe a duty to shareholders as a class to manage the corporation within the law, with due care and in a way intended to maximize the long run interests of shareholders.

There is a time, however, when the board’s duty becomes more targeted and specific and its range of options becomes narrower. In *Revlon* . . . , the board of directors had decided in the exercise of its judgment to engage in a sale transaction that might terminate the interest of all of the existing holders of stock. In that circumstance, the Supreme Court held that the board’s duty was the single one: to exercise its judgment in an effort to secure the highest price available. . . .

In the setting of a sale of a company for cash, the board’s duty to shareholders is inconsistent with acts not designed to maximize present share value, acts which in other circumstances might be accounted for or justified by reference to the long run interest of shareholders. In such a setting, for the present shareholders, there is no long run. For them it does not matter that a buyer who will pay more cash plans to subject the corporation to a risky level of debt, or that a buyer who offers less cash will be a more generous employer for whom labor peace is more likely. The rationale for recognizing that non-contractual claims of other corporate constituencies are cognizable by boards, or the rationale that recognizes the appropriateness of sacrificing achievable share value today in the hope of greater long term value, is not present when all of the current shareholders will be removed from the field by the contemplated transaction.³⁷

³⁶ 14 DEL. J. CORP. L. 1169 (Del. Ch. 1989).

³⁷ *Id.* at 1183-84 (internal citations omitted).

Throughout the rest of his judicial career, Chancellor Allen adhered to that view of Delaware law,³⁸ which can be summarized in this way: when the corporation is not engaging in a sale of control transaction, the directors have wide leeway to pursue the best interests of stockholders as they perceive them, and need not put any specific weight on maximizing current share value. As a means to the end of increasing stockholder welfare, directors may consider the interests of other constituencies, such as the corporation's employees, but only as a means, and not an end.

When *Revlon* duties are invoked, however, there is no long run over which non-required investments in other constituencies may generate benefits for stockholders, and the sole focus must be on getting the highest sale price. In other words, the sale context's exception in terms of the focus on immediate shareholder value proves the rule that the singular end in all periods is stockholder welfare.

In non-judicial writings, Chancellor Allen confirmed the understanding he articulated in *TW Services*. In a wonderful essay that all corporate law students should read, Chancellor Allen dilated on the two major traditions in American corporate law. In

³⁸ For example, in his decision in *Paramount Communications Inc. v. Time Inc.*, 15 DEL. J. CORP. L. 700 (Del. Ch. July 14, 1989), Chancellor Allen recognized that there was a possibility that the directors were taking action that was not going to turn out to be economically beneficial to the stockholders. His decision not to enjoin their action, however, was explicitly premised on his conclusion that he could not find that they were intentionally doing so, and rather that they were acting in a manner that they believed would generate returns for the Time stockholders in the long run that justified preventing them from receiving the premium on the offer from Paramount. *Id.* at 715-16 ("Thus, while the record suggests that the 'Time culture' importantly includes directors' concerns for the larger role of the enterprise in society, there is insufficient basis to suppose at this juncture that such concerns have caused the directors to sacrifice or ignore their duty to seek to maximize in the long run financial returns to the corporation and its stockholders.").

that essay, Chancellor Allen gave his own reading of *Dodge v. Ford*, where the Michigan Supreme Court observed that “a business corporation is organized and carried on primarily for the profit of the shareholders. The powers of the directors are to be employed for that end.”³⁹ He explained:

Dodge v. Ford . . . reflects as pure an example as exists of the property conception of the corporation. In this conception, the corporation is seen as it is in its nineteenth century roots, as essentially a sort of limited liability partnership. The rights of creditors, employees and others are strictly limited to statutory, contractual, and common law rights. Once the directors have satisfied those legal obligations, they have fully satisfied all claims of these “constituencies.” This property view of the nature of corporations, and of the duties owed by directors, equates the duty of directors with the duty to maximize profits of the firm for the benefit of shareholders.⁴⁰

In another article reflecting on his judicial career, Chancellor Allen indicated that he understood Delaware law as requiring directors, when they are not subject to the duty to maximize current stock value as in *Revlon*, to maximize the value for (hypothetical) stockholders who have entrusted their capital to the firm indefinitely.⁴¹

Chancellor Allen was not alone in interpreting *Revlon* as a larger statement about Delaware law. Notably, Chancellor Allen’s distinguished successor, William B.

Chandler III, dealt with a case redolent of *Dodge v. Ford*, in that a founder who controlled a corporation confessed that he was taking action to advance an end that was

³⁹ *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919).

⁴⁰ William T. Allen, *Corporate Takeovers and Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 268 (1992).

⁴¹ See William T. Allen, *Ambiguity in Corporation Law*, 22 DEL. J. CORP. L. 894, 896 (1997) (“[M]uch of the utility of the publicly traded corporate forum derives from the fact that shareholders will be passive and management [is] only loosely constrained in their exercise of discretionary judgment. Therefore, it can be seen that the proper orientation of corporate law is the protection of long-term value of capital committed indefinitely to the firm.”) (emphasis omitted).

not that of stockholder welfare. *eBay Domestic Holdings, Inc. v. Newmark*⁴² is an odd case. But the part that is relevant for present purposes is relatively simple. Craig Newmark, the founder of craigslist, the online classifieds firm, said that he was not focused on “monetizing” its site because that was best for the stockholders in the long run.⁴³ Rather, he contended that he was more concerned with the community of consumers of craigslist’s services than with stockholder welfare.⁴⁴ Because Newmark admitted that he was favoring the interests of another constituency over the stockholders – and not considering that constituency as an instrument to the ultimate end of stockholder welfare – Chancellor Chandler held that Newmark and James Buckmaster, who together owned a majority of craigslist’s shares and dominated the craigslist board, had breached their fiduciary duties.⁴⁵ In so finding, Chancellor Chandler stated:

Jim and Craig did prove that they personally believe craigslist should not be about the business of stockholder wealth maximization, now or in the future. As an abstract matter, there is nothing inappropriate about an organization seeking to aid local, national, and global communities by providing a website for online classifieds that is largely devoid of monetized elements. Indeed, I personally appreciate and admire Jim’s and Craig’s desire to be of service to communities. The corporate form in which craigslist operates, however, is not an appropriate vehicle for purely philanthropic ends, at least not when there are other stockholders interested in realizing a return on their investment. Jim and Craig opted to form craigslist, Inc. as a *for-profit Delaware corporation* and voluntarily accepted millions of dollars from eBay as part of a transaction whereby eBay became a stockholder. Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that

⁴² 16 A.3d 1 (Del. Ch. 2010).

⁴³ *Id.* at 8.

⁴⁴ *Id.*

⁴⁵ *Id.* at 35 (“Directors of a for-profit Delaware corporation cannot deploy a rights plan to defend a business strategy that openly eschews stockholder wealth maximization – at least not consistently with the directors’ fiduciary duties under Delaware law.”).

accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders. The “Inc.” after the company name has to mean at least that. Thus, I cannot accept as valid for the purposes of implementing the Rights Plan a corporate policy that specifically, clearly, and admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders – no matter whether those stockholders are individuals of modest means or a corporate titan of online commerce.⁴⁶

As with Chancellor Allen’s reading of *Dodge v. Ford*, scholars have taken issue with Chancellor Chandler’s holding, indicating that he did not need to rule for the reasons he said he did, or did not in fact premise his ruling on the reasons he stated.⁴⁷ I understand that there are forms of legal thought tied to deconstructionist linguistics and philosophy, such as critical legal studies, and that are premised on the idea that authors themselves can never understand what they intend to say or are in fact saying.⁴⁸ For

⁴⁶ *Id.* at 34 (emphasis in original).

⁴⁷ See, e.g., Johnson, *supra* note 2, at 441-44; note 4, at 274-75 (“In Delaware, the 2010 *eBay* decision is touted by some . . . as mandating shareholder primacy. Yet, the opinion cited no authority for its assertions on that point and, as in *Dodge*, did nothing to alter craigslist’s business focus strategy. In addition, it is remarkable that, lacking any statutory predicate for doing so, a public judge would order a business to pursue (or not pursue) a corporate strategy that was thoughtfully established by the company’s own lawfully constituted governance body. Outside Delaware, moreover, over half of the states have expressly permitted consideration of non-shareholder constituencies in a way that blunts judicially prescribed shareholder primacy.”); David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L. J. 181, 194 (2013) (“Remarkably, Chandler did not cite a single case, statute, or piece of scholarship to support his conclusion. As with the *Dodge* court in Michigan, the proposition seemed so obvious and fundamental to Chandler that it needed no citation. Those who prefer to have one now have *eBay*.”); Maxwell S. Kennerly, *eBay v. Newmark: Al Franken Was Right, Corporations Are Legally Required to Maximize Profits*, LITIG. & TRIAL (Sept. 13, 2010), available at: <http://www.litigationandtrial.com/2010/09/articles/series/special-comment/ebay-v-newmark-al-franken-was-right-corporations-are-legally-required-to-maximize-profits/>.

⁴⁸ Deconstructionism is “a theory used in the study of literature or philosophy which says that a piece of writing does not have just one meaning and that the meaning depends on the reader.” Merriam-Webster Dictionary, 2014, available at <http://www.merriam-webster.com/dictionary/deconstruction>. See also 4 Oxford English Dictionary 346 (2d ed. 1989) (defining deconstructionism as “[a] strategy of critical analysis associated with the French philosopher Jacques Derrida (b. 1930), directed towards exposing unquestioned metaphysical

those of us who are more traditional, we tend to credit accomplished jurists such as Chancellor Chandler, Chancellor Allen, and Justice Moore with understanding most of what they write, especially when it is in a high-profile context and when they underscore their understanding of the importance of the subject matter they are addressing.

Of course, it is true that the business judgment rule provides directors with wide discretion, and that it enables directors to justify by reference to long run stockholder interests a number of decisions that may in fact be motivated more by a concern for a charity the CEO cares about, or the community in which the corporate headquarters is located, or once in a while, even the company's ordinary workers, than long run stockholder wealth. But that does not alter the reality of what the law is. *Dodge v. Ford* and *eBay* are hornbook law because they make clear that if a fiduciary admits that he is treating an interest other than stockholder wealth as an end in itself, rather than an instrument to stockholder wealth, he is committing a breach of fiduciary duty. And these confession cases illustrate the very foundation for the business judgment rule itself.

assumptions and internal contradictions in philosophical and literary language.”); J. M. Balkin, *Deconstructive Practice and Legal Theory*, 96 YALE L. J. 743, 774 (1987) (“When one attempts to formulate the distinction between reading and misreading, one inevitably relies on some notion of identity and difference. Reading and understanding preserve or reproduce a content or meaning, maintain its identity, while misunderstanding and misreading distort it; they produce or introduce a difference. But one can argue that in fact the transformation or modification of meaning that characterizes misunderstanding is also at work in what we call understanding. If a text can be understood, it can in principle be understood repeatedly, by different readers in different circumstances. These acts of reading or understanding are not, of course, identical. They involve modifications and differences, but differences which are deemed not to matter. We can thus say, in a formulation more valid than its converse, that understanding is a special case of misunderstanding, a particular deviation or determination of misunderstanding.”).

*Air Products and Chemicals, Inc. v. Airgas, Inc.*⁴⁹ is also notable, but not for the reasons given by those who argue that Delaware corporate law is not focused on stockholder welfare.⁵⁰ In that case, the Court of Chancery refused to require the board of Airgas to redeem a poison pill in the face of a premium bid by Air Products. In holding that the Airgas board had satisfied its duties under *Unocal*, Chancellor Chandler never focused on any other question than whether the Airgas board had a reasonable basis to conclude that remaining independent would be better for Airgas stockholders as stockholders than accepting Air Products' offer.⁵¹ In determining that the Airgas board acted reasonably, Chancellor Chandler also gave weight to the fact that the new directors elected at the insistence of Air Products, the hostile bidder, came to the conclusion, with

⁴⁹ 16 A.3d 48 (Del. Ch. 2011).

⁵⁰ For example, Lynn Stout uses *Airgas* to demonstrate that directors have substantial leeway when deciding what is in the long run interest of the corporation. She highlights that the Court of Chancery supported the Airgas board's decision to reject Air Products' offer because the board "is not under any per se duty to maximize shareholder value in the short term." Stout, *supra* note 4, at 5 (quoting *id.* at 98). She then concludes: "As Airgas and many other cases show, disinterested and informed directors are free to reduce profits and share price today when they claim to believe this will help the corporation in 'the long run.' They are also free to decide what is in the corporation's 'long run' interests." *Id.* But stating that directors are able to focus on a long-term horizon does not establish that directors may put other interests above the interests of the stockholders. Promoting long term corporate profitability is aligned with an outlook that is focused on maximizing shareholder welfare. In fact, the stock price of Airgas proved that its board cared about shareholder welfare in the long run, as the company's stock price soared well above Air Products' bid of \$70 per share within a year of the bid's rejection. See *Nasdaq Airgas, Inc. Historical Stock Prices*, NASDAQ, available at <http://www.nasdaq.com/symbol/arg/historical> (showing that Airgas's stock price was trading above \$70 by July 2011, and it closed at \$79.56 on December 22, 2011, exactly one year after the Airgas board rejected Air Products' bid). By the middle of 2012, Airgas' stock hit \$90 per share and continued on an upward trajectory thereafter. *Id.*

⁵¹ 16 A.3d at 58.

advice from their own handpicked advisors, that Air Products' bid was materially below Airgas' lay-firm value.⁵²

Scholars sometimes confuse the means that Delaware employs in corporate law – a republican model of corporate democracy giving the board strong power to pursue its own vision of what is best for stockholders⁵³ – with the debate about the ends of corporate law.⁵⁴ The length at which Chancellor Chandler's decision focused on whether the Airgas board had a reasonable basis to conclude that the corporation's standalone value would generate returns over time for stockholders that would justify rejecting the premium on the table again demonstrates that he considered the board's sole end to be stockholder welfare. There is not a hint or suggestion in the case that the directors should consider other constituencies. Instead, Chancellor Chandler put the Airgas board under the more intensive microscope of heightened *Unocal* review to ensure that the board was

⁵² *Id.* at 56.

⁵³ See, e.g., Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 557-59 (2003) (arguing that stockholders' best interests are served by empowering a strong central authority – the board of directors – to make business decisions and not interfering with its unconflicted judgments).

⁵⁴ See, e.g., Blair & Stout, *supra* note 2 (describing a model in which the primary function of the board is resolving disputes among other corporate constituencies). Professor Bainbridge has noted the problems with this concept:

If directors suddenly began behaving as mediating hierarchs rather than shareholder wealth maximizers, an adaptive response would be called forth. Consistent with the predictions above, shareholders would adjust their relationships with the firm. In particular, shareholders would demand a higher return as compensation for the increase in risk to the value of their residual claim resulting from director freedom to make tradeoffs between shareholder wealth and nonshareholder constituency interests. Ironically, this adaptation would raise the cost of capital and thus injure the interests of all corporate constituents whose claims vary in value with the fortunes of the firm.

Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 600 (2003).

employing a reasonable method of advancing the best interests of the stockholders, in accordance with the core values inherent in the business judgment rule.⁵⁵

That rule is, of course, named in a way that reveals what it is about: business. The business judgment rule is premised on the notion that when directors have interests aligned with those of the stockholders, their good faith business judgment should be respected.⁵⁶ The premise, however, depends on the directors not having a contrary self-interest that gives them some motive not to pursue the course of action that is best for stockholders.⁵⁷ When a fiduciary confesses that he in fact harbors the personal motive to put another interest, of whatever kind, ahead of the stockholders, the foundational premise of the business judgment rule is absent.⁵⁸

Revlon did not invent the notion that consideration of other constituencies had to be tied to the end of advancing stockholder welfare. That was a venerable principle of our corporate law long before the Supreme Court issued its decision. Take DGCL § 122

⁵⁵ 16 A.3d at 48.

⁵⁶ See *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (“First, its protections can only be claimed by disinterested directors whose conduct otherwise meets the tests of business judgment. From the standpoint of interest, this means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally.”).

⁵⁷ See *id.*; see also Bainbridge, *supra* note 41 at 604 (2003) (“The business judgment rule, however, has no application where the board of directors is disabled by conflicted interests.”).

⁵⁸ As Chancellor Allen explained, directors have many reasons to deviate from loyalty: “Greed is not the only human emotion that can pull one from the path of propriety; so might hatred, lust, envy, revenge, or, as is here alleged, shame or pride. Indeed any human emotion may cause a director to place his own interests, preferences or appetites before the welfare of the corporation.” *In re RJR Nabisco, Inc. Shareholders Litigation*, 1989 WL 7036, *15 (Del. Ch. Jan. 31, 1989). Whatever the reason, the protections of the business judgment are unavailable “to a fiduciary who could be shown to have caused a transaction to be effectuated (even one in which he had no financial interest) for a reason unrelated to a pursuit of the corporation’s best interests.” *Id.*

as an example, which allows corporations to “[m]ake donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof.” Although commentators point to § 122 as evidence that directors may subordinate stockholder welfare to other interests,⁵⁹ the reality is that caselaw interpreting the statute further proves the rule: when approving contested charitable gifts, Delaware courts have emphasized that the stockholders would ultimately benefit from the gift in the long run.⁶⁰ Moreover, Delaware courts have clarified that only “reasonable” gifts would be deemed consistent with the directors’ fiduciary duties.⁶¹

⁵⁹ See, e.g., Elhauge, *supra* note 2, at 767-68 (contending that Delaware’s statute authorizing boards to directors to make charitable donations suggests a power to sacrifice profits when doing so is in the public interest); Robert J. Rhee, *Fiduciary Exemption for Public Necessity: Shareholder Profit, Public Good, and the Hobson’s Choice During a National Crisis*, 17 GEO. MASON L. REV. 661 (2010) (using § 122 to argue that it is legally permissible for boards to promote the welfare of other constituencies during a national emergency).

⁶⁰ Kahn v. Sullivan, 594 A.2d 48 (Del. 1991) (approving the Court of Chancery’s determination that a settlement which included a charitable donation was fair to the corporation’s stockholders: “[T]he Court of Chancery found that Occidental would, in fact, receive an economic benefit in the form of good will from the charitable donation to the Museum proposal. It also found that Occidental would derive an economic benefit from being able to utilize the Museum, adjacent to its corporate headquarters, in the promotion of its business.”); Theodora Holding Corp. v. Henderson, 257 A.2d 398, 405 (Del. Ch. 1969) (“It is accordingly obvious, in my opinion, that the relatively small loss of immediate income otherwise payable to plaintiff and the corporate defendant’s other stockholders, had it not been for the gift in question, is far out-weighted by the overall benefits flowing from the placing of such gift in channels where it serves to benefit those in need of philanthropic or educational support, thus providing justification for large private holdings, thereby benefiting plaintiff [as a stockholder] in the long run.”); see also Allen, *supra* note 23, at 272-73 (1992) (“Corporate expenditures which at first blush did not seem to be profit maximizing, could be squared with the property conception of the corporation by recognizing that they might redound to the long-term benefit of the corporation and its shareholders. Thus, without purporting to abandon the idea that directors ultimately owe loyalty only to stockholders and their financial interests, the law was able to approve reasonable corporate expenditures for charitable or social welfare purposes or other actions that did not maximize current profit.”); Melvin Aron Eisenberg, *Corporate Conduct that Does Not Maximize Shareholder Gain: Legal Conduct, Ethical Conduct, the Penumbra Effect, Reciprocity, the Prisoner’s Dilemma, Sheep’s Clothing, Social Conduct, and Disclosure*, 28 STETSON L. REV. 1, 14-15 (1998) (explaining that sometimes business decisions that appear to be profit-nonmaximizing, such as charitable

The reality is that Delaware case law is replete with an understanding of our law identical to that of Chancellor Chandler, Chancellor Allen, and Justice Moore.⁶²

Furthermore, when other states moved to adopt express constituency statutes that allowed their boards of directors to consider the interests of other constituencies on an equal

donations, can in fact be justified on a “straight maximizing basis” and in fact a corporation can often earn greater profits by appearing to be philanthropic than by appearing to maximize profits); Ian B. Lee, *Efficiency and Ethics in the Debate About Shareholder Primacy*, 31 DEL. J. CORP. L. 533, 555-56 (2006) (“Similarly, few would disagree . . . with the claim that eliminating . . . discretion [to make profit-sacrificing decisions] would be counterproductive even from the standpoint of shareholder profit-maximization.”).

⁶¹ *Theodora*, 257 A.2d at 405 (“I conclude that the test to be applied in passing on the validity of a gift such as the one here in issue is that of reasonableness, a test in which the provisions of the Internal Revenue Code pertaining to charitable gifts by corporations furnish a helpful guide.”).

⁶² See, e.g., *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007) (“The directors of Delaware corporations have ‘the legal responsibility to manage the business of a corporation for the benefit of its shareholder[] owners.’”) (quoting *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998)); *In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 40-41 (Del. Ch. 2013) (“[T]he standard of conduct for directors requires that they strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm’s value, not for the benefit of its contractual claimants.”); *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 750 (Del. Ch. 2005) (internal citations and quotations omitted) (“In the duty of care context with respect to corporate fiduciaries, gross negligence has been defined as a reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason.”); *In re J.P. Stevens & Co., Inc. S’holders Litig.*, 542 A.2d 770, 783 (Del. Ch. 1988) (“In these circumstances, reasonable directors, exercising honest, informed judgment, might differ as to what course of action would most likely maximize shareholder interests. . . . Certainly, the decision to accede to the topping fee in these circumstances does not fall so far afield of the expected range of responses to warrant an inference that the Special Committee must have been motivated by a concern other than maximizing the value of shareholders’ interests.”); *In re Fort Howard Corp. S’holders Litig.*, 14 DEL. J. CORP. L. 699, 722 (Del. Ch. 1988) (“*Revlon* explicitly recognized that a disinterested board acting in good faith and in an informed manner may enter into lock-up agreements if the effect was to promote, not impede, shareholder interests.”); *Katz v. Oak Indus. Inc.*, 508 A.2d 873, 879 (Del. Ch. 1986) (“It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation’s stockholders. . . .”).

footing with stockholders, Delaware did not join them,⁶³ and its statutory power structure is intensely focused on stockholders.

III. The Most Important Determinant of For-Profit Corporate Governance in Delaware: The Power Structure Established by the DGCL

There is a well-intentioned movement among those who believe that it is vital that for-profit corporations be managed in a more responsible, sustainable manner, not only to create the most durable long-term wealth, but to avoid causing great harm by irresponsible practices.⁶⁴ Those in this movement bemoan what they see as a wrong-headed belief that the for-profit corporation in the U.S. must be managed within the bounds of the law for the sole end of improving stockholder welfare.⁶⁵ They say nay, and contend that stockholders are simply one constituency among many and that the directors are free to give other interests – such as the workers, consumers, the environment, and society as a whole – equal or even greater priority.⁶⁶ In so doing, these commentators pretend that corporate directors do not, under corporate law of the most important American jurisdiction – Delaware – have to make stockholder welfare the sole end of corporate governance within the limits of their legal discretion.⁶⁷ They point to Delaware’s corporate purpose statute,⁶⁸ which states that a corporation may conduct “any

⁶³ See Licht, *supra* note 23, at 702.

⁶⁴ See *supra* note 2.

⁶⁵ See *supra* note 2.

⁶⁶ See *supra* note 2.

⁶⁷ See *supra* note 2.

⁶⁸ Under § 101(b) of the DGCL: “A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes, except as may otherwise be provided by the Constitution or other law of this State.” Further, under § 102(a), the certificate of incorporation shall set forth: “(3) The nature of the business or purposes to be conducted or promoted. It shall be sufficient to state, either alone or with other businesses or purposes, that

lawful business or purpose.”⁶⁹ They claim that *Revlon* and its progeny are anomalies,⁷⁰ and that a shareholder-welfare maximization norm only applies when a corporation is for sale.⁷¹ They argue that the business judgment rule is cloaking a system of law that is focused on giving directors the ability to act for any reason they deem appropriate.⁷² But,

the purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the [DGCL] and by such statement all lawful acts and activities shall be within the purposes of the corporation, except for express limitations, if any.”

⁶⁹ See, e.g., Johnson, *supra* note 4, at 273-74.

⁷⁰ See, e.g., STOUT, *supra* note 2 (arguing that *Revlon* is the “exception that proves the rule” and “it is only when a public corporation is about to stop being a public corporation that directors lose the protection of the business judgment rule and must embrace shareholder wealth as their only goal”); Elhauge, *supra* note 2, at 849-50.

⁷¹ See Sneider, *supra* note 5, at 1007. But see *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 35 (Del. Ch. 2010) (ruling outside of the *Revlon* context that “[d]irectors of a for-profit Delaware corporation cannot deploy a rights plan to defend a business strategy that openly eschews stockholder wealth maximization—at least not consistently with the directors’ fiduciary duties”); Johnson & Ricca, *supra* note 13, at 219 (“[T]he immediate share price maximization norm may not be so easily cabined within the sale of company context.”).

⁷² See, e.g., Stout, *supra* note 2, at 5 (“[T]hanks to a vital legal doctrine known as the business judgment rule, directors of public companies enjoy virtually unfettered legal discretion to determine the corporation’s goals.”); Elhauge, *supra* note 2, at 770-72 (arguing that even if directors are nominally required to pursue profit maximization, the business judgment rule affords directors such wide and substantial deference that they can exercise their discretion to sacrifice corporate profits in the public interest, because some relationship between the public interest and long run profitability can almost always be conceived); Jonathan Macey, *Sublime Myths: An Essay in Honor of the Shareholder Value Myth and the Tooth Fairy*, 91 TEX. L. REV. 911, 920 (2013) (“[T]he business judgment rule eviscerates large swathes of the notion of shareholder value maximization. The business judgment rule, which protects most business decisions from judicial second-guessing, means that top executives and directors are free to do virtually anything they want with and to shareholders’ money and never have to say they are sorry to shareholders, courts, workers, or anybody else.”).

Interestingly, a distinguished scholar who believes that directors must make stockholder welfare their end, within their legal discretion, also argues that the business judgment rule gives directors cover to put other interests first. E.g., Steven Bainbridge, *Case Law on the Fiduciary Duty of Directors to Maximize the Wealth of Corporate Shareholders*, May 5, 2012, <http://www.professorbainbridge.com/professorbainbridgecom/2012/05/case-law-on-the-fiduciary-duty-of-directors-to-maximize-the-wealth-of-corporate-shareholders.html> (“In most jurisdictions, courts will exhort directors to use their best efforts to maximize shareholder wealth. In a few, courts may exhort directors to consider the corporation’s social responsibility. In either case, however, the announced principle is no more than an exhortation. The court may hold forth on the primacy of shareholder interests, or may hold forth on the importance of socially

the problem with that argument is that it does not happen to be true;⁷³ it is inconsistent with judge-made common law of corporations in Delaware, as I have described.⁷⁴ It may well be the case that a certificate of incorporation that said that a for-profit corporation would put other constituencies' interests on par with stockholders would, in view of § 101(b), be respected and supersede the corporate common law. But, in the case of silence, the idea that directors can subordinate stockholder interests to other interests of the directors' choosing is strained and at odds with the structure of our overall statute.

As to the corporations whose behavior is most important to society in this debate – for-profit corporations – the bare citation to § 102(a) exposes the market reality, which is that large corporations have not used this as a method to put specific non-stockholder

responsible conduct, but ultimately it does not matter. Under either approach, directors who consider nonshareholder interests in making corporate decisions, like directors who do not, will be insulated from liability by the business judgment rule.”); Steven Bainbridge, *The Relationship Between the Shareholder Wealth Maximization Norm and the Business Judgment Rule*, May 5, 2012, <http://www.professorbainbridge.com/professorbainbridge.com/2012/05/the-relationship-between-the-shareholder-wealth-maximization-norm-and-the-business-judgment-rule.html> (“Despite the powerful rhetoric of cases like *Dodge*, of course, current law in fact allows boards of directors substantial discretion to consider the impact of their decisions on interests other than shareholder wealth maximization. This discretion, however, exists not as the outcome of conscious social policy but rather as an unintended consequence of the business judgment rule.”). My point, however, is not whether the law permits directors to engage in pretext, it is what the law allows them to do expressly and forthrightly. Furthermore, although Professor Bainbridge has a very different social perspective than scholars like Professor Stout, they both bemoan the increasing influence of stockholders over boards and the corresponding constraints that have been placed on boards to exercise discretionary authority. See STOUT, *supra* note 2, at 63-73; Lynn A. Stout, *Why Carl Icahn Is Bad for Investors*, WALL ST. J., Aug. 1, 2008, at A11; Stephen Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2005-2006).

⁷³ See, e.g., Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) (“There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value.”).

⁷⁴ See *supra* pages 9-24.

related purposes in their corporate certificates.⁷⁵ That is, one does not find many, if any, public companies that say that they exist to pursue any lawful business for the purpose of protecting the environment, curing disease, or alleviating hunger.⁷⁶ And historically, states, including Delaware, adopted statutes permitting corporate charters to simply state that the corporation was authorized to pursue “any lawful business or purposes” for a reason entirely unrelated to permitting for-profit corporations to put the interests of non-stockholder constituencies first. Rather, this statutory change was made in the 1967 to give corporate managers the authority to move freely into new business lines and out of old ones without the inhibiting effect of old style charters and their complement, the *ultra vires* doctrine.⁷⁷

⁷⁵ Although Professor Stout observes that § 102(a) allows corporations to be formed for any lawful purpose, she does not identify any large public corporations that have specifically put non-stockholder related purposes in their corporate certificates. See Stout, *supra* note 4. Instead, the vast majority of public corporations in Delaware specify that they generally intend to pursue “any lawful act.” See Yosifon, *supra* note 35, at 185.

⁷⁶ See Yosifon, *supra* note 35, at 185 (noting that most corporations use the “any lawful act” language in the purpose section of their articles of incorporation).

⁷⁷ These twin purposes were accomplished by two amendments to the DGCL introduced in 1967: DEL. C. ANN. tit. viii, § 102(a), which permits a corporation to incorporate for “any lawful purpose,” and DEL. C. ANN. tit. viii, § 124, which abolished the *ultra vires* doctrine. See Ernest L. Folk, III, THE DELAWARE GENERAL COMMON LAW, A COMMENTARY AND ANALYSIS, § 102.4; S. Samuel Arsht, *A History of Delaware Corporation Law*, 1 DEL. J. CORP. L. 1, 16 n.97 (1976). The purpose of these amendments was to allow Delaware corporations the flexibility to move into different business lines than those that they had originally specified in their charter. See ROBERT CHARLES CLARK, CORPORATE LAW § 1.2.3 (1986) (“In contrast to the situation under early incorporation statutes, most state statutes now allow a corporation’s [charter] to state its purpose as being to engage in any lawful business, without committing itself to any particular lines of activity.”); 1A FLETCHER CYC. CORP. § 102 (2014) (“Under older statutes that enumerated a large number of special purposes for which corporations could be formed and also provided that a corporation could be formed ‘for any other purpose intended for mutual or pecuniary profit or benefit not otherwise specially provided for, and not inconsistent with the constitution and laws of this state,’ a corporation could be formed for any other unspecified lawful purpose.”); see also David G. Yosifon, *Corporate Aid of Governmental Authority*:

I suppose some would argue that Delaware law could be different if only the judges would just say it was. If the Delaware Court of Chancery and Delaware Supreme Court would simply say that directors may consider stockholders as just one of many interests the directors may treat as ends, then the law would be what they wish. But for the Delaware courts to do that would require an aggressive act of hubris. The DGCL's design is intensely and intentionally stockholder-focused. For example, the statute makes clear that only stockholders can bring derivative actions.⁷⁸ In addition, only stockholders have the right to vote for directors,⁷⁹ to approve certificate amendments,⁸⁰ to amend the bylaws,⁸¹ and to vote on important transactions such as mergers.⁸² In sum, under Delaware corporation law, no constituency other than stockholders is given any power.⁸³

For Delaware courts to declare that boards of directors have leeway to subordinate stockholder welfare to other interests would involve them making a policy determination jarringly inconsistent with the structure of our law, which has remained focused on stockholders. As an example, when the General Assembly wished to provide an option that would allow for the consideration of multiple interests, it adopted a specific new

History and Analysis of an Obscure Power in Delaware Corporate Law, 10 U. ST. THOMAS L.J. 1086, 1088-89 (2014).

⁷⁸ DEL. C. ANN. tit. viii, § 367.

⁷⁹ *Id.* § 211(b).

⁸⁰ *Id.* § 242.

⁸¹ *Id.* § 109.

⁸² *Id.* § 251.

⁸³ Professors Stout and Blair admit that “[b]ecause only shareholders normally enjoy voting rights and derivative standing, it seems natural to infer that corporate law intends directors to be subject only to shareholders; control and to serve only shareholders’ interests.” Blair & Stout, *supra* note 2, at 288-89. But they minimize the importance of the statutory regime by contending that because directors are not required under Delaware law to serve shareholder interests alone, the law actually encourages directors to serve the joint interests of all stakeholders who comprise the corporate “team.” *Id.*

form of corporation, the benefit corporation, which may be formed for the purpose of putting non-stockholder ends – such as the environment or its workers – on a footing equal to stockholders as ends.⁸⁴ Notably, that statute is unlike the constituency statutes of many states in which boards may consider other constituencies.⁸⁵ Under Delaware’s benefit corporation statute, the board has a duty to honor the non-profit ends of the corporation as stated in its certificate of incorporation and the public benefit is protected through the use of supermajority voting requirements to alter the non-profit ends.⁸⁶

Most fundamentally, nothing has happened in Delaware outside of the enactment of the benefit corporation statute to provide practical power to any constituency other

⁸⁴ See DEL. C. ANN. tit. viii, § 362; see also Frederick Alexander, Lawrence Hamermesh, Frank Martin, and Norman Monhait, *M&A Under Delaware’s Public Benefit Corporation Statute: A Hypothetical Tour*, 4 HARV. BUS. L. REV. 255 (2014).

⁸⁵ See J. Haskell Murray, 4 HARV. BUS. L. REV. 345, 350 (2014) (noting that Delaware’s benefit corporation statute “contains broader mandatory language” than other constituency statutes and requires entities formed under it to be “operated in a reasonable and sustainable manner. In addition, [benefit corporation] directors . . . must not only consider the pecuniary interest of the stockholders and the specific public benefit(s) of the [benefit corporation], but also the broad category of the best interests of those materially affected by the corporation’s conduct” (internal quotations omitted)); Leo E. Strine, Jr., *Making It Easier for Directors to “Do the Right Thing”?*, 4 HARV. BUS. L. REV. 235, 243 (2014) (“To begin with, the Delaware statute is mandatory and thus meaningfully distinct from permissive constituency statutes. . . . [Its] statutory provisions operate to create a mandatory, enforceable duty on the part of directors to consider the best interests of corporate constituencies and those affected by the corporation’s conduct when they make decisions.”).

⁸⁶ See DEL. C. ANN. tit. viii, § 362 (“A ‘public benefit corporation’ is a for-profit corporation organized under and subject to the requirements of this chapter that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner. To that end, a public benefit corporation shall be managed in a manner that balances the stockholders’ pecuniary interests, the best interests of those materially affected by the corporation’s conduct, and the public benefit or public benefits identified in its certificate of incorporation.”); *Id.* § 365(a) (“The board of directors shall manage or direct the business and affairs of the public benefit corporation in a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation’s conduct, and the specific public benefit or public benefits identified in its certificate of Incorporation.”); *Id.* § 367 (“Stockholders of a public benefit corporation . . . may maintain a derivative lawsuit to enforce the requirements set forth in § 365(a) of this title.”).

than stockholders. Stockholders remain the sole constituency with voting rights and the right to sue to enforce the DGCL and fiduciary duties.⁸⁷ And that is perhaps the main point.

IV. A More Productive Path for Advocates of Corporate Responsibility

I am more than moderately sympathetic with those who argue that for-profit corporations should behave lawfully, responsibly, and ethically. But in my view, pretending that the nation's leading corporation law is fundamentally different than it really is runs contrary to that goal. It is counterproductive to pretend that corporate directors – hardly the most representative slice of society – are effective and unbiased champions for workers, communities, the environment, and society generally, given that they are elected solely by stockholders.⁸⁸

⁸⁷ Another exception that proves the rule is what happens when a corporation is bankrupt. In that case, the creditors are able to enforce fiduciary duties because the corporation does not have sufficient assets to pay off all legal enforceable contractual claims, the stockholders are therefore out of the money, and the creditors are given enforcement rights they ordinarily would not have. See *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101-02 (Del. 2007) (“It is well settled that directors owe fiduciary duties to the corporation. When a corporation is *solvent*, those duties may be enforced by its shareholders, who have standing to bring *derivative* actions on behalf of the corporation because they are the ultimate beneficiaries of the corporation's growth and increased value. When a corporation is *insolvent*, however, its creditors take the place of the shareholders as the residual beneficiaries of any increase in value. Consequently, the creditors of an *insolvent* corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties. The corporation's insolvency ‘makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value.’ Therefore, equitable considerations give creditors standing to pursue derivative claims against the directors of an insolvent corporation.”).

⁸⁸ Professor Elhauge admits that “we should expect corporate shareholders to be more relentless than other business owners in pressing managers for unabashed profit-maximizing untempered by social consequences because shareholders don't have the knowledge to feel moral guilt or the social exposure to feel social sanctions.” *Supra* note 2, at 799.

It is more productive to take the legal rules and corporate power structure as it is, and to advance proposals that make sure that corporations operate in a way that encourages more responsible behavior and that maximizes long-term welfare, within the bounds of that structure. Doing so requires an understanding that strong and effective externality regulation is important, because the profit-pressure put on corporations by institutional investors is strong.⁸⁹ Moreover, understanding the boundaries of the law is

⁸⁹ That corporate managers are pressured to deliver immediate profits is not as much a source of debate as the question of whether that pressure has long-term effects that are adverse to wealth creation for long-term stockholders and for other constituencies affected by corporate conduct. A sampling of thinkers with diverse political, economic, and social perspectives who harbor this concern includes: William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 702 (2010) (“In a world where institutional fund managers benchmark portfolios by reference to quarterly earnings per share (EPS), sensitivity to stock market reactions implies a focus on quarterly earnings numbers. Once management prioritizes meeting the market’s EPS expectations, investments that enhance long-term value but impair near-term earnings may be delayed or foregone.”); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1047-70 (2007) (arguing that hedge funds have become critical players in both corporate governance and corporate control, and that “[s]hort-termism . . . presents the potentially most important, most controversial, most ambiguous, and most complex problem associated with hedge fund activism”); Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255 (2008) (“[A]ctivist shareholders are using their growing influence not to improve overall firm performance, as has generally been assumed, but to profit at other shareholders’ expense.”); Stephen M. Bainbridge, Response, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1751 (2006) (noting that activist investors are the stockholders most likely to take advantage of increased stockholder powers and most likely to misuse those powers for their own purposes); STEPHEN M. BAINBRIDGE, CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 243–51 (2012) (“Public employee pension funds are vulnerable to being used as a vehicle for advancing political/social goals unrelated to shareholder interests generally.”); Joseph A. Grundfest, *The SEC’s Proposed Proxy Access Rules: Politics, Economics, and the Law*, 65 BUS. LAW. 361, 380–83 (2010) (describing interests of labor unions and state pensions that are unrelated to interests of stockholders generally, and which might motivate these institutional investors to use proxy access rules for their own purposes and not for stockholder value creation); Aspen Institute, OVERCOMING SHORT-TERMISM: A CALL FOR A MORE RESPONSIBLE APPROACH TO INVESTMENT AND BUSINESS MANAGEMENT 4 (2009), available at http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/overcome_short_s

critical to protecting society, because stockholders will put pressure on corporate managers to seek as much profit as they can within the range of legally permissible conduct. With this awareness, people who wish to see for-profit corporations act in a manner that is aligned with the ordinary Americans whose capital they hold for generations will realize that it is necessary to figure out how to make sure that those who act as direct stockholders – institutional investors – invest and vote with these interests in mind.⁹⁰

tate0909_0.pdf (calling for the interests of financial intermediaries and shareholders to be better aligned and worrying that many financial intermediaries holding retirement and college savings of Americans “engage in . . . activism in pursuit of short-term financial objectives at the expense of long-term performance and careful analysis of fundamental risk”); Brian J. Bushee, *The Influence of Institutional Investors on Myopic R&D Investment Behavior*, 73 ACCT. REV. 305, 307 (1998) (finding that firms with more short-term shareholders are more likely to cut research and development expenses to meet short-term targets); COLIN MAYER, FIRM COMMITMENT: WHY THE CORPORATION IS FAILING US AND HOW TO RESTORE TRUST IN IT 200 (2013) (“It [is] . . . increasingly difficult for directors to do anything other than reflect what is perceived to be in the immediate interests of their most influential, frequently short-term shareholders. . . .”); see also Lawrence Mitchell, Op-Ed., *Protect Industry from Predatory Speculators*, FIN. TIMES, July 8, 2009, <http://www.ft.com/cms/s/0/fac881b6-6be5-11de-932000144feabdc0.html#axzz2sgCsb192> (“[Fund] [m]anagers thrive by increasing their portfolios’ value. That is a hard thing to do and it takes time. So for years fund managers have increased their pay by putting pressure on corporate managers to increase short-term stock prices at the expense of long-term business health.”); *Shareholder Activism: Boon, Bane or Both?*, N.Y. TIMES DEALBOOK, June 13, 2007, <http://dealbook.blogs.nytimes.com/2007/06/13/shareholder-activism-boon-bane-or-both/?scp=4&sq=investor%20activism%20leverage&st=Search> (observing that investor activism often results in increasingly leveraged corporations).

⁹⁰ For some of my own ideas on how to do just that, see *Can We Do Better By Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 454 n.16 (2014); *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1 (2010); *Breaking the Corporate Governance Logjam in Washington: Some Constructive Thoughts on a Responsible Path Forward*, 63 BUS. LAW. 1079 (2008); *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. CORP. L. 1, 16 (2007).

Under the current legal rules and power structures within corporate law, it is naïve to expect that corporations will not externalize costs when they can. It is naïve to think that they will treat workers the way we would want to be treated. It is naïve to think that corporations will not be tempted to sacrifice long-term value maximizing investments when powerful institutional investors prefer short-term corporate finance gimmicks. It is naïve to think that, over time, corporations will not tend to push against the boundaries of whatever limits the law sets, when mobilized capital focused on short-term returns is the only constituency with real power over who manages the corporations. And it is naïve to think that institutional investors themselves will behave differently if action is not taken to address the incentives that cause their interests to diverge from those people whose funds they invest.

In arguing that the law be seen for what it is, I am not contending that anyone should abandon their beliefs about what the law ought to be. In fact, that is my point. Rather than pretend that the law is already what they wish it to be, advocates of change should take on the harder work involved in real reform. Nor does acknowledging the reality of the legal framework and power relations within which corporate boards operate mean that I oppose efforts to encourage corporate boards to act as responsibly as they can and with regard to the interests of other corporate constituencies. But it does mean that I fear that pretending that corporate directors, at least those who serve on the boards of Delaware companies, are free to treat the good of society as an end of the for-profit corporation will impede the undertaking of genuinely meaningful measures required if corporations are to operate in the manner most beneficial to society.

By way of example, the current political moment finds Americans of all political stripes decrying a growing phenomenon that illustrates the fundamental reality of corporate politics: the re-domiciling of business entities through transactions that are in material measure motivated by the desire to pay fewer taxes.⁹¹ These transactions are now being deemed inversions, but they are not new in spirit or purpose. After all, Bono, a hero of the left, is the leader of the world's most famous Dutch rock band, having incorporated U2 in the Netherlands in order to escape paying higher taxes to his homeland, Ireland.⁹²

In the current furor, commentators from the left and right have questioned the patriotism of boards of directors of American corporations that have engaged in mergers in which the surviving corporation will become a foreign corporation, in a nation with lower corporate taxes.⁹³ Corporations such as Carnival Cruises and Michael Kors⁹⁴ have

⁹¹ E.g., Shayndi Raice, *How Tax Inversions Became the Hottest Trend in M&A*, WALL ST. J., Aug. 5, 2014, available at <http://online.wsj.com/articles/how-tax-inversions-became-the-hottest-trend-in-m-a-1407240175>.

⁹² See Kelly Phillips Erb, *Achtung Baby: Bono Defends U2 Tax Moves*, FORBES, Sept. 24, 2013, available at <http://www.forbes.com/sites/kellyphillipserb/2013/09/24/achtung-baby-bono-defends-u2-tax-moves/>.

⁹³ For example, President Obama and Jack Lew, his treasury secretary, have labeled companies that relocate overseas “unpatriotic.” Andrés Martínez, *Obama Is Wrong. In Defense of Burger King and Companies Fleeing the IRS*, WASH. POST, Sept. 23, 2014, available at <http://www.washingtonpost.com/posteverything/wp/2014/09/23/obama-is-wrong-in-defense-of-burger-king-and-companies-fleeing-the-irs/>. Conservatives such as Rand Paul also view the rise of tax inversions as a problem, and contend that tax reform that would lower the corporate tax rate is the solution. See, e.g., Jeff Joseph, *Sen. Rand Paul: U.S. Tax Code Makes Nation Less Competitive*, FUTURES MAGAZINE, June 23, 2014, available at <http://www.futuresmag.com/2014/06/23/sen-rand-paul-us-tax-code-makes-nation-less-compet>; John D. McKinnon, *Inversion Debate Considers Tax Breaks*, WALL ST. J., Sept. 8, 2014, available at <http://online.wsj.com/articles/inversion-debate-considers-tax-breaks-1410313116>.

done this, and Pfizer has recently proposed to do the same thing.⁹⁵ It is not clear why this should be surprising.⁹⁶ The citizens of corporate polities are not the citizens of the nations that charter them. The citizens are the owners of their shares, who are the only ones given the right to elect directors and vote on corporate matters. Given that reality, when corporate fiduciaries take action to reduce the taxes paid by the corporation and benefit stockholders, they are merely being responsive to the interest to which corporation law in the United States makes them primarily accountable. To expect that corporate directors elected by stockholders will forswear the chance to reap materially higher post-tax profits for the benefit of their stockholders is naïve, and even immature.

Under the law as it exists, tax arbitrage is a permissible way to reduce the corporate tax bill and further stockholder welfare. For those who decry this reality, the solution must come from other bodies of positive law that constrain corporate behavior, such as the tax code itself, and cannot rationally rest on calls for corporate directors to “be patriotic.”⁹⁷ That is also the case because corporations increasingly operate on a transnational basis, and their corporate domicile may be more important as the language of internal affairs than as a badge of national affiliation.

⁹⁴ Eduardo Munoz, *US Cracks Down on “Unpatriotic” Corporations’ Tax Inversion Deals*, REUTERS, Sept. 24, 2014, available at <http://rt.com/usa/190080-us-acts-corporations-tax-inversion/>.

⁹⁵ Richard Rubin, Manuel Baigorri, & Ruth David, *Pfizer Seeking Inversions Shows Companies Unfazed by Lew*, BLOOMBERG, September 24, 2014, available at <http://www.bloomberg.com/news/2014-09-24/pfizer-pursuing-inversions-shows-companies-undeterred-by-lew.html>.

⁹⁶ Martinez, *supra* note 79.

⁹⁷ *C.f.*, *Helvering v. Gregory*, 69 F.2d 809 (2d. Cir. 1934) (Hand, J.) (“Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.”).

If we wish to make the corporation more socially responsible, therefore, we must do it the proper way. We must address the duties and the incentives of the stockholders themselves, who are often agents of others – human beings who have a strong interest in durable wealth creation.⁹⁸ In so doing, we must recognize that directors are increasingly vulnerable to pressure from activist investors and shareholder groups with short-term objectives,⁹⁹ and that this pressure may logically lead to strategies that sacrifice long-term performance for short-term shareholder wealth.¹⁰⁰ The real world power of the

⁹⁸ As an example of the strength of the human interest in wealth creation, I note that Vanguard's FTSE Social Index Fund voted in exactly the same manner as all other Vanguard funds, including on socially-oriented shareholder proposals. *Compare* Vanguard FTSE Social Index Fund, Form N-PX, Aug. 31, 2013, *available at* <https://personal.vanguard.com/pub/Pdf/proxyvote0213.pdf>, *with* Vanguard 500 Index Fund, Form N-PX, Aug. 31, 2013, *available at* <https://personal.vanguard.com/pub/Pdf/proxyvote0040.pdf>. This suggests that simply designating a fund as socially-oriented may not have the intended effect. Nor does increased disclosure necessarily lead to more conscientious voting, according to a paper comparing mutual fund proxy voting data before and after the SEC enacted a rule requiring the disclosure of annual voting records. Surprisingly, after the rule was passed, "support for resolutions filed by corporate management increased and support for resolutions filed by shareowners on corporate social responsibility (CSR), and climate change in particular, decreased." See Bill Baue, *Counting Votes: Data Show Mutual Fund Proxy Voting Far from Conscientious*, SOCIAL FUNDS, Jan. 17, 2006, *available at* <http://www.socialfunds.com/news/proxy.cgi#3>.

⁹⁹ In a recent memo, Wachtell Lipton observed that the number of activist attacks "has surged from 27 in 2000 to nearly 250 year-to-date in 2014, in addition to numerous undisclosed behind-the-scenes situations." Martin Lipton, Steven A. Rosenblum, & Karessa L. Cain, *Some Thoughts for Boards of Directors in 2015*, WACHTELL, LIPTON, ROSEN & KATZ, Dec. 1, 2014, at 1, *available at* <http://www.wlrk.com/docs/SomeThoughtsforDirectorsin2015.pdf>. Moreover, activist funds have amassed an estimated \$200 billion of assets under management. *Id.* As a result, "boards and management teams have been spending a significant amount of time preparing for and responding to activist attacks, and proactively considering whether adjustments to their companies' business strategies are warranted in order to avoid becoming a target. Three decades of campaigns by public and union pension funds, Institutional Shareholder Services (ISS) and Council of Institutional Investors (CII), and their academic and corporate raider supporters, have served to promote majority voting standards, eliminate rights plans, declassify boards and otherwise shift power to shareholders." *Id.*

¹⁰⁰ There is, of course, a robust argument about whether stockholder activism will lead to such strategies. *Compare* Lucian A. Bebchuk, Alon Brav, & Wei Jiang, *The Long-Term Effects of*

Hedge Fund Activism, 114 COLUM. L. REV. (forthcoming 2015); Lucian A. Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013) (arguing that even if “theoretically possible that activists might . . . want companies to act in ways that are not value-maximizing in the long term,” empirical evidence demonstrates that expected benefits from those situations exceed expected costs, and therefore, “shareholder ability to intervene . . . provides long-term benefits to companies, shareholders, and the economy”); and Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005); with Stephen M. Bainbridge, Response, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1751-58 (2006) (refuting Bebchuk’s contentions that efforts to increase shareholder participation in corporate governance would increase firm performance); Daniel M. Gallagher & Joseph A. Grundfest, *Did Harvard Violate Federal Securities Law? The Campaign Against Classified Boards of Directors*, Rock Center for Corporate Governance Working Paper No. 199 (December 2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2536586 (contending that the Harvard Shareholder Rights Project had presented misleading information to investors by arguing that classified boards were inconsistent with stockholder welfare without citing studies suggesting the opposite, such as a recent study that concludes, “contrary to the implications of the extant research on staggered boards and claims made by active investors, destaggering does not appear to always lead to improved firm performance; on the contrary, destaggering could lead to managerial short-termism and less effective board monitoring.” Weili Ge, Lloyd Tanlu & Jenny Li Zhang, *Board Destaggering: Corporate Governance Out of Focus?*, AAA Management Accounting Section (2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2312565); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 703 (2010) (arguing that “shareholder empowerment delivers management a simple and emphatic marching order: manage to maximize the market price of the stock” and that the prevailing legal model strikes a better balance); Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561 (2006) (arguing that increasing shareholder power will not benefit shareholders generally, but instead, shareholders will use any incremental power conferred on them to benefit their private interests); STEPHEN M. BAINBRIDGE, CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 211–12 (2012) (arguing that the separation of ownership and control currently mandated by corporate law is highly efficient and “one ought not lightly interfere with management or the board’s decision-making authority”); STOUT, *supra* note 7 at 74 (arguing that the corporation’s distinct identity and insulation from direct stockholder influence reduces the ability of particular stockholders to engage in opportunism at the expense of other stockholders); Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174, 222 (2001) (noting a “striking absence of evidence that shareholder activism improves targeted firms’ performance”); John C. Coffee, *Hedge-Fund Activism: New Myths & Old Realities*, NEW YORK LAW J. (May 15, 2014) (citing scholarship showing that the majority of firms targeted by activist investors experience negative long-term returns, and that other studies find no improvement on operational performance and reported profits); Martin Lipton, *Twenty-Five Years After Takeover Bids in the Target’s Boardroom: Old Battles, New Attacks and the Continuing War*, 60 BUS. LAW. 1369, 1377 (2005) (arguing that special-interest shareholders “seek to conquer the corporate boardroom with their personalized agendas” by “using withhold-the-vote campaigns . . . to

direct stockholders of public companies has rendered their boards more directly subject to the immediate whims of stockholders, as breaking mechanisms like classified boards, poison pills, and other checks on stockholder direct democracy have rapidly eroded.¹⁰¹

If we believe that other constituencies should be given more protection within corporation law itself, then statutes should be adopted giving them enforceable rights that they can wield. The benefit corporation is a modest, but genuine, example of that kind of step forward. Even more, if interests such as the environment, workers, and consumers are to be protected, then what is required is a revival of effective externality regulation that gives these interests more effective and timely protection. Critically, this externality

exercise pressure on boards to conduct their affairs in the manner desired by those shareholders – without consider[ing] . . . the long-term interests of the corporation and its shareholders”); David F. Larcker, Allan L. McCall, Gaizka Ormazabal, *Outsourcing Shareholder Voting to Proxy Advisory Firms*, Rock Center for Corporate Governance at Stanford University Working Paper No. 119, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2101453 (noting that institutional investors have a material impact on say-on-pay voting outcomes, and that pressuring directors in this way decreases overall shareholder value); Yvan Allaire & Francois Dauphin, *‘Activist’ Hedge Funds: Creators of Lasting Wealth? What Do the Empirical Studies Really Say?*, INSTITUTE FOR GOVERNANCE OF PUBLIC AND PRIVATE ORGANIZATIONS, July 2014, available at <http://igopp.org/wp-content/uploads/2014/09/IGOPP-Article-Allaire-2014-Activism-EN.pdf> (concluding that Bebchuk has not demonstrated that activist hedge funds create lasting, long-term value, and instead generate short-term wealth for some shareholders); and Yvan Allaire & Francois Dauphin, *Still Unanswered Questions (and New Ones) to Bebchuk, Brav, and Jiang*, INSTITUTE FOR GOVERNANCE OF PRIVATE AND PUBLIC ORGANIZATIONS, January 2015 (noting issues with the argument that empowering stockholders creates lasting value not addressed in Bebchuk et al.’s latest paper, *The Long-Term Effects of Hedge Fund Activism*).

But, as discussed, the respected commentators who contend that Delaware law makes stockholder welfare no more important than any other corporate constituencies all tend to bemoan the increased influence of stockholders over boards. See *supra* note 59. For an example of a situation they would likely find dismaying but results from the real-world power structure under which boards operate, see Nelson D. Schwartz, *How Wall Street Bent Steel*, N.Y. TIMES, Dec. 6, 2014, available at http://www.nytimes.com/2014/12/07/business/timken-bows-to-investors-and-splits-in-two.html?_r=0.

¹⁰¹ See *id.*

regulation must be undertaken on a more global scale to match the regulatory structure to the scope of corporate conduct's impact in a globalizing economy.

This is a challenging agenda to achieve. But advocates for corporate responsibility are most likely to achieve it by dealing with the world as it is, and not as they wish it was or think it should be.